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MEMBER OF THE BOARD OF DIRECTORS
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**TESTIMONY BEFORE
THE SENATE FOREIGN RELATIONS COMMITTEE**

“DEMOCRACY ON THE RETREAT IN RUSSIA”

February 17, 2005

INTRODUCTION

I wish to thank Chairman Lugar and Senator Biden for convening this hearing today. The past 18 months has seen a veritable onslaught against Group Menatep, its holdings and its shareholders by the authorities in Russia, against the backdrop of an apparent retreat in democratic development in Russia. I am grateful to you, Mr. Chairman and Senator Biden, along with your colleagues in the Senate, for your early recognition of the serious nature of these events in the Resolutions that were introduced in the previous session of Congress.

My name is Tim Osborne and I am a member of the independent Board of Directors of Group Menatep. My fellow Board members and I were appointed in March 2004 to conduct the day to day operations for the company following the detainment of Director Platon Lebedev in July 2003 and then the still-unexplained death of Mr. Stephen Curtis, appointed as his successor, in a helicopter accident in the spring of 2004.

Group Menatep is a diversified financial holding company, established in 1997 by Mikhail Khodorkovsky, Platon Lebedev and others, and it owns strategic stakes in a number of Russian companies, including YUKOS, as well as a number of financial portfolio investments on stock markets in Russia and internationally. It is incorporated and existing in accordance with the laws of Gibraltar. Group Menatep is the majority owner of Yukos Oil Company, holding approximately 51 percent of Yukos equity capital through wholly owned subsidiaries.

As a member of the Group Menatep Board of Directors, I am responsible for stewardship of the company in keeping with recognized standards of transparency and corporate governance and, more recently, in protecting the company's remaining assets. I do not represent Yukos Oil Company or the individuals mentioned above, however, the attacks on Group Menatep holdings and its founders are an integral part of an orchestrated and sustained campaign against the company by the Russian authorities and therefore need to be explained in the context of what is happening in Russia.

I hope at some stage there will be an opportunity for a hearing on the nature of these charges and the conduct of the criminal cases against these individuals. Foreign policy experts, government officials, financial analysts, the defense attorneys and independent human rights groups agree that the trials, like the charges against Yukos, are politically motivated and that they have been riddled with violations of due process and human rights. I will submit for the record along with my written testimony some of their statements and reports.

THE ATTACKS AGAINST GROUP MENATEP

The Tax Issues

While some Russian companies' accounting practices may remain insufficient for the standards of international investment markets, Group Menatep adopted a different approach. It chose to hire top quality financial professionals and auditors for its

companies, including Yukos, putting into place internal controls sufficient to meet the highest standards of market economies. Prior to the assault undertaken by the Russian authorities, Yukos had been widely praised for its financial openness and the maintaining of its accounts in accordance with Western accounting practices. While its competitors included firms whose accounts remained less than transparent, it was Yukos, the company that had opened its books to the world, which was selected for prosecution. The fact that Yukos keeps open books meant that it was audited by both outside accounting firms and the Russian government, neither of which raised any issues of tax evasion when the books were closed out and taxes paid for the relevant years.

The assessment by the Russian authorities that Yukos had paid all of its taxes changed completely in the wake of the political dispute between the Russian authorities and the leadership of Group Menatep. Suddenly, massive amounts became due, in some years amounting to more than 100 percent of the gross revenue of a company for that year. The Russian authorities only raised tax evasion allegations after they had already initiated their political crackdown on Group Menatep's shareholders. The tax charges against Yukos both tracked, and followed in parallel, the events in the trials of these executives. Thus, as the trial against these executives heated up, the initial charge for US \$3.5 billion in back taxes quickly ballooned to over US \$27 billion.

A few simple numbers provide the context for the absurdity of the Russian authorities' assessments. Yukos has already paid \$15 billion in taxes for the period 2000 through 2003, on total gross income for that period of \$29 billion. Thus, the taxes paid amount to approximately 52% of gross income. Beyond that amount, the Russian authorities allege that Yukos owes an additional US \$27 billion for that period, bringing Yukos' total tax liability for the period to over US \$42 billion, or nearly 145% of the company's gross income. Let us call a spade a spade. This is not taxation. This is confiscation.

