G. ESSENCE OF THE ACCUSATIONS AGAINST THE APPLICANTS

Question 32. Was the applicants' conviction for embezzlement and money laundering[1] based on a novel, extensive and/or retrospective interpretation of the Criminal Code, and thus in breach of Article 7 of the Convention?

SUMMARY OF THE GOVERNMENT'S RESPONSE

G1. The Government assert that "*the Court adheres to a restricted interpretation in the assessment of compliance with Article 7 of the Convention*" (paragraph 240 of the Memorandum). The Government state "*the Government believe that the conviction of the applicants was not based on any interpretation of the criminal law, which would contradict Article 7 of the Convention*" (paragraph 243 of the Memorandum). Despite that assertion, they say that "*the "second" criminal case against the applicants, in terms of its scale and complexity, had no comparable counterparts among other cases of economic crimes*" (paragraph 241 of the Memorandum).

G2. The Government do not provide any explanation as to why the case was said to be so "*complex*". The omission by the Government of any explanation is deliberate. In fact the case was straightforward and the legal principles to be applied to it were well established (see further below).

G3. The Government also assert that "*the majority*" of the Court's questions in Section G "*concerning the substance of the charges against the applicants cannot be the subject of consideration by the Court*" (paragraph 321 of the Memorandum).

G4. The Government refer to the Plenum of the Supreme Court RF Resolution of 18 November 2004 no. 23 *On Judicial Practice in Cases of Illegal Business Activities and Legalisation (Laundering) of Money or Other Property Acquired by Criminal Means*[2] and Resolution of 27 December 2007 no. 51 *On Judicial Practice in Cases of Fraud, Misappropriation and Embezzlement.*[3]

[1] The applicants were in fact convicted of theft by way of misappropriation of oil and legalisation. It is incorrect therefore to speak of convictions for embezzlement and money laundering. See further the applicants' discussion of the applicable domestic below at paragraphs G20 to G26.

[2] Resolution of 18 November 2004 no. 23 "On Judicial Practice in Cases of Illegal Business Activities and Legalisation (Laundering) of Money or Other Property Acquired by Criminal Means" at tab 55 to this Reply.

[3] Resolution of 27 December 2007 no. 51 "On Judicial Practice in Cases of Fraud, Misappropriation and Embezzlement" at tab 78 to this Reply

Properly understood and applied however, both these decisions, as well as a number of other important and binding judgments directly relevant to the case against the applicants (all of which the authorities were well aware of from the outset and which were intentionally ignored and violated) support the applicants' central submission that their convictions were consciously entirely without substance, that they were entirely inconsistent with the domestic law and that consequently they were entirely unforeseeable and contrary to Article 7 of the Convention.

G5. The Government also refer to international conventions in relation to legalisation (laundering): references which are at best of marginal relevance since the Government themselves later acknowledge that criminal prosecutions are only possible on the basis of the RF Criminal Code (see paragraph 241 of the Memorandum). Article 8 of the RF Criminal Code states "*the basis of criminal liability shall consist of committing a deed which satisfies all the elements of the corpus delicti for an offence stipulated by this Code*."

APPLICANTS' REPLY TO THE COURT'S QUESTIONS

(a) Introduction

G6. There can be no doubt that the applicants were indeed convicted of theft (in the form of misappropriation) of oil and of legalisation as a consequence of a novel, arbitrary and unlawful interpretation of the Russian Criminal Code in breach of Article 7 of the Convention. Indeed, as discussed in detail below, there was no proper legal interpretation and application of the rules of the criminal law (and indeed of civil and financial law[4]) in the applicants' case. In other words, the authorities simply falsified the charges and the verdict, including in the verdict findings that were mutually exclusive and absurd.

G7. Intentionally, and with the aim of enabling themselves unlawfully to convict and sentence the applicants, the Russian authorities severely and extensively violated fundamental principles of legal certainty and of the rule of law. The authorities disregarded binding judicial decisions as well as judgments that had the force of *res judicata*. When the authorities subjected the applicants to a criminal prosecution

[4] The inter-connection between criminal and civil law is discussed further below, for example in relation to the applicants' answers to Question 34.

which they knew to be unlawful, they deliberately ignored or violated a vast number of judicial decisions of which they were well aware from the outset, which were in force at the time of the verdict, and which were directly relevant to the substance of the case brought against the applicants. In the Government's response to the Court's Questions, the Government continues to remain silent regarding such important judicial decisions which had been ignored or violated in the applicants' cases. To remain deliberately silent on such important matters is a clear demonstration of the authorities' underlying bad faith in relation to the prosecution of the applicants. The extent of the violation set out above and below was such that the verdict in respect of the applicants contained interpretations of legal norms and principles that undoubtedly breached the fundamental principles of legal certainty and the rule of law. The interpretations were in direct contradiction to well-established legal norms and practices of their interpretation and application that had hitherto been consistently applied by the courts. It is for that reason that this is a unique case, not because of its alleged complexity or volume.

G8. Those were the conclusions unanimously arrived at by the Presidential Council of the Russian Federation for Civil Society and Human Rights ("the Presidential Council") based on opinions by independent experts prepared at its request (see further below). That was also the conclusion of the Arbitral Tribunal in the ECT Decision in the Award made in favour of the shareholders of Yukos against Russia.[5] The Arbitral Tribunal commented critically of the "*creative legal theory*" underpinning the "second" case against the applicants:

> "… Yukos was subjected to processes of law, but the Tribunal does not accept that the effective expropriation of Yukos was "carried out under due process of law"... The harsh treatment accorded to Messrs. Khodorkovsky and Lebedev remotely jailed and caged in court, the mistreatment of counsel of Yukos and the difficulties counsel encountered in reading the record and conferring with Messrs. Khodorkovsky and Lebedev, the very pace of the legal proceedings, do not comport with the due process of law. Rather the Russian court proceedings, and most egregiously, the second trial and second sentencing of Messrs. Khodorkovsky and Lebedev on the creative legal theory of their theft of Yukos' oil production, indicate that Russian courts bent to the will of Russian executive authorities to bankrupt Yukos, assign its assets to a State controlled company, and incarcerate a man who gave signs of becoming a political competitor."[6]

[5] There were three separate Awards made on 18 July 2014 for identical reasons: *Hulley Enterprises Ltd v. Russian Federation,* 18 July 2014; *Yukos Universal Limited v Russian Federation* 18 July 2014; and *Veterans Petroleum Ltd v. Russian Federation* 18 July 2014. See tabs 159 - 161 to this Reply.
[6] § 1583 of the ECT Decision. A copy is at tab 159 to this Reply.

G9. The Tribunal accepted the "*central submission*" of the Claimants "*that the Russian authorities were conducting a "ruthless campaign to destroy Yukos, appropriate its assets and eliminate Mr. Khodorkovsky as a political opponent.*""[7]

G10. It is to be noted that a different Arbitral Tribunal appointed by the Stockholm Chamber of Commerce was similarly critical of the circumstances of the first and second case, rejecting the prosecution's contentions that the transactions between Yukos, the producing entities and the trading companies were "*sham*" or "*fictitious*" (see further below at paragraphs G84 to G86).

G11. Equally it is to be noted that the Amsterdam District Court, in its decision (which has entered into legal force) dated 31 October 2007, directly pointed (at paragraphs 3.8, 3.9) to the lack of justice in the Yukos case and deemed impossible the acknowledgment of the decision on its bankruptcy in the Netherlands on the grounds of it going against public law and order.[8] The District Court found that there had been "*a violation of the fundamental principles of due process of law."*

G12. The individual expert reports presented to the Presidential Council prompted the Presidential Council to recommend "*urgent measures of an individual and general character*" to the President. *Inter alia,* the Presidential Council made a series of recommendations directly relevant to this Question from the Court:

> "With the objective of eliminating conditions conducive to the wrongful practice of criminal prosecution of business, the RF Criminal Code ought to be supplemented by instructions prescribing, in particular, that:
>
> - a broad interpretation of the criminal law shall be impermissible (with the exception of norms improving the position of the accused), inasmuch as anything else signifies a violation of the constitutional prohibition on holding persons criminally liable for acts not provided for by the law;
>
> - the actions of persons exercising the rights and obligations of a commercial and other organisation on its behalf as prescribed by legislation or incorporation documents cannot be recognised as a criminal act in and of themselves;
>
> - the organisational structures of legal entities prescribed by legislation or the

[7] § 811 of the ECT Decision.
[8] *Godfrey, Misamore & Yukos Finance B.V. v. Rebgun, Hogerbrugge & Shmelkov* (case no. 355622/HA ZA 06-3612), 31 October 2007, a copy of which is at tab 77 to this Reply.

corresponding incorporation documents cannot be regarded as an organised criminal group (or other form of complicity);

- the receiving of income in the absence of harm caused as the result of this activity, or the non-receiving of income or profit (foregone benefit) cannot be regarded as circumstances entailing criminal liability for entrepreneurial activity;

- no one can be criminally prosecuted in connection with his or her not being in a position to fulfil a contractual obligation, while a transaction in the sphere of private legal relations cannot be regarded as a criminally punishable act."

G13. It is a fundamental principle of criminal law that there is no crime without a law, and the law must be sufficiently precise at the time of the implementation of the act to the extent of describing all the requisite aspects of the act that is subsequently complained of. The simple fact in the instant cases is that the applicants' conduct was not criminal either at the time when the events took place, or when the applicants were charged with commission of crimes. Nor would such conduct be criminal now. The applicants never stole any volumes of oil as alleged by the prosecution, the court and the Government, nor did they legalise any "stolen property" or proceeds of that alleged "theft" subsequently. The trial court, endorsed by the cassational court and subsequently by the supervisory courts, has retrospectively characterised the applicants' entire business conduct as criminal. The domestic courts' findings were contrary to the applicable substantive law as well as the previous binding judgments of the superior courts on applicable legal principles and norms. Moreover, at the times the charges were brought against the applicants in the second case (let alone before the verdict was issued) there were final judicial decisions directly relevant and had they been correctly applied the applicants could not have been charged or convicted. The trial court's judgment, and the subsequent endorsement of the judgment[9] in subsequent challenges, were "*arbitrary*", "*manifestly unreasonable*"[10] and issued in "*flagrant denial of justice.*"[11]

[9] Subject to minor changes
[10] See *Ravnsborg v. Sweden*, 23 March 1994, § 33, Series A no. 283-B; *Bulut v. Austria*, 22 February 1996, § 29, *Reports of Judgments and Decisions* 1996-II; and *Tejedor García v. Spain*, 16 December 1997, § 31, *Reports of Judgments and Decisions* 1997-VIII, discussed further below.
[11] See *Stoichkov v. Bulgaria*, no. 9808/02, § 54, 24 March 2005.

(b) The Convention

G14. Article 7 of the Convention provides:

> "1. No one shall be held guilty of any criminal offence on account of any act or omission which did not constitute a criminal offence under national or international law at the time when it was committed. Nor shall a heavier penalty be imposed than the one that was applicable at the time the criminal offence was committed."

G15. The object and purpose of the guarantee in Article 7, "*which is an essential element of the rule of law*", is "*to provide effective safeguards against arbitrary prosecution, conviction and punishment*" (see *Streletz, Kessler and Krenz v. Germany* [GC], nos. 34044/96, 35532/97 and 44801/98, § 50, ECHR 2001-II). In this way it occupies a primary place in the Convention system of protection, as is underlined by the fact that no derogation from it is permissible under Article 15 in time of war or other public emergency. It embodies two separate principles each of which are essential elements of the rule of law: first, a criminal conviction can only be based on a norm which existed at the time of the incriminating act or omission (*nullum crimen sine lege*); and, secondly, that no heavier penalty may be imposed than one that was applicable at the time the offence was committed (*nulla poena sine lege*).

G16. If Article 7 is to provide an effective safeguard against arbitrary prosecution, conviction and punishment then it is essential for the purposes of the Convention that an offence is clearly defined in law: see *Veeber v. Estonia (no. 2),* no. 45771/99*,* 21 January 2003. An accused must know what acts (whether actions or omissions) will make him liable for a criminal penalty, either under statute or, in certain legal traditions, by reason of judge made law. Russian law mandates that all charges are brought solely in accordance with a specific norm of the RF Criminal Code – see Article 8 cited above. Further, the construction of the law must operate so as to conform with the principle of reasonable certainty, such that "*constituent elements of an offence such as, for example, the particular form of culpability required for its completion may not be <u>essentially</u> changed, at least not to the detriment of the accused, by the case law of the courts*" (*X Ltd and Y v. UK,* no. 8710/79, 7 May 1982, (1982) 28 DR 77 at paragraph 9, emphasis added).

G17. Where the courts adopt a new interpretation of the criminal law, this Court has held that Article 7 of the Convention permits the gradual clarification of the rules of criminal liability through judicial interpretation from case to case, but only "*provided that the resultant development is consistent with the essence of the offence and could reasonably be foreseen*" (emphasis added): see *S.W. v. United Kingdom* and C.*R. v. United Kingdom*, 22 November 1995, §§ 34 and 36 respectively[12]; see also *Liivik v. Estonia*, 25 June 2009, no. 12157/05, § 94.

G18. In *Khodorkovskiy (no.2)* the Court noted that "*the absence of previous identical cases in the domestic judicial practice does not mean that a criminal conviction is contrary to Article 7; it is conceivable that the national jurisdictions have not yet had a chance to be confronted with such situations*"[13], citing *Soros v. France*, no. 50425/06, §§ 57-58, 6 October 2011. In fact in *Soros* the issue was whether there were appellate decisions that were sufficient to meet the requirement of "*foreseeability*". In any event in the instant cases there were not even any first instance decisions that could be relied upon to meet that requirement.

G19. For the reasons set out below, the applicants submit:

(a) Their convictions were arbitrary and the product of a flagrant non-observance of the applicable domestic law. The Government's assertions that the Court is not entitled to ask the "*majority of the questions*" it has asked relating to the "*substance of the charges*" is misconceived and inconsistent with the established case law of the Convention, both in relation to Article 7 and the so-called fourth instance principle. The Court is entitled to review domestic judgments and to make its own findings of fact in instances where it is satisfied that the domestic judgment was arbitrary and/or the product of a flagrant non-observance of the applicable domestic law or otherwise a flagrant denial of justice. The reason why the Government assert that the

[12] In *S.W. v. the United Kingdom* the Court was confronted with criminalisation of "marital rape" by means of judicial interpretation of a very ancient legal norm, which appeared to exclude criminal liability for such act. The Court did not find a violation of Article 7 in that case referring to the fact that the old distinction between "*lawful*" and "*unlawful*" involuntary sexual intercourse was clearly obsolete, that the new interpretation continued "*a perceptible line of case-law development*" and that "*the essentially debasing character of rape*" was so manifest that the judicial recognition of such behaviour as criminal was not "*at variance with the object and purpose of Article 7 of the Convention*" (see §§ 42-44).

[13] § 785 of the judgment.

Court is not entitled to ask the "*majority of the questions*" in relation to Article 7 is that it wishes to conceal from this Court the true reasons for the prosecution thereby abusing the presumption that states act in good faith;

(b) The essential constituents of the offence – theft by way of misappropriation and legalisation of stolen property – are well established in Russian criminal law and there is clear guidance on them in the binding legal positions of superior courts. In addition there was a substantial body of final judicial decisions of overarching general applicability, which were directly relevant to the cases against the applicants, which were ignored or violated. Consequently it cannot conceivably be argued that the trial court (and subsequent cassational and reviewing courts) were facing "*a new situation in which it had to take a stand for the first time*"; and

(c) The Court has already considered the substance of these transactions in its judgments in *OAO Neftyanaya Kompaniya Yukos v. Russia*, no 14902/04 (merits), 20 September 2011, and recognised that what took place was the sale of oil by the oil producing entities, meaning that it had not been stolen. Moreover, in those proceedings, the Government had expressly asserted in response to the Court's questions that "*... and OAO NK Yukos was the owner of oil and oil products...*"[14] and "*... Thus, OAO NK Yukos, being the owner of oil and oil products, when selling them, incurred the obligation to pay VAT, profit tax, as well as property tax...*"[15] These contentions by the Government, which were supported by the Court's final judgment, completely exclude any possibility of this same oil having been stolen.

(c) The RF Criminal Code's definition of theft by misappropriation and legalisation

G20. As noted above, although Question 32 refers to "*the applicants' conviction for embezzlement and money laundering,*" the applicants were in fact convicted of theft of oil (in the form of misappropriation) and of legalisation.

[14] Paragraph 129 of the Government's Memorandum in the *Yukos* case, referred to in the defence closing submissions at the trial.
[15] Paragraph 140 of the Government's Memorandum in the *Yukos* case.

G21. The definition of misappropriation under Russian criminal law is to be found in Article 160 of the RF Criminal Code, which defines it as "*Misappropriation or embezzlement, that is, the theft of another's property entrusted to the convicted person.*" As the applicants discuss further below in response to the Court's Question 45, under Russian criminal law, misappropriation or embezzlement are distinct ways of committing theft. Consequently, to find a person guilty of the commission of misappropriation it must be proven irrefutably that each of the mandatory common features of any theft, and the mandatory specific features characterising specifically misappropriation as a way of committing theft, are both present in its actions. Note 1 to Article 158 of the RF Criminal Code states "*By theft in the articles of the present Code is understood the self-interested, unlawful seizure and (or) conversion of another's property without exchange for value to the benefit of the guilty party or other persons, which causes damage to the owner or other possessor of this property*." As such, a mandatory feature of any theft, including misappropriation, is the causing of damage to the injured party. The Supreme Court has further issued binding explanations on judicial practice in rulings[16] confirming that the taking or conversion must occur against the owner's will – see the Ruling no. 51 of the RF Supreme Court: "*On Judicial Practice in Cases Concerning Fraud and Embezzlement*" given on 27 December 2007, the "the 2007 Ruling."[17]

G22. The differences between embezzlement and misappropriation are explained in paragraph 19 of the 2007 Ruling:

> "19. …misappropriation consists of the **unlawful** conversion by a person, for his benefit and **against the owner's will**, **without exchange for value**, of property that had been entrusted to him. The crime of misappropriation is considered to be completed from the moment when the lawful possession of the property **entrusted** to the person becomes wrongful and the person has begun to carry out acts that are directed toward conversion of that property to his own benefit (e.g., from the moment when the person by way of forgery hides his possession of the entrusted property, or from the moment of the non-performance of the person's duty to place funds that had been entrusted to this person in the owner's bank account).
>
> Classified as embezzlement should be wrongful acts by a person who, for mercenary purposes, has spent property entrusted to him, against the owner's will, by way of

[16] Under Article 126 of the Constitution, the Supreme Court has jurisdiction to give binding explanations on judicial practice in its rulings. These explanations of the Plenary Supreme Court are regularly cited by the lower courts when providing reasons for their verdicts, as binding legal positions.

[17] Resolution of the RF Supreme Court of 27 December 2007, no. 51, "*On Judicial Practice in Cases Concerning Fraud and Embezzlement*" at tab 78 to this Reply.

consuming said property, expending it or turning it over to other persons. Embezzlement should be considered a completed crime once the entrusted property has been wrongfully spent (consumed, expended or disposed of).

If a person commits, with a common intent, theft of property entrusted to him, by misappropriating a portion of such property and by embezzling the other portion, the act does not constitute multiple offences." (Emphasis added).

G23. Thus "misappropriation" as a method of theft occurs when the charges describe both all the mandatory general attributes of theft and all the mandatory specific attributes that specifically characterise "misappropriation", and when each of those attributes has been proven to exist in acts incriminated to a person.

G24. The definition of legalisation (laundering) under Russian criminal law (Article 174.1 of the RF Criminal Code) in effect at the time of the delivery of the verdict provided:

"Article 174.1. The Legalisation (Laundering) of Amounts of Money or Other Property Acquired by a Person as the Result of an Offence Committed by Him/Her

1. The accomplishment of large-scale financial transactions and other deals in amounts of money or other property acquired by a person as the result of his/her having committed an offence (**except for the offences stipulated by Articles 193, 194, 198 and 199 of the present Code**) or the use of these amounts of money or other property for the pursuance of entrepreneurial or another economic activity." (Emphasis added).

G25. It is to be noted that at the time of delivery of the verdict revenue offences, including corporate tax evasion under Article 199 based on which the applicants were convicted in their first trial, were specifically excluded from among the predicate offences whose commission enabled criminal prosecution for legalisation (laundering).

G26. Criminal legalisation (laundering[18]), under Article 174.1 of the RF Criminal Code, is understood as "*performance of financial operations or other transactions involving monetary funds* ***or other property acquired as a result of committing a crime****...*" (emphasis added). Therefore, specific property (and only that property) that was obtained directly as a result of committing the underlying (predicate) offence can constitute the subject of legalisation. Such property does not necessarily have to be money.

[18] The term "laundering" is of a subsidiary nature with respect to the term "legalisation" (which is exactly why it is placed in brackets in the heading of articles 174 and 174.1. of the RF Criminal Code), and, as is clear under domestic law, it only applies to monetary funds as an object of legalisation. Therefore, the term "laundering" is applicable only to those situations where the subject of the predicate crime consisted specifically of monetary funds and, correspondingly, they are the object of legalisation.

