Further Legal Observations on the Yukos Affair
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I. Introduction

Starting last November, I have been distributing through JRL a short series of comments on the criminal indictments against Mikhail Khodorkovsky and Platon Lebedev (JRL #7462, 8170, 8171). These comments were made from a technical legal perspective for the purpose of evaluating the soundness of the charges and the structure of the government's case, both under general principles common in western countries and also, based on some familiarity with Russian law and my reading of the relevant legislation.

Since that time, the criminal cases against Khodorkovsky and Lebedev have been overshadowed by the related tax claims brought by the Russian Tax Ministry ("MNS") against the Yukos Oil Company. I have not provided similar comments on these claims because few technical legal details of these claims have been made public; moreover, press reports describing the claims and the court proceedings often appear to be incomplete or inaccurate from the legal standpoint. The only material court decision in the Yukos tax cases to have been published was the substance of the order of the Moscow Arbitration Court, issued on April 15, 2004, freezing Yukos's assets as security for the tax claims made by MNS for the year 2000. Given this official piece of material, I provided a short comment on this order in JRL #8204.

Although the lack of official information on the tax claims and the court proceedings surrounding them makes legal analysis very difficult, a number of brief and basic, but sufficiently non-trivial observations can be made at this point. I think a number of the comments I make below contrast with aspects of the coverage of the "Yukos affair" in the western press.

In my comments below, I will not review in detail the "procedural history" of the tax claims and related proceedings. A number of press sources (particularly in Russia) have published, in various degrees of detail, chronologies of the hearings and the decisions on the tax and criminal claims. My office has also produced a detailed chronology of the proceeding in the Yukos tax and criminal cases which I make available separately to JRL readers by request to me at pclateman@spkgroup.com. (This chronology is rough and not for publication.)

II. Basis of the Tax Claims

Although the actual details of the tax claims have not been made public, the press seems to have settled on a clear description of the structure of the scheme that forms the basis of the claims against Yukos. This structure is quite simple:

1. Yukos established shell companies (Yukos disputes that these companies are under its control) in a special zone within the Russian Federation in which companies were entitled to receive a reduced rate on corporate profits tax.

2. The shell companies applied and received permission to take advantage of the low corporate tax rate from the local administration of the region.

3. Other subsidiaries of Yukos sold oil at below-market prices to the shell companies (and thus were able to greatly reduce their reported profits);

4. The shell companies resold the oil at market prices, achieving considerable profits, which were subject only to the minimal taxes applied in the low-tax zone.

This structure constitutes a blatant tax evasion scheme in the US and Europe—it is a simple "transfer pricing scheme." It is not a subtle or complex scheme, although steps taken to hide the affiliation between the companies in the scheme may be elaborate, and proving affiliation may be difficult. The tax authorities also need to show that goods were sold below market price, but with oil, this should be a relatively simple process.

Many press sources, however, state without further commentary that this scheme was legal in Russia during the period in which it was carried out. I do not know of any Russian lawyer who agrees with this conclusion. It is probably true that many major transfer pricing schemes involving Russia's large natural resource companies operated without much disturbance from the authorities. However, there are numerous publicly-known precedents spanning more than a decade in which the authorities overturned such structures and demanded back taxes and penalties. One prominent and relatively recent example is LUKOIL's settling a $200 million back tax claim for 2000 and 2001 for use of a very similar (but actually more complicated and less easily challenged) scheme. In fact, it is a day-to-day experience in Russia for the tax authorities to question non-market pricing in agreements. This comes up both in the context of transfer pricing among affiliates and in suspected barter transactions among non-affiliates.

The idea that transfer pricing was legal in Russia in the 1990s (let alone in 2000-2003) is simply a myth. At best, one can call such a position a "practical assessment" of law enforcement, but not a legal conclusion. In any event, guidelines for the tax authorities to examine unusual pricing, particularly among affiliates, were explicitly written into the Tax Code in 1999—that is, before the year 2000, which is the year to which MNS's initial claims against Yukos relate.

