

WHITE PAPER

ON

**ABUSE OF STATE AUTHORITY
IN THE RUSSIAN FEDERATION**

—

**THE NEW POLITICALLY-DRIVEN CHARGES
AGAINST MIKHAIL KHODORKOVSKY**

**FEBRUARY 7, 2007
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My task in the upcoming process is to demonstrate by my own example that today's Russia is a country...where the law enforcement system, including its efforts to invoke requests for international legal assistance from other countries, is not being used to further legitimate law enforcement, but rather to facilitate corrupt officials' political and personal interests....The current ruling elite and power knows no shame. The court...will, no doubt, sign on to a guilty verdict....[M]y personal destiny is defined solely by our motherland's destiny and its face after the power change in 2008. I do believe that the truth and fairness will prevail.

Statement by Mikhail B. Khodorkovsky
Chita, Pretrial Detention Centre
7 February 2007

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ABUSE OF STATE AUTHORITY IN THE RUSSIAN FEDERATION

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TABLE OF CONTENTS

EXECUTIVE SUMMARY	4
1. THE NEW CHARGES	9
2. THE KHODORKOVSKY SHOW TRIAL AND FISCAL ATTACK ON YUKOS	16
3. THE KREMLIN'S INSTRUMENTALISATION OF LAW IN THE KHODORKOVSKY AFFAIR	29
4. THE MISTREATMENT OF KHODORKOVSKY IN PRISON	32
5. MOTIVES BEHIND THE CAMPAIGN AGAINST KHODORKOVSKY AND YUKOS	36
<i>ELIMINATION OF KHODORKOVSKY AS A POLITICAL OPPONENT</i>	36
<i>ELIMINATION OF YUKOS AND ACQUISITION OF ITS ASSETS</i>	40
6. THE YUGANSKNEFTEGAZ AUCTION	44
7. INDEPENDENT INTERNATIONAL OBSERVATIONS	49
8. THE KREMLIN'S AGENDA	56
<i>RETRENCHMENT OF REFORMS AND CONSOLIDATION OF A VERTICAL OF POWER</i>	56
<i>INSTRUMENTALISATION OF THE LEGAL SYSTEM: THE DUAL STATE</i>	64
<i>RUSSIA'S STATE-OWNED ENERGY ENTERPRISES AS TOOLS OF KREMLIN POWER</i>	66
<i>EXPORTING INJUSTICE – THE KREMLIN'S ATTEMPTS TO EXPLOIT FOREIGN COURTS</i>	70
9. CHALLENGES FOR THE INTERNATIONAL COMMUNITY	73
10. CONCLUSIONS	76

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EXECUTIVE SUMMARY

In the spring of 2003, the Kremlin decided that Mikhail Khodorkovsky's vision and actions in favour of a vibrant civil society, and market-based competition in the energy sector, were incompatible with its ideology and political goals. Mr Khodorkovsky's subsequent arrest, show trial and disproportionate sentence on trumped-up charges were used as a legal pretext to incarcerate him in a Siberian prison camp. Bogus and exorbitant tax assessments were used as a cover to steal the prime asset of Yukos – Russia's most successful energy company, headed by Mr Khodorkovsky.

The Kremlin has brought new charges against Mr Khodorkovsky for reasons that have nothing to do with justice, a legitimate concern for upholding Russian law, or punishing criminal behaviour. These charges are brought to:

- Ensure that Mr Khodorkovsky is not released in October 2007, when he would be eligible for release under current Russian law and practice;
- Ensure that Mr Khodorkovsky has no opportunity to play an active role shaping Russia's political future, or opposing Russia's current course;
- Legitimise the past state campaign against Mr Khodorkovsky;
- Legitimise a series of upcoming fraudulent acquisitions by Russian state-owned enterprises of the remaining Yukos assets, worth \$33 billion; and
- Legitimise the seizure of whatever remaining assets Mr Khodorkovsky may have abroad through the artifice of money laundering charges.

Before his arrest in 2003, Mr Khodorkovsky had publicly set out a clear vision for Russia. He exercised his civil rights to become involved in politics, providing support for a more vibrant political system. He was committed to the growth of civil society and had become the first great modern Russian philanthropist, supporting pro-democracy programmes. When it became clear

that the state was going to move against his vision and beliefs, he stayed to fight. He could have fled, but in a testament to his character and to his conviction of innocence, he stood his ground.

Mr Khodorkovsky had hoped his country would become a socially progressive, market-oriented democracy. As the head of the country's largest oil company, he was an advocate for the integration of Russia into the global market through Russian free enterprise over state monopoly. He promoted a variety of initiatives: the construction of new, privately funded pipelines to facilitate energy exports to China and the United States; the liberalisation and the break-up of state monopolies; the adoption of Western standards of corporate governance; and increased investment by international oil companies to augment off-shore production. Mr Khodorkovsky also spoke out about the need to stamp out the pervasive state corruption which had created tremendous economic distortions. This vision clashed with the Kremlin's agenda, and as a result of Khodorkovsky's persecution, Russia has moved not toward democracy, but toward authoritarianism, not toward liberalisation, but toward monopoly, not toward justice, but only toward attempts to mask corruption with legal fictions.

The new proceedings against Mr Khodorkovsky are a miscarriage of justice in the context of a system of total injustice. There is nowhere in Russia that this defendant can have a fair trial, because those who have the power to control the legal system have an interest, both materially and personally, in the finding of guilt.

Rather than being isolated events, the persecution of Mr Khodorkovsky and expropriation of Yukos were pivotal developments in the implementation of the Kremlin's political agenda – the elimination of any competing centres of power, and the eradication of any effective separation of powers through the consolidation of a “vertical of power” in the Kremlin.

In fulfilling this political agenda, the Kremlin has:

- Consolidated power into the hands of the so-called military and security *siloviki*, who have eliminated or marginalised voices for market-based economic reform in Russia;
- Pulled back from the development of democracy, human rights and the rule of law in Russia;
- Instrumentalised the legal system to engage in the ongoing capture of energy assets of both domestic and foreign investors; and

- Manipulated energy assets to project Russian state power over the near abroad and Europe, and destabilised international security through the uncontrolled sale of nuclear and arms technology to gain further energy leverage with key competitors.

As a result, the ongoing persecution of Khodorkovsky, the theft of Yukos, and the implementation of the Kremlin agenda has far-reaching implications for the international community. It threatens the national security, energy security and political stability of all democratic nations committed to the rule of law.

Those who bring these charges against Mr Khodorkovsky have overseen the greatest theft in modern history – the theft of Yukos. They have destabilised the world’s energy markets, extorted some of its largest companies, co-opted some of its leading political figures, and their actions have been met largely with complicity and silence. They have turned Russia back into a country where property rights are politically determined, and where contract murders of journalists and reformers occur regularly, this practice apparently having been recently exported. One man has faced them down. This White Paper deals with his fate.¹

¹ The authors wish to acknowledge the valuable contributions to this paper made by Sanford Saunders, John Pappalardo and Maria Logan of Mikhail Khodorkovsky’s International Defence Team.

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FULL TABLE OF CONTENTS

EXECUTIVE SUMMARY	4
1. THE NEW CHARGES	9
<i>“Trial by Headline”</i>	10
2. THE KHODORKOVSKY SHOW TRIAL AND FISCAL ATTACK ON YUKOS	16
<i>Presumed Guilt, Collusion of State Authorities, and Retroactive Tax Liabilities</i>	16
<i>Denial of the Right to an Independent and Impartial Tribunal</i>	19
<i>Denial of the Right to Equality before the Law</i>	19
<i>Denial of the Right to Release Pending Trial</i>	20
<i>Denial of the Right to Effective Legal Assistance</i>	21
<i>Unwarranted Raid on Defence Counsel’s Office</i>	22
<i>Denial of the Right to Disclosure of the Prosecution’s Case</i>	22
<i>Denial of the Right to Call Witnesses and the Right to Examine Expert Witnesses</i>	23
<i>Ongoing Unlawful Investigation during Trial</i>	23
<i>Denial of the Right to Exclude Out-of-Court Statements</i>	24
<i>Denial of the Right to be Heard and of the Right to a Reasonable Amount of Time to Prepare and Present</i>	25
<i>Degrading Treatment</i>	25
<i>Disproportionate Punishment</i>	25
<i>The Gladyshev Testimony</i>	27
3. THE KREMLIN’S INSTRUMENTALISATION OF LAW IN THE KHODORKOVSKY AFFAIR	29
<i>No Presumption of Regularity</i>	31

4.	THE MISTREATMENT OF KHODORKOVSKY IN PRISON	32
	<i>Obstruction of Lawyers – November 2005</i>	32
	<i>First Reprimand – December 2005</i>	33
	<i>Cancellation of Family Visit – January 2006</i>	33
	<i>Obstruction of Lawyers – January 2006</i>	33
	<i>Second Reprimand – January 2006</i>	34
	<i>Third Reprimand – March 2006</i>	34
	<i>Knife Attack – April 2006</i>	34
	<i>Fourth Reprimand – June 2006</i>	35
5.	MOTIVES BEHIND THE CAMPAIGN AGAINST KHODORKOVSKY AND YUKOS	36
	<i>ELIMINATION OF KHODORKOVSKY AS A POLITICAL OPPONENT</i>	36
	<i>ELIMINATION OF YUKOS AND ACQUISITION OF ITS ASSETS</i>	40
6.	THE YUGANSKNEFTEGAZ AUCTION	44
	<i>Betrayal of Official Commitments Regarding State Intentions for Yukos</i>	47
7.	INDEPENDENT INTERNATIONAL OBSERVATIONS	49
	<i>The World Bank</i>	49
	<i>The Organisation for Economic Co-operation and Development (OECD)</i>	49
	<i>Parliamentary Assembly of the Council of Europe (PACE)</i>	50
	<i>Amnesty International</i>	53
	<i>Assessment of Compliance with G8 Standards</i>	54
8.	THE KREMLIN’S AGENDA	56
	<i>RETRENCHMENT OF REFORMS AND CONSOLIDATION OF A VERTICAL OF POWER</i>	56
	<i>INSTRUMENTALISATION OF THE LEGAL SYSTEM: THE DUAL STATE</i>	64
	<i>RUSSIA’S STATE-OWNED ENERGY ENTERPRISES AS TOOLS OF KREMLIN POWER</i>	66
	<i>EXPORTING INJUSTICE – THE KREMLIN’S ATTEMPTS TO EXPLOIT FOREIGN COURTS</i>	70
9.	CHALLENGES FOR THE INTERNATIONAL COMMUNITY	73
10.	CONCLUSIONS	76

1. THE NEW CHARGES

On February 5, 2007, the Kremlin brought new charges against Mikhail Khodorkovsky for reasons that have nothing to do with justice or a legitimate concern for upholding Russia's laws or punishing criminal behaviour. These charges are brought for five main reasons:

- To ensure that Mr Khodorkovsky is not released in October 2007, when he will have served half of his original sentence and would be eligible for release under current Russian law and practice;
- To ensure that Mr Khodorkovsky has no opportunity to play an active role shaping Russia's political future, or opposing Russia's current course, particularly in light of the forthcoming 2007 parliamentary elections and 2008 presidential election;
- Legitimise the past state campaign against Mr Khodorkovsky by again trying to paint the man as a criminal;
- Legitimise a series of upcoming fraudulent acquisitions by Russian state-owned enterprises of the remaining Yukos assets, worth \$33 billion; and
- Legitimise the seizure of whatever remaining assets Mr Khodorkovsky may have abroad through the artifice of money laundering charges.

“Trial by Headline”

In late December 2006, Mr Khodorkovsky was moved from his Siberian prison to a regional pre-trial detention facility in the city of Chita, to face questioning in a new criminal investigation. Even before the “investigation” and questioning ended, the Russian Procuracy-General announced at a press conference that it would bring new charges against Mr Khodorkovsky, including charges apparently related to Yukos trading companies and the funding of Mr Khodorkovsky’s charitable foundation, Open Russia.

The Kremlin is well aware that under current Russian law and practice, Mr Khodorkovsky could be eligible for parole in October, 2007, when he will have served half of his current eight-year sentence. The timing of the new charges means that Mr Khodorkovsky will inevitably be locked up at least through this year’s parliamentary elections and the 2008 presidential transition.

In addition, new charges seem intended to provide moral cover for the Russian government’s illegal sale, later this year, of the remaining assets of Yukos, which have been valued at \$33 billion.² The Kremlin may hope that the new charges, along with another Khodorkovsky trial, will create a smokescreen to distract attention from, and attempt to justify, the illegal acquisition of these Yukos assets by state-owned energy companies.

Although the remaining assets of Yukos have been valued at \$33 billion, which would be sufficient to cover the \$26.6 billion in court-approved creditors’ claims, the state’s bankruptcy receiver has declared the value of the remaining assets to be \$22 billion.³ As with the forced sale in 2004 of the core production subsidiary of Yukos, the state is again undervaluing Yukos assets to facilitate their low-cost acquisition by state-owned enterprises, and, this time, to destroy Yukos forever.⁴

With any one or a combination of these motives, the Kremlin seems intent on yet another “trial by headline” – through which the smear of allegations, coupled with systematic abuses of

² According to January 2007 reports in the business daily Vedomosti and the news service Prime-Tass, a consortium of appraisers led by the Russian company Roseco performed this evaluation, which it submitted to bankruptcy receiver Eduard Rebgun. Mr Rebgun has acknowledged that he has close ties to the Russian security establishment, and the leadership of the main state-owned energy companies.

³ These figures were reported by Vedomosti and Prime-Tass in January 2007, quoting the chief spokesperson for Mr Rebgun. These news reports also stated that the assets are unlikely to be sold for \$33 billion, but rather at a discount of 5% to 30%.

⁴ According to Alexander Temerko, the former Vice President of Yukos, “Yukos would have been worth more than \$100bn, but they want to take it from us for about \$25bn.” “Khodorkovsky faces fresh charges”, by Catherine Belton, The Financial Times, February 5, 2007.

Russian law and procedure, propel the machinery of justice towards a pre-ordained guilty verdict.⁵

The new allegations against Mr Khodorkovsky demonstrate the Kremlin's willingness to ignore facts in order to pursue what they decide to label as criminal activity. A new trial can expect to see allegations that Khodorkovsky, as part of an organised group, misappropriated billions of dollars in oil proceeds by causing Yukos' production entities to sell oil at reduced prices to Yukos subsidiaries, which in turn resold the oil on the domestic and foreign markets. The Yukos consolidated financial reporting practices, implemented in compliance with the Generally Accepted Accounting Principles ("GAAP"), reflect that the proceeds of what is alleged as criminal activity were tracked and remained within the Yukos corporate structure.⁶ The investigators' refusal to apply the most basic fundamentals of vertical corporate financial structuring or forensic accounting, and to acknowledge the existence and validity of such consolidated financial reports, indicates that they will elevate form over substance in order to label Mr Khodorkovsky a criminal. Moreover, the wilful blindness of investigators to essential technical elements germane to the allegations demonstrates that the conclusions of the current investigation are devoid of legitimacy and legality and clearly are the product of political and commercial motives.

To lead the new investigation the Kremlin has brought special prosecutor Salavat Karimov back to Moscow. Referred to as the "oligarch killer" by Russian media for his lead role in the original Yukos case, Mr Karimov was posted last year to Bashkortostan to investigate privatisations in that mineral-rich Russian republic. His return to Moscow presages a determination by Russia's highest authorities to orchestrate yet another show trial, no matter how weak the evidence or how high the international political cost.

What has changed in the current context is that the Russian regime has by now lost its moral authority to dispense justice. The Kremlin's exploitation of its prosecutorial and regulatory powers has become criminal in nature, though shielded by state immunity. Selective

⁵ Every indication is that the courts will be wholly compliant with the Kremlin's wishes. In June 2006, a Moscow court decided to include an additional \$13 billion in back-tax claims on Yukos's creditors' list after taking just 15 minutes to consider 127,000 pages of information submitted by Russian tax officials.

⁶ The Yukos consolidated financial reporting practices were established in consultation with, and its consolidated financial statement reviewed by, PriceWaterhouseCoopers [PwC]. In what seems to be a pre-emptive strike against one of the obvious defences to the anticipated charges, the Procuracy-General has announced criminal charges against PwC concerning its work for Yukos. PwC has denied the validity of the charges and pointed out that it advised Yukos in the same manner that it advises Gazprom and other companies that comprise approximately half of the Russian GDP, none of whom have been subject to similar charges.

enforcement of tax and environmental laws is now the favoured means of stealing assets from both domestic and foreign owners, assisted by the use of prosecutors as prevaricators and thugs.

In the context of the Yukos case and the creeping expropriation which this White Paper describes, it should be noted that the Procuracy-General of the Russian Federation was found by the European Court of Human Rights, in the case of *Gusinskiy v. Russia*, to have used its criminal power of incarceration to achieve economic objectives.⁷ Rather than ensure such activity never take place again, it appears that the Kremlin has literally embraced the strategies that the European Court of Human Rights condemned. Indeed, Mr Karimov, the investigator mentioned above who is now pursuing the new charges against Mr Khodorkovsky, was the senior investigator who was also involved in the Gusinskiy case, whose methods were condemned by the European Court of Human Rights.

The next phase of the exploitation of the power to prosecute involves allegations of transactions characterised as “money laundering” – regardless of the absence of any predicate criminal offence.

If the trial is marked by even a modicum of objectivity, the “money laundering” label will deflate like a failed trial balloon. From what has been revealed about the charges to date, no objective expert assessment would conclude that the relevant corporate structures and transactions were illegal. Indeed, the Procuracy-General’s apparent reinterpretation of the law would render illegal the current and past practices of many major energy and other companies in Russia. Furthermore, for the time period in question, intensive due diligence of Yukos had been undertaken by experienced independent legal and accounting professionals, in view of merger discussions with Sibneft, ExxonMobil and ChevronTexaco.

Yet with Mr Karimov leading the investigation, there is no question that the Kremlin intends either to push ahead with a show trial that ignores the facts, or to attempt to fabricate other charges based on a deliberate misinterpretation of Russian law.