(d) The court's interpretation of the crime of "theft by way of misappropriation" was wholly arbitrary, unforeseeable and flagrantly inconsistent with the domestic law

G27. The applicants consistently argued during the proceedings that the charges that had been brought against them were unclear and devoid of meaning since they did not describe any criminality. Furthermore the applicants argued that the charges and the convictions were inconsistent with previous court judgments, including:

(a) Rulings of the RF Supreme Court in relation to the offences of theft by way of misappropriation and of legalisation (see paragraphs G21 to G23 above);

(b) Rulings of the RF Constitutional Court in relation to the application of Article 90 of the RF CCrP and the principle of *res judicata* (discussed below in paragraphs G140 to G144);

(c) Rulings of the RF Constitutional Court and the RF Supreme Arbitrazh Court in relation to the rights of shareholders to appoint or dismiss a company's executive body at their discretion (see further below in the applicants' replies to Question 34);

(d) Rulings of the RF Constitutional Court regarding the objectives of the establishment and operation of a vertically integrated holding company similar to Yukos (see further below in the applicants' replies to Question 35);

(e) Court judgments that have come into legal effect in relation to the general agreements between Yukos and the producing entities (see further below at paragraph G74); and

(f) Court judgments that had come into legal effect prior to the first case against the applicants in relation to the activities of the trading companies in the ZATOs. The applicants strongly believe that the Court was misled in bad faith by the Government in previous proceedings brought by the applicants and by Yukos in this Court, but that issue does not arise for determination in these proceedings. Importantly however, and directly relevant to these

applications, the Government not only concealed from the Court binding legal positions that had been expounded by the Russian courts, but also itself took a position before the Court that was based on bad faith. Thus, in *OAO Neftyanaya kompaniya YUKOS v. Russia*, no. 14902/04 (merits), 20 September 2011, the Government asserted in respect of these same oil transactions that the oil was being sold by the subsidiary producing companies. This fact was never contested by anybody and it is supported by the Court's final judgment. In the present case, however, the Government is asserting to the Court that the oil sales never took place since the applicants had stolen this oil from the producing entities.

(α) The judgments of the RF Constitutional Court

G28. The prosecution were required to comply with (rather than to ignore or distort) the judgments of the RF Constitutional Court that had been given in relation to the approach that all courts should take to cases concerning the examination of transactions between commercial entities. Thus the RF Constitutional Court issued two judgments at once on 4 June 2007, no. 320-O-P and 366-O-P, which stated:

> "Civil law regards entrepreneurial activities as stand-alone activities carried out at one's sole risk aimed to make profit systematically (Art. 2 para. 1 of the Civil Code of the Russian Federation) which is for business entities the main purpose of their activities and for non-profit ones serves to achieve the purposes for which they were set up (Art. 50 of the Civil Code of the Russian Federation).
>
> Chapter 25 of the Tax Code of the Russian Federation governs taxation of corporate profit and establishes to those ends a **certain correlation between income and expenses and a link of the latter exactly to the profit-making activities of an entity**. ... The same criterion is identified expressly in Art. 252 para. 1 (4) of the Tax Code of the Russian Federation as the main condition for finding costs to be well-grounded or economically sound: **any costs shall be found to be expenses provided they have been incurred to carry out activities aimed to generate income.**
>
> Plenum of the Supreme Commercial Court of the Russian Federation proceeds on the same basis when it states in Decree No. 53 of 12 October 2006 On Assessment by Commercial Courts for Well-Groundedness of a Taxpayer's Tax Benefits[19] that expenses taken into account in tax base calculation shall be assessed for well-groundedness, taking into account the circumstances attesting the taxpayer intends to get economic impact as a result of real entrepreneurial or other economic activities. The matter in question is exactly intent and purposes (focus) of such activities, rather than their outcome. At the same time, the well-groundedness of getting a tax benefit, as the same decree points out, cannot be made contingent on the capital use efficiency.

[19] A copy of the judgment referred to here is at tab 65 to this Reply.

> **Tax law does not use the concept of economic expediency** and does not govern procedure or conditions for running financial and business activities, and, therefore, expenses which reduce generated income for tax purposes cannot be assessed for well-groundedness from the viewpoint of their expediency, rationality, efficiency, or achieved outcome. **By virtue of the principle of freedom of economic activities (Art. 8 para. 1 of the Constitution of the Russian Federation), a taxpayer shall carry them out independently at its sole risk and it shall have a right to assess independently and solely their efficiency and expediency.**
>
> Within the meaning of the legal view of the Constitutional Court of the Russian Federation expressed in Decree No. 3-P of 24 February 2004, **judicial control is not intended to check for economic expediency the decisions made by subjects of entrepreneurial activities who have independence and broad discretion in business** because by virtue of risky nature of such activities there are objective limits to a court's ability to detect business errors in them" (Emphasis added).[20]

G29. The second applicant explained the significance of this judgment both in his evidence and in his cassational appeal.[21] The fact that the producing entities did not have to incur expenses, which made up most of the price of the oil that was exported, was directly relevant to the question of what was the appropriate price of the "stolen" oil – see further below and the discussion of the judgments of the RF Supreme Arbitrazh Court.

(β) *The judgments of the RF Supreme Arbitrazh Court*

G30. Similarly the prosecution and the trial court were required to comply with (rather than to ignore or distort) the judgments of the RF Supreme Arbitrazh Court. Equally, the applicants were entitled to expect that the prosecution and the trial court would act in conformity with such judgments.

G31. Of direct relevance to the issues before the court in the case against the applicants was a judgment of the Presidium of the RF Supreme Arbitrazh Court, which was concerned with evaluating sales and purchase agreements for the purchase of oil.[22] In *Ruling No. 6288/02* of 12 November 2002 the Presidium of RF Supreme Arbitrazh Court examined a dispute arising from a sale-purchase agreement concluded between OAO Rosneft-Purneftegaz and Rosneft Oil Company to sell up to 9,300,000 tonnes of

[20] See tabs 73-74 to this Reply.
[21] See p.13 of the supplementary cassational appeal of Mr Lebedev, a copy of which is at Volume C, tab C227, of the November 2011 Memorial.
[22] The second applicant specifically drew the trial court's attention to this judgment when he gave his evidence.

oil at the price of 1,110 roubles per tonne including VAT and excise duty. The RF Supreme Arbitrazh Court allowed the appeal on the following basis:

> "The standard on determining the market price of alienated (acquired) property specified under articles 77 and 83 of the Federal Act On Joint-Stock Companies is aimed at concluding transactions on the basis of conditions ruling out the possibility of inflicting a commercial loss on the business. As the parties to the transaction indicate, the price of the crude oil specified by the Board of Directors of the Business not only allowed to cover all costs but also provided a necessary amount of profit. This argument was not examined by the court."[23]

G32. At the remitted hearing, Moscow's Commercial Court found the transaction to be valid and lawful determining that:

> "The price in the agreement was set by agreement of the parties in accordance with Art.424 of the Civil Code of the Russian Federation ... the price of oil ... not only ensured that all the costs were covered, but also the necessary level of profits."[24]

G33. The second applicant specifically drew the court's attention in his evidence[25] to the Judgment of the Presidium of the RF Supreme Arbitrazh Court 28 October 2008 *no. 6272/08* where the court was concerned with issues that bore a striking resemblance to the issues that arose in the case against the applicants and Yukos. Significantly however, in this judgment, the RF Supreme Arbitrazh Court came to conclusions that were completely different from what the prosecution alleged in the case against the applicants and Yukos.

G34. In *No-6272/08* the RF Supreme Arbitrazh Court considered an appeal by the Russian company RussNeft, which purchased crude oil from oil traders, against a decision by the tax authorities to charge additional taxes on these transactions. The traders (also Russian companies) purchased oil from oil-extracting companies. The oil was delivered from oil extracting companies to RussNeft through a pipeline owned by TransNeft. The principal argument made by the tax authorities was that the oil-extracting companies were controlled by RussNeft, and therefore putting traders as intermediaries between the oil-extracting companies and RussNeft was not economically justifiable. The tax authorities further argued that the structure implemented by RussNeft unnecessarily increased the price of the oil (which was not

[23] A copy of the judgment is at tab 48 to this Reply.
[24] See extract from the second applicant's presentation to the trial court, at tab 105 to this Reply.
[25] See trial record for 7 September 2010 (which is to be found in Vol. 264 c.f.s. 1-261 of the case materials) at tab 132 to this Reply.

economically efficient) and thus the deductible input VAT accordingly. The court rejected the argument, stating that economic justification and efficiency of transactions are not the proper criteria for determining whether a taxpayer is eligible to claim for input VAT deduction. There is nothing in the RF Tax Code, the court continued, to support the arguments of the tax authorities.

(γ) Defence arguments were consistent with the subsequent findings of the independent experts who reported to the Presidential Council

G35. The defence arguments were rejected by the trial court and subsequently by the cassational court and the supervisory courts but were never refuted by them on their merits. Furthermore, it is to be noted that nobody ever declared transactions of the same type by the state-owned company Rosneft to be "theft at artificially reduced prices." Quite the reverse: as soon as this was shown, these transactions were declared by the court to have been lawful and not in breach of anyone's rights.

G36. Moreover, the defence arguments that the charges were entirely untenable and false are consistent with the findings of the independent experts who reported to the Presidential Council.

G37. Professor Jeffrey Kahn, a distinguished expert in Russian criminal law at the Dedman School of Law in the United States, analysed the applicants' conviction for embezzlement for the Presidential Council and came to the clear conclusion that the court's interpretation of the offence as set out in the verdict was wholly novel and incompatible with the essence of the offence.

G38. In Professor Kahn's opinion "*[The prosecution] theory of the defendants' criminal liability under Article 160 was unforeseeable, and thus a violation of Article 7 of the Convention.*"[26] He sets out a number of detailed reasons for that view in his report, explaining that the interpretation lacked the key elements of theft and was at variance with guidance from the RF Supreme Court. Professor Kahn observed that the conviction was based on the "*the omission or admitted non-existence of the traditional elements of the crime*" in three different respects.

[26] See p. 185 of the report. A copy of the report is at tab 140 to this Reply.

(δ) "*The element of 'another's property'*"

G39. Professor Kahn commented:

> **"The element of "another's property."** [T]he verdict concludes that although "the oil passed on into *de facto* ownership of OAO NK Yukos; however, it was not the oil owner *de jure*. In reality, the oil belonged to its producing subsidiaries," i.e. the victims of the embezzlement. See Verdict, p. 660. The verdict refers to two legal sources in support of this legal conclusion: the judgment of 26 May 2004 by the Moscow City Commercial Court against Yukos, and a decision of the Russian Federation Constitutional Court, No. 138-O (25 July 2001) mentioned in that judgment.
>
> Neither legal source supports this bifurcated concept of simultaneous *de facto/de jure* ownership."[27]

G40. The trial court's arbitrary reasoning in this respect[28] was the basis for it rejecting (clearly in bad faith) the very significant number of commercial and tax judgments that had all concluded that the oil, after its purchase from the production companies, had been owned by Yukos – see the summary of extracts from the judgments that is contained at Annexe 1 to this Reply. That reasoning is analysed further below in the applicants' answers in response to Question 38. For the purposes of the current analysis however, it is sufficient to note that Professor Kahn's views on this aspect are strongly endorsed by the other independent experts who reported to the Presidential Council: see reports of Professor Luchterhandt[29] and Professor Naumov[30] in particular. They are also strongly endorsed by the findings of the Stockholm Arbitral Tribunal in the *Spanish Shareholders Award* (see further below).

(ε) "The element of 'entrusted to the perpetrator."

G41. The second mandatory element of the offence that was found by Professor Kahn to be absent was the element of theft of property that had been "entrusted" to the accused. Professor Luchterhandt was of the view:

> "Conviction and sentencing for embezzlement was groundless because oil-production companies OAO Yuganskneftegaz, OAO Samaraneftegaz, and OAO Tomskneft VNK had not "entrusted" the oil to Khodorkovsky and Lebedev."[31]

[27] See p. 186 of the report. A copy of the report is at tab 140 to this Reply
[28] See pp. 658, 659 and 660 of the verdict. A copy of the verdict is at Volume C, tab C213, to the November 2011 Memorial.
[29] pp. 215-216 at tab 140 to this Reply.
[30] pp. 231-232 at tab 140 to this Reply.
[31] pp. 216 at tab 140 to this Reply.

G42. Professor Naumov, the head of the Department of Criminal Law Disciplines of the Academy of the Procuracy-General of the Russian Federation and a member of the Consultative-scholarly council of the Supreme Court of the Russian Federation, also came to the same conclusion as Professors Kahn and Luchterhandt. He drew particular attention to the fact that the trial court's verdict was at complete variance with the binding guidance of the Supreme Court:

> "Let us cite the provisions of decree No. 51 of the Plenum of the Supreme Court of the Russian Federation "On judicial practice in cases of fraud, embezzlement and misappropriation" of 27 December 2007. "The wrongful conversion without exchange for value of property that has been entrusted to a person to his own advantage or the advantage of another person, which has caused damage to the owner or other lawful possessor of this property, should be classified by courts as embezzlement or misappropriation, provided that the stolen property was in the lawful possession or authority of this person, who by virtue of his office or official position, contract or special commission exercised powers of disposition, administration, delivery, use or custody in relation to another's property…
> … The crime of misappropriation is considered to be completed from the moment when the *lawful possession* of the property **entrusted** to the person becomes wrongful and the person begins to carry out acts that are directed toward conversion of the given property to his benefit (e.g., from the moment when the person by way of forgery hides the presence with him of the entrusted property, or from the moment of the non-performance of the person's duty to place monetary funds entrusted to this person in the owner's bank account…)
> The executor of embezzlement or misappropriation can *only* be a person to whom another's property *had been entrusted* by a legal entity on lawful grounds with a specific objective or for certain activity" (*Byulleten' Verkhovnogo Suda Rossiyskoy Federatsii* [*Bulletin of the Supreme Court of the Russian Federation*]. 2008, No. 2, p. 6-7).
>
> It could not be any clearer. The Supreme Court links the presence of the *corpus delicti* of misappropriation of another's property *only* with an imperative, in its opinion, condition: the misappropriated property must be entrusted to the lawful possession of the thief. There can be no other interpretation of the *corpus delicti* of the crime under examination, since this requirement is formulated by the legislator itself in the disposition of art. 160 para 1 CC RF.
> ….
>
> In such a manner, both the scholarship of criminal law, and judicial practice, unambiguously link the presence of the *corpus delicti* provided for by art. 160 CC RF with the premise that the theft of another's property will be such (*i.e.* criminal precisely in the form of misappropriation) only in the event that the stolen property had been entrusted to the person who was found to be the thief of this property
>
> …..
>
> "The basis of criminal liability shall be the commission of an act containing all of the features of a *corpus delicti* provided for by the present (*i.e.* the CC RF) Code" (art. 8). In the verdict with respect to the given case, there is not a single fact confirming that the property supposedly stolen by the defendants (oil) had been entrusted by the injured

parties (recognised as such by the court) to the defendants M.B. Khodorkovsky and P.L. Lebedev"[32]

(ζ) The element of theft

G43. The independent experts also pointed to the absence of any theft having been committed and in particular the absence of real material damage in the form of direct losses. Professor Kahn commented:

> **"3) The element of "theft."** The court states that the contracts between Yukos and the three oil companies "obviously contradicted the interests of the latter" (p. 9), were procured by the defendants' misleading statements to the companies' shareholders and boards of directors (p. 9), and were "economically disadvantageous for them right from the start" (p. 10). Even if true, the court notes that each contract established prices that were, in fact, paid for the oil. It thus cannot be claimed that the defendants' actions amounted to the "uncompensated withdrawal and (or) conversion of someone else's property to the benefit of the perpetrator or other persons, which causes damage to the owner or other possessor of this property."
>
> The court's theory appears to be that, using a variety of sham companies, the theft was accomplished "by means of the deliberate underestimation of the prices of oil" owned by the oil companies (p. 242). The Court describes the defendants' "intent to embezzle someone else's property by means of clearly nonequivalent payment of its value." (p. 159). The court makes frequent reference to its conclusion that the contracts "did not involve exchange for value" (e.g. p. 164, 167). Because the court's theory of liability does not even track the elements of the offense, it cannot be held that it is "consistent with the essence of the offence and could reasonably be foreseen" by the defendants. *Moiseyev v. Russia*, App. No. 62936/00 (6 Apr. 2009), at ¶234. Indeed, it is hard to imagine a crime more unforeseeable than one that depends on a court's *post hoc* conclusions that the agreed contract price was not of quite the right amount."[33]

G44. The first applicant sought to bring a challenge to the RF Constitutional Court against the arbitrary and unforeseeable interpretation of "*misappropriation*", complaining that it was too vague and uncertain, such that it effectively subjected to criminal prosecution any person engaging in a commercial transaction perceived by the prosecution to be under value. The Constitutional Court declined to examine the complaint, holding that the assessment of what amounted to "*gratuitousness*" during the process of theft fell within the competence of the criminal courts.[34] However, the RF Constitutional Court expressly stated that under no circumstances could a lawful civil transaction be recognized as criminal embezzlement, and, specifically because of that, the Constitutional Court did not provide any grounds for inspecting Article 160

[32] pp. 231-232 at tab 140 to this Reply.
[33] pp.189 at tab 140 to this Reply.
[34] *Case of Khodorkovsky*, Constitutional Court, 2 July 2009, no. 1037-O-O. A copy of the ruling and the dissent is at tab 99 to this Reply.

and Note 1 to Article 158 of the Criminal Code, or the established practice of their construction and use for their conformity to the constitutional principle of legal certainty. In an important dissenting judgment, the Constitutional Court's Judge Kononov compellingly argued that the interpretation of those rules in the manner they were interpreted by the prosecution in the applicants' case created a real danger of "*arbitrary application*":

> "[T]he general principles of law categorically prohibit an expansive interpretation of criminal-law norms. Second, such an interpretation has imparted an even smaller definiteness to the norm, inasmuch as it includes many other concepts not completely clear for classification of the act: unequivalence or non-equivalency of exchange, understatement of (contractual, market, world) prices, the factual price of property, unequal value of compensation and even disadvantageousness of a transaction.
>
> Such an interpretation at the present time relies on the judicial practice of the Supreme Court of the Russian Federation, expressed by it in Decree of the Plenum N 51 of 27 December of 2007, which was perceived of uncritically as an argument by the Constitutional Court of the Russian Federation, although it is precisely this interpretation that is being contested by the appellant from the point of view of its constitutionality. It ought to be noted that this position ascends also to the judicial practice of the Soviet time and other legal conditions of the application of criminal law, when what was being spoken of was the special protection of state property ownership, the predominantly plan-based regulation of economic transactions, the total absence of freedom of contract and the practically exclusively state establishment of price-formation.
>
> Today there has arisen a new constitutional and economic reality, in which the old criminal-law prohibitions and doctrinal notions in a certain part remain an anachronism and, perhaps, ought to be rethought, inasmuch as they have lost [their] former definiteness. Thus, such a feature of theft as unlawfulness can perfectly well raise doubts if a transaction with respect to the transfer of property from the point of view of civil law is not contested and is recognised as valid. The venal objective discussed formerly can change connotation, inasmuch as the obtaining of profit is a mandatory feature of economic activity. Recognition of the fact of the causing of harm is not likely to be convincing without the manifestation of the will and the consent of the imputed owner.
>
> The concepts of "equivalence/unequivalence" of compensation, based on the concept of the price of the transaction, at the present time in conditions of freedom of contract and contractual prices do not have objective content. From the point of view of civil law there are no legal requirements towards the participants in civil turnover on the correspondence of prices to some kind of criteria. Unequivalence of exchange does not discredit a transaction in any way. As a rule, in market conditions, in the opinion of specialists, the purchase [price] and the actual price of property objectively cannot be equivalent. Bearing witness to the fact that market prices - are an entirely provisional concept is the determination cited in article 3 of the Federal Law "On Appraisal Activity in the Russian Federation", where for the calculation of the market price of an object are used a minimum of eight probabilistic and variable factors.
>
> In such a manner, the contested norms of criminal law on the strength of their indefiniteness create a real danger of their arbitrary application, while the appeal of the appellant has all grounds for acceptance and examination on the merits by the Constitutional Court of the Russian Federation."

G45. The court's impermissibly expansive and arbitrary interpretation of the applicable law in the verdict was demonstrated when, in order to "establish" theft of oil, it compared the contract price paid to the producing entities (at the oilfield in Russia) with its "global market price" (i.e. the price of oil exported to Europe). However, contrary to the Government's claims, no experts determined the "market price". Instead, the prosecution experts were given instructions as to what price they should use to calculate the proceeds of the sale. The market price applied had been incompetently and arbitrarily determined by the prosecution. This was fundamentally flawed on two further counts:

(a) First, the prosecution and the court did not establish (either via documents or through experts) the actual value of oil as required by the Supreme Court's 2007 Ruling. With regard to the oil produced such value was constituted by the cost of producing such oil, i.e. the amount of costs of extracting, treating (bringing into conformity with the requirements of a product standard) and delivering into the pipeline system.[35] Instead of performing that duty the court in a bad faith manner replaced the actual value of oil with some kind of its "market price" that was knowingly inapplicable to the circumstances under consideration;

(b) Second, the prosecution and the court arbitrarily used a "market price" of oil determined according to 'world prices', i.e. commodity exchange prices applied in the export destination in Western Europe, rather than at the point of its alleged theft (the extraction point at oilfields in Siberia or the Volga region) as required by the Supreme Court's 2007 Ruling. As a consequence, the measure used as a basis for a (knowingly false) conclusion that the applicants had committed misappropriation of oil by taking possession of it in exchange for no value bore no relationship to the actual value of the oil extracted by the producing entities.[36]

[35] See for example paragraph 6 of the Accountancy Regulation for Inventory Accounts (PBU 5/01), enacted by the Ministry of Finance Order no. 44n on 9 June 2001, which defines 'actual cost' as the cost of production less any value added tax. A copy of the Regulations is at tab 8(c) to this Reply.

[36] As explained in greater detail in the response to Question 34 below, the costs of transporting the crude oil from the extraction point to world markets, as well as export taxes and duties payable to the State are quite

G46. As to the second of those two points, contained within the case materials was the judgment of the Federal Commercial Court for Western Siberian Okrug of 22 October 2001[37] which established:

> "sales of oil for export and on the domestic market are economically incomparable, therefore, the plaintiff determined lawfully the price for oil without taking into account export prices;" and
>
> "given the economic conditions on the foreign and domestic market, the court instances concluded correctly that the plaintiff had determined validly the price for oil without taking into account export prices."