Therefore, there can be little dispute that, if MNS can establish that Yukos operated the scheme set forth above, then Yukos would be subject to substantial claims for back taxes, penalties and fines. However, a number of pieces of information reported indicate that the claims of MNS against Yukos may not be based upon a transfer pricing theory.

First, as I noted in my comments in JRL #7462 and #8170, the apparently related criminal charges against Khodorkovsky and Lebedev are not based upon a transfer pricing theory—and one would think that these largely overlapping cases (against the individuals and against the company) would be based upon the same legal theory. However, while the criminal charges accuse Khodorkovsky and Lebedev of masterminding tax evasion by Yukos through the same shell structure, the actual charges focus on the use of the low-tax zone, not on transfer pricing. The prosecutor alleges that the shell companies established in the low-tax zone did not have the right to claim low-tax status because they had no activities in the region. As I noted in my earlier comments, the prosecutor fails to cite a legal basis for the requirement to have activities in the region and there does not appear to have been one under the law.

Second, according to a number of reports, the appellate judge who, on June 29, 2004, upheld the tax claims against Yukos for 2000 also did not view the tax claims as based upon a transfer pricing theory. This judge reportedly stated that the law establishing the low-tax zones contained an

implied requirement that companies availing themselves of the special tax concessions should make investments in the local region commensurate with the amount of tax relief they received. The law on the low tax zones creates no such explicit requirement and Russian law provides no way to create such an "implied" requirement. However, it is not clear that this is what the judge actually said or, if such statements were made, that they were in fact the basis of her ruling.

Third, as discussed below, if the tax claims are based on a transfer pricing theory, MNS has brought the case against the wrong defendant—under such a theory, it would appear to be the Yukos production subsidiaries that sold oil at below market rates that owe the tax, not Yukos itself.

On the other hand, it should be noted that Yukos has reportedly lodged its further appeal against the tax claims largely on the basis that its affiliation with the shell companies in the low-tax zone was not proven. Proving the connection between Yukos and the companies in the low-tax zone is an essential element of proving the transfer pricing scheme, as noted above. Therefore, the fact that Yukos's appeal is (at least in part) based upon this aspect of the case would seem to indicate that transfer pricing is perhaps the reasoning behind the tax claims after all.

[I note that Yukos's position that the shell companies were not affiliates and that their income did not flow back to Yukos raises a disturbing question: if the profits did not flow back to Yukos, where did they go? Unfortunately, examination of Yukos's US GAAP financials for 2000, which apply standard US GAAP consolidation rules, does not make this issue "transparent".]

In summary, while the structures reportedly established by Yukos constitute clear tax evasion under Russian law (as they would in any western jurisdiction), it is not clear that the actual claims for back taxes, penalty interest and fines for 2000 have been formulated in a proper manner by MNS. It is equally unclear whether the reasoning of the courts in upholding these claims has been sound. Only publication of the claims and the decisions regarding them (including Yukos's further appeal to the court of cassation) will clarify this. The appeal to the court of cassation is scheduled to start on September 6, 2004.

III. Identity of the Defendant

In addition to, and partly as a result of, the lack of clarity regarding the theory behind the tax claims, it is not clear who is the proper defendant in this case. Since tax assessments and accounting are not performed on a consolidated basis in Russia, it is important to determine which Yukos entity underpaid its taxes as the claims must properly be brought against that entity only. The "Yukos Oil Company" (the parent company of the group) is reportedly the defendant in the tax claims, yet it does not appear to be the entity that underpaid taxes. Under the transfer pricing theory, it is the Yukos production subsidiaries which are the proper defendants (since under this theory, they are the ones who underreported their profit by selling oil at below market prices). Under the theories that claim that the shell companies did not have the right, for one reason or another, to take advantage of the tax concession, it is the shell companies themselves that failed to pay sufficient tax and are the proper defendants. Unless the actual claims are based on yet an entirely different theory or set of facts not discussed in any of the press articles, it would appear that Yukos is not the proper defendant.

