

# YUKOS RISK THE DOUBLE-EDGED SWORD

## A CASE NOTE ON INTERNATIONAL BANKRUPTCY LITIGATION AND THE TRANSNATIONAL LIMITS OF CORPORATE GOVERNANCE

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The history of one bankruptcy or “TREST, KOTORYY LOPNUL”<sup>1</sup>

The Yukos case will enter the textbooks not as a unique case of the bankruptcy of an oil company, but as an example of economic, political and juridical manipulation.<sup>2</sup>

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1. The translation from Russian is “Trust which has burst” and is the title of a 1982 USSR Crime musical comedy, which in turn is an adaptation of O. Henry's film entitled the *Full House* directed by Henry Hathaway, Howard Hawks, Henry King, Henry Koster, Jean Negulesco. O. HENRY'S FULL HOUSE (Twentieth Century-Fox Film Corp. 1952).

2. See generally Yevgenia Albats, *Doomed to Repeat History*, MOSCOW TIMES, Dec. 20, 2004, at 9.

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## I.

## INTRODUCTION

What is it about Yukos risk that compels issuers with assets in Russia and seeking capital through publicly offered shares and notes in Western jurisdictions (mainly London) to cite “Yukos”<sup>3</sup> as an emblem of legal and political risk factors in

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3. Yukos refers to Yukos Oil Company, an open joint stock company organized under the laws of the Russian Federation, whose shares were traded in the Russian stock exchange, indirectly on multiple European exchanges, and in the over-the-counter market in the United States as Ameri-

their public offering documents?<sup>4</sup> Is the phenomenon of

can Depository Receipts. It was the largest oil producer in Russia as of January 22, 2003. See *In re Yukos Oil Co. Sec. Litig.*, No. 04 Civ. 5243, 2006 U.S. Dist. LEXIS 78067, at \*4-\*5 (S.D.N.Y. Oct. 25, 2006). When Yukos filed for a voluntary petition under Chapter 11 of the United States Bankruptcy Code on December 14, 2004, it was considered the "largest bankruptcy case ever filed in the United States." See *In re Yukos Oil Co.*, 321 B.R. 396, 399 (Bankr. S.D. Tex. 2005).

4. For a discussion of the Rosneft listing and legal challenge, see discussion *infra* Part 8. In the prospectus of CityMortgage MBS Finance B.V. of August 10, 2006, the events of Yukos from 2003 are cited as a risk factor in a section entitled "Unlawful, Selective or Arbitrary State Action" noting that the "[a]rbitrary state actions have included withdrawal of licences [sic], sudden and unexpected tax audits, criminal prosecutions and civil actions." CITYMORTGAGE MBS FINANCE B.V., PROSPECTUS OFFERING OF CLASS A-FL, A-IIO, CLASS B, AND CLASS Z NOTES 54 (Aug. 10, 2006), available at [http://data.cbonds.info/emissions/6262/Prospectus\\_CityMortgage\\_MBS2033.pdf](http://data.cbonds.info/emissions/6262/Prospectus_CityMortgage_MBS2033.pdf). In the prospectus of Russian Mortgage Backed Securities 2006-1 S.A. of July 18, 2006, under "Risk Factors" and cited as "Political Intervention," the prospectus notes:

The convictions of Mikhail Khodorovsky and Platon Lebedev on charges of fraud and tax evasion in May 2005, the related attachment of approximately 42 per cent. of the shares of Yukos Oil Company alleged to be beneficially owned by Mr. Khodorovsky, the tax claims brought by the state against Yukos Oil Company and the subsequent sale in December 2004 of OJSC Yuganskneftegaz, Yukos Oil Company's primary production unit, have led some commentators to question the strength and progress of political reforms in Russia, which has caused significant fluctuations in the market prices of Russian securities and spurred capital flight. Even after the prosecutions and investigations of Yukos Oil Company and its controlling shareholders are concluded, similar events may continue to affect the Russian market negatively in the future.

RUSSIAN MORTGAGE BACKED SECURITIES 2006-1 S.A., PROSPECTUS OFFERING OF CLASS A, B, AND C RESIDUAL MORTGAGE BACKED NOTES 35 (July 18, 2006), available at [http://www.ifsra.ie/data/in\\_mark\\_prosp/1292%20Final%20II B.pdf](http://www.ifsra.ie/data/in_mark_prosp/1292%20Final%20II B.pdf). In the prospectus of The International Industrial Bank (subsequently referred to as "the group"), Joint Stock Company of July 31, 2006, a similar warning can be found, as part of the risk factors disclosures and under the specific heading of "Economic Instability in Russia Could Adversely Affect the Group's Business." INTERNATIONAL INDUSTRIAL BANK, PROSPECTUS OFFERING OF U.S. \$100,000,000 9.5% LOAN PARTICIPATION NOTES DUE 2009 19-20 (July 31, 2006), available at [http://www.ifsra.ie/data/in\\_mark\\_prosp/3444Final.pdf](http://www.ifsra.ie/data/in_mark_prosp/3444Final.pdf). In the same prospectus, Yukos is mentioned under another risk factor entitled "Unlawful or Arbitrary State Action May Have a Material Adverse Effect on the Group's Business", referring specifically to "the Ministry for Taxes and Levies, and its successor, the Federal Tax Service, have challenged certain Russian companies' use of tax optimisation [sic] schemes including

Yukos simply an example of the arbitrariness of Russian politics and therefore, with a bowing acknowledgement of "Yukos," has the Western investor been duly forewarned that his investment may collapse almost instantaneously due to dictatorial displeasure<sup>5</sup> or face the rule of law of judicial corruption?<sup>6</sup> Lesson learnt, caveat investor? As we shall see, the Yukos case as an on-going saga is not so simple, as it involves lawsuits in multiple jurisdictions; therefore, the thumbnail sketch in prospectuses referring to the Yukos case or cases may be extremely misleading as to what Yukos risk actually represents.

For legal practitioners and issuers of capital, the Yukos disclosure embedded under the "Risk Factors" section of the prospectus may be a mischaracterization, if not a misrepresentation, of what constitutes material disclosure of new issues and violations of on-going disclosure requirements for those companies carrying Yukos risk.<sup>7</sup> The theory of liability for mis-

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claims made against prominent oil companies such as Yukos and TNK-BP, communications companies such as OJSC Vimpelcom, and others." *Id.* at 23. Reference to Mr. Khodorovsky's arrest in October 2003 on charges of fraud and tax evasion and the attachment of the approximately 42% of Yukos shares, where the "[p]ress reports have suggested that the decision of the court to grant this provisional remedy to the prosecutor general's office, as well as other decisions in the cases involving Mr. Khodorosky and Yukos, may have been influenced by political factors." *Id.* It is interesting to note how this particular set of facts is interpreted in the prospectus as a risk factor regarding "Inexperience and lack of independence of certain members of the judiciary and the difficulty of enforcing court decisions and governmental discretion in instigating, joining and enforcing claims could prevent the Group or Noteholders from obtaining effective redress in a court proceeding, including in respect of expropriation and nationalization [sic]." *Id.* This confirms the perceived need by Yukos executives to exercise their discretion in seeking alternative jurisdictions for adjudication of their claims.

5. Under the "Political Activity Allegations", the plaintiffs in a U.S. class action suit intriguingly assert that at a "secret meeting" in 2000, President Putin met with "Khodorkovsky and other oligarchs" where "Putin promised not to investigate potential wrongdoing at their companies if the oligarchs refrained from opposing Putin." *In re Yukos Oil Co. Sec. Litig.*, 04 Civ. 5243, 2006 U.S. Dist. LEXIS 78067, at \*13. The plaintiffs further allege that "Khodorkovsky was actively engaged in 'professional political activities'". *Id.* at \*14.

6. For an opinion on Russian judicial corruption, see BUREAU OF DEMOCRACY, HUMAN RIGHTS, & LABOR, U.S. DEP'T OF STATE COUNTRY REPORTS ON HUMAN RIGHTS PRACTICES: RUSSIA (2004), available at <http://www.state.gov/g/drl/rls/hrrpt/2003/27861>.

7. Under U.S. law, professional advisers such as lawyers, accountants and bankers, who misrepresent material facts in prospectuses may incur pri-

representation is clear for professional advisers who undertake due diligence verification of prospectuses on behalf of their corporate client-issuers.<sup>8</sup> However, professional advisers may have different opinions regarding Yukos risk disclosures, with a majority of professionals presuming that disclosures of a few court filings are sufficient information to protect the prospective investor in relation to price sensitive information.<sup>9</sup> Profes-

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mary civil liability under Section 10(b) under the Securities Exchange Act. See *Cent. Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164, 177 (1994). District Judge Denise Cote in considering the law of third party professional liability for misrepresentations to the public, distinguished primary liability under 10(b) and aiders and abettors liability by explaining that the distinguishing line between the two is "difficult to trace," but that a broker-dealer could be held primarily liable for fraudulent misrepresentations if one "had knowledge of the fraud and assisted in its perpetration". *Sec. & Exch. Comm. v KPMG LLP*, 412 F.Supp.2d 349, 373 (S.D.N.Y. 2006) (internal citation omitted). Judge Cote goes on to cite *Shapiro v. Cantor* where the Second Circuit held that "a defendant must actually make a false or misleading statement in order to be held liable under Section 10(b)." *Id.* (citing *Shapiro v. Cantor*, 123 F.3d 717, 720 (2d Cir. 1997)). Thus, "[a]nything short of such conduct is merely aiding and abetting, and no matter how substantial that aid may be, it is not enough to trigger liability under Section 10(b)". *Id.* "The touchstone of the inquiry is not whether isolated statements within a document were true, but whether defendants' representations or omissions, considered together and in context, would affect the total mix of information and thereby mislead a reasonable investor regarding the nature of the securities offered." *Halperin v eBanker USA.COM, Inc.*, 295 F. 3d 352, 357 (2d Cir. 2002). Under UK law, disclosures in prospectuses are governed by the Section 80 (1) of the Financial Services Market Act (general duty of disclosure in listing particulars) that requires listing particulars submitted to the Financial Services Authority (FSA) "to contain all such information as investors and their professional advisers would reasonably require, and reasonably expect to find there, for the purpose of making an informed assessment of: (1) the assets and liabilities, financial position, profits and losses, and prospects of the issuer of the securities; and (2) the rights attaching to the securities." UK FINANCIAL SERVICES AUTHORITY, FSA HANDBOOK: LISTING RULE 4.2.1, available at <http://fsahandbook.info/FSA/html/handbook/LR>.

8. Compare *Esso Petroleum Co. v. Mardon*, [1976] Q.B. 801, 819-20 (C.A.) (discussing the "course of business" principle), with *Mutual Life & Citizens' Assurance Co. v. Evatt*, [1971] A.C. 793, 801-09 (P.C.) (appeal taken from Austl.) (discussing the "skill" principle).

9. For an analysis of the complex set of facts in Russia from distinctly Russian perspectives, see Уголовно - правовой анализ действий, совершенных руководителями и собственниками группы "МЕНАТЕП-РОСПРОМ - ЮКОС" в процессе предпринимательской деятельности [The Criminal Analysis of the Action Committed by the Shareholders and Manag-

sional advisers may also take the view that their own potential due diligence liability stemming from badly drawn Yukos risk disclosures is *de minimis*, since they may assume that the subscribers are unlikely to rely on such representations to their detriment.<sup>10</sup> Debating the pros and cons of professional liability on this matter may appear legally picayune if it were not for the fact that Yukos actually demarks a level of catastrophic risk<sup>11</sup> that represents the total destruction of corporate capital through so-called legitimate means.<sup>12</sup>

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ers of the MENATEP-ROSPROM-YUKOS Group in the Course of its Business Activity] (2003) (Russ.), available at <http://www.compromat.ru/main/khodorkovskiy/ugo.htm>; *The Oil and Gas Industry 2000-2004*, KOMMERSANT (Russ.), May 17, 2004, available at [http://www.kommersant.com/tree.asp?rubric=3&node=33&doc\\_id=474677](http://www.kommersant.com/tree.asp?rubric=3&node=33&doc_id=474677); *THK-BP взяли на карандаш [TNK-BP has been taken on record]*, OSHAJA GAZETA (Russ.), July 14, 2006 available at <http://www.og.ru/news/2006/07/14/13061.shtml>; *Gorbachev vs. Khodorkovsky*, PRAVDA (Russ.), June 6, 2005 available at [http://english.pravda.ru/main/18/89/355/15600\\_gorby.html](http://english.pravda.ru/main/18/89/355/15600_gorby.html); Nikki Bourke & Karen Van Peursem, *Detecting Fraudulent Financial Reporting: Teaching the 'Watchdog' New Tricks*, (University of Waikato Dep't. of Accounting Working Paper Series, Working Paper No. 79, 2004), available at <http://wmssros.mngt.waikato.ac.nz/NR/rdonlyres/efzj5npkwjyhagaursd4hph7baza2kgehnzn5dll5nsq7n5hvzkq6vunvagysnpwqzvbo3pcalnp/No791.pdf>; Margaret Chudnovsky, *Privatizing Russia: Case Study of YUKOS Oil Company*, (2004) (unpublished research paper, University of Pittsburgh) (on file with Center for Russian & East European Studies, University of Pittsburgh).

10. See Beat D. Speck & Joseph Tanega, *Private Equity Placements: Comparing the Laws in Switzerland, the European Union, the United Kingdom and the United States: Part I*, 21 J. INT'L BANKING L. 213 *passim* (2006). For a judicial analysis of the principles concerning material matters which should be disclosed in IPO prospectus, such as agreements for warrants and threatened litigation, see *Oxus Gold Plc v Templeton Insurance Ltd.*, [2006] EWHC (Comm) 864, [55] (Eng.) (citing the now superseded Financial Services Public Offer of Securities Regulation 1995, Reg. 9 which sets out a reasonable expectation test for informed assessment by investors, paragraph 185).

11. Judge Clarke makes clear the historic proportions of the case by stating: "On the assets identified in the schedules and other pleadings filed in the instant case, [the Yukos case] is the largest bankruptcy case ever filed in the United States." *In re Yukos Oil Co.*, 321 B.R. 396, 399 (Bankr. S.D. Tex. 2005) (alteration in original).

12. For a clear synopsis of the facts leading up to the US Yukos bankruptcy filing, see Matteo M. Winkler, *Arbitration Without Privy and Russian Oil: The Yukos Case Before the Houston Court*, 27 U. PA. J. INT'L ECON. L. 115, 115-121 (2006). Winkler argues that arbitration is one of the remedies that should have been pursued in the Yukos case, but that the bankruptcy judge dismissed the case for cause under 11 U.S.C. § 1112(b) (2000). *Id.* at 151-52. See discussion *infra* Part 9 for the arguments of the court. Winkler also con-

Yukos is also a legal campaign which has continually tested the limits of corporate governance in the transnational realm. The Yukos legal campaign has helped define the limits of convergent corporate governance, a process which originally spawned "wave[s] of privatizations of large state-owned enterprises of infrastructure, natural resource, and manufacturing areas"<sup>13</sup> and through which "privatization and deregulation [had] devolved important decisionmaking authority away from governments and into private firms."<sup>14</sup> There is no question that the origination of a corporation occurs within the territory of its registration; however, the matter of defining the limits of corporate governance conflates with the of determination of its nether ends—i.e., where it is terminated and its assets are orderly distributed by law. In other words, bankruptcy law, by force of its equitable distribution of the debtor assets through liquidation or reorganization, defines the ultimate value of the corporate assets. The limits of corporate governance have been defined by judicial decisions which assert the divergent principles of sovereign jurisdiction, and, more importantly in the Yukos U.S. bankruptcy case, of the impossibility of fairly adjudicating contests in a host jurisdiction which requires the participation of an unwilling home government.<sup>15</sup> Thus, the existence of this broad corporate governance limit may actually inform corporate managers that apparent opportunities to take advantage of international regulatory arbitrage should not be pursued unless the original local rules and regulations protecting the corporate form have been completely exhausted. This may appear to be a narrow

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firms Yukos risk as a many-headed monster since the Yukos legal campaign has resulted in Group Menatep, Yukos's major shareholder, requesting "arbitration according to article 26 of the ECT and the rules of UNCITRAL in the amount of \$28 billion! This proceedings [sic.] will follow the others currently pending before the Russian courts, against both the Ministry of Finance and all companies involved in the YNG auction. In conclusion, the Yukos affair is far from finished and seems to have more surprises ahead." *Id.* at 152-53.

13. CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE 2 (Jeffrey N. Gordon & Mark J. Roe eds., Cambridge University Press, 2004).

14. *Id.*

15. See *In re Yukos Oil Co.*, 321 B.R. 396, 409 (Bankr. S.D. Tex. 2005).

territorialist perspective<sup>16</sup> of corporate governance, but in fact, the Yukos bankruptcy cases can be fairly interpreted as helping us see the edge of universalism. As Pottow (2006)<sup>17</sup> comments:

An excellent example of this fair-weather preference for universalism or territorialism is the ongoing 2006 Yukos insolvency proceeding, in which a Russian creditor-representative is complaining about the unfair “piecemeal dismemberment” of the debtor allowed under Russian territorialist law and the U.S.-related creditors are protesting the unfairness that would result from the universalist “pooling” of Dutch assets they had seized in the Netherlands with the Russian assets. Citing *In re Yukos Oil Co.*, No. 06-B-10775-RDD (Bankr. S.D.N.Y. filed April 13, 2006).

It is precisely this ambiguity of the Yukos cases that persuades us that Yukos stands as a special wall between territorialism and universalism, where despite the fact that the doctrines of comity, forum non conveniens, and act of state could have been literally if not mechanically applied, they were not.<sup>18</sup> Pottow has argued that the Yukos bankruptcy case functions as a half-way house between extreme territorialism and universalism and exemplifies what he dubs as a “modified universalist approach,” where a universalist judge would revert to territorialism when she finds a conflict with fundamental U.S. policies and makes use of the well-known “escape clause from choice of law” doctrine.<sup>19</sup> As he states,

For a current example of this, consider the 2006 claims of Yukos’s Russian equity owners that the United States should not cooperate as an ancillary proceeding to assist a Russian main bankruptcy because the Russian government illegally expropriated a corporate subsidiary of Yukos on dubiously and ret-

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16. For a leading territorialist perspective, see generally Lynn M. LoPucki, *Cooperation in International Bankruptcy: A Post-Universalist Approach*, 84 CORNELL L. REV. 696 (1999).

17. John A.E. Pottow, *Greed and Pride in International Bankruptcy: The Problems of and Proposed Solutions to “Local Interests”*, 104 MICH. L. REV. 1899, 1909 n.48 (2006).

18. See *In re Yukos Oil Co.*, 321 B.R. at 408-10.

19. Pottow, *supra* note 17, at 1920.



roactively assessed taxes without just compensation or due process of law.<sup>20</sup>

However, the U.S. bankruptcy judge in this case confounded Pottow's "modified universalist approach" and rode rough-shod over any fundamental policies. Indeed, the Court felt compelled on the basis of the totality of the circumstances, which includes the ability of the host judicial system to adjudicate the case in a fair manner and to give strong deference to the foreign home state despite allegations of unfairness and judicial corruption.<sup>21</sup> The Yukos bankruptcy sheds light on the yin-yang of territorialism and universalism, and defines the limit of corporate governance in the sense that the merest presence of a corporation in a host jurisdiction, for the sake of seeking advantage against the home jurisdiction, is not sufficient for it to be within the ambit of the bankruptcy court. This is because in order for the host court to render a useful decision in this instance, it would have to interfere with the host government's central functions and rule over that government's economy. This is beyond the limits of any reasonable judicial authority.

Recast in the debate of territorialism versus universalism, the Russian Federation are the territorialists and the Yukos management are the universalists, except that instead of being creditors, the corporate executives have the unfortunate position of debtors who are viewed by the territorialists as fugitive regulatory arbitrageurs. The limits of corporate governance are found in the local rules of bankruptcy, just as the original tether of the governance of a corporation is in the situs of the corporation's registration,<sup>22</sup> replete with the laws attendant to the host jurisdiction. In essence, the local bankruptcy laws form an integral part of the rules associated with the on-going existence of a corporation.

One can understand how the intent of the Yukos management in seeking remedies in foreign jurisdictions could be in-

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20. *Id.* at 1920 n.88.

21. *Id.*

22. For the proposition that a debtor's place of registered offices are rebuttably presumed to be the centre of its major interests, see U.N. COMM'N ON INT'L TRADE LAW (UNCITRAL), MODEL LAW ON CROSS-BORDER INSOLVENCY WITH GUIDE TO ENACTMENT at art. 16(3), U.N. Sales No. E.99.V.3 (1999); Council Regulation 1346/2000, EU Insolvency Regulation, 2000 O.J. (L 160) 2, art. 3(1) (EC).

terpreted by the Russian Federation as fugitive, or at best as a vain attempt at forum shopping and risky regulatory arbitrage. By crossing borders, it had intensified the challenge to its existence within its home jurisdiction *de jure*. The substantive saga that underlies Yukos risk was subtle, complex, and ushered in new authority that reached to the very limits of convergent corporate governance.<sup>23</sup>

What Yukos risk represents is perhaps best understood, from the perspective of the Yukos management<sup>24</sup> and the core shareholders,<sup>25</sup> (herein the "Control Group") as a multi-national,<sup>26</sup> multi-jurisdictional<sup>27</sup> legal campaign based on the in-

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23. See generally Eur. Parl. Ass., *Report on the Circumstances Surrounding the Arrest and Prosecution of Leading Yukos Executive*, DOC No. 10368 (2004), available at <http://assembly.coe.int/Main.asp?link=/documents/WorkingDocs/doc04/EDOC10368.htm>; DEFENSE LAWYERS ON BEHALF OF KHODORKOVSKY, LEBEDEV & PICHUGIN, CONSTITUTIONAL AND DUE PROCESS VIOLATIONS IN THE KHODORKOVSKY/YUKOS CASE (2004) (hereinafter WHITE PAPER), available at [http://www.khodorkovskytrial.com/pdfs/yukos\\_white\\_paper.pdf](http://www.khodorkovskytrial.com/pdfs/yukos_white_paper.pdf).

24. Michail Khodorkovsky, who was Yukos' President, Chief Executive Officer and largest shareholder, and Bruce Misamore, who was the Chief Financial and Principal Accounting Officer of Yukos, were both named in the federal securities litigation. *In re Yukos Oil Co. Sec. Litig.*, No. 04 Civ. 5243, 2006 U.S. Dist. LEXIS 78067, at \*2 (S.D.N.Y. Oct. 25, 2006). For the rest of the top Yukos employees involved, see Mikhail Khodorkovsky Press Center, *Victims of the Yukos Affair: Yukos Employees Arrested or Sanctioned for Arrest in connection with the "YUKOS Case"*, <http://www.khodorkovsky.info/timeline/134250.html> (last visited Mar. 3, 2007).

25. According to data provided by the MENATEP Group website, the main shareholders of the Group included Mikhail Khodorkovsky, Leonid Nevzlin, Platon Lebedev, Vladimir Doubov, Mikhail Broudno, Vassily Shakhonovsky. See MENATEP Group, 2003 "Group Structure" (on file with the NYU Journal of Law & Business).

26. According to data compiled by the authors from numerous websites, legal actions were taking place in Russia, U.K., U.S., Cyprus, Switzerland, Latvia, Lithuania, Israel, Spain, Italy, Liechtenstein, France, Netherlands and some others. See Yukos Oil Co., <http://www.yukos.ru> (last visited April 9, 2007); Platon Lebedev, <http://www.platonlebedev.ru/> (last visited April 9, 2007); Robert Amsterdam, *Perspectives on Russia, Europe, and International Affairs*, <http://www.robert-amsterdam.com/> (last visited April 9, 2007).