G47. The trial court effectively reclassified, in an unforeseeable fashion, ordinary business activity within a vertically integrated corporate holding into a vast criminal enterprise.

G48. The defence consistently drew the trial court's attention (as well as that of the cassational and reviewing courts) to the absence of the mandatory features of theft: among many other things, there was no gratuitous taking possession of oil or the causing of damage to the so-called injured parties. The defence similarly drew attention to the fact that as a matter of unequivocal law**,** the damage from theft must be not just any damage, but exclusively real damage in the form of direct losses – in the amount of the factual value of what has been stolen, by which the volume of the injured party's property is reduced. This approach is indisputable both in criminal law doctrine and in judicial practice.

G49. The defence arguments were succinctly expressed in the joint application for supervisory review of 22 February 2012[38]:

> "Thus it is indicated in para. 25 of decree No. 51 of the Plenum of the RF Supreme Court of 27.12.2007: *"Determining the value of property stolen as the result of fraud, embezzlement, or misappropriation, one ought to proceed from its* ***factual value*** *as of the moment of the commission of the crime"*. The factual value of output is determined for the producer based on the factual expenses for its fabrication[39]. As applies to the present

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considerable. Therefore, within the oil industry the value of crude oil is defined as the "netback" which is calculated by taking the price at delivery less all taxes and costs associated with getting the oil to market.

[37] See copy at tab 46 to this Reply. The judgment is at Vol. 268 c.f.s. 12-15 of the case materials.

[38] A copy of the application is at tab 144 to this Reply.

[39] The application has a footnote reference at this point that reads "See para 51 of Order No. 25n of the RF MinFin On Confirmation of the Instruction on Budgetary Accounting of 10.02.2006; earlier - para 3 PBU 5\98 (conf. by Order No. 25n of the RF Ministry of Finance of 15.06.1998), para 7 PBU 5/01 (conf. by Order No. 44N of the RF Ministry of Finance of 09.06.2001), para 59 of the Provisions on the Conducting of Financial

case, the factual value of oil for its producer is the sum of the expenses for production and treatment of the oil (bringing it up to GOST's 9965-76 and/or TU 39-1623-93 quality).

Damage in the form of incomes not received (foregone benefit), irrespective of its character and amount, rules out criminal liability for theft. It is not by chance that para. 16 of that same decree No. 51 of the Plenum of the RF Supreme Court contains the following prescription for differentiating theft from other crimes against property: *"…it is imperative for the court to establish whether real material damage has been caused to the owner or other possessor of the property, or damage in the form of foregone benefit, that is incomes not received, which this person would have received under ordinary conditions of civil turnover".*

Any information whatsoever about the causing of real damage to the "injured parties" is absent in ***the verdict under appeal***. Correspondingly, neither are any substantiations of such damage having been caused contained in it.

Furthermore, it was established by a multitude of evidence presented both by the party of the prosecution and by the party of the defence that such damage could not even have been caused at all under the circumstances established with respect to the case and described in the verdict. The "injured parties" - subsidiary production companies of OAO NK YUKOS - received monetary funds as payment under sale-and-purchase (shipment) agreements for the oil produced and treated by them in an amount that always exceeded its factual value. In other words, they had proceeds from the sale of the oil in an amount that provided them with not only a full compensation of expenses (the factual value), but a profit as well. These facts were corroborated, apart from other evidence, by written certificates presented by the "injured parties" themselves,[40] and **in *the verdict under appeal*, the court recognised the receipt of proceeds and profit by each "injured party" (OAO Yuganskneftegaz, OAO Samaraneftegaz, and OAO Tomskneft VNK) from the sale of the oil produced by them, and the absence of a shortfall of either oil or monetary funds[41], factually having corroborated, in such a manner, the obvious and indisputable absence of real damage.**

If there are proceeds and profit from the sale of the oil, then it goes without saying that one cannot speak of the theft of that same oil. The assertion about the opposite is heresy from the point of view of economics, law, and common sense. It is precisely for this reason that to create the appearance that there are grounds for the knowingly false charge, the court resorted to a bad-faith trick when issuing *the verdict under appeal*, having attempted to pass off some sort of semblance of "foregone benefit" for real damage. With this objective, having compared knowingly incommensurate prices for oil at oil fields in the RF and on board a vessel in Western Europe, the court "came" to a knowingly false "conclusion" about the purchase of the oil from the subsidiary production companies of OAO NK YUKOS at some kind of "understated" prices. This, in the opinion of the court, entailed an under-receiving by the "injured party" production companies of a part of the profit supposedly due to them, which they supposedly could have received having sold the oil for export to Western Europe on their own. Further, factually making an assertion about the existence of the made-up "foregone benefit" (but not having made an attempt to prove even it), the court came to a knowingly

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Accounting and Financial Reporting in the RF (conf. by Order No. 34n of the RF Ministry of finance of 29.07.1998)." Copies of those references are at tab 8 to this Reply.

[40] The application has a footnote reference at this point that reads "See case Vol. 268 c.f.s. 103, 105, 107". Copies of the references are at tabs 134-136 to this Reply.

[41] See, for example. pgs. 41, 652, 655, 674 of the verdict. A copy of the verdict is at Volume. C, tab C213, to the November 2011 Memorial.

inappropriate and false "conclusion" about how it is specifically this that the real (direct) damage, and consequently theft (!), consists of.

In order to avoid any ambiguity whatsoever, we consider it imperative to particularly underscore that the subsidiary oil-production companies of OAO NK YUKOS, which did in actuality receive a profit of many billions from the sale of the oil (which irrefutably bears witness to the positive economic result of the transactions for its sale performed by them), did not suffer any real damage of any sort nor the "foregone benefit" made up by the court. However, as has already been said, the only thing that has significance for the resolution of a criminal case of theft is real damage (direct losses), inasmuch as it is precisely its causing that is a mandatory feature of theft.

It is illustrative that the former executives of the subsidiary production enterprises of OAO NK YUKOS examined in court hearing as witnesses: Anisimov (Samaraneftegaz), Filimonov (Tomskneft VNK), and Gilmanov (Yuganskneftegaz), who occupied these positions precisely in the period of the commission of the inculpated acts, directly disavowed not only the facts of the theft of the oil and the causing of real damage, but even the existence of some kind of foregone benefit[42]; the court, however, "did not agree" with them, citing their "lack of information"(!).

Nevertheless, the attempts to describe the features of the "foregone benefit" made up by the court instead of real damage can be clearly seen from the whole prosecution narrative contained in ***the verdict under appeal.*** Bearing witness to this, in particular, are the assertions that speak for themselves that the oil production enterprises were supposedly "put into conditions economically disadvantageous for them right from the start", inasmuch as they were "deprived of a significant part of the profit", which was "taken out at understated prices", "seized", etc.[43]

Indicating on numerous occasions in ***the verdict under appeal*** at the "lack of exchange for value" in the taking of the entrusted oil by the defendants[44], the court "discerned" this lack of exchange for value not in the receiving of the oil by the "members of the organised group" without consideration, *i.e.* gratis, as is directly prescribed by art. 423 RF Civil Code, but in a supposedly "insufficient" amount of payment, received by the "injured parties" from OAO NK YUKOS (and subsequently other oil trader companies under the control of the latter as well) for the oil produced by them and sold under sale-and-purchase (shipment) agreements involving exchange for value.

In other words, the "not involving exchange for value" character of the taking of the oil was expressed, according to ***the verdict under appeal,*** in that the supposedly stolen oil was substituted by supposedly "less valuable" property - a sum of money that did not correspond to the "world market price" of oil (factually the exchange quotations for URALS in Western Europe). In so doing, the court made reference to para. 25 of Decree No. 51 of the Plenum of the RF Supreme Court of 27.12.2007, where it is indicated that theft of property with the concurrent substitution of less valuable [property] for it shall be classified as theft in the amount of the value of the seized property. With reference to this clarification, the court made a wrongful, inappropriate, and untenable conclusion about how "*...the prosecution has justifiably calculated the damage in accordance with*

[42] The application has a footnote reference at this point that reads "See trial record of 26.07.2010 (Vol.256 c.f.s. 225-272), 27.07.2010 (Vol. 257 c.f.s. 4-66), 26.08.2010 (Vol. 261 c.f.s. 171-243)."

[43] See, for example, pp. 10, 12, 47, 130, 548, 619 of the verdict. A copy of the verdict is at Volume. C, tab C213, to the November 2011 Memorial.

[44] See, for example, pp. 124, 164, 165, 167, 189, 190, 604, 650, 651, 652, 681of the verdict. A copy of the verdict is at Volume. C, tab C213, to the November 2011 Memorial.

the market prices that existed at that period, namely oil prices at commodity exchanges…"[45].

As has already been mentioned, however, para. 25 of the Decree indicated above contains, first and foremost and in the capacity of a general rule, a direct requirement to determine the value of stolen property, proceeding from its factual value, since specifically such an approach fully corresponds to the sense and content of real (direct) damage. In the event that it is impossible to establish the factual value, the Plenum prescribes determining it by way of experts; such an expert examination with respect to the case was likewise not conducted, however.

As is indicated above, it was indisputably established in the court hearing, and is not denied in *the verdict under appeal(!)*[46], that the prices at which the oil was acquired from the "injured parties" under sale-and-purchase (shipment) agreements not only fully covered the factual value (lifting cost) of the oil, but even exceeded it. Besides that, it was established that these prices corresponded to the prices of other analogous transactions in the regions of YUKOS's activity. In so doing, for a series of objective reasons (transport expenditures, export and customs duties, insurance, *et al.*), it goes without saying that they were not and could not have been the same as in Western Europe.

Proof of this is, *inter alia*, reference statements from the MNS RF [Ministry of Taxes and Charges of the Russian Federation—*Trans.*][47], oil sale-and-purchase agreements with other Russian organisations that have no relation to VIOC YUKOS[48], and the witness testimony of Soboleva[49], Tyan[50], Orlov[51], Polzik[52], Maly[53], Zubkov[54], Kasyanov[55], Gref[56], and Khristenko[57].

In such a manner, the prices were not at all "understated" (in the terminology of the prosecution and of *the verdict under appeal),* while this term itself is absolutely devoid of content as applies to what is subject to proving with respect to the present case.

Besides the monetary compensation for oil sold received by the "injured parties" with its factual value exceeded. recognised by the court, another fundamental argument of the defence about the absence of the feature of a lack of exchange for value consists of the

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[45] See p. 685 of the verdict. A copy of the verdict is at Volume. C, tab C213, to the November 2011 Memorial.
[46] See pp. 41, 652, 673, 674, 675, 685 of the verdict. A copy of the verdict is at Vol. C, tab C213, to the November 2011 Memorial.
[47]The application has a footnote reference at this point that reads "See case Vol. 86 c.f.s. 301-305."
[48] The application has a footnote reference at this point that reads "See case Vol. 49 c.f.s. 118-157, Vol. 50 c.f.s. 140-147, 157-164, vol. 62 c.f.s. 298-310."
[49] The application has a footnote reference at this point that reads "See trial record of 03.12.2009 (Vol.227 c.f.s. 47-85)."
[50] The application has a footnote reference at this point that reads "See trial record of 10.12.2009 (Vol.227 c.f.s. 193-234)."
[51] The application has a footnote reference at this point that reads "See trial record of 25.12.2009."
[52] The application has a footnote reference at this point that reads "See trial record of 11.01.2010 (Vol.230 c.f.s. 28-81)."
[53] The application has a footnote reference that reads "See trial record of 01.02, 03.02 and 08.02.2010 (Vol.232 c.f.s. 48-77, Vol.232 c.f.s. 123-142, Vol.232 c.f.s. 163-203)."
[54] The application has a footnote reference at this point that reads "See trial record of 03.09 and 04.09.2010."
[55] The application has a footnote reference at this point that reads "See trial record of 24.05.2010 (Vol.249 c.f.s. 121-140)."
[56] The application has a footnote reference at this point that reads "See trial record of 21.06.2010 (Vol.253 c.f.s. 4-43)."
[57] The application has a footnote reference at this point that reads "See trial record of 22.06.2010 (Vol.253 c.f.s. 47-80)."

act that **in *the verdict under appeal,* the content of the understanding of "theft of property with the concurrent substitution of less valuable [property] for it" has been replaced.**

As has been noted above, theft can take place only if an aggregate exists of all the mandatory features of this act enumerated in the note to Art. 158 RF Criminal Code and clarified by the Plenum of the RF Supreme Court. Therefore, such a substitution during theft can take place only without regard for the will of the injured party for concealing the crime, leading the owner or another lawful possessor of the property into delusion (for example by way of replacing an original with a copy, money with a dummy wad of blank paper, and the like). In so doing, such property, turning out to be in the possession of the injured party in exchange for what has been stolen, does not become the property of the injured party and cannot be taken into account in such a capacity, inasmuch as, first, there was no will of the injured party for this either, and second, an appropriate basis for the origination of the right of ownership to this substituted property for him is absent.

With respect to the present case, however, as has been established in the court hearing, the "injured parties" were performing transactions and accepting monetary compensation for a produced and sold good (the oil) by their own will, reflecting it in their reporting specifically as proceeds from the sale of the oil[58]. And what is more, even after the "injured parties" had passed under the control of the Rosneft company, the given fact - receiving of proceeds from the sale of oil in the indicated period - was unfailingly and officially corroborated, including also in the course of the court proceedings with respect to the present case, by their new management, not under the control of the defendants.

Acting according to their own will and in their own interest, participants in economic activity are free to establish their own rights and obligations on the basis of an agreement and to determine any conditions of an agreement that do not contradict legislation (Arts. 1, 421 RF Civil Code). The price of an agreement is its material condition and, in accordance with Art. 424 para. 1 RF Civil Code, is likewise established by agreement of the parties, consequently it can be anything.

The receiving or non-receiving of economic benefit by that or the other party to a transaction, and the amount of this benefit, as well as the motives prompting it to voluntarily agree with a concrete price, likewise with the other conditions of the agreement as well, is the exclusive discretion of the parties to the transaction. Consequently, in the absence of proven flaws of will, these circumstances cannot be the object of assessment in a criminal case, and all the more so, under no circumstances can they be regarded as a feature of theft of property "by way of the concurrent substitution of less valuable [property] for it".

According to the constitutional principle of equality of all before the law and the principles of legal certainty and inter-branch congruence in law that are inseparably connected with it, no provisions of criminal law can contradict the rules governing property rights. Otherwise, the supposedly not-involving-exchange-for-value character of transactions, and consequently cause for criminal- law intervention in the private affairs of economic agents, could be arbitrarily discerned in all situations of the effecting of civil-law transactions, the price of which for some reason or another "does not suit" the law-enforcement agencies and the courts.

[58] The application has a footnote reference at this point that reads "See, for example, Vol.268, c.f.s. 103, 105, 107."

> However, it is precisely such arbitrariness, which is taking place with respect to the present case, that is recognised by *the judicial acts under appeal* to be "lawful and substantiated", having served, among other things, as the start of a whole series of wrongful decisions with respect to other cases and having become a textbook example of inadmissible perversion of the sense of the law and the fundamental principles of business turnover."

(e) Legalisation (Laundering)

G50. An essential element of the legalisation charge brought against the applicants under Article 174.1 of the RF Criminal Code was that the accused dealt with property acquired through a predicate offence, in this case the charges of misappropriation described above.

G51. As noted above, there was no reasonable or foreseeable basis in fact or law to conclude that the applicants had 'misappropriated' the oil, and therefore taken possession of the subject of the legalisation. Since the charges of misappropriation served as the sole predicate offence justifying application of the legalisation charge, there was no lawful basis to bring criminal charges of legalisation either. Accordingly, the entirety of the legalisation charges breached Article 7 together with the charges of misappropriation for this reason alone.

G52. However, without prejudice to what is said above, the legalisation (laundering) charge as it is phrased and found by the court as proven is arbitrary and was brought in bad faith.

(f) Nulla poena sine lege.

G53. Finally, as noted in the applicants' response to Section A, the verdict of the Khamovnicheskiy Court failed to take into account the period of almost three years (from February 2007 to December 2010), during which the applicants were unlawfully held in pre-trial detention, in the time already served by the applicants under the sentence of the Meshchanskiy District Court, contrary to the explicit requirements of the law (Art. 69 (5) CrPC) and the universally binding position of the Supreme Court. Accordingly, the term of imprisonment remaining to be served by the applicants was artificially and unlawfully increased by almost three years. Consequently there was a breach of Article 7 ("*Nor shall a heavier penalty be*

imposed than the one that was applicable at the time the criminal offence was committed") on that basis alone.[59]

Question 33. What particular acts were characterised as "misappropriation" and "money laundering" (*legalizatsiya*)[60] in the prosecution case? Would it be correct to say that, according to the prosecution, "misappropriation" consisted of forcing producing entities to sell oil "below the market price", in breach of the rules of corporate law, whereas all other transactions (related to channelling the oil sales through a network of Russian and foreign trading companies, withdrawing, dispersing and reinvesting profits) were regarded as "legalisation"? If that formula is incorrect, the Government are invited to give a short description of what was regarded as "embezzlement" and what as "money laundering".

SUMMARY OF THE GOVERNMENT'S RESPONSE

G54. The Government's response is a series of mutually contradictory assertions: at times inconsistent with the verdict and consistently contradictory to the applicable law.

G55. The Government did not answer the Court's question concerning the criteria applied by the prosecution to determine which particular acts were characterised as "misappropriation" and which were characterised as "legalisation (laundering)."

G56. The Government say that the applicants "*were charged with the embezzlement of property by misappropriation, using their official position, committed by an organized group in 1998-2003. Their actions involved the misappropriation of oil from oil producing companies of Yukos Oil Company through registering of property rights to this oil by the subsidiary companies at artificially low prices*" (paragraph 244 of the Memorandum). However, at paragraph 248 they recognise that sale and purchase agreements were entered into and that the "*stolen*" and "*misappropriated*" oil was in fact sold which excludes any possibility of theft. Moreover, the assertion that criminality was demonstrated by "*registering of property rights to this oil by the subsidiary companies at artificially low prices"* is devoid of any meaning under the

[59] See further section 6.1 of the applicants' joint supervisory appeal of 22 February 2012, copy at tab 144 to this Reply.
[60] See the applicants' comments in relation to the definition of "legalisation (laundering)" under the domestic law and its application to the instant cases.

domestic law and doctrine, since during a theft no transfer of title takes place – stolen property always remains the property of the victim.

G57. The applicants' detailed rebuttal of the prosecution case is contained in their answers to the Questions that follow.

APPLICANTS' RESPONSE TO THE COURT'S QUESTIONS

G58. There is a real difficulty in giving an accurate and exact answer to the Court's question which "*particular acts*" were characterised as "*misappropriation*" and as "*legalisation*" in the prosecution case because of the lack of precisely formulated charges. The charges were, contrary to statutory requirements, strewn with a large quantity of diverse allusions to unspecified and unparticularised criminality (which the defence referred to as "poison pills") containing a number of references to other, apparently criminal, acts allegedly committed by the applicants and other persons not prosecuted in the case but said to have been members of the "organised group" led by the applicants. However, these acts were not given any legal classification in the charges. The truth is that the lack of precisely formulated charges was a direct result of the fact that there was no criminality and an attempt to conceal this. See further the applicants' submissions earlier in reply to the Court's Questions in Section A.[61]

G59. The verdict describes what are completely routine transactions involving sale and purchase of oil from the producing entities (all of which had been subjected to continual audit by external auditors and supervision by various government bodies) as theft by way of misappropriation. As discussed below in Section J, it is to be noted that in the ECT Decision the Arbitral Tribunal concluded that PWC had been subjected to improper pressure to withdraw the audits of Yukos:

> "1253. ..[T]he pressure mounted by the Russian authorities against Yukos' auditors, which led to PwC's eventual withdrawal of its audits and even to a PwC auditor testifying against Messrs. Khodorkovsky and Lebedev at their second trial, informs the Tribunal's view that Yukos was the object of a series of politically-motivated attacks by the Russian authorities that eventually led to its destruction, as alleged by Claimants."

[61] It is for this reason that the applicants are not able to answer footnoted question 2 at page 18 of the Statement of Facts *"Buy-back of Yukos shares; payments to the creditors of Menatep…. The question arises whether those facts amounted to a separate episode incriminated to the applicants, or whether it was an illustration of various forms of "legalisation" used by the applicants to invest the profits from oil.*"

G60. Moreover, it is important to note, that despite that improper pressure PWC in fact did not withdraw any of the audits that they had prepared in relation to the producing entities. Those audits show that the producing entities received revenues and substantial profits from the sale of the oil that was allegedly stolen by the applicants. The audits confirm that profits received by the producing entities (the so-called "injured parties") for the sale of the oil allegedly stolen from them amounted to around $ 3 billion.

G61. Despite allegations that the prosecution repeatedly made during the trial that the applicants were guilty of theft of oil, it is not clear from the verdict what exactly was the object that was misappropriated. Despite numerous, variously phrased, indications in the verdict that it was specifically oil[62] that was stolen, the verdict also mentions misappropriation of cash[63], stolen oil products[64], theft of OAO NK Yukos property[65], products of oil producing and oil refining enterprises being stolen are referenced[66], and some unspecified "*property*"[67] is indicated. Additionally, the phrase "*misappropriation of the bulk of the stolen property*"[68] is used on occasion.