There has been some mention in the press and on Yukos's website that the company has raised the issue that it is not the proper defendant, but it is not clear how this objection was raised and whether there has been any ruling on it. One may assume that this is one of the issues that will be raised on

further appeal. If its claims are dismissed on this basis, MNS will of course be free to bring them against the proper defendant, but the legal process will largely start over.

[It has recently been reported that MNS is pursuing claims for approximately $3 billion in back taxes and penalties against Yuganskneftegaz, Yukos's main production subsidiary and apparently one of the companies that sold oil at reduced prices to shell companies in low-tax zones. Under the transfer pricing theory, this subsidiary would in fact be one of the proper defendants. It is possible to speculate that MNS is preparing to bring claims against Yuganskneftegaz in the event that its claims against Yukos fail for the reasons mentioned above (improper defendant). If so, then this claim would be an alternate claim and not an additional tax claim against the group. The arrest of the accounts of Yukos's production subsidiaries—which was announced publicly only yesterday—would give further support to the idea that the prosecutor and tax authorities are preparing alternate versions of their tax claims in case their claims against the holding company are rejected on appeal. Information on this arrest is sparse, other than that it is directed at the proceeds from the exact same transfer pricing scheme as forms the basis of the other tax claims. The press is generally reporting that such actions against the subsidiaries are being taken for the purpose of lowering the value of the subsidiaries to enable the government to sale more of Yukos's assets.]

IV. Fines and Penalties

Reportedly, more than half of the $3.4 billion claims of MNS against Yukos related to 2000 taxes consist of penalty interest and fines. Without specifics regarding the claims themselves, it is not possible to make even a basic guess as to whether the interest and fines have been properly applied. The Tax Code provides for fines of 40% of the unpaid tax, which may be doubled if aggravating factors are present. Penalty interest is assessed at the refinance rate of the Central Bank for the period of non-payment. Therefore, penalties and fines amounting to more than 50% of the tax bill are theoretically possible, but there are a myriad of factors to consider in their assessment. I merely note here that Yukos may appeal not only its tax liability, but also the assessment of these large fines and penalties.

If such large fines and penalties are eventually collected, they may be considered to be damages caused to Yukos by those managers who implemented the tax avoidance schemes. Yukos (or its shareholders by way of derivative suit) may seek compensation for these damages. Such a suit would be quite significant to Yukos's overall economic situation as approximately $1.8 billion in fines and penalties are being sought for 2000 and similar sums may be sought for 2001-2002.

V. Yukos vs. MNS

After MNS had filed suit against Yukos for back taxes related to 2000, Yukos countersued MNS for alleged improper conduct of the tax audit that led to MNS's decision to assess these back taxes. The exact grounds for Yukos's suit have not been made clear. Despite certain interim rulings in its favor, Yukos has basically lost this suit in the first and second instances. It is apparently planning to file a further appeal to the court of cassation. While there is virtually no information with which to judge the merits of this suit, it is worth noting that if Yukos does succeed in its further appeal, such a ruling would overturn the current judgment regarding tax for 2000 and stop collection.

VI. Security Measures

On April 15, 2004, the day after MSN filed suit against Yukos for approximately $3.4 billion in back taxes, penalty interest and fines, the Moscow Arbitration Court granted MNS its request to freeze all of Yukos's assets as security against these claims. In my comment in JRL #8204, I stated that this freezing order appeared to be improperly granted because (i) freezing orders should only be granted when truly necessary to protect the plaintiff and, in this case, the order is probably not necessary as Yukos is a large public company and is not in a position to hide the bulk of its assets (in particular, the shares of its subsidiaries) since they are located in Russia and subject to much scrutiny; and (ii) even if some order was justified, the scope of this order is too broad—Yukos's assets by any calculation were worth far in excess of the claims for $3.4 billion, and so only a portion of its assets should have been frozen. As I also noted in my comment, it is common in most jurisdictions for overly-broad freezing orders to be granted and then the scope of the order to be modified by application of the defendant to the court or even by simple agreement between the parties as to reasonable security.