27. According to our research, some of the principal decisions have been rendered by the London Magistrate Court, Moscow City Court, Supreme Court of the Russian Federation, Lefortovo Court in Moscow, Moscow's Simonovsky Court, Nefteyugansk Regional Court, Meshchansky Court in Moscow, Zamaskvoretzki court in Moscow, European Court of Human Rights in Strasbourg, United States District Court, Southern District of New York, United States District Court, District of Columbia, and the United

nocent hypothesis that winning a case in a host jurisdiction may result in a positive extra-territorial legal influence on the disposition of the company in the home jurisdiction. This seems an unobjectionable hypothesis except that even a coarse assessment shows that the risk of litigation failure is literally doubled, if not actually multiplied by a large factor, since the positive outcome for Yukos under this set of assumptions requires (1) a positive disposition in the host country court system and (2) the recognition by the home country's court system of the host country's decision. One is tempted to draw an analogy between the Yukos legal campaign and theories of transnational law where the assumption of global convergence is severely tested at the divergent local level.<sup>28</sup> However, one of the main points to draw from the actions of the Control Group is a strong belief in the certainty of catastrophic failure of litigation under the Russia court system. This assumption carried certain damaging procedural consequences in the Group's prosecution of their legal campaign. By not originally taking advantage of their home jurisdiction's procedures, they could not later expect to gain from these procedures just because another jurisdiction had adjudicated in their favour. The simple fact is that there is no authoritative hierarchy between court systems in different jurisdictions.<sup>29</sup> The Control Group's argument is essentially that they would not receive procedural justice under the Russian court system, but the force of their logic meant that could not take advantage of that system's substantive justice in any case. Ironically, the Yukos legal campaign is based on the fear of Russian judicial discretion yet pinned on the hope of non-Russian judicial discretion. Whenever judicial discretion is sought, the general principle *ex-ante* is that all normal legal channels and remedies should be exhausted first, and then and only then can a complainant justifiably seek equitable remedies. But carrying out

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States Bankruptcy Court, Southern District of New York. This however is by no means meant to be an exhaustive list.

28. See Susan Strange, *The Furture of Global Capitalism; Or Will Divergence Persist Forever*, in *POLITICAL ECONOMY OF MODERN CAPITALISM: MAPPING CONVERGENCE AND DIVERSITY* 182-92 (Colin Crunch & Wolfgang Streeck eds., Sage Publications 1997).

29. See Anthony Ogus, *Competition Between National Legal Systems: A Contribution of Economic Analysis to Comparative Law*, 48 INT'L & COMP. L.Q. 405, 407 (1999).

this rule is exactly what Yukos managers feared most. The ultimate justification of the Control Group's fear has been shown *post-hoc* in that the exhaustion of legal remedies in Russia has led to the criminal convictions of the executives (Khodorkovsky and Lebedev)<sup>30</sup> and the bankruptcy of Yukos.<sup>31</sup>

The Yukos saga encompasses many legal cases and claims<sup>32</sup> where jurisdiction matters. Even more importantly, the reach of extra-territorial jurisdiction, perhaps most dramatically of U.S. bankruptcy law with specific reference to Chapter 11 concerning the global stay of creditor proceedings,<sup>33</sup> comes up against the rails of the equitable and discre-

30. See Eur. Parl. Ass., *supra* note 23; WHITE PAPER, *supra* note 23.

31. *Ходорковский в тюрьме ЮКОС в руинах – это ли конец игры?* [*Khodorkovsky is in Jail, Yukos is Ruined - Is This the End of the Game?*], ВЕДОМОСТИ (Russ.), Sept. 26, 2005.

32. At various times, based on the personal experience of one of the co-authors, the number of material tax and tax-related cases exceeded fifty. For a discussion of the criminal cases, see *Решения в ряд: дела ЮКОСа поставлены на конвейер* [Judgments in line: Yukos case on the Conveyor], КОММЕРСАНТ (Russ.), Apr. 27, 2005.

The claims against Yukos totaled approximately \$29.5 billion, and could be categorized as follows at the commencement date of the bankruptcy procedure:

- A. Claims of Russian taxing authorities for taxes, penalty interest and fines totaling approximately \$11.5 billion;
- B. Claims of ordinary trade creditors totaling approximately \$89 million;
- C. Claim of YNG, now a subsidiary of Rosneft, filed in the amount of approximately \$2.45 billion, concerning which attachments have been filed against assets in the Netherlands;
- D. Any other valid "Allowed Claims" against Yukos;
- E. Claim of the Bank Group now held by Rosneft, arising out of a loan totaling approximately \$485 million, concerning which attachments have been filed against assets in the Netherlands;
- F. Claim of Moravel (SPV of Menatep Group) arising out of loan totaling approximately \$700 million, concerning which attachments have been filed against assets in the Netherlands;
- G. Claims by current subsidiaries of Yukos totaling approximately \$13.7 billion;
- H. Claims of former Yukos subsidiaries, excluding Yuganskneftegaz ("YNG") totaling approximately \$565 million.

See Exhibit A, Outline Of Proposed Financial Rehabilitation Plan And Debt Repayment Schedule And/Or Offer Of Voluntary Arrangement To Creditors, *In re* Petition of Eduard Rebgun, No. 06-B-10775-RDD (Bankr. S.D.N.Y. April. 13, 2006).

33. See *infra* Section 7 for a discussion of the facts concerning the Yukos bankruptcy case in Houston. Under 11 U.S.C. § 105(a), the court may issue any order that is necessary or appropriate to carry out the provisions of Title

tionary judicial doctrine of forum non conveniens. The inconvenient transnational legal lesson of Yukos is that from a practical litigation standpoint, whether or not there is a sufficient nexus in rem<sup>34</sup> or in personam,<sup>35</sup> last minute preferential fo-

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11. 11 U.S.C. §105(a) (2000). The simple filing of a petition before a bankruptcy court creates a procedural situation called an "automatic stay" and accordingly, all the actions filed by the creditors are automatically suspended. H.R. REP. NO. 95-595, at 340 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6296-97. As intended by Congress, the automatic stay aims to protect both the debtor, who in this way can escape the creditors' financial pressure, and the creditors, who are protected by the *par conditio*. *Id.* The automatic stay is not permanent and can be revoked by the judge according to specific provisions of law. *See generally* MARK A. SHAIKEN & CINDI S. WOOLERY, *AUTOMATIC STAY LITIGATION IN BANKRUPTCY* (1995). *See also In re Zale Corp.*, 62 F.3d 746, 764-65 (5th Cir. 1995) (citing *In re Commonwealth Oil Ref. Co.*, 805 F.2d 1175 (5th Cir. 1986)).

34. Yukos assets in Russia comprised:

- More than 600 subsidiaries
- A team of approximately 100,000 professionals
- Total production of 80.8 million tons (591 million barrels) in 2003
- 19.2% of Russian oil production in 2003
- Proven oil reserves of 14.709 billion barrels
- Market capitalization ~ 46 billion USD
- Dividends: approximately \$300 million in 2000, \$500 million in 2001, \$700 million in 2002, and \$2 billion for the first 9 months of 2003

*See* Yukos Oil Company, About Us, [http://www.yukos.com/About\\_us](http://www.yukos.com/About_us) (last visited Mar. 3, 2007).

In the US, Yukos' assets were considerably less. Bruce K. Misamore, Debtor's chief financial officer, testified that a subsidiary of Debtor has approximately US\$2 million in funds in an account at Southwest Bank of Texas, a bank located within the Southern District of Texas. In addition, Debtor has deposited approximately US\$6 million to the trust account of its attorneys, Fulbright & Jaworski, L.L.P., as a retainer to be applied to the payment of legal fees and administrative expenses incurred in connection with this case. These funds represent Debtor's principal assets in the United States. Misamore additionally testified that approximately 15 percent of Debtor's shares are held by United States institutional investors. *Yukos*, 321 B.R. at 400-02.

35. In *Frene v. Louisville Cement Co.*, Judge Rutledge, after reviewing the opinions, concluded that "... the fundamental principle underlying the 'doing business' concept seems to be the maintenance within the jurisdiction of a regular, continuous course of business activities. . .". *Frene v. Louisville Cement Co.*, 134 F.2d 511, 515 (D.C. Cir. 1943) (citing *American Asph. Roof Corp. v. Shankland*, 219 N.W. 28, 30 (Iowa 1928); *Tauza v. Susquehanna Coal Co.*, 115 N.E. 915, 917 (1917)). *See also In re Brierlev*, 145 B.R. 151 (Bankr. S.D.N.Y. 1992); *In re Paper I Partners*, 283 B.R. 661 (Bankr. S.D.N.Y. 2002).

rum shopping is a desperate move unlikely to prove successful in any court of law where the claim concerns equitable distribution of existing assets, especially where the home government would be required to cooperate in the reorganization of the enterprise.<sup>36</sup> This means that one of the risk lessons of the Yukos saga is that U.S. Bankruptcy Chapter 11 protection does not extend to situations where the home government would be one of the parties ordered to comply under the Chapter 11 bankruptcy stay proceedings.

## II.

### THE YUKOS LEGAL CAMPAIGN

From 2004 the Yukos management and the core shareholders, (the "Control Group") initiated a number of lawsuits on their own behalf<sup>37</sup> and on behalf of the Yukos company in

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36. See Yukos, 321 B.R. at 410-11. In its judgment, the court applied 11 U.S.C § 1112(b) (2000) of the Bankruptcy Code, which justifies the dismissal of the case "for cause," i.e., for a specific reason provided by the law. See *id.* However, the court did not refer to any of the causes listed by § 1112(b), but instead referred to the intention of Congress. According to Congress, the list of causes is not exhaustive. *Id.* at 410 (citing H.R. Rep. No. 95-595). Thus, the totality of circumstances convinced Judge Clark to grant Deutsche Bank's motion to dismiss:

The vast majority of the business and financial activities of Yukos continue to occur in Russia. Such activities require the continued participation of the Russian government, in its role as the regulator of production of petroleum products from Russian lands, as well as its role as the central taxing authority of the Russian Federation.

Finally, although the act of state doctrine, standing alone, does not compel dismissal of the instant case, the evidence indicates that Yukos was, on the petition date, one of the largest producers of petroleum products in Russia, and was responsible for approximately 20 percent of the oil and gas production in Russia. The sheer size of Yukos, and correspondingly, its impact on the entirety of the Russian economy, weighs heavily in favor of allowing resolution in a forum in which participation of the Russian government is assured.

*Id.* at 411. The court concluded, based on the totality of the circumstances, that the instant Chapter 11 case should be dismissed. *Id.* at 410-11.

37. The most important lawsuits initiated by Yukos management are: *In re Yukos Oil Co.*, 321 B.R. 396 (Bankr. S.D. Tex. 2005); *Rebgun/Nautadutilh N.V., Arrondissementsrechtbank [Rb.]* [District Court], Amsterdam, 24 November 2005 (350421/KG06-1503 P); *Yukos Oil Co. v. Russia*, App. No.14902/04 (2004); *Allen v. Russian Fed'n*, Case No. 05-cv-02077 (D.D.C.);

Western and international courts.<sup>38</sup> The stated goal of this legal campaign was to avoid the judicial system perceived to be captured by the executive of the Russian government and its Administration.<sup>39</sup> The Control Group hoped that foreign

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Group Menatep v. Russian Fed'n, (UNCITRAL 2005) (alleging expropriation of the Group's majority shareholding in the Yukos oil firm);

On February 9, 2005, Group Menatep proceeded to file a claim against the Russian Federation under the terms of the 1994 Energy Charter Treaty. Group Menatep's claims are based on the Russian Federation's failure to protect the company's investments in Russia, and specifically the expropriation of Yuganskneftegaz. The claims seek compensation of approximately US \$28.3 billion. Under the terms of the Treaty, breaches by the Russian Federation of its international obligations entitle the Claimants to the payment of prompt, adequate and effective compensation. Under Article 26 of the Energy Charter Treaty, disputes can be referred to international arbitration if they are not settled amicably between the disputing parties within 3 months of a notification of claim. The Claimants delivered original notifications to the Russian Federation on November 2, 2004. Since then, the Russian Federation has totally ignored the notifications and has failed to settle amicably the dispute. *Democracy on the Retreat in Russia: Hearing Before the S. Comm. on Foreign Relations*, 109th Cong. (2005) (statement of Tim Osborne, Member, Bd. of Dirs., Menatep Group).

*In re Yukos Oil Co. Sec. Litig.*, No. 04 Civ. 5243, 2006 U.S. Dist. LEXIS 78067 (S.D.N.Y. Oct. 25, 2006); and *Yukos v. FSA* [2006] EWHC (Admin.) 2044 (Eng.).

38. Major lawsuits initiated on behalf of the Yukos Oil Company include: *Yukos*, 321 B.R. 396 (Bankr. S.D. Tex. 2005) – Bankruptcy Court for the Southern District of Texas; *Rebgun/Nautadutilh N.V., Arrondissement-srechtbank [Rb.]* [District Court], Amsterdam, 24 November 2005 (350421/KG06-1503 P) – Interlocutory proceeding in the Amsterdam District Court; *In re Yukos Oil Co. Sec. Litig.*, No. 04 Civ. 5243, 2006 U.S. Dist. LEXIS 78067 (S.D.N.Y. Oct. 25, 2006) – United States District Court. Southern District of New-York; *Yukos Oil Co. v. Russia*, App. No.14902/04 (2004) – ECHR *Allen v. Russian Fed'n*, Case No. 05-cv-02077 (D.D.C.) – United States District Court for the District of Columbia; \$28.3 Billion (US) claim by Group Menatep against the Russian Federation alleging expropriation of the Group's majority shareholding in the Yukos oil firm (International Arbitration); and *Yukos v. FSA* [2006] EWHC (Admin.) 2044 (Eng.).

39. *See* S. Res. 322, 109th Cong. (2005) (“[T]he criminal justice system in Russia has not accorded Mikhail Khodorkovsky and Platon Lebedev fair, transparent, and impartial treatment under the laws of the Russian Federation.”). The widespread recognition of the political motivations lurking behind the campaign against Yukos was further noted in its brief before the Bankruptcy Court for the Southern District of New York:

[A]fter he made over \$20 million in political contributions to opponents of the current Russian administration in the 2003 elections, that administration instituted criminal prosecutions against him and put him in jail (he is currently incarcerated in Siberia in a

courts, unaffected by Russian government influence, could come to an independent and fair adjudication on the tax claims and, respectively, money laundering charges made against the managers and employees.<sup>40</sup> The Control Group's off-shore legal campaign was premised on the idea that if these criminal charges were adjudicated in their favour, then this foreign legal decision would pre-empt, invalidate, positively influence or mitigate any negative home judgment against Yukos. This fear of the government influencing the decision-making of its judiciary may appear justified given the latter's notorious reputation for taking bribes.<sup>41</sup> As the U.S. State Department observed during this period, the Russian judiciary is seriously impaired by a shortage of resources and corruption and thus still subject to influence from other branches of Government.<sup>42</sup> But in the Yukos cases, there has never been any

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prison camp built near a uranium mine). The Russian Government then began a campaign of creeping expropriation of Yukos' assets under the pretext of retroactively assessed taxes eventually totaling over \$32 billion, imposed without due process, in a selective, discriminatory and confiscatory misapplication of Russian tax law. These essential facts have been recognized to be true by: (1) U.S. Bankruptcy Judge Letitia Clark in Houston, Texas; (2) U.S. District Judge Nancy Altas in Houston, Texas; (3) the United States State Department; (3) the Counsel on Foreign Relations; (4) the Council of the European Union; (5) the English Courts; and (6) the world financial press, including, for example, this week's *Wall Street Journal* and London *Financial Times*. The European Court of Human Rights has put this case on an accelerated timetable. Everything that has occurred to force Yukos into bankruptcy in Russia (and bring the Petitioner before this Court) has emanated from these illegal retroactive taxes, enforced with utter lack of due process.

Memorandum of Law of Yukos Oil Company in Opposition to Verified Petition under Chapter 15 for Recognition of a Foreign Main Proceeding and Application for Order to Show Cause with Temporary Restraining Order and Preliminary Injunction Filed by Eduard K. Rebgun, *In re* Rebgun at 3-4, No. 06-B-10775 (Bankr. S.D.N.Y. Apr. 21, 2006).

40. See *Victims of the Yukos Affair: Yukos Employees Arrested or Sanctioned for Arrest in connection with the "YUKOS Case"*, *supra* note 24.

41. See generally RUSSIAN AXIS INFORMATION AND ANALYTICAL CENTRE, THE JUDICIAL SYSTEM OF THE RUSSIAN FEDERATION: A SYSTEM CRISIS OF INDEPENDENCE 4-6 (2005); Louise I. Shelley, *Corruption in the Post-Yeltsin Era: Why A Corrupt State Can't Be a Strong State*, 9 E. EUR. CONST. REV. 70-75 (2000); Neil Buckley & Arkady Ostrovsky, *Back in Business - How Putin's Allies are Turning Russia into a Corporate State*, FIN. TIMES, June 19, 2006, at 17.

42. COUNTRY REPORTS ON HUMAN RIGHTS PRACTICES: RUSSIA, *supra* note 6 (though it must also be noted that the State Department concluded that



proof that bribes had been perpetrated.<sup>43</sup> The U.S. State Department's statement, as well as those of other governments, can be seen as a form of political finger-wagging. The projection of "political risk" found itself replayed many times in the Western and Russian press<sup>44</sup> and had been taken up by the European Parliament as a point of political criticism:

The circumstances of the arrest and prosecution of leading Yukos executives suggest that the interest of the State's action in these cases goes beyond the mere pursuit of criminal justice, to include such elements as to weaken an outspoken political opponent, to intimidate other wealthy individuals and to regain control of strategic economic assets.<sup>45</sup>

Our purpose, however, in this article is not aimed at determining whether the Yukos management was justified in believing a fair trial was impossible in a politically captured and corrupt Russian judicial system, but rather at examining whether Yukos risk may portend a growing set of international corporate legal maneuvers and cross-border litigious actions

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"the judiciary continued to show some increasing independence, and the criminal justice system was slowly undergoing reforms). The authors are of the opinion that these generalisations are not based on hard facts, but rather on outrageously wild innuendos. See also Laurence S. Moss, *Bankruptcy Reform in Russia: The Case for Creditor Rights in Russia*, 13 REV. AUSTRIAN ECON. 121, 136 (2000) (describing the "influence-buying [of the judges] by the bank" in a Ben & Jerry's case). It is not simply that the judiciary can be bought, but even if the judgement is rendered, and the judge orders a "writ of execution to transfer a debtor-owned deposit to a judgment creditor," these are routinely and bizarrely ignored by the bank. *Id.* at 136 (citing Glenn P. Hendrix, *Enforcement of Russian Arbitrazh Judgments*, 7 E./W. EXECUTIVE GUIDE 17 (1997)).

43. Despite the voluminous evidence introduced, no proof of a bribe was ever adduced in *In re Yukos Oil Co.*, 321 B.R. 396, 411 (Bankr. S.D. Tex. 2005).

44. See *Арест активных [Arrest of the Active]*, КОММЕРСАНТ (Russ.), Nov. 22, 2004; *Ходорковский в тюрьме ЮКОС в руинах – это ли конец игры? Khodorkovsky is in Jail, YUKOS is Ruined - Is This the End of the Game?*, ВЕДОМОСТИ (Russ.), Sept. 26, 2005; *Генпрокуратуре России понадобился лондонский адвокат чтобы добиться бывшего вице-президента ЮКОСа [Russia Attracts British Lawyer to Get Extradition for YUKOS Official]*, КОММЕРСАНТ (Russ.), Nov. 8, 2005; *London Court Denies Russia Extradition of YUKOS Official*, RIA NOVOSTI, Dec. 23, 2005; C.J. Chivers, *Return of the Show Trial: Stalin and the Czars Haunt Khodorkovsky in the Dock*, N.Y. TIMES, §4, at 7 (Nov. 7, 2004).

45. Eur. Parl. Ass., *The Circumstances Surrounding the Arrest and Prosecution of Leading Yukos Executives*, Resolution 1418, Doc. No. 14 (2005).

that have no foreseeable end. The relevance to prospective investors in Russian assets is due to the fact that the risk is not Russian politics, but whether such assets can be so easily sequestered into non-Russian jurisdictions and thus legitimately protected by the Control Group. One of the aims of this analysis is to delineate the main features and results of Yukos's legal campaign in the West. Firstly, we examine to what extent the Control Group has succeeded in transplanting various legal actions of Yukos to non-Russian judicial fora. Secondly, we examine whether such forum-shopping has enhanced the Control Group's chances of survival and success. Whilst we will attempt to focus mainly on the corporate issues, criminal and purely procedural issues implicating individuals are occasionally, necessarily, and messily co-mingled. However, before examining each case in detail, let us first clarify the "Western strategy" of the Yukos legal campaign.

### III.

#### THE EUROPEAN COURT OF HUMAN RIGHTS (ECHR)

The role of the ECHR in the Russian political and judicial system has grown tremendously since 1998, when Russian signed the European Convention. It is a curious yet generally held belief by Russian citizens that the ECHR is the only forum where they can defend their rights against a corrupted judicial infrastructure.<sup>46</sup>

The Control Group, recognizing that the European judicial body is perhaps the only authority which may indirectly help the victims of the Yukos case,<sup>47</sup> placed special emphasis

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46. See La Russophobe, *Crazed Russia Forces ECHR to Expand*, <http://russophobe.blogspot.com/2006/11/crazed-russia-forces-echr-to-expand.html> (Nov. 14, 2006). For information on the Russian claims filed with ECHR, see generally Европейский Суд по правам человека, <http://www.eurocourt.ru> (last visited Mar. 3, 2007).

47. These issues are seen as a quite controversial since Russia may find several ways to ignore the decisions of the ECHR or avoid their direct enforcement. Meanwhile, filing an application with the ECHR may result in a serious aggravated persecution of the individuals who have already been incarcerated. On this problem, see Адвокат Каринна Москаленко: сорвать подачу жалобы Ходорковского в Страсбургский суд не удастся [Interview of Khodorkovsky's ECHR Lawyers] (Russ.) (Dec. 5, 2005), *available at* <http://www.bestlawyers.ru/php/news/archnew.phtml?id=172&idnew=19581&start=155>; CENTRE FOR CIVIL SOCIETY RESEARCH DEMOS, *REVIEW OF ECHR*

on the ECHR. They assumed that the ECHR was one of a group of non-Russian courts that might have some influence over the Russian judiciary. Yukos, Khodorkovsky, Lebedev and Pichugin filed several applications with the ECHR, which in turn granted priority of hearing to the applicants.<sup>48</sup> However, as of the end of 2006, no final award had been granted. The Final Decision on the admissibility of the Application no. 4493/04 by Platon Leonidovich Lebedev against Russia, dated the 18th of May 2006, shed no light on the future of the Yukos-related decisions. Indeed, this decision may prove to be disadvantageous to both claimants and defendants.<sup>49</sup>

The Court has yet to resolve whether to join the separate applications filed by Yukos itself and by Yukos-related persons or to review them separately. Various professionals, including a high ranking QC have expressed doubts about the positive effect of the joined cases, expecting at best a Pyrrhic victory.<sup>50</sup>

Several politicians and lawyers have also expressed the opinion that the Russian Federation will exercise all of its influence to postpone the final hearing on Khodorkovsky and the Yukos related cases until after the forthcoming presidential election, in order to mitigate the possible negative impact on the Russian case.<sup>51</sup> David Anderson, a self-employed barrister who resides in London and practices before the European Court of Human Rights ("ECHR"), testified as an expert in the area of ECHR procedures and remedies. He stated that the

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DECISIONS CONCERNING RUSSIAN CITIZENS IN 2006 (2006), *available at* <http://www.demos-center.ru/reviews/13491.html>.

48. *See, e.g.*, KhodorkovskyTrial.com, *The European Court of Human Rights Is To Consider Mikhail Khodorkovsky's Appeal on a Priority Basis*, <http://www.khodorkovskytrial.com/qanda/lawyersOct272006.cfm> (last visited Mar. 3, 2007).

49. *See, e.g.*, Final Decision as to the Admissibility of Application no. 4493/04 by Platon Leonidovich in Lebedev v. Russia (wherein the Court found that some of the complaints are "manifestly ill-founded and must be rejected in accordance with Article 35 §§ 3 and 4 of the Convention" which created a serious confusion for the defense team.)

50. Indeed, in our experience, we question how any defendant can ever fight the state when the whole state and all its courts are against her. Any victories that may be achieved will be at best nominal.

51. For an update on future development in the case, *see, e.g.*, KhodorkovskyTrial.com, *How Will Khodorkovsky Find Russia When He Is Released in Five Years?*, [http://www.khodorkovskytrial.com/documents/release\\_25Oct2006.cfm](http://www.khodorkovskytrial.com/documents/release_25Oct2006.cfm) (last visited Mar. 3, 2007).