Today there is no indication that the abuses that continue to characterise the Khodorkovsky Affair will end. The location in Siberia where the current investigation is taking place, for example, places Mr Khodorkovsky at a significant disadvantage. Russian law prescribes that criminal investigations should be undertaken in the jurisdiction where an alleged crime has

⁷ *Gusinskiy v. Russia*, European Court of Human Rights, 19 May 2004 (Appl. No. 70276/01).

occurred, in this case Moscow.⁸ Yet the Russian Procuracy-General has moved Mr Khodorkovsky and his former business partner, Platon Lebedev, to a prison in Chita, Siberia, thousands of kilometres from Moscow, a choice of venue which materially impedes Mr Khodorkovsky and his legal team from mounting an effective defence. Distancing the investigation from Moscow is a prosecutorial strategy to render defence resources unavailable or inaccessible. Mr Khodorkovsky's Russian counsel, Yuri Schmidt, has repeatedly complained of the invalidity of the investigation, let alone the trial, occurring in Chita.⁹

In addition, since Mr Khodorkovsky was moved to Chita, the defence team has challenged the composition of the investigatory team on the basis that in light of the history of the prosecutors and their behaviour in the past investigations, there is an obvious and well-founded apprehension of bias.

Besides the improper venue chosen for the current interrogation of Mr Khodorkovsky, the Procuracy-General has also violated Mr Khodorkovsky's fundamental right to be informed of the exact content of the charges. Mr Schmidt has noted in a submission to the Procuracy-General that the most basic underlying guarantee of the constitutional right to a defence, and one of the fundamental rights of an accused in the Russian criminal process, is the right to know the charges being laid.¹⁰

Reacting to the new charges announced on February 5, 2007, the United States State Department made the following statement: "As we have commented in connection with the original trial, the continued prosecution of Mikhail Khodorkovsky and the dismantlement of Yukos raise serious questions about the rule of law in Russia. Khodorkovsky and his associate, Platon Lebedev, would have been eligible to apply for parole this year, having served half of their terms. These new charges would likely preclude their early release. Many of the actions in the case against Khodorkovsky and Yukos have raised serious concerns about the independence of courts, sanctity of contracts and property rights, and the lack of a predictable tax regime. The conduct of Russian authorities in the Khodorkovsky Yukos affair has eroded Russia's reputation and confidence in Russian legal and judicial institutions. Such actions as this and other cases raise questions about Russia's commitment to the responsibilities which all democratic, free market economies countries embrace."

⁸ Article 152, Russian Code of Criminal Procedure.

⁹ There is only one direct non-stop flight from Moscow to Chita, which takes 6 hours. All other flights stop mid-way and take almost 9 hours. The train journey takes four days.

¹⁰ Article 198 of the Russian Code of Criminal Procedure grants an accused considerable rights during forensic expert examinations. Article 6, Paragraph 3 (a) of the European Convention on Human Rights requires that every person accused of having committed a criminal offence be informed promptly and in detail of the nature and cause of the accusation.

Before Mr Khodorkovsky's arrest in October 2003, the Russian justice system enjoyed enough of a presumption of legitimacy that the accused did not flee the country, as he easily could have done, but rather stayed and co-operated with the Procuracy-General. Mr Khodorkovsky readily challenged what seemed to be an attempt by corrupt state officials to manipulate justice to intimidate him.

Now, however, as his interrogation on the new charges began, Mr Khodorkovsky declared that he has lost whatever hope in the Russian justice system he had in 2003, and that he refuses to co-operate with the investigators in another politically-driven farce of a trial. He applied for the replacement of the entire investigative team, since Mr Karimov and his officers had so deeply discredited themselves through their brutal and blatantly illegal actions against so many people associated with Yukos. Mr Khodorkovsky's application was refused.

The manner in which Mr Khodorkovsky, Yukos and Open Russia have been persecuted signals new trends of wilful disregard for law and procedure, and reckless disrespect for property rights. The Kremlin has openly abused its powers in order to crush its opponents, violating constitutional rights and fundamental principles of due process, and ignoring laws which should have prevented such a travesty of justice from occurring in a modern industrialised country. For the allegations recently announced, the new investigation contravenes the letter and spirit of Article 14 of the United Nations Guidelines on the Role of Prosecutors, which states that "[p]rosecutors shall not initiate or continue prosecution, or shall make every effort to stay proceedings, when an impartial investigation shows the charge to be unfounded."¹¹

There is general consensus that Mr Khodorkovsky is a victim of something far worse than selective or malicious justice. The Kremlin itself has defended making an example out of Mr Khodorkovsky, regardless of his innocence, as a necessary step in its consolidation of power. "We had to get somebody" said Vladislav Surkov, Deputy Chief of Staff of the Presidential Administration.

The timing of the new charges is not accidental. Russia's image abroad has been badly tarnished by a series of highly publicised murders, both in Moscow and in London, while there is intense behind the scenes jockeying for favour and power inside the Kremlin as the 2008 change in presidential leadership nears. The Kremlin may hope that the continued persecution

¹¹ Guidelines on the Role of Prosecutors adopted by the Eighth United Nations Congress on the Prevention of Crime and the Treatment of Offenders, Havana, Cuba, 27 August to 7 September 1990.

of Mr Khodorkovsky will divert attention from Russia's international and domestic problems; and may also hope to convince the world that, even if Mr Khodorkovsky's first trial was universally seen as a sham, the new charges will be more persuasive. This is an important consideration for a political leadership which has sought to present Russia as a functioning and "normal" democracy where laws are respected and courts are independent of political control, rather than the increasingly authoritarian, violent and corrupt country that Russia has become.

As will be discussed herein, in addition to the Khodorkovsky case, a series of other cases mirror the same systemic issues of politically-driven prosecutorial and judicial misconduct in today's Russia. Both the Council of Europe and Amnesty International have catalogued these cases and highlighted the prevalence of political control over threats of investigation and over outcomes in courts. Mr Khodorkovsky belongs to a growing group of political prisoners of the Russian state. Given the egregious violations of legal procedure that have been sustained by these prisoners, including systemic gross violations of domestic and international law concerning due process, fair trial and prison conditions, and given the factual and legal inaccuracies underlying their sentences, under law they merit no less than immediate and unconditional release.

In the case of Mr Khodorkovsky, considering the unnecessary destruction of billions of dollars worth of his property and his imprisonment for nearly four years, he has paid an exorbitant economic and personal price for his alleged wrongs.

2. THE KHODORKOVSKY SHOW TRIAL AND FISCAL ATTACK ON YUKOS

The sheer number and seriousness of procedural violations...in my view exceeds a mere accumulation of mistakes that could be explained by a lack of experience or professionalism. During my mandate, I have been confronted with a number of examples of the serious problems from which the Russian judiciary suffers in general, including its notorious openness to corruption, lack of respect for the rights of the defence, and, in particular, the overwhelming influence of the procuracy, which in turn is a tool in the hands of the executive.

Sabine Leutheusser-Schnarrenberger¹²

The Khodorkovsky show trial ran from June 2004 to May 2005. As Mr Khodorkovsky was subjected to grave injustices in the interpretation and application of Russian law, the Kremlin concurrently pursued a fiscal attack on Yukos based on ludicrously unjustifiable tax charges.

The Kremlin's campaign against Mr Khodorkovsky and Yukos was the critical turning point – violating not only Russian law, but also fundamental principles of international law. The onslaught of the state's legal machinery against Mr Khodorkovsky was so unfair that it constituted political persecution. In both the criminal and tax proceedings the courts lacked independence, did not adhere to the principle of equality before the law, and committed multiple, severe violations of procedural and substantive law. What follows is a description of the procedural violations of the Procuracy-General and the courts in the course of the criminal and tax proceedings. Many of these violations are so grossly erroneous or irrational that they exclude any semblance of good faith from the proceedings, and reveal the state's political motives. Indeed, the unjust nature of the proceedings, coupled with the political motives behind Mr Khodorkovsky's persecution, qualify Mr Khodorkovsky as a political prisoner according to the criteria of the Council of Europe and as determined by Günter Nooke, the German federal government commissioner for human rights policy and humanitarian aid.

Presumed Guilt, Collusion of State Authorities, and Retroactive Tax Liabilities

On October 25, 2003, Mr Khodorkovsky was arrested at gunpoint and detained on criminal charges. Within a few weeks, the Tax Ministry announced that as a result of an offsite audit it had undertaken, it was of the view that Yukos owed some \$5 billion in tax arrears, interest and

¹² Rapporteur of the Council of Europe Parliamentary Assembly Committee on Legal Affairs and Human Rights, "The circumstances surrounding the arrest and prosecution of leading Yukos executives", Committee on Legal Affairs and Human Rights, Council of Europe, November 29, 2004 (Doc. 10368) at p. 59.

finer. This signalled the opening of a second front in the attack on Mr Khodorkovsky, and was the first sign that Yukos would be assessed with a massive confiscatory tax.

On December 29, 2003 the Russian Tax Ministry issued an “Act of Audit” report alleging that Yukos owed \$3.3 billion in unpaid taxes, interest and fines for 2000. Under Russian tax law, Acts of Audit are required to be objective reports, based on a reasoned analysis of documentary evidence.¹³ The Yukos Act of Audit, by contrast, was written instead on the assumption that Yukos, and Mr Khodorkovsky, were guilty. The Act of Audit stated that “[t]he guilt of the officials of OAO NK Yukos is also confirmed by documents from criminal proceedings instigated by the Procuracy General of the Russian Federation.” This astounding statement of presumed guilt makes clear that the Tax Ministry worked closely and illegitimately with the Procuracy-General in carrying out the audit and preparing the allegations. According to the Russian Code of Criminal Procedure, the documents and other materials collected in a criminal investigation are accessible only to a limited number of participants in the case, including investigators, prosecutors and defence counsel who have been expressly authorised by the court to review those records. Materials from the investigation may be made public only with the permission of a prosecutor or investigator, and only if the disclosure does not violate the rights and lawful interests of the accused.¹⁴ One can only assume that the Procuracy-General disclosed these materials to Tax Ministry officials. Indeed, it is difficult to imagine how the auditors could have obtained all of the information they relied upon, in the space of two weeks, without obtaining this information from the procuracy. The state agencies were clearly acting collusively and with great urgency.

The materials obtained by the Tax Ministry officials contained financial information recorded in the normal course of business, and did not in fact prove non-payment of taxes. Nevertheless, the Tax Ministry required records to refer to in an attempt to give credence to its allegations.

The entire approach of the audit – its hurried nature and its timing in relation to the prosecution of Mr Khodorkovsky – suggests that the Act of Audit was either written by or closely in conjunction with the Procuracy-General. The Tax Ministry regularly audited Yukos. It audited Yukos in mid 2000 for the tax year 1999. The 2000 audit was closed and all applicable taxes were paid at that time. However, after the legal proceedings against Mr Khodorkovsky were initiated, the Tax Ministry reopened the 2000 audit and alleged that Yukos had new tax

¹³ Article 100 of the Tax Code and Regulation 60 of the Russian Federation Tax Ministry dated April 10, 2000 (Rules for Issuing Field Tax Audit Reports and Procedures to be Followed in Case of a Violation of the Tax Legislation).

¹⁴ Russian Federation Code of Criminal Procedure, Article 161.

liabilities. The Tax Ministry's reopening of its previous assessment was also made urgent by a statute of limitations – which was about to expire.

Furthermore, at the times in question, the tax structures employed by Yukos were wholly lawful vehicles for tax minimisation, and the conduct of which the Procuracy-General complained could not constitute any criminal, or even civil, tax violation.¹⁵

A series of official documents, including reports and memoranda from the Russian Procurator-General and the Russian Ministry of Internal Affairs, as well as correspondence with the Presidential Administration, acknowledge the civil and not criminal nature of allegations that were being considered against Mr Khodorkovsky in 2003. The documents also indicate that the alleged activities constituted no violation of Russian competition law. Despite these internal assessments, a political decision was made to press ahead with criminal charges against Mr Khodorkovsky.¹⁶

According to Yukos financial director Bruce Misamore, prior to the state's attack on Yukos in 2003, the company had prepared itself for a possible listing on the New York Stock Exchange and for an anticipated Eurobond issue. Yukos retained the international law firm Akin Gump Strauss Hauer and Feld, and also PwC, for this purpose. Experts from these firms, in addition to possible underwriters and their advisers, performed rigorous due diligence on the historical and then-current finance and governance practices of Yukos and its subsidiaries. The company's accounting, finance and governance practices, as well as its internal controls, were in compliance with the standards that would have been necessary for either a New York Stock Exchange listing or Eurobonds issue.¹⁷

¹⁵ Sanford M. Saunders, Jr., A. John Pappalardo and Maria P. Logan, "Analysis of the Criminal Charges against and the Trial of Mikhail B. Khodorkovsky and Platon Lebedev", May 29, 2005, at p. 14.

¹⁶ Memorandum of April 2003 from Vladimir Ustinov, Procurator-General of the Russian Federation, to President Putin, as well as related report of V.S. Fomichev, Acting Head of the Department for Supervision of Observance of Laws and Lawfulness of the Legal Acts, Procuracy-General of the Russian Federation; Memorandum of April 14, 2003 from the Russian Federation Ministry of Internal Affairs to the Russian Federal Property Fund; Letter of April 29, 2003 from Mikhail Kasyanov, Chair of the Government of the Russian Federation, to President Putin; letter of April 14, 2003 from the Deputy Head of the Department of Economic Crimes of the City of Moscow, replying to an inquiry of the Deputy Head of the Economic Crimes Department of the Russian Federation Ministry of Internal Affairs; submission of October 9, 2002 from the Procurator-General of the Russian Federation to the Russian Federal Antimonopoly Service; statement of November 10, 2002 from the Russian Federal Antimonopoly Service.

¹⁷ Yukos needed only to implement certain additional requirements to comply with the new Sarbanes-Oxley Act requirements of the United States, which were legislated in 2002. According to Mr Misamore, when he assumed his responsibilities as Chief Financial Officer in 2001, he was directed by the Board and the CEO to ensure that Yukos met international "best practices" standards with respect to all aspects of the company's financial management, and in particular with respect to accounting, finance, investor relations and corporate governance. Mr Misamore implemented internal company guidelines even more stringent than the standards required under Russian law. When the Kremlin launched its attack on Yukos,

Denial of the Right to an Independent and Impartial Tribunal

In the course of the proceedings against Mr Khodorkovsky and Yukos, the Russian authorities arranged for the dismissal of two judges who were allegedly sympathetic to Yukos, replacing them with judges who were to be more amenable to executive control. In June 2004, Judge Natalya Cheburashkina was removed from hearing one of the Yukos tax cases for not being sufficiently receptive to the claims of the Tax Ministry. Judge Cheburashkina was a highly respected judge who was initially appointed to adjudicate a claim by Yukos to overturn the 2000 tax reassessment. She lost favour with the Tax Ministry by granting a stay order requested by Yukos, which effectively prevented the Tax Ministry from seizing company assets at its own convenience. Judge Cheburashkina was replaced by Judge Olga Mikhailova. However, Judge Mikhailova recused herself the day she was appointed, publicly stating that she had been subject to outside pressure. A third judge, Judge Petrov, was appointed as her successor. He subsequently overturned the stay order granted to Yukos, denying the company's claim seeking to overturn the 2000 assessment.

Denial of the Right to Equality before the Law

Both the criminal and tax proceedings were in violation of the principle of equality before the law. The accused in the criminal proceedings, and Yukos in the tax proceedings, were arbitrarily singled out by the authorities. Dmitri Medvedev, the head of the Presidential Administration in the Kremlin, and concurrently a high-level Gazprom official, stated that Mr Khodorkovsky's prosecution was about "equality before the law for everyone, however wealthy."¹⁸ However, as noted by the Parliamentary Assembly of the Council of Europe (PACE), the allegedly abusive practices used by Yukos to minimise taxes were also used by other oil and resource companies operating in Russia. Those companies have not been subject to a similar tax reassessment, or its forced execution, and their leading executives have not been criminally prosecuted.¹⁹ The Organisation for Economic Cooperation and Development (OECD) echoed PACE, describing the case against Yukos and its former executives as "a case

the company had become the model for financial reporting, corporate governance and investor relations in Russia.

¹⁸ "Yukos: High Stakes." *Petroleum Economist*. February 16, 2004, at p. 3.

¹⁹ Parliamentary Assembly of the Council of Europe, Resolution 1418 (2004).

of highly selective law enforcement.” The OECD also described the prosecutors and the courts as being “highly politicised.”²⁰

The Russian tax authorities were well aware that Yukos and other Russian oil companies were carrying out transactions with entities located in the low-tax regions of Russia. Indeed, the low-tax regions introduced reduced tax rates to encourage companies to boost economic activity in these regions. The Russian tax authorities did not previously raise any concerns in this regard.

The Rapporteur of the Committee on Legal Affairs and Human Rights of the Parliamentary Assembly of Council of Europe described the discriminatory nature of the tax assessments, stating that a representative of the Tax Ministry confirmed that in 2000 the techniques in question were widely used and considered legal. The law making the alleged abuses possible was therefore changed, raising the issue of retroactive application of laws. The Rapporteur further observed that the total tax burden for Yukos was about triple that of its competitors. The Rapporteur states that she asked the tax authorities whether other Russian oil companies had been subjected to similar assessments and whether the executives of such companies had been criminally prosecuted, given that other oil companies engaged in the same tax minimisation practice as Yukos. The authorities did not respond to the Rapporteur’s questions.

Denial of the Right to Release Pending Trial

Mr Khodorkovsky’s arrest, at gunpoint by armed security forces storming a private jet, was disproportionate to the non-violent economic crimes with which he was charged. Mr Khodorkovsky was incarcerated during the pre-trial phase, yet under Russian law, pre-trial detention for non-violent crimes is extremely rare. Pre-trial detention is meant to be exceptional and is only sanctioned if it is impossible to find alternative means to guarantee appearance at trial. The usual practice would be not to incarcerate, with the onus of justifying incarceration borne by the state prosecutor.²¹ Yet at every detention hearing, the Procuracy-General failed to tender credible evidence to justify the continued detention of Mr Khodorkovsky.

According to criteria established by the European Court of Human Rights, Mr Khodorkovsky’s prolonged pre-trial detention was arbitrary. A judicial officer before whom the arrested person appears must review the circumstances militating for or against detention, to decide by reference to legal criteria whether there are reasons to justify detention, and to order release if there are no

²⁰ Economic Survey of the Russian Federation, Organisation for Economic Co-operation and Development, July 2004.

²¹ Russian Federation Code of Criminal Procedure, Article 108.

such reasons.²² Furthermore, “continued detention can be justified in a given case only if there are specific indications of a genuine requirement of public interest which, notwithstanding the presumption of innocence, outweigh the rule of respect for individual liberty...”²³ The principal public interests to be considered are public safety and guarantees that the accused will appear for trial.