MNS apparently has not been willing to negotiate with Yukos regarding the tax claims or the securities measures, including the scope of the freezing order over its assets. Yukos, however, has not applied to the court to throw out or amend the freezing order on either of the grounds mentioned above. Instead, Yukos proposed to have the freezing order against all of its assets replaced with a freezing order over a 20% block of shares of Sibneft, which it had acquired in the course of its merger with Sibneft. Sibneft's former shareholders, however, have indicated that this merger will not be completed and that steps taken toward its completion will likely be unwound (or at least Sibneft's former shareholders will press for the unwinding of the transaction). Therefore, the ownership of the Sibneft shares held by Yukos is clearly under dispute. Yukos's attempt to offer these shares to MNS as security certainly has a clear economic rationale from Yukos's point of view. However, there is no reason why MNS should accept, or the arbitration court force MNS to accept, an asset whose title is under dispute as security for its claims. The court did in fact refuse Yukos's request for this modification to the order on April 23, 2004 (appeal dismissed on July 2).

VII. Enforcement of the Judgment for Back Taxes for 2000

On June 29, 2004, the appeals court upheld (almost) in full the claims of MNS against Yukos for back taxes, penalty interest and fines for 2000 and this decision came into force—that is, the claims became subject to collection. Collection of these claims is made in accordance with the Law on the Execution of Judgments. This law sets forth a strict and rapid procedure for the enforcement of judgments by court bailiffs. Bailiffs must initiate an enforcement procedure within three days of receipt of the necessary documents from the creditor and may give the debtor no more than five days to make voluntary compliance. Collection measures are supposed to be completed within two months. The bailiff appears to be operating with the speed called for by law, which has resulted in the much-publicized actions by the bailiff against the shares of Yukos's main production subsidiary, Yuganskneftegaz (as well as other subsidiaries).

As has been widely discussed, the current situation in which a company with assets reportedly worth in excess of $30 billion is subject to forced assets sales to satisfy a judgment of some $3.4 billion is quite anomalous. The reason for this anomalous situation is two-fold: first, Yukos is prevented from selling its assets on its own to raise cash to pay the tax bill by the freezing order (which is overly-broad for the reasons set forth above); second, Yukos has decided to avoid declaring bankruptcy, which would stay execution of the judgment until it could be settled in the context of

settlement of all claims against Yukos through the bankruptcy procedure. It is a difficult call to determine whether the management of Yukos "should" declare bankruptcy in light of their fiduciary duty to shareholders and, given the pre-bankruptcy situation, to creditors as well. On the one hand, its assets are in the process of being sold to satisfy one creditor (MNS), which potentially may result in prejudicing other creditors and shareholders. On the other hand, Yukos appears to be in discussion with its outside creditors and core shareholders. The lack of declaration of default by these parties on the loans owed them by Yukos, despite the right to do so, may indicate that they have approved this course of action. It is probable that these parties prefer the current situation to bankruptcy because they fear that bankruptcy could potentially wrest management control of the company from the shareholders and might not, in the long run, prevent massive asset sales outside their control anyway. Unless bankruptcy is declared, the court bailiff will seize and sell assets as called for by Law on the Execution of Judgments to satisfy MNS's claims without seeking a global resolution to Yukos's financial situation.

A number of actions of the bailiff have been protested by Yukos. I review the main objections below:

A. Fine for Non-Compliance

When Yukos did not voluntarily pay the $3.4 billion claim within the five-day compliance period, the bailiff imposed a fine on Yukos of some $230 million. The Law on the Execution of Judgment permits such fines to be levied for such non-compliance unless the debtor has "valid" reasons for non-compliance. While the simple lack of cash compounded by the freeze over its assets may seem like a valid reason for non-compliance, I have not reviewed court practice to determine whether these circumstances would constitute a "valid" reason. On August 2, Yukos successfully protested this fine in the first instance, but the fine was reinstated after the bailiff appealed on August 25. Without access to the actual argument and decisions is it difficult to discern whether this fine is proper. If Yukos does win its appeal on the underlying case, this fine should be revoked and any money collected should be returned. It should also be noted that this fine would have been avoided had Yukos declared bankruptcy.