The crux of the Russian government's allegation is that Yukos evaded taxes through the illegal use of tax havens in the years 2000 through 2003. Beyond the fact that Yukos paid taxes at a level equivalent to or in excess of, on a percentage basis, every one of its competitors in the Russian energy business, there is a fundamental problem with the Russian government's legal case against Yukos. The fundamental problem is that the structures used by Yukos to limit its taxes were lawful under Russian law at the time that Yukos employed them. Russian authorities first had to change the tax law and then apply these changes retroactively in order to even allege tax evasion. Notably, Yukos' competitors in the oil and gas field also employed these same tax structures and yet no significant charges of tax evasion have been brought against these companies.

One need not be a Russian legal expert to judge that the actions of Russian authorities are improper. Not only is Russia imposing tax laws retroactively, it is singling out and punishing one company for actions that were industry norms.

The retroactive application of tax law and the selective prosecution by Russian authorities of Yukos are two objective indicators of the abusive nature of these cases.

But there are many other objective facts that show that the Russian tax assessments were improper. Prior to the levy of any of these additional taxes against Yukos, the company was already the third largest taxpayer in Russia. Indeed, its tax-to-revenue ratio ranged between 30%-32% during that time and during this period, Yukos paid more in taxes during this period than the industry average. In fact, if one was to add the amount of taxes Yukos originally paid in these years to the amount of taxes that the Russian government alleges that Yukos evaded, the Yukos tax payments would represent 175% to 244% of the industry average. These figures do not include the further fines, penalties or interest that the Russian government has added to the tax bill. If such things as fines, penalties and interest payments are included, the amount that the Russian government has asked Yukos to pay represents approximately 267%-402% (depending on the year) of the industry average for taxes paid during this period.

Let us examine a single year of taxes assessed by the authorities – 2002. On November 1, 2004, the Tax Ministry assessed Yukos an additional US \$10 billion in back taxes and penalties for the year 2002. According to these new allegations Yukos was expected to pay a total of US \$7.9 billion in taxes for 2002. This US \$7.9 billion does not include penalties, fees and interest and therefore represents what the Tax Ministry alleges Yukos should have paid in taxes in 2002. US \$7.9 billion represents 70% of the total revenues earned in 2002 and approximately 115% of the company's gross income for the year. If penalties, fees and interest are included, the total tax bill for 2002 represents 111% of total revenue earned by Yukos for the year 2002 and 184% of gross income for the year.

The Russian tax authorities chose not to provide Yukos any opportunity to address these charges prior to the issuance of tax bills. Their demands for back taxes were immediately rubber stamped by the Russia courts. There was absolutely no effort on the part of the tax authorities and the courts to negotiate any schedule for repayment.

The behavior by the Russian authorities in this case demonstrates how, when abused, the power to tax is indeed the power to destroy. To provide you with just some of the highlights of the abuses:

- On July 2, 2004, the Russian Tax Ministry issued a claim against Yukos for US \$3.3 billion in back taxes for the year 2001. This US\$ 3.3 billion was in addition to a tax bill of US\$ 3.5 billion that the Russian Tax Ministry had issued the previous December in connection with taxes for the year 2000. On the same day, court bailiffs freeze Yukos bank accounts and notify the company that it must pay a 2003 tax bill of US \$3.4 billion *within five days*.
- On September 3, 2004 the Tax Ministry presents Yukos with a new US \$ 4.1 billion tax bill for 2001 and announces that the company has *only one day to pay*.
- On September 8, 2004 Russian government officials begin to collect on a Yukos tax bill from 2001, immediately confiscating US \$2.7 billion from Yukos bank accounts.

These disproportionate tax claims against Yukos have been accompanied by the government's freezing of Yukos assets, making payment impossible. These improper actions by Russian authorities were then followed by the forced sale of Yuganskneftegas in December 2004 in an auction in which a false veneer of formal process was used to cover what was actually an illegal expropriation.