There was no basis to assert that Mr Khodorkovsky would fail to appear for trial, commit continuing crimes, destroy evidence or obstruct the judicial process. Mr Khodorkovsky stated his determination to defend his reputation under the law, and to stay in Russia with his spouse and children. He had made numerous trips abroad as the Procuracy-General began to attack his associates, and yet he returned each time. After his detention, Russian parliamentarians and other well-respected Russian citizens personally vouched for the performance by Mr Khodorkovsky of any bail obligations. However, without any basis, Mr Khodorkovsky was treated as if he posed a serious threat to society, or a serious risk of non-appearance in court.

Denial of the Right to Effective Legal Assistance

Mr Khodorkovsky was denied the right to the effective assistance of his defence counsel, including adequate time and facilities to review the charges and prepare a defence, as well as the opportunity to speak with counsel in confidence as guaranteed by Article 14(3) of the United Nations International Covenant on Civil and Political Rights and Article 6 of the European Convention on Human Rights. The right to legal assistance entails the right to communicate with an attorney in absolute confidence, in a private manner that preserves the attorney-client privilege. The International Covenant on Civil and Political Rights requires, in the case of criminal charges, that the accused has the right, “to be informed promptly and in detail...of the nature and cause of the charge against him [and] to have adequate time and facilities for the preparation of his defence and to communicate with counsel of his own choosing.”²⁴ The European Convention on Human Rights provides for the same rights. According to the European Court of Human Rights, the guarantee of legal assistance includes the defendant’s “right to communicate with his advocate out of hearing of a third person...[because] if a lawyer were unable to confer with his client and receive confidential instructions from his client without surveillance, his assistance would lose much of its usefulness.”²⁵

²² *Aquilina v. Malta*, Eur. Ct. H.R., April 29, 1999.

²³ *Kalashnikov v. Russia*, Eur. Ct. H.R., July 15, 2002. See also *IA. v. France*, Eur. Ct. H.R., September 23, 1998.

²⁴ Article 14(3)(b).

²⁵ *S. v. Switzerland*, Eur. Ct. H.R., November 28, 1991.

Mr Khodorkovsky was denied the right to confer freely with defence counsel not only during the trial but before it as well, during the investigative phase. The counsel was denied access to hearings and interrogations by investigators of Mr Khodorkovsky, and was afforded limited time to review the Procuracy-General's case and prepare the defence. This violated the Russian Federation Code of Criminal Procedure, which states that the timing to prepare cannot be cut off unless it is obvious defence counsel is seeking a delay.²⁶ The defence counsel's access to Mr Khodorkovsky was also restricted in practice by the detention administration, which required that a letter from the Procuracy-General granting access be obtained in advance. While in court, before a note could be passed between Mr Khodorkovsky and his counsel, it had to be read by the presiding judge. Often, when Mr Khodorkovsky and his counsel attempted to communicate directly through the bars of the cage in which the defendant sat, armed guards stepped between them to block communications.

When Mr Khodorkovsky, pursuant to Article 24(2) of the Constitution, requested disclosure of materials justifying the restriction of his communications with counsel, the court avoided his requests, referring him to the rules of the detaining authorities. However, the detaining authorities considered those rules to be a state secret. As such, the defence was unable to refer to any specific provisions as the grounds for its appeals.

Interference with communications with counsel constitutes a denial of the right to counsel established in Article 48 of the Constitution.

Unwarranted Raid on Defence Counsel's Office

Defence counsel's offices were searched and confidential materials were seized. Some of these searches were conducted in a manner obviously intended to intimidate. For instance, the offices of defence counsel Anton Drel were illegally searched by armed officers of the Federal Security Service. Hundreds of files and personal records were seized, including the confiscation of Mr Drel's computer and mobile phone, and he was subsequently summoned to testify as a witness against his own client.

Denial of the Right to Disclosure of the Prosecution's Case

The state prosecutor is required under Russian law to disclose evidence that may exonerate a criminal defendant. In several instances of which defence counsel is aware concerning the

²⁶ Article 217(3).

allegations of corporate and personal tax evasion and theft, the state prosecutor had access to exculpatory evidence from governmental entities but failed to introduce it into the record of the preliminary investigation or to provide it to defence counsel.

Denial of the Right to Call Witnesses and the Right to Examine Expert Witnesses

On several occasions the court refused defence counsel's requests to cross-examine the prosecution's expert witnesses.

From the earliest stages of preparing for trial, Mr Khodorkovsky wanted to challenge the conclusions of three expert reports which were offered by the state prosecutor in support of the charges for fraud and misappropriation related to trading of Apatit fertilisers as well as personal tax evasion. The defence made three applications for the authors of the reports to be called for cross-examination. On all three occasions the court refused the application, stating that there were no grounds to support the motion as the assessment of the experts' opinion was carried out by the court. This refusal to call witnesses violated Mr Khodorkovsky's rights under domestic Russian procedural law, but also under Article 6(3) of the European Convention on Human Rights, which provides that a criminal defendant has a right "to obtain the attendance and examination of witnesses on his behalf under the same conditions as witnesses against him."

The state prosecutor threatened at least two key defence witnesses, Lyubov Myasnikova and Marat Rakhmankulov, who testified regarding tax payments and the illegal searches of the homes of Khodorkovsky associates. The court overruled defence counsel's objections to these threats, and refused to admonish the state prosecutor. In several instances, the court allowed the prosecution to introduce evidence suggesting that several potential witnesses were under criminal investigation. This tactic was designed to discredit the potential witnesses as well as to impose coercive pressure on them by raising fears over their own personal safety and security.

Ongoing Unlawful Investigation during Trial

Under the Russian Federation Code of Criminal Procedure, the prosecution's right to conduct an investigation and collect evidence is limited to the preliminary investigation stage of criminal proceedings. The procuracy ignored this rule and interrogated witnesses just prior to their appearance at the trial, under the guise of separate criminal investigations. For example, state prosecutors interrogated Oleg Khvostikov five times just a few days before his testimony at trial on the same issues as during the court hearing. The court ignored defence counsel's objections and allowed the prosecution to influence witness testimony in this manner. Meanwhile, the

court objected and sanctioned defence counsel each time defence counsel undermined the prosecution's arguments on cross examination because it viewed defence counsel's questions as an improper influence with respect to the witness's testimony.

Denial of the Right to Exclude Out-of-Court Statements

The court permitted the use of and ultimately relied upon out-of-court statements in its verdict, despite objections by defence counsel. This deprived defence counsel of their means to confront witnesses regarding those points not covered by their in-court testimony. Two such statements, cited in the verdict, were from Messrs Vostrikov and Klassen. Years earlier, these witnesses were interrogated in the investigator's office. Both witnesses emphasised at trial that there were no significant contradictions between their in-court and out-of-court reports. Despite the absence of any material discrepancies between the out-of-court and in-court testimony, the court admitted out-of-court testimony over the objection of defence counsel on the grounds that neither Mr Khodorkovsky nor his counsel were allowed to participate in the interrogations during the pre-trial investigation and, therefore, had no opportunity to contest the manner in which they were conducted.

In addition to the prejudice created by the admission of out-of-court statements, the court permitted the prosecution to supplement the testimony of its own witnesses when they did not testify as the state prosecutor had wanted.

The court also disregarded witnesses' complaints that the state prosecutor attempted to wear them down during pre-trial interrogations. The interrogations lasted for four to six hours at a time. At the end of the interrogations, witnesses were told to sign lengthy statements which had been prepared by the state prosecutor. Witnesses complained that they were reluctant to sign because some statements were inaccurate. However, under the intense pressure of the interrogators, many witnesses signed the statements as prepared by the state prosecutor.

In instances where interrogations are recorded and then transcribed by the state prosecutor, the law requires production of the recordings to defence counsel. However, the prosecution failed to produce such recordings. The court ignored defence counsel's objections to introducing such testimony transcribed by the state prosecutor, even though some pages in the reports were signed only by the investigator and not by the witness.

Denial of the Right to be Heard and of the Right to a Reasonable Amount of Time to Prepare and Present

Speed has been a particularly important factor in this case. The excessive haste with which the judicial proceedings were conducted deprived Mr Khodorkovsky and Yukos the right to be heard properly, let alone to prepare their defence. The undue haste also had the effect of exerting maximum financial pressure on Yukos, facilitating the rapid sale of the company's main production subsidiary, Yuganskneftegaz. Given the short time period within which decisions were made about highly complicated transactions, it was impossible for the court to examine all relevant materials as required by law. The limited time available was also allocated unfairly between the parties. For example, at the lower court of first instance hearing, the Tax Ministry was given three days to present its case and Yukos was given only three hours to present its defence.

Degrading Treatment

From the start of his ordeal with Russian justice, Mr Khodorkovsky was treated in a degrading manner. While in the courtroom for the eleven month trial, he was required to sit for long hours on a wooden bench in a metal cage. He had to instruct his lawyers through the bars of the cage. Upon leaving the cage he was handcuffed to guards. On days that the court was in session, he received only dry food, no exercise and no fresh air. Mr Khodorkovsky was accused of economic crimes and there were no security concerns that could justify such measures. Some of the measures taken might be warranted in the case of a violent or dangerous person, or when there is a well-founded risk of escape; however such concerns were wholly unjustified in the case of Mr Khodorkovsky. Indeed, the treatment of Mr Khodorkovsky violated Article 3 of the European Convention for the Protection of Human Rights and Fundamental Freedoms, which states that "no one shall be subjected to torture or to inhuman or degrading treatment or punishment."

Disproportionate Punishment

For his alleged offences, Mr Khodorkovsky has been subjected to two years of pre-trial detention, an eight-year sentence, imprisonment in a remote prison in an area heavily contaminated with radioactive waste, the loss of his assets, and a compromised reputation.

The conviction of Mr Khodorkovsky was based on evidence that was, at best, doubtful, and often wholly nonexistent. Even the most generous interpretation of the evidence presented by

the prosecution would support no more than civil actions, which would fail in an unbiased court. The issues of which in several instances were previously litigated and resolved to the satisfaction of the parties, including the Russian state.

Following conviction, Mr Khodorkovsky was removed from pre-trial detention in Moscow by the Russian authorities. His whereabouts were unknown to his family and defence counsel for a period of two weeks. He surfaced in Krasnokamensk, at one of the most remote Siberian prison camps in all of Russia, contrary to Russian law which requires that every prisoner shall be detained either close to their place of residence or their place of sentencing. Mr Khodorkovsky was a resident of Moscow, his trial was held in Moscow, and Russian law required that, if imprisoned, he serve his sentence in or near Moscow.²⁷ Instead, Mr Khodorkovsky faces the prospect of serving out his eight-year term in a prison near a uranium mine with levels of radioactivity in the area reportedly thirty times over the safe limit. Undeniably, the punishment imposed on Mr Khodorkovsky is grossly disproportionate to the purely economic crimes for which he was charged.

In July 2006, German Chancellor Angela Merkel stated that her “government has repeatedly drawn the Russian side’s attention to the unacceptable prison conditions of Mr Khodorkovsky,” and she expressed hope that Russia would respect international legal standards in its treatment of Mr Khodorkovsky. Other current and former political leaders, such as European Commission President José Manuel Barroso, former Czech President Vaclav Havel, former Irish President Mary Robinson and former Polish President Lech Walesa, have expressed concern for Mr Khodorkovsky’s case.

²⁷ See Article 73 of the Russian Criminal Penitentiary Code.

The Gladyshev Testimony

Vladimir Gladyshev, a leading Russian lawyer and authority on Russian corporate and tax law, served as an expert witness in the extradition case before the Bow Street Magistrates' Court. Mr Gladyshev was one of the few persons to have access to the collection of documents of the Yukos tax proceedings before the Moscow *Arbitrazh* Court, and says: "What I saw stunned me."²⁸

The following statements by Mr Gladyshev merit attention:

The Yukos tax case is not a genuine tax assessment with a few corners cut and subsequent brutally efficient enforcement. It is a politically motivated drive to destroy the company and expropriate its principal production assets, using the tax process as a cover.

The case unfolded in 2004, and by the end of the year the company was crippled, its main production unit ... expropriated and bogus tax liabilities had piled up.

(...)

The Yukos tax case is a story of how former KGB officers in positions of power pursue their personal political goals through the illegitimate use of the machinery of the Russian state, enriching themselves in the process.

The Yukos tax case is also a story of how the obsession of Vladimir Putin with Mikhail Khodorkovsky led to deep and probably irreparable damage to the state he avowedly sought to preserve."²⁹

The tax case, comprised of more than fifty separate cases heard all over the country "has been a huge and minutely organised operation coordinated from the political centre, with the involvement of a sizable proportion of the state machinery. Tax inspectors and judges were playing assigned roles in a manipulation of the Russian judicial system."³⁰ Gladyshev moreover holds that the purpose of this operation was to destroy the company and expropriate its considerable assets, but all this behind a façade of legality.

²⁸ Vladimir Gladyshev, "Caged Justice," p. 1.

²⁹ Vladimir Gladyshev, "Caged Justice," p. 2-3.

³⁰ Vladimir Gladyshev, "Caged Justice," p. 5.

Gladyshev notes that there is no public record of the Yukos case that is anywhere complete. None of the court proceedings or decisions was made public, and some decisions were never even disclosed to the aggrieved party. From the sale of Yuganskneftegaz, for instance, it is not clear whether the winning bid was paid at all, or who actually contributed funds to the winning bidder; “the auction was pure smoke and mirrors.”³¹

A few months before the arrest of Mr Khodorkovsky, the Constitutional Court issued a binding interpretation of Article 199 of the Criminal Procedure Code, which states: “It is inadmissible to establish [criminal] liability for the actions of a taxpayer that, while resulting in non-payment of a tax, or reducing a tax liability, consist of the use of lawfully conferred taxpayer’s rights, related to a legal possibility not to pay a tax or to choose the most profitable forms of entrepreneurial activity for the taxpayer and, accordingly, of mode of payments.”³² Gladyshev comments: “All through the Yukos case, and the criminal case in respect of Khodorkovsky and Lebedev, Kremlin’s prosecutors did not bother to prove any illegal form of tax planning measures used by Yukos. They just compared the lawful arrangements with invented constructs that would bring the maximum amount of taxes – and collected the difference.”³³ The Constitutional Court’s interpretation was thus swept aside.

As Peter Baker and Susan Glasser describe in their book “Kremlin Rising:”³⁴

In the case of YUKOS, authorities reopened company tax returns from the past years that had already been audited, then reinterpreted a key section of Russian law to rule that tax shelters widely used by Russian companies were no longer legitimate – even though the state’s own audit chamber had decreed those tax shelters legal just months earlier. Relying on the new interpretation, authorities slapped YUKOS with a \$3.4 billion bill for back taxes, penalties and interest from 2000, then began going through returns of 2001, 2002 and 2003 as well.

Gladyshev asserts that in this case, it was not that there was a retroactive interpretation of laws, but rather that “the government did not bother to reinterpret anything – they just declared Yukos liable, without bothering to mention any law in support of the expropriatory claim.”³⁵

³¹ Vladimir Gladyshev, “Caged Justice,” p. 5-6.

³² Decree No. 9-P of 27 May 2003.

³³ Vladimir Gladyshev, “Caged Justice,” p. 8.

³⁴ P. Baker and S. Glasser, “Kremlin Rising,” New York: Scribner (2005), p. 344.

³⁵ Vladimir Gladyshev, “Caged Justice,” p. 17-18.

3. THE KREMLIN'S INSTRUMENTALISATION OF LAW IN THE KHODORKOVSKY AFFAIR

John Pappalardo, a member of Mr Khodorkovsky's international defence team, brought experience and perspectives to the case as someone who had served as a prosecutor for 20 years in the United States. At a press conference delivered prior to Mr Khodorkovsky's verdict, he stated the following with respect to the criminal charges predicated upon accusations that Mr Khodorkovsky and his co-accused Platon Lebedev had assembled an "organised group":³⁶

[I]f you tell a big enough lie and keep repeating it, you hopefully will get people to believe it. That is what the procuracy has done in this case with respect to an organized group.

An organized group is defined as...a stable group of persons who combined beforehand to commit one or several crimes. What is the big lie?

The big lie is that this is a conscious and calculated effort to recast two of Russia's foremost business and economic reformers as nothing but nefarious criminals. And of course, it is not supported. The trial that just ended resulted in nine months of evidence, nine months of documents, nine months of argument in the past week and at the conclusion of the trial there is absolutely no evidence whatsoever to support the charge that either Mr Lebedev or Mr Khodorkovsky were organizers of a criminal group, much less that Menatep was a criminal group. There is not a shred, not a scintilla, not a miniscule piece of evidence that goes to the heart of an organized group which is criminal intent, scienter, the knowledge requirement. There is absolutely nothing in the trial in nine months.

What is clear and it is shown by the government's own evidence is that both Mr Lebedev and Mr Khodorkovsky as well as Group Menatep were associated for the lawful purpose of engaging in legitimate business activities on the government's own evidence. The ultimate irony here is that the procuracy is charging business leaders who espoused openness and transparent business practices and trying to charge them as organized criminals. Their entire existence at Menatep was punctuated by Western transparency. They brought in accounting firms,[t]hey published their financial documents on a website...What fraud case can you remember where an individual engaged in fraud didn't try to conceal something. This case is not punctuated by concealment, but rather by openness, by transparency. You do not have a fraud case here. You do not have an organized group.

³⁶ See also Sanford M. Saunders, Jr., A. John Pappalardo and Maria P. Logan, "Analysis of the Criminal Charges against and the Trial of Mikhail B. Khodorkovsky and Platon Lebedev", May 29, 2005.

Why are they doing this? Well, they are doing it for two reasons. They are doing it first and foremost to manipulate the criminal code in this country, and secondly, to try to generate a feeling of public opinion and turn the tide against Mr Lebedev and Mr Khodorkovsky, again for political and economic reasons. Specifically, what the structuring as an organized group allows the procuracy to do is create a longer statute of limitations. You can go back 10 years in this case if you allege and establish the existence of an organized group, as opposed to two years or six years. You also have the potential for much greater penalties. If you are an organizer, you can be charged up to 10 years.

