Dear David,

Following upon my earlier comments regarding the indictments against Khodorkovsky and Lebedev (JRL #7462, #8170 and #8171), I would like to provide JRL readers with some further comment on the arrest of Yukos's assets by order of the Moscow Arbitration Court issued on April 15, 2004. I had been hoping to locate a copy of this Order and delayed commenting on this development. However, this Order has taken on significant importance in the overall context of the "Yukos affair" since many observers (and indeed the Russian stock market) are viewing the Order as the first salvo in an attempt by the "authorities" to force Yukos into bankruptcy and then seize its assets from its principle shareholders. Therefore it is worth providing some comment on the Order despite the fact that its full text is not available nor have any of the submissions made by the tax authorities to obtain the Order been disclosed or discussed publicly.

The key provisions of the Order have been published on the website of the Moscow Arbitration Court, which I translate below:

> "The Arbitration court of the City of Moscow… has forbidden OJSC "NK Yukos":
>
> > to alienate, encumber by any means property belonging to it, including in particular shares (including a prohibition on the transfer of securities to nominal holders and to trust management), participation interests in the charter capital of other legal entities, but not including the basic types of products, produced by OJSC "NK Yukos".
>
> The court has also forbidden the register holders for the securities [belonging to] "NK Yukos" to conduct operations introducing any changes to the register connected with transactions in the securities, concluded by "NK Yukos"."

(I note that Orders are not subject to publication under the Russian Arbitration Procedure Code and even those documents that must be published by law are often not published promptly or in a practical manner. Therefore the publication of even this excerpt from the Order represents an unusual, if incomplete, attempt at "transparency".)

Based on the general circumstances surrounding the case and Yukos as gleaned from the press, it may be readily concluded that the Order should be dismissed or modified for two principle reasons:

1. The Order is not necessary

The Russian Arbitration Procedure Code provides that a plaintiff may apply for and receive "preliminary protective measures" (what would be called "injunctive relief" in the US or UK) if not granting such measures would encumber or render impossible fulfillment of the final court judgment should the plaintiff win its claim. These criteria generally match the principle criteria established in western jurisdictions for obtaining such protection. To a certain degree, these criteria have been further clarified by two decrees of the Supreme Court. Nevertheless, Russian law lacks a significant degree of detail as to how these criteria are to apply in practice to particular cases. Furthermore, Russian law omits certain additional criteria found in most western jurisdictions which help prevent the abuse of injunctive relief: (i) a finding that the plaintiff's main case has some minimal degree of merit and (ii) the requirement that the plaintiff fulfill a very high standard of candor with the court in its application to receive such an order, including providing all significant facts and arguments to the court even if they may support the defense's case (in the UK, this is

called the "doctrine of clean hands"). For these reasons, combined with the continued inexperience, incompetence and corruption in the judiciary, the abuse and misapplication of injunctions is widespread in Russia and accounts for a significant portion of the "wildness" in the Russian litigation environment.

However, even based on the sparse criteria provided by the Arbitration Procedure Code, this Order does not appear to be necessary to protect the tax authorities' claim for $3.5 billion from Yukos. "Necessary" requires a far greater showing than the simple concern of the tax authorities that Yukos may not be able to pay. The fact that Yukos has published accounts showing that it has insufficient cash to pay the tax claim should it become due today is not a basis for freezing its assets. Even if its accounts revealed that it had insufficient overall assets to cover the claim (which appears to be far from the case), it would not be a sufficient reason to freeze its assets. Typically, defendants are left to themselves to organize their affairs and determine how they will raise funds to pay a claim. Protective measures are only justified when the plaintiff can provide evidence that the defendant or third parties have taken or intend to take actions that will, without proper justification, hinder the ability of the defendant to honor the plaintiff's claim should it win its case. In the case of Yukos, it is difficult to imagine what evidence of such actions the tax authorities have put forward. The actions would clearly have to involve the transfer of the bulk of Yukos's assets to third parties without providing Yukos with cash or other valuable assets in return from which the tax authorities claims could be settled.

Given the most general data on Yukos, it would seem that such transfers could occur only in two ways. Firstly, the tax authorities may have attempted to show that Yukos intends to make massive transfers of assets to pre-pay third-party creditors (for example, shareholders, banks, etc.) and unfairly favor such creditors over the tax authorities. However, there has been no indication that such massive debts exist or that Yukos intended to make any pre-payments (in fact, pre-payment of certain creditors has apparently become more likely as a result of the Order). Secondly, the tax authorities may have claimed that the managers of Yukos intend to engage, or are of such character that there is a significant risk that they would engage, in massive secretion of assets. I would guess that this has been the tack of the tax authorities, undoubtedly with reference to the criminal cases against Khodorkovsky and Lebedev and the alleged secretion of assets that occurred in connection with schemes set forth in those indictments. However, these individuals and other members of the "organized group" described in the indictments are apparently no longer part of the day-to-day management of the company. The asset secretion and fraud allegations in the indictments did not involved Yukos itself. It must be remembered that Yukos is a profitable, publicly traded company. Such transfers would clearly destroy the value of the company (still worth in the area of $30 billion) in order to evade a $3.5 billion claim. In any event, such secretion of assets is hardly feasible in such a public company, particular in light of the current level of scrutiny directed at it.