Russia's Illegal Expropriation of Yuganskneftegas

Having improperly levied abusive taxes on Group Menatep's main holding, Yukos, Russian authorities then seized Yukos subsidiary Yuganskneftegas in August 2004. Yuganskneftegas had been valued by Western bankers as worth between US \$15-18 billion. It represents 60% of Yukos oil production and was, until its seizure, the heart of the company. By seizing Yuganskneftegas, the Russian authorities essentially assured Yukos' inability to pay any of the outstanding tax bills. They then proceeded to put Yuganskneftegas to auction, arranged to have a sole friendly bidder, and to have the company bought up by a state-controlled firm.

In an attempt to preserve shareholder value in the face of these improper actions by Russian authorities, Yukos declared bankruptcy in a federal bankruptcy court in Houston on December 15, 2004, which under traditional bankruptcy law rules would halt the auction. The Russian authorities chose to proceed regardless, auctioning off Yuganskneftegas on December 19, 2004, in violation of a December 16th Temporary Restraining Order ("TRO") issued by the United States Bankruptcy Court for the Southern District of Texas.¹ One Russian firm, Gazprom, participated in the bidding despite the express prohibition of the same by the TRO.

As noted above, Yuganskneftegas has been valued at between US \$15-18 billion and yet the Russian government auctioned it off for only US \$9.4 billion. The winner of the auction for Yuganskneftegas was an absolutely unknown company by the name of Baikal Finance Group. Baikal Finance Group had no apparent means of financing the purchase. It was obviously operating as a front company for the state-owned company Rosneft in this sale. Some have speculated that the reason for the use of the front company was an effort to shield Rosneft from any legal liability stemming from, amongst other things, the fact that the auction was in violation of the federal judge's stay order. What is absolutely certain is that Baikal itself was not a legitimate bidder.

When research on the Baikal was conducted, nothing could be discovered regarding who owned Baikal or where its financing had come from. The company had no previous operations, no capital, and no known shareholders. The only information available on the company was that it shared an address with a tiny grocery store in the small Russian provincial town of Tver. Three days after the auction, Baikal Finance was "sold" to Rosneft, although public information as to who was paid what for this \$15 billion to \$18 billion asset remains scanty. Press accounts suggest that Rosneft received a loan of some \$6 billion from a consortium of Chinese banks which paid that sum to the Russian government in order for Rosneft to "buy" Yuganskneftegas. The foreign policy

¹ *In Re Yukos Oil Company*, Case No. 04-47742-H3-11 (S.D. Tex., December 16, 2004).

implications of this sale are underlined by the recent disclosure that the Chinese helped fund Rosneft's acquisition of Yuganskneftegas.² The Chinese banks were reportedly acting on behalf of the Chinese and Russian governments. Following the acquisition, Rosneft now controls 16% of Russia's total crude oil output.³

In summary, this was no auction in any normal sense, but an extraordinarily unethical, illicit and cynical expropriation of private sector assets by the Russian authorities. Group Menatep continues to contest the illicit proceedings relating to the sale of Yuganskneftegas, in Russia and in courts around the world. As Mr. Theede discussed, Yukos is serving notice under the U.S. bankruptcy law that the December 19 sale in contravention of the Bankruptcy Court's order was illegal and that it will seek to recover from those involved in the sale.