ECHR has never awarded a significant sum of money as damages for violation of a right. He testified that the ECHR tends to “proceduralize” disputes and thus to compensate litigants for the lack of an adequate procedure rather than for the substantive damage they may have suffered.<sup>52</sup>

Despite the positive plans and promises of the Yukos advocates, and despite the potential significance of ECHR to the Yukos saga and Mr. Khodorkovsky, it is unlikely that the ECHR application will be decided before 2008. Given this lack of finality, we will not provide any further analysis of the ECHR-related issues in our discussion of Yukos risk. This is not to say the ECHR decision is not relevant to how Yukos risk might be characterized in Prospectuses involving Russian based assets, as the ultimate ECHR disposition may indeed effect the Russian government or Russian judicial action.

#### IV.

#### QUESTIONS OF JURISDICTION

Critical legal issues concerning the appropriate jurisdiction have yet to be definitively decided in the existing court cases.<sup>53</sup> Obviously, the question of jurisdiction is pertinent to whether future Yukos-related litigation has any chance of being substantively adjudicated in non-Russian fora. In the papers filed in the case under Chapter 15 of the Bankruptcy Code Case No. 06-B-1077S, we find a fundamental principle of home-host rules of application first enunciated in *Canada Southern Railway* (1883):

A corporation ‘must dwell in the place of its creation, and cannot migrate to another sovereignty’ though it may do business in all places where its charter allows and the local laws do not forbid. But wherever it goes for business it carries its charter, as that is the law of its existence and the charter is the same abroad that it is at home. Whatever disabilities are placed upon the corporation at home it retains abroad, and whatever legislative control it is sub-

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52. See *In re Yukos Oil Co.*, 321 B.R. 396, 411 (Bankr. S.D. Tex. 2005).

53. Although the final decision has been reached in *In re Yukos Oil Co. Sec. Litig.*, in the principal case of *Allen v. Russian Fed’n*, Case No. 05-cv-02077 (D.D.C.) (which is, in effect, the *Group Menatep v the Russian Federation*), the fundamental question of jurisdiction has yet to be decided.

jected to at home must be recognized and submitted to by those who deal with it elsewhere. . . . Such being the law, it follows that every person who deals with a foreign corporation impliedly subjects himself to such laws of the foreign government. . . .<sup>54</sup>

The above argument represents a truism which may be translated into a general risk factor, in that dealing with a foreign company necessarily means that one is dealing with a legal entity limited by the laws of that company's incorporation. Applied to Yukos, this principle means that Yukos is, and will be, treated as a Russian company and that any attempts to apply foreign law and corporate standards to its activity will be restricted by the relevant local courts. Thus, this general principle is a major barrier to the successful outcome of Yukos in Western courts. Specifically, we observe that foreign managers and employees have been precluded from claiming that Russian law should not apply to their employment contracts and tax payments.<sup>55</sup>

On the one hand, applying certain Russian legal rules (such as ownership rights) to all Yukos-related cases in Western and international courts may be advantageous to the Control Group. On the other hand, the Control Group argue that the Russian judicial system is so corrupt that the home laws would not be applied fairly to them in Russia. Therefore, their conclusion is that the home laws should not be applied in the host jurisdictions. This home-host rule should be distinguished from actions which are politically motivated.

## V.

### REFUTING POLITICAL MOTIVATION

Some procedural and criminal aspects of the Yukos saga clearly fall into the category of extra-judicial Machiavellian political processes. These issues cannot be completely segregated from the legal questions relating to the jurisdiction of Western and international fora. However, for purposes of this article, the discussion of their role is limited to a few essential

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54. *Canada S. Ry. Co. v. Gebhard*, 109 U.S. 527, 537-39 (1883) (internal citations omitted). *See also In re Vimpel-Communications Sec. Litig.*, No. 04 Civ. 9742 (NRB), 2006 WL 647981 (S.D.N.Y. Mar. 14, 2006).

55. *See also*, Kramer, *supra* note 40.

remarks outlining their impact and relationship to the corporate legal issues.

Although the Russian prosecutors may appear to be politically motivated under the ECHR, and in general, political motivation and filings in the ECHR may appear essentially inter-related, this is not an accurate description of most of the legal cases. Granted, the presence of political motivation in some Yukos-related cases has been already established by the British courts in the course of the extradition hearings which have taken place at the London Magistrates Court. As Judge Workman states:

I am satisfied that the request for the extradition of Mr Temerko is in fact made for the purpose of prosecuting and punishing him for his political opinions. . . I find that Mr Temerko's extradition is barred. . . and I order his discharge. . .<sup>56</sup>

International human rights organizations have also added some fuel to the fire:

Amnesty International takes the view that there is a significant political context to the arrest and prosecution of Mikhail Khodorkovskii, former head of the YUKOS company, and other individuals associated with YUKOS.<sup>57</sup>

However, the Russian Federation contends that the alleged political character of the case is functioning as a red herring and further argues that it is simply applying the Russian law as is deemed appropriate in Western courts.<sup>58</sup> In a strong

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56. Jeremy Lovell, *UK Rejects Extradition Of Former YUKOS Executive*, REUTERS, Dec. 23, 2005, available at <http://en.epochtimes.com/news/5-12-23/36130.html>.

57. Public Statement, International Secretariat of Amnesty International, Russian Federation: The Case of Mikhail Khodorkovsky and Other Individuals Associated with YUKOS (Apr. 11, 2005), available at <http://web.amnesty.org/library/index/engneur460122005>.

58. Specifically, President Putin responded to this very concern within the business community at a speech given in October of 2003:

At the same time, I do understand the business community's concern because any action taken by the federal authorities often gets turned into some kind of campaign. I must make it clear that the Yukos case should in no way be seen as setting a precedent or giving rise to analogies and generalisations [sic] regarding the results of previous privatisations [sic], and I would ask therefore that all

sense, it is merely consistently applying the traditional home-host principle as stated above in *Canada Southern Railway* (1883). The Interim Receiver, as petitioner in response to Yukos Oil Company's objections to a Russian court order, stated:

The Company's attack on the credibility of the Russian judicial system, and the Russian Government, is nothing new. The Company is merely rehashing accusations and allegations that it previously made to the Texas bankruptcy court overseeing the Company's Chapter 11 case. In fact, the Company is using the same witnesses that it used in the Chapter 11 case, quoting many of the same sources, and relying on many of the same arguments. None of those accusations or "evidence" in any way implicate Mr. Rebgun<sup>59</sup> or the Arbitration Court.

Tellingly, the Texas bankruptcy court dismissed the Company's Chapter 11 case, *finding that disputes related to the Company should properly be resolved in Russia*. As described below, in rejecting the Company's position, the Texas bankruptcy court recognized the important role that the Russian Government and the Russian judicial system should have with respect to the affairs of the Company. Moreover, and of significant relevance to the case at hand, the Texas bankruptcy court explicitly recognized the Russian *arbitrazh* courts. As part of its rationale for dismissing the Chapter 11 case, the Texas bankruptcy court noted that "Yukos has proceedings which appear to remain pending in Russia, and additionally may have access to a bankruptcy proceeding in the *arbitrazh* courts of Russia. . . ."<sup>60</sup>

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speculation and hysteria on this issue come to an end and that the government not get drawn into this debate.

Vladimir Putin, President, Russian Federation, Speech at a Meeting with Members of the Government regarding Criminal Code Amendments (Oct. 27, 2003), *available at* [http://www.president.kremlin.ru/eng/speeches/2003/10/27/2136\\_54623.shtml](http://www.president.kremlin.ru/eng/speeches/2003/10/27/2136_54623.shtml); *see also Democracy on the Retreat in Russia: Hearing Before the S. Comm. on Foreign Relations*, 109th Cong. (2005) (statement of Tim Osborne, Member, Bd. of Dirs., Menatep Group) (hereinafter *Statement of Menatep Group*).

59. Mr. Eduard K. Rebgun is the receiver under Russian bankruptcy law. *See infra* section 10.4.

60. *In re Yukos Oil Co.*, 321 B.R. 396, 411 (Bankr. S.D. Tex. 2005).

In response to these types of allegations, Menatep has stated that:

Each time the allegations by the Russian Federation have come before an independent court outside of Russia, the Court has found the allegations [of tax evasion and money laundering by the Menatap Group]<sup>61</sup> were substantively deficient. . .

The Russian Government. . . began a campaign of creeping expropriation of Yukos' assets under the pretext of retroactively assessed taxes eventually totaling over \$32 billion, imposed without due process, in a selective, discriminatory and confiscatory misapplication of Russian tax law. These essential facts have been recognized to be true by: (1) U.S. Bankruptcy Judge Letitia Clark in Houston, Texas; (2) U.S. District Judge Nancy Altas in Houston, Texas; (3) the United States State Department; (3) the Counsel on Foreign Relations; (4) the Council of the European Union; (5) the English Courts; and (6) the world financial press, including, for example, this week's Wall Street Journal and London Financial Times. The European Court of Human Rights has put this case on an accelerated timetable.<sup>62</sup>

To date the final legal disposition of these allegations of political motivation remains unresolved, apart from the personal extradition cases heard at the London Magistrates Court.<sup>63</sup> So, the Menatep Group lawyers can justifiably make reference only to two cases<sup>64</sup> which have resolved the questions concerning political motivation, whilst the cases *per se* focused mainly on requests by the Russian Federation for mutual assistance. However, these two cases, due to their auxiliary nature, can hardly be regarded as sweeping victories justifying

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61. Osborne, *supra* note 37, at 11.

62. Memorandum of Law of Yukos Oil Company in Opposition to Verified Petition under Chapter 15 for Recognition of Foreign Main Proceeding and Application for Order to Show Cause with Temporary Restraining Order and Preliminary Injunction at 3, *In re* Petition of Eduard Rebgun, No. 06-B-10775 (Bankr. S.D.N.Y. Apr. 21, 2006).

63. The Bow Street Magistrate Court explicitly relied upon the political motivations of the prosecutions in denying the extradition request of the Russian Federation in relation to Dimitry Maruev and Natalya Chernysheva. See International Secretariat of Amnesty International, *supra* note 57.

64. See *Statement of Menatep Group*, *supra* note 58, at 9.



the claim that Yukos-Khodorkovsky case is predominantly politically motivated on an international level.

Whilst several Western courts have recognized that the prosecution of several Yukos-related individuals was politically motivated, no decision has yet been rendered which can serve as an overarching framework for the entire Yukos saga. The central theme of the Western part of the Yukos saga is rather its life and death struggle in bankruptcy court.

## VI.

### YUKOS BANKRUPTCY

The Yukos bankruptcy recalls the mythical image of many-headed Hydra whose sprouting heads could only be contained by scorching the root of each with fire.<sup>65</sup> After the announcement of Yukos's bankruptcy in Russia on August 3rd, the biggest Russian business newspaper "Kommersant" commented:

Now that YUKOS, once Russia's largest oil company, is being inventoried, assessed and sold off, its place in the textbooks is guaranteed. From the point of view of economics, its bankruptcy was impossible but, with capitalization of \$32.54 billion at the start of the case, its bankruptcy ranks among the largest of all times, along with those of Worldcom (communications, \$103 billion), Enron (energy trading, \$63 billion), Consec (financial services, \$61 billion) and Refco (insurance, \$33 billion). Among the 30 largest bankruptcies in the United States since 1980, there is only one company, Texaco, that dealt in mineral wealth.<sup>66</sup>

The first part of the Yukos bankruptcy raised its "head" in Houston, Texas, ten time zones away from its Moscow corporate centre. In the following sections, we examine the legal motivation for this foreign initiation of the bankruptcy and the function of the dismissal of the case as a transnational limit to corporate governance.

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65. See APOLLODORUS, *THE LIBRARY OF GREEK METHODOLOGY* (Sir James G. Frazer trans., Harvard University Press, 1976) (1921).

66. *The YUKOS Case Is History*, KOMMERSANT, Aug. 3, 2006 available at [http://www.kommersant.com/p694769/The\\_YUKOS\\_Case\\_Is\\_History](http://www.kommersant.com/p694769/The_YUKOS_Case_Is_History).

### A. U.S. Bankruptcy – Debtor Friendly

The motivation for debtors to seek protection under the U.S. Bankruptcy laws is that these laws are well-known to be amongst the most favorable in the world to debtors.<sup>67</sup> The United States is one of the few countries in the world that allow the debtor's management to remain in control of the company after filing.<sup>68</sup> The attraction for Yukos was that the U.S. Bankruptcy Courts claim jurisdiction over the bankrupt's assets throughout the world and can prohibit creditors and others from interfering with those assets.<sup>69</sup> That is, "[i]f the injunction works, the debtor's management remain in control of the assets."<sup>70</sup> Yukos' apparent legal strategy was that

. . . no bankruptcy filing in Russia will be necessary since it expects to challenge successfully the main claims that are causing its current insolvency—the tax claims for over \$25 billion made against it and its subsidiaries by the Russian tax authorities. Yukos's position is that it has a right to refer this dispute to international arbitration and that it will win such arbitration. Consequently, either the tax claims will be withdrawn or compensation to the amount of the claims paid will be returned. Once this happens, Yukos will not be insolvent and the bankruptcy proceeding may end.<sup>71</sup>

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67. See, e.g., Theodore Eisenberg & Stefan Sundgren, *Symposium: Is Chapter 11 Too Favorable to Debtors? Evidence From Abroad*, 82 CORNELL L. REV. 1532 (1997).

68. See S. REP. NO. 95-989, at 54 (1978), as reprinted in 1978 U.S.C.C.A.N. 5787, 5840-41 ("It gives the debtor a breathing spell from his creditors. It stops all collection efforts, all harassment, and all foreclosure actions. It permits the debtor to attempt a repayment or reorganization plan, or simply to be relieved of the financial pressures that drove him into bankruptcy."); See also Frank R. Kennedy, *The Automatic Stay in Bankruptcy*, 11 U. MICH. J.L. REFORM 175 (1977).

69. Comment, *Adequate Protection and the Automatic Stay under the Bankruptcy Code: Easing Restraints on Debtor Reorganization*, 131 U. PA. L. REV. 423, 423-24 (1982).

70. Lynn LoPucki, *Court Shopping Bankrupts U.S. System*, S.F. CHRON., Feb. 20, 2005, at C3.

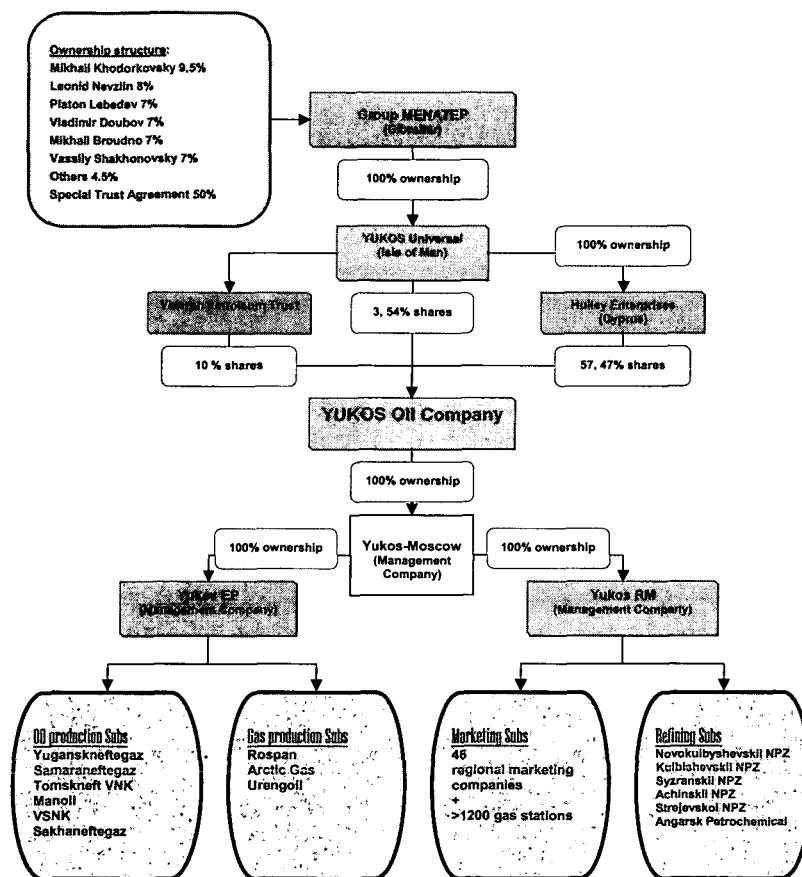
71. Peter Clateman, *Legal Observations on the YUKOS Affair: Part V.*, JOHNSON'S RUSSIA LIST, Jan. 17, 2005, available at <http://www.cdi.org/russia/johnson/Yukos-auction.pdf>.

From a simple assets versus liabilities perspective (see Table 1: Yukos debts and assets in 2004 below), Yukos appeared to have had some chance of surviving in a truncated form after satisfying tax claims from the sale of some assets. However, despite its asset-rich position, the Yukos management at the start of 2004 continued to moan that the Company was likely to become bankrupt, literally, within a couple of days.<sup>72</sup>

TABLE 1: YUKOS DEBTS AND ASSETS IN 2004

YUKOS ASSETS	YUKOS DEBTS
(a) Two major oil production assets located in Russia worth between \$8.5 and \$19.5 billion;	Russian tax claims of approximately \$6 to \$10 billion;
(b) Other oil and gas production assets located in Russia worth between \$2 and \$4 billion;	Yuganskneftegaz ("YNG") claims in the combined amount of approximately \$2 billion
(c) Oil and gas refining assets located in Russia worth in excess of \$2 billion;	Moravel Investment claims of approximately \$655 million;
(d) Stock ownership in Sibneft worth approximately \$3.6 billion;	Yukos' Bank Group claims (purchased by Rosneft) of approximately \$500
(e) Other assets, which include electricity and transportation assets, located in Russia worth in excess of \$1.5 billion	
(f) International assets, including the Mezeikiu Nafta refinery, with bids outstanding of approximately \$1.5 billion.	Miscellaneous creditors of approximately \$70 million.
(g) YNG shares valued at \$3.9 billion	
TOTAL: BETWEEN \$23BN AND \$36BN	TOTAL: BETWEEN \$9.225 AND \$13.225 BN

72. See Press Release, Yukos Oil Co., Yukos Oil Company Statement in Connection with the Court Decision on Collection of Additional Profit Tax for the Year 2000 (May 27, 2004) [hereinafter Yukos, Profit Tax], available at <http://www.yukos.com/vpo/news.asp?year=2004&month=5>.

FIGURE 1: YUKOS' CORPORATE STRUCTURE IN 2002<sup>73</sup>

As the management of the Company stated in its press-statement,

At present, the Company is under an injunction prohibiting it to sell any of its property, including the shares owned by the Company. Until the injunction is lifted, the Company is unable to sell its assets in order to obtain liquid funds. Consequently, if the Tax Ministry's efforts continue, we are very likely to

73. For background information on the Menatep Group, see Wikipedia, Bank Menatep, [http://en.wikipedia.org/wiki/Group\\_Menatep](http://en.wikipedia.org/wiki/Group_Menatep) (last visited Mar. 26, 2007).

enter the state of bankruptcy before the end of 2004.<sup>74</sup>

After numerous announcements of its imminent and inevitable bankruptcy in its press-statements, the Company made the decision on December 14th to file a Chapter 11 application in Houston,<sup>75</sup> in clear defiance of several provisions of the Russian Criminal Code<sup>76</sup> and the Insolvency Law.<sup>77</sup> Although

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74. YUKOS, PROFIT TAX, *supra* note 72.

75. See Press Release, Yukos Oil Co., Yukos Files for Bankruptcy Protection (Dec. 14, 2004), available at <http://www.yukos.com/vpo/news.asp?year=2004&month=12>.

76. On the one hand, if Yukos had not been an actual bankrupt then the actions of the management would need to have been considered under the "Fictitious bankruptcy" provisions of the Russian Code. That is, under *Article 197 of the Russian Criminal Code* (Federal Law No. 63-FZ of June 13, 1996), a "fictitious bankruptcy" is defined as consisting of a knowingly false declaration made by the manager or owner of a profit-making organization, or by an individual businessman, about the pending insolvency with the aim of deluding creditors and [creating] delays or [taking] time to make pay payments due to creditors, or a debt allowance, and likewise for defaults on debts, with the condition that this has caused large-scale damage. *Ugolovnyi Kodeks RF [UK] [Criminal Code] art. 197 (Russ.)*. For comments, see *THE CRIMINAL CODE OF THE RUSSIAN FEDERATION* (William E. Butler, trans., Simmons & Hill Publishing 3rd ed. 1999). On the other hand, if Yukos had been an actual bankrupt, and the management evaded the bankruptcy procedure in Russia, then Russian law should have been applied. That is, the bankruptcy court in Houston stated that the only legitimate bankruptcy procedure for Yukos was that of its home state. *In re Yukos Oil Co.*, 321 B.R. 396, 411 (Bankr. S.D. Tex. 2005). It is at least arguable that the following relevant articles of the Russian Criminal Code would be applied:

(1) *Article 196 Deliberate Bankruptcy*, deliberate bankruptcy is defined as the "intentional creation or increase of insolvency, committed by the manager or the owner of a profit-making organization, or by an individual businessman, for the doer's benefit or for the benefit of other persons, which has caused large-scale damage or any other grave consequence." *Ugolovnyi Kodeks RF [UK] [Criminal Code] art. 196 (Russ.)*;

(2) *Article 195 Lawless Actions in Case of Bankruptcy* – 1, whereby the "concealment of property or of property liabilities, of information about property, its size, and place of location, or of other information about property, transfer of property into another's possession, alienation or destruction of property, and also concealment, destruction, or falsification of accounting and other records reflecting economic activity, if these actions have been committed by the manager or the owner of a debtor organization or by an individual businessman in case of bankruptcy or in expectation of bankruptcy, and have caused sizable damage"; 2. "Unlawful satisfaction of the property claims of particular creditors by the manager of a debtor organization or by an individual businessman who knows about his actual insolvency (bankruptcy),

Yukos may have intended the filing of the petition to act as a shield, it provoked to its own detriment the application of the traditional home-host rules. Yukos' untenable legal position in the U.S. bankruptcy court is succinctly captured in the following excerpt:

Question by the Interim Receiver: Was YUKOS solvent in 2004, when it filed bankrupt with the U.S. court? Mr. Osborne answered that it was solvent and that Mr. Zack Clement, who represented the company's interests in the U.S. court, would answer this question.

Answer of the debtor's representative: Mr. Zack Clement explained that he acted as an attorney of YUKOS Oil Company in the bankruptcy case in Texas Court and signed the bankruptcy petition together with the company's representative. At that time, the assets on the company's balance sheet exceeded its debt by many billions of dollars. This petition was forced by the necessity to stop the nationalization of ??? "Yuganskneftegaz", to satisfy the claims of legitimate creditors, and to ensure that the company still possessed funds. The U.S. laws permit this kind of actions (filing a voluntary bankruptcy petition in the absence of actual bankruptcy) (Chapter 11 of the U.S. Bankruptcy Law).<sup>78</sup>

Normally, bankruptcy statutes define the financial situation that determines whether a company is technically insol-

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knowingly done to the detriment of other creditors, and also the acceptance of such satisfaction by a creditor who knows about the preference given to him in the insolvency to the detriment of other creditors, if these actions have caused large-scale damage." Ugolovnyi Kodeks RF [UK] [Criminal Code] art. 195 (Russ.). However, the action pursued by the General Prosecutor Office of the Russian Federation was not a case under "LAWLESS ACTIONS IN CASE OF BANKRUPTCY" but was in fact a case accusing them of "stealing the company's foreign assets." ARKADY OSTROVSKY, *Russia Accuses Former Yukos Chiefs of Asset Theft*, FIN. TIMES, Aug. 18, 2006, at 20.

77. Articles 9 and 10 of the Russian Law on Insolvency (Federal Law N 127 FZ dated October 26, 2002) stipulate that if the management body (CEO) of the company has reasonable suspicions that the situation with company's debts may have an adverse effect on some creditors, he has a obligation to file an application for a voluntary bankruptcy (analogy of Chapter 11 application in the U.S.). If he fails to do so, he may be held liable for the damages incurred by the company and the creditors.