G62. The verdict is similarly unclear and imprecise in relation to the substance of the legalisation charge. While it would follow from the logic of the described charges (to the extent such logic is comprehensible) that the object of theft is oil and, therefore, specifically oil is the property acquired as a result of committing a crime, the object of legalisation is most often specified as funds[69] and less frequently as oil.[70] However, the sections of the verdict that address legalisation describe the legalisation both as the refining of oil into oil products, and purchase of securities, and payment of

[62] p. 3 – committed theft by way of misappropriating entrusted property – oil; p. 9 – taking possession of oil; p. 10 – illegally transferring oil for others' benefit; p. 77 – having received on behalf of OAO NK Yukos into [his] disposal the oil from oil producing companies, i.e. having stolen it by way of misappropriation; p. 309 – removal of all produced oil at transfer prices; etc. The verdict is at Volume. C, tab C213, of the November 2011 Memorial.
[63] pp. 20,21,22,24,32,33,63,72,74,75,97,99,101,105,107,124,271,531, and 547 of the verdict. The verdict is at Volume. C, tab C213, of the November 2011 Memorial.
[64] pp. 127,526 of the verdict. The verdict is at Volume. C, tab C213, of the November 2011 Memorial.
[65] p. 592 of the verdict. The verdict is at Volume. C, tab C213, of the November 2011 Memorial.
[66] p. 22 of the verdict. The verdict is at Volume. C, tab C213, of the November 2011 Memorial.
[67] p. 31 – theft of subsidiaries' property; p. 32 – stolen property and funds; p. 39 – theft of others' property. The verdict is at Volume. C, tab C213, of the November 2011 Memorial.
[68] pp. 20, 74, and 105 of the verdict. The verdict is at Volume. C, tab C213, of the November 2011 Memorial.
[69] pp. 20, 85,110,304 of the verdict. The verdict is at Volume. C, tab C213, of the November 2011 Memorial.
[70] For instance, pp. 6,22,24,77,87,92,95,96,99,107,119 of the verdict. The verdict is at Volume. C, tab C213, of the November 2011 Memorial.

dividends, and purchase and sale of oil products, and purchase of new assets, etc. As is the case with the charge of theft of oil, the verdict also contains a number of meaningless phrases, such as "*legalisation (laundering) of funds stolen in the process of selling stolen oil*"[71] and "*final legalisation into one's property.*"[72]

G63. The Court's difficulty in disentangling the substance of the prosecution case is understandable and reflects the applicants' own numerous and fruitless attempts to understand what they were accused of during the whole prosecution.

G64. The fact that the applicants, just like the Court, are forced to guess what exactly the prosecution and the court meant by each of the charges brought constitutes compelling proof of the arbitrary and glaringly bad faith application of criminal law against the applicants. It is no accident therefore that the Government failed to provide any clear answer to this Question of the Court.

Question 34. It appears that the prosecution case was based on the assumption that the producing entities were "forced" by the applicants to sell their oil at a very low price, and that this was not their free choice. How did the applicants "force" the producing entities to enter into disadvantageous agreements? What particular mechanisms were used and how did the law at the time distinguish between agreements which breached only the Public Companies Act and the Civil Code and were thus invalid, or agreements which had an additional criminal intent behind them?

SUMMARY OF THE GOVERNMENT'S RESPONSE

G65. The Government do not provide a coherent answer to the Court's question as to how the law distinguished between agreements which breached only the Public Companies Act and the Civil Code and agreements which had an additional criminal intent and/or were concluded in order to disguise a crime. They assert that "*external management*" was introduced over the producing entities and "*general agreements*" were introduced under which "*oil producing companies were obliged to supply oil only to OAO NK YUKOS, while the title to products extracted as part of the borehole fluid was transferred at the wellhead immediately after its extraction from the subsoil, and the prices established for the supplied oil were artificially lowered manifold as*

[71] p. 125 of the verdict. The verdict is at Volume. C, tab C213, of the November 2011 Memorial.
[72] p. 127 of the verdict. The verdict is at Volume. C, tab C213, of the November 2011 Memorial.

compared to actual prices for such products" (paragraph 254 of the Memorandum).

G66. The Government purposefully neglect to explain to the Court that the transfer of powers of an executive body at any time and to any person (including a management company) is explicitly provided for by the law and that powers to make such decisions are vested in shareholders or by the Board of Directors. Similarly, the Government do not explain to the Court that in fact not a single transaction between Yukos and the producing entities was invalidated by a competent court under the procedure established by law (see further below).

APPLICANTS' RESPONSE TO THE COURT'S QUESTIONS

G67. In responding to these Questions the applicants will also comment on the additional questions posed by the Court in its footnotes to the Statement of Facts:

(a) "*It is understood that those "general agreements" were distinct from the "administrative agreements". While the latter concerned the management of the subsidiaries, the former established the principles of selling the producing entities' oil. The parties are invited to clarify this information.*" (Footnote 1, page 11).

(b) "*The judgment, with some exceptions, did not specify how many votes the applicants had at the general meeting of shareholders, how many votes they needed to approve the sales of oil, and why those approvals were obtained in breach of the Public Companies Act.*" (Footnote 2, page 11).

(c) "*It needs to be clarified whether the system of selling the oil at those "auctions" replaced the previous system based on "general agreements" between Yukos and its subsidiaries*." (Footnote 1, page 12).

(d) "*If "general agreements" provided that the producing entities were selling the oil only through Yukos itself, the question is at what moment did those trading companies start to participate in the sales chain, and what place did they occupy*

in that chain: immediate purchasers of the oil from the producing entities, intermediate re-sellers or end-buyers (within the group)?" (footnote 1, page 13)

(e) In relation to "*From 2000 the sales scheme was reorganised*" the Court asked "*It is unclear what called for that reorganisation – the investigations begun in certain countries at the request of the Yukos minority shareholders or the applicants' plans to issue Yukos shares on the international securities market.*" (Footnote 2, page 16).

(a) General agreements

G68. At the outset, the applicants note that the Court's questions in relation to "general agreements" are irrelevant to whether or not the applicants were guilty of misappropriation of oil. The applicants address the questions however in order to assist the Court as much as possible.

G69. The Court correctly notes that "general agreements" were distinct from "management agreements" and that while the latter concerned the management of the subsidiaries, the former established the principles of selling the producing entities' oil.

G70. General agreements were concluded between Yukos Oil Company and its oil-production subsidiaries OAO Yuganskneftegaz[73], OAO Samaraneftegaz (in July 1996)[74] and OAO Tomskneft VNK (in November 1998).[75] These general agreements essentially constituted indefinite contractual obligations for Yukos permanently to acquire all the oil produced by the producing entities and to pay for it. The agreements provided that the transfer of the title to the oil extracted from the producing entities to OAO 'NK 'Yukos' "*shall take place at each specific wellhead, immediately upon its extraction from under the ground*"[76].

G71. The managerial decisions in selecting the companies to which the functions of management and control in the relevant sectors of the Yukos' vertically integrated oil

[73] See tab 18 to this Reply. See Vol.49 c.f.s. 43-47.
[74] See tab 19 to this Reply. See Vol.49 c.f.s. 24-28.
[75] See Vol.49 p.33-37of the case materials. Copies are at tab 25 to this Reply.
[76] See for example paragraph 5.1 of the general agreement at tab 18 to the Reply.

company were delegated served completely different purposes. The system of management companies was introduced to improve the mechanism for management of the group. Thus, on the basis of resolutions of the general shareholders' meetings of the three oil producing entities, in September 1998 contracts were concluded to transfer the powers of the executive bodies of those companies to the management company Yukos-EP.[77] Similar agreements were concluded under the same procedure between the oil-refining enterprises and the management company Yukos-RM.[78] In turn, in the same manner, in 2000 the management company Yukos-Moskva became the executive body for OAO NK Yukos.[79] It is crucial to note that the decisions listed above were approved under the procedure established by law, including at general shareholders' meetings.[80] Furthermore, the said managerial decisions were approved in advance by the State Anti-Monopoly Committee of the Russian Federation.[81]

G72. To characterise these arrangements as "*external management*" as the Government have sought to do[82] is a deliberate attempt to mislead the Court. First, "*external management*" is not an applicable legal term in this context (in domestic law it is used solely in relation to bankruptcy proceedings) and, secondly, this form of management structure is a widespread one in a vertically integrated company. [83]

G73. On the basis of the general agreements the parties would conclude contracts twice a month for the sale and purchase of the oil, each of which would state the quantity of commercial-grade oil to be supplied and its price. In March 1999 the contracts for the sale and purchase of the oil were approved by the general shareholders' meetings of these companies.[84]

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[77] See Vol.69 pp. 3-21 of the case materials. Copies are at tab 24 to this Reply.
[78] See Vol.69 pp. 24-78 of the case materials at tab 22 to this Reply.
[79] See Vol.67 p. 65 of the case materials at tab 43 to this Reply.
[80] See Vol.69 pp. 96, 98-125, 127-135 of the case materials at tab 21 to this Reply.
[81] See Vol.245 pp. 53, 54, 54 (rev) of the case materials at tab 23 to this Reply.
[82] Paragraph 254 of the Memorandum.
[83] The meaning of the term "external management" implies that control over managerial decisions is taken away from a company and assigned to an external manager appointed by a court, and that, indeed, is what happens in bankruptcy proceedings. However, this is entirely different to the concept of management companies, including within a group of companies, where powers of management and control in dealings between the parent company and subsidiary remain entirely unchanged, and the management company acts as the executive body of the subsidiary company. The applicants maintain that Government has deliberately misused this term in order to create a misleading and incorrect impression in order to support their baseless case made in bad faith.
[84] Vol.2, pp. 4-33; Vol.27 pp. 286-300, Vol. 64 pp. 197-215 of the case materials at tab 28 to this Reply.

G74. The legitimacy of the use of the general agreements was confirmed in court. The general agreements were challenged on three occasions in commercial courts. The challenges were brought consecutively by the tax authorities, the anti-monopoly authorities and the prosecutor. All claims were dismissed. It was established by binding judgments from courts in three regions that the general agreements were in no way inconsistent with the law, did not infringe on the interests of the producing entities, and constitutes valid transactions.[85] By way of example, the Tomsk Oblast commercial court considered the legality of the general agreement between OAO NK Yukos and OAO Tomskneft and concluded:

> "The Agreement concluded by the Parties does not entail the abuse of a right (Art.10 of the Civil Code of the Russian Federation), which in itself does not constitute grounds to declare a transaction invalid. The reference by the claimant (the Department of the Ministry of Taxes and Levies) to Art.170(1) of the Civil Code of the Russian Federation (sham transaction) is unsupported. After concluding the agreement, the Parties executed transactions for the sale and purchase of oil, thus discharging their obligations. The claimant's argument that the agreement was artificial, i.e. a transaction executed with the aim of concealing another transaction (Art.170(2) of the Civil Code of the Russian Federation) lacks grounds."[86]

G75. Up to and including February 2000 OAO NK Yukos itself acted as buyer of the oil, but subsequently the oil was purchased by its trading companies. This development was introduced to increase the efficiency of the group of companies.[87]

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[85] See Decision of the Khanty-Mansiysk Autonomous Okrug Court dated 10 December 1998 (Vol. 192 pp. 32-38, Vol. 201 pp. 231-237 of the case materials), a copy of which is at tab 26 to this Reply and subsequent judgments of the cassation instance courts (Vol. 192 pp. 39-42, 43-46, Vol. 201 pp. 238-241, 242-245 of the case materials) copies of which are tabs 20 and 29 to this Reply in respect of a claim brought by the prosecutor for Khanty-Mansiysk Autonomous Okrug against OAO NK Yukos and OAO Yuganskneftegaz for declaration of a transaction as invalid, namely the general agreement between the respondents dated 31 July 1996.
See also Decision of the Tomsk Oblast Arbitrazh Court dated 7 July 1999 (Vol. 200 pp. 278-283 of the case materials), copy at tab 31 to this Reply in respect of a claim brought by the Ministry of Taxes and Levies of the Russian Federation Department for Tomsk Oblast against OAO NK Yukos and OAO Tomskneft VNK for declaration of a transaction as invalid, namely the general agreement concluded between the respondents on 04 November 1998.
Finally, see Decision of the Khanty-Mansiysk Autonomous Okrug Arbitrazh Court dated 26 August 1999 (Vol.192 pp.55-57, Vol. 201 pp. 212-214 of the case materials), copy at tab 32 to this Reply and subsequent judgments of the cassational instance courts (Vol.192 pp. 58-63, 64-69, Vol. 201 pp. 215-220, 221-226 of the case materials) copies at tabs 36 - 37 to this Reply in respect of a claim brought by OAO NK Yukos against the Territorial Department of the Ministry of Anti-Monopoly Policy of the Russian Federation for Khanty-Mansiysk Autonomous Okrug for declaration of decisions and orders of the respondent as invalid.
See similarly: Decision of the Khanty-Mansiysk Autonomous Okrug Arbitrazh Court dated 27 May 1999 (Vol.192 pp. 47-51, Vol. 201 pp. 202-206 of the case materials) copy at tab 30 to this Reply in respect of a claim brought by OAO NK Yukos against OAO Yuganskneftegaz and a number of creditors of the latter for a freezing order over assets (oil) to be lifted.

[86] See tab 31 to this Reply; this is found at Vol. 200 pp. 282 of the case materials.

[87] See the Court's question at footnote 2, p.16 of the Statement of Facts "*From 2000 the sales scheme was reorganised*" the Court asked "*It is unclear what called for that reorganisation – the investigations begun in*

G76. The possibility of involving third parties in this manner was explicitly stipulated by the terms of the general agreements: clause 11.2 stated: "*The buyer is entitled, without any authorisation from the seller, to transfer his rights and/or assign his duties arising from the Contracts entered into within the framework of the Agreements.*"[88] The trading companies acted in various capacities in relation to the producing entities: in some instances they were the immediate purchasers of the oil from the producing entities,[89] in others they performed the functions of agents;[90] and sometimes they acted as the ultimate buyers within the group.[91] It is important to emphasise that all these trading companies, irrespective of their legal status in specific transactions (buyers, agents) were part of the Yukos group of companies, were within its perimeter for consolidation purposes, and because of this, were controlled by Yukos, and their profits were included in the consolidated profits of the Yukos group of companies.

G77. During the currency of the general agreements between OAO NK Yukos and its subsidiary producing entities, the amounts of money stipulated by the contracts were paid to the producing entities in full. There was never any challenge to the resolutions of these companies' general shareholders' meetings which approved the general agreements and, as noted above, when the general agreements were contested by the state authorities they were recognised by the courts to be lawful and not in violation of any rights.[92] In this connection it is important to note that the Russian Federation (as represented by the Government) continued to be a minority shareholder in OAO NK Yukos longer than any other minority shareholder – until 2003, and received dividends in that capacity, as well as all the information that is required to be disclosed to shareholders. As a Yukos shareholder the Government, as representative of the Russian Federation, at no stage raised any complaints, objections or even questions in connection with the company's activities.

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certain countries at the request of the Yukos minority shareholders or the applicants' plans to issue Yukos shares on the international securities market."

[88] See tabs 18, 19 and 25 to this Reply, Vol. 53 pp. 161, 215, 246 of the case materials.

[89] See for example, Vol.53 pp. 25-38, 39-42, 50-52 of the case materials; copies at tab 40 to this Reply.

[90] See Vol.49 p.162-164 of the case materials; copies at tab 39 to this Reply.

[91] See Vol.49 p.118-161, 194-196, of the case materials at tab 38 to this Reply, Vol.50 pp. 140-203, of the case materials at tab 41 to this Reply Vol.62 pp. 298-310, Vol.63 pp. 148-163, 172-206 of the case materials at tab 47 to this Reply.

[92] See the decisions referred to earlier at footnote 85.

G78. The practice of purchasing oil on the basis of the general agreements with Yukos' producing entities essentially remained unchanged throughout the entire period covered by the charges brought against the applicants. It was, however, modified in 2000, without rescinding or terminating the general agreements, with a system of competitive bidding in the form of open auctions being added.[93] Any organisation that had applied to the tender committee in due time and that had satisfied the bidding conditions was able to take part in these auctions, which were announced in the press.[94] Therefore, theoretically and technically, during the period 2000-2003 two systems for the procurement of oil were being used simultaneously. However, in reality no contracts for the supply of oil were concluded with independent companies on the basis of the results of the auctions, and all the oil produced by Yukos' producing entities continued to be sold to its own subsidiaries and affiliates on terms that were beneficial to the seller. However, these circumstances are not indicative of any manipulation and/or other dishonesty on the part of the applicants, contrary to the accusations made in the charges.

G79. The reason for the introduction of the auctions was explained by the first applicant during the trial when during his testimony he responded to the question that he himself had raised "*Who set up the process of monthly tenders for the right to enter into contracts for the sale and purchase of oil, and why*?". Mr Khodorkovskiy said:

> "I was the one who set up this procedure, as executive manager of YUKOS, at the request of a number of regional heads (specifically the governor of Tomsk). I knew that holding tenders for the right to conclude contracts of sale was only mandatory for state bodies, and YUKOS and its subsidiaries were not state bodies. However, the governors thought they would be able to attract other buyers to the bidding process, thus increasing the price and therefore shifting the tax burden in favour of their territories. I did not see any necessity to flatly refuse to conduct this pointless procedure, which is not proscribed by law. I was aware that due to technical reasons (a lack of refining capacities), no-one other than the trading subdivisions of YUKOS and other vertically integrated oil companies would be in a position to purchase oil in such volumes (i.e. millions of tonnes). The other vertically integrated oil companies' production capabilities exceeded their capacities for refining, as was the case for YUKOS as well, and therefore they had no interest in purchasing Yukos's oil either." [95]

[93] See tab 42 (found at Vol.67 pp. 280-290 of the case materials) to this Reply.
[94] See tab 17 (found at Vol.67 pp. 318 of the case materials) to this Reply.
[95] See extract of transcript of 13 April 2010 at tab 108 to this Reply.

G80. The first applicant's explanation was never rebutted. Moreover, the objective impossibility for external buyers to acquire large amounts of oil was also confirmed by the testimony of witnesses. The responses to the prosecutor's questions given by former tender commission member T.S. Vedeneeva were noted in the court session record for 14 December 2009:

> "....All the oil that the production enterprises 'Yugansk', 'Samara' and 'Tomsk' produced, they sold at these tenders (the entire monthly capacity), the winner would then need to pay 60%. It was in the region of over five billion. To ensure payment, availability and so on. Within a specific timeframe, because there were specific timeframes set out in the terms of the contracts to be concluded with the winner as to when a certain percentage of the prepayment would have to be paid, it was a prepayment (…).
>
> State prosecutor G.B. Ibragimova: Tatiana Sergeevna, could you please clarify the following. Using your own terminology (to clarify - organisations within the perimeter of NK YUKOS, as you explained to the court), did other organisations that were not within this perimeter, within NK YUKOS, take part in the tenders?
>
> Witness T.S. Vedeneeva: never. This was impossible.
>
> State prosecutor G.B. Ibragimova: could you please shed light on this by going into more detail for the court. Why was this the case?
>
> Witness T.S. Vedeneeva: to buy 3.5 million tonnes at the tenders, to pay 60%, in other words to pay something like 500 million roubles as a deposit, this diverted a huge amount of funds. Plus you would need a transportation contract or at least an agency contract with a production enterprise and a processing contract, and then you would need to sell the oil products that you received, which would require the ordering of railway tank cars, the routing and scheduling of oil tankers, and so on. So, it was impossible in my view," (record of court session dated 14 December 2009).[96]

G81. In addition it is necessary to note once again that the contracts for the supply of specific consignments of products, which were concluded pursuant to the general agreements, stipulated terms that were advantageous to the sellers: consistent oil purchases (twice a month) from them were made at total production capacity (for example, from OAO Yuganskneftegaz – 1,061,849 tonnes under a contract dated 31 December 1998, 1,089,475 tonnes under a contract dated 26 February 1999[97]) which provided them with guaranteed sales and revenues and, by extension, a smooth cash flow. Such payment terms allowed oil production companies to operate successfully,

[96] There was other evidence before the trial court that supported the first applicant's explanation. For instance, in Vol.67, pp. 292 of the case materials, there is record No.5/5 dated 29 May 2000 on the results of the tenders for the conclusion of contracts for the purchase of oil from OAO Yuganskneftegaz, see copy at tab 44(a) to this Reply. According to the record, the tenders were declared invalid, since only one organisation made an application - ZAO Yukos-M (see also vol.67, pp. 291 of the case materials, copy at tab 44(b) to this Reply.

[97] See tabs 27(a) and 27 (b) to this Reply (Vol.53, pp.162-163, 171-172 of the case materials).

including during the 1998 economic crisis in Russia, the consequences of which were felt in the years that followed.

G82. Subsequently, invitations to tender in the form of auctions were made part of the practice of selling oil, even more favourable conditions were created for the producing entities, which stipulated a substantial prepayment by the winner of oil that was acquired under contract. For instance, under the terms of the auction of 29 May 2000 for the sale of a very significant amount of oil – 2,400,000 tonnes, a 100 percent mandatory prepayment was stipulated to be made within three days from the date of signature of the contract.[98] In other cases, buyers were able to make a prepayment of 90% to 100% within 15 days.[99]

G83. As noted above, on various occasions these general agreements were subjected to inspection by the courts at the request of various state bodies (tax and anti-monopoly bodies, the prosecutor's office), and all the courts without fail acknowledged that they were lawful and did not violate the interests of the subsidiary producing entities. It is clear that the terms of the general agreements were favourable to the producing entities, and the auctions clearly could not have provided them with more favourable terms for the sale of oil. As a consequence, the applicants had no reason to manipulate the auctions in their own interests.