There has been widespread condemnation of the forced sale of Yuganskneftegas, internationally and within Russia itself, including explicit recognition of its political nature. Most telling is the criticism of the sale from within the Russian government itself. Andrei Illarinov, then the most senior economic adviser to Russian President Vladimir Putin, described the sale as "the swindle of the year."⁴ Shortly after he voiced his criticism of the sale, Illarinov was stripped of most of his responsibilities.⁵ Even Russian Economic Minister German Gref, a close associate of President Putin, referred to the sale as "unjustified."⁶ Criticism outside of Russia has also been pointed. As summarized in one foreign press report: "the Yugansk auction was the culmination of a Kremlin campaign to crush Yukos' politically ambitious principal owner, Mikhail Khodorkovsky, and seize control of strategic sectors of the economy sold off in the chaotic privatizations of the 1990s."⁷

Actions against Individuals

I have discussed at some length the corporate cases brought against key assets of Group Menatep. However, it would be misleading to look at this solely as a corporate matter. As I have suggested earlier, this case originated in politics. The vendetta brought by the Russian authorities against essentially every person involved with Group Menatep has included a wide range of criminal proceedings that are, like the tax charges, expressions of politics rather than law. For this reason, I feel it is necessary to discuss the actions taken by the Russian government against key individuals. While I do not represent these individuals, I have followed their plights closely because they are so intertwined with the fate of Group Menatep.

The most notorious of these is the prosecution of Mikhail Khodorkovsky and Platon Lebedev. Khodorkovsky was until recently the CEO of Yukos and Lebedev was

² *China Had Role in Yukos Split-Up*, BBC News, February 2, 2005.

³ *Putin Backs State Grab for Yukos*, BBC News, December 23, 2004.

⁴ *Minister hits out at Yukos sale*, BBC news, January 11, 2005.

⁵ *Id.*

⁶ *Id.*

⁷ Richard Ayton and Andrew Hurst, *State seizes Yukos' core oil unit*, The Age, December 24, 2004.

director of Group Menatep. My understanding is that all of charges against Khodorkovsky and Lebedev are what one would consider “white collar” crimes and that there is no compelling state interest in their continued imprisonment during their trials. Despite the fact that they pose no threat to society and in spite of Lebedev’s reported poor state of health, these two men remain in a Russian prison.

I have tried to understand the charges against Khodorkovsky and Lebedev but there appears to be little rhyme or reason to the government’s case. The case against these two focuses on the privatisation of a fertilizer company by the name of Apatit. However, this privatisation took place in 1994 and the allegations surrounding this transaction would seem to be issues of contract law, not criminal law. Nine years passed from the privatisation sale to the arrest of Khodorkovsky and Lebedev. During those nine years, three separate civil suits were concluded with regards to this privatisation, focusing on breach of contract issues, with no criminal issues being raised. They resulted in a signed settlement agreement between a Group Menatep company, Volna, and the Russian Federal Property Fund that seemingly brought an end to what has now become referred to as the “Apatit affair.”

Remarkably, not only was the Russian government a signatory to the settlement agreement, but the Prosecutor General Vladimir Ustinov, in a letter to President Putin in April 2003, stated that there were no legal reasons for initiating an investigation into the Apatit affair. Throughout all three of these proceedings and the nine years that passed from the time of the transaction and the arrest of Lebedev and Khodorkovsky, no allegations of any criminal behavior were made against these two. Furthermore, although the Russian Federation has since moved to set aside the civil settlement, it has never returned the \$16 million paid by Group Menatep as part of the settlement. I can only imagine that no allegations of criminal behavior were made in the civil proceedings because there was no evidence of any criminal behavior.

Khodorkovsky and Lebedev are the highest profile Yukos and Group Menatep executives, but the Russian government has targeted many more and has shown no sign of stopping in its persecution of anyone who is willing to defend Yukos or Khodorkovsky and Lebedev. In fact, some are being detained in an effort to build cases against Yukos and Menatep executives. Alexei Pichugin, a retired FSB major, was the first target in the Russian authorities’ assault on Yukos. Pichugin worked in the department of economic and financial security at Yukos during 1998. In May 2003, Russian authorities used the disappearance of his close friends, Sergei and Olga Gorin, as a pretext to grill Pichugin on internal financial matters at Yukos. He was charged on June 26, 2003 with the double murder of the Gorins, and later in August 2003 with three additional attempted murders (Victor Kolesov, Olga Kostina and Evgeni Rybin) from 1998. The initial trial began in October 2004 but ended in a mistrial in December. According to many observers, the jury was dismissed after it became apparent to the court that they would not return a guilty verdict. A second trial began in January of this year with a new jury.