78. Status Report Filed by Edwin K. Rebgun,, Exhibit "E" to the Status Report, *In re* Petition of Eduard Rebgun, No. 06-B-10775 (Bankr. S.D.N.Y. Aug. 7, 2006).

vent, which in turn precipitates the filing for bankruptcy.<sup>79</sup> However, U.S. Chapter 11 provisions are odd in that they do not provide any such guidance, and much depends on the management's discretion as to whether it is able to continue the business after a stay of creditor proceedings.<sup>80</sup>

However, Yukos presented "paradoxical symptoms," arguing that whilst it was solvent, it expected to become bankrupt by imminent government action and thus was "forced" to seek Chapter 11 protection. We can dissect the quotation into three major facts:

(1) Either Yukos management was expecting the pending bankruptcy of the Company during 2004 or it was intentionally making false and misleading statements;<sup>81</sup>

(2) Management filed for Chapter 11 protection, believing that it would be deemed the debtor in possession and thus be able to curtail rights of its creditors on a global basis.<sup>82</sup>

(c) Yukos management had not made any reasonable efforts to file for bankruptcy in Russia prior to seeking Chapter 11 protection.

As Yukos CEO Steven Theede testified,

... Yukos came to the Houston court because he believed the company would not be allowed to file for bankruptcy in

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79. According to the U.S. Bankruptcy Code, "[t]he commencement of a case. . . creates an estate" that "is comprised of all the following property, wherever located and by whomever held". 11 U.S.C. § 541 (2000). "A voluntary case under a chapter of this title is commenced by the filing with the bankruptcy court of a petition under such chapter by an entity that may be a debtor under such chapter". 11 U.S.C. § 301(a) (2000).

80. See 11 U.S.C. § 301(a) (2000).

81. For example, see Press Release, Yukos Oil Co., YUKOS' SHAREHOLDERS WILL CONSIDER LIQUIDATION OR BANKRUPTCY OF THE COMPANY (Nov. 26, 2004), available at <http://www.yukos.com/vpo/news.asp?year=2004&month=11>.

82. Attached to the petition was a resolution of the Management Board of Yukos-Moscow Ltd., the management company of Yukos, authorizing the filing of the instant Chapter 11 case in the United States Bankruptcy Court for the Southern District of Texas. The resolution recites that six members of the Management Board met (with Misamore appearing by telephone), and five of the six listed members voted for, and signed, the resolution. See *In re Yukos Oil Co.* 321 B.R. 396, 399 (Bankr. S.D. Tex. 2005).

Moscow, where he said the company had been harshly treated by the courts.<sup>83</sup>

However, under Russian law, the Yukos management was required to pursue the bankruptcy procedures and remedies contained in the provisions of Articles 9-10 of the Insolvency Law, which provides:

The management of the Debtor. . . shall apply to the Arbitraz Court if discharge of the obligation of one creditor (creditors) makes impossible the discharge of the obligations of the other creditors in full.

If the persons obliged under the Article 9 of the Law to file the application with the Arbitraz Court fail to do so, they shall be held vicariously labile for the debts arising after the period of time specified in part 3 of Article 7 of the Law .

The Russian Law also provides that management of the company which failed to apply to the Court is liable for the relevant damages of the Company.<sup>84</sup> Moreover, the Company cannot be “a little bit bankrupt”; it is an all or nothing matter. If the company is found to be not bankrupt, then the management of the company can be held liable for either a *deliberate bankruptcy* (that is, where the management recognize that the company is not bankrupt or where management intentionally drove it into bankruptcy) or a *fictitious bankruptcy* (when the management make false statements about the company’s insolvency [see the above statement about the pending bankruptcy in 2004] which may cause damages to the creditors). In support of these theories of law, the relevant articles provide as follows:

#### Article 196. Deliberate Bankruptcy

Deliberate bankruptcy, that is, the intentional creation or increase of insolvency, committed by the manager or the owner of a profit-making organization, or by an individual businessman, for the doer’s benefit or for the benefit of other

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83. *Lawyers Spar in Yukos Bankruptcy Hearings*, MOSCOW TIMES, Feb. 21, 2005, at 5.

84. Russian Law on Insolvency (Bankruptcy), Articles 9 and 10, N 127 FZ, October 26, 2002.



persons, which has caused large-scale damage or any other grave consequences,

Article 197. Fictitious Bankruptcy

Fictitious bankruptcy, that is the knowingly false declaration by the manager or owner of a profit-making organization, or by an individual businessman, about the doer's, insolvency with the aim of deluding creditors and receiving delays or time to make pay payments due to creditors, or a debt allowance, and likewise for defaults on debts, if this deed has caused large-scale damage.

Regardless of the findings of the U.S. courts, it is clear that the Yukos management made the following two errors of judgment which may haunt them in the future: (1) they made questionable allegations of fact about an imminently pending bankruptcy; and (2) they did not make any genuine attempt to proceed with bankruptcy proceedings in Russia. These two facts could be used as a basis for a type of equitable estoppel argument against Yukos. In other words, because Yukos had made public its imminent bankruptcy in Russia and yet did not take advantage of the bankruptcy law in Russia, it could hardly be fair for it to claim bankruptcy in a "foreign" jurisdiction. The flavour of the equitable estoppel can be tasted in the U.S. bankruptcy court's interpretation of Yukos' intention in its multi-jurisdictional filings:

. . . Yukos seeks to substitute United States law in place of Russian law, European Convention law, and/or international law, and to use judicial structures within the United States in an attempt to alter the creditor priorities that would be applicable in the law of other jurisdictions. Yukos appears to hope to subordinate its tax debt, and to transfer causes of action it believes it holds, into a trust for continued litigation. Yukos has commenced or attempted to commence proceedings in several other forums, including the European Court of Human Rights, and in arbitration. In addition, Yukos has *proceedings which appear to remain pending in Russia*, and additionally *may have access to a bankruptcy proceeding in the arbitrazh courts of Russia*.<sup>85</sup> [Emphasis added.]

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85. *Yukos*, 321 B.R. at 411.

Even if we grant that Yukos management's could have a potentially innocent intention in filing for bankruptcy to avoid an allegedly "hostile and . . . unfair legal system rather than unfavorable substantive law",<sup>86</sup> this is hardly proven on the facts. According to Pottow, Yukos' claim is similar to one made in *In re Head*, 223 B.R. 648, 653 (Bankr. W.D.N.Y. 1998) where a Canadian debtor attempted to circumvent a hostile Canadian law by filing a U.S. bankruptcy petition in the United States despite the fact that the debtor lacked any real connection to the United States.<sup>87</sup> Pottow concludes that "[t]he new 2006 Yukos filing is a *Head*-like stretch for U.S. jurisdiction to avoid unfavorable home bankruptcy law."<sup>88</sup>

B. *Uncle Sam says: "You are bankrupt now . . ."*

Section 109(a) of the U.S. Bankruptcy Code provides as follows:

- . . . only a person that resides or has a domicile, a place of business, or property in the United States. . . may be a debtor under this title.

Thus, a 'person'<sup>89</sup> is eligible to be a debtor under the U.S. Bankruptcy Code if it: (a) resides or has a domicile in the U.S.; (b) has a place of business in the U.S.; or (c) has property in the U.S.

Once qualified as a debtor, the person or legal entity may take advantage of the tremendous power of the automatic stay provision against creditors. This power takes the form of the following:

- actions taken in violation of it are void *ab initio*;
- the stay applies to actions against the debtor and its property outside the U.S.;
- the district court in which the bankruptcy case has commenced has exclusive *in rem* jurisdiction over all of the property in the estate;

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86. Pottow, *supra* note 17, at 1911 n. 54.

87. *See id.*

88. *Id.*

89. For purposes of Section 109(a), Section 101(41) of the U.S. Bankruptcy Code defines 'person' to include individuals, partnerships and corporations. 11 U.S.C. §101(41) (2000).

- fear of contempt proceedings in the U.S. inspires foreign creditors with operations in the U.S. to comply with the stay, even in the absence of a temporary restraining order.<sup>90</sup>

U.S. bankruptcy jurisdiction, with all of the above consequences, is found to exist on the basis of the slightest presence in the U.S. jurisdiction. For example, in *In re Cenargo International plc* jurisdiction was found to exist on the basis of joint bank accounts in the U.S. opened just prior to the filing.<sup>91</sup> Prior to the enactment of Chapter 15, U.S. courts applied this test quite literally and permitted entities to be debtors under the U.S. Bankruptcy Code even if such entities only had nominal assets located in the U.S. The property could be several thousand dollars in a U.S. bank account, a retainer held by the company's U.S. professionals, or stock in a U.S. corporation held by the company.<sup>92</sup> U.S. courts have stated that there is "virtually no formal barrier" to having non-U.S. debtors become subject to U.S. bankruptcy proceedings.<sup>93</sup>

The intent of the broad grant of jurisdiction is to permit the U.S. bankruptcy court to "deal efficiently and expeditiously with all matters connected to the bankruptcy estate".<sup>94</sup> In order to hear a case, a U.S. court must establish that it has subject matter jurisdiction

*in personam* (or personal) jurisdiction, and that the venue is proper.

We examine the arguments for each in turn.

### C. *Jurisdiction of U.S. Bankruptcy Courts*

The jurisdiction of the US Bankruptcy Courts derives from the U.S. Constitution (Art. VI, § 8). Whilst the district court has exclusive jurisdiction over all the property, wherever located, of the debtor as of the commencement of such case, (28 U.S.C. § 1334), Congress granted "comprehensive jurisdic-

90. See Kennedy, *supra* note 68; Comment, *supra* note 69, at 423-24.

91. 294 B.R. 571, 603 (Bankr. S.D.N.Y. 2003).

92. See *In re Global Ocean Carriers, Ltd.*, 251 B.R. 31, 37-39 (Bankr. D. Del. 2000); *In re McTague*, 198 B.R. 428, 428-29 (Bankr. W.D.N.Y. 1996).

93. *In re Globo Comunicacoes E Participacoes S.A.*, 317 B.R. 235, 249 (Bankr. S.D.N.Y. 2004) (internal quotes omitted).

94. *Celotex Corp. v. Edwards*, 514 U.S. 300, 308 (1995) (internal quotes omitted).

tion to the bankruptcy courts so they might deal efficiently and expeditiously with all matters connected with the bankruptcy estate."<sup>95</sup> Judge Clark in the Bankruptcy Court's decision confirmed the principle that "this broad grant of jurisdiction extends to *extraterritorial application* of the Bankruptcy Code as it applies to property of the bankruptcy estate,"<sup>96</sup> [emphasis added] and held that Yukos as a foreign corporation having relatively nominal amount of property in the United States qualified as a debtor under § 109(a) the Bankruptcy Code.<sup>97</sup> The test under Title 11 § 109(a) determines whether the claimant has standing to sue and provides that "only a person that resides or has a domicile, a place of business, or property in the United States, or a municipality, may be a debtor."

In determining whether it would be proper for the U.S. court to assert personal jurisdiction<sup>98</sup> over a particular entity (and, therefore, have the ability to adjudicate rights to property located outside of the U.S.), the U.S. court will consider: (i) whether the debtor had sufficient 'minimum contacts' with the jurisdiction to subject itself to personal jurisdiction in such jurisdiction, and (ii) whether the exercise of personal jurisdiction over the debtor is reasonable under the circumstances of the particular case.<sup>99</sup>

To address the first part of this test, the U.S. court engages in a broad survey of the debtor's presence and activities in the U.S. to ensure that "the maintenance of the suit does not offend "traditional notions of fair play and substantial justice".<sup>100</sup> As to the second factor for the establishment of per-

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95. *In re Yukos Oil Co.*, 321 B.R. 396, 407 (Bankr. S.D. Tex. 2005) (citing *Celotex Corp.*, 514 U.S. at 308).

96. *Id.*

97. *Id.*

98. If the U.S. court is unable to exercise personal jurisdiction over a debtor and, instead, is only able to exercise in rem jurisdiction (*i.e.*, jurisdiction over property of the debtor), then its power over the assets of the debtor is limited to property which is "legally or physically located within its own jurisdiction". See *In re Globo Comunicacoes E Participacoes S.A.*, 317 B.R. at 251 (citing 4A CHARLES ALAN WRIGHT & ARTHUR R. MILLER, *FEDERAL PRACTICE & PROCEDURE* §1070 (3d ed. rev. 2004)).

99. See *Int'l Shoe Co. v. Washington*, 326 U.S. 310 (1945); *World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. 286 (1980); *Burger King Corp. v. Rudzewicz*, 471 U.S. 462 (1985); *Asahi Metal Indus. Co. v. Superior Court*, 480 U.S. 102 (1987).

100. *Int'l Shoe*, 326 U.S. at 316 (internal quotes omitted).

sonal jurisdiction, the U.S. Supreme Court has held that the reasonableness of the exercise of personal jurisdiction in a particular case depends upon "an evaluation" of the following factors: "the burden on the defendant, the interests of the forum state and the plaintiff's interest in obtaining relief", as well as, "the interstate judicial system's interest in obtaining the most efficient resolution of controversies. . . and the shared interest of the several states in furthering fundamental substantive social policies."<sup>101</sup> Given the rather large breadth of judicial discretion, Supreme Court Justice Scalia feels the U.S. courts are hard pressed to find consistent meaning in the Bankruptcy Code, and that decisions tend to be somewhat of an arduous "search for a neutral and rational interpretive methodology."<sup>102</sup>

#### D. *Venue*

The venue of a bankruptcy case, however, is clearly determined by 28 U.S.C. Section 1408, which limits venue in plenary U.S. bankruptcy cases to the district:

. . . in which the domicile, residence, principal place of business in the United States, or principal assets in the United States, of the person or entity that is the subject of [the bankruptcy proceeding] have been located for the one hundred and eighty days immediately preceding [the] commencement [of such proceeding], or for a longer portion of such one-hundred-and-eighty-day period than the domicile, residence, or principal place of business, in the United States, or principal assets in the United States, of such person were located in any other district.<sup>103</sup>

The principal place of business is determined by the location of the corporation's "nerve center", or where significant business decisions are made. The "nerve center" is based on a variety of factors, such as where activities like marketing, accounting, and management take place.<sup>104</sup>

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101. *Asahi*, 480 U.S. at 113.

102. *Patterson v. Shumate*, 504 U.S. 753, 766-67 (1992) (Scalia, J., concurring).

103. 28 U.S.C. § 1408 (2000).

104. *In re Peachtree Lane Assocs.*, 198 B.R. 272, 280 (Bankr. N.D. Ill. 1996).

### E. *Forum Non Conveniens*

Whilst the venue may be easily established for foreign corporations registered and conducting business in the U.S., the courts apply various doctrines to determine whether a foreign corporation's claims may be fairly adjudicated in the U.S. One such doctrine, *forum non conveniens*, is a common law principle that gives courts the discretion to decline exercising jurisdiction over certain cases involving foreign parties where the underlying principles of justice and convenience favor dismissal. The doctrine of *forum non conveniens* is normally used to protect defendants from being subjected to jurisdiction in a particular forum where an adequate alternative forum is available and also where an action in the plaintiff's choice of forum is substantially inconvenient to such an extent that justifies transfer or dismissal.<sup>105</sup>

Among the jurisdictions with a *forum non conveniens* rule in place, there is a wide variety of factors that may be taken into account by the court in order to determine whether or not it is appropriate. Most notably, U.S. courts may use a type of cost-benefit analysis, taking into account factors such as the burden of the court and public costs, and may therefore dismiss a case on *forum non conveniens* grounds based in "its inherent power."<sup>106</sup> Courts throughout the Commonwealth of Nations may only take into account factors relating to this particular matter and may therefore only stay a case at the request of one of the parties.<sup>107</sup> In the U.S., possible factors to be taken into account include:

- the location of potential witnesses and relevant evidence,
- the choice of law applicable to the dispute,
- possible undue hardship for the defendant,
- the most expeditious use of judicial resources,
- questions of public policy and other similar factors.<sup>108</sup>

A court's power to dismiss on grounds of *forum non conveniens* is discretionary, and is generally conditioned on an in-

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105. See, e.g., *Gulf Oil Corp. v. Gilbert*, 330 U.S. 501, 507-08 (1947).

106. See *In re Yukos Oil Co.*, 321 B.R. 396, 408-09 (Bankr. S.D. Tex. 2005) (concerning *forum non conveniens*).

107. See LoPucki, *supra* note 16, at 709-20 (1999).

108. See David W. Feder, *The Forum Non Conveniens Dismissal in the Absence of Subject-Matter Jurisdiction*, 74 *FORDHAM L. REV.* 3147, 3165-72 (2005).

itial determination that an adequate alternative legal forum is open to the plaintiff.<sup>109</sup>

F. *Abstention or Dismissal of Chapter 11 Proceedings Under Section 305*

Section 305(a)(1) gives the U.S. court discretion to dismiss or suspend a proceeding under the U.S. Bankruptcy Code if “the interests of creditors and the debtor would be better served by such dismissal or suspension.” It should be noted that the mere existence of a proceeding outside of the U.S. does not automatically require abstention or dismissal under Section 305(a)(2).<sup>110</sup>

VII.

YUKOS SEEKS PROTECTION UNDER U.S. BANKRUPTCY CODE:  
FRIENDS AGAINST RUSSIA

A. *Summary of Facts*

In November 2004, the Russian Government announced that it would hold an auction on December 19, 2004 (the “Auction”) to sell the stock of Yukos’ largest wholly owned subsidiary, YNG. The Russian Federation announced that it would auction the YNG stock to raise funds for payment of the alleged tax debt. Three Russian entities, OOO Gazpromneft (“Gazpromneft”), ZAO Intercom, and OAO First Venture Company filed applications to bid at the auction, which was scheduled to take place December 19, 2004 in Moscow. OAO Gazprom, a company related to Gazpromneft, began negotiating a financing arrangement with a consortium of international banks to finance its bid at the auction.

On December 14, 2004, Yukos filed for Chapter 11 bankruptcy protection in the federal bankruptcy court for the Southern District of Texas. Simultaneously, Yukos filed an Original Complaint for Injunctive Relief pursuant to Section 105 of the Bankruptcy Code in order to, among other things, enforce the automatic stay set out in Section 362(a) of the Bankruptcy Code by enjoining certain parties from participating in the YNG Stock Auction.

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109. *See id.* at 3173.

110. *In re Maxwell Communication Corp.*, 93 F.3d 1036, 1049 (2d Cir. 1996).

As a result of this filing, an automatic stand-still order went into effect, which prohibited the company's creditors from taking action against its assets. In addition to making this filing, Yukos sought a temporary restraining order ("TRO") against Gazpromneft ordering the latter not to participate in the auction for shares in Yukos's subsidiary, Yugansk.<sup>111</sup>

On December 16, 2004, after conducting an evidentiary hearing, United States Bankruptcy Court Judge Clark entered a TRO enjoining certain entities from taking any actions with respect to the YNG Stock, including participating in the Auction. The entities enjoined by the TRO were:

(1) The three companies registered to bid at the Auction, including OOO Gazpromneft ("Gazpromneft"), a subsidiary of Gazprom, ZAO Intercom, and OAO First Venture Company;

(2) Six western financial institutions that had announced an intention to fund Gazpromneft's bid at the Auction [names of the 6 institutions]; and

(3) "those persons in active concert or participation with them."<sup>112</sup>

The TRO expanded the scope of the stand-still imposed by the bankruptcy filing by extending it to parties who would benefit from the company had the stand-still not been imposed.

### B. *International Legal Arms Race—Tit for Tat*

The issuance of the TRO effectively put the Russian Government and the group of "siloviki"<sup>113</sup> in the Administration, who had actually organized the attack on Yukos, in a difficult position. On the one hand, they could easily ignore the injunc-

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111. See Clateman, *supra* note 17, at 1-2.

112. See *In re Yukos Oil Co.*, 320 B.R. 130 (Bankr. S.D. Tex. 2004).

113. Traditionally, the term *siloviki* referred to an informal name for the heads of "power" ministries (e.g., the Ministry of Defense, the Ministry of Interior Affairs, and so on) and military or intelligence agencies. In recent years, the word (rooted in a Russian term for power) is more commonly used to refer to a clan of former and present members of security or military services, often the KGB (and its post-Soviet successor the FSB), who came to power during the Yeltsin years and had significantly increased their influence after Vladimir Putin became President. See Mosnews.com, MN-Files, <http://www.mosnews.com/mn-files/siloviki.shtml> (last visited February 20, 2007).



tion issued by the U.S. court using the sovereign jurisdiction of the Russian Federation. The law provides that any order issued by international or foreign courts must pass through a special procedure which enables the order to be executed within the jurisdiction of the Russian Federation. However, the events of corporate irresponsibility of 1990's had passed and state-owned companies were being required to carefully review not only their revenues, but also their image and compliance with international laws. In the summer of 2006, the Rosneft share listing on the LSE had shown that the Russian Government enjoys monetising its new found financial market power. In the run-up of events prior to this listing, the consortium of "siloviki", Rosneft and Gazprom management, and the legal officials, evidently on the advice of an international adviser who has remained anonymous, came to the clever decision to not ignore the TRO directly but rather to indirectly control the Yugansk Auction and the bidders. By doing so, these entities aimed to avoid the TRO limitations and possible U.S. court sanctions. However much the Yukos Control Group and their anti-Putin supporters complained in public about the injustice of the siloviki's actions,<sup>114</sup> pushing the button on the U.S. Chapter 11 global stay of credit proceedings is tantamount to using a international "nuclear legal weapon" which indiscriminately ignores jurisdictional boundaries and freezes all claims on a worldwide basis. The Russian Federation's response was very much like that of a "judoka"—someone schooled in the Japanese martial art which emphasizes the use of the attacker's own mind, strength and force against the attacker.<sup>115</sup> The Russian state used one of Western capitalism's sophisticated financial-legal techniques for "adding value" and "erasing the liabilities of balance sheets" against Yukos. In terms of making use of sophisticated financial engineering of market instruments, one might say that just as the Yukos used Chapter 11 to obtain a standstill order of creditor claims and a reorganisation of the company's balance sheet, the Russian

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114. See, e.g., *Reuters*, Soros Speaks Out Against Listing, ST. PETERSBURG TIMES, July 7, 2006, available at [http://www.sptimes.ru/index.php?action\\_id=2&story\\_id=18154](http://www.sptimes.ru/index.php?action_id=2&story_id=18154).

115. President Putin is a Judoka. See ABC News Online, Judo, <http://www.abc.net.au/news/olympics/sports/judo.htm> (last visited March 3, 2007).

Federation's used Special Purpose Entities (SPEs) to completely avoid liability.

The decision of the Russian Federation to indirectly control the Yugansk Auction has raised the level of Russian statutory corporate governance to a new level and represents a type of state control over businessmen through the use of financial legal techniques which are normally reserved for sophisticated market players. Notwithstanding the issuance of the temporary restraining order, the auction proceeded as scheduled and the Company's shares of YNG were sold for \$9.4 billion.<sup>116</sup> The state effectively used a SPE (Baikalfinancegroup, registered Tver) to buy the YNG shares and avoided the possible sanction, which could not damage the state but could have had an adverse effect on the bidders who violated the TRO. Before the YNG deal, the Russian Federation had never used such financial structuring tactics in similar situations, whether by refusing to participate in the relevant understandings (like sending aircraft to the international avia-saloons, where they could be arrested – Noga case<sup>117</sup>) or by fighting the court orders directly.<sup>118</sup>

The new era of state steerage of the economy via "flexible legal means of financial structuring" is clear from the President's interview:

QUESTION: Mr President, there is a film called 'All you wanted to know but never had the chance to ask'. I would like to ask you about a certain scheme. Your oligarchs made quite extensive use of non-transparent schemes to do their deals. Mikhail Khodorkovsky did so, as did Roman Abramovich. But why is the state using non-transparent schemes? Why, for example, use Baikalfinancegroup to buy Yuganskneftegaz? And why use this scheme with Rosukrenergo to supply gas to Ukraine? Why are these schemes necessary?

VLADIMIR PUTIN: I will tell you why. . .

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116. Elif Kaban, *Yukos May Seek US Court Ruling Against Gazprom*, BUS. REP., Dec. 22, 2004, available at <http://www.busrep.co.za/index.php?fSectionID=565&fArticleId=2353716>.

117. Nikola A. Lazarev,, *Aspects of Russian Legislation Relating to Recognition and Enforcement of Foreign Awards: the Noga Case*, 72 ARB.: J. CHARTERED INST. ARBITRATORS 189 (Aug. 2006).

118. Press Release, Alan Callison & Russell Gold, "Putin Criticizes the US Position on Yukos," (Dec. 24 2004), available at [http://www.strategiya.ru/index.php?cnt=67&news\\_id=1677](http://www.strategiya.ru/index.php?cnt=67&news_id=1677).

QUESTION: Sometimes it seems that they are used so as to avoid taxes. Even the Northern Gas Pipeline has its legal address in Switzerland if I am not mistaken.