The prosecutorial presumptions in this case, politically prescribed and based on bogus criminal allegations, sealed Mr Khodorkovsky's fate before the trial began. Even with all the unfair advantages it enjoyed, however, the prosecution could not avoid revealing itself as woefully incapable of understanding fundamental concepts of law and business. What the prosecution did prove is its expertise in the intimidation of witnesses and lawyers, and its expertise in putting on a show trial.

A prominent 2004 European Court of Human Rights ruling against Russia further demonstrates the trend that has emerged of the state's manipulation of law. In the case *Gusinskiy v. Russia*,³⁷ the Court established that Gazprom had pressured Mr Gusinskiy to sign a commercial agreement when he was in prison, endorsed by a state minister and subsequently implemented by a state investigating officer who dropped the criminal charges – strongly suggesting that prosecution of Mr Gusinskiy was a political tool used to intimidate him.³⁸ The Court held that

³⁷ *Gusinskiy v. Russia*, European Court of Human Rights, 19 May 2004 (Appl. No. 70276/01).

³⁸ The "July Agreement" of 2000 included a provision calling for a cessation of the criminal prosecution. The provision read as follows: "The Parties realise that successful implementation of the Agreement is possible only when individuals and legal entities acquire and exercise their civil rights of their own free will and in their own interests, without compulsion by any other party to act in any particular way. In the current situation, this implies that certain interrelated conditions must be met, namely:

- termination of the criminal prosecution against Mr Vladimir Aleksandrovich Gusinskiy in connection with the criminal case initiated against him on 13 June 2000, his re-classification as a witness in the said case and suspension of the precautionary measure prohibiting him from leaving [the country]. Should this condition not be met, the Parties are relieved of performance of their obligations hereunder;
- provision to Mr Vladimir Aleksandrovich Gusinskiy and other shareholders (stockholders) and executives of the [Media Most subsidiaries] of guarantees regarding their security and protection of their rights and freedoms, including the right to travel freely, to choose their place of stay and residence, to leave the Russian Federation freely and to return to the Russian Federation without hindrance;
- renunciation of any steps, including public statements or dissemination of information by the Organisations, their shareholders and executives, which would damage the foundations of the constitutional regime and violate the integrity of the Russian Federation, undermine the security of the State, incite to social, racial, national and religious discord or lead to the discrediting of the state institutions of the Russian Federation." *Gusinskiy v. Russia*, European Court of Human Rights, 19 May 2004 (Appl. No. 70276/01).

“it is not the purpose of such public-law matters as criminal proceedings and detention on remand to be used as part of [the state’s] commercial bargaining strategies.”³⁹

No Presumption of Regularity

According to an old legal maxim known as the presumption of regularity, “All acts are presumed to have been rightly and regularly done.” This presumption generally applies when a matter is being examined retroactively, often in light of evidentiary difficulties. The essence of the presumption, which may apply either to the actions of state officials or private persons, is that those in question acted honestly, duly discharging their duties, whether those duties are imposed by law or morals. Yet it is also an established rule that the presumption of regularity only applies in the absence of substantial evidence to the contrary. The presumption of regularity is therefore a rebuttable presumption.

An examination of the Khodorkovsky case, and subsequent events, incontestably demonstrates that no presumption of regularity can operate in favour of the Russian regime.

³⁹ *Gusinskiy v. Russia*, European Court of Human Rights, 19 May 2004 (Appl. No. 70276/01).

4. THE MISTREATMENT OF KHODORKOVSKY IN PRISON

Mr Khodorkovsky has been repeatedly denied rights afforded to him as a prisoner under Russian and international law. A pattern has emerged of constant fault-finding by prison authorities, in order to reprimand Mr Khodorkovsky as many times as possible, thereby justifying additional restrictions of his rights and undermining the likelihood of an early release. With sufficient reprimands on his record, Mr Khodorkovsky will be denied parole in 2007, when he will have served half of his sentence.

The following is a summary of the treatment of Mr Khodorkovsky since he was incarcerated in Krasnokamensk in October 2005. The treatment of Mr Khodorkovsky provides yet more evidence of the Russian authorities' abuse of their power to enforce rules.

Obstruction of Lawyers – November 2005

Prison administrators imposed procedures infringing upon the rights of the lawyers and the client, impeding a court appeal that was under preparation.

Members of a four-person team of lawyers were permitted to see Mr Khodorkovsky strictly one at a time, despite the fact that there is no law prohibiting visits to the client by the defence team as a whole. In light of the time restrictions imposed on access to his lawyers, Mr Khodorkovsky was unable to benefit from the efficiencies of group discussion.

The visit of one of the lawyers was abruptly ended with no reason given. Due to this and other practical impediments that were imposed during their three-day stay in Krasnokamensk, the total time the lawyers spent with Mr Khodorkovsky was five hours, rather than the twelve hours permitted by law.

Prison officials repeatedly tried to examine the defence team's confidential materials, including lawyers' records on their client's case. The personal papers and documents of one lawyer were seized when he left the prison grounds. Lawyers were subjected to body searches, including searches of items of underwear, without the presence of witnesses.

Prison officials scrutinised the lawyers' private notes made by them during their talks with Mr Khodorkovsky. According to the prison administration, officials had the right to look through the notes "for the purpose of preventing terrorist attacks." Following the thorough examination

and attempts to decode the notes made by one lawyer, a prison administrator requested that the lawyers undertake in writing that they would commit “to speak and write only in Russian” with their client.

The lawyers were threatened that non-compliance with any of the demands of the prison administration would result in a cut-off in communications with the client for “objective” reasons.

Later in November 2005, two lawyers who travelled from Moscow to the prison, to discuss preparations for Mr Khodorkovsky’s appeal to the European Court of Human Rights, had access to their client obstructed without legally justifiable grounds.

Despite his legal right to telephone calls, Mr Khodorkovsky does not have access to a telephone and therefore communications with his family and lawyers can only occur in person.

First Reprimand – December 2005

While working in a camp workshop, Mr Khodorkovsky left his station to find the equipment serviceman to inform him of the breakdown of a machine. Immediately afterwards he was reprimanded “for the unauthorised escape from his work place.”

According to Mr Khodorkovsky’s Russian counsel, Yuri Schmidt, the reprimand was absolutely unreasonable: Mr Khodorkovsky strictly followed the instructions above his work desk. Moreover, he did not “leave” his work place as the whole workshop is considered the work place and Mr Khodorkovsky did not go beyond its premises.

Cancellation of Family Visit – January 2006

The prison authorities cancelled a visit by Mr Khodorkovsky’s spouse on the grounds that the visitors’ area was under renovation.

Obstruction of Lawyers – January 2006

Mr Khodorkovsky was deprived of the ability to work on documents during his meetings with his lawyers. Communications must take place through glass and bars. The lawyers must put sheets of paper up to a glass window for Mr Khodorkovsky to read. The lights on Mr

Khodorkovsky's side of the glass window are switched off, making it difficult or impossible for him to read the text of the documents.

Second Reprimand – January 2006

Mr Khodorkovsky was transferred to solitary confinement for five days for being in possession of unauthorised printed material – in this case, a publication of the prison regulations. Prison officials seized from Mr Khodorkovsky two decrees issued by the Russian Federation Ministry of Justice and approved bylaws of the decrees concerning convicts' rights in penal colonies. Mr Khodorkovsky had received the seized documents through the mail and they were handed over to him, on receipt of his signature, by a prison official responsible for transmitting mail.

The right of convicts to information about their rights is explicitly provided for under Russian law.⁴⁰

Third Reprimand – March 2006

Mr Khodorkovsky was transferred to solitary confinement for the second time, for seven days, for "eating outside the designated premises." More specifically, Mr Khodorkovsky was punished for drinking tea in an unauthorised location.

A spokesman for Mr Khodorkovsky explained that since meetings with lawyers were permitted only after eight-hour shifts at the production unit, Mr Khodorkovsky had to forego dinner if he wished to meet with his lawyers, and this is what motivated him to drink the tea in question.

Knife Attack – April 2006

While sleeping, Mr Khodorkovsky was slashed across the face by a fellow inmate using a cobbler's knife. The aggressor was in possession of a knife and razor blade in contravention of prison regulations. Prison authorities subsequently placed Mr Khodorkovsky in solitary confinement, stating that "In order to put an end to all speculation on convict Khodorkovsky, including about his life being in danger, we have decided to put him in solitary confinement. He will be safe there." When interrogated by the prison administration, the aggressor stated: "I wanted to cut his eye out, but my hand slipped."

⁴⁰ This was confirmed by a local appeals court ruling that the transfer of Mr Khodorkovsky to solitary confinement had been unlawful since he did in fact have the right to possess the prison regulations.

Fourth Reprimand – June 2006

Mr Khodorkovsky was transferred to solitary confinement for the third time, for ten days, for breach of a prison regulation prohibiting inmates from “selling, buying, presenting, accepting, or seizing personal food products, objects, or substances.” Mr Khodorkovsky was placed in the cell the day after his spouse’s visit to the penal colony ended. He was punished for not reporting to the prison authorities an inventory of two lemons his spouse gave to him when she visited. The punishment contradicted the right of prisoners under Russian law to use and dispose of personal items, “such as foodstuffs”, at their own discretion.⁴¹

⁴¹ In January 2007 a local Russian court ruled that there were no legal grounds for imposing solitary confinement on Mr Khodorkovsky for the undeclared lemons. This was the second time that a prison reprimand of Mr Khodorkovsky was quashed.

5. MOTIVES BEHIND THE CAMPAIGN AGAINST KHODORKOVSKY AND YUKOS

There were two central motives behind the Kremlin's campaign against Mr Khodorkovsky: eliminating Mr Khodorkovsky as a political opponent, and eliminating Yukos as a competitor to state-owned energy companies. In the pursuit of these motives, the Kremlin considered Mr Khodorkovsky and Yukos to be inextricably intertwined.

What many fail to realise is that this attack was the prerequisite for the Kremlin's overall strategic desire to strengthen Gazprom and Rosneft in a monopolistic, anti-competitive manner. These state-owned enterprises were then exploited as instruments of Russian energy imperialism. It is difficult to imagine the Kremlin's behaviour over the last three years in wielding energy as a weapon if Yukos had not been destroyed and if the Russian state-owned enterprises had faced any market competition.

ELIMINATION OF KHODORKOVSKY AS A POLITICAL OPPONENT

It is apparent that Mr Khodorkovsky was seen as an enemy of the current political leadership for three main reasons.

First, since the late 1990s, Mr Khodorkovsky had taken steps to bring Yukos closer to the Western business community. These steps included the introduction of corporate transparency, the adoption of Western accounting standards, the hiring of Western management, the creation of an independent board of directors with a corporate governance subcommittee, corporate growth through mergers and acquisitions, and increased Western investment. These actions had marked Mr Khodorkovsky as an outspoken leader who was pro-Western and challenged the non-transparent means by which government and business are conducted in the Russian energy sector.

Second, Mr Khodorkovsky had invested substantial resources and time into initiatives to promote civil society, democracy, the rule of law, education and economic development in Russian society. Mr Khodorkovsky commenced these initiatives in 2000 through Yukos and in 2001 he created the non-profit Open Russia Foundation. Open Russia's mission statement declared the Foundation's goal was to "help create the conditions...in which people will prefer to work and earn a living in Russia, facilitating the country's emergence as one of the leading world economies. We are completely certain that this is possible if the country continues

moving along the road of democratic reforms, strengthening civil society and stimulating the entrepreneurial spirit.” The Foundation strove to be not just a donor, but also an “incubator” of initiatives contributing to the social and economic progress of Russia. Open Russia had an annual budget of approximately \$15 million in its first years of operation, and operated under high standards of transparency.

Funds were disbursed for philanthropic programs and competitive grant programs in a wide variety of educational, cultural and social spheres. Typical programs included the Federation for Internet Education, establishing training centres across the country to teach schoolteachers to use computers and access the Internet; a program in partnership with the Ministry of Culture and Mass Communications and professional library associations to support the modernisation of rural libraries through computers, Internet access and training; a “New Civilisation” program geared towards youth based on the values and practices of democracy, civil society, and market economics; and funding for the “Russian Booker Prize” for literature. In addition to such programs, Open Russia was among the rare domestically-funded organisations that donated funds to human rights organisations. Beyond human rights research and education programs, some of the beneficiaries of the Foundation’s funding also had active monitoring functions.

One human rights group funded by Open Russia ran a program to support secondary school students undertaking research on tragic yet little-known human rights abuses of the Soviet past. The Foundation also established a National School of Public Policy, with locations across the country. The purpose of the School was to educate students about democracy and to train aspiring politicians about the principles underlying a democratic system. Mr Khodorkovsky’s arrest occurred one day before he was due to deliver a provocative speech on “Power, Business and Society” at the School of Public Policy in Irkutsk, Siberia.

Third, Mr Khodorkovsky had been steadily increasing his involvement in political and public policy issues. Through public appearances and lobbying, he had become an active participant in the Russian political process. Mr Khodorkovsky was merely exercising his civil rights, but his activities violated the administration’s unwritten edict that business leaders should stay out of politics. In 2002 and 2003, Mr Khodorkovsky became outspoken on the need to end corruption and to create a more robust civil society. In February 2003, in a televised meeting between President Putin and the Russian Union of Industrialists and Entrepreneurs, Mr Khodorkovsky stated that corruption was spreading in Russia and that the administration “must be willing to show its readiness to get rid of some odious figures” in the regime, to prove its readiness and ability to combat corruption. Many believe that Mr Khodorkovsky’s fate was sealed that day. In May 2003, Mr Khodorkovsky announced that he would provide grants to the Yabloko

opposition party and the Union of Right Forces opposition party. He also honoured requests to finance United Russia – President Putin’s party. Both Yabloko and the Union of Right Forces are liberal parties that promote democracy and the rule of law.

Surely not by coincidence, a smear campaign was launched against Mr Khodorkovsky in the months before his arrest. In May 2003, *Kompromat* magazine devoted an entire 100-page issue to negative articles about Mr Khodorkovsky, his business partners and Yukos.⁴² The Council of National Strategy, a Moscow think tank, released a report entitled “Russia on the Eve of an Oligarchic Coup.”⁴³ The report stated that business oligarchs, having privatised Russia’s economy, were planning to privatise its political sphere. The report alleged that the business leaders, supposedly led by Mr Khodorkovsky, sought “to limit the powers of the President of the Russian Federation and transform Russia from a presidential republic into a president-and-parliament republic.” The report identified Mr Khodorkovsky as the main proponent of this reform.

According to the report: “Pursuant to the plans of the key protagonist of the ruling circles, a new government of the Russian Federation, that would be under control of the parliament and will report to it, may be formed already in 2004. The prime candidate for the role of the chairman of such government to be formed in accordance with the new Constitution is Mikhail Khodorkovsky.” The report advocated that steps be taken to prevent an oligarchic coup: “We have very little time for changing the nature of the country’s development. If we fail to stop the oligarchy now, we will miss the time for efficient modernisation of the country on the basis of its considerable natural, industrial and intellectual potential....The task that the nation faces is to deprive the oligarchs of unjustified influence on the country’s development, of their super-profits and their capability for shady influence on government authorities of every level as well as political parties, intellectuals and expert committees.”

Referring threateningly to Mr Khodorkovsky at a press conference held shortly after the release of the report, President Putin stated that Russia would not allow individual business people to influence the political life of the country in their own corporate interests. He stated that those

⁴² There was virtually no advertising in this issue of *Kompromat*, which suggested that it was paid for by a wealthy external sponsor. After the magazine was published, Mr Khodorkovsky inquired and was advised that the state-owned oil major Rosneft had paid for its publication.

⁴³ The Council of National Strategy is an independent organisation established in 2002, composed of leading Russian political scientists. This report was written and published in the name of the entire organisation by only two of its members. The report was neither reviewed by, nor provided to, all Council members in advance of its release. Several Council members publicly expressed dissatisfaction with the report after its release. One prominent Council member called for the expulsion from the Council of the report’s authors.

who disagreed with this principle should remember that others had tried and failed: “Some are gone forever and others are far away.”⁴⁴

⁴⁴ As quoted in S. Glasser and P. Baker, “In Russia, 2 visions, 1 battle of wills”, The Washington Post, November 5, 2003. President Putin’s statement, in response to a question on the Council of National Strategy report, was a reference to Vladimir Gusinsky and Boris Berezovsky, who had been forced into exile.

ELIMINATION OF YUKOS AND ACQUISITION OF ITS ASSETS

Since 2000, Yukos was perceived as an economic competitor of the Russian state. Despite the privatisations in the oil sector in the 1990s, the Russian state had retained significant ownership interests. Three state-owned or state-controlled companies in particular – Rosneft, Transneft and Gazprom – had interests that were often in direct competition with the interests of Yukos.

Rosneft is the largest Russian domestic oil company wholly owned by the state. Its board of directors is made up almost entirely of senior government ministers and officials.⁴⁵ Relations between Yukos and Rosneft deteriorated significantly in 2002 and 2003, as the companies clashed in several serious disputes. Rosneft officials were particularly angry that Yukos had prevailed in gaining control over the lucrative Vankorskoye field, estimated to contain 125 million metric tons of oil reserves and 76 billion cubic meters of gas reserves.

Transneft is a wholly state-owned pipeline company responsible for the distribution of 93% of all oil produced in Russia. Unlike most of Russia's oil companies, the pipeline network in Russia was not privatised in the 1990s, enabling the state to maintain control of oil distribution through quotas and other mechanisms and to collect taxes and fees on oil production, transport and export. Transneft opposed a Lukoil-Yukos proposal to build a new pipeline to the northern port of Murmansk, the only all-weather port in Russia that would allow significant oil exports to the United States.

Gazprom is the world's largest gas production company, with a global market share of approximately 25%. In Russia, Gazprom owns approximately 60% of Russian gas reserves, produces approximately 94% of Russian gas, and owns the gas pipeline system.

In 2006 Gazprom was valued at approximately \$210 billion, placing it at fourth place in the list of the world's biggest oil and gas companies, almost on par with British Petroleum and Royal

⁴⁵ There are widespread cross-appointments of high-level officials to posts in both the state-owned energy enterprises and government or executive agencies, with an obvious impact on state policy. This impact is in violation of the OECD Guidelines on Corporate Governance of State-Owned Enterprises, which state that the "legal and regulatory framework for state-owned enterprises should ensure a level-playing field in markets where state-owned enterprises and private sector companies compete in order to avoid market distortions...There should be a clear separation between the state's ownership function and other state functions that may influence the conditions for state-owned enterprises, particularly with regard to market regulation." The Guidelines further state that state-owned enterprises "should not be exempt from the application of general laws and regulations" and that competitors "should have access to efficient redress and an even-handed ruling when they consider that their rights have been violated." In addition, state-owned enterprises "should face competitive conditions regarding access to finance" with their relations with state-owned banks, financial institutions and other state-owned companies "based on purely commercial grounds." The Guidelines also state that "government should not be involved in the day-to-day management" of state-owned enterprises, and should respect the independence of their boards.

