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Russia Wins $50Bln Yukos Battle, But War's Not Over

By Peter Hobson

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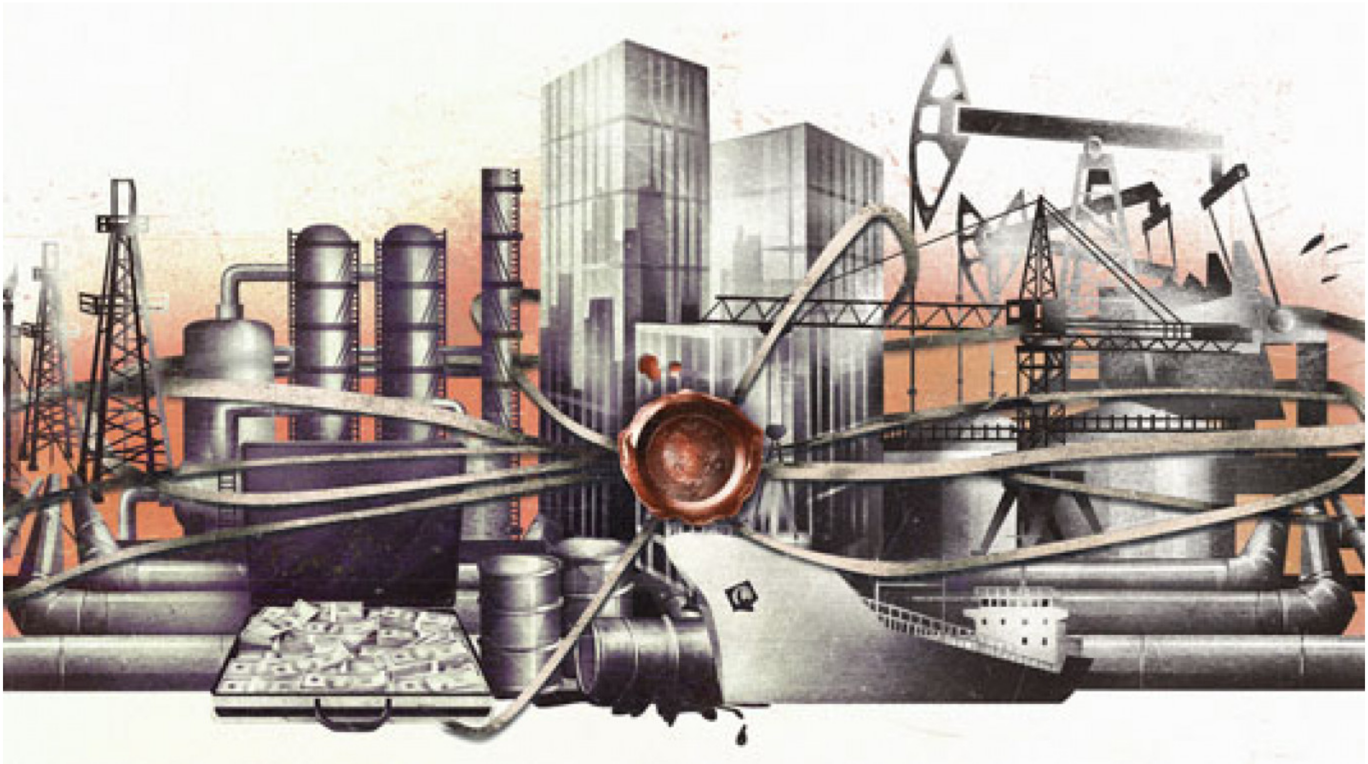

It is a monumental game of attack and counterattack, a global struggle with stakes of $50 billion.

Former shareholders in Yukos, the now defunct oil firm, prowl most of world looking for cash, shares and property belonging to the Russian state, which they then try to seize. Moscow, meanwhile, plays defense, assiduously veiling its assets and threatening to retaliate whenever one is found.

The story begins in 2014, which is when the Permanent Court of Arbitration in The Hague awarded $50 billion in compensation to Yukos' former owners. The court agreed that Russian authorities had destroyed the company through punitive tax claims in the early 2000s after its chief, the oligarch Mikhail Khodorkovsky, fell out with President Vladimir Putin's Kremlin.

But on April 20, Yukos hit a snag, when a Dutch court overturned the award, saying the arbitrators had exceeded their authority. Yukos shareholders vowed to continue to fight for asset seizures and appeal the ruling — a process which will take years.

The win strengthens Russia's position in the cat and mouse game. Andrei Kondakov, the official in charge of coordinating the country's counterattacks on Yukos, pledged to "fight in every court and every jurisdiction, knowing we have the facts, the rule of law, justice and now this decision on our side."