VLADIMIR PUTIN: Regarding Baikalfinancegroup, the situation is quite simple. This *was not an administrative or repressive issue, but a legal issue*. [Emphasis added.] The future owners had to think about how they were going to work and how they would perhaps have to respond to lawsuits in the court, if such ever arose. When Baikalfinancegroup acquired the corresponding stake it became the owner and everything that took place subsequently took place on the secondary market.<sup>119</sup>

C. *Corporate Governance Risk Disclosures Apres le Renvoi*

To return to the risk disclosures contained in future Western prospectuses regarding the sale of Russian assets, how will we describe Yukos risk? In many ways, Yukos risk involves the governmental use of arguably legitimate, sophisticated, and very aggressive legal mechanisms for the re-distribution of assets to private parties. Under Fox and Heller's concept of good corporate governance, where firms simply maximize the value of residual claims and then "distribute the wealth so generated to shareholders in a pro rata fashion,"<sup>120</sup> the authors attempt to explain the etiology of corrupt Russian corporate performance in terms of a "rich array of deviant behavior".<sup>121</sup> Given their typology of pathologies, two in particular, "Pathology 6: Diversion of Claims" and "Pathology 7: Diversion of Assets" under the "Failure to Make Pro Rata Distributions" appear to be the most relevant. The "Diversion of Claims" pathology is described as follows:

The key feature of these non pro rata distributions is that the people perpetrating them, usually insider owner-managers, are keeping the firm intact, including its assets and opportunities. They gain instead by manipulating the corporate legal system, the bankruptcy law, and other laws to reduce or elimi-

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119. Interview by the Spanish Media with President Vladimir Putin, in Moscow, Russ. (Feb. 7, 2006), *available at* [http://www.kremlin.ru/eng/text/speeches/2006/02/07/2343\\_type82916\\_101277.shtml](http://www.kremlin.ru/eng/text/speeches/2006/02/07/2343_type82916_101277.shtml).

120. Merritt B. Fox & Michael A. Heller, *Corporate Governance Lessons from Russian Enterprise Fiascos*, 75 N.Y.U. L. REV. 1720, 1722 (2000).

121. *Id.*

nate the claims of some or all of the firm's shareholders on the firm's residuals—usually wiping out the outside minority shareholders.<sup>122</sup>

The Diversion of Assets pathology “involves the direct diversion of assets and opportunities belonging to the firm”.<sup>123</sup> Its “key feature” is that

insiders leave the ownership structure intact as they hollow out the firm—taking cash or assets belonging to the firm and effectively giving title to themselves. Or it may take the form of sweetheart business deals with firms controlled by insiders or their families, using, for example, transfer pricing agreements that move profits to subsidiaries or parents in which the insiders have a larger interest.<sup>124</sup> [Citations omitted.]

On the one hand, by extending Pathology 6 or the diversion of claims, to all jurisdictions, one could plausibly argue it actually applies quite aptly to Yukos' management in its attempt to use US bankruptcy law for their own advantage. On the other hand, Pathology 7 or the diversion of assets, clearly applies to the Russian Federation with its orchestrated forced sale of YNG. Fox and Heller warn that Pathology 7 is not something that can be rooted out easily in a well-developed and reputedly incorruptible legal system. They state that even in:

The Delaware Chancery Court, presumably the most sophisticated court in the world for detecting breaches of the duty of loyalty, has a difficult time separating out management decisions that are legitimately taken to increase residuals, but have the incidental effect of disproportionately benefiting insiders from management decisions primarily motivated by management desire to effect a non pro rata distribution.<sup>125</sup>

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122. *Id.* at 1741 (citing F. Norris, *The Russian Way of Corporate Governance*, N.Y. Times, April 5, 1999, at A20 (referring to a Yukos case in Russia where a judge barred minority shareholders from voting)).

123. *Id.* at 1743.

124. *Id.* at 1743-44.

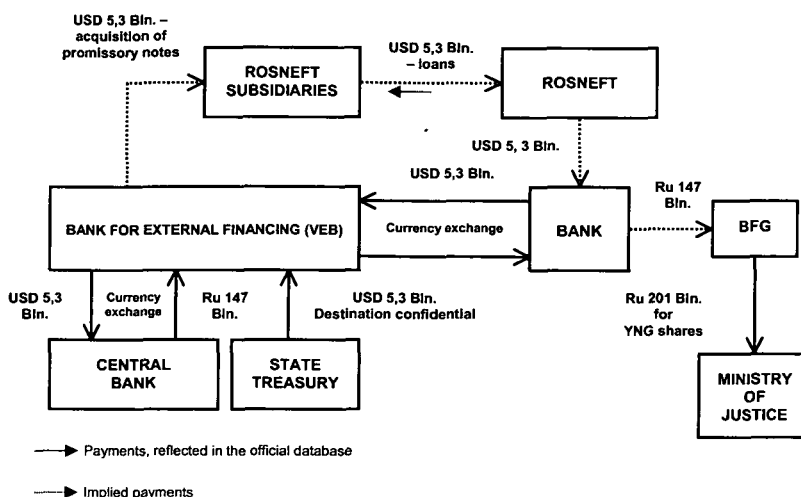
125. *Id.* at 1771 (citing L. D. SOLOMON ET AL., *CORPORATIONS LAW AND POLICY* 748 (4th ed. 1998)).

Whilst it may be a strong insult to our sensibilities that the Russian Federation should make use of sophisticated legal structuring to take advantage of Yukos, we can hardly argue against the use of such legal-financial techniques, since such structuring occurs as a matter of course whenever corporate managers wish to isolate business risk behind the ever-cherished doctrine of limited liability. In the real-politic of corporate governance, it is impractical to assume that any government will remain a distant law-maker and judicial arbiter in the face of threats to its incumbency. The complex boundary of Yukos risk necessarily implicates the use of sophisticated legal instruments. In this fractured image, do we not see that this is what is taught to students in western business schools, implemented by investment bankers, and condoned by the most sophisticated financial rule-making body in the world?<sup>126</sup> We are not commenting on the ethics of the legal maneuvering; rather, we are looking for a way to understand how Yukos risk has actually developed and its real implications for future transactions. In this regard, let us now turn to an examination of YNG and its auction.

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126. See *infra* Part VII(B) for a discussion regarding an anonymous western banker giving President Putin advice on legal financial strategy. See also Report and Recommendations Pursuant to Section 401(c) of the Sarbanes-Oxley Act of 2002 On Arrangements with Off-Balance Sheet Implications, Special Purpose Entities, and Transparency of Filings by Issuers (June 15, 2005) 23 (discussing with approval how sophisticated financial instruments have revolutionized capital markets), available at <http://www.sec.gov/news/studies/soxoffbalancerpt.pdf>; Disclosure in Management's Discussion and Analysis about Off-Balance Sheet Arrangements and Aggregate Contractual Obligations, Release No. 33-8182, 17 C.F.R. §§ 228, 229, 249 (April 7, 2003), available at <http://www.sec.gov/rules/final/33-8182.htm>.

FIGURE 2: YUGANSKNEFTEGAZ<sup>127</sup>  
THE SCHEME OF FINANCING



### VIII.

#### FROM YUGANSKNEFTEGAZ (YNG) TO BAIKALFINANCEGROUP TO ROSNEFT

On 22 December 2004, Rosneft acquired, for nominal consideration, a 100% interest in Baikalfinancegroup, which had won an auction for the sale of 76.79% of the shares (100% of the common shares) of YNG at a price of RUB 260.78 billion (USD 9.40 billion at the Central Bank of Russia (CBR) exchange rate in effect as at the settlement date). The auction was conducted on 19 December 2004 by the Russian bailiff service to enforce tax liens against Yukos, which had previously controlled YNG.

Following Rosneft's acquisition of Baikalfinancegroup, Rosneft made loans to Baikalfinancegroup to enable it to repay the principal and interest of the debt it had incurred to finance its deposit for the auction, and also to purchase and pay for the shares of YNG it had won in the auction. Baikalfinancegroup purchased and paid for these shares on 31 December 2004.

127. Anonymous. (June 3, 2005) "Who paid for Ygansk", *Vedomosti* №100 (1381); (Безавтора. 03.06.2005. «Кто оплатил "Юганск." Вестомости №100 (1381).

The sources of the funds Rosneft loaned to Baikalfinancegroup and also used to meet YNG's immediate working capital requirements included:

- Borrowings characterized as long-term loans in the aggregate amount of USD 6,465 million;
- Short-term borrowings in the aggregate amount of USD 1,442 million;
- Funds, in the aggregate amount of approximately USD 1,746 million, accumulated from the sale of Rosneft's interests in the Prirazlomnoye and Shtokmanovskoye projects, including USD 1,344 million from the sale of Rosneft's 50% interest in CJSC Sevmorneftegaz, described in more detail below under, "Results of Operations—Other Income/Expenses—Gain on disposal of share in CJSC Sevmorneftegaz."<sup>128</sup>

The borrowings characterized as long-term loans included USD 6,000 million obtained from Vnesheconombank, initially through the sale of promissory notes by the Company and its subsidiaries in December 2004. The financing was intended to be, and was, put on a long-term basis in January 2005, when Vnesheconombank raised funds from two Chinese banks, China Development Bank and the Export-Import Bank of China, and loaned these funds to Rosneft, who used them to repay the promissory notes. The loan from Vnesheconombank is repayable in monthly installments, with the final installment due in 2011.<sup>129</sup>

The mass-media was extremely critical of the deal. The *Financial Times* wrote that the strange outcome of the auction would further undermine confidence of investors in Russian corporations.<sup>130</sup> The *Financial Times* also called the winning

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128. See OJSC ROSNEFT OIL COMPANY, PROSPECTUS: OFFERING OF 1,380,232,613 ORDINARY SHARES IN THE FORM OF ORDINARY SHARES AND GLOBAL DEPOSITARY RECEIPTS 76 (July 14, 2006) [hereinafter PROSPECTUS], available at <http://www.rosneft.com/english/investors/ipo.html>. See also Anonymous (3 June 2005) "Editorial: Who paid for Ygansk," *Vedomosti*; OJSC ROSNEFT OIL CO., CONSOLIDATED FINANCIAL STATEMENTS 30 (June 24, 2005) [hereinafter FINANCIAL STATEMENTS], available at [www.rustocks.com/put.phtml/rsnt\\_2004\\_GAAP.pdf](http://www.rustocks.com/put.phtml/rsnt_2004_GAAP.pdf).

129. FINANCIAL STATEMENTS, *supra* note 128, at 49.

130. Bertrand Benoit & Paivi Munter, *Yukos Shareholder Threatens Legal Move*, FIN. TIMES, Dec. 13, 2004, at 19.

company “mysterious”.<sup>131</sup> The *Wall Street Journal* wrote that the auction created “a cloud of uncertainty” about the fate of Russia’s largest oil company,<sup>132</sup> at a time when the market was seriously concerned about stability of international fuel supplies.<sup>133</sup> The *New York Times* wrote that the auction was reminiscent of the privatizations of the early 1990s, with their mysterious sources of financing, shady participants, and unknown companies representing influential financial groups.<sup>134</sup>

However, having acquired Baikalfinancegroup, Rosneft disclosed the scheme of the deal’s financing, and the risks related to it, in its Prospectus<sup>135</sup> registered in the course of its IPO in London. All attempts made by Yukos to challenge the results of the Auction on YNG stock in Russia have failed, like all other Yukos-related litigation commenced in Russia.<sup>136</sup>

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131. Doug Camerson & Arkady Ostrovsky, *Mystery Bidder Pays Dollars 9.35bn to Win Auction for Yukos Arm*, FIN. TIMES, Dec. 20, 2004, at 1.

132. G. White and G. Chazan, *Mystery Russian Company Wins Bid on Yukos Unit*, WALL ST. J., Dec. 20, 2004, at A1. See generally G. Chazan, *Yukos’s U.S. Case Heightens Scrutiny Of Russian Justice*, WALL ST. J., Dec. 17, 2004, at A12; G. Chazan and R. Gold, *Kremlin-Owned Firm Buys Yukos Asset*, WALL ST. J., Dec. 23, 2004, at A3.

133. Chazan & Gold, *supra* note 132,

134. See Erin Arvedlund & Jad Mouawad, *Yukos Sale Deepens Investor Doubts*, N.Y. TIMES, December 21, 2004, at C8.

135. See PROSPECTUS, *supra* note 128, at 34.

136. As noted in the prospectus:

Yukos had brought a claim in the Moscow Arbitration Court against the Company and other persons to invalidate the auction at which Baikalfinancegroup won 76.79% of the shares (100% of the common shares) of Yuganskneftegaz. In the claim, Yukos sought to recover the auctioned shares, as well as damages in the amount of approximately RUB 388 billion (USD 14 billion). Among other things, Yukos alleges the following:

- The court decisions on recovering Yukos’ tax indebtedness that served as the basis for the subsequent levy and auction of Yuganskneftegaz shares were illegal, and thus the auction itself was illegal, since it was aimed at satisfying claims confirmed by such illegal court decisions;
- The Yuganskneftegaz shares were core assets of Yukos, and under Russian law, core assets should be foreclosed upon only after non-core assets;
- Under Russian law, in order to hold an auction, at least two participants must take part, and one of them, LLC Gazpromneft, was, at the time, subject to an injunction issued by a U.S. bankruptcy court, rendering its participation invalid;
- Even if it was permitted to participate in the auction, Gazpromneft’s involvement was a sham, as evidenced by its not having submitted a bid, and part of a conspiracy between Baikalfinancegroup, Gazpromneft and Rosneft for Rosneft ultimately to acquire the Yuganskneftegaz shares;



The last attempt to challenge the results of the tender took place in London just before the notorious Rosneft IPO in July 2006. Yukos requested that the Financial Services Authority stop the Rosneft listing, submitting “a 33-page document claiming that Yuganskneftegaz was ‘expropriated’ in breach of British, Russian and European laws and [saying] it would take legal action to halt the share sale if the FSA did not act.”<sup>137</sup> As one of *The Oxford Council on Good Governance* experts stated:

In the IPO prospectus, Rosneft has been obliged to list all the conceivable risks it faces. One can only commend the company for its honesty. One risk it lists are possible legal liabilities of at least \$14.7bn arising from the fact that its main production asset, Yuganskneftegaz, was acquired through rather kafkaesque government orchestrated proceedings in 2004 following the forced break-up of Yukos, the private oil group, of Mikhail Khodorkovsky, the jailed oligarch. Another risk that is mentioned stems from the fact that the Kremlin controls the board, six out

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- The acquisition of Yuganskneftegaz shares by Baikalfinancegroup was a sham transaction aimed at their ultimate acquisition by Rosneft;
  - The auction was carried out with a purpose contrary to legal order and morality because it was aimed at depriving Yukos of its property and that, under Russian law, transactions with such a purpose are null and void;
  - The value of the Yuganskneftegaz shares was underestimated; and
  - Under Russian law, the Russian Federal Property Fund had no authority to sell the Yuganskneftegaz shares.

In addition, there are allegations of procedural irregularities relating to the period of time between the announcement and the auction, as well as relating to the amount of the excess of the initial bid in the auction over the initial price. In January 2006, a lower court ruled on procedural matters against Yukos, which was seeking injunctions in support of its claims. Yukos filed an appeal of that procedural decision, which was denied in March 2006. Yukos then filed a second appeal of that procedural decision, which was denied on 5 June 2006. A hearing on the merits had been postponed pending resolution of these procedural matters. The first hearing on the merits was held on 13 July 2006. The next hearing was scheduled for 4 September 2006 to allow more time for the production by the Federal Property Fund of certain additional documentary evidence. Rosneft believes that it has strong defenses to both the substantive and the procedural allegations and intends to contest these claims vigorously. *Id.* at 190. As of December 1, 2006, the case had been adjourned again.

137. Edward Simpkins, *Rosneft Float Could Be Reversed, Oligarch Warns*, TELEGRAPH (UK), available at <http://www.telegraph.co.uk/money/main.jhtml?xml=/money/2006/06/25/cnros25.xml>.

of nine directors being officials of the government, suggesting maximizing shareholder value and protecting minority shareholders may occasionally have to take a backseat to political objectives.

Rosneft is not however a unique case of state involvement in the economy in Russia. Under Vladimir Putin the state has increasingly used a number of public mechanisms to steer the economy.<sup>138</sup>

When the FSA declined to halt the IPO, Yukos applied for a judicial review of the FSA's decision. In *Yukos Oil Company v. (1) Financial Services Authority (2) London Stock Exchange* [2006] EWHC 2044, Yukos Oil Company challenged the decisions taken by the Financial Services Authority and the London Stock Exchange in relation to the proposed float of OJSC Rosneft. Yukos also asked The High Court of Justice to impose a temporary injunction on the share sale, pending a full judicial review of the flotation decisions, but the judge warned that a decision would be unlikely before the IPO deadline.

By the time the matter reached the Court on July 14, 2006, the bases of the challenge were that:

- the Prospectus did not fairly describe the litigation pending in the European Court of Human Rights;
- the FSA and the LSE were wrong in concluding that the Proceeds of Crime Act 2002 ("POCA") did not apply to them and thus that they did not need to make an authorised disclosure; and
- the FSA and the LSE were wrong in concluding that the listing of the securities did not involve money laundering issues and that this should have been, but was not, accurately disclosed in the Prospectus.<sup>139</sup>

The FSA and Rosneft argued that, "since the seizure was an 'act of state,' the UK's Proceeds of Crime Act, which at-

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138. Andre Nilsen, *Russian Capitalism*, OXFORD COUNCIL ON GOOD GOVERNANCE, 1-2 (2006), available at <http://www.oxfordgovernance.org/fileadmin/Publications/EB002.pdf>.

139. *Yukos v. FSA* [2006] EWHC (Admin.) 2044 (Eng.).

tempts to prevent the resale of stolen property and money laundering, could not be applied.”<sup>140</sup>

With respect to the first ground, the Court noted that the FSA was under a statutory duty to approve the Prospectus, which was required to contain all the information necessary for investors to make an informed assessment of the issuer. Whilst the involvement of the issuer in litigation could clearly impact on this, the FSA was not the arbiter of competing claims and in any litigation there would be disagreements about the relative strengths and weaknesses of the parties’ positions. In this case, the Prospectus highlighted the litigation and described the claims and defenses in general terms. The FSA was not unreasonable in approving it on this basis as it could not be expected to do any more.<sup>141</sup>

With respect to the second and third grounds:

In essence, the FSA and the LSE had concluded that there were no money laundering issues because if there had been criminal conduct, as had certainly been alleged, then that criminality was on the part of the Russian Federation. As such, the Act of State doctrine meant that it was not justiciable in the English Court and hence no issue arose under POCA.<sup>142</sup>

The Court reaffirmed the importance of acknowledging the statutory role given to the regulators and deferring to their expertise when considering whether to override their decisions. The Court also re-affirmed the principle of judicial review of administrative decisions, that where the regulators erred with respect to the law in the course of making required decision, their conclusions could be challenged.<sup>143</sup>

Since Yukos did not succeed in its legal challenge of the Rosneft IPO, it would not be untoward to draw the implication that the international business community had acquiesced

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140. Reuters, *UK Judge Refuses Yukos Bid to Halt Rosneft Trading*, EPOCH TIMES, July 18, 2006, available at <http://en.epochtimes.com/news/6-7-18/44040.html>.

141. HERBERT SMITH LLP., REGULATORS’ DECISIONS ON SALE OF ROSNEFT SHARES SURVIVE JUDICIAL REVIEW CHALLENGE (Aug. 16, 2006), available at [http://www.herbertsmith.com/NR/rdonlyres/D058C3F4-7A1A-4B7F-9EEC-B22CFE0D90A4/2397/Public\\_law\\_16\\_August\\_06.html](http://www.herbertsmith.com/NR/rdonlyres/D058C3F4-7A1A-4B7F-9EEC-B22CFE0D90A4/2397/Public_law_16_August_06.html).

142. *Id.*

143. *Id.*

and, by accepting the UK Court decision, had also indirectly approved the Rosneft scheme of YNG acquisition as a risky but probable way of dealing with competitors.

In sum, the facts of the Rosneft-Baikalfinanciegroupp episode show that if Khodorkovsky's lawyers intend to convince the international community and ECHR that Yukos used its SPEs network absolutely legitimately, the symmetrical risk is that there they cannot argue barriers exist to the Russian Government using SPEs for the avoidance of TRO's issued by U.S. bankruptcy courts<sup>144</sup> and having such transactions condoned by the UK judicial system.<sup>145</sup>

### IX.

#### U.S. BANKRUPTCY LITIGATION: "WE ARE RUSSIANS, AND A WEE BIT AMERICAN"

On December 14, 2004, Yukos as Petitioner and Chapter 11 Debtor sought an injunction prohibiting the Defendants from enforcing judgments obtained in the courts of Russia pre-petition against property asserted by the Plaintiff to be that of the bankruptcy estate.<sup>146</sup> Theede, the Company's CEO, testified that Yukos' goals in filing the instant Chapter 11 case in the United States were to obtain a halt in the Russian government's actions to enforce its tax claims, to obtain the financial flexibility to obtain loans superior to claims of the Russian government, to finance operations, to restructure tax debt, and to create a surviving entity that could seek redress against the Russian government and other entities on behalf of shareholders, employees, and creditors.<sup>147</sup>

The accelerated footprint of Yukos into the U.S. jurisdiction was made possible by Bruce K. Misamore, the Debtor's chief financial officer, and the quick action of Yukos' counsel, Fulbright & Jaworski. The most relevant facts concerning Yukos' corporate presence in the U.S. prior to, on the date of,

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144. It is important to note that in Yukos bankruptcy case, this TRO was cancelled by the U.S. bankruptcy court on May 20, 2006. See Order, *In re* Petition of Eduard Rebgun, No. 06-B-10775 (Bankr. S.D.N.Y. May 25, 2006). See discussion *infra* Part 9.3.

145. Yukos v. FSA [2006] EWHC (Admin.) 2044 (Eng.).

146. *In re* Yukos Oil Co., 321 B.R. 396, 403 (Bankr. S.D. Tex. 2005).

147. Yukos Files for Bankruptcy Protection, *supra* note 75.

and just after the filing of the bankruptcy petition which Judge Clark considered in her opinion were as follows:

- One group of shareholders were alleged to be composed of American and Western European investors in which the group holds at 10 percent of the shares of Yukos.<sup>148</sup>
- On December 10, 2004, the Yukos-Moscow management board passed a resolution to authorize filing of the instant Chapter 11 case and that Misamore caused Yukos Hydrocarbons to transfer \$1 million to Fulbright & Jaworski, Yukos' counsel in the instant case.<sup>149</sup>
- On December 14, 2004, Darice Angel of F&J incorporated Yukos USA, Inc, a Texas corporation.<sup>150</sup>
- At 1:30pm on December 14, 2004 or 96 minutes before filing the bankruptcy petition, "approximately \$480,000" was transferred from F&J to Yukos USA's account at Southwest Bank of Texas (this was the amount from Yukos Hydrocarbons after F&J deducted a payment for services rendered).<sup>151</sup>
- On December 15, 2004, Brittany Assets, Ltd transferred another \$1.5 million to Yukos' Southwest Bank account though Misamore signed a document acknowledging receipt of the \$1.5 million by Yukos USA on December 14, 2004.<sup>152</sup>
- Brittany Assets Ltd. Transferred an additional \$20 million to Yukos USA on or about December 22, 2004 for the benefit of Yukos.<sup>153</sup>

Misamore had conducted activities as chief financial officer of Yukos from his home in Houston, Texas since December 4, 2004.<sup>154</sup>

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148. Yukos, 321 B.R. at 402.

149. *Id.*

150. *Id.*

151. *Id.*

152. *Id.*

153. *Id.*

154. *Id.*

Misamore presently remains in the United States because he has been advised that he would be in danger of arrest if he were to return to Russia.<sup>155</sup>

The contention between Deutsche Bank, the movant for dismissal, and Yukos concerned the indicia of Yukos' presence in the US. This would always be a factual question.