As mentioned, some have commented that the real purpose of the Order is to force Yukos into bankruptcy and that this would somehow benefit the tax authorities. Seeking the Order for the purpose of forcing Yukos into bankruptcy is not a legitimate legal tactic. Injunctive relief is meant to protect the plaintiff without punishing the defendant and, in fact, court orders should be carefully crafted to minimize the damage they may cause. In any event, if the tax authorities are truly interested primarily in satisfying their claim for back taxes (and not causing harm to Yukos for its own sake), bankruptcy does not seem to promote the tax authorities' goal. While bankruptcy would ensure the tax authorities priority satisfaction of their claims, such protection would be applicable now if Yukos were truly unable to satisfy the tax authorities' claims and ended up in bankruptcy in the near future. Any transaction that Yukos makes now which depletes its assets would be subject

to challenge later if it turned out that Yukos went bankrupt and could not satisfy the tax authorities' claims in full. Furthermore, if Yukos did in fact go bankrupt, satisfaction of the tax authorities' claims could be delayed for many months as such payments would have to be resolved through the bankruptcy court. If the bankruptcy of Yukos proceeded past the initial stage of the procedure, Russian bankruptcy law provides that all interest and penalties accruing on Yukos's back taxes would be suspended for the term of the bankruptcy. In general, forcing Yukos into bankruptcy is hardly the proper mechanism for the tax authorities to secure satisfaction of their tax clams either from the commercial or legal standpoint.

2. The Order is overly broad

Even should the tax authorities have somehow provided sufficient evidence to demonstrate that some form of asset freeze was necessary to protect its claims, it is clear from the face of the Order that it is overly broad. The website of the Arbitration Court confirms that the Order was issued to protect claims of approximately RUR 99 billion ($3.5 billion) against Yukos. Yukos's assets, however, are still valued at approximately $30 billion. Unless the tax authorities have thrown this valuation into serious doubt, the Order is overly broad in that it should only freeze assets (even conservatively valued) equivalent to the value of the claims. This limitation is explicit in the Arbitration Procedure Code and has been confirmed and emphasized by decrees of the Russian Supreme Court. There has been speculation that additional massive tax claims are facing Yukos for tax years other than 2000 (the year to which the current claims relate). However, the court cannot grant an order to protect claims that have not yet been brought or are not brought within a few days of the granting of the order.

Although it is quite clear that the Order appears to have been improperly granted and is clearly overly broad, it is not surprising that it was granted. In Russia as elsewhere, protective orders are granted in "ex parte" proceeding (that is, the defendant is not present). These proceedings can last a matter of minutes after the judge has reviewed the written application of the plaintiff. In theory, the plaintiff bears liability for the damaged caused to the defendant by the Order should it be modified or dismissed, whether due to the final resolution of the case in the defendants favor or because it was improperly granted for any reason. Such potential liability should, again in theory, incentivize the plaintiff to seek only protection it truly needs based on real claims it feels it can win. Once the order is granted, the parties have reason to negotiate appropriate security amongst themselves—sufficient to cover the plaintiff's claims, while narrow enough to minimize hard to the defendant and allow it to continue its business as much as possible. For these reasons, while overly harsh orders are often granted, they are also often dismissed or modified.

Therefore, what we should have expected in the wake of the Order is a rapid appeal by Yukos and, in parallel, discussions between the tax authorities and Yukos regarding provision of a far more limited form of security. Such discussions would be expected in a private commercial litigation. Given that one side here is a state body which presumably has an additional interest in protecting innocent parties (small Yukos shareholders, outside creditors, employees and the economy as a whole), the tax authorities should be expected to curb their aggression and take a greater interest than a private plaintiff in minimizing the collateral damage and general havoc caused by such an order. Unfortunately, there has been no news of such an appeal, which could have been filed and decided in the month that has transpired since the Order. Of course, the lack of news of an appeal could indicate that discussions are taking place regarding modification of the Order on the basis of an agreement between the parties. With almost a month having passed since the Order was issued, telling news will hopefully surface soon.

Developments with respect to this Order will be important to watch since the damage it is causing to Yukos is clearly massive. Yukos could miss significant merger and acquisition opportunities due to the freezing of its assets (including opportunities to resolve its de-merger with Sibneft). Its credit rating has been damaged undoubtedly increasing its cost of financing and perhaps preventing it from seeking refinancing. Its general reputation has suffered as well from the implication that not only is it incapable of paying it debts, but that it is likely to seek illegally to evade paying them. According to Yukos's own public statements, certain major financings have been thrown into technical default by the Order, which in turn could lead to acceleration of these obligations and bankruptcy. The damage caused by the Order, if in fact Yukos does go bankrupt, could be in the billions of dollars. (I note that loss of market capitalization is probably not a form of damage recoverable by Yukos.)

If this Order stands it would tend to indicate that the courts are colluding with the tax authorities in attempting not only to collect taxes, but to punish Yukos without a legitimate legal basis. The Order would then appear to be a logical step in a plan, as some have speculated, to force Yukos into bankruptcy and then, through a "controlled" bankruptcy, cause Yukos to be liquidated (despite the fact that it is clearly a going concern) and the bulk of its assets to be transferred to the state at discounted prices. In other words, the tax authorities, working with the prosecutor and the courts, would dismantle Yukos using one of the primary shady tactics of the corporate battles of the 1990s, which have themselves been sharply criticized by the presidential administration. This would be extremely disappointing, not to mention hypocritical.

While we should not jump to conclusions based upon the granting of the Order, it would be hard not to draw certain conclusions if the Order stands.