In Pichugin’s trial, the authorities’ entire case has rested on testimony from a convicted serial murderer and child abuser, Igor Korovnikov (“Korovnikov”). Korovnikov is currently serving a life sentence in the FSB-run Lefortovo Detention

Center for eight murders committed between October 1998 and February 1999, and for the sexual assault of five young girls. While little is known of the actual testimony of Korovnikov because all of the proceedings have been held in secret, it is important to note that Korovnikov was imprisoned at the time some of these alleged crimes were committed and Korovnikov's "evidence" surfaced only after he was moved in 2003 by the authorities from Ogenny Island, a penal colony for life-sentence prisoners renowned for its harsh regime, to Lefortovo prison.

Beyond prosecutors putting on testimony from Koronikov which the original jury evidently found insufficient, and the state's ending the proceedings in order to avoid Pichugin's acquittal, outside experts assessing the proceedings have found that the authorities violated international human rights and due process standards in conduct of Pichugin's trial. Russian authorities classified the case as top secret, trying it in private. Portions of Pichugin's case files have been classified by the government. Pichugin was denied opportunities for confidential communication with his lawyers, and the judge in his case once gave Pichugin's counsel just days to review 35 volumes of documents. Pichugin's lawyers had limited access to his case files and were forced to sign "state secret" nondisclosure agreements that would give them a 10-year prison sentence should they disclose the files.

The Parliamentary Assembly of the Council of Europe ("PACE") has resolved that the unjustified restrictions on public access to court proceedings and the fact that, "in particular, all proceedings against Pichugin have been held *in camera* even though only a small portion of the case file has been classified as secret" are among the "most serious corroborated shortcomings" of the Yukos related prosecutions.⁸

Notably, the Pichugin case is merely one, if egregious, example of a pattern of abuses by Russian authorities, which have undertaken these legal cases in a coordinated legal assault on people with ties to Khodorkovsky and Yukos. These abuses include the arrests of Svetlana Bakhmina and Elena Agronovskaya. Ms. Bakhmina worked in the Yukos legal department. Ms. Agronovskaya was a Yukos outside counsel. Both were expected to testify for the defense in the Khodorkovsky and Lebedev trials. They also include the issuance of arrest warrants in January 2005 for other associates of Khodorkovsky and Lebedev, including Mikhail Brudno ("Brudno"), Vladimir Dubov ("Dubov"), Alexander Gorbachev, Vladislav Kartashov, Alexei Spirichev, and Irina Chernikova, after Brudno and Dubov were invited to the U.S. to discuss the Yukos affair with members of Congress.

Independent Judicial Review

Each time the allegations by the Russian Federation have come before an independent court outside of Russia, the Court has found the allegations were substantively deficient:

⁸ EUR. PARL. ASS., *Circumstances Surrounding the Arrest and Prosecution of Leading Yukos Executives*, Res. No. 1418 at ¶ 8 (January 25, 2005) (Exhibit 2).

In August of 2003, Defendant Russian Federation secretly submitted requests for mutual legal assistance to the Attorney General of Switzerland requesting the seizure of business documents related to, inter alia, Group Menatep, its subsidiaries, Khodorkovsky, Lebedev, Yukos, and Yukos related trading companies. Subsequently in March 2004, Defendant Russian Federation sought the freeze of numerous bank accounts in Switzerland in the name of the same entities and individuals, and the Swiss Attorney General froze accounts holding approximately \$4.9 billion dollars. On June 8, 2004, the Swiss Federal Supreme Court directed the Swiss Attorney General to release several of the accounts subject to orders ripe for review and held that “the [Russian] request and its amendments do not contain any fact enabling determination, even minimally, of the cause, nature and scope of such extensive damages, which would be of a nature to justify the ordering of the contested freeze.” *Pecunia Universal Ltd. v. The Office of the Attorney General of Switzerland*, No. 1A.86/2004/col at 6 (Tribunal Fédéral June 8, 2004). The Court went on to assess a 5,000 Swiss Franc penalty on the Swiss Attorney General. *Id.*

Prior to implementing the Swiss Supreme Court’s ruling, the Swiss Attorney General contacted Defendant Russian Federation representatives and asked whether it had any additional evidence to warrant the freeze of the accounts. Defendant Russian Federation’s representatives did not offer such evidence and accounts containing approximately \$4.7 billion dollars were released.