A. *The Position of the Court: Commencement of the Case*

As previously mentioned, for a foreign corporation to qualify as a debtor under 11 U.S.C. § 109(a), a court must determine whether the person resides or has a domicile, a place of business, or property in the United States or a municipality. The use of the "disjunctive" in Section 109(a), as Judge Clark reasoned, means that only one of the criteria need be met for the party to qualify as a debtor under the statute.<sup>156</sup> Whilst the movant Deutsche Bank argued that on the facts Misamore had not established a "place of business" of Yukos in the U.S., the Court did not consider it necessary to decide on this basis and instead focused on the alternative basis of "property" within the U.S. Under this particular criterion, the U.S. courts read the legislation literally and required only that "nominal amounts of property" be located in the United States to "enable a foreign corporation to qualify as a debtor under Section 109(a)."<sup>157</sup> The courts have noted that there is "virtually no formal barrier" to having federal courts adjudicate foreign debtors' bankruptcy proceedings.<sup>158</sup>

The court found that:

- the Debtor maintains significant assets in the Southern District of Texas.
- the Debtor has standing to be a debtor under Chapter 11 of the Bankruptcy Code.
- the instant case was properly commenced.

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155. Affidavit of Bruce K. Misamore, *In re Yukos Oil Co.*, Case No. 04-47742-H3-11 (Dec. 14, 2004).

156. *Id.* at 406-07.

157. *See Yukos*, 321 B.R. at 407.

158. *In re Globo Comunicacoes E Participacoes S.A.*, 317 B.R. 235, 249 (S.D.N.Y. 2004) (citing *In re Aerovias Nacionales de Colombia S.A. (In re Aviance)*, 303 B.R. 1 (Bankr. S.D.N.Y. 2003)).

- it has jurisdiction with respect to the instant Chapter 11 case.<sup>159</sup>

### B. *Motion to dismiss*

On December 28, 2004, Deutsche Bank AG filed a motion to dismiss the Chapter 11 bankruptcy case, asserting six specific grounds for dismissal and one general equitable ground, including:

Yukos' ineligibility to be a debtor under Section 109(a) of the Bankruptcy Code,

- dismissal "for cause" under § 1112(b) of the Bankruptcy Code,
- considerations of forum non conveniens,
- Yukos' inability to fulfill the duties of a Chapter 11 debtor, international comity,
- the act of state doctrine
- "such other an further relief to which it is justly entitled".<sup>160</sup>

The major question before the court in considering the instant motion to dismiss was not so much whether the alleged wrongs had occurred as whether the United States bankruptcy courts present a proper and suitable forum for addressing the needs of this Debtor and its creditors and equity security holders.<sup>161</sup> The main arguments for dismissal included:

- Standing and jurisdiction
- Forum non conveniens
- International comity
- Act of State Doctrine
- Totality of circumstances under Chapter 11

For analytical purposes, we refer to Deutsche Bank AG as the "Creditor" representing the group of Yukos' creditors and Yukos as the "Debtor". It is also important to note that the legal reasoning of Judge Clark was mainly based in finding *factual distinctions* which would allow her to limit the application of relevant precedents. As she says in the second paragraph of her opinion,

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159. *Yukos*, 321 B.R. at 407.

160. *Id.* at 399-400

161. *Id.* at 403.

While there is precedent for maintenance of a bankruptcy case in the United States by corporations domiciled outside the United States, none of those precedents cover a corporation which is a central part of the economy of the nation in which the corporation was created.<sup>162</sup>

This emphasis on factual distinguishments leads Clark to a restrictive, discretionary interpretation of the Bankruptcy statute which she dubs as a "totality of the circumstances" approach;<sup>163</sup> this approach dangerously encroaches upon, if not paradoxically defies, the debtor-friendly spirit of Chapter 11 jurisdiction that views corporate re-organisation as a part of the fundamental right of bankruptcy under the U.S. constitution.<sup>164</sup> Since bankruptcy is a fundamental right for U.S. persons, and since the Court accepts that Yukos USA Inc. is in fact such a person, merely restating the facts that the case involves the "largest bankruptcy case" in U.S. history, that Yukos represents 20 percent of the oil and gas production in Russia,<sup>165</sup> and that the participation of the Russian Federation is required for purposes of the administration of justice,<sup>166</sup> only makes the case more difficult, to adjudicate; these facts are not sufficient to negate the fundamental right to a voluntary bankruptcy. The danger is that Yukos may signal a restrictive interpretation of Chapter 11 jurisdiction against foreign parties despite a long line of precedents in their favor. That is, if it is possible to maintain nominal presence and achieve subject matter jurisdiction for a fundamental bankruptcy right yet be denied the opportunity to present the pertinent facts for adjudication, a failure of due process of law has arguably occurred.

This is not to say, however, that the Court had not considered the question of jurisdiction over this particular set of circumstances very carefully. Thus, we discuss each argument in turn.

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162. *Id.* at 399.

163. *Id.* at 411.

164. *See* U.S. CONST. art. I, § 8, cl. 4 (providing inter alia that Congress shall have the power to establish "uniform Laws on the subject of Bankruptcies throughout the United States").

165. *Yukos*, 321 B.R. at 411.

166. *Id.*



*Standing and Jurisdiction*

The Creditor alleged that Yukos is not eligible to be a debtor under Section 109(a) of the Bankruptcy Code because Yukos has no place of business in the United States. In response, the Debtor argued that Misamore had performed the functions of the Debtor's Chief Financial Officer out of his home in Houston since December 4, 2004. He deposited funds of Yukos in an account at Southwest Bank of Texas, styled in the name of Yukos USA, Inc., an entity created for the specific purpose of receiving deposits of such funds belonging to Yukos.

The Court found that it need not consider the "place of business" criterion and fell back on an alternative criterion of the party having "property" in the U.S. The Court explained that where the foreign corporation has nominal amounts of property located in the United States, the foreign corporation may qualify as a debtor under Section 109(a) of the Bankruptcy Code,<sup>167</sup> and pointed to precedent for the proposition that there is "virtually no formal barrier" to having federal courts adjudicate foreign debtors' bankruptcy proceedings.<sup>168</sup> The Court also re-stated the long-held doctrine that where a debtor has property in the United States, the United States courts may exercise discretion as to whether to administer that property or to defer to foreign courts.<sup>169</sup> Under these particular circumstances, the Court held that Yukos had standing to be a debtor under Section 109(a) of the Bankruptcy Code and that the Court had subject matter jurisdiction with respect to the instant case.

*Forum non Conveniens*

In its motion to dismiss, the Creditor argued that under the doctrine of forum non conveniens the Federal District Court is required to dismiss the case. It is important to note that the Court found "no published opinion" on whether "forum non conveniens applies with respect to the entirety of a voluntary case".<sup>170</sup> The cases which the Creditor cited as au-

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167. *Id.* at 407.

168. *Id.* (citing *In re Globo Comunicacoes E participacoes S.A.*, 317 B.R. 235, 249 (S.D.N.Y. 2004)).

169. *See id.* (citing *Banque de Financement, S.A. v. First Nat'l Bank of Boston*, 568 F.2d 911, 918-19 (2d Cir. 1977)).

170. *Id.* at 407.

thority were distinguished by the Court on factual grounds.<sup>171</sup> Although the Court recognized its inherent power<sup>172</sup> to "control the administration of the litigation before it and to prevent its process from becoming an instrument of abuse, injustice, or oppression,"<sup>173</sup> it declined to extend either the Fairchild or Xacur rulings and in effect denied the Creditor's proposition that "the doctrine of forum non conveniens requires dismissal of a voluntary bankruptcy case."<sup>174</sup>

*International Comity*

In examining the Creditor's argument for the application of international comity, the Court noted again that it was not aware of any "published decision dismissing a voluntary bankruptcy case filed in the United States on grounds of international comity."<sup>175</sup> Whilst the Creditor based its argument on matters relating to jurisdiction, such as Yukos' minimal property in the United States, its incorporation in Russia, the fact that its largest indirect shareholder was a Russian citizen, and the fact that only one of its employees, Misamore, was located in the United States, the Court viewed these matters as inapposite to the definition of comity. The Court provided a classic definition of comity as

...the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation, having due regard both to the international duty and convenience, and to the rights of its own citizens or of other persons who are under the protection of its laws.<sup>176</sup>

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171. While citing *In re Xacus*, 219 B.R. 956 (Bankr. S.D. Tex. 1998) for the proposition that forum non conveniens could be used for dismissal, Judge Clark stated that the Court in *Xacus* dismissed the case on other grounds, holding that "Mexico provided an adequate alternative forum to the United States." *Yukos*, 321 B.R. at 407. And, though the creditor in *Yukos* had argued that *Baumgart v. Fairchild Aircraft Corp.*, 981 F.2d 824 (5th Cir. 1993) stood for the proposition that forum non conveniens applies to bankruptcy cases, Judge Clark again distinguished it by saying that the case did not seek "dismissal of the entirety of a voluntary Chapter 11 proceeding. . .but rather dismissal of a wrongful death action related to the bankruptcy case." *Id.* at 407-08.

172. *Yukos*, 321 B.R. at 408 (citing 28 U.S.C. § 151 (1984)).

173. *Id.* at 408 (noting that this power is derived from U.S. CONST. art. III).

174. *Id.*

175. *Id.*

176. *Id.* (citing *Hilton v. Guyot*, 159 U.S. 113 (1895)).

The Court carefully separated the cases applying the doctrine of comity into two sets of fact patterns: (1) where proceedings are commenced in the United States and where courts in other jurisdictions have rendered judgments within a “system of procedures compatible with the requirements of due process of law”<sup>177</sup> and (2) where “a foreign bankruptcy is pending” and where “equitable principles demand that all claims against the debtor’s limited assets be addressed in a single proceeding”.<sup>178</sup> Whilst there is more than adequate authority for the application of the doctrine of comity to both sets of facts, the Court found no authority for the proposition that in a case in which a foreign entity voluntarily avails itself to the United States Bankruptcy Court, comity requires the dismissal of the case.<sup>179</sup>

*Act of State Doctrine*

The Creditor argued that dismissal was required under the “act of state doctrine” since the “court should not adjudicate a politically sensitive dispute which would require the court to judge the legality of the sovereign act of a foreign state”.<sup>180</sup> In essence, the act of state doctrine operates as a self-restraint mechanism on the limits of judicial authority and defers to the power of the executive. Thus, the courts of one country will not “sit in judgment on the acts of the government of another” country where those acts occurred within the territory of the other country.<sup>181</sup> The only means of redress for grievances caused by such acts is “through the means

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177. In support of its discussion of how U.S. courts have applied the principle of comity to proceedings commenced in the United States, the Court cites a vast array of precedent: *Hilton v. Guyot*, 159 U.S. 113 (1895); *Int’l Transactions, Ltd. v. Embotelladora Agral Regiomontana S.A. de C.V.*, 347 F.3d 589 (5th Cir. 2003); *Cunard S.S. Co. v. Salen Reefer Services AB*, 773 F.2d 452 (2d Cir. 1985); *Bank Melli Iran v. Pahlavi*, 58 F.3d 1406 (9th Cir. 1995); *Ma v. Continental Bank, N.A.*, 905 F.2d 1073 (7th Cir. 1990). See *Yukos*, 321 B.R. at 408.

178. In support, the Court cites *Finanz AG Zurich v. Banco Economico S.A.*, 192 F.3d 240 (2d Cir. 1999); *Allstate Life Ins. Co. v. Linter Group, Ltd.*, 994 F.2d 996 (2d Cir. 1993); *Victrix S.S. Co., S.A. v. Salen Dry Cargo A.B.*, 825 F.2d 709 (2d Cir. 1987); *Cunard S.S. Co.*, 773 F.2d at 452. See *Yukos*, 321 B.R. at 408-09.

179. See *Yukos*, 321 B.R. at 408-09.

180. *Id.* at 409.

181. *Id.*

available to sovereign powers as between themselves.”<sup>182</sup> This deference to the executive is part of the judiciary’s recognition of the separation of powers between the judiciary, the executive, and the congress.

The Court explained that Congress recognized the need for a “coordinating mechanism between the insolvency laws of the United States and of other jurisdictions,” and had established an “option of filing of a case ancillary to a foreign proceeding.”<sup>183</sup> But a gap exists where there are no applicable treaties and where “Congress has not provided a coordinating mechanism for the resolution of disputes between a foreign entity and United States investors.”<sup>184</sup> The Court also noted that, in light of the size of the underlying transactions and the purported acts of the Russian government, as well as its apparent refusal to accept service of process, resolution of matters raised in this case with respect to the Russian government may rise to the level of the conduct of foreign policy, which is reserved to the President of the United States.<sup>185</sup> As a matter of law, the Court stated that resolving whether dismissal of the case is required under the act of state doctrine necessitates deciding if the court would have to evaluate the legality of final acts of the Russian courts.<sup>186</sup> The Court found that although the acts of the Russian government doubtless have a significant impact upon the efforts of Yukos to reorganize itself financially, the filing and conduct of this Chapter 11 case does not in itself require that this Court judge those acts.<sup>187</sup> The Court held that “the act of state doctrine does not form an independent basis requiring dismissal of the instant case.”<sup>188</sup>

*Dismissal pursuant to § 1112(b) of Bankruptcy Code*

Section 1112(b) of the Bankruptcy Code provides:

Except as provided in subsection (c) of this section, on request of a party in interest or the United States trustee or bankruptcy administrator, and after notice and a hearing, the

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182. *Id.* (citing *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398 (1964)).

183. *Id.* (citing 11 U.S.C. § 304).

184. *Id.*

185. *Id.* (citing *Banco Nacional de Cuba*, 376 U.S. at 398; *American Ins. Ass’n V. Garamendo*, 539 U.S. 396 (2003)).

186. *Id.* at 410.

187. *Id.* at 409-10.

188. *Id.* at 410.

court may convert a case under this chapter to a case under Chapter 7 of this title or may dismiss a case under this chapter, whichever is in the best interest of creditors and the estate, for cause, including:

- (1) continuing loss to or diminution of the estate and absence of a reasonable likelihood of rehabilitation;
- (2) inability to effectuate a plan;
- (3) unreasonable delay by the debtor that is prejudicial to creditors;
- (4) failure to propose a plan under section 1121 of this title within any time fixed by the court;
- (5) denial of confirmation of every proposed plan and denial of a request made for additional time for filing another plan or a modification of a plan;
- (6) revocation of an order of confirmation under section 1144 of this title, and denial of confirmation of another plan or a modified plan under section 1129 of this title;
- (7) inability to effectuate substantial consummation of a confirmed plan;
- (8) material default by the debtor with respect to a confirmed plan;
- (9) termination of a plan by reason of the occurrence of a condition specified in the plan; or
- (10) nonpayment of any fees or charges required under chapter 123 of title 28.<sup>189</sup>

Whilst the Court examined a number of factors in considering the totality of circumstances, it noted that the above list was “not exhaustive”<sup>190</sup> and that the factor of the “debtor’s good faith” should be accounted for in light of the court’s “on-the-spot valuation of the debtor’s financial condition, motives and local financial realities”.<sup>191</sup> It is arguable that the Court’s decision to dismiss the case did not allow the Debtor the opportunity to evidence its “good faith,” and that the Court, in applying its totality of circumstances test, may have completely ignored the explicit language of the Section 1112(b) which instructs the court to take account of both the interests of the

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189. 11 U.S.C. § 1112(b) (amended by Pub. L. No. 109-8, § 442(a) (2005)).

190. *Yukos*, 321 B.R. at 410.

191. *Id.*

creditors and the estate. To emphasize the point we re-quote the operative language of Section 1112(b) which provides:

the court may convert a case under this chapter to a case under Chapter 7 of this title or may dismiss a case under this chapter, whichever is in the best interest of creditors and the estate.

At the very least, the Court should have considered the possibility of Chapter 7, and more importantly, considered "the best interests" of the estate in balancing the factors in its totality of the circumstances analysis. This is especially relevant where the Court already has drawn conclusions that the acts of the Russian government amounted to confiscation under United States law<sup>192</sup> and therefore implied that due process of law may not be afforded to the Debtor in Russia. Since due process of law is fundamental, it behoved the Court to consider this factor in its determination of whether dismissal was in the best interests of the estate. The Court may have erred by not taking into account the "wrongs" upon Yukos as part of its totality of the circumstances determination, since such wrongs directly implicate the best interests of the estate.

Nevertheless, the Court's argument ran as follows. First, the Court considered that the Debtor's good faith depends largely upon the bankruptcy court's on-the-spot evaluation of the debtor's financial condition, motives, and the local financial realities.<sup>193</sup> Second, since most of Yukos' assets were oil and gas within Russia, the ability of Yukos to effectuate reorganization without the cooperation of the Russian government was extremely limited.<sup>194</sup> Third, the funds which created jurisdiction in this particular Court were transferred to banks in the United States less than one week prior to the filing of the petition, and were transferred for the primary purpose of attempting to create jurisdiction in the United States Bankruptcy Court.<sup>195</sup> Fourth, Yukos sought to substitute United States law in place of Russian law, European Convention law and/or international law, and to use the judicial system within

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192. *Id.* at 404.

193. *Id.* at 410.

194. *Id.* at 411. *See also* *Can. S. Ry. Co. v. Gebhard*, 109 U.S. 527, 537 (1883); *Finanz AG Zurich v. Banco Economico S.A.*, 192 F.3d 240, 246 (2d Cir. 1999).

195. *Yukos*, 321 B.R. at 409.

the United States in an attempt to alter the creditor priorities that would be applicable in the law of other jurisdictions.<sup>196</sup> Fifth, Yukos had commenced or attempted to commence proceedings in several other forums, including the European Court of Human Rights and in arbitration.<sup>197</sup> Sixth, Yukos had proceedings which appeared to remain pending in Russia, and additionally may have had access to a bankruptcy proceeding in the arbitrazh courts of Russia.<sup>198</sup> Seventh, the question of whether Yukos is entitled to relief in each such other forum depends on the construction of the laws of those jurisdictions.<sup>199</sup> Thus, the Court concluded, none of the evidence with respect to the instant motion suggested that the Court was uniquely qualified, or more able than the other forums, to consider the issues presented.

In the Court's eyes it was important to note that the vast majority of the business and financial activities of Yukos continue to occur in Russia and that such activities require the continued participation of the Russian government in the roles as the regulator of production of petroleum products from Russian lands and as the central taxing authority of the Russian Federation.<sup>200</sup> The evidence indicated that Yukos was, on the petition date, one of the largest producers of petroleum products in Russia and was responsible for approximately twenty percent of the oil and gas production in Russia.<sup>201</sup> The sheer size of Yukos, and correspondingly, its impact on the entirety of the Russian economy, weighed heavily in favor of allowing resolution in a forum in which participation of the Russian government could be assured.<sup>202</sup>

The court concluded that based on the totality of the circumstances the instant Chapter 11 case be dismissed.

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196. *Id.* at 410.

197. *Id.* at 411. See also *Can. S. Ry. Co.*, 109 U.S. at 537; *Finanz AG Zurich*, 192 F.3d at 246.

198. *Yukos*, 321 B.R. at 410.

199. *Id.* at 411.

200. *Id.*

201. *Id.*

202. *Id.*

### C. Summary

The Bankruptcy court in Houston granted a temporary restraining order against a number of Russian and western organisations and banks, restraining them from taking any action in respect of a proposed auction of valuable assets of the Russian company. The auction was to take place in Moscow. At an early stage, the court adopted the 'virtually no formal barrier' approach to jurisdiction and found that bankruptcy jurisdiction existed on the basis of the presence of trust account money in the U.S. and on the presence of the debtor's chief financial officer in the U.S.<sup>203</sup> In the course of the hearing the court came to several conclusions that were quite unusual for the U.S. courts and were unpleasant for the Russian Federation and state-owned companies.

The citizens of Russia, the United States and elsewhere have a public interest in the ordinary progress of the rule of law. . . . In the instant case, the appearance to plaintiff and its investors, of such a confiscation, is created by what appears, on the evidence before this court, to be the inconsistent application of Russian law within the Russian legal system.

[t]he weight of the evidence supports a finding that it is substantially likely that the assessments and manner of enforcement regarding [Yukos'] taxes were not conducted in accordance with Russian law.

[t]he evidence supports a finding of the likelihood that [Yukos'] shares of YNG will be sold for approximately half the value estimated by two different investment bankers.<sup>204</sup>

However, the bankruptcy proceedings were then dismissed on the basis of the "totality of the circumstances". The court felt constrained by the absence of authority from applying the doctrine of *forum non conveniens*. The court held that the 'act of state' doctrine did not form an independent basis requiring dismissal of the case, notwithstanding that the essential reason for the filing appeared to fall clearly within the statement of the doctrine set out by the court in *Yukos*:

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203. *See Id.* at 407.

204. *In re Yukos Oil Co.*, 320 B.R. 130, 136 (Bankr. S.D. Tex. 2004).



... a U.S. court should not adjudicate a politically sensitive dispute which would require the court to judge the legality of the sovereign act of a foreign state.<sup>205</sup>

In explaining the considerations behind its decision, the Bankruptcy Court revisited many of the facts it had raised earlier in the opinion:

(i) Yukos' ability to successfully reorganize without the cooperation of the Russian government was severely limited;

(ii) the funds that supplied the basis for Yukos' standing as a debtor and the Bankruptcy Court's jurisdiction had been transferred less than a week prior to the filing of the bankruptcy petition and specifically for the purpose of creating jurisdiction;

(iii) Yukos sought to substitute U.S. law for that of other jurisdictions;

(iv) Yukos had attempted to commence proceedings in several other fora, including the European Court of Human Rights and arbitration;

(v) the case would require the interpretation of foreign statutes which the Bankruptcy Court was not uniquely qualified to consider;

(vi) the Bankruptcy Court likely would be unable to assert personal jurisdiction over the many parties necessary to grant meaningful relief (including the Russian government); and

(vii) the majority of Yukos' business and financial activities continued to take place in Russia and would require the participation of the Russian government.<sup>206</sup>

While none of these factors standing alone would have been sufficient to justify dismissal,<sup>207</sup> this last factor distinguished the *Yukos* case from similar cases and may have ultimately led the court to its decision to dismiss the Chapter 11 case.<sup>208</sup> In the end, the *Yukos* opinion should serve as a guide

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205. *In re Yukos Oil Co.*, 321 B.R. 396, 409 (Bankr. S.D. Tex. 2005).

206. *Id.* at 410-11.

207. *Id.* at 411 ("The court concludes, based on the totality of the circumstances, that the instant Chapter 11 case should be dismissed").

208. "While there is precedent for maintenance of a bankruptcy case in the United States by corporations domiciled outside the United States, none of those precedents cover a corporation which is a central part of the economy of the nation in which the corporation was created." *Id.* at 399.

to other foreign debtors on how to slip into bankruptcy in the United States so long as they are not a “central part of the economy of the nation in which the corporation was created.”<sup>209</sup>

This focus on the presence of economic assets which would require the participation of the state government may also show that this limited application of Chapter 11 acts as a boundary of transnational corporate governance. In essence, since the existence of a corporation is dependent on the laws of its incorporation, the corporate entity itself, if it is to survive in some form in the home jurisdiction, must look to its home jurisdiction first to exhaust its legal remedies; where it fails to take advantage of all the remedies of its home jurisdiction, it is unlikely to find miraculous resurrection in a temporary host jurisdiction, especially where its assets are considered centrally permitted and controlled by the home government. Whilst it is impossible to rewind history, for purposes of future litigation strategy of multi-national corporations, this tells us that Yukos shareholders and creditors may have survived in some truncated domestic form if it had pursued the full remedies of *forum non conveniens*. In other words, perhaps the regulatory arbitrage which Yukos management pursued in a host jurisdiction was based on the wrong assumptions of law and thus resulted in catastrophic failure. But this is a counter-factual speculation and raises only contentious spectral propositions. The reality is that Yukos’ international litigation has only begun. We turn now to another battleground, where the Yukos legal campaign is focused not on obtaining “global injunctions affecting all creditors and all assets” throughout the world, but rather limited to productive assets located within a particular jurisdiction outside of Russia, a jurisdiction where the justiciable issues center on applying the host rules to competing foreign parties. Welcome to the Netherlands.

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209. *Id.*

## X.

## THE DUTCH RESTRUCTURING

A. *Theede Millionaire. He who keeps company with the wolf, will learn to howl.*

By the end of 2003 all the top managers of Yukos had left Russia, effectively moving the decision-making centre to London. By that time none of the managers had any doubts that a hostile take-over of Yukos by state-owned companies would occur in just a matter of months.

Encouraged by the extradition decisions stating that Yukos case was politically motivated, and also by the failure of the Russian Federation to obtain a positive response from its international cooperation requests, Yukos management ‘in exile’ decided to take some steps towards corporate restructuring which would allow it to sell the Yukos assets located off-shore. Some assets, like Alans (the pump-machine plant) were sold even before the reorganization program was approved.<sup>210</sup>

The program was discussed by the Company’s Board and “confidentially” approved on the 5th of December 2005.<sup>211</sup> As a result, the Company completely restructured its off-shore network of subsidiaries.