G84. Finally, it is to be noted that the Government's argument that the transactions between Yukos, the producing entities and the trading companies were "*fictitious*" and that the trading companies themselves were "*front*" companies were decisively rejected by the Arbitral Tribunal appointed by the Stockholm Chamber of Commerce. On 20 July 2012 the Stockholm Chamber of Commerce delivered the Arbitral Award in the *Spanish Shareholders Award.* [100]

G85. The Tribunal examined whether the Russian Federation had acted lawfully in relation to the re-assessments of Yukos' tax liabilities for the years 2000-2003. As such, a central issue was whether the transactions between Yukos and trading companies in

[98] See tab 42(b) (Vol. 67, pp. 290 of the case materials).
[99] See – Vol.50, pp. 1-4, 5-8, 9-12, 13-16, 17-20 of the case materials. Copies at tab 45 to this Reply.
[100] A copy of the Award was supplied to the Court in November 2012 but for ease of reference a copy is attached at tab 146 to this Reply.

tax havens were "*sham*" transactions and whether the trading companies were themselves "*dummy companies*." The Tribunal was entirely unpersuaded by the "sham" analysis. It stated that it was:

> "unwilling to find that Yukos engaged in sham transactions with its affiliated trading entities. For one thing, the notion of a "sham" suggests something surreptitious, whereas the tax authorities obviously had access to the tax returns of both Yukos and the affiliated entities in question and would, or should, have had little difficulty in seeing that Yukos was assigning significant revenues to the latter by way of inter-company transfers.
>
> …
>
> The sales transactions were just that: the transfer of title to goods for a certain price. From the ultimate independent purchaser, a legal relationship was created between that purchaser and the intermediate Yukos affiliate. There was no "fake" transaction."[101]

G86. The Tribunal went on:

> "Reverting to the issue of Article 209, without needing to adopt Professor Mozolin's word *illegitimate*, the present Tribunal contents itself with observing that the tax authorities' reference to Article 209 seems to have been rather cavalier, reaching for the nearest available general legal text — defining the rights of ownership as possession, use, and disposal — for the sake of appearance, without explaining how the assignment of ownership to Yukos could override the transmission of title, as per the sales contracts, in light of the directly apposite Article 218. Mr Konnov's defence of the tax authorities' approach was that "the tax authorities referred to Article 209 not as a standalone/separate concept but in the context of the anti-abuse theories described above" (2nd witness statement ¶ 43). This comment rather gives the game away; if the reference to Article 209 did not "stand alone", it was unnecessary; if it was unnecessary, why was it invoked, if not as a rather jejune fig leaf? **Rather than a part of the foundation of undoing a sham transaction, this seems to be an indicium of a sham tax assessment**. (The Tribunal is aware that Article 209 may have been invoked by the Tax Ministry once before Yukos, as a basis for making an assessment, but there had been no judicial endorsement of it until Yukos)."[102] (Emphasis added)

(b) Alleged deprivation of management powers

G87. As already shown above, far from amounting to illegal 'coercion' or 'deprivation of powers', Yukos Oil's appointment of the Management Companies as governing bodies of the Yukos producing entities by decision of their general shareholders' meetings was a normal and lawful manifestation of shareholder rights under Russian law.

[101] §§ 67-68 of the Award at tab 146 to this Reply.
[102] § 79 of the Award at tab 146 to this Reply.

G88. In particular, Article 69(4) of the Public Companies Act expressly provides for the shareholders' right to appoint or dismiss a subsidiary's governing body at their discretion. Such decisions require no special grounds or specific justification and are commonplace in parent/subsidiary company relationships in Russia.

G89. This principle is well-established in Russian law and has been upheld by the Constitutional Court. In a ruling dated 15 March 2005, the Constitutional Court held:

> "Art.69(4) of the Federal Law "On joint-stock companies", of an owner's power to terminate an employment contract with the head of an organisation …, without substantiating the necessity of this decision, is aimed at the exercising and protection of the owner's rights to possess, use and dispose of his property, including to determine how to manage it on his own or jointly with others, to freely use his property for entrepreneurial and other economic activities not prohibited by law"[103]

G90. Moreover, where a management company is appointed to act as the company's executive body, its actions in that capacity are the actions of the company itself, just the same as with any individual appointed as CEO. This was confirmed by the Presidium of the RF Supreme Arbitrazh Court in its judgment dated 1 June 2010:

> "[T]he actions of a management company in its capacity as the [management] body of a legal entity are the actions of the legal entity itself. The powers of the management body in this case are determined by the law and the contract on transfer of powers of the executive body." [104]

G91. Accordingly, Yukos Oil acted entirely within its rights as a matter of law when it decided to appoint the Management Companies as the executive bodies of the producing entities in place of their previous general directors. As a matter of fact, in most cases the general directors retained their positions as managers of the producing entities, as they were issued powers to act on behalf of the Management Companies.

G92. Once the Management Companies were lawfully appointed as the producing entities' executive bodies, all decisions taken by them in that capacity and within their competence under the law and the producing entities' constitutional documents were

[103] Ruling of the RF Constitutional Court, 15 March 2005, no. 3-P in a case relating to enquiries from the Volkhov City Court and others. See tab 56 to this Reply.
[104] *Neftegaztekhnologiya LLC v. CJSC NORD-Servis*, Presidium of the RF Supreme Arbitrazh Court, 1 June 2010, no. 18170/09. See tab 116 to this Reply.

legal and in fact an expression of the will of the producing entities themselves. In the meantime, the relationships among those businesses – joint-stock companies – with their shareholders did not undergo any changes, including in terms of control and accountability of the governing bodies to the shareholders.

G93. In light of the above, there were patently no reasonable *bona fide* grounds in law or in fact to characterise Yukos Oil's appointment of the Management Companies as a form of unlawful 'coercion' and "deprivation" of the production entities of "powers" and "independence", including in terms of disposing of their output.

(c) Alleged deceit as to value of the oil

G94. Both as a matter of fact and of law, the prosecution theory (accepted by the trial court) about alleged "*deception of shareholders*" is nothing but a glaring lie.

G95. As a matter of fact, the producing entities' minority shareholders (which only existed until 2000, when Yukos bought out their blocks of shares) could not, in principle, be misled as to the actual value of oil.

G96. In particular, market quotations for Urals oil were constantly published by Platts and by other sources and, therefore, were publicly available. In the meantime, there is nothing in the case file to suggest that the applicants or anyone acting under their direction misrepresented Urals oil quotations to the producing entities' shareholders.

G97. On the other hand, all those taking part in the market, were well aware that the domestic selling prices of oil bore no relation to the export prices of oil (Urals), since those prices are not economically comparable. There was no deception of the shareholders in this regard. On the contrary, the "*deception*" is the state's assertion that Urals prices are applicable to the sale of oil on the domestic market, and at the oilfields in particular. The non-comparability of domestic and export prices is confirmed inter alia by publicly available data on domestic prices in the various regions of the Russian Federation, published by the well-known and established Kortes Information Agency, a Russian energy information provider active since 1991 that specialises in oil, petrochemical, and transportation industry content across the markets of the Russian Federation and Commonwealth of Independent States (CIS).

G98. Deception, meaning the misleading of the owner of property with a view to taking possession of his/its property, as well as coercion, are ways of committing other standalone types of theft such as fraud (art. 159 of the Criminal Code), robbery (art. 162 of the Criminal Code) and extortion (art. 163 of the Criminal Code). Such acts cannot constitute the way of committing misappropriation. In addition, the producing entities were the owners of oil, not their shareholders, let alone minority shareholders. The principal shareholder (and the sole one since 2000) was NK Yukos whose representatives constituted the majority at shareholder meetings. Thus, allegations of "*deception*" or "*coercion*" of minority shareholders as ways of taking possession of production entities' oil are not only false but completely mutually exclusive in regard to the charge of taking possession of the producing entities' oil.

G99. Just as importantly, as a matter of Russian law, transactions falling within the provisions of the Civil Code and the Public Companies Act cited by the court are merely voidable, not void. This means that unless and until such transaction is recognised by a court in civil proceedings on the application of a properly interested party as void, it is deemed valid (Article 166 of the Civil Code). Therefore, any interested shareholder that believed that such transactions were detrimental to his or the company's interests could freely move a court to recognise them as void or reverse them, just like he could challenge in court decisions made by a shareholder meeting to approve such transactions. However, there was never any attempt to challenge any transaction or any decision, whereas the statute of limitations for such claims is set at one year (paragraph 2, art. 181 of the Civil Code) and, therefore, had expired long before the verdict against the applicants was issued. For this reason alone oil sales on terms (including prices) approved by decisions of general shareholder meetings could not be seen as made as a result of deception or illegal "*coercion*" of anyone, including a minority shareholder. Subsequently, in 1999-2000, the shares of all minority shareholders were bought out by Yukos on terms agreed upon with them, and all settlements with them were completed.

(d) How did the law at the time distinguish between agreements which breached only the Public Companies Act and the Civil Code and were thus invalid, or agreements which had an additional criminal intent behind them?

G100. Both misappropriation and legalisation (laundering) are intentional crimes and can only be committed with direct intent when the guilty person is aware of the criminal nature of his acts, foresees the occurrence of their publicly dangerous consequences and wishes them to occur (part 2, art. 25 of the RF Criminal Code). In the meantime, as noted above, in its decision on the first applicant's appeal, the Constitutional Court noted that under no circumstances a lawful civil law transaction could be ruled a criminal act.

G101. By way of contrast, it is possible for a company officer (due to a variety of reasons and circumstances, including accidentally, or, in any event, without having any criminal intent in regard to the company or anyone else) to commit a breach of Article 83 of the Public Companies Act, which sets out the procedure for approval of related party transactions. However, such a procedural violation does not cause a transaction to be ruled void.[105] It must be proved that the vote of the plaintiff who has appealed to a court could have influenced the results of the vote and that harm was done to the plaintiff's or company's rights and legitimate interests. In addition, such lawsuits may not be granted if the transaction was subsequently approved. Finally, even the finding of a related transaction void would not have meant any presence of criminality in making and performing the transaction. The only consequences of a transaction that contradicts the requirements of the law being recognised as void are bilateral or unilateral restitution, depending on the nature of the violation (see paragraph 2, Article 167 of the Civil Code).

G102. Article 179 of the Civil Code provides various grounds for recognising a transaction to be void on the grounds of "*fraud, coercion, a threat or an ill-intentioned agreement*" of the injured party.[106] Although some of these grounds will almost always involve bad faith acts by the counterparty with a view to harming the injured party (for instance in the event of conspiracy or deception), invalidating a transaction on that ground does not mean that such person's acts were criminal but merely entails

[105] See part 1, Article 84 FZ "On Public Companies". A copy is at tab 12 to this Reply.
[106] Article 179 of the Civil Code is at tab 10 to this Reply.

property consequences in the form of reinstatement of the victim's violated rights. In particular, if the alleged deception, coercion or conspiracy did not cause the contract to be made or did not affect its material conditions then, regardless of the third party's intention, there is no violation of Article 179. In addition, invalidating a transaction on any grounds is only possible by way of action proceedings under the rules of civil procedure. A court hearing a criminal case does not have such powers, it can only consider a civil suit over infliction of harm caused directly by the crime (Article 44 (1) of the RF CCrP). On the contrary, a court considering a civil case does not establish criminal intent or other elements of the crime and is not authorised to make decisions on their presence or absence.

G103. As already mentioned above, in order to make a finding that an act (whether an action or omission) is of a criminal nature it must first be established in accordance with Article 8 of the Criminal Code that all of the mandatory elements of criminality, as set out in the relevant provisions of the RF Criminal Code, are present. Clearly this can only be done by a court seized of a criminal case.

G104. Finally, the applicants can respond succinctly to the Court's question at footnote 2, page 11. "*The judgment, with some exceptions, did not specify how many votes the applicants had at the general meeting of shareholders, how many votes they needed to approve the sales of oil, and why those approvals were obtained in breach of the Public Companies Act.*" This issue does not in fact arise as there was no challenge to the decisions. All decisions were passed by the board of directors or general shareholders' meeting according to their remit, and indeed the minority shareholders had not applied to be "injured parties" or been recognised as such during the applicants' trial[107]. However, the applicants have no difficulty in answering the Court's question. Yukos, which was under the applicants' control, had a majority of votes until 2000 and thereafter all votes (following the purchase of the minority shareholders' interests at an agreed price that was not challenged). None of the shareholders ever sought to challenge any of the decisions of the shareholders'

[107] The minority shareholders could have applied to an Arbitrazh court to challenge the decisions, but did not do so. They could also have applied to the court hearing the criminal case against the applicants to be recognised as injured parties if they considered that they were immediately affected by the alleged "criminality". In the instant cases the minority shareholders made no such applications. Nor did the prosecution or the court seek to recognise them as injured parties. It follows clearly from this that the question of "deception" of minority shareholders is not relevant to the point at issue in the criminal case, specifically the charge of theft of oil.

meetings, and none of the courts entitled to hear shareholders' disputes has ever found that there was a breach of the Public Companies Act. Moreover, all the oil sale transactions were subsequently approved in 2002 under the procedure established by law by the sole shareholder (when the company was preparing for its IPO), which in itself excludes any legal possibility of the transactions being contested.

G105. In this connection the applicants once again draw the Court's attention to the fact that the Russian Federation continued to be a minority shareholder in OAO NK YUKOS longer than any other – until 2003, receiving dividends and information on the company's operations in this capacity, and no complaints, objections or even questions were ever raised by the representatives of this shareholder.

Question 35. How did the court calculate the "market price of oil" which served as a basis for calculating the overall value of the "misappropriated" oil? Was it correct, in calculating the price of the oil allegedly misappropriated by the applicants, to use the market price of oil and its derivatives in the ports of Amsterdam, Rotterdam, etc. as the starting point, rather than the domestic prices (see, in particular, page 616 of the judgment)?

SUMMARY OF THE GOVERNMENT'S RESPONSE

G106. The Government state that the court calculated the "*market price of oil*" in accordance with the minimum and maximum Urals quotes for oil on board a ship in the Rotterdam or in Mediterranean ports (paragraph 281 of the Memorandum). They then proceed to mislead the Court by stating that forensic expert examinations established the market value of oil purchased by Yukos from the producing entities (paragraph 282) of the Memorandum. Instead, as noted above in paragraph G45, the prosecution experts were given instructions by the investigators as to what price they should use to calculate the revenues from the sales. This revenue, which was identified by the experts by multiplying the Urals prices by the volumes of oil sold (in a number of cases making mathematical errors in their calculations), was subsequently presented in bad faith by the prosecution and court as the "*damage caused by the theft*". With the specific objective of avoiding exposure of these machinations, the defence was not permitted to make enquiries in court with regard to the findings of these experts and their competence, which is dealt with in more detail in the applicants' replies to the Questions in section F above.

G107. The Government assert that the misappropriation occurred in Russia at the oil fields in Siberia or Povolzhie (paragraphs 245 and 254 of the Memorandum) but, without explanation, then proceed to state that the value of the stolen oil was assessed by reference to the quotes for oil in Rotterdam or Mediterranean ports.

APPLICANTS' RESPONSE TO THE COURT'S QUESTIONS

G108. The trial court defined the "*market price of oil*" by reference to the market quotations of Urals oil[108] on board a ship in Rotterdam or in Mediterranean ports. In doing so the court did not analyse any specific transactions involving sales of oil. The cassational court rejected the defence arguments that the trial court had been wrong to do so[109]. These Urals oil quotations were compared against data on prices at which Yukos and its trading companies purchased oil from the producing entities at the oil fields in Siberia or Povolzhie. The cassational court endorsed that approach.[110]

G109. The defence repeatedly argued that in a criminal case concerning alleged "*theft*" of oil at oil fields in parts of Russia, valuation by reference to market quotations of oil and its derivatives in Rotterdam or the Mediterranean was completely unacceptable and constituted falsification of charges. The trial court dismissed the applicants' arguments (as well as the witness evidence in support) giving knowingly false and meaningless "*grounds*":

> "From the testimony of witness **A.Ye. Mirlin** it follows that he, while working for ZAO Yukos RM, was involved in establishing prices and calculating the weighted average sale price for oil products that YUKOS RM was selling on the domestic market. Prices for crude oil refining products in the ports of Augusta, Amsterdam or Rotterdam are much higher than the prices at which oil products are sold to Russian users and purchasers. His opinion that the oil was not stolen is based on the data on the balance-sheet of oil processing at Yukos plants.
>
> Disagreeing with the arguments of the defence, who submitted that oil product prices in Dutch and Mediterranean ports were higher than on the Russian market – and that because of that pricing on the domestic market was different from market prices abroad

[108] Urals oil is a reference oil brand used as a basis for pricing for the Russian export oil mixture. It is a mix of heavy and high grade oil of the Urals and the Volga region with light oil of Western Siberia.
[109] See p.55 of the cassational ruling at Volume C, tab C232, of the November 2011 Memorial: "*The lawyers' arguments that the court, when determining the amount of what was stolen, applied wrongfully the concept of "world market price" and "Rotterdam price," failed to take into account that prices in other production companies in the regions of operation of Yukos had been similar and did not assess the testimony of witnesses Kasyanov, Gref, and Khristenko, are also rejected by the collegium.*"
[110] See p.34 of the cassational ruling at Volume C, tab C232, of the November 2011 Memorial.

> just as the oil prices on the domestic and global markets were different – and, consequently, the defendants were incorrectly charged with theft of all the oil at the prices that existed on global markets, the court also cannot agree with the testimony of witness A.Ye. Mirlin because it has been established in the court hearing that misappropriation of oil was constituted by execution of documents concerning its sale at understated prices and therefore according to the documents the volumes of oil did not disappear but moved from production companies to the ownership of Yukos and its operating companies."[111]

G110. "By disagreeing" with the defence and the witness Mirlin, a Yukos employee, the trial court at the same time ignored or distorted the evidence given by the witnesses Kasyanov and Khristenko, (Prime Minister and vice-premier of the RF Government respectively in the period that falls within the time frame of the charges), who explained the following to the court:

> **Khristenko**: "If we are talking about the pricing process, then on the whole the Russian domestic price differs from that of Rotterdam by an amount that constitutes export duty, as a rule, as well as logistical costs. In fact, this is why the export duty is usually introduced – to level out the field or adjust how the domestic market operates."[112]
>
> **Kasyanov**: "...export duty is a very important part... in the case of oil exports, removing the bumper profits which oil companies may generate... domestic prices differed substantially from the foreign prices, they... are much lower... on the Russian market, than say, at the European Commodities exchanges"[113]

G111. Moreover, Rosneft itself, in its official financial statements audited by the companies PWC and Ernst&Young, which were published in the public domain and were never disputed or questioned by anyone, stated the following: "*Sale of product to companies in the YUKOS group was conducted on regular commercial terms at market prices.* "[114]

G112. As the defence argued in its supervisory review, cited above at paragraph G49, the trial court's approach, and that of the superior courts that agreed with it, was deeply flawed, arbitrary, and manifestly inconsistent with the applicable domestic law, of which the government was patently aware, as well as with established court practice formed prior to the applicants' prosecution and conviction – see for example the

[111] See p. 616 of the verdict. A copy of the verdict is at Volume C, tab C213, to the November 2011 Memorial.
[112] See Trial record dated 22 June 2010, p. 5 (Vol.253 c.f.s. 47-80) at tab 121 to this Reply.
[113] Trial record dated 24 May 2010 (Vol. 249 c.f.s. 121-140) at tab 114 to this Reply.
[114] See tab 52 to this Reply, Vol. 264 p. 170 of the case materials.

judgment of the Federal Commercial Court for West Siberia Okrug dated 22 October 2001, an extract from which is cited above at paragraph G46.[115]

G113. It was flawed *inter alia* for the following reasons:

(a) It is a clear impossibility for export supplies to take place between Russian counterparties and yet here the purchasers of the oil from the producing entities were always Russian companies;

(b) Urals oil is a general brand reference which incorporates a wide variety of crude oils of varying quality extracted in Russia (REBCO – Russian Export Blend Crude Oil). Therefore, the Urals oil price itself had no precise or necessary relationship to the value of the crude oil at the point where it was actually extracted by each of the producing entities, and nor could it possibly have had such a relationship. It also was not a price used in any specific transactions with oil;

(c) The Urals oil price references used by the court were CIF ('cost, insurance, freight') prices for delivery to Rotterdam in the Netherlands ('Urals (Rotterdam)') and to Augusta in Italy ('Urals (Mediterranean)'). No adjustments were made for the costs associated with delivery of the oil to those ports, which include, *inter alia*, high export duties and customs fees,[116] freight costs, insurance costs, storage costs, port fees and the costs of pipeline access and oil transit through these pipelines;

(d) In addition, CIF Rotterdam and CIF Mediterranean prices assume that the risk is borne by the seller up until its delivery to a water-borne vessel travelling the final leg to Rotterdam or Augusta. In the case of oil extracted by the producing entities, this would include the assumption of risk of loss for the entire length of the crude oil's delivery within Russia, i.e. for very substantial distances (3-4 thousand kilometres) from Siberia (in the case of

[115] The judgment was at Vol.268 p.12-15 of the case materials and was relied upon by Mr Lebedev in his cassational appeal, see p.13, a copy of which is at Volume C, tab C227, of the November 2011 Memorial.
[116] See p.17 of the supplementary cassational appeal at Volume C, tab C227, of the November 2011 Memorial and extract from the statement of Mr Lebedev at tab 104 to this Reply (Vol. 264, 225 of the case materials)

Yuganskneftegaz and Tomskneft) or the Volga Region (in the case of Samaraneftegaz) to the Baltic Sea (as per Urals (Rotterdam) prices) or the Black Sea (as per Urals (Mediterranean) prices);

(e) None of the above-mentioned costs were incurred by Yukos' production entities and, therefore, the prices of oil purchased from them could not be and were not set taking into account such costs. Yet the verdict makes the knowingly false claim that the 'victims' were exporting oil by themselves,[117] while alongside this it is alleged that the 'theft' of the oil was committed immediately at the oilfields, which is where the act was completed, and also that this 'theft' involved the transfer of title;[118]

(f) Only 30-40% of the oil that was produced by the "*injured parties*" was supplied for export. The remainder was supplied to the Russian oil refineries.