B. Requests for Delayed or Installment Payment

Yukos has apparently requested that the bailiff permit delayed or installment payment of the judgment. The bailiff has rejected these requests. Under the law, the bailiff has discretion to grant such a request if there are circumstances "hindering" performance (although it is likely that any delay granted would be for relatively short term). Without consent of MNS, there does not appear to be a right for Yukos to seek such a delay from the court—this decision is entirely within the bailiff's discretion. While Yukos's performance is clearly "hindered" by the factors mentioned above, Yukos could get the delay it seeks by declaring bankruptcy. It is understandable that a bailiff would not use its discretion to grant Yukos a "work-out plan," when this should properly be considered by a bankruptcy court. Furthermore, if the bailiff were to exercise its discretion to grant a significant delay in payment, it would also be effectively granting Yukos a special tax payment schedule, which, as I discuss below, is something that otherwise can only be done by governmental decree. It is unlikely that the bailiff would use this provision of the Law on Execution of Judgments to usurp the government's authority to grant Yukos any significant stay in the collection procedure.

C. Preparations for Asset Sales

Under the Law on the Execution of Judgments, Yukos has the right to indicate what property should be realized first by the bailiff to satisfy its debts. However, the final order in which property will be realized is established by the bailiff in accordance with rules in the Law. The Law, in fact, does not specify to what extent the bailiff must take into consideration the debtor's preferences and it appears that the bailiff's judgment is final, so long as it is compliant with the Law. The Law classifies the debtor's property into three categories in order of which should be realized first to pay debts: (i) cash and assets not directly or indirectly necessary for production; (ii) finished goods and asset not directly necessary for production; (iii) real estate and assets used in production. The Law also specifies that assets should only be realized up to the amount necessary to cover the debt plus any penalties and cost of enforcement.

During the first half of July, the bailiff froze the shareholders registers of a number of Yukos subsidiaries, including Yuganskneftegaz, which reportedly owns approximately 60% of all of Yukos's reserves and is responsible for a similar percentage of its production. Apparently, Yukos attempted again to propose its 20% block of Sibneft shares as the assets of "first order" to be realized by the bailiff, which was rejected. Yukos's appeal of this rejection was denied. The bailiff, in turn, indicated that Yukos's shares in Yuganskneftegaz would be the first assets realized. In its "act" incorporating this decision, the bailiff characterized these shares as "production assets." Yukos successfully protested the selection of these shares as the first asset to be sold based upon the bailiff's own characterization of these shares as "production assets." When the arrest on these shares was lifted by the court, the bailiff immediately issued another arrest confirming that these shares would be sold first. However, this time, the bailiff reportedly indicated that such shares were "assets not used in production" and this freeze has been upheld. Yukos has also appealed the freezing of its shares in other subsidiaries. These appeals are moving forward separately.

While the Law on the Execution of Judgments does provide that "production assets" should be the last to be sold to cover a judgment, the Law specifically classifies "shares" as assets to be sold in the first order, which indicates that they are not to be viewed as assets involved in production. The Supreme Arbitration Court, however, has recognized that companies in a group may be so interrelated that the sale of shares in one of them would interfere with the ability of the group (or its parts) to continue production. According to the relevant Decree of March 3, 1999, shares that have been contributed to holding companies in the course of privatization by a governmental or presidential decree should be considered part of a "single economic complex" which were intended to be kept together and such shares shall be considered "production assets" and be sold only the in "third order." Unfortunately, this Decree clearly applies only to shares directly contributed by the government to specific holdings companies by decree. Only 38% of Yuganskneftegaz was contributed to Yukos through a presidential decree when it was formed, and Yukos has undergone restructurings and shares issues since then. Therefore, it is not clear whether the Decree would apply to a portion of Yukos's Yuganskneftegaz shares or to any of them at all, but it clearly does not apply to most of them.