Dutch Shell, who hold the second and third places but who have far less growth potential. The largest energy company in the world is ExxonMobil, valued at approximately \$375 billion. British Petroleum has capitalisation of \$237 billion, while Royal Dutch Shell is worth \$223 billion.

The state is Gazprom's single largest shareholder. Revenues from Gazprom generate approximately 20% of total Russian state budget revenues. Gazprom viewed Yukos as a threat to its monopoly. Mr Khodorkovsky publicly stated that Gazprom would inevitably have to be broken up and privatised. Yukos owned gas reserves in addition to oil reserves and already produced gas in certain markets. Yukos was rapidly acquiring new gas reserves. Mr Khodorkovsky declared that Yukos could produce gas more cost-effectively than Gazprom. Yukos had been exploring the idea of building a pipeline to the Arctic Ocean where its gas could be liquefied at a terminal and exported to Europe – completely bypassing Gazprom's pipelines and placing Yukos in competition with Gazprom in the sale of gas to Europe. Meanwhile, the head of Gazprom, Alexei Miller, a Kremlin insider who is one of the people closest to President Putin, announced that his company was planning to become a major oil producer, and was proactively seeking opportunities to solidify a position in that area.

In addition to direct competition, Yukos challenged the state-owned enterprises with its corporate transparency. Beginning in 2000, Mr Khodorkovsky embarked on an ambitious program to transform the company's corporate culture. Yukos adopted the most modern corporate governance and transparency practices of any major company in Russia, including Western-style disclosure practices. The company retained internationally-recognised audit firms. Independent directors were appointed to the company's Board of Directors, most of whom were high profile and reputable Western figures. The number of directors holding management positions in the company was set at only three. In June 2000, the Yukos Board of Directors adopted a Corporate Governance Charter. In June 2002, Yukos began disclosing the names and holdings of its key shareholders. Once the corporate transparency program was fully implemented, Mr Khodorkovsky began to advocate that other Russian corporations should adopt similar transparency and corporate governance reforms. However, Yukos-style corporate transparency was anathema to the state-owned enterprises. Mr Khodorkovsky was challenging an established order that was highly lucrative for those involved in it.

Beyond eliminating Yukos as a competitor to state-owned energy companies, a related motive behind state action against the company was to prevent foreign influence in the Russian energy sector. For several years Yukos had obtained Western investment by issuing American Depositary Receipts on the New York Stock Exchange. In 2003, Yukos began to discuss

publicly the possibility of a more significant foreign investment by a Western oil major. At the time of Mr Khodorkovsky's arrest, Yukos was on the cusp of implementing a merger with Sibneft, Russia's fifth-largest oil company. The merger would have created a non-state-owned national champion the size of the largest private oil companies in the world – in the league of ExxonMobil, Royal Dutch Shell and British Petroleum, and larger than TotalFinaElf or ChevronTexaco. At the same time, it was widely reported that Yukos was engaged in merger discussions with Western oil majors, and that such a merger would likely take place once the Yukos-Sibneft merger had been completed. This threatened bringing foreign ownership to the heart of Russia's strategic oil industry. Halting these plans would help the state to regain full control over the oil and gas industries. This control not only enables the state, rather than private industry, to reap the financial benefits of world energy demand, but also allows the state to withhold or to bestow energy supplies to other countries, thereby enhancing its global power through fuel diplomacy.

Throughout the proceedings against Yukos, the tax authorities and the executive refused to consider any offer to settle the alleged tax obligations. Over fifty settlement offers were proposed by the embattled company, most of them following a luncheon meeting in the Kremlin in July 2005. At that meeting, President Putin assured former Canadian Prime Minister Jean Chrétien, representing Yukos and Mr Khodorkovsky, that a settlement of the criminal tax dispute was possible. However, as Yukos made these offers, billions more dollars were incrementally added to the tally of alleged tax obligations. The Russian authorities refused to provide any reasons for their failure to respond to the settlement offers.

Among the numerous settlement offers from Yukos were proposals to sell non-core assets in order to obtain the funds required to pay the claims. However the non-core assets concerned had been frozen – in order to secure payment of the claims – and the authorities refused to unfreeze them even if doing so was solely to permit their sale and the satisfaction of the claims.

From a legal standpoint, the authorities' failure to respond to the settlement offers, or to provide any reasons for doing so, was irrational. It was also illegal under Russian law, which calls for the sale of non-core assets first, before core assets, for the settlement of tax claims.⁴⁶ From a tactical standpoint, however, the failure to entertain the offers made perfect sense. The authorities did not have any intention to reach a settlement. On the contrary, the orchestration of a forced takeover of the prime assets of Yukos required bringing the company to the brink of bankruptcy and keeping Mr Khodorkovsky in jail.

⁴⁶ *Russian Federal Law On Executory Process.*

The above analysis demonstrates how interdependent strategic motives led to the imprisonment of Mr Khodorkovsky and the confiscation of the prime assets of Yukos. Mr Khodorkovsky was increasingly considered to be a source of political opposition to the regime, and the success of Yukos was an unwelcome source of competition for state-owned energy companies. Ultimately, the elimination of Mr Khodorkovsky as a political opponent and as the corporate head of Yukos, and the eventual confiscation of Yukos itself, were politically engineered, and had little to do with law.⁴⁷

⁴⁷ As stated by a prominent Western observer regarding the arrest of Mr Khodorkovsky: “Putin’s key motive was to enhance his political control...while some of his aides wanted to seize Yukos’s assets.” A. Åslund, “Putin’s Decline and America’s Response”, Washington: Carnegie Endowment for International Peace, Policy Brief 41, August 2004 at p. 2.

6. THE YUGANSKNEFTEGAZ AUCTION

In December 2004, the Kremlin engineered the forced sale of Yuganskneftegaz, the most important production branch of Yukos, to a front company it controlled. The Yuganskneftegaz auction contravened the *Russian Federal Law On Executory Process*, which explicitly states that non-core assets are to be sold first, before core assets, for the settlement of tax claims. Days later the front company was acquired by state-owned Rosneft, a previously insignificant player in the global oil industry. In 2006 Rosneft floated internationally and raised approximately \$10 billion in capital, with its value ascribed mainly to the Yuganskneftegaz acquisition.

The zeal of the fiscal attack on Yukos is most vividly demonstrated by the tax obligations imposed for 2004, which amounted to an absurd 8 roubles of taxes per 1 rouble of revenue. With additional, fines, penalties and surcharges, the total tax burden imposed for 2004 was 15.5 roubles per 1 rouble of revenue. In previous years the tax authorities had no substantial issue with Yukos, which paid its taxes diligently and in full. In fact, Yukos was the largest private taxpayer in Russia, with only Gazprom remitting more taxes to the state. The absurd tax arrears levied against Yukos exclude any rationality, unless understood as the sum of a series of incremental charges designed to increase financial pressures on the company until it reached a breaking point. Without a doubt, the campaign against Mr Khodorkovsky and Yukos sought not to recoup unpaid taxes but rather to destroy the company and expropriate its assets, beginning with the Yuganskneftegaz auction.

In an effort to block the auction, Yukos filed for Chapter 11 bankruptcy in December 2004, in the United States Bankruptcy Court for the Southern District of Texas. While events in Russia ultimately rendered this effort unsuccessful, the Texas court initially issued a temporary restraining order prohibiting the sale. It found that the “weight of the evidence supports a finding that it is substantially likely that the [tax] assessments [of Yukos] and manner of enforcement regarding taxes were not conducted in accordance with Russian law.”⁴⁸ The court also found that the “evidence supports a finding of the likelihood that Plaintiff’s shares of YNG [Yuganskneftegaz] will be sold for approximately half the value estimated by two different investment bankers.”⁴⁹

⁴⁸ *In re Yukos Oil Co. v. Russian Federation, et al.*, Case No. 04-47742-H3-11; ADV.No.04—3952 (S.D. Tex. Dec. 16, 2004).

⁴⁹ *In re Yukos Oil Co. v. Russian Federation, et al.*, Case No. 04-47742-H3-11; ADV.No.04—3952 (S.D. Tex. Dec. 16, 2004).

The legitimacy of the Russian tax authorities' interpretation of the Russian tax laws as applied to Yukos also came before a United States Federal District Court. In that case, Judge Pauley dismissed the securities claims against Yukos and its management for misrepresentations concerning Yukos's tax compliance filed by three Yukos shareholders as a class action. A key basis for the dismissal was that plaintiffs failed to allege sufficient facts to demonstrate that Yukos, et al., violated Russian tax laws or knew or should have known that the company's tax strategy was illegal. Based on Amended Complaint wherein plaintiffs cited extensively from the Russian court's decisions in Yukos tax cases, Judge Pauley concluded that there were no sufficient facts to demonstrate that "...[Yukos's] tax strategy violated Article 40 of the Russian Federation Tax Code" or "...to support an inference of conscious misbehaviour or recklessness" by Yukos management in complying with regional tax benefits rules.⁵⁰

At the December 2004 auction, Baikal Finance Group, which had a charter capital of some \$300, won Yuganskneftegaz for an uncontested bid of \$9.35 billion. Pumping one million barrels of crude oil per day, Yuganskneftegaz was valued by DrKW at \$14.7 to \$17.3 billion. According to an evaluation by JPMorgan, Yuganskneftegaz could have fetched from \$16 billion to \$22 billion. It is now understood that Baikal Finance Group was a front company using state-controlled funds to purchase Yuganskneftegaz. As demonstrated by the Yuganskneftegaz sale price, stolen goods do not sell well at auction. Just days after the auction, the state-owned oil company Rosneft announced that it had purchased Baikal Finance Group, thereby acquiring Yuganskneftegaz. Apart from the aforementioned political goals that were pursued by means of Mr Khodorkovsky's prosecution, these developments also indicate another important goal: the Russian authorities were able to annul the economic power that had been gained by Yukos.

Baikal Finance Group's winning bid went unchallenged because no one else dared to make a bid, or participate in the auction, for fear of billion-dollar liabilities resulting from an inevitable cascade of lawsuits and foreign court orders resulting from the illegality of the procedure. Yuganskneftegaz was auctioned ostensibly to cover alleged Yukos tax obligations. However its value was so deflated in the auction process that the sale yielded far less than it would have under legitimate conditions. The obvious advantage to be gained in deflating the price of Yuganskneftegaz was facilitating its purchase by Baikal Finance Group with state-controlled funds. It is not even clear that Baikal Finance Group ever paid the purchase price. However what is clear is that none of the \$10 billion gained by Rosneft in its 2006 flotation, made possible by the acquisition of Yuganskneftegaz, went to state coffers. In contravention of Russian law, the proceeds of the Rosneft flotation stayed with Rosneft – generating incredible

⁵⁰ *In re Yukos Oil Co.*, 04 Civ. 5243 (WHP) (S.D.N.Y. October 25, 2006).

profits for several individuals behind the flotation – rather than contributing to the state budget.⁵¹

To date, Yukos has not been credited the amount the Russian Property Fund received for Yuganskneftegaz's shares sold at the auction. In May 2005, Vedomosti revealed that files from the Russian Central Bank reflect that to the extent funds were transferred to create the appearance of payment of the auction price, the funds were paid from the Central Bank of Russia rather than from Rosneft's accounts. The Russian government has not denied this report of sham transfers in connection with the auction of the Yukos subsidiary.⁵²

Meanwhile, Rosneft immediately made clear its intention concerning the treatment of undisputed liabilities of its newly acquired asset. As reported in the Moscow Times in April 2005, Rosneft, without questioning the legitimacy of the liabilities, informed various banks which loaned funds secured by Yuganskneftegaz that it would not service the debt. Rosneft also warned the banks not to take legal actions to collect the debt "if the banks wanted to continue doing business in Russia and maintain good relations with the Kremlin."

The banks entered into an agreement with Rosneft whereby it would pay the Yukos debt in exchange for the banks filing an involuntary bankruptcy proceeding. Pursuant to this agreement, in March 2006, a consortium of international banks led by Société Générale – acting at the direction of Rosneft – launched involuntary bankruptcy proceedings against Yukos in Moscow. Rosneft promptly paid these banks the full amount owed to Yukos and assumed their position as a principal Yukos creditor, after the Russian Tax Ministry. With Rosneft at the helm of the involuntary bankruptcy proceedings, Yukos's legitimate management was promptly frozen out of the bankruptcy process.

The approach to the Yuganskneftegaz auction was so openly illegal that Andrei Illarionov, a senior economic advisor to President Putin and one of the last remaining advocates of a market economy in Russia, called it the "swindle of the year," saying that Russia was run by state-

⁵¹ The flotation was also profitable for the Western financial institutions who were involved – chief among them ABN AMRO, Dresdner Kleinwort, JP Morgan and Morgan Stanley. These institutions were readily willing to deal in what were essentially stolen assets, choosing to ignore violations of property rights, constitutional rights and human rights. Rosneft's coming to market violated not only Russian law, but also international norms of business conduct expressed in the United Nations Global Compact, the United Nations Principles for Responsible Investment and the OECD Guidelines for Multinational Enterprises. The voluntary codes of ethical conduct of the institutions involved were also betrayed. For its part, the actions of Rosneft broadly violated the OECD Guidelines on Corporate Governance of State-Owned Enterprises.

⁵² Furthermore, the receiver's list of liabilities in today's bankruptcy proceedings does not reflect a credit for the \$9.35 billion against the Tax Ministry's claim.

owned enterprises acting in their own interests. Mr Illarionov resigned from his Kremlin post in protest, asserting that Russia was “no longer politically free.”⁵³

Betrayal of Official Commitments Regarding State Intentions for Yukos

The effective expropriation of Yukos through the Yuganskneftegaz auction exposed a tremendous betrayal of official statements regarding the state’s intentions.

From the beginning of the tax enforcement campaign, Russian authorities have repeatedly stated that their objective was simply the even-handed execution of Russian law, that the state had no intention to destroy or bankrupt Yukos, and that the state had no plan to re-nationalise Yukos’ assets and resources, and was receptive to a negotiated settlement of the tax issues.

The following statements were made by President Putin and various government officials as the attack on Yukos unfolded:

- On November 5, 2003, President Putin stated: “The state surely does not want to destroy [Yukos].”
- On November 29, 2003, the Russian Minister of Economic Development and Trade, German Gref, stated: “The nationalisation of Yukos is not an issue.”
- On June 17, 2004, President Putin stated: “Russian authorities, the government, and the economic officials of our country are not interested in seeing Yukos go bankrupt.”
- On July 21, 2004, Rosneft press spokesperson Alexander Stepanenko stated: “[Rosneft is] not planning any asset acquisitions in the near future. None.”
- On September 6, 2004, President Putin stated: “I don’t want to bankrupt Yukos...Give me the names of the government officials who want to bankrupt Yukos and I’ll fire them.”
- On September 24, 2004, President Putin stated: “[T]here was no, and there will be no plan for nationalisation of Yukos or the state assuming control of it...The state did not set before itself the task to nationalise this company or lay hands on it. And there is no such aim now.” The President also asserted that any Yukos

⁵³ Mr Illarionov resigned just after the Yuganskneftegaz auction, in late December 2004. He had already been removed from his role as Russia’s G8 co-ordinator in April of that year, after having publicly criticised the state’s unfair treatment of Yukos.

asset sales would abide by Russian law: “We shall do this in strict accordance with the law. I want to stress it – in strict accordance with the law.”

Despite these assurances, the state orchestrated the forced sale of Yuganskneftegaz and the involuntary bankruptcy proceedings of Yukos. The state used prosecutors and courts to further its political and economic agenda, and in doing so to promote the interests of the state-owned enterprises.⁵⁴

⁵⁴ According to the Financial Times, “[s]tate companies can...seek to use a compliant judiciary and tax policy to put pressure on targets.” “Back in business - how Putin's allies are turning Russia into a corporate state”, by Neil Buckley and Arkady Ostrovsky, The Financial Times, June 19, 2006.

7. INDEPENDENT INTERNATIONAL OBSERVATIONS

The World Bank

The World Bank's "Russian Federation Country Brief 2006" indicates the following:

The investment climate in Russia still suffers from increased uncertainty since mid-2003 in business-government relations, including expectations of more probable discretionary state intervention in the economy. The protracted Yukos Affair has been the center of attention in this regard, but many other companies have also apparently experienced increased harassment.

In its September 2006 report on global governance, the World Bank shed light on Russia's governance rankings in relation to other countries. Russia was ranked 151st among 208 countries in terms of political stability, democratic voice and accountability, effectiveness of government, quality of regulatory bodies, rule of law and control over corruption. Russia was therefore overall in the league of Swaziland and Zambia, and just ahead of East Timor. Russia's political stability – defined as the perceived likelihood that the government will be destabilised or overthrown by unconstitutional or violent means – was comparable to that of the Philippines and Kyrgyzstan. On the credibility of the state's commitment to policy formation and implementation, Russia was in a group with Pakistan and Tanzania. For regulatory quality, Russia was ranked alongside Madagascar and Senegal. Rule of law in Russia was as effective as in Ecuador, Indonesia and Bangladesh.

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The Organisation for Economic Co-operation and Development (OECD)

In a November 2006 report, the OECD criticised the Russian state's intrusions into the country's energy sector as a "disturbing" phenomenon that "bodes ill for Russia's growth prospects." In a 216-page assessment of the Russian economy, the OECD stated that pervasive corruption was a significant barrier to investment. In the report, the OECD traced the rise of the state's invasiveness in commercial spheres to the forced auction of Yuganskneftegaz in 2004. The report listed subsequent acquisitions by state-controlled energy companies to show that the interventionist trend had only intensified.

According to the OECD report:

Perhaps the most disturbing recent policy trend has been the ongoing drive to expand the direct role of the state in 'strategic' sectors. Increasingly, policy seems to have been focused not on market reforms but on tightening the state's grip on the 'commanding heights' of the economy. This bodes ill for Russia's growth prospects.