G114. These flaws were succinctly expressed by the defence expert, Mr Haun, whose report the trial court refused to admit:

> "Yukos and its management are accused of buying the oil from its exploration and production companies at a price that was lower than the end user price. The charges ignore one very basic fact. No purchaser of crude oil, whether an affiliated trading company or an independent third party, would pay a price at the wellhead equal to the price of crude oil after it has been treated and transported to a port or marketing location. To pay such a price at the wellhead would ignore the costs of transporting, treating, and selling the crude oil as it moves from the wellhead through the segments to consumption. Oil at the wellhead is not as valuable, nor will it receive as high a price, as oil that has been treated and transported to a major trading point, or to a shipping port.
>
> For example, for the month of February of 2000, according to the Russia's Publishing House "Oil and Capital" the price of crude oil for Khanty-Mansiysk Region was 907.4 R Rubles per metric ton, which is equal to $4.31 USO per barrel. According to Energy Information Administration of the US Government, the price in the same month for Daqing crude in China was $25.50 USD per barrel; the price in Australia for Gippsland crude was $26.45 USD per barrel; and the price in United Kingdom for the UK's BRENT was $27.49 USD per barrel. Hence, the price that customers paid in various world markets was almost 6 times the value of the oil at the well-head in Siberia.
>
> According to a JP Morgan analysis, Yukos, Sibneft and Lukoil were all selling their oil from their exploration and production companies to their refining and marketing companies at prices that were lower than the full export price as could easily be justified.

[117] pp. 40 and 67 of the verdict at Volume C, tab C213, of the November 2011 Memorial.
[118] For example see pages 652, 675 of the verdict at Volume C, tab C213, of the November 2011 Memorial.

The Russian government at the time was considering imposing a reference price for such sales:

> "The government has proposed the introduction of a reference price for intra-company transactions. This would enable the government to collect similar amounts from all the players calculated on the basis of a 'market price' for oil. The problem centers on how to determine this with the internal market for crude oil (sold to third parties) both small and opaque. Officials have proposed that it be worked backwards from product prices, given that a vibrant product market is in operation in Russia. This, though, looks unworkable."

Major vertically integrated oil and gas companies use their trading subsidiaries to sell their production because it makes business sense to do so. The exploration and production companies are huge and have to operate their production which is very technical in nature. The functions of trading, logistics and transportation are in the downstream affiliates because it allows the exploration and production companies to focus on their asset driven business while trading works with refining and marketing to sell or upgrade the crude oil and be constantly responding to market changes. Vertically integrated oil and gas companies that are very large such as Yukos and all of the other major international oil and gas companies, operate this way. Yukos dealt with its production units in line with industry custom and practice for major vertically integrated oil and gas companies."[119]

G115. This perverse approach allowed the courts to classify as "misappropriation" what was in fact a very profitable activity for the producing entities. The courts even ignored the incontestably established fact that the producing entities were not only compensated, but received a hefty profit (around US$ 3 billion) from the sale of crude oil as compared to its actual cost. Indeed those profits were recorded in the verdict:

> "in 2001,… **profit made** by three producing enterprises amounted to **RUB 26,756 mln** over that year. In 2002,… **profit made** by three producing enterprises amounted to **RUB 4,154 mln** over that year." [120]

G116. This information had been provided to the court by the current owner of the '*injured parties'*: the state-owned company Rosneft.

G117. The trial court's use of the price of Urals oil was flawed economically (for the reasons set out, *inter alia,* by the defence expert Wesley Haun cited above and in the defence application for supervisory review cited above), and it was directly contrary to the 2007 Ruling which states (at paragraph 25):

[119] See p. 82-83 of his report at tab 97 to this Reply.
[120] p. 674 of the Verdict at Volume C, tab C213, of the November 2011 Memorial.

> "When determining the cost of property misappropriated as a result of… embezzlement… [the courts] should proceed from its actual cost at the moment the crime was committed. If there is no information about the value of the misappropriated property, its cost may be established on the basis of an expert report" [emphasis added].

G118. In light of the 2007 Ruling, the international and indeed the domestic market price of the producing entities' crude oil was entirely irrelevant. Under the applicable law, one of the mandatory criteria under which the oil sales did not constitute its '*gratuitous taking*' amounting to criminal 'misappropriation' is that the producing entities received proceeds from the sale of the oil in an amount that always exceeded its 'actual cost'. The concept of the 'actual cost' to the producer of a product was and is well established in Russian accounting law and practice as the aggregate of expenses required for the production of that product.[121]

G119. The fact that that the producing entities received proceeds from the sale of the oil in an amount that always exceeded its '*actual cost*' and that in fact they received profits was clearly demonstrated by evidence provided to the trial court by the producing entities themselves: a point forcefully emphasised in the second applicant's supplementary cassational appeal:

> "The oil-producing companies confirmed to the court they had achieved the following financial performance for the entire period of **2000-2003** (which could only be assessed in *"Danilkin's verdict"* by virtue of the requirements of Art. 78 CC RF):
>
> **OAO Yuganskneftegaz** (in the person of OAO Rosneft):
>
> proceeds: RUB 183 bln;
> cost of production (actual cost): RUB 150.1 bln;
> **profit** from sale of oil: RUB **32.9** bln.[122]
>
> **OAO Tomskneft:**
> proceeds: RUB 68.3 bln;
> cost of production (actual cost): RUB 58.7 bln;
> **profit** from sale of oil: RUB **9.6** bln.[123]
>
> **OAO Samaraneftegaz:**
> proceeds: RUB 46.3 bln;
> cost of production (actual cost): RUB 38.3 bln;

[121] See Article 11 of the Federal Law on Accountancy (as in force at the relevant time), paragraph 23 of Ministry of Finance Order no. 34n of 29 July 1998. A copy of which is at tab 15 to the Reply.
[122] See copy of the evidence cited at tab 136 to this Reply. This is found at Vol. 268 c.f.s. 103 of the case materials.
[123] See copy of the evidence cited at tab 135 to this Reply. This is found at Vol. 268 c.f.s. 107 of the case materials.

profit from sale of oil: RUB **8** bln.[124]

Thus, as per above pieces of evidence, total **profit** from sales (sale) of oil the three companies made amounted to: **RUB 10 bln 344 mln** in 2000; RUB **26 bln 756 mln** in 2001; RUB **4 bln 154 mln** in 2002; and RUB **9 bln 287 mln** in 2003**.**

As a result, total **profit** from sales (sale) of oil OAO Yuganskneftegaz, OAO Tomskneft, and OAO Samaraneftegaz made over 2000-2003 amounted to **RUB 50 bln 541 mln.**

Over 2000-2003, with the **actual cost** of oil of **RUB 247.2 bln**, OAO Yuganskneftegaz, OAO Tomskneft, and OAO Samaraneftegaz generated from its sales total **proceeds of RUB 297.7 bln** and, accordingly, total **profit** from sales (sale) of oil of more than **RUB 50.5 bln (~ USD 2 bln)**."[125]

(Emphasis as per original).

G120. Instead of establishing the actual cost, the courts simply made references to Western European oil quotations, a contrivance for which there was no foreseeable basis in domestic law. The defence objections to this approach were rejected by the cassational court in a judgment that this Court is both entitled and indeed should conclude is "*manifestly unreasonable*":

"The lawyers' argument that the court, when determining the amount of stolen [property], unlawfully applied the concept of 'world market prices' and 'Rotterdam prices' and failed to take into account that similar prices were applied in other extraction companies in the regions where Yukos operated… is rejected by the [appeal court] panel… [A]ccording to the above-mentioned paragraph 25 of the [2007 Ruling], when determining the cost of property misappropriated as a result of… embezzlement… [the courts] should proceed from its actual cost at the moment the crime was committed. If there is no information about the value of the misappropriated property, its cost may be established on the basis of an expert report, which occurred in this case.

The evidence examined by the court confirms that there was no actual (market) cost of the oil in the regions where it was extracted. The market price could not be formed because the oil business in Russia was carried out by major oil companies which, through sales contracts between dependent companies, formed the price level for the region. But these prices were far from the level of real market prices… [emphasis and explanation added].[126]

G121. It is self-evident that the trial court's conflation of 'actual cost' and 'market value', and equally its division of market prices into 'real' and 'unreal' is another example of

[124] See copy of the evidence cited at tab 134 to this Reply. This is found at Vol. 268 c.f.s. 105 of the case materials.
[125] See the supplementary cassational appeal of the second applicant, a copy of which is at Volume. C, tab C227, of the November 2011 Memorial,
[126] pp. 55-56 of the cassational ruling, a copy of which is at Volume. C, tab C73, of the November 2011 Memorial.

its numerous absurdities and arbitrariness. It is also clearly apparent that the crude oil, like any asset, had an actual cost; if it did not, then there would have been nothing of value to 'misappropriate' (nor to sell). A comparison of actual sales prices with the crude oil's actual cost, however, did not fit into the prosecution case theory, because by that benchmark the producing entities obtained sizeable profits, which in itself ruled out theft. Therefore, the prosecution and the courts simply substituted the actual cost with an imputed and knowingly irrelevant "world market price". Moreover, they did not impute an actual cost reasonably related to the moment and place the crime was allegedly committed (as prescribed by the 2007 Ruling), but instead invoked a hypothetical scenario in which the producing entities themselves had already made delivery of the crude oil to the European ports of Rotterdam and Augusta, with no adjustment for higher export duties, customs fees and the business expenses that were necessary to achieve that result but were never left for the producing entities to incur.

G122. This unwarranted substitution of concepts was not only contrary to the requirements of the law, RF Supreme Court's binding guidance and widespread law-enforcement practices. It had the consequence of artificially converting wholly legitimate economic activity into a vast criminal enterprise. As summarised by the trial court in its verdict (at page 618):

> "The court comes to the conclusion that the defendants managed activities of OAO Samaraneftegaz, OAO Yuganskneftegaz and OAO Tomskneft VNK not with the objective of receiving the maximum profit from their business activity but rather with the objective of producing the maximum amount of oil and concentrating the profit in the profit centre of the holding company."

G123. In making this absurd and unlawful contention that the aim of increasing oil production and concentrating profits in the holding's profit centre was 'criminal' in nature, the trial court, inter alia, ignored the binding position of the RF Constitutional Court regarding the objectives of the establishment and operation of a vertically integrated holding company similar to Yukos. As set out in paragraph 5.1 of Ruling no.3-P dated 24 February 2004:

> "A number of the applicants were minority shareholders of the subsidiaries of large joint-stock companies structured as holding companies, where consolidation of shares had the primary purpose of creating vertically integrated business structures as part of an effort to switch subsidiaries to a "unified share" owned by the master company, and sought to

> satisfy the criterion of general well-being of the joint-stock company such as creation of a unified profit center, improved governance of subsidiaries, higher value of shares of the master company, stronger investment appeal, and, eventually, obtainment of competitive advantages both in the domestic and foreign markets...."[127]

G124. In sum, the applicants' alleged 'crime' was that they, through their control over Yukos Oil, operated the producing entities and achieved increased oil production so that the said entities obtained profits, and so as to bring profit to the Yukos Oil group as a whole.

Question 36. Did the court try to assess the difference between the "internal price" as applied by Yukos to pay the producing entities in the regions where the oil was extracted, and the price which the producing entities' competitors (i.e., the oil-extracting subsidiaries of Lukoil, Sibneft, TNK, etc.) in those regions received for their oil?

SUMMARY OF THE GOVERNMENT'S RESPONSE

G125. The Government do not directly answer the Court's question.

G126. The Government assert that the trial court concluded that "*there were no actual (market) oil prices in the regions of its production and sales*" (paragraph 284 of the Memorandum). The court's conclusion is manifestly unreasonable and arbitrary: any property always has an "actual" or "factual" value that is quite distinct from its "market price" which is variable – see further the applicants' response below.

APPLICANTS' RESPONSE TO THE COURT'S QUESTIONS

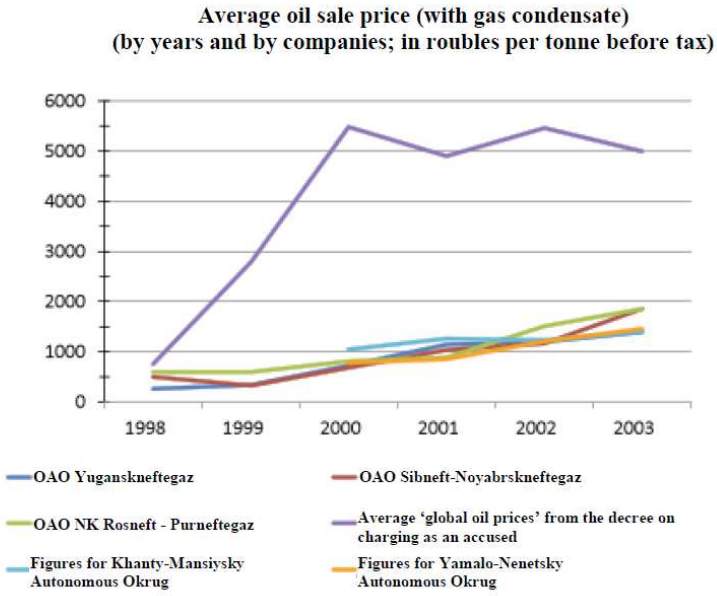
G127. The applicants invite the Court's attention to the fact that any matters of pricing in oil sales are incompatible with the allegation of theft of this same oil, because property that has been sold at any price cannot have been stolen.

G128. The courts repeatedly refused not only to take account of, but even to examine, the "internal price" as applied by the producing entities' competitors in the regions where the oil was extracted, despite the defence arguments that they were directly relevant to determining the case against the applicants. Thus, for example, the trial court refused to admit the report from the defence expert Mr Wesley Haun who gave evidence

[127] See copy at tab 54 to this Reply.

(some of which is cited above) that bore directly upon this point, as well as all the other materials and documents that contained such information.

G129. In fact, the case file contained official statistics of average oil prices within specific regions of Russia in the period 2000-2004 that had been prepared by the Tax Ministry.[128] These figures clearly demonstrated that such prices were far below foreign export market prices, and also that the Yukos producing entities' prices were very closely aligned with those of its domestic competitors such as Rosneft and Sibneft, while differing from them within a 10-20% band in both directions. The following graph, which was presented by the first applicant during his testimony to the trial court, clearly illustrates the comparison:



G130. Since the Tax Ministry's figures were only average prices, the applicants sought to establish the actual range of prices to demonstrate that Yukos Oil's internal prices fell reasonably within industry standards. Accordingly, the applicants sent requests to the Federal Antimonopoly Service seeking to obtain specific price information in respect of certain other Russian oil majors active in the Tyumen Region (the place of Yukos Oil's main production subsidiary, Yuganskneftegaz), and in particular Sibneft and the

[128] See tab 51 to this Reply which is to be found at case materials Vol. 86, pp.301-305.

Russian State-owned Rosneft Oil Company. None of these enquiries received a substantive response.[129]

G131. When the applicants then applied to the court requesting that it send requests of their own to the Federal Antimonopoly Service concerning the internal prices of Rosneft and Sibneft during the relevant period, their application was rejected on the basis that prices of such other companies were "*not the benchmark prices*"[130]

G132. Moreover it is to be noted that Yukos' competitors were themselves buying oil from Yukos at the "theft" prices: see for example the contract between ZAO Yukos-M and OAO Rosneft-Krasnodarneftegaz, one of Rosneft's subsidiaries dated 1 March 2000.[131]

G133. Finally, it is to be noted that the trial court's conclusion that there was "*no actual (market) oil prices in the regions of its production and sales*" is manifestly incorrect. There is a statutory mechanism for determining the factual value of property. Clearly the value of the stolen property must be established – see paragraph 25 of decree No. 51 of the Plenum of the RF Supreme Court already cited: "*Determining the value of property stolen as the result of fraud, embezzlement, or misappropriation, one ought to proceed from its* ***factual value*** *as of the moment of the commission of the crime."* The factual value of output is determined for the producer based on the factual expenses for its production.[132] In the instant case, the factual value of oil for its producer is the sum of the expenses for production and treatment of the oil (bringing it up to GOST's 9965-76 and/or TU 39-1623-93 quality).[133]

[129] See lawyer's inquiries dated 9 July 2009 and 27 January 2010 and trial record of 29 July 2010 (Vol.257 c.f.s. 106-142, copies at tab 126 and the petition of the applicants' lawyer Mr Dyatlev dated 29 July 2010 which is at Volume C, tab C176, of the November 2011 Memorial (Vol.257 c.f.s. 102-104 of the case materials).
[130] See p.50 of the record of court session dated 5 August 2010 where it is recorded **"***the Court sees no grounds for satisfying the mentioned motion, since the prices of the mentioned companies are not the benchmark prices*". The record of court session dated 5 August 2010 at tab 127 (Vol.258 c.f.s. 45-97).
[131] See copy at tab 41(i) to this Reply. See Vol.50 c.f.s. 157-160.
[132] See para 51 of Order No. 25n of the RF Ministry of Finance On Confirmation of the Instruction on Budgetary Accounting of 10 February 2006; earlier - para 3 PBU 5\98 (conf. by Order No. 25n of the RF Ministry of Finance of 15 June 1998), para 7 PBU 5/01 (conf. by Order No. 44N of the RF Ministry of Finance of 9 June 2001), para 59 of the Provisions on the Conducting of Financial Accounting and Financial Reporting in the RF (conf. by Order No. 34n of the RF Ministry of finance of 29 July 1998). Copies at tab 8 to this Reply.
[133] See further the applicants' supervisory appeal section 1.2 of 22 February 2012, at tab 144 to this Reply.

Question 37. Did the court assess the difference between the "internal price" of Yukos oil as applied on the date when it crossed the border (i.e. changed hand between a Russian trading company and a foreign trading company) and the prices of oil extracted by Yukos's competitors in Russia and declared by them at the border for the purpose of export?

SUMMARY OF THE GOVERNMENT'S RESPONSE

G134. The Government state **"***The court did not assess the difference between the "internal price" of OAO NK YUKOS oil as applied on the date when it crossed the border (i.e. changed hand between a Russian trading company and a foreign trading company) and the prices of oil extracted by OAO NK YUKOS' competitors in Russia and declared by them at the border for the purpose of export. This assessment would be biased and would not reflect the actual market oil price*" (paragraph 286 of the Memorandum).

APPLICANTS' RESPONSE TO THE COURT'S QUESTIONS

G135. As the Government themselves conceded, the short answer to the Court's question is "no". It will be recalled that the court rejected all the defence motions for discovery of the documents which contained information about prices applied in the oil transactions by Rosneft, Sibneft, and its subsidiary trader companies over the period of 1998-2003. Information obtained would have demonstrated unequivocally to the court what experts such as Wesley Haun and Kevin Dages had stated in their reports: namely that Yukos' activities with respect to production, refining, and sale of oil, including internal corporate prices in the oil sales transactions, were no different from those at other leading Russian oil-producing companies.

G136. Theft is considered completed as of the moment when the thief has an opportunity to dispose of stolen property at his discretion. Because the applicants were charged with "stealing oil" from the producing entities directly at the oil fields, an analysis of export prices was beyond the limits of proving that charge.

Question 38. **The applicants alleged that the material conclusions of the Khamovnicheskiy District Court contradicted earlier findings by the other courts which examined cases against the applicants themselves, against their business partners and against Yukos plc as a whole. In particular, in the applicants' words, the award made against Yukos in previous proceedings were based on the assumption that Yukos was a *de facto* owner of the oil which had been traded through the chain of "sham entities" (trading companies). In the criminal case under examination the court decided that the oil had been the property of the producing entities, which had been "embezzled" by the applicants. How did the findings of the Khamovnicheskiy District Court accommodate the earlier findings of the courts in the criminal cases and tax proceedings related to the activities of Yukos? More generally, does Article 7 of the Convention, or any other Convention provision, in particular Article 6, guarantee consistency in the individual decisions of domestic courts concerning the same matters and the same parties, let alone consistency in the case-law?**

SUMMARY OF GOVERNMENT'S RESPONSE

G137. The Government acknowledge that the judgments of these courts established "*that OAO NK YUKOS was the owner of oil produced by oil producing companies, which implied that it was impossible to treat actions committed by the applicants as the oil theft*" (paragraph 290 of the Memorandum). They cite the RF Constitutional Court Ruling no. 30-Il but ignore a key passage in that ruling (see further the applicants' response below).

G138. The Government rely upon the arbitrary conclusions drawn by the courts at every level in which they sought to draw a legally impermissible distinction between *de facto* and *de jure* ownership (paragraphs 292, 294 and 296 of the Memorandum) – see further the applicants' analysis of that issue below.

APPLICANTS' RESPONSE TO THE COURT'S QUESTIONS

(a)The earlier judgments

G139. The defence referred to a number of verdicts and judgments of domestic courts[134] concerning the activities of Yukos which established:

[134] The applicants have not supplied copies of these judgments to the Court for fear of over-burdening the Court but would of course be happy to provide them, in paper and /or on a CD-rom.