In the Appeal Brief, counsel to Yukos, Yukos Finance, Yukos International. and Stichting Yukos gave the following explanation: (Appeal Brief Par. 1.11 pages 6 and 7):

Yukos *cum suis* have in April 2005 implemented a restructuring in order to reduce the risk of interference by the Russian state. . . . Yukos *cum suis* feared that the Russian State would cause the bankruptcy of Yukos Oil and that the Russian liquidator—who would without a doubt execute the wishes of the Russian state—would subsequently appoint directors in Yukos Finance and all subsidiaries who would not listen to the directors of Yukos Oil, but to the Russian state. A second reason for the restructuring was the safekeeping of the proceedings before the Human Rights

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210. The company was allegedly sold in November 2005. See Anonymous, Rusneft Acquired Yukos’ Company for ALROSA (Nov. 2, 2005), <http://lenta.ru/news/2005/11/02/rusneft>.

211. See Minutes of the Board of Directors Meeting of Yukos Oil Co. (Dec. 5, 2005).

Court. It is not so that the restructuring intended to make that some creditors of Yukos Oil would be satisfied and others would not. . . . The intention is, that the creditors who will have a title of claim that is enforceable in the Netherlands will be paid from the dividend streams by Yukos Finance B.V. If Yuganskneftegaz would ever obtain such a title of claim in the Netherlands it would so enter the ranks of legitimate creditors. As long as its claim has not yet been determined at the time of any dividend distribution by Yukos Finance a proportionate amount would have to be reserved.

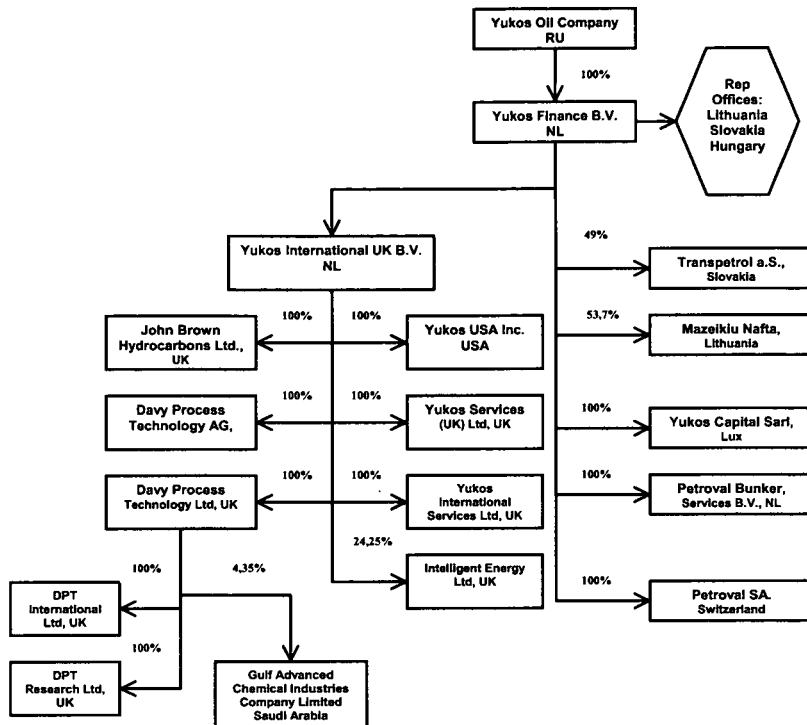
The structure is not chosen to - as Yuganskneftegaz suggests one time after another - impair its rights compared to other creditors, but to liquidate this part of the Yukos Group without the aforementioned interference of the Russian state.<sup>212</sup>

Between the 8th of June 2000 and the 19th of April 2005, Yukos Finance was the only shareholder of Yukos International.<sup>213</sup> See Figure 3 Yukos Oil Company Legal Structure below.

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212. Declaration of Gerald H. Gispén at 11-12, *In re* Petition of Eduard K. Rebgun, No. 06-B-10775-RDD (Bankr. S.D.N.Y. Apr. 13, 2006).

213. *Id.* at 3.

FIGURE 3: YUKOS OIL COMPANY LEGAL STRUCTURE<sup>214</sup>

According to information revealed in Court filings:

- Stichting Yukos, a foundation (*stichting*), was incorporated on April 14, 2005.
- In April 2005, Yukos Finance transferred its assets and liabilities to Yukos International which at the time was a fully owned subsidiary of Yukos Finance.
- On or after April 19, 2005, Yukos Finance sold and transferred its entire shareholding in the capital of Yukos International. . . to Stichting Yukos, in exchange for depository receipts of the shares (*certificaten van de aandelen*).<sup>215</sup>

214. The figure was created based on information contained in the Declaration of Gerald H. Gispén, *In re* Petition of Eduard K. Rebgun, No. 06-B-10775-RDD (Bankr. S.D.N.Y. Apr. 13, 2006).

215. *Id.* at 3.

This led to the restructuring of the company, as per Figure 4 Yukos Oil Company Restructuring below.

In its description of the restructuring, the Annual Reports notes that it was “considered necessary in order to protect the interests of the stakeholders, legitimate creditors and other third parties. . . , further stat[ing] that despite the restructuring transaction ‘the economic and beneficial ownership of the assets remain with Yukos Finance BV.’”<sup>216</sup>

At the issuance of depository receipts for shares of a Dutch company, the shares are not directly held by the relevant equity provider, but by a foundation (which administrates shares) (such a foundation is commonly referred to as a *Stichting Administratiekantoor*) specially formed for that purpose (the “Foundation”), which Foundation issues depository receipts for shares to the relevant equity provider. The Foundation acquires the shares in its own name and is legally entitled thereto, whereas the depository receipt holder is the “beneficial” owner of such shares. At the issuance of depository receipts the controlling rights attached to a share (e.g. voting rights) are separated from the financial rights attached to a share (e.g. dividend rights).<sup>217</sup>

Yukos Finance has the right to receive any and all dividends and distributions on the Shares and the (other) rights as mentioned above. According to its Articles of Incorporation,<sup>218</sup> Stichting Yukos is restricted from doing anything with any distributions from Yukos International except on-paying such distributions to Yukos Finance, as sole holder of the DR’s, or its successor(s).<sup>219</sup>

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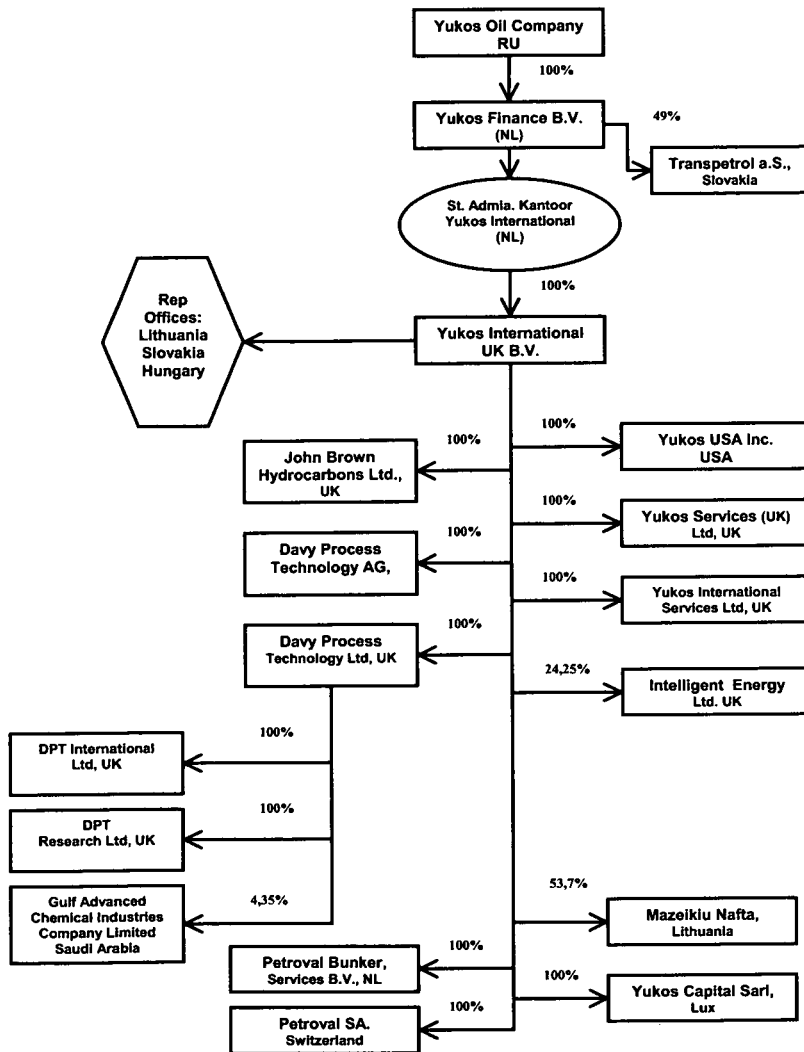
216. *Id.* at 4 (citing YUKOS FIN. & YUKOS INT’L., ANNUAL REPORT FOR THE FISCAL YEAR ENDING DECEMBER 31, 2004 (February 15, 2006)).

217. *Id.* at 6.

218. *Id.* at 5.

219. *Id.* at 13.

FIGURE 4: YUKOS OIL COMPANY RESTURCTURING



As a result of the above transactions, all powers controlling Yukos International and its policy have been vested in Stichting Yukos as the single shareholder and at its absolute discretion. Stichting Yukos in the same manner controls any dividends or distributions by Yukos International to Stichting

Yukos. The object of Stichting Yukos is subject to discretionary interpretation by Stichting Yukos.<sup>220</sup>

Section 2 of the Stichting Articles reads:

Excluded from the Foundation's object are the exercising of rights attached to the shares as a result of or in the implementation of an unlawful claim, judgment or transaction, including but not limited to those resulting from or related to the tax assessments imposed on Yukos Oil Company and members of the Group in the Russian Federation on or after the fourteenth of April two thousand and four, specifically including, but without prejudice to the above, any claim against, transfer of, sale of, revindication of, attachment judgment in respect of, allocation of or other applicability to, or expropriation of the shares, assets or other property of, or other imposition of charges on Yukos Oil Company and any part of the Group.<sup>221</sup>

In this context it is noteworthy that between the Kingdom of the Netherlands and the Russian Federation there is no treaty in relation to the recognition of judgments by courts in the Russian Federation nor in relation to the recognition of any insolvency proceeding conducted in the Russian Federation.

As a result of these restructuring "deals", the Yukos Oil Company had lost control of its off-shore network which, after resignation of the American management, remained under their control as the Directors of Stichting Yukos. Moreover, by "secret isolation" of the off-shore assets of Yukos Oil Company, the former management had created a basis for the further alienation of the assets and accumulation of the funds received from the prospective deals made outside of the new management's control. This act was crucially important for the management, taking into consideration the pending sale of the major foreign Yukos subsidiary Majek Nafta, located in Lithuania. This situation was also quite helpful for the Western creditors of Yukos Oil Company, headed by the Menatep

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220. *Id.* at 13-14.

221. *Id.* at 11-12.



Group, who could file their claims outside the Russian jurisdiction.

### B. *The Empire Strikes Back*

After the so-called “optimization” of the off-shore network of the Company, the management settled in London and began a step-by-step alienation of the off-shore assets on the premise of protecting the needs of all interested parties.<sup>222</sup> The reported transactions included the following:

Moscow, 1 February 2006: The sale of Davy Process Technology Limited (DPT) was completed today following the purchase of the London headquartered business for \$71 million (£40 million) by Johnson Matthey, the specialty catalyst, precious metals and chemicals company.<sup>223</sup>

Moscow, 7 February 2006: YUKOS Oil Company’s subsidiary, YUKOS Finance BV—owner of a 49% stake in the Slovakian company, Transpetrol a.s,—has agreed to sell its shares to OAO NK RussNeft for U.S.\$ 103 million.<sup>224</sup>

The Russian Government looked at all these deals quite indulgently until the management began negotiating the sale of Yukos stock in Mazeikiu Nafta AB. This deal concerned the geopolitical interests of the Russian Federation, and the Government was far from agreeing to allow the small group of Americans, controlled by the Menatep Group, to sell the Yukos stock and make free use of the proceeds. Moreover, certain political motives undoubtedly played a part:

Russian authorities have not consigned themselves to the idea that almost half of the proceeds of the sale of Mazeikiu Nafta will go to Group MENATEP, which had caused them considerable inconvenience during the highly visible international court proceedings connected with the forcible alienation of

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222. See Press Release, Yukos Oil Co., Yukos Oil Company Completes Sales Transaction of its Subsidiary, Davy Process Technology Limited (Feb. 1, 2006) [hereinafter Yukos, Davy Process], available at <http://www.yukos.com/vpo/news.asp?year=2006&month=2>; Press Release, Yukos Oil Co., Yukos Oil Company Signs a Shares Sale and Purchase Agreement to Sell Transpetrol A.S. (Feb. 7, 2006) [hereinafter Yukos, Transpetrol], available at <http://www.yukos.com/vpo/news.asp?year=2006&month=2>.

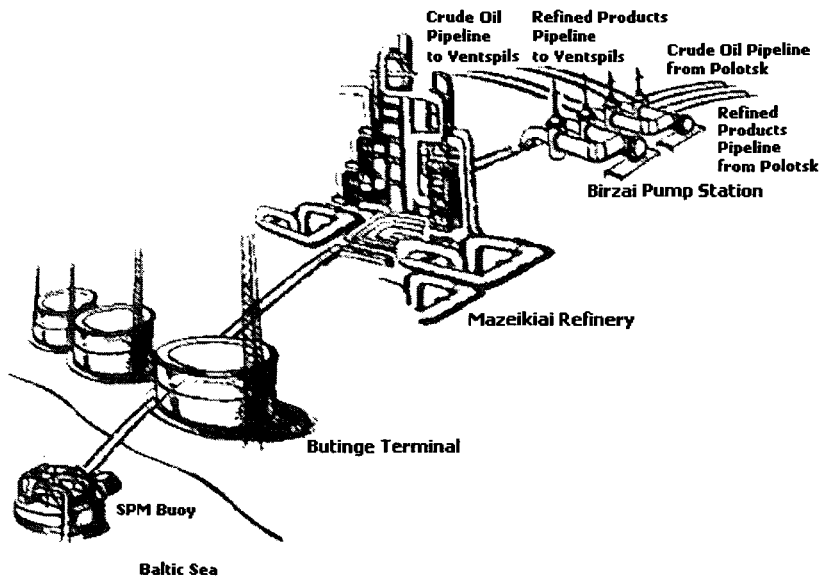
223. YUKOS, DAVY PROCESS, *supra* note 222.

224. Yukos, Transpetrol, *supra* note 222.

Yuganskneftegaz, the main YUKOS production asset, now controlled by Rosneft.<sup>225</sup>

Thus, this tit-for-tat course of actions, as one commentator put it, had created a “. . . situation over Yukos’ foreign assets [that had become] increasingly complex, politicized and fraught with serious consequences for the parties involved.”<sup>226</sup>

FIGURE 5: MAZEIKIU NAFTA AB<sup>227</sup>



### C. Mazeikiu Nafta

Mazeikiu Nafta AB is a Lithuania-based downstream oil company engaged in pipeline operations, oil refining, marine terminal operations, and logistics of crude oil and refined products. Its full product range includes unleaded gasoline, gasoline with multifunctional additives, diesel fuel with mul-

225. Olga Pleshanova et al., *Dutch Fortune // Most of the Money from the Sale of YUKOS’ Western Assets Will Go to Group MENATEP*, KOMMERSANT, August 18, 2006, <http://www.kommersant.com/> (search “Search the Archives” for “Dutch Fortune”; then follow hyperlink for “Dutch Fortune.”).

226. Reuters, “Russia Asks U.S. to Stop Yukos Asset Sale,” April 15, 2006, available at <http://archive.gulfnews.com/articles/06/04/15/10033109.html>.

227. Mazeikiu Nafta AB – Figure, <http://www.nafta.lt/en/content.php?pid=5> (last visited Feb. 26, 2007).

tifunctional additives, fuel oils, aviation fuel, liquefied petroleum gas, construction bitumen, sulfur, as well as other feedstock, such as gas condensate, atmospheric residue and middle distillates. The Company is active through four principal divisions: Mazeikiai Refinery, which has a design capacity of 15 million tons of crude oil per annum; subsidiary Mazeikiu Nafta Trading House, which is responsible for marketing of refined products; Butinge Terminal, an oil loading facility with a design capacity of eight million tons of export crude oil per annum, and the Pipeline System, which includes two pump stations, crude oil pipelines and a pipeline supplying diesel fuel to Latvia.<sup>228</sup>

The Russian Government, acting through the state-owned companies Rosneft and Gazprom has made several attempts to get its hands on Mazeikiu Nafta. The first attempt can be characterized as a direct attack undertaken without proper preparation. The results can be seen from two Yukos' press-statements.

Moscow, 24 November 2005: Today, November 24, 2005, the District Court of Amsterdam rendered a judgment in the summary proceedings between Yuganskneftegaz and Yukos. Yuganskneftegaz had asked the District Court to give an order to Yukos to abstain from inter alia selling its subsidiaries ("freezing order"). The most important subsidiaries are Mazeikiu Nafta which runs a refinery in Lithuania (joint venture with Lithuanian government), Davy Process Technology and Transpetrol which owns pipelines in Slovakia. The District Court in its judgment refused to give the freezing order, because Yuganskneftegaz had not shown that the present sales process in any way prejudices the interests of the creditors of Yukos. Furthermore the District Court took a decision on the counterclaim of Yukos asking for lifting of attachments made by Yuganskneftegaz on shares held by Yukos in its subsidiaries. The court lifted all attachments on the shares held in subsidiaries located outside the Netherlands.

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228. Wikipedia, Mazeikiu Nafta, <http://en.wikipedia.org/wiki/Ma%C5%B3Nafta> (last visited Feb. 26, 2007).

Mr Robert van Galen, lawyer of Yukos: "This is an important victory for Yukos which enables Yukos to continue the sales process of its non-Russian assets and to pay its creditors."<sup>229</sup>

Amsterdam, 02 February 2006: Today, the Court of Appeal of Amsterdam confirmed the judgment of the District Court of Amsterdam of November 24, 2005. The Court of Appeal refused to grant freezing orders to Yuganskneftegaz against YUKOS Oil Company, which would have prevented the Russian oil company from selling its non-Russian subsidiaries. As a direct result of the judgment of the Court of Appeal, YUKOS Oil Company can continue, unhampered, its strategic divestment of its non core, non Russian assets."<sup>230</sup>

The reason for this decision is evident to any corporate lawyer: one of the prospective creditors of the Company claimed that the transactions and certain assets, which actually did not belong to the Company directly, should not be sold. Meanwhile, the Company demonstrated to the Court: (1) that it was not in the state of formal bankruptcy and the relevant legal limitations concerning the transactions of its assets should not be applied; and (2) it was taking all reasonable efforts to obtain the best price for the assets under negotiation. In this situation, the Plaintiff had no proper grounds for the claim since its financial interest (to get its debt fully and timely paid) was not restrained in any way.

The second attempt to freeze the prospective sale of the refinery was much better planned. The principal difference was that by the time of the legal action, Yukos had fallen into a state of bankruptcy and the interim manager had been appointed by the Court. The receiver in bankruptcy came to a rather reasonable application of the double edged sword of the U.S. bankruptcy law against the management in exile.

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229. Press Release, YUKOS OIL CO., STATEMENT FROM YUKOS OIL COMPANY (Nov. 24, 2005), available at <http://www.yukos.com/vpo/news.asp?year=2005&month=11>.

230. PRESS RELEASE, YUKOS OIL CO., Yukos Wins Important Victory in Dutch Court of Appeal (Feb. 2, 2006), available at <http://www.yukos.com/vpo/news.asp?year=2006&month=2>.

On April 13, 2006, the interim receiver commenced the Chapter 15 U.S. Bankruptcy Code case after learning that Yukos' management had been actively attempting to sell Yukos' 53.7 percent indirect interest in AB Mazeikiu. The relevant portion of the Bankruptcy Code under Section 109(b)(3)(B) explains that Chapter 15 of the Bankruptcy Code, which governs cross-border bankruptcy and insolvency cases, was part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 enacted on April 20, 2005, and is patterned after the Model Law on Cross-Border Insolvency, a framework of legal principles formulated by the United Nations Commission on International Trade Law in 1997 to deal with the rapidly expanding volume of international insolvency cases. Section 1501(c) of the Bankruptcy Code sets forth broad eligibility requirements for chapter 15 — with only two minor exceptions, any entity that is eligible to be a debtor under chapter 7 of the Bankruptcy Code may be the subject of a case under chapter 15.<sup>231</sup>

The interim receiver's admitted purposes in commencing the Chapter 15 case were to prevent the sale of the shares in AB Mazeikiu, an asset he maintained was worth approximately \$1.4 billion, and to prevent liquidation with the intent of favoring certain creditors of Yukos. Prior to the chapter 15 application, the Arbitraz Court in Russia, acting upon a request of the interim receiver, granted a special order imposing additional protective measures aimed at preserving Company assets. The Company and its management were prohibited from taking any actions or approving any transactions without the interim receiver's prior written consent, in connection with:

1. Acquisition, alienation or possible alienation, directly or indirectly, of the debtor's property, the balance sheet value of which exceeds thirty (30) million Rubles [approximately U.S. \$1.1 million] as of the date of such transaction;
2. Acquisition, alienation or possible alienation, directly or indirectly, of any immovable property of the debtor, without limiting the value of such property;
3. Any transactions with participatory interests and shares (both common and preferred ones) directly or indirectly held by the debtor in legal entities, in-

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231. 11 U.S.C.A. §109(b)(3)(B),1501(c).

cluding those registered outside the RF [Russian Federation];

4. Using the voting rights in the course of approving major transactions by the management bodies of business entities in the charter capital of which the debtor holds at least 50% participatory interest or 50% of the total outstanding shares;

5. Using the voting rights in the course of approving interested party transactions by the management bodies of business entities in the charter capital of which the debtor holds at least 20% participatory interest or 20% of the total outstanding shares.<sup>232</sup>

On April 13, 2006, the interim receiver asked the U.S. bankruptcy court to extend comity to the order granted in the Russian proceeding and to enjoin Yukos's U.S. management from consummating a sale of Yukos's majority interest in AB Mazeikiu. On the same day, the U.S. bankruptcy court entered an Order to Show Cause with a Temporary Restraining Order, which mimicked the Russian order and temporarily enjoined Yukos's management from consummating a sale of the shares in AB Mazeikiu until the court had an opportunity to rule on the interim receiver's request for a preliminary injunction after notice to all affected parties.<sup>233</sup>

The interim receiver's request for injunctive relief was opposed by Yukos and its majority shareholder, both of whom had been extensively involved in a marketing process to identify a potential buyer for Yukos's indirect interest in AB Mazeikiu. In their opposition papers, both parties described how the primary concern raised by the interim receiver—the sale of the shares in AB Mazeikiu—was already the subject of a pending Dutch proceeding in which the interim receiver was a participant. As a result, both parties argued that the U.S. bankruptcy court should abstain in favor of a process already under

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232. Verified Petition Under Chapter 15 For Recognition of a Foreign Main Proceeding and Application for Order To Show Cause with Temporary Restraining Order and Preliminary Injunction at 12, *In re* Petition of Eduard Rebgun, No. 06-B-10775 (Bankr. S.D.N.Y. Apr. 20, 2006).

233. Corinne Ball, *Navigating Cross-Border Insolvency Proceedings*, N.Y.L.J., June 22, 2006, available at <http://www.jonesday.com/pubs> (search under "Author" for "Ball"; then follow the "June 22, 2006" hyperlink).

way in The Netherlands, a proceeding in which several of Yukos's largest creditors were already actively involved.<sup>234</sup>

The TRO granted by the U.S. bankruptcy court was extended several times in order to permit sufficient time for Yukos's management to provide the interim receiver with all of the relevant details regarding the contemplated sale.<sup>235</sup> Notwithstanding the information provided to him, the interim trustee refused to withdraw his request for injunctive relief because of certain transaction risks he believed existed. As a result, on May 25, 2006, the U.S. bankruptcy court held another hearing on the interim receiver's request for injunctive relief. This time, the court refused to further extend the TRO, convinced that the sale of the stock in AB Mazeikiu was for reasonable value and in the best interests of all parties, and further that a procedure could be established by the Dutch courts to hold the net proceeds from the sale pending the filing and adjudication of various claims against Yukos.