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Parliamentary Assembly of the Council of Europe (PACE)

PACE has stated that:

[T]he 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.⁵⁵

As described in PACE Resolution 1418 and the corresponding report,⁵⁶ as well as several expert witness reports brought forward in cases related to Mr Khodorkovsky, numerous violations of the Russian Constitution and the European Convention for the Protection of Human Rights and Fundamental Freedoms occurred. The most fundamental constitutional rights of Mr Khodorkovsky were violated in a gross and persistent manner.

Resolution 1418 by PACE holds that “[t]he rule of law requires the impartial and objective functioning of the courts and of the prosecutors’ offices, free from undue influence from other branches of state power, and the strict respect of procedural provisions guaranteeing the rights of the accused.”⁵⁷ PACE continues to state that it “regrets that legislative reforms introduced in the Russian Federation in December 2001 and March 2002 have not protected judges better from undue influence from the executive and have even made them more vulnerable. Recent studies and highly publicised cases have shown that the courts are still highly susceptible to undue influence. The Assembly is particularly worried about new proposals to increase further

⁵⁵ Resolution 1418 of the Parliamentary Assembly of the Council of Europe, adopted on 25 January 2005, para. 1-14.

⁵⁶ Resolution 1418 of the Parliamentary Assembly of the Council of Europe, adopted on 25 January 2005; Report of Mrs. S. Leutheusser-Schnarrenberger of the committee for legal affairs and human rights to the Parliamentary Assembly of the Council of Europe, *The circumstances surrounding the arrest and prosecution of leading Yukos executives*, November 2004.

⁵⁷ Resolution 1418 of the Parliamentary Assembly of the Council of Europe, adopted on 25 January 2005, para. 2.

the influence of the Presidential Administration over the judges' qualification commission."⁵⁸ The Parliamentary Assembly accuses Russia of committing a "co-ordinated attack by the state" in Mr Khodorkovsky's case.

Examining a broader context, in September 2006 PACE issued a report on fair trial issues in Russian criminal cases concerning alleged espionage or alleged divulging of state secrets.⁵⁹ The report states the following:

A series of high profile espionage cases against scientists, journalists and lawyers in the Russian Federation resulting in harsh prison terms [has] had a chilling effect on these professional groups. The climate of "spy mania" fuelled by these cases and controversial statements of senior government representatives are obstacles to the healthy development of civil society in this country.

[...]

The Committee...urges all member states of the Council of Europe to refrain from prosecuting any scientists, journalists and lawyers who engage in generally accepted professional practices and to rehabilitate those already sanctioned. It appeals in particular to the competent bodies of the Russian Federation to set Mr Sutyagin, Mr Danilov and Mr Trepashkin free without further delay, and in the meantime to provide them with adequate medical care.

With respect to the cases cited, the report set forth the following PACE resolutions:

10.4. *Trials should be speedy, and long periods of pre-trial detention should be avoided;*

10.5. *Courts should be vigilant in ensuring a fair trial with particular attention to the principle of equality of arms between the prosecution and the defence, in particular:*

10.5.1. *The defence should be adequately represented in the selection of experts advising the court on the secret nature of relevant information;*

⁵⁸ Resolution 1418 of the Parliamentary Assembly of the Council of Europe, adopted on 25 January 2005, para. 7.

⁵⁹ "Fair trial issues in criminal cases concerning espionage or divulging state secrets" (Doc. 11031) September 25, 2006, Committee on Legal Affairs and Human Rights, Parliamentary Assembly of the Council of Europe.

- 10.5.2. *Experts should have a high level of professional competence and should be independent from the secret services;*
- 10.5.3. *The defence should be allowed to question the experts before the jury and challenge their testimony through experts named by the defence, including experts from other jurisdictions;*
- 10.6. *Proceedings should be as open and transparent as possible, in order to boost public confidence in their fairness; at the very least, the judgments must be made public;*
- 10.7. *Changes of judges and juries should be permitted only in very exceptional and well-defined circumstances...to avoid the impression of...lack of independence of the courts;*
- 10.8. *The question whether the information that was divulged is already in the public domain should always be a question of fact to be decided by the jury and, upon an affirmative answer by the jury, the judge must in all cases direct an acquittal.*
11. *The Assembly finds that in a number of high-profile espionage cases in the Russian Federation, including those of Mr Sutyagin and of Mr Danilov, there are strong indications that the above-mentioned principles (para. 10) were not respected, and notes that the prison sentences handed down (14 and 15 years respectively) are in any case out of line with the practice of other Council of Europe member states; in particular:*
- 11.1. *as in the earlier cases of Mr Nikitin, Mr Pasko (cf. Resolution 1354 (2003)) and Mr Moiseyev, the proceedings against Mr Sutyagin and Mr Danilov took many years, which the defendants spent mostly in detention, while the FSB carried out criminal investigations;*
- 11.2. *judges and juries were changed repeatedly, without adequate reasons being provided;*
- 11.3. *the defence was unable to question the experts advising on the secret nature of the information concerned before the jury;*

- 11.4. *some of the experts appear to have lacked the necessary independence;*
- 11.5. *the proceedings lacked openness; in the Danilov case, even the judgment itself was secret. In several cases, the courts appear to have relied on a secret decree (No 055-96) as a basis for imposing criminal sanctions.*

The above-cited cases mirror the same issues of defective prosecutorial and judicial processes that prevailed throughout the Khodorkovsky Affair. Indeed, Mr Khodorkovsky belongs to a growing group of political prisoners of the Russian state, for whom release from prison is the minimal appropriate remedy for the abuses sustained.

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Amnesty International

On 11 April 2005, Amnesty International made a public statement,⁶⁰ indicating: “that there is a significant political context to the arrest and prosecution of Mikhail Khodorkovsky, former head of the YUKOS company, and other individuals associated with YUKOS.”

Amnesty moreover indicates:

[C]oncerns raised by Amnesty International included reported interference in client-lawyer access and communication in the cases of Mikhail Khodorkovsky and Platon Lebedev, the closed nature of court proceedings, in particular in the case of Aleksei Pichugin, the continued detention of Mikhail Khodorkovsky and Platon Lebedev in an investigation-isolation prison (...) in the investigation and trial stages, alleged shortcomings in medical care in the cases of Platon Lebedev, Aleksei Pichugin and Svetlana Bakhmina, allegations concerning the ill-treatment of Aleksei Pichugin and Svetlana Bakhmina while in detention, and the detention of Aleksei Pichugin in Lefortovo, a detention facility under the jurisdiction of the Federal Security Service (...).⁶¹

It then holds that this situation is generally indicative of the situation of an independent judiciary in Russia, where it states that: “the concerns in these cases are indicative of wider

⁶⁰ Amnesty International, Public Statement, AI Index: EUR 46/012/2005 (Public), News Service No. 087, 11 April 2005.

⁶¹ Amnesty International, Public Statement, AI Index: EUR 46/012/2005 (Public), News Service No. 087, 11 April 2005.

problems in the criminal justice system in the Russian Federation relating to the independence of the judiciary; access to effective legal counsel; conditions of detention; and the use of torture and ill-treatment in order to extract confessions.”⁶²

Moreover, Amnesty concludes as follows: “Certainly Russian human rights groups have noted a ‘chilling’ effect on freedom of expression and political pluralism in Russia as a result of the prosecution of these individuals.”⁶³

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Assessment of Compliance with G8 Standards

In January 2006, the Foreign Policy Centre in London published a report on Russia entitled: “Russia in the Spotlight: G8 Scorecard.”⁶⁴ With regard to the status of the rule of law in Russia, the report states that:

Law enforcement corruption and political pressure on the judiciary have raised concerns about the erosion of Russia’s leaders’ accountability to the people. The executive branch appeared to drive judicial decisions in high profile or Kremlin directed cases.

(...)

Significant reforms occurred in law enforcement and judicial procedures; however, the imprisonment of former Yukos chief Mikhail Khodorkovsky raised a number of concerns over the arbitrary use of the judicial system.

(...)

*The trial of Mikhail Khodorkovsky was widely perceived as politically motivated, and allegations of prosecutorial misconduct raise questions about judicial independence and selective application of investment and tax laws.*⁶⁵

⁶² Amnesty International, Public Statement, AI Index: EUR 46/012/2005 (Public), News Service No. 087, 11 April 2005.

⁶³ Amnesty International, Public Statement, AI Index: EUR 46/012/2005 (Public), News Service No. 087, 11 April 2005.

⁶⁴ H. Barnes & J. Owen, “Russia in the Spotlight: G8 Scorecard,” January 2006.

⁶⁵ H. Barnes & J. Owen, “Russia in the Spotlight: G8 Scorecard,” January 2006, p. 25-27.

The report states that it is a matter of urgency for Russia to respect judicial independence and to abide by the principles enunciated in the European Convention on Human Rights and other international instruments.

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8. THE KREMLIN'S AGENDA

RETRENCHMENT OF REFORMS AND CONSOLIDATION OF A VERTICAL OF POWER

At midnight on New Year's Eve in 1991, the flag of the Soviet Union was lowered from its pole atop the Kremlin and replaced by the Russian tricolour. Mikhail Gorbachev's glasnost and perestroika reforms had culminated in a failed coup in the summer of 1991, after which Boris Yeltsin rode a wave of popular support that led to the dissolution of the Soviet Union and the emergence of Russia as its main successor. Russia quickly made great strides towards building a new state modelled upon the industrialised democracies of the world.

As stated by one observer, what the Russians were attempting was, "all at once, to dismantle an Empire, to operate an economic miracle, to transform a moral and economic climate ... to settle old national border and other disputes, and to revive a culture."⁶⁶ Faced with the enormity of these tasks, the first priority was a new constitution.

The Constitution of the Russian Federation, introduced in 1993, established the foundations for a new era. Article 1 of the Constitution describes the Russian Federation as a "democratic rule-of-law state." Article 2 declares that individuals and their rights and freedoms would have supreme value, with the state mandated to recognise, respect and protect these rights and freedoms. Article 8 guarantees the state's support of competition and freedom of economic activity. Article 10 calls for a separation of state powers among legislative, executive and judicial branches, with each branch exercising its powers independently. In Article 15, the Constitution is given supreme legal force and direct effect. Generally recognised principles and norms of international law and the international treaties of the Russian Federation are integrated into the Russian legal system, with the rules of the international treaties to be given precedence should they be inconsistent with Russian domestic law. Article 19 guarantees equality of all persons before the law and courts of law. Article 29 guarantees freedom of speech and freedom of the mass media. Articles 34 and 35 guarantee entrepreneurial freedoms and rights of private ownership. Article 46 states that rights and freedoms enjoy judicial protection, and further affirms that, where domestic remedies of legal protection have been exhausted, applications may be made to international bodies concerned with the protection of human rights and freedoms. Article 48 sets forth rights of defence by a lawyer, with Article 123 stating that proceedings in all courts must be conducted on the basis of adversarial principles and equality

⁶⁶ E. Huskey, ed., *Executive Power and Soviet Politics: The Rise and Decline of the Soviet State* (Armonk, N.Y.: M.E. Sharpe, 1992) at p. 263. The same observer goes on to state that "[i]f any significant part of this agenda is achieved, we shall indeed be able, and obliged, to salute a miracle."

of the parties. The presumption of innocence is found in Article 49. Article 50 disallows the use by a court of evidence obtained in violation of the law. Article 54 states that any law that establishes or increases liability cannot have retroactive force, and no one may be held liable for an act which was not recognised as a violation of the law at the time of its commission.⁶⁷

As the 1993 Constitution began to take root, the next priority was the replacement of old discredited political and legal institutions with new and more legitimate successors.⁶⁸ Laws were rapidly introduced on an as-needed basis to create a framework for privatisation and the development of a market-based economy. Concurrently, the country's foremost legal experts worked on the elaboration of the new Civil Code of the Russian Federation, drawing upon the continental European tradition. Introduced in phases from 1994 to 2001, the Civil Code has been widely hailed as the country's "economic constitution"⁶⁹. In tandem with the 1993 Constitution, the Civil Code revolutionised the Russian economy and ignited the country's great market potential. These two major fundamental sources of law were followed by a cascade of other legislation, including a Criminal Code, a Labour Code, a Land Code, a Tax Code, Civil Procedure Codes and a Criminal Procedure Code.

This legislation was brought into force against the backdrop of a legal tradition that afforded weak protection of civil liberties and property rights. Historically, the prerogatives of the state were given priority to secure law and order and to protect the collective. To these ends, the achievement of desired results was traditionally more important than the process by which they were achieved.⁷⁰ The new Russia however was to turn its back on the Bolshevik past, which was characterised by police surveillance, intimidation and terror, "telephone justice", a presumption of guilt for the criminally accused, and the imprisonment of political opponents. While it was sure to be a difficult transition, the new Russia was resolutely in favour of adherence to modern Western norms. Seeking a "certificate of democracy"⁷¹, Russia applied to join the Council of Europe in 1992, and acceded to the organisation in 1996. In 1998, Russia ratified the European Convention on Human Rights. Through these and a broad range of other instruments and activities, co-operation between Russia and its bilateral and multilateral partners intensified in several spheres.

⁶⁷ In a similar vein, Article 57 more specifically states that laws cannot have retroactive force if they impose new taxes or negatively affect the position of taxpayers.

⁶⁸ See G.B. Smith, *Reforming the Russian legal system* (Cambridge: Cambridge University Press, 1996).

⁶⁹ See P.B. Maggs and A.N. Zhiltsov, trans., *The Civil Code of the Russian Federation* (Armonk, NY: M.E. Sharpe, 1997).

⁷⁰ G.B. Smith, *Reforming the Russian legal system* (Cambridge: Cambridge University Press, 1996), at p. xii.

⁷¹ See P. Leuprecht, "Innovations in the European System of Human Rights Protection: Is Enlargement Compatible with Reinforcement?" (1998) 8:2 *Transnational Law and Contemporary Problems*, pp. 313-336.

However, a functioning law-based democratic state could not be expected to take root spontaneously. Problems arising from the inevitable gaps in the legislative framework were only compounded by a cadre of state officials lacking the necessary experience and policy guidance. From the outset of Russia's post-communist reform period, numerous challenges threatened the success of the transition process. From widespread economic hardship to ethno-political instability, the rationale quickly emerged to justify a consolidation of power. Boris Yeltsin's presidency was built on his personal authority, to the detriment of other branches of government and other political structures, such as the parliament and political parties, which might have served to strengthen the rule of law.⁷² Under President Yeltsin the state experienced a crisis of governance.⁷³ People in positions of power, including those surrounding the President, were focused on personal enrichment and self-preservation. Widespread government corruption became an unfortunate reality affecting virtually all entrepreneurial activity, directly and indirectly.

In September 1993, facing opposition over his efforts to consolidate power and implement reforms, President Yeltsin decreed the dissolution of parliament, in contravention of the Constitution. The parliamentarians rejected the decree and moved to impeach the President. A constitutional crisis ensued, bringing the bloodiest conflict to the streets of Moscow since the 1917 Bolshevik Revolution. Military and security leaders sided with President Yeltsin, attacking the parliament building and ejecting the elected representatives. In the aftermath President Yeltsin ruled by decree, clearing out state officials deemed disloyal and pressing charges against the former parliament's leaders. New parliamentary elections were held in December 1993, and a new Constitution of the Russian Federation was brought into force by the end of the year.

Against the backdrop of a weak and rudderless regime, Vladimir Putin came to power at the end of 1999, on the promise of vigorous change. A "hegemonic presidency" was at the core of all institutional arrangements of Russian governance, dominating, if not controlling outright, all political processes and their outcomes.⁷⁴ This hegemony drives a system of "managed democracy" which today has resulted in a marginalised parliament, a muzzled media and an intrusively controlled business community. Under President Putin's rule, a growing number of ex-intelligence and military officials, known as the *siloviki*, began to dominate and nudge out

⁷² See R. Sakwa, "Presidential Power: The Struggle for Hegemony" in W.A. Pridemore, ed., *Ruling Russia: Law, Crime, and Justice in a Changing Society* (Oxford: Rowman & Littlefield Publishers, 2005).

⁷³ *Ibid.*, at p. 27.

⁷⁴ *Ibid.*, at p. 19.

members of the liberal wing of the executive branch. President Putin declared a “dictatorship of law”, stating that “[i]n a lawless and consequently weak state, man is defenceless and not free. The stronger the state, the freer the individual.”⁷⁵ The “dictatorship of law” enjoyed popular support as an antidote to the lawlessness of previous years, and as a means of reining in business leaders whose power and influence threatened the Kremlin. The first two high-profile targets of the Kremlin were Boris Berezovsky and Vladimir Gusinsky, two controversial figures forced into exile following relentless state-led campaigns against their media interests. They were to serve as notice to other powerful entrepreneurs that the executive would not tolerate challenges to its authority.

The Putin administration concurrently undertook a vast reorganisation of the state apparatus. The country’s eighty-nine regions were divided into seven federal districts, with a presidential representative appointed to each federal district. The elected leaders of the eighty-nine regions lost significant powers and privileges, including their automatic appointment to the upper house of parliament, the Federation Council. Through this rebalancing of power, central authority was significantly reinforced, with generals and other *siloviki* appointed to the majority of the posts in the new federal districts.

In parallel, significant institutional reforms were undertaken, led in great part by German Gref, Minister of Economic Development and Trade. Gref proclaimed the need to develop a self-regulated economy, reducing state interference in private business by putting an end to excessive state regulation and by limiting the duplication of executive powers held by federal bodies.⁷⁶ Meanwhile, Prime Minister Mikhail Kasyanov led reforms that sought to prevent the state and its agencies from acting both as referees and players.⁷⁷ Significant changes rationalised and streamlined the state apparatus.

The Russian courts presented additional reform challenges. During the Soviet period, the courts were traditionally used as a mechanism of control in a crime-fighting chain that also included the KGB, the Ministry of the Interior and the Procuracy.⁷⁸ The separation of powers did not exist, and “management” of the courts by state officials occurred at all levels and at every stage of the proceedings.⁷⁹ Although during the Yeltsin era piecemeal efforts had been made to

⁷⁵ Cited in N. Ascherson, “Law v. Order”, 26:10 London Review of Books (2004).

⁷⁶ R. Sakwa, “Presidential Power: The Struggle for Hegemony” in W.A. Pridemore, ed., *Ruling Russia: Law, Crime, and Justice in a Changing Society* (Oxford: Rowman & Littlefield Publishers, 2005) at p. 32.