The logic and reasoning of the Decree need not be limited to shares contributed to a holding company in privatization. The same reasoning could apply to the shares of any subsidiary in a group whose operations are so integrally connected to other companies in the group that transfer of its ownership would seriously disrupt production. If Yuganskneftegaz is in fact so integrated in terms of operations (and I would assume physical operations are what is meant by the Supreme Court, not financial interconnections) that a change in the ownership of its assets would disrupt its

production or the operations of other companies in the group, Yukos may attempt (and perhaps has attempted) to argue that Yuganskneftegaz shares should not been sold in the first order. Admittedly, given that this reasoning is outside the scope of the Decree of the Supreme Court, it is unlikely that a lower court would venture into such uncharted territory. Even if a court could be persuaded that a sale of 100% of Yuganskneftegaz in the "first order" is inappropriate, the same reasoning would not seem to apply to a minority stake, which could hardly be expected to effect operations at all.

Apart from the selection of assets to be sold by the bailiff, it must be emphasized that the value of assets sold should not exceed the outstanding debt to be repaid. Although the press generally sees the valuation of Yuganskneftegaz and its preparation for sale as a done deal, such a sale would be improper if the valuation of Yuganskneftegaz commissioned by the Ministry of Justice from Dresdner Kleinwort Wasserstein demonstrates that the value of these shares greatly exceeds the outstanding debt. Yukos does not appear to have raised any objection to the freezing of its subsidiaries' shares by the bailiff on the grounds that their value exceeds the outstanding debt. Perhaps it is premature for it to do so. But if Dresdner's valuation, when completed, falls within the range estimated in the press (widely put at $12 billion to $20 billion), Yukos would certainly have very strong grounds to object to any sale of more shares than necessary.

VIII. Reaching a Tax Settlement

In order to avoid both the bankruptcy of Yukos and its dismemberment by the bailiff, and at the same time ensure full payment of the tax claims against it, many parties inside and outside the company, including a number of government officials, have called for a tax payment schedule to be agreed for Yukos.

Unfortunately, the Tax Code simply provides no discretion for MNS to grant Yukos the time it would need to pay its current obligations (the remaining portion of the judgment against it for $3.4 billion) plus the additional expected claims for back taxes. The Tax Code does permit, under limited circumstances, MNS to grant "tax deferments" (up to six months) and "tax credits" (up to one year), but tax payers are only eligible to qualify for such relief if there are no charges of criminal or civil tax evasion associated with the tax bill in question. In the current case, there are, or course, both civil and criminal charges.

Granting tax restructuring on the scale and of the kind Yukos requires is a matter for the government (the president or the cabinet of ministers). I believe that a tax restructuring of this scale would similarly require formal approval on the highest level of government in most western countries (it certainly does in the US). A tax rescheduling on this scale is clearly a political decision and it has been treated as such in the many precedents in Russia. As far as I am aware, the last examples of such tax restructurings were granted at the end of 2001, when Avtovaz (Russia's leading automaker) and Krasnoyarsk GRES-2 (a major regional power plant) were granted significant multi-year restructurings. These companies were reportedly controlled by Boris Berezovsky and Oleg Deripaska, respectively.

Bankruptcy, as opposed to seeking special executive orders, is the usual means for obtaining relief from creditors, including the tax authorities. Analyzing various Yukos bankruptcy scenarios could form the basis of an extensive comment on its own. Without going into detail, I point out that bankruptcy (unless the court decided to liquidate the company) would provide an effective shield of up to two and a half years for Yukos to meet its tax obligations as well as the chance to agree a payment schedule for its debts under an "amicable settlement." MNS could not veto such

arrangements unless it controlled the creditors meeting (at this time, the level of debt to MNS would appear to put it in the minority with respect to other Yukos creditors). If MNS's approval were needed to approve creditors' actions or enter into an amicable settlement, it appears that MNS could give such approval without a government or presidential decree—MNS has the legal authority to represent itself in bankruptcy. (While clearly any settlement of the Yukos affair will be considered on the highest levels of government, a settlement through bankruptcy would not require official legal action by the government.)