(a) The oil produced by the producing entities of OAO NK Yukos (the "*injured parties*" in the trial) was sold by them on the basis of agreements involving exchange for value, moreover, at a price that exceeded the factual value (lifting cost). The given agreements were lawful, valid, and factually executed. The proceeds from the sale of this oil were received by the "injured parties" in full and were entered on their books; [135]

(b) This oil did not leave the lawful possession of the producing entities of Yukos against their will and was shipped by them to end users; [136]

(c) The practice of corporate mutual relations that had emerged between the head company and subsidiaries in Yukos, including the establishing of intra-corporate prices for oil purchased from the production enterprises, corresponded to the law and did not violate anybody's rights;[137]

(d) The main objective of the activity of the trading companies under the control of NK Yukos that were registered on territories with a tax-haven regime

[135] See Judgment by the Commercial Court KhMAO [Khanty-Mansiysky Autonomous Okrug] of 27 May 1999 in case no. 3254 – G-/98-G; Judgment by the Commercial Court KhMAO of 10 December 1999 in case no. 2682-G; Judgment by the Commercial Court KhMAO of 26 August 1999 in case no. 850-; Judgment by the Tomsk Oblast Commercial Court of 07 July 1999 in case no. A-67-1476/; Judgment by the Commercial Court of the City of Moscow of 07 April 2005 in case no. A40-64943/04-108-387; Order by Povolzhsky Okrug FAS [Federal Anti-Monopoly Service] of 08 February 2000 in case no. A55-5301/99-13; Verdict by the Miass City Court of Chelyabinsk Oblast of 16 July 2007 regarding N.A. Lubenets; Verdict by the Kushva City Court of Sverdlovsk Oblast of 07 February 2007 regarding A.I. Ivannikov; Judgment by the Simonovsky District Court of the City of Moscow of 19 April 2006 regarding S.P. Bakhmina.

[136] See: Judgment by the Commercial Court KhMAO of 27 May 1999 in case no. 3254 – G-/98-G; Judgment by the Commercial Court KhMAO of 10 December 1999 in case no. 2682-G; Judgment by the Commercial Court KhMAO of 26 August 1999 in case no. 850-A; Judgment by the Tomsk Oblast Commercial Court of 07 July 1999 in case no. A-67-1476/99; Judgment by the Commercial Court of the City of Moscow of 07 April 2005 in case no. A40-64943/04-108-387; Order by Povolzhsky Okrug FAS of 08 February 2000 in case no. A55-5301/99-13; Verdict by the Miass City Court of Chelyabinsk Oblast of 16 July 2007 regarding N.A. Lubenets; Verdict by the Kushva City Court of Sverdlovsk Oblast of 07 February 2007 regarding A.I. Ivannikov; Judgment by the Simonovsky District Court of the City of Moscow of 19 April 2006 regarding S.P. Bakhmina.

[137] See: Judgment by the Tomsk Oblast Commercial Court of 07 July 1999 in case no. A-67-1476/99; Judgment by the Commercial Court of the City of Moscow of 04 May 2005 in case no. A40-4096/05-128-50; Order by Povolzhsky Okrug FAS of 08 February 2000 in case no. A55-5301/99-13; Judgment by the appeals instance of the Commercial Court KhMAO of 27 January 1999 in case no. 2682-G/98; Judgment by the appeals instance of the Commercial Court KhMAO of 15 October 1999 in case no. 805-A\99; Order by FAS ZSO [Western Siberian Okrug] of 31 March 1999 in case No. F04/683-121/A75-99; Order by FAS ZSO of 27 December 1999 in case F/2726-621/A75-99; Verdict by the Nefteyugansk District Court KhMAO of 4 February 2006 regarding T.R. Gilmanov.

was to get an economic (which includes tax) advantage from selling oil and oil products;[138] and

(e) The given trading companies (traders) functioned and received profit exclusively in the interests of the YUKOS holding company, which was recognised as the owner of all the oil and the beneficiary from its sale.[139]

G140. Under domestic law a court is bound to have to "recognise" findings of fact established in final judicial decisions "without additional verification" (see Article 90 of the RF CCrP which was set out above in Section D at paragraph D4). Those judgments had all come into legal force at the time when the verdict against the applicants was delivered and so the trial court was bound by their findings of fact by reason of Article 90 of the RF CCrP and the principle of *res judicata*.

G141. In the *Academic Commentary on Practice in Criminal Cases (Collected Conclusions of the chair in criminal procedure of the Urals State Legal Academy)*, Professor A.D. Proshlyakov considered the question "*Is a decision of a commercial court in relation to a civil case of any significance for the criminal justice authorities during the process of investigation and examination of a criminal case?*" His learned answer is set out below:

[138] See: Judgment by the Commercial Court of the City of Moscow of 15 October 2004 in case no. A40-45410/04-141-34; Judgment by the Commercial Court of the City of Moscow of 23 December 2004 in case no. A40-61058/04-141-151; Judgment by the Commercial Court of the City of Moscow of 28 April 2005 in case no. A40-4338/05-107-9; Judgment by the Commercial Court of the City of Moscow of 26 May 2004 in case no. A40-17669/04-109-241; Verdict by the Nefteyugansk District Court KhMAO of 04 February 2006 regarding T.R. Gilmanov; Verdict by the Miass City Court of Chelyabinsk Oblast of 16 July 2007 regarding N.A. Lubenets; Verdict by the Kushva City Court of Sverdlovsk Oblast of 07 February 2007 regarding A.I. Ivannikov; Verdict by the Basmanny District Court of the City of Moscow of 13 March 2006 regarding D.A. Velichko; Verdict by the Basmanny District Court of the City of Moscow 04 April 2008 regarding A.A. Karaseva at Vol.C, tab C80; Verdict by the Meshchansky District Court of the City of Moscow of 16 May 2005 regarding P.L. Lebedev and M.B. Khodorkovskiy at Vol. C, tab C31; Verdict by the Lesnoy City Court of Sverdlovsk Oblast of 16 July 2008 regarding S.G. Karfidov; Verdict by the Samara Oblast Court of 19 May 2006 regarding P.A. Anisimov and Ye.I. Marochkina.

[139] See: Judgment by the Commercial Court of the City of Moscow of 15 October 2004 in case no. A40-45410/04-141-34; Judgment by the Commercial Court of the City of Moscow of 23 December 2004 in case no. A40-61058/04-141-151; Judgment by the Commercial Court of the City of Moscow of 28 April 2005 in case no. A40-4338/05-107-9; Judgment by the Commercial Court of the City of Moscow of 26 May 2004 in case no. A40-17669/04-109-241; Order by FAS MO [Moscow Oblast] of 17 September 2004 in case No. KA-A40/6914-04-I, B; Judgment by the Commercial Court of the City of Moscow of 20 May 2005 in case no. A40-8352/05-139-49; Judgment by the Commercial Court of the City of Moscow of 10 June 2005 in case no. A40-6287/05-116-74; Judgment by the Commercial Court of the City of Moscow of 4 May 2005 in case no. A40-4096/05-128-50.

"Article 28 of the Criminal Procedure Code of the Russian Soviet Federal Socialist Republic (1960) formerly established that a decision, determination or judgment in a civil case that had entered into legal force was *binding* for a court, prosecutor, investigator or person conducting an inquiry during the course of proceedings in a criminal case only insofar as concerned whether an event or act had taken place, and not insofar as concerned the guilt of the convicted person.

These prescriptions of criminal procedure law also applied in full to commercial courts examining civil cases.

In accordance with Art.90 of the Criminal Procedure Code of the Russian Federation, circumstances established by a court decision that has entered into legal force are to be recognised by a court, prosecutor, investigator or inquiry officer without any further inquiry, provided these circumstances are not doubted by the court.[140]

There is no provision similar or equivalent to Art.28 of the Criminal Procedure Code of the Russian Soviet Federal Socialist Republic in the current criminal procedure law. However, this does not mean that a court decision in a civil case that has entered into legal force has ceased to be of any significance for criminal proceedings.

Firstly, under an analogy that has always been recognised in criminal procedure law it is entirely possible for the provisions of Art.90 of the Criminal Procedure Code of the Russian Federation to also be applied to a court decision in a civil case. It should be noted that it was precisely in this manner that the prescriptions of Art.28 of the Criminal Procedure Code of the Russian Soviet Federal Socialist Republic applied in relation to previous verdicts, since the Criminal Procedure Code of the Russian Soviet Federal Socialist Republic said nothing about their being of res judicata effect in respect of subsequent criminal case proceedings.

Secondly, Art.7 of the Federal Constitutional Law 'On Commercial Courts in the Russian Federation' dated 28 April 1995 contains an instruction that judgments that have entered into legal force - decisions, determinations and rulings of the commercial courts - *are binding for all* state authorities, local government bodies, other authorities, organisations, officials and citizens, and are to be given effect throughout the whole of the territory of the Russian Federation.

Thirdly, Art.6 of Federal Constitutional Law no.1-FKZ dated 31 December 1996 'On the Court System in the Russian Federation'[1] (as amended as of 25 December 2012) establishes that rulings of federal courts, magistrates and courts of constituent territories of the Russian Federation that have entered into legal force, as well as their lawful instructions, demands, orders, summonses and other communications, are *binding* for all state authorities, bodies of local self-government, public associations, officials and other individuals and legal entities *without exception* and must be strictly complied with everywhere in the Russian Federation.

[140] The edition of Art.90 of the RF CCrP that was in force at the time of the delivery of the verdict, as introduced by a Federal Law dated 29/12/2009, reads as follows: "*Circumstances that have been established by a verdict that has come into legal force or by another court decision taken during the course of civil, commercial or administrative proceedings that has come into legal force shall be recognised by the court, by the prosecutor, by the investigator and by the inquiry officer without any further inquiry. At the same time such a verdict or decision cannot predetermine the guilt of a person that has not previously been involved in the criminal case under examination.*" The conclusion which is quoted was written during the period when the previous edition of Art.90 of the RF CCrP was still in force, and the content of the conclusion which is quoted shows that the conclusion's writer has anticipated the development of the legislation and provides further proof of the correctness and reasonableness of his findings.

These provisions, which are contained in federal constitutional laws, are of greater legal force that the provisions of the Criminal Procedure Code of the Russian Federation, and must be applied, inter alia, by the criminal justice authorities during the investigation and examination of criminal cases, directly and immediately, irrespective of whether or not the relevant provisions are contained in the criminal procedure law. However, these laws do not contain any clarifications concerning which of the component parts of a court decision are binding (the description and substantiation section, the operating section)[141]. The res judicata effect of any court decision is traditionally thought of as one of the elements and manifestations of the universally binding nature of decisions.

The Plenum of the Supreme Court of the Russian Federation, in para 23 of ruling no.64 'On the Practice of Application by the Courts of Criminal Legislation Relating to Liability for Tax Offences'[2] dated 28 December 2006, explained that when examining criminal cases relating to tax offences the courts must take into account decisions of commercial courts and general jurisdiction courts that have entered into legal force, and also other decisions issued in civil proceedings that are of significance to the case. These decisions are to be assessed together with the other items of evidence gathered in the case under the rules of Art.88 of the Criminal Procedure Code of the Russian Federation.

However, it is entirely apparent that a commercial court decision that has entered into legal force in a civil case cannot be subjected to assessment during the examination of a criminal case from the perspective of its admissibility and credibility, since that would essentially mean subjecting it to a review under criminal procedures. Consequently, a commercial court decision that has entered into legal force in a civil case cannot be treated as an ordinary document, but rather it is of *special evidential significance*.

The special evidential value of a commercial court decision that has entered into legal force in a civil case was also confirmed by the Constitutional Court of the Russian Federation in a legal position that was expressed in Determination no.193-O-P dated 15 January 2008 in respect of an application by the citizen Tatevos Romanovich Surinov regarding the violation of his constitutional rights by Article 90 of the Criminal Procedure Code of the Russian Federation.[142] The Constitutional Court of the Russian Federation came to the conclusion that circumstances that have been confirmed by a commercial court which favour the accused may only be rebutted after the enforceable commercial court judgment that has entered into force has been annulled under the procedures specified for this purpose. To act otherwise would not be consistent with the Constitution of the Russian Federation and the rules of evidence established on its basis by the criminal procedure legislation. Thus, Art.90 of the Criminal Procedure Code of the Russian Federation does not envisage the possibility that circumstances that have been established by decisions of a commercial court in a civil case that have not been overturned and have entered into legal force may not be taken into consideration during the examination of a criminal case until such time as they are disproved by the prosecution.

Thereby the Constitutional Court of the Russian Federation essentially recognised circumstances established by a commercial court decision that has entered into legal force as a form of presumption - a specific occurrence of the presumption of innocence, which must necessarily be rebutted by the prosecution during the trial proceedings in a criminal case."[143]

[141] In the original text there is a footnote stating "Nor are there any of these in Federal Constitutional Law no.1-FKZ dated 7 February 2011 'On the General Jurisdiction Courts in the Russian Federation' (as amended as at 1 December 2012) (Collected Legislation of the Russian Federation. 2011. No.7. Art.898)."
[142] In the original text there is a footnote stating "Supreme Court of the Russian Federation 2007. No3."
[143] See copy of the extract from the Academic Commentary at tab 148 to this Reply.

G142. Thus, the Khamovnicheskiy District Court was required by law to take into account the factual circumstances that had been previously determined by judgments that had entered into force in Arbitrazh proceedings and tax courts. The primary objective in including this wording of the article into the RF CCrP was (and that is confirmed by numerous writings and commentaries) to establish once and for all that the findings of judgments in civil and tax cases are binding on a court in a criminal case. In its Ruling no. 193-O-P of 15 January 2008, the RF Constitutional Court said:

> "presumption of innocence dictates recognition by the court of all facts bearing witness in favour of the accused - until they have been refuted by the party of the prosecution in proper procedural form … circumstances corroborated by a commercial court bearing witness in favour of an accused may be disallowed only after an executable judicial act of a commercial court that has entered into legal force has been vacated in the procedures prescribed for this. …
>
> Thus, Article 90 of the Criminal Procedure Code of the Russian Federation does not envisage the possibility that circumstances that have been established by decisions of an arbitration court in a civil case that have not been overturned and have entered into legal force may not be taken into consideration during examination of a criminal case until such time as they are disproved by the prosecution, and therefore cannot be treated as a violation of the constitutional rights of T.R. Surinov."[144]

G143. These principles were reaffirmed by the RF Constitutional Court in a subsequent judgment dated 21 December 2011 no 30-P, which was handed down only days before the supervisory ruling in the applicants' case:

> "The refutation of the res judicata effect of a judicial act taken in the course of civil proceedings on the basis of simply the disagreement of the investigator (or the court) conducting the proceedings in the criminal case with the conclusions set forth in this judicial act… would allow the legal force of the court decision to be overridden in violation of the constitutional principle of presumption of innocence and the ensuing specific features of proof in the criminal proceedings, and to ignore the substantiated doubts over the person's guilt ensuing from the res judicata effect (if the decision in the civil case points to his innocence)."[145]

G144. Despite the terms of Article 90 of the RF CCrP, which the authorities were most definitely aware of, and the mandatory legal positions of the RF Constitutional Court, the verdict contradicts prior related cases in Russian domestic courts, as well as the RF Government's case in the *OAO Neftyanaya Kompaniya Yukos v. Russia*

[144] See Determination of the Constitutional Court of the RF no. 193-O-P, 15 January 2008, at Vol. C, tab C76 of the November 2011 Memorial.
[145] A copy is at tab 142 to this Reply.

proceedings before this Court, and equally the Court's findings in that case. The punitive tax re-assessments that bankrupted Yukos were validated in Russia by numerous rulings in cases brought before the courts. In those cases the structuring and terms (including price) of these same transactions for the sale of oil by Yukos' producing entities were scrutinised and characterised specifically as sale (not theft). Either what took place was the sale of oil by the producing entities, accompanied by the transfer of the title to the oil to the buyers (this is a legally settled fact under Russian law as determined by all previous courts) or, the applicants stole the oil, in which case it could not have also been bought from the injured parties and then sold. In finding the applicants guilty of stealing, the court created an irreconcilable contradiction with an entire corpus of previous domestic judicial findings as well as the findings of this Court.

(b) How did the findings of the Khamovnicheskiy District Court seek to accommodate the earlier findings of the courts in the criminal cases and tax proceedings related to the activities of Yukos?

G145. In his report for the Presidential Council, Professor Luchterhandt summarised the arguments used by the trial court to accommodate the earlier findings of the courts that contradicted its own conclusions:

> "The [trial] verdict [declared] irrelevant more than 60 decisions of commercial courts of Russia since 2004 which had regarded the sale-and-purchase agreements as valid and, therefore, NK Yukos as the owner of oil was the pinnacle of Judge Danilkin's egregiously wrongful actions…..
>
> The Khamovnichesky Court tries to neutralise the positions of the commercial courts, which differ drastically from its position regarding the ownership issue, by means of three arguments:
>
> (1) *First*, it claims that the commercial courts dealt specifically just with the issue of tax evasion during transaction manipulations by Yukos concern, rather than with the ownership issue. One could retort to that that the commercial courts examined without doubt and had to examine the ownership relations because taxation could only concern oil which OAO NK Yukos had obtained legally as an owner. The court's objection to that argument by Khodorkovsky aims to conceal that circumstance the goes without saying by means of technical tax definitions and digression from the circumstances of the case (24). As per the verdict, relations where taxes are paid to the budget are the object of a tax crime. It is the difference between income and expenses, rather than the ownership, that is the basis for the calculation of tax. The verdict disregards [the fact] that a criminal should not pay tax on that difference either if it arises as a result of sales of what was stolen; rather, it shall be confiscated by the state as a part of the stolen property. Worse still, it suggests by its line of reasoning that it would be fair to punish Khodorkovsky and Lebedev for theft of all the oil Yukos sold in 1998-2003, at the same time obligating

Yukos to pay tax in the entire amount of profit made over that period from sales of the same allegedly stolen oil.

(2) *Second,* the court claims that the commercial courts assessed the sale-and-purchase agreements as valid because they [the commercial courts] fell into a trap of respective claims by Yukos managers and, furthermore, had not yet known about the "oil theft mechanisms" the Khamovnichesky Court is now aware about already. That remark borders on misleading because the court is not relying on facts that were unknown during the first trial and are therefore, new ones. The "mechanism" is more of a reference to the conclusion of the master agreements and the oil sale-and-purchase agreements that the Khamovnichesky Court simply assesses differently now, namely as a means of "theft by the accused of another's property entrusted to them". This happens, as will be shown in greater detail below, with complete, grotesque distortion of the crime of "embezzlement"[146] (Art. 160 Criminal Code).

(h) The court claims that the commercial courts regarded concerning the tax issues they examined (30) that the oil was just "*de facto* owned" by OAO NK Yukos. The verdict says the following about it *verbatim*:

> "The aforementioned court judgment affirmed that OAO NK Yukos had *de facto* had rights of possession, use and disposal of oil and oil products and had carried out with regard to them at its discretion any actions, including alienation, transfer for refining through a number of entities dependent on OAO NK Yukos and that OAO NK Yukos had been the beneficiary of economic benefits through specifically established entities dependent on the company. Thus, it follows from those commercial court judgments that the oil was transferred into the factual ownership of OAO NK Yukos; however, it was not the oil owner *de jure*. In reality, the oil belonged to its producing subsidiaries."

The verdict makes an attempt here to reconcile its claim that OAO NK Yukos was not the owner of oil with the decisions of the commercial courts to the contrary. To do that, it invented the "factual ownership" concept and ascribes it to the commercial courts in order to make thereby an impression that they did not regard OAO NK Yukos as the oil owner either. But, in reality, the commercial courts, invoking Art. 209 of the RF Civil Code, only talk about "ownership" all the time, and that is absolutely appropriate *de jure* because the Russian civil law does not know the difference between "factual" and "*de jure*" ownership (28). Ownership right in the Civil Code is, like everywhere, the quintessence of rights, a legal institution where rights of possession, use, disposal and sale are its nucleus. The Khamovnichesky Court makes "factual ownership" out of one comment by the Moscow Commercial Court, made most likely in passing, by the way, that the one who "*de facto*" has rights of possession, use, disposal, etc. and "*de facto*" exercises its rights is the owner in the *de jure* sense pursuant to Art. 290 of the Civil Code and it [the Khamovnichesky Court] tries to impress it by means of a verbal trick that the matter in question in this event is a special, stand-alone form of manifestation of ownership along with "*de jure* ownership." The only point of that "civil law" structure in the verdict brought forth by the malicious intent and crossing over the border of the ridiculous is to present OAO NK Yukos not as the owner of oil because otherwise it would have been impossible to explain the punishment of Khodorkovsky and Lebedev for theft of oil as allegedly another's property entrusted to them and the trial would have had to end in an acquittal.

(i) ….. The thing is that the Khamovnichesky Court goes against not just the commercial courts' decisions but also the official position held by Russia during consideration of

[146] See earlier the applicants explanation of "misappropriation" and "embezzlement."

> OAO NK Yukos's application at the European Court of Human Rights since 2004. There, Russia has been defending itself against the charges that its officials and justice destroyed Yukos by means of groundless tax claims and bankruptcy proceedings tampering and cold-bloodedly turned it into a state-owned company in order to prove lawfulness of the additional tax claims on the oil Yukos had sold as an owner."[147]

G146. Other experts who reported to the Presidential Council were equally critical of the trial court's approach: Professor O.M. Oleynik, head of the Department of Entrepreneurial Law of the Faculty of Law of the National Research Unit, Higher School of Economics, commented:

> "If one proceeds from this, then, being guided by the instructions of the RF Criminal Code, both the prosecutor's office and the court should have first attained the repeal of the previously adopted court decisions in the established procedure on various grounds, and only after this issued the verdict being analysed.
>
> But otherwise, it turns out that court decisions recognising the corresponding agreements as lawful and a court decision proceeding from the premise that the given agreements are void retain their legal force concurrently. Such a discord can not exist in a rule-of-law judicial system."[148]

G147. Finally, it should be noted that the trial court not only blatantly ignored the requirements of the law regarding prejudicial meaning of circumstances established in other courts' effective judgments but subjected them to review and also resorted to conjecture regarding motives underlying those courts' findings. Thus, the court illegally appropriated the powers of those superior instances.