In 2003, the Russian Federation also requested the Attorney General of Liechtenstein seize records located in Liechtenstein and relating to Khodorkovsky and Group Menatep’s alleged illegal activity. Menatep and Khodorkovsky objected and Liechtenstein’s highest court denied the request and held (i) that there were no facts presented underlying the alleged criminal offenses against Khodorkovsky and Lebedev, (ii) that “the suspicion arises that the alleged tax offenses do not even exist . . . and the other alleged crimes are mere allegations without substance,” and (iii) that the request by the Russian government was a “fishing expedition” and to grant the seizure request would amount to a violation of International Law. *Case No. 12 RS.2003.255-ON 25 at 6 (Fürstliches Obergericht April 25, 2004).*

Political and Economic Motivations for Legal Cases

One does not have to specialize in human rights issues to see that in these cases Russian authorities are not abiding by international standards relating to rule of law, but are instead approaching these cases politically. These proceedings exhibit a “Red Queen” approach to justice: “verdict first – evidence later.” These are not merely my conclusions, they are shared by essentially every outside observer. As the Parliamentary

Assembly of the Council of Europe has recently found following an extensive fact-finding by a senior Rapporteur,

“The circumstances of the arrest and prosecution of leading Yukos executives suggest that the interest of the State's action in these cases goes beyond the mere pursuit of criminal justice, to include such elements as to weaken an outspoken political opponent, to intimidate other wealthy individuals and to regain control of strategic economic assets.”⁹

Similar conclusions were reached late last year by the U.S.-based human rights organization, Freedom House. On December 20, 2004, Freedom House downgraded Russia's status to “Not Free,” in its annual survey of global freedom. Russia was the only country to register a negative category change in 2004, moving from Partly Free to Not Free. In making the designation, Freedom House Executive Director Jennifer Windsor stated that “Russia's step backwards into the ‘Not Free’ category is the culmination of a growing trend under President Vladimir Putin to concentrate political authority, harass and intimidate the media, and politicize the country's law-enforcement system.” Freedom House described the arrest of Khodorkovsky as the event that “signaled the increasing politicization of the legal system,” and concluded that “the arrests and investigations in 2003 of Mikhail Khodorkovsky, the Yukos energy company, and the Menatep Group reinforced perceptions that the rule of law is subordinated to political considerations and the judiciary is not independent of the president and his inner circle.”¹⁰

The abnormal nature of the arrest and prosecution of Khodorkovsky, Lebedev and others affiliated with Yukos, as well as the treatment of other business leaders not affiliated with Yukos which has been held in violation of international law,¹¹ reflect the Russian authorities' political motivations in prosecuting the Yukos-related defendants. But it is also worth looking at the processes of the trials themselves, because they raise the question of whether the founders of Menatep are in essence now political prisoners in Russia. As I appreciate it, the U.S. government is required by the Congress to make such human rights judgment on an annual basis, looking country-by-country. Last year, while expressing concern about the political nature of these cases, the U.S. State Department did not make a finding that Khodorokovsky, Lebedev and Pichugin were political prisoners. However, the facts that have emerged over the past twelve months, combined with what preceded them, may provide a basis for the U.S. government to give further consideration to that question.

Separately from the personal cases, there is the issue of the handling of Yukos by Russian authorities, its tax cases, and the forced auction of Yukos' most important energy subsidiary, Yuganskneftegas, for a fraction of its actual value by Russian authorities to a shell company. This shell company in turn sold the subsidiary back to a state-owned

⁹ EUR. PARL. ASS., *Circumstances Surrounding the Arrest and Prosecution of Leading Yukos Executives*, Res. No. 1418 at ¶ 14 (January 25, 2005) (Appended hereto as Exhibit 2).