In particular, the order entered by the U.S. bankruptcy court following the hearing:

- authorized Yukos's management to consummate the sale of stock in AB Mazeikiu held indirectly by Yukos;
- required Yukos's management to deposit all of the net sale proceeds with the bailiff under the supervision of the district court in Amsterdam; and
- requested that the district court in Amsterdam establish a claims filing and resolution procedure so that the proceeds from the sale of the stock in AB Mazeikiu could be distributed to creditors of Yukos.<sup>236</sup>

The final relief granted by the U.S. bankruptcy court was partially the product of a compromise between Yukos's management and the interim trustee with respect to the treatment and disposition of the net sale proceeds and the recognition of Russian insolvency proceeding claims in The Netherlands.<sup>237</sup> As described in a Press Release from Yukos issued after termination of the temporary restraining order:

The judge found that Yukos Oil Company conducted itself appropriately in its dealings with Mr Rebgun

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234. *Id.*

235. *Id.*

236. *Id.*

237. *Id.*

and have obtained a fair sale price for the 53.7% share stake it has in the Lithuanian refinery AB Mazeikiu Nafta. The risk of not going forward to sign a sale to the nominated purchaser far outweighed any concerns raised by Mr Rebgun and the judge permitted the termination of the temporary restraining order so that Yukos Oil Company can sign the Sale Purchase Agreement as a fair and proper transaction. Yukos Oil Company is very happy about this. Its management is thereby vindicated on two fiduciary goals; one to obtain a fair sales price, and two to take proper care of the proceeds secured at the closing of the sale. The judge's ruling this morning supported the first goal and this afternoon further court discussion will address the second goal. We are confident that an appropriate system will be put in place to protect legitimate creditors.<sup>238</sup>

The final relief resulted in the immediate sale of 53.7 percent Mazeikiu Nafta stake to the Polish oil company PKN Orlen for \$1.49 billion. In its statement, Orlen said "it had also agreed to buy an additional nearly 30.7 percent stake in Mazeikiu from the Lithuanian government for \$852 million, pending approval from the Lithuanian parliament."<sup>239</sup>

As a result of an extremely hectic legal battle lasting more than a month, the former management of Yukos formally won but had to sell the notorious stake quickly under several unfavourable conditions. These conditions included a Purchaser's refusal right in case of the substantial downward adjustment of the share's price. The Russian Government immediately began putting pressure on the refinery, by causing problems with crude oil supply that resulted in a 30% share price drop. Currently, Orlen is waiting for the EU anti-trust committee approval of the transaction and looking for the \$1.49 billion, and is considering possible refusal, which is

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238. Press Release, Yukos Oil Co., Statement from Yukos Oil Company (May 25, 2006), available at <http://www.yukos.com/vpo/news.asp?year=2006&month=5>.

239. *Poland's PKN Orlen Signs Deal to Buy Stake in Mazeikiu Nafta From Yukos*, MOSNEWS.COM, May 27, 2006, available at <http://www.mosnews.com/money/2006/05/27/yukosmn.shtml>.



likely to result in a resale of Mazeikiu Nafta from a different seller.

#### D. *The Dutch Fortune*

Having lost his chance to freeze the sale of the Mazeikiu Nafta in the U.S. Court, the interim receiver immediately went to the Dutch jurisdiction; if not trying to block the sale of the shares, he was at the very least attempting to get his hands on the proceeds.

The situation in the Dutch Court is accurately summarized as follows:

Yukos Oil has two creditors that have claims that are enforceable in the Netherlands. One is Moravel, which has obtained an arbitral award in the amount of USD 655,725,238.60 plus interest and reasonable legal costs and the Dutch court has granted an exequatur with respect to that award pursuant to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 10 June 1958. A second claim was previously owned by a group of banks which was led by Societe Generale S.A. This group of banks obtained an English judgment in the amount of USD 472,787,663.10 plus interest and legal costs. The Dutch court has granted an exequatur with respect to that award pursuant to Council Regulation (EC) No. 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters.<sup>240</sup>

The basic legal principles governing the case were also indicated in the same memorandum:

Under Dutch law, recognition of a foreign judgment and enforcement of such judgment is only possible if The Netherlands has a treaty with such country to that effect.<sup>241</sup>

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240. Declaration of Robert Van Galen at para. 2, *In re* Petition of Eduard Rebgun, No. 06-B-10775 (Bankr. S.D.N.Y. Apr. 20, 2006).

241. *Id.* at para. 4.

There is neither such a treaty between The Netherlands and Russia nor between The Netherlands and the United States of America.<sup>242</sup>

Therefore, in order to take recourse against assets of Yukos Oil in The Netherlands, Yuganskneftegaz needs to relitigate its claim in The Netherlands<sup>243</sup>

In order to obtain leave from the court to make a conservatory attachment, no judgment for payment of a claim is required. The attachee can subsequently ask the court in summary proceedings to lift the attachment. The court will lift the attachment *inter alia* if the claim of the attachor appears to be *prima facie* unsound or if it appears that the attachment is not necessary.<sup>244</sup>

Under Dutch law, other creditors would have to file their own attachments, before foreclosure of the shares of Yukos Finance, to be entitled to receive a distribution from the sale proceeds.<sup>245</sup>

Prior to Yukos's bankruptcy, Rosneft and OAO Yuganskneftegaz obtained conservatory attachments in the Netherlands on the depository receipts issued by Stichting Yukos and on the shares of Yukos International UK B.V. YNG also obtained a conservatory attachment on the shares of Yukos Finance. In addition, Moravel and Rosneft obtained executory attachments on the shares of Yukos Finance. Until the conservatory attachments are released, the proceeds of the Mazeikiu Nafta sale will not be able to be upstreamed to Yukos Finance.<sup>246</sup> No other creditors, especially those representing the Russian Federation or the state-owned companies, were recognized by the Dutch Court. The upshot of the decision was that the Menatep Group obtained access to the proceeds from the deal with Yukos assets. This situation was absolutely unacceptable in the eyes of the Russian authorities.<sup>247</sup>

On April 18, 2006, the interim receiver filed a Statement of Defense and Request for Intervention in the main proceed-

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242. *Id.*

243. *Id.*

244. *Id.*

245. *Id.*

246. Status Report at 10, *In re* Petition of Eduard Rebgun, No. 06-B-10775-RDD (Bankr. S.D.N.Y. April. 13, 2006).

247. Pleshanova, et al., *supra* note 225.

ings in the District Court in Amsterdam, stating that he is an “interested party” in his capacity as receiver under Russian bankruptcy law and therefore is entitled to intervene in the proceedings. Mr. Rebgun has requested that the Amsterdam District Court:

- (i) admit him as an interested party to these proceedings;
- (ii) suspend and/or adjourn these proceedings, in any event until 27 June 2006, or at least until such a date that the meeting of creditors on the basis of the Bankruptcy Law of the Russian Federation has made a final decision as detailed in the written pleading/request of 18 April 2006 under 2.7, and that decision is followed by an irrevocable decision of the Court of Arbitration in Moscow (Russia);
- (iii) permit Rebgun and/or the insolvency officials to be appointed by the Court of Arbitration in Moscow (Russia), in consideration of the result of the meeting of creditors of 27 June 2006, to make further requests if the developments in the insolvency proceedings give grounds for this;
- (iv) provide Rebgun with perusal rights and a copy of the full proceedings dossier;
- (v) prohibit Yukos Finance and Yukos International from entering into transactions or making decisions, pending this action, without the prior approval of the interim receiver, or at least of the court, which may lead to alienation of the material assets of the Company;
- (vi) find that prior to the executorial sale of the shares, which Yukos Oil holds in Yukos Finance, this prohibition will have to be announced in English and Russian in the international edition of the *Financial Times* and in *Vedomosti*;
- (vii) find that the executorial sale shall not take place within two months after the above-mentioned announcement, or another date to be determined by the court;
- (viii) find that Yukos Oil, Yukos Finance, the administration office, and Yukos International must make all necessary decisions jointly in as short a time as possible and must perform other actions which shall guarantee that the sales proceeds from the shares in AB Mazeikiu Nafta, and all other liquid resources flowing from the sale of participatory interests or otherwise, as a dividend or different distribution, shall be distributed to Yukos Finance firstly on the shares in Yukos International, then on the warrants in Yukos International, and sub-

sequently on the shares in Yukos Finance, and furthermore to issue an order to these parties to transfer by means of interim dividend payments or other distributions on the shares of Yukos Finance;

(ix) to determine that in the event, by virtue of the order of the court, monies are transferred on any basis whatsoever, either in the name of, or on behalf of, Yukos Finance to the bailiff, before the executorial sale of the shares in Yukos Finance takes place, all creditors who impose a seizure on the shares in Yukos Finance before the executorial sale thereof shall be entitled to exercise their rights on both the monies transferred to the bailiff and the executorial sale proceedings from the shares in Yukos Finance.

The position of the interim receiver was based on the assumption that in his position he must ensure that the entire capital of Yukos Oil, located anywhere in the world, is and remains available to the joint creditors.<sup>248</sup>

In its decision, the Dutch Court concluded that requests (i) and (iv) be allowed, that requests (ii), (iii), (v), (viii) and (ix) be disallowed, and that the decision on requests (vi) and (vii) be deferred. The interim receiver was also recognised as “an interested party” and granted the right to access all the documents of the proceedings. The majority of the disallowed requests were rejected due to the lack of clarity or the lack of “the legal means of imposing the requested injunction.”<sup>249</sup> The Court declared a principle, used throughout the whole decision, which is highly likely to be used as a “universal legal instrument” in future decisions:

Also if Yukos Oil is declared bankrupt under Russian law, the position of the judgment creditors will not be affected. Under Dutch private international law, except insofar as a Dutch binding treaty otherwise provides (which is not the case here, however), a bankruptcy order issued in another country has a territorial scope, not only in the sense that the property

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248. See Verified Petition Under Chapter 15 for Recognition of a Foreign Main Proceeding and Application for Order to Show Cause with Temporary Restraining Order and Preliminary Injunction, *In re* Petition of Eduard Rebgun, No. 06-B-10775 (Bankr. S.D.N.Y. April 13, 2006).

249. *In re BNP Paribas S.A. en al v. Yukos Oil Company en al* [HA RK] [Amsterdam Civ. Div.], 28 June 2006, 05-0568, at 4.3.8 (Neth.).

falling under the bankruptcy proceedings in this country does not also include its income present in the Netherlands . . . but also in the sense that the legal consequences of bankruptcy under the bankruptcy law of the other country cannot be invoked in the Netherlands insofar as that would result in unpaid creditors not (or no longer) being able to seek recovery from assets of the bankrupt party located in the Netherlands (during the bankruptcy). . . There would therefore be no point in suspending or staying the proceedings.<sup>250</sup>

Thus, the results of the third attempt of the Russian Government to stop the sale of Mazeikiu Nafta or to seize the proceeds of such a deal were not successful. However, the method utilized by the Dutch Court to solve the complicated legal dispute did not prejudice the Russian party. The case simply demonstrates that the interests of the creditors, recognised in compliance with the national legislation, prevail over the interests of the shareholders recognised in the bankruptcy procedure, which qualifies as a “main foreign procedure”. This type of technical obstacle creates significant problems for the interim receiver and the Russian state-controlled creditors who do not want any questionable court decisions concerning the Yukos taxes to be reviewed by the Western courts.

#### E. *Dura lex sed lex*

On August 17, 2006, the Attorney General’s Office initiated a criminal case under Art. 160, 174 of the Russian Criminal Code (misappropriation or embezzlement of entrusted other people’s property and legalization [laundering] of funds and other property acquired in an illegal way) against the former JSC “PC YUKOS” president Steven Theede, two top-managers of the company, the financial director Bruce Misamore and managing adviser David Godfrey, and also the director of Group Menatep Ltd., Tim Osbourne.<sup>251</sup> This criminal investigation and prosecution can be seen as another tit-for-tat response to a third unsuccessful attempt of the Russian Federation to stop the Mazeikiu Nafta sale.

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250. *Id.* at 4.3.5.

251. Vyacheslav Kalinin, *Theede Millionaire* . . . , Sept. 1, 2006, <http://prigovor.com/info/37402.html> (last visited March 5, 2007).

It is difficult to predict the consequences of this case. If it remains solely within the Russian jurisdiction, it may result only in some inconveniences for the Americans, in particular where relevant international search warrants are issued. However, if the Russian Federation makes a decision to ask the British or Dutch authorities to start parallel investigations, this may spur a considerable legal battle. It is not within the scope of this paper to provide a comprehensive analysis of all the legal issues of this case, and therefore, we confine our remarks to general legal principles which may affect the potential battle.

1) "Good bankruptcy governance rules"

Although different countries have different bankruptcy doctrines and laws, there are several basic principles which are recognized in some form worldwide. Hart has identified three goals that all good bankruptcy procedures should meet:

First, a good procedure should deliver an *ex post* efficient outcome that maximizes the value of the bankrupt business and that can be distributed to stakeholders.

Second, a good procedure should promote *ex ante* efficient outcomes by penalizing managers and shareholders adequately in bankruptcy states, so that the bonding role of debt is preserved.

Third, a good procedure should maintain the absolute priority of claims to protect incentives for senior creditors to lend and to avoid the perverse incentives that may arise if some creditors have a lower priority in bankruptcy states than in normal states.<sup>252</sup> This point generally complies with the principle declared by the UNCITRAL Model Law on Cross-Border Insolvency, which provides:

*Article 21. Relief that may be granted upon recognition of a foreign proceeding*

Upon recognition of a foreign proceeding, whether main or non-main, the court may, at the request of the foreign representative, entrust the distribution of all or part of the debtor's assets located in this State to the foreign representative or another person designated by the court, provided that the court is satis-

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252. Oliver Hart, *Different Approaches to Bankruptcy* 4-5 (Harvard Inst. of Econ. Research, Discussion Paper No. 1903, 2000), available at <http://post.economics.harvard.edu/hier/2000papers/2000list.html>.

fied that the interests of creditors in this State are adequately protected

*Article 23. Actions to avoid acts detrimental to creditors*

Upon recognition of a foreign proceeding, the foreign representative has standing to initiate [refer to the types of actions to avoid or otherwise render ineffective acts detrimental to creditors that are available in this State to a person or body administering a reorganization or liquidation].<sup>253</sup>

In general, good bankruptcy rules dictate that no priority need be granted to any creditors. Thus, if the “Yukos scheme” focused on the preferential treatment of the Western creditors even on the basis of “political motivation”, this rule could vitiate any sense of certainty and fairness regarding established economic expectations derived from an absolute priority of claims.

2) Rules for multinational business groups.<sup>254</sup>

Some countries follow a separate-entity doctrine in which the subsidiary of the foreign parent company is treated as if were a separately incorporated legal entity for the purpose of insolvency procedure.<sup>255</sup> Other countries follow a single-entity doctrine in which the whole consolidated group is treated as a single corporate entity.<sup>256</sup> Under either interpretation, all creditors would be entitled to participate in the liquidation,

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253. U.N. COMM’N ON INT’L TRADE LAW (UNCITRAL), UNCITRAL MODEL LAW ON CROSS-BORDER INSOLVENCY WITH GUIDE TO ENACTMENT 15 (1999), <http://www.uncitral.org/pdf/english/texts/insolven/insolvency-e.pdf>.

254. See generally THE LAW RELATING TO CORPORATE GROUPS (Michael Gillooly ed., The Federation Press 1993); JOSE ENGRACIA ANTUNES, *Liability of Corporate Groups: Anatomy and Control in Parent-Subsidiary Relationships in the US, German and EU Law*, in 10 STUDIES IN TRANSNATIONAL ECONOMIC LAW (Kluwer Law and Taxation Publishers 1994); CORPORATE PERSONALITY IN THE 20TH CENTURY (Charles E.F. Rickett & Ross B. Grantham eds., Hart Publishing 1998); PHILLIP BLUMBERG, THE LAW OF CORPORATE GROUPS (2005).

255. See Pottow, *supra* note 17, at 1904 (defining the territorialist view). See also Paul B. Stephan, *The Futility of Unification and Harmonization in International Commercial Law*, 39 VA. J. INT’L L. 743, 784-85 (1999); Andre J. Berends, *The UNCITRAL Model Law on Cross-Border Insolvency: A Comprehensive Overview*, 6 TUL. J. INT’L & COMP. L. 309, 397-99 (1998).

256. See Pottow, *supra* note 17, at 1904 (defining the universalist view). See also LoPucki, *supra* note 16, at 704-25 (providing an extended discussion of the universalist perspective).

with no preference given to claims of the creditors of a particular entity.

The attempt to secure a claim over the worldwide assets of the single entity clearly conflicts with the efforts of those separate-entity countries to withhold the assets of the local entity for the satisfaction of the claims of creditors of that entity. In the Yukos case, in absence of the relevant binding legal treaties, the Netherlands' acts are representative of a separate-entity doctrine country,<sup>257</sup> while Russia's actions may be considered those of a single-entity doctrine. Russia has arguably never acted in this manner before.<sup>258</sup> In this situation, the Dutch Court has adopted the only possible approach, in which all the prospective creditors may voluntarily file their claims and other creditors and the interested parties, including the interim receiver, can submit their objections.

However, the former management may have inadvertently facilitated the commencement of a second "parallel" (auxiliary) bankruptcy procedure which may have an adverse effect on the Russian creditors.<sup>259</sup> It is already clear that in the main procedure the commercial (third tier) creditors will be entitled only to a fraction of their debts.

### 3) Consolidation.

Ironically, the former management of the Company has replayed the legal strategy taken earlier by the Russian Federation, a strategy based on the non-recognition of the actions of the consolidated company (corporate group). As the Company stated:

The shares of MazeikiuNafta do not belong to NK YUKOS. Moreover OAO NK YUKOS is not a nominal holder of the stated shares and does not have any legal authority which would allow it dispose of MazeikiuNafta shares.<sup>260</sup>

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257. *In re BNP Paribas S.A. en al v. Yukos Oil Company en al* [HA RK] [Amsterdam Civ. Div.], 28 June 2006, 05-0568, at 4.3.8 (Neth.).

258. *Id.* at 4.1.1.

259. See Vyatcheslav Kalnin, *Theede Millionaire*, PRESS CENTER, Jan. 9, 2006, <http://prigovor.com/info/37402.html> See also Ivan Shestakov, *Again YUKOS or How Foreigners Have Plundered Russia*, <http://prigovor.com/info/37409.html> (last visited Feb. 28, 2007).

260. Press Release, Yukos Oil Co., Yukos Oil Company Confirmed to the Court Appointed Interim Receiver that It Intends to Comply with Requests that Are Within the Scope of Russian Bankruptcy Law (April 13, 2006), *avail-*



This characterisation is completely at odds with the characterisation found in the Yukos Oil Company Consolidated Accounts:

*Acquisition of stakes in AB Mazeikiu Nafta.* In June 2002, the Company purchased a 26.85 percent interest in AB Mazeikiu Nafta ("MN"), a Lithuanian company that owns a refinery, export terminal and pipeline. The Company's investment included USD 75 million for the purchase of the shares and a USD 75 million loan guaranteed by the Lithuanian government to MN to modernize the refinery. In addition, the Company secured an agreement to supply 4.8 million metric tons (35 million barrels) of crude oil annually to the refinery for ten years, beginning in July 2002. In September 2002, the Company purchased an additional 26.85 percent interest in MN for USD 85 million. In connection with this additional purchase, the Company acquired the rights and obligations relating to a second loan to MN of USD 75 million (also guaranteed by the Lithuanian government). In addition to the share purchase and loans, the Company secured the rights to manage MN. Other acquisition costs related to the purchase of MN totalled USD 4 million.

The financial position and results of operations of MN were included in the Company's consolidated financial statements beginning September 2002.<sup>261</sup>

By making an attempt to conceal its indirect control of the Mazeikiu Nafta, the former management of YukosOil company may have simply tipped off its intention to sell the refinery's stake in avoidance of the Russian Laws. This attempt contradicts the home jurisdiction principle that management needs to first comply with the law in which the company is registered. Defiance of this principle logically puts the actions of the company at legal risk.

4) Fraudsters or political refugees.

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able at <http://www.yukos.com/vpo/news.asp?year=2006&month=4> (last visited Feb. 27, 2007).

261. YUKOS OIL CO., CONSOLIDATED FINANCIAL STATEMENTS 12 (Dec. 31, 2002), available at [http://www.yukos.com/pdf/Yukos\\_GAAP\\_2002\\_final.pdf](http://www.yukos.com/pdf/Yukos_GAAP_2002_final.pdf), accessed 19 July 2006.

As we mentioned, our aim is not to aid in the on-going investigation but rather focus our research on the problem of cross-border insolvencies. On this point, both the Russian and the U.S. legislation contain provisions which may prohibit any final disposition of the company's property where it is in bankruptcy. The relevant U.S. law reads as follows:

*Fraudulent Transfer or Concealment*

[A person who] in a personal capacity or as an agent or officer of any person or corporation, in contemplation of a case under title 11 by or against the person or any other person or corporation, or with intent to defeat the provisions of title 11, knowingly and fraudulently transfers or conceals any of his property or the property of such other person or corporation [shall be fined not more than [\$250,000], or imprisoned not more than five years, or both.]<sup>262</sup>

This provision may be used to reach the transfer of funds and property between related persons or corporations just before filing a bankruptcy petition.

*Elements of the Offense*

1. The defendant transfers or conceals his/her property or the property of another.

2. Such act of concealment or transfer was done in contemplation of a case under title 11 or with the intent to defeat the provisions of title.<sup>263</sup>

Although the paragraph does not state from whom the concealment must be, it is safe to conclude that it must be from someone with an interest in the bankruptcy.<sup>264</sup>

[T]he provisions of Title 11 of the Bankruptcy Law are defeated when a person without Court approval acts in a manner that diminishes the estate of the debtor, and thus interferes with the equitable use of distribution of any material part of the assets of the estate.<sup>265</sup>

As previously mentioned, the Company's management made statements about the pending bankruptcy in the first

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262. 18 U.S.C. §152(7) (2006).

263. 5 UNITED STATES DEPARTMENT OF JUSTICE, LEGAL MANUAL FOR UNITED STATES TRUSTEES 31 (Aug. 1997).

264. *See id.*

265. *United States v. Cardall*, 885 F.2d 656, 678 n.43 (10th Cir. 1989).

half of the year 2006. This makes clear that all the actions afterwards were taken with knowledge of the company's insolvency. Moreover, they were taken in a direct violation of the Russian Law, which must be respected by the American management in accordance with the precedent cited above.

The above facts confirm the proposition that the actions of the former Yukos management resulted in the transfer of part of the Consolidated Company's assets to a specially created legal structure, which was intended to be used for the preferential treatment of a small group of selected creditors.<sup>266</sup> Although, the sale of some transferred assets have been approved by the Courts of the relevant jurisdiction, it has resulted in prospective damages for the Russian creditors of the Company.

## XI.

### CONCLUSION

Yukos risk is a complex, evolving and highly unpredictable set of multi-national legal cases implicating the nether ends of corporate governance and involving members of the Yukos control group and the Russian Federation. From the very beginning of the Yukos legal campaign, the Company and its core shareholders have attempted to bring the bulk of the legal cases to Western or international courts. They hoped that the Western courts could at least adjudicate the tax optimization strategies of the Company based on its consolidated structure. They also alleged that political motives caused the usurpation of the Company and persecution of its managers and employees. However, resorting to non-Russian courts has turned out to be a "double-edged sword", in that these very courts are able to apply legal tests and standards that could highlight the legally desperate, dubious, and indefensible nature of Yukos schemes. Although, the final decisions of the high profile courts are not expected for several years, it is already clear that complete victory for either the former Yukos owners or the Russian Federation is unlikely.

Justifying its aggressive international legal campaign on the basis of malign "political motives", the former management have taken several unprecedented steps which have re-

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266. For more information, see Shestakov, *supra* note 259.

sulted in the alienation of part of the Yukos Oil Company offshore structure. As a result, the duly appointed interim receiver could not obtain control of the bankruptcy estate, which is likely to have a detrimental economic impact on the company's Russian creditors. We would not be surprised if Western courts would look upon these transactions with a jaundiced eye.