(c) Does Article 7 of the Convention, or any other Convention provision, in particular Article 6, guarantee consistency in the individual decisions of domestic courts concerning the same matters and the same parties, let alone consistency in the case-law?

G148. Article 19 requires the Court "*ensure the observance of the engagements undertaken by the Contracting Parties to the Convention*": see *Perlala v. Greece*, no. 17721/04, § 25, 22 February 2007. In doing so, the Court must have regard to whether any inconsistency between individual decisions of domestic courts concerning the same matters and the same parties is such as to lead the Court to conclude that one of the decisions was arbitrary, "*manifestly unreasonable*" or a consequence of a "*flagrant*

[147] pp. 218-220 of the report at tab 140 to this Reply.
[148] p. 254 of the report at tab 140 to this Reply.

denial of justice" (to use the language used by the Court in considering a complaint of Article 7, see above at paragraphs G14 to G19).

G149. Thus it is not suggested that the Court should become a court of third or fourth instance but that the Court should carefully scrutinise:

(a) whether or not the patent disparity between the domestic decisions in the related cases indicates that the trial court has wilfully disregarded the applicable provisions of Article 90 of the RF CCrP; and

(b) whether the court's conclusion in the verdict that the applicants stole oil, despite countless other domestic judgments that concluded that Yukos' producing entities had sold the "*stolen*" oil, is "*arbitrary*" and "*manifestly unreasonable*". There can be no doubt that the conclusions were a "*flagrant denial of justice*".

Question 39. What proportion of the profits received from the sale of oil extracted by the producing entities or processed in Yukos's refineries was "returned" to Yukos and its producing entities? Was the return of profits (reinvestment) made in the form of gratuitous payments (without any obligation to re-pay) or did the producing entities receive funds from the trading companies in exchange for something, such as promissory notes, for example, or as credits? If the reinvestment was one-way, without reciprocal provision of securities, goods or obligations, what was the legal basis for such transfers? If, in order to justify such payments, the producing entities had to issue promissory notes to the payers, were those promissory notes always issued by the producing entities themselves, by Yukos plc, or by any other intermediary company or companies?

SUMMARY OF THE GOVERNMENT'S RESPONSE

G150. The Government do not answer the first of the Court's questions in Question 39.

G151. The Government assert at paragraph 303 of the Memorandum that through *"the loan obligations the applicants and other members of their organised group intended to continue the production of oil with a view of its subsequent misappropriation as well as to recover interest rates from the oil producing companies for the provided loans*"

– an allegation that is not found in the verdict of the trial court. Moreover, ensuring the production of oil by the producing entities must be something in the best interests of the producing entities as well as serving a socially useful purpose.

APPLICANTS' REPLY TO THE COURT'S QUESTIONS[149]

G152. At the outset the applicants respectfully draw the Court's attention to the fact that they were not charged with stealing any monetary funds. As the Government make plain in their Memorandum, the accusation against the applicants was that they had stolen oil.

G153. The producing entities received substantial profits from the sales of their oil production, as explicitly confirmed by the verdict itself. In aggregate between 1998 and 2003 the producing entities received roughly US$ 3 billion in profits on oil sales.[150] The producing entities received all of their profits as a consequence of the sales of the oil that they produced, under contracts of sale (supply), its sales profitability was about 20%. Those profits were never removed from them and, therefore, no question arose as to "returning" the profits to the producing entities. As far as Yukos' consolidated profits, those were distributed for dividend payments and various needs following decisions of authorised governing bodies and were not in any other way taken outside the consolidation perimeter. That is why the applicants proceed from the fact that, in the context of this question of the Court, the issue at hand is in fact the distribution of profits in Yukos, not their "return", because for profits to be "returned" to a company they need to have first been removed from it, which did not take place.

[149] The applicants' reply to the issues raised in Question 39 also addresses the question at footnote 1, p. 18 Statement of Facts: "It is not entirely clear how the money was "returned" to the producing entities and to Yukos itself. The prosecution implied that the "trading companies" had been accumulating profits from the sales without any reciprocal obligation vis-à-vis the producing entities or Yukos to return those profits in the future. Therefore, to reinvest the money the applicants needed to fabricate a sham legal transaction which would explain the transfers. In such transactions the money accumulated on the trading companies' accounts would be exchanged for something valuable – for example, the promissory notes of Yukos. However, those promissory notes would have to be repaid, sooner or later, and the "loans" would have to be returned. The question is how, in this scheme, the producing entities' legal obligations to the trading companies would ultimately be extinguished."

[150] See the notes in relation to the revenue and profit of the producing entities – at tabs 134-136 to this Reply. The documents are to be found at Vol. 268, c.f.s. 103, 105, 107 of the case materials. They were referred to in the second applicants' supplementary cassational appeal, a copy of which is at Volume C, tab C227, of the November 2011 Memorial.

G154. In the course of the trial, both applicants drew the court's attention to the fact that the principal company, OAO NK Yukos, was entitled to take as dividends from the oil producing companies, or any other subsidiaries, all the profits received by these companies or any part thereof; however it never did that. Thus, the first applicant explained to the court:

> "Notably, this is something I am drawing particular attention of the court to, that during that period, by decision of the sole shareholder … OAO NK Yukos, that profit invariably remained at the producing companies' disposal and represented a free source of working capital to double the oil production. I will explain, Your Honour; Yukos, as the sole shareholder, was fully entitled to take all that profit to itself as dividend, while exactly the opposite happened: Yukos left all profits [of the producing entities] at the disposal of the oil producing enterprises."[151]

G155. Where funds were reinvested in the producing entities, this took place in the usual manner as with any other company, i.e. either through direct capital investment or debt financing (where additional operational funds were required). Debt financing was advanced through intra-corporate loans made by Yukos Oil group companies specially set up for the purpose of financing group operations, such as Yukos Capital S.a.r.L, or by Yukos Oil itself from its Production Development Fund, which was operated in accordance with internal company regulations.

G156. The purpose and effect of this approach was clearly described in the Record of Interview by Counsel by Bruce Misamore, Yukos Oil's Chief Financial Officer:

> "In 1998, Yukos created a management company named Yukos-EP in order to establish more uniform, value-focused, efficient and cost-effective operations for the [Producing entities]. It is well known within the oil and gas industry that exploration and production companies are very capital intensive and require a relatively predictable cash flow to function properly and grow. Since they are so capital intensive, they also have a higher risk of waste and abuse. The centralization of management under Yukos-EP was essential in transitioning Yukos' exploration and production operations to operate like other major vertically integrated international oil and gas companies around the world…
>
> Thus, Yukos management restructured the company from a geographically managed business with a large number of disjointed entities, to a segmented company… These changes gave Yukos a significant economic advantage because each company in the structure did not hire duplicate staff or incur duplicate expenses. In doing so, Yukos took advantage of economies of scale and eliminated duplicate functions, and thereby, greatly reduced operating and management costs…
>
> The concept of an efficient holding company is redistribution of capital at a point where it will maximum the rate of return. The object is to benefit the entire group of companies

[151] See trial record dated 29 October 2010 at tab 137 to this Reply, Vol. 272, p. 174 of the case materials.

> consolidated under the umbrella of a holding company. Accordingly, each was treated [not only] as a separate cost or profit centre, but also as part of a larger entity and capital was allocated between entities in a manner so that cash flows were optimised and allocated between the companies of the Yukos group to achieve the best overall result. In order to do so in Yukos, management assessed the potential return and investment requirements and allocated cash were required or desirable to try to achieve the best return for the company as a whole. For example, Yukos allocated the funds from the [refining and marketing] segment to the [exploration and production] segment because projects in [exploration and production] were expected to be more attractive economically than those in [refining and marketing] were expected to be.
>
> Yukos absolutely did not siphon cash flow out of the [producing entities]. To the contrary, Yukos was constantly re-investing into the [producing entities]… In fact, Yukos constantly advanced funding well in excess of the cash flow from [the producing entities] because production projects were generally the most profitable projects in the company and capital directed to these companies and their projects was highly desirable. As I understand the prior years, and I know with certainty from 2001 forward, all decisions regarding distribution of capital, operations, and management of the producing entities were aimed at growing these subsidiaries disproportionately as part of the vertically-integrated holding company structure. They were the most attractive investment opportunities and received much more capital than their shares of revenues."[152]
>
> (Emphasis added).

G157. In addition to the profits obtained directly from the sales of crude oil and investment and financing from the Yukos group, the producing entities received other substantial economic benefits as part of the Yukos Oil group of companies. These included use of the Yukos Oil brand, an expanded market share, know-how and other benefits achieved from greater economies of scale as part of an integrated holding.

G158. Perversely, the prosecution and the courts characterised this centralised budgeting policy, which actually operated to the overall advantage of the producing entities, as an extension of the applicants' 'criminal' enterprise. The reinvestment of funds was characterised as 'money laundering' which, when used to develop the producing entities' production, had the alleged aim of 'further embezzlement' (see pp. 52, 62-63 and 72 of the verdict).[153]

G159. The second applicant explained to the trial court that Yukos had gratuitously provided billions of roubles as it funded capital expenditures into the oil producing companies

[152] See pp. 8-12 of the record of interview at tab 88 to this Reply (Vol. 197, p. 22 of the case materials).
[153] The verdict is at Volume C, tab C213, of the November 2011 Memorial.

and, with reference to specific documents,[154] pointed out that Yuganskneftegaz explanatory notes refer to amounts obtained by that producing entity on a unilateral basis (in exchange for no value) for capital expenditure purposes. In addition, oil producing entities received know-how *gratis* and used such know-how in their production operations.[155]

G160. The case file materials similarly include explanations as to the reasons for financial support to the producing entities in exchange for value.

G161. Mr Leonovich, Yukos Treasury Chief stated in his interview record:

> "If the profit remaining at the disposal of the producing enterprises was insufficient to fund capital projects such as exploration and development drilling, well workovers, etc., the treasury would arrange for long-term investment loans to be provided to them on terms and conditions approved by the Company. Such redistribution of financial resources within OAO NK Yukos took place pursuant to reasonable requests of its subsidiaries and within an approved budget. This was consistent with the Russian and global operating practices of vertically integrated companies."[156]

G162. Mr Bruce Misamore, Chief Financial Officer of Yukos stated:

> "The only reason why the funds were repatriated to Yukos in Russia through the use of intra-company loans is simple: tax minimization and cash management flexibility strategy, which was and continues to be today a common practice not only for Russian companies, but by virtually all companies involved in international commerce. Using the mechanism of loans is a tax-efficient vehicle available to multi-national companies for moving money amongst operations, and results in saving money by reduced income tax on profits transferred from offshore subsidiaries, and paying either no withholding tax altogether or the withholding tax is greatly minimised by doing so."[157]

G163. Mr Stephen Wilson, Chief of Yukos' International Taxation Division stated:

> "The use of intra-group loans is an extremely common mechanism for moving funds around a group in a tax efficient manner and is certainly not unique to Yukos. Withholding taxes on interest are usually lower than for dividends and interest expense is often tax deductible whereas dividend payments are not. It would not have been appropriate to ignore these simple tax characteristics when deciding on how to fund the Russian production subsidiaries. The mechanism is commonly used by companies around the world. I understand that the mechanism of intra-group borrowing was also employed at Yukos on a domestic level. For example, if Yukos trading companies in Russia had excess funds which were needed to fund capital expenditure of the production

[154] To be found at Vol. 210, p. 167 of the case materials. See copy at tab 53 to this Reply.
[155] To be found at Vol. 272, p 174 of the case materials. A copy is at tab 137 to this Reply.
[156] See tab 111 to this Reply.
[157] See p. 34 of the record of interview at tab 88 at tab 88 to this Reply.

subsidiaries, then a trading company would lend the money to a production company."[158]

Question 40. Were the applicants free to withdraw the money concentrated in the trading companies and use that money at their own discretion? In other words, what guarantees (besides the applicants' good will) were there that the profits accumulated in the trading companies would be returned to Yukos plc or to its producing entities as reinvestment or for the payment of dividends etc.? Did the situation in this respect change at the point when Yukos started to include its major trading companies in the consolidated financial reports, under the US GAAP rules?

SUMMARY OF THE GOVERNMENT'S RESPONSE

G164. The Government state (entirely misleadingly) that "*the first applicant confirmed that he had disposed of the money received from the sale of oil at his own discretion, without taking into account the opinion of the shareholders and management of the company, and stated that he had paid remuneration to persons who had rendered services to OAO NK YUKOS in the amount and in the manner he had deemed appropriate. Nobody, including the minority shareholders of OAO NK YUKOS, could prevent him from paying that money, because essentially nobody could interfere with the course of execution of the decisions he had taken as the principal owner of YUKOS and its sole executive director*" (paragraph 306 of the Memorandum). The correct position in relation to the first applicant's testimony in this regard is set out above at paragraph G79.

G165. Similarly, the Government make false assertions in relation to information contained within the consolidated financial statements and the distribution of profits (see paragraphs 308-312 and 319 of the Memorandum). For example, the Government assert that "*the consolidated financial statements did not contain all the information to be disclosed under the Russian laws and did not allow any user of this information to build up a complete view of Yukos's activity*" (paragraph 309 of the Memorandum). They also claim that the "*applicants' uncontrolled use of the income accumulated in the accounts of the trading companies, has not changed after their inclusion in consolidated financial statements in 2000*" (paragraph 319 of the Memorandum). Nonetheless the Government do finally acknowledge that the

[158] The Record of Interview with Counsel is at tab 109 to this Reply.

producing entities received payment for the oil that was purportedly stolen by the applicants (see paragraphs 313 and 318 of the Memorandum).

APPLICANTS' RESPONSE TO THE COURT'S QUESTIONS

G166. The applicants once again note the fact that they were not charged with stealing any funds, including from the trading companies' proceeds. The object of "theft", according to numerous allegations in the verdict, was oil produced by Yukos' producing entities. Accordingly, the applicants view this question of the Court as a theoretical question that is not linked to the legal substance of the charges and the verdict. The applicants respond so as to assist the Court as best that they can and, of course, to defend their good name. The fact that these questions are asked by the Court is a yet further demonstration of the incomprehensibility of the charges brought against the applicants and the ensuing verdict.

G167. Profits (after tax) of a legal entity can only be disposed of by shareholders who, as represented by authorised governing bodies, are entitled to dispose of the company's profits exclusively at their discretion, including using the entirety of the profits to pay dividends and for any other purposes that are not against the law. Undoubtedly, the first applicant, as the principal shareholder in Yukos (via GML) and the Chairman of the Executive Committee of the Board of Directors of Yukos, had the right to participate, and did in fact participate, in the governing bodies' decision-making to distribute profits of the subsidiaries and of the parent companies. The second applicant, who, as director of GML,[159] managed the controlling stake in Yukos, participated in distributing profits of the parent company by attending and voting at shareholder meetings. This is precisely what the applicants told the court.[160] The applicants could not, and never attempted to, freely remove the money accumulated within the trading companies or use it at their own discretion. Any such decisions would have to be made by the governing bodies of the companies within the group. Such instances did not occur, and no such examples are found in the criminal case file. On the contrary, it follows from all of the company documents that all the

[159] At footnote 1, page 9 to the Statement of Facts the Court asked "*It is unclear whether GML became the direct owner of that block of shares immediately after the privatisation or some time [later], and whether this ownership structure remained the same throughout the period under examination, i.e. 1998-2003*." A detailed response to this question is at Annexe 2 to this Reply.

[160] There was never any doubt as to the applicants entitlement to act in this way or that they had such authority.

monetary funds available to the trading companies were used for the common benefit of the Yukos group of companies.

G168. In his Record of Interview with Counsel, Mr Bruce Misamore stated:

> "I understand the prosecution alleges that Messrs. Khodorkovsky and Lebedev harmed the production subsidiaries by the manner in which the oil was taken from them without appropriate compensation and that the prosecution quantifies this harm as being in the amount of 892 billion Rubles or 25.3 billion USD using an exchange rate of 35.3. Both the concept and the figure are contrary to the facts and logic. In fact the prosecution's allegations reflect a complete vacuum of understanding, probably deliberate, of the workings of the Russian domestic oil markets and international accounting practices. I rely upon Yukos' auditing and reporting safeguards and on my personal knowledge as CFO about how the company used the revenues it generated, which for 1998- 2003 amounted approximately $55.165 billion as a basis for rejecting completely the possibility of embezzlement by the majority shareholders as alleged by the prosecution. The auditing and reporting safeguards are described in detail below. Regarding expenditures, Yukos paid for operating expenses, research and development, made capital expenditures, paid taxes, made acquisitions, repaid debt and distributed shareholder dividends, and it did so without incurring any new debt until the acquisition of Sibneft. All of these cash outlays are reflected in the company's consolidated US GAAP financial statements. It is impossible that Yukos could have funded all of its required expenditures if massive amounts of money had been embezzled from its operations. It is really simple math. For example, in 2001 Yukos generated $9.461 billion in revenues and paid among other things, the government $ 2.777 billion in taxes, paid $3.7 billion in expenses, expended $2.9 billion for investment, activities which included capital improvements and acquisitions, and distributed $468 million of the net profit as dividends to all Yukos shareholders, while retaining $1.4 billion in cash and cash equivalents at the end of the year. Thus, contrary to the charges, it would have been impossible for the majority shareholders to have embezzled these funds. Nor is there any basis to believe that any of these expenditures is fictitious because Yukos could not have achieved its tremendous success if the money was being embezzled rather than pumped back into the company for the benefit of all shareholders."[161]

G169. The principal means of ensuring that profits were either distributed or accumulated within the trading companies was found in Yukos' corporate governance system that incorporated controls on a number of levels: the Company's Board of Directors, the Audit Committee, financial services, and external auditors. A number of further factors ensured profits were disposed or accumulated including: a) buyer obligations to pay for the oil, as set out in the contracts in a legally binding manner; b) the fact that the trading companies fell within the Yukos group and were thereby controlled and c) the financial policy pursued by Yukos' management.

[161] See pp.12-13 copy of the Record of Interview at tab 88 to this Reply (to be found at Vol. 198, p. 15 of the case materials).

G170. All transactions in which Yukos' oil-trading companies took part were included in the consolidated financial statements under the GAAP rules, and were also confirmed by the auditors PwC.[162] Behles Petroleum S.A. and South Petroleum Limited were involved in Yukos' export shipments of oil and oil product supplies in 1998-1999, as was Baltic Petroleum Trading Limited, whereupon Yukos resolved to improve and expand its own system of export sales and declined the services of the aforementioned companies. At the same time, oil sales transactions with them were made at market prices, and Yukos received the proceeds. In that regard, Mr Khodorkovskiy explained to the trial court: "*... the case file materials include a PricewaterhouseCoopers report*[163], *which, incidentally, has not been recalled, where they examine the prices of transactions between Yukos and Baltic, Behles, and South, and confirm that they have found no sign of such prices somehow deviating from potential arm's-length prices. And most importantly, the prosecution has not found any sign either. In any event, there is no description of the criminal actions that are imputed to me personally.*" [164]

G171. Specifically, this PwC report analyses Yukos' export prices in comparison with: a) the data on export prices published by the *Petroleum Argus* publication; b) the average export prices of ten Russian companies; c) the prices of Yukos' main competitor – the company Lukoil. It was established as a result of the analysis that the prices calculated via netback[165] from the BRENT oil reference prices contained in the Platt's reference guide were applied correctly. PwC stated in its report:

> "YUKOS's average price for the selected 1998 and 1999 crude oil export sales was US$ 11.5 per barrel compared with the Petroleum Argus average price of US$ 11.4 per barrel[166]… .
>
> The YUKOS 1999 average crude oil export price was US$ 85.9 per ton compared with the 1999 average price of ten Russian oil companies of US$ 80.1 per ton[167]...

[162] See tab 49 to this Reply, Vol.131 p.301-304 (note from D. Miller).
[163] A copy of the report, "Yukos, the Export Sales Project", is at tab 33 to this Reply. It is to be found at Vol.118 pp. 13-36 of the case materials.
[164] See page 47 record of court session dated 20 April 2010 at tab 110 to this Reply, which is to be found at Vol.243 c.f.s. 3-36 in the case materials.
[165] See p. 3 (report pagination) of the report for details of the methodology, "Yukos, the Export Sales Project" is at tab 33 to this Reply. It is to be found at Vol.118 pp. 13-36 of the case materials.
[166] See bottom of p. 5 (internal pagination of the report), "Yukos, the Export Sales Project is at tab 33 to this Reply. It is to be found at Vol.118 pp. 13-36 of the case materials.
[167] See p. 7 (internal report pagination), paragraph E2 (Diagram 5.1) the report, "Yukos, the Export Sales Project" is at tab 33 to this Reply. It is to be found at Vol.118 pp. 13-36 of the case materials.

The YUKOS 1998 average crude oil export price was US$ 78.8 per ton compared with the 1998 average price of ten Russian exporters of US$ 77.8 per ton[168]…

the YUKOS 1999 average crude oil export price was US$85.9 per ton compared with the LUKOIL 1999 average price of US$ 74.5 per ton[169]…

[t]he YUKOS 1998 average crude oil export price was US$ 78.8 per ton, compared with the LUKOIL 1998 average price of US$76.7 per ton…[170]"

[168] See p.7 (internal pagination of the report), paragraph E2 (Diagram 5.2) of the report, "Yukos, the Export Sales Project" See tab 33 to this Reply. It is to be found at Vol.118 pp. 13-36 of the case materials.
[169]See p. 8 (internal pagination of the report), para E3 (Diagram 6.1) of the report, "Yukos, the Export Sales Project. See tab 33 to this Reply. It is to be found at Vol.118 pp. 13-36 of the case materials.
[170] See p. 8 (internal pagination of the report) para E3 (Diagram 6.2) the report, "Yukos, the Export Sales Project". See tab 33 to this Reply. It is to be found at Vol.118 pp. 13-36 of the case materials.