⁷⁷ *Ibid.*

⁷⁸ See O. Schwartz, “The Creation of an Independent Judiciary” in W.A. Pridemore, ed., *Ruling Russia: Law, Crime, and Justice in a Changing Society* (Oxford: Rowman & Littlefield Publishers, 2005).

⁷⁹ *Ibid.*, at p. 60.

improve the functioning of the courts, it was the Putin administration that made reform of the courts a major priority. President Putin appointed the liberal jurist Dmitri Kozak, with whom he had served in the administration of the city of Saint Petersburg, to lead an overhaul of the courts. The Kozak reforms, to be implemented over several years, included significantly increased financing, independent judicial control over court administration, better security for judges and courtrooms, computerisation, and increased accountability and transparency. President Putin, himself educated in law, openly elaborated the rationale for court reform on numerous occasions. The President's pronouncements demonstrated his recognition of the weaknesses of the existing system and of the urgency of instituting change.

President Putin's programs of public administration reform and court reform have been implemented alongside the consolidation of executive power. Public administration reform directly served the interests of the executive, since it would be strengthened by a well-organised structure and professionally trained and loyal public service corps. The intense push towards court reform, on the other hand, seemed inconsistent with the widely observed autocratic tendencies of the Putin administration. The unprecedented interest of the political leadership in the functioning and reputation of the judiciary was motivated in part by the recognition of the critical role that courts could play in effectively implementing laws. Effective implementation of laws meant a more stable economy and more favourable investment climate.⁸⁰ Speaking on the ongoing need to strengthen trust in the courts, President Putin declared the need for "the consistent application of the principle of legal and financial independence and impartiality of the courts, by improving the professional skills of judges, and by making justice transparent."⁸¹ He added that Russia must also "broadly apply methods that have won acclaim in the world, in particular pre-trial and trial settlement of conflicts through negotiations and out-of-court settlements."

At the same time, President Putin proceeded to appoint a new chief justice of the Supreme *Arbitrazh* Court: the new chief justice, Anton Ivanov, born in 1965, had no prior experience as a judge. He came to the judiciary from Gazprom-Media, a subsidiary of the state-controlled gas giant that was often at loggerheads with Mr Khodorkovsky and Yukos. The appointment process seemed to ignore the Supreme *Arbitrazh* Court's full bench of experienced and highly-respected judges in favour of the relatively inexperienced Mr Ivanov. Despite this, more recently, President Putin stated that "[i]f part of Russian society continues to see the court system as corrupt, there can be no speaking of an effective justice system in our country."⁸²

⁸⁰ Ibid., at p. 70.

⁸¹ Address to the Sixth Congress of Judges, November 30, 2004.

⁸² Annual Address to the Federal Assembly of the Russian Federation, April 25, 2005.

Such a statement, in the face of the reality of ongoing state manipulation of the courts, is an ominous sign of the emergence and entrenchment of a dual state in Russia, in line with the theory of Ernest Fraenkel described above. On the one hand, the courts are to serve the goals of the normative state. Yet on the other hand, the prerogative state ultimately maintains its control.

Within this dual state it was not clear until recently to what extent the liberal wing of President Putin's administration was counter-balanced by the *siloviki*. Despite evidence of reform backsliding due to the growing influence of the *siloviki*, many Western leaders have tended to give President Putin the benefit of the doubt. In some instances Western leaders are motivated by friendship diplomacy – expecting osmosis of common values and interests through friendly relations. In other cases geopolitical concerns, such as energy supplies or the war against terror, trump concerns over domestic developments in Russia.

Valery Zorkin, the first and current Chair of the Constitutional Court of the Russian Federation, has stated that “[b]ribe-taking courts have become one of the largest corrupted markets of Russia. Research shows that courts are quite vulnerable to corrupted attacks by business.” He also stated that “[f]urther reform of courts is unthinkable without a comprehensive legal reform in Russia. I am confident that all the other reforms will slow down pretty soon if...legal reform is not given a boost.”⁸³

Professor Peter Solomon, a leading authority on Russian criminal justice, states: “Resistance to innovations in policies is a normal part of policy change, but when it is so extreme as to undermine a reform, it may be understood as counterreform.”⁸⁴

Beginning in 2003, juries became involved in cases alleging crimes against the state. Due to a perception of juries as unpredictable, the Federal Security Bureau (FSB)⁸⁵ intervened. In February 2004, a proposal was made to remove cases alleging crimes against the state from adjudication by juries. The Criminal Procedure Code had to be amended for this, and in the absence of that development, the FSB initiated a process of influencing the selection of jurors and judges who would preside over such trials.⁸⁶

⁸³ Valery Zorkin, quoted presentation by Ethan S. Burger, Esq., “A View of the Problem of Corruption in the Russian *Arbitrazh* Court System.” 31 May 2005, p. 21.

⁸⁴ Peter H. Solomon, Jr., “Threats of Judicial Counterreform in Putin's Russia” 2005, p. 18 (URL website: www.reec.uiuc.edu/events/Conference/ACConf/lawconf_paper/solomon.pdf).

⁸⁵ The FSB is the main successor of the KGB.

⁸⁶ Peter H. Solomon, Jr., “Threats of Judicial Counterreform in Putin's Russia” 2005, p. 19-20 (URL website: www.reec.uiuc.edu/events/Conference/ACConf/lawconf_paper/solomon.pdf).

The Basmanny District Court in Moscow, where many of the preliminary motions in the criminal proceedings against Mr Khodorkovsky were handled, is closely controlled by the Procurator-General.⁸⁷ The City Court of Moscow (Mosgorsud) where Mr Khodorkovsky's appeal was heard, is strongly influenced by the executive, in particular in cases that are essentially of a political nature. Mosgorsud relies for part of its budget on the City of Moscow. The powerful president of this court, Olga Yegorova – appointed by President Putin – is highly influenced by both the executive and prosecutorial authorities.

Russian courts in their current constellation clearly remain subject to external influence. Judges exposed to such extrajudicial pressures are often forced to find means to decide a case in favour of the party applying the pressure. As a result, Russian courts are widely believed, inside and outside of Russia, to be far from impartial, particularly in cases where major political or financial interests are involved. The circumstances surrounding the campaign against Mr Khodorkovsky and Yukos are clearly consistent with these observations.

In the Khodorkovsky case, the abuses of the prerogative state were so egregious that Western leaders were challenged to revise their assumptions about the priorities of the Kremlin. The liberal wing of the Presidential Administration had been marginalised. By 2003, the *siloviki* had gained control of the administration in a system unprotected by checks and balances of state power. According to a prominent Western observer, “the unanimous judgment of Russian insiders is that the Kremlin has never been as pervasively corrupt as it is today.”⁸⁸

Indeed, in addition to marginalising reformers within the Kremlin and seizing control of the courts, the *siloviki* have moved aggressively to consolidate a “vertical of power” – antithetical to the separation of powers underlying normal market-based democracies. The *siloviki* have done away with regional elections, with governors now appointed by the Kremlin. They have bought up and control the last major bastions of the free press, turning most national media into propaganda outlets. They have also imposed stringent regulations on NGOs, leading many to curtail or shut down their operations. From the courts to the legislatures to the media and to civil society, no independent centres of power have been allowed to develop in any significant way.

⁸⁷ One of the judges of the Basmanny Court altered the documents of the Court's clerk to support the prosecution in its reaction to an important procedural argument raised by the defence; while the defence did not receive a reaction to a complaint lodged with the entire court of justice.

⁸⁸ A. Åslund, “Putin's Decline and America's Response”, Washington: Carnegie Endowment for International Peace, Policy Brief 41, August 2004 at p. 6.

With a firm grip on all levers of power, the Kremlin has developed a culture of impunity typical of a classic autocracy. Impunity and corruption are on display at the highest levels, giving a cue to the rest of the country to disrespect the law when doing so can be done without consequence. A viral and pervasive spread of corruption, and lack of faith in the law, both result from the vertical of power and the abuses it engenders.

A series of events in 2006 and 2007 have further blackened the Kremlin's reputation in matters of the rule of law. Through the betrayals of foreign energy majors with interests in Russia, and the bullying of trade partners, whether Ukraine, Belarus, Georgia, Poland or the European Union, the Kremlin has deeply undermined its reliability as a business partner. The prerogative state also showed its hand with the xenophobic and unconstitutional roundup and deportation of Georgian citizens, and the forced closure of Georgian-owned businesses using various regulatory pretexts. Meanwhile, the murders of Andrei Kozlov, Anna Politkovskaya and Alexander Litvinenko are all additional bellwethers of Russia's atmosphere of growing lawlessness.

INSTRUMENTALISATION OF THE LEGAL SYSTEM: THE DUAL STATE

Ernst Fraenkel was a German lawyer and political theorist who emigrated to the United States in 1939. In 1941 he published *The Dual State*, in which he described the coexistence of legalism with illiberal political regimes within autocratic states.⁸⁹ In referring to 1930s Germany, Fraenkel portrayed the political system as a combination of the “normative state”, defined as a rational state governed according to clearly elaborated legal norms, and the “prerogative state”, defined as a state which exercised power arbitrarily, unchecked by law. The entire legal system had become an instrument at the disposal of the political authorities, even though “insofar as the political authorities do not exercise their power, private and public life are regulated either by the traditionally prevailing or newly enacted law.”⁹⁰ The normative state was to be sustained as a precondition for the stability of capitalism, while the coexistence of the prerogative state preserved the capacity to eliminate or neutralise enemies and perceived threats. Fraenkel noted the growing friction throughout the 1930s between proponents of the normative state and proponents of increased authoritarianism.

Fraenkel’s analysis of the dual state also described how the prerogative state stifled public opinion. The insidious side of the dual state “thrives by veiling its true face”⁹¹ and as such public discussion must be reined in. Fraenkel referred to the records of judicial proceedings to demonstrate the creeping dominance of the prerogative state. His analysis showed that the courts were responsible for assuring the maintenance of “capitalist order”, even though the prerogative state occasionally exercised its ability to deal with specific cases in the interest of expediently achieving its aims. The prerogative state accepted that the courts were necessary to assure entrepreneurial liberty, the sanctity of contracts, private property rights and competition, but this did not mean that the courts or the law were inviolable. Indeed, according to Fraenkel, the abolition of the inviolability of law was the chief characteristic of the prerogative state.

Fraenkel’s theory of the dual state may be applied to the situation in Russia today.

The perniciousness of the dual state lies in its ability to mask the abuses of the prerogative state with the order and progress of the normative state. Until recently, outside observers of post-communist Russia may have been tempted to focus their attention on positive elements of reform, from the great advances made in building the normative state, to repeated official statements about democracy and the rule of law that belie the very existence of a prerogative

⁸⁹ E. Fraenkel, *The Dual State* (New York: Oxford University Press, 1941).

⁹⁰ *Ibid.*, at p. 57.

⁹¹ *Ibid.*, at p. xvi.

state. However, the Khodorkovsky case was a loud alarm bell, warning that a prerogative state does indeed exist in Russia. This prerogative state has the capacity to control events at will, while hiding its true face behind the legitimate institutions that have been built up in recent years. An examination of the Khodorkovsky case, and of the motives behind the case, exposes the extreme abuse of authority and disrespect towards law that has fundamentally undermined the progress Russia has made in recent years towards developing the rule of law.

Without reference to the theory, many commentators have discussed factional Kremlin infighting over economic policies and over key assets that have been expropriated. This Byzantine infighting, which many believe has had a dramatic influence on the Khodorkovsky case, burst into public view after the expropriation of Yukos assets and the reported infighting between bureaucrats who, while employed by the state, were also employed by Gazprom, and other bureaucrats who, while working for the state, were also employed by Rosneft. This architecture of Russian political and economic power explains the idiosyncratic nature of authoritarianism in Russia today. State policy is driven by the competing interests of individuals in power and the state-owned enterprises they work with.

The discussion of the dual state is completely appropriate given the state corporatism which has seen both Gazprom and Rosneft senior management and board of directors populated by members of the *siloviki* Kremlin faction. This mixture of political and commercial drivers has been reflected in the single-minded pursuit by the Kremlin of energy objectives through the agency of state bureaucratic and political activity. The use of environmental laws to achieve the capture of controlling interests in foreign-led energy interests in Sakhalin is but one example. The recent shut-offs of pipelines to Ukraine and Belarus, to extort energy infrastructure, with a mixture of political hardball and economic sweeteners through corrupt intermediary companies demonstrate the growing pathology of the dual state.

RUSSIA'S STATE-OWNED ENERGY ENTERPRISES AS TOOLS OF KREMLIN POWER

Events subsequent to the Khodorkovsky trial reveal that rather than being an isolated event, the affair was a pivotal moment in the unleashing of a strategic plan to crush internal dissent and to bring Russia's privatised energy sector back under state control. These objectives were achieved by corrupt elements in the executive through widespread abuses of their control over the levers of state power; through the improper use of Russia's courts and tax laws, they have not only crushed Mr Khodorkovsky and re-nationalised Yukos, but have also succeeded in building new empires of wealth for themselves. Meanwhile, locked away in jail, Mr Khodorkovsky is a political prisoner and energy hostage whose continued incarceration is a deliberate and cruel reminder to any Russian or international energy executives, or foreign governments, who may dare challenge the Kremlin's absolute control of Russia's energy resources.

The use of high-profile bureaucrats or prosecutors to instrumentalise tax, environmental and bankruptcy laws to achieve commercial aims of state-owned enterprises is now a widely-understood tactic. As supported by an OECD analysis, far from being a one-off, the tactics employed in the Yukos case have become systemic in nature.⁹²

The politically engineered anti-Khodorkovsky campaign makes clear that a new cast of wealthy and influential property owners has emerged in Russia – and they operate within President Putin's entourage. Following Russia's long tradition of state usurpation of private rights, the President's men have consolidated control over the energy industry, letting no domestic or international norms stand in their way. To achieve their objectives they have exploited their access to the state's institutions of authority and power. They are the face of the prerogative state in today's Russia.

Dmitri Medvedev has been chair of Gazprom's Board of Directors since 2002. From 2003 to 2005 he concurrently headed the Presidential Administration in the Kremlin, and since late 2005 he has concurrently served as First Deputy Prime Minister. With Mr Miller chairing Gazprom's Management Committee, the two most influential figures of the company exercise tremendous influence from within the Kremlin. As stated by *The Economist*, "many observers wonder whether Gazprom...is really a company at all. Often, it seems more like an arm of the state."⁹³ At Rosneft, Igor Sechin serves as chair of the Board of Directors, and he is also deputy head of

⁹² According to a November 2006 OECD report, the Russian state's increasing interventions into a broad range of the country's industries is a "disturbing" phenomenon that "bodes ill for Russia's growth prospects."

⁹³ "Russia's energetic enigma." *The Economist*. October 6, 2005.

the Presidential Administration. Mr Sechin leads the *siloviki* group within the Kremlin. These three powerful men have succeeded in reversing privatisations of the 1990s and chasing away the independent business leaders who wielded influence beyond Kremlin control.⁹⁴ They have also marginalised the liberal wing of the Presidential Administration. As stated above, in December 2005, respected presidential economic adviser Andrei Illarionov resigned in protest over Kremlin policy, saying that there was “no free economic space remaining anywhere in Russia”⁹⁵ In January 2006, Mr Illarionov stated that Russia “has become a corporate state, in which the state concerns itself primarily with looking out for the interests of its own inner circles and discriminates against outsiders.”⁹⁶

For these “new oligarchs”, proximity to political power has been a precondition for their ascendancy. Their objectives cannot be achieved on a level playing field, and as a result they exploit their control over institutions of state authority and power, from the Procuracy-General to the tax police to the judiciary, and over the mass media. The power they wield is a source of considerable risk for the outside world. Today Russia is the largest exporter of natural gas in the world. Since mid-2006 Russia has surpassed Saudi Arabia as the largest exporter of oil in the world. As stated by one observer, major economies that are “increasingly dependent on Russian gas and oil exports...are rendering themselves vulnerable to the ambitions of an autocratic, imperial state that has not refrained from using energy as a geopolitical weapon and has been ruthless in its treatment of both internal political opponents and neighbouring states.”⁹⁷ Indeed, “fuel diplomacy” has become the primary lever exercising Russian influence on the geopolitical stage.

This influence can be readily seen in Gazprom’s appointment of former German chancellor Gerhard Schroeder as chair of the supervisory board of the \$4.7 billion Nord Stream pipeline. The pipeline deal, signed ten days before the German elections, provides for the transport of gas via a sea route under the Baltic Sea directly from Russia to Germany, by 2010. Other West European countries will eventually feed from the German supply route. Russia could then cut off gas to Ukraine, Central Europe and the Baltic states without directly affecting European supplies.⁹⁸ Unsurprisingly, it was Mr Schroeder who, for seven years, consistently ignored the gradual rollback of political rights in Russia, and derailed attempts to bring unified Western

⁹⁴ See Daniel Twining, “Putin’s Power Politics” 11:17 The Weekly Standard (2006).

⁹⁵ As cited by Radio Free Europe/Radio Liberty. Earlier in 2005, Mr Illarionov was demoted from his post as presidential representative to the G8, after speaking out against the state’s actions in the Yukos Affair.

⁹⁶ Stated in Kommersant-Daily, as cited by Radio Free Europe/Radio Liberty.

⁹⁷ Daniel Twining, “Putin’s Power Politics” 11:17 The Weekly Standard (2006).

⁹⁸ See “Gerhard Schroeder’s Sellout”, The Washington Post, December 13, 2005.

pressure to bear on Moscow to modify its conduct.⁹⁹ Rather, Mr Schroeder focused only on deepening Germany's commercial and political ties with Russia. Mr Schroeder's complete absence of criticism of the regressions of the Russian regime demonstrates the extent to which he was skilfully co-opted by the Kremlin. Meanwhile, the opportunism of Mr Schroeder has only buttressed the intransigence of the Kremlin in its deflection of foreign concerns and criticisms.

Although less successfully so than Germany under Mr Schroeder, other Western governments are also compelled to embrace Russia for its newfound influence in world energy markets. The subdued reaction of Western governments to the Yukos Affair can be explained in part by fears of crossing the Kremlin, whether in relation to a pipeline project, liquefied natural gas imports or other energy-based concerns. This "business-as-usual" policy legitimises the normative state, and belies the existence of the prerogative state, thereby supporting the perpetrators of the Yukos Affair.