IX. Other Legal Actions

As in other major corporate scandals, the suits brought by law enforcement and regulatory bodies will only be the first part of the story. As judgments on the tax claims are paid, the damaged parties (largely shareholders) will seek compensation through various means. For example, on July 2, 2004, an entrepreneurial law firm in the US filed a class action suit against Yukos, its senior managers and outside advisors for material non-disclosure under US securities laws regarding the company's true financial state between the period of February 2003 (when it announced particularly positive economic news) and the date of Khodorkovsky's arrest in October 2003. The complaint appears to be rather standard securities class action suit under US law and it is publicly available, so I do not provide any detailed comment here. I merely note that this suit is representative of the litigation that will probably be launched as fallout from the tax cases against Yukos mounts. Insider trading claims stemming from the material non-disclosure case may also be brought if the core shareholders or companies related to them traded profitably in Yukos shares during the relevant period. Furthermore, as mentioned above, Yukos or its shareholders (through a derivative suit) may seek compensation from the company's former managers for damages cause by the scheme they alleged carried out.

X. Summary

+ The scheme allegedly operated by Yukos was a clear transfer pricing scheme that was illegal in Russia, as it would be in just about any western country.

+ It is not clear, however, that MNS has brought its claims against Yukos based upon a transfer pricing theory. The alternate theories look weak and probably should be thrown out. If this happens, MNS would be forced to start legal proceedings over.

+ Yukos does not appear to be the right defendant under any theory of the tax claims discussed in the press. There may be some reasoning or undisclosed facts that explain why Yukos is a proper defendant, but this information certainly has not been reported. If Yukos is not the right defendant, MNS should be forced to re-initiate is claims against the proper defendants—the subsidiaries that sold oil below market prices.

+ The freezing order issued against Yukos on April 15, 2004 appears to be overly broad in that the value of assets frozen far exceeds the value of the claims. Yukos, however, appears to have failed to protest the order on this basis.

+ Yukos's attempts to offer Sibneft shares as security for the claims and to be sold to satisfy them have been understandably rejected by MNS and the court since these assets are under dispute.

+ After the judgment against Yukos for $3.4 billion in taxes, penalty interest and fines for 2000 came into force on June 29, 2004, the bailiff acted swiftly in starting execution measures, as called for by law.

+ The selection of Yuganskneftegaz for sale to satisfy the judgment probably does not violate Russian law, although after valuation of the company is complete, no more than the necessary number of shares should be sold to cover the outstanding portion of the judgment against Yukos—at this time, less than half of the $3.4 billion judgment remains outstanding.

+ The massive tax claims, combined with the overly-broad freezing order, are pushing Yukos toward bankruptcy. Yet Yukos and, apparently, its creditors are resisting bankruptcy for various reasons. The resulting situation is unusual in that the bailiff's role has become quite large, but under the circumstances it is clear that the bailiff has little choice other than rapidly to seize assets and to sell them. Under more normal circumstances, the company would declare bankruptcy and the company's financial situation would be addressed in a more holistic manner according to the more developed bankruptcy procedures.

+ While Yukos could be declared bankrupt at any moment by its managers or creditors (including MNS), none of these parties appears interested in this. Yukos may yet achieve delay in the prosecution of the tax claims through its various legal appeals. The asset sales currently being prepared may not turn out to be massive as they should not exceed the amount of the outstanding tax debt (reportedly about $1.5 billion). Therefore, the bankruptcy of Yukos and/or its dismantling through massive asset sales may be postponed for quite a long time and are far from foregone conclusions.

+ Various lawsuits (including the US securities class action suit filed in July) seeking compensation for damages cause to Yukos and its shareholders should be expected as Yukos pays out on the tax claims and the various penalties imposed.