Catch If You Can

The chase began in January 2015, when Russia missed the payment deadline for the $50 billion damages award, leading Yukos' former owners to target assets in some of the 150 countries that have signed the New York Convention, an international arbitration enforcement treaty.

Diplomatic and military possessions were protected by law. Yukos couldn't impound a Russian warship or cordon off an embassy. On the other hand, any commercial property controlled by the Russian state was fair game for confiscation. First up were the most accessible targets, says Tim Osborne, director of GML, the former Yukos holding company spearheading the litigation. That meant real estate and bank accounts.

Moscow immediately began countermeasures. As the first notifications of litigation arrived in Moscow in early 2015, Russia abruptly removed public state databases of its overseas possessions. Its Foreign Ministry dressed down ambassadors and warned of "retaliatory steps" against the countries where Yukos was allowed to proceed. More subtly, when Osborne's team identified a building they thought was commercial and owned by Russia and petitioned to have it frozen, the next day a plaque appeared on the wall indicating it was, in fact, an annex of the Russian Embassy.

Undeterred, Yukos' lawyers opened proceedings in courts in the United States, Britain, the Netherlands, Germany and India. In France and Belgium — where, unlike in other jurisdictions, assets can be frozen even before the arbitration ruling is recognized — it is battling to impound assets worth more than $1 billion.

Pierce the Veil

To get from the single digit billions toward $50 billion, however, Yukos prepared to target Russia's state companies, first and foremost, Gazprom and Rosneft. These two energy behemoths — Russia's largest companies and both run by friends of Putin — were the main beneficiaries of the Yukos break up. Indeed, the dismantling of Yukos served not only to ruin the uppity Khodorkovsky — who subsequently spent a decade in jail — but to seize the commanding heights of Russia's petro-economy for the Russian government.

These firms have massive overseas industries and trading operations in countries from Vietnam to Brazil. Payments to them via foreign banks could also be targeted by Yukos.

But neither company is fully state-owned, and getting at them would mean proving they are "run as fiefdoms of the government," Osborne said. Gazprom, at least, took the threat seriously: The company's lawyers insisted it include warnings about the effect of Yukos litigation in its recent bond issuance.

All this has been thrown into doubt by the The Hague district court's April 20 ruling. The court decided the arbitration panel did not have jurisdiction to award compensation because the arbitration was based on an energy treaty that Russia had signed but had not ratified.

After Yukos was acquired by Khodorkovsky and his partners in the mid 1990s, the shares were transferred to offshore companies in Cyprus and the Isle of Man. It was with these offshore companies that the Yukos shareholders — though not Khodorkovsky, who disposed of his shares — sued for damages, claiming the status of foreign investors in Russia protected by an agreement called the Energy Charter Treaty.

Russia said this was ludicrous. Its lawyers also argued the arbitration should not apply because the claimants were Russian, not foreign, and that any compensation was void because Yukos' privatization — part of a widely condemned "loans for shares" scheme that helped a handful of oligarchs gain control of key Russian industries — was illegal.

"With the arbitration awards quashed," the verdict by The Hague court reads, "the Russian Federation is no longer liable for paying compensation."

The Game Continues

If that sounds like the end of the matter, it isn't.

"The court has misapplied the law," said Osborne at a defiant press conference following the ruling. He insisted he had "full faith" in a successful appeal.

The ruling does not automatically affect litigation in other countries and enforcement courts are not obliged to defer to the Dutch judgement, says Yas Banifatemi, a lawyer representing Yukos.

But the bravado masks a genuine setback. Russia's legal team — led by David Goldberg, a Russian-born lawyer for U.S. law firm White & Case once described by clients in a legal directory as "a highly trained ruthless assassin" — will lever its Dutch victory in other courts.

It could also influence the potential sale of Yukos debt to third parties. A source close to the shareholders told The Moscow Times before the April 20 decision that rights to part of the $50 billion award could be sold — perhaps to Ukraine, which could have used it to offset a $3 billion overdue loan owned to Russia. The source said any sale was still only a theoretical possibility, but the decision to overturn the award weakens its enforceability, reducing its value and the likelihood that it will be sold.

Osborne denied having heard such conversations. He said his focus in on the two-way legal battle that he appears to relish. "We will just keep on until we've got to $50 billion dollars," he says. "This is certainly not the end of recognition and enforcement."

Kondakov, however, is equally firm. No settlement is being discussed, he insists. "We don't have to pay a single penny to this bunch of guys," he says, "It's not about money. It's a matter of principle."

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