Take for example the July 2006 announcement that, despite longstanding engagements to the contrary, Gazprom had made the audacious decision to shut out all foreign energy majors that had previously been short-listed as potential partners in the multi-billion-dollar development of the Shtokman gas field. Gazprom's move, nonsensical from a business standpoint, was clear proof of the Kremlin's readiness to politicise energy. The Shtokman developments demonstrate the unacceptably high risk of assuming that, in dealing with the Russian state, business sense will prevail over political whim and design.

The Kremlin's geopolitical impudence was also on display with the cut-off of gas to Ukraine in January 2006 and the cut-off of oil to Belarus in January 2007. Both incidents signalled the Kremlin's readiness to engage in energy brinksmanship to achieve not only commercial but also political ends.

As a new energy superpower, the Kremlin has become accustomed to enjoying and abusing the advantages of asymmetrical relations, whether with domestic or foreign energy companies.¹⁰⁰

⁹⁹ Ibid.

¹⁰⁰ A Wall Street Journal editorial stated the following about an imminent Kremlin attack on the French oil company Total: "Remember that foreign firms and investors showed comparatively little concern about the shortcomings in Russian rule of law back when only oligarchs like Yukos founder Mikhail Khodorkovsky were seeing their wealth confiscated. Russia's foreign investors were never the ideal lobbyists for private-property protections and other democratic and free-market institutions, given the way they'd profited from the country's Wild East economy. Now they know a little better how...Khodorkovsky felt." Regarding accusations of Total's infliction of ecological harm at its Kharyaga oil field, the Wall Street Journal states: "Unlike when Royal Dutch Shell saw its Sakhalin-2 deal scuppered...Moscow didn't bother with an actual environmental agency to make the accusations."

Facing the brinkmanship of a Kremlin fuelled with the confidence of petrodollars, foreign political and business leaders have lacked a strategic response. Now they must more forcefully advocate a principled commitment to the rule of law in Russia, making clear the costs and consequences of the whimsical attitude towards law that has become the norm of the current regime.

It is the non-market-oriented state corporatism of today's Kremlin that necessitated the incarceration of Mr Khodorkovsky and the expropriation of Yukos. By jailing Mr Khodorkovsky and expropriating Yukos, the Kremlin cleared the energy sector of any competitors. No one will now build competing pipelines; no one will advocate the break-up of Gazprom; no one will promote the corporate governance and transparency that are anathemas to the state-owned enterprises. The costs of these Kremlin actions are becoming increasingly evident, from mismanagement of state resources and declines in the growth of energy production, to the risks of reliance on an energy supplier whose political stability depends upon one corrupt clan maintaining its grip on power.

Instead, word came...from Sergei Stepashin, head of the federal Audit Chamber...Stepashin wasted little time in identifying the Kremlin's real beef with Total: that the company's missed deadlines and production shortages have 'cut into [government] revenues.' Throw in that Kharyaga is the rare energy project left in Russia not controlled by a Russian company, and Total was obviously a sitting duck." "A Total Mess", The Wall Street Journal, January 25, 2007.

EXPORTING INJUSTICE – THE KREMLIN’S ATTEMPTS TO EXPLOIT FOREIGN COURTS

During and after the trial against Mr Khodorkovsky, Russia submitted requests to several countries for legal assistance related to the prosecution.

Dutch authorities were requested in 2004 and 2005 to transfer financial and administrative documents regarding several Dutch companies and the interview notes of the management of those companies, to be obtained pursuant to various searches and seizures.

In addition, the Russian authorities requested that Great Britain extradite three of Mr Khodorkovsky’s co-accused. This request was refused by His Lordship Senior District Judge Timothy Workman of the Bow Street Magistrates’ Court in London, who held that the trials that would await these co-accused would be politically motivated in the same way the proceedings against Mr Khodorkovsky had been.¹⁰¹

This judgment was rendered in the extradition case against two co-accused associates of Mr Khodorkovsky, Dmitry Maruev and Natalya Chernysheva. Judge Workman observed that “Mr Khodorkovsky was seen as a powerful political opponent of Mr Putin”, “it is more likely than not that the prosecution of Mr Khodorkovsky is politically motivated,”¹⁰² and, ultimately, “[I]n respect of this particular case I am satisfied that it is so politically motivated that there is a substantial risk that the judges of the Moscow City Court would succumb to political interference in a way which would call into question their independence.”¹⁰³ Furthermore, the judgment considered that “a fair trial of these two defendants is likely to be prejudiced by their political opinions and the opinions of those associated with them.” These observations were reinforced in the ruling of 23 December 2005 in the case *Russian Federation v. Temerko*, also heard before the Bow Street Magistrates’ Court.¹⁰⁴ The British judge again refused to comply with a Russian extradition request, this time regarding Mr Alexander Temerko, since the

¹⁰¹ Bow Street Magistrates’ Court, *Government of the Russian Federation v. Dmitry Maruev and Natalya Chernysheva*, Senior District Judge Timothy Workman, 18 March 2005. Bow Street Magistrates’ Court, *Russian Federation v. Temerko*, Senior District Judge Timothy Workman, 23 December 2005.

¹⁰² Bow Street Magistrates’ Court, *Russian Federation v. Dmitry Maruev and Natalya Chernysheva*, Senior District Judge Timothy Workman, 18 March 2005.

¹⁰³ Bow Street Magistrates’ Court, *Russian Federation v. Dmitry Maruev and Natalya Chernysheva*, Senior District Judge Timothy Workman, 18 March 2005 (unreported, at p. 5 of the transcript), see also: International Bar Association, “Striving for Judicial Independence: A Report into Proposed Changes to the Judiciary in Russia,” June 2005, p. 37.

¹⁰⁴ Bow Street Magistrates’ Court, *Russian Federation v. Temerko*, Senior District Judge Timothy Workman, 23 December 2005.

motivation for the criminal proceedings against him, the second in command under Mr Khodorkovsky, was deemed political.

In August 2006, Russia announced the opening of a criminal investigation of former Yukos president Steven Theede, financial director Bruce Misamore and corporate counsel David Godfrey, as well as Tim Osborne, a director of GML, the majority shareholder of Yukos. The Procurator-General's office announced that "the above-mentioned individuals illegally appropriated assets" and "embezzled and laundered property" causing "serious damage" to Yukos. These assertions of criminal conduct, absolutely lacking merit and made with complete disregard for the presumption of innocence, were the first open salvo in the Kremlin's renewed campaign to tarnish anyone close to the top of Yukos. Based on the little reliable information available concerning this investigation, the actions being characterised as criminal relate solely to legal actions taken in courts in New York, Amsterdam and Moscow, in opposition to the initiation of involuntary bankruptcy proceedings against Yukos. According to current British court practice, however, there is little chance that any of these foreign executives will ever be extradited to Russia for interrogations. Lack of co-operation from foreign courts is the natural consequence of the flagrant manner in which Russian courts have flaunted fundamental norms of law and procedure in recent years, particularly in the politically charged Yukos Affair.

Indeed, justice officials in other countries should not presume that the Russian legal system resembles their own, in terms of adherence to the fundamental legal norms of democratic constitutional states. When the long arm of Russian justice extends abroad with extradition requests or requests for judicial co-operation, other countries should examine the requests carefully, and be prepared to respond with a firm and principled rebuke.

A January 2007 report of the Parliamentary Assembly of the Council of Europe, on fair trial issues in criminal cases in the Russian Federation, echoes this caution. The report urges all member states of the Council of Europe to refrain from prosecuting any scientists, journalists and lawyers who engage in generally accepted professional practices and to rehabilitate those already sanctioned.¹⁰⁵

¹⁰⁵ The report is mainly concerned with a series of high profile espionage cases against scientists, journalists and lawyers in Russia resulting in harsh prison terms, and having had "a chilling effect on these professional groups". The report states that such cases constitute obstacles to the healthy development of civil society in Russia. The conclusions of the Council of Europe are equally applicable to state-led campaigns in the economic sphere, such as the campaign against Mr Khodorkovsky and Yukos. "Fair trial issues in criminal cases concerning espionage or divulging state secrets" (Doc. 11031) September 25, 2006, Committee on Legal Affairs and Human Rights, Parliamentary Assembly of the Council of Europe.

These new charges carry with them the urgent need by the Kremlin to gain traction in foreign courts through the use of such exaggerated claims of money laundering that they can somehow cling to the Enron analogy, which has been the cornerstone of the disinformation campaign in the latest phase of the attack on Yukos.

Following the uproar in late 2006 and early 2007 over the fatal poisoning in London of former KGB officer Alexander Litvinenko, a British citizen, the Kremlin once again demonstrated its propensity to politicise legal proceedings. The Kremlin made and is continuing to make numerous attempts to deflect British investigators, and media attention, from what seem to be the most promising leads in the investigation. Stalling tactics by Russian officials, accompanied by unhelpful assertions related to issues of sovereignty, have frustrated British investigators and only raised suspicions about suspects connected to the Russian security services. The Russian authorities have also exploited international attention surrounding the Litvinenko case to make public claims regarding the possible involvement of exiled figures being vigorously pursued by the Kremlin as part of its ongoing campaign against these former leaders of Russian industry. Such far-fetched allegations, and the public manner in which they have been made, only further undermine the Russian authorities' expectation of genuine reciprocity in matters of international co-operation.

9. CHALLENGES FOR THE INTERNATIONAL COMMUNITY

According to Lilia Shevtsova of the Carnegie Moscow Centre, “The model in which Russia imitates democracy and the West responds by imitating partnership has died out.” Yet many international political and business leaders have continued with their uncoordinated free-for-all in Russia, muting their criticisms of the Kremlin’s increasing authoritarianism while simultaneously scrambling for access to Russian energy supplies. Meanwhile, the entire world is witnessing dramatic developments in Russia, from the politically-motivated execution of Anna Politkovskaya, to the xenophobic roundup and deportation of Georgian citizens, to the strong-arming of foreign firms in the Sakhalin oil and gas development.

In the past few years, many countries have consistently ignored or downplayed Russia’s drastic retreat from commitments to a competitive market economy, democracy and the rule of law. Perhaps unwittingly, the general policy of “business-as-usual” with the Russians has made these countries complicit in entrenching the corrupt figures that have consolidated their power in the Kremlin.

Despite Russia’s status as a signatory to the European Convention of Human Rights and member of the Council of Europe, a charter member of the Organisation for Security and Co-operation in Europe, a member of the G8, and a prospective member of the World Trade Organisation, the flagrant manner in which the campaign against Mr Khodorkovsky and Yukos was, and continues to be, carried out suggests that those in power believe that their unlawful conduct is without consequence.

Unless that belief is challenged and Mr Khodorkovsky’s case becomes of specific concern to foreign governments and institutions, Russia’s ruling elite will be emboldened to go even further in consolidating their control over the government and using Russia’s energy reserves politically, threatening competitive markets and undermining the energy security of Western Europe, Japan, China and the United States.

The weak responses to Russia’s backsliding have been a shocking surrender to sinister forces within the Russian leadership, and an overt signal to them that their belligerent authoritarianism will be tolerated – in exchange for preferential treatment in energy relations. This is a dangerous signal to send to a regime that has taken to wielding power with recurring disregard for both Russian law and international law.

Russia's international peers must not ignore their own core values, and must lay these values down as the baseline for the development of relations with the Russian leadership.

Recent developments should have been taken as warnings about the true nature of those who have come to power in Russia. Yet too many foreign business and political leaders have chosen instead to deny, dismiss or discount the gravity of what has been occurring. Russia is an important business partner, and therefore, so goes the argument, a strong Kremlin is good for stable business relations.

This argument is short-sighted and flawed. Undoubtedly it is important to secure stable market conditions for foreign companies active in the Russian economy. It is also important to secure long-term energy supplies from Russia. However, doing so through a mix of opportunism and cowardice is not the right approach in the long term, and it has already begun to backfire. The time for self-interested opportunism has passed.

Engaging Russia is critical for all of the benefits that a healthy, stable Russian economy will entail for the rest of the world. However this engagement must be within a constructive framework, built upon real respect for fundamental principles of market economics, the rule of law and democratic processes.

Foreign media have been more outspoken in their criticisms than foreign political leaders. The *Wall Street Journal* has urged the adoption of a tough and consistent policy towards Russia, stating that “[a]n authoritarian Russia, the Kremlin must be told, has no place in the Western world. Forget about membership in the G8, a club of industrialised democracy (today Russia is neither) or close military or economic contacts.” The newspaper further stated that Western interests “go beyond ensuring a steady supply of oil or the illusion of stability. Those interests include a Russia that is building the foundations of democracy to become a peaceful and reliable partner of Europe and the U.S. Right now, Russia is heading in the opposite direction.”

Notably, European political institutions, particularly the European Commission and the European Parliament, have been the least hesitant to express concern over the arrest of Mr Khodorkovsky and the seizure of Yukos assets. Both at European Union-Russia summit meetings and in the context of the Permanent Council of the European Union-Russia Partnership dialogues, the European Commission has repeatedly underlined the need for Russia to guarantee a non-discriminatory and proportionate application of the rule of law. The Commission has sought commitments and reassurances from the Russian leadership with regard

to these principles, and has shown a keen interest in the outcome of the legal proceedings instituted by Mr Khodorkovsky at the European Court of Human Rights.

For the most part, however, Russia's peers in the international community have shied away from anything more than tepid expressions of concern over the Khodorkovsky case. Yet the Russian authorities' campaign against Mr Khodorkovsky and Yukos cannot be regarded as a purely internal Russian matter. The campaign has played out in the context of deepening authoritarianism in Russia. The Russian political system is mutating rapidly, with serious implications for the rule of law in Russia, jeopardising the protection of human rights and legal guarantees of private property, including foreign investments.

The expanding catalogue of selective prosecutions and destruction of property rights carried out in Russia in broad daylight brings the sanctity of justice into disrepute – not only within Russia but within the international organisations of which Russia is or seeks to become a member.

The place of Russia in frameworks of partnership with the rest of the world, in a shared marketplace and a shared space of justice and human rights, demands the attention of all concerned whenever and wherever fundamental principles are under attack. The flagrant abuses of the current regime in Moscow suggest that those in power believe that their conduct is without consequence. This is what “business-as-usual” with the outside world has taught them.

To counter this perception, foreign governments and institutions should declare that Mr Khodorkovsky merits being freed on the basis of what was obviously a mistrial. Such declarations should be made not only because Mr Khodorkovsky is clearly the victim of political persecution and injustice but also because, just as the Kremlin has used him as a caution and warning to other opponents of the regime, foreign governments and institutions must view him as a symbol: Mr Khodorkovsky represents what needs to change in Russia if it is to be seen as a genuine member of the group of friendly, market-oriented nations bound by shared values and adherence to the rule of law.

A new relationship with Russia must be built upon solid foundations to ensure growth, prosperity and security for the future, both in Russia and the rest of the world. If not, the international community may soon face troubles on an even more serious scale, with a wealthy and hubristic post-Putin regime that is even less committed to prolonging any appearances of democracy and a market economy.

10. CONCLUSIONS

In the Khodorkovsky case, the magnitude and scope of the abuses of state authority exceed any rationally defensible prerogative. This is not a case about one man or one company. The imprisonment of Mr Khodorkovsky was a stern message to the Russian people: do not dare. Do not dare to take your paper freedoms seriously, to stand up for principles, to speak your mind, to challenge, to rise up. If you dare, you will be crushed. You must live in perpetual fear that the whip will be cracked. The state will stop at nothing to tame critics and consolidate control over the country's natural wealth.

Events subsequent to the Khodorkovsky verdict of 2005 indicate that the power to prosecute has become the instrument of choice in the Kremlin's means of achieving its desired political and commercial outcomes. The Kremlin wields great influence through the constant threat of heavy-handed intimidation and unfair incarceration and expropriation. Multiple grievous violations of the Constitution of the Russian Federation have accumulated in recent years, making a mockery of its primacy in the Russian legal system. Numerous other Russian laws have also been disobeyed at will, as have obligations under international treaties and conventions.

Paradoxically, the law, which has been so blatantly disrespected by the Russian Procuracy-General both in procedure and in substance, continues to serve as a pretext where convenient for the exercise of intimidation or control by the state. The instrumentalisation of law that was so openly on display in the expropriation of Yukos has now been replicated elsewhere, such as the Sakhalin shakedown, with seemingly less and less concern for a pretence or semblance of credibility. Extortion has been entrenched as a method of acquisition by the state. An increasingly hubristic Kremlin has calculated that it has space for manoeuvre in disregarding legal and moral obligations where convenient – whether with respect to treaty obligations, or business ventures such as the Shtokman development, or commitments to send gas and oil through pipelines without political interference.

The Kremlin exploits legal mechanisms not only domestically, but is increasingly seeking to do so internationally as well. Moscow is eager to settle scores with certain high-profile exiled business leaders who have vexed the Kremlin for not bending to its wishes, and who continue to frustrate the Kremlin through their attempts to influence events in Russia from abroad. These business leaders fled Russia because they fear not only for their livelihoods, but also for their lives. Among the prime targets are former Yukos employees – both Russian and American citizens and Yukos shareholders.

Their record shows that Russia's prosecutors no longer deserve to be trusted in these matters. Co-operation with Russia's prosecutors would be well-founded if the Russians had an independent, properly functioning prosecutorial system. To comply with requests from Russia's prosecutorial system demands that it meet a minimum level of modernity, justice and legal rigour. All are sorely lacking.

The Khodorkovsky case is about the criminalisation of domestic political opposition and economic competition. The next chapter in this tale seems set to be about money laundering. The Kremlin appears to have decided upon money laundering as the means of keeping Mr Khodorkovsky out of Russian society – despite the fact that the predicate for doing so is entirely false. What is likely however is that the Kremlin will once again cast a large net, bringing in anyone they wish, whether or not they are in fact connected to the financial transactions under review. Mr Khodorkovsky will loom in this process as a living symbol and a frightening precedent of what the authorities are capable of – summarily deciding whom to put in jail and what property to seize.

Worldwide esteem for the Russian leadership is at an all-time low. Today's Kremlin has not hesitated to abuse the grammar of international political or business relations. There is a heavy onus on the Kremlin to earn back its legitimacy and to promote the true rule of law in Russia and respect for international obligations. Otherwise today's Russian leaders may well be responsible for a tailspin into anarchy.

In his statement to the authorities investigating new charges at the end of 2006, Mr Khodorkovsky stated: "In the first days of my arrest I said that I want to achieve justice specifically in Russia. I do not doubt that such a time will come, and the untenability of all the charges made against me – both old and new – will be established. Unfortunately, this will not be as soon as I would like."