¹⁰ <http://www.freedomhouse.org/research/freeworld/2004/countryratings/russia.htm>

¹¹ See e.g., *Gusinskiy v. Russia*, Eur. Ct. H.R., April 29, 2004, all European Court of Human Rights cases cited are available at <http://www.echr.coe.int>.

enterprise, though there is no record that any payments were actually made in the purchases. Thus, the Russian government levied false taxes against Yukos, not lawfully due the government, as a strategy to steal its prime assets. These proceedings, too, were a sham, fundamentally unjust, and reflecting not just improper political motivations, but improper commercial ones as well, as I will discuss further later in this testimony.

The Question of Political Imprisonment

I wish to address here the question of the political imprisonment of Khodorkovsky, Lebedev, and Pichigun as part of the vendetta engaged in by Russian authorities against Group Menatep.

I understand that the State Department examines the existence of political prisoners in its Annual Country Reports on Human Rights Practices, usually without elaboration on the standard applied in making judgments about the existence of political prisoners in a country.¹² I have been advised that in 1992, in response to congressional concerns expressed about human rights conditions in Turkey, Assistant Secretary of State for Legislative Affairs Janet Mullins wrote a letter to the Chairman of the Subcommittee on Europe and the Middle East of the Committee on Foreign Affairs explaining the Department's review and opinion on the situation or existence of political prisoners in Turkey. Ms. Mullins explained:

Our working definition of political prisoner is broadly inclusive. To summarize, it includes persons who are incarcerated without charges, or on charges for offenses commonly held to be matters of belief or for membership in a religious social, racial or national group. This definition extends our concern to persons prosecuted even under ostensibly internationally acceptable law when the charges are trumped up, or trial unfair. Our definition includes those convicted of politically motivated acts where the punishment is unduly harsh because of the person's race, religion, nationality or social group.¹³

I have been advised that the U.S. continues to apply this working definition in assessing persons as foreign political prisoners.¹⁴ Under this working definition, the trumped-up charges against Khodorkovsky, Lebedev and others affiliated with Yukos, the unfair nature of their trials, the political motivation of the authorities in the conduct of these cases, and the circumstances of their arrests, detention and trials, would appear to provide grounds for an assessment in the upcoming 2004 Report on Human Rights Practices in Russia that Khodorkovsky, Lebedev, and Piguchin are being held as political prisoners.

¹² U.S. Department of State, *Country Reports on Human Rights Practices: China* (2003), available at <http://www.state.gov/g/drl/rls/hrrpt/2003/27768.htm>.

¹³ 138 CONG. REC. E2747 (September 22, 1992) (extension of remarks of Hon. Lee H. Hamilton on Human Rights in Turkey).

¹⁴ Telephone interview with Peter Su, Office of Legislative Affairs, U.S. Department of State on January 27, 2005.

I understand that Congress may also request a report from the State Department that addresses the specific situation of these individuals. The more detailed criteria adopted by the Parliamentary Assembly of the Council of Europe (PACE) for identifying political prisoners, discussed below, may provide a useful analytical framework for U.S. government officials and members of the Senate to consider the question of whether these persons are political prisoners from the perspective of U.S. law.

PACE has adopted a series of objective criteria developed by a group of experts to define “political prisoners.”¹⁵ According to PACE:

A person deprived of his or her personal liberty is to be regarded as a political prisoner:

- if the detention has been imposed in violation of one of the fundamental guarantees set out in the European Convention on Human Rights and its Protocols (“ECHR”), in particular freedom of thought, conscience and religion, freedom of expression and information, freedom of assembly and association;
- if the detention has been imposed for purely political reasons without connection to any offense;
- if, for political motives, the length of the detention or its conditions are clearly out of proportion to the offense the person has been found guilty of or is suspected of;
- if, for political motives, he or she is detained in a discriminatory manner as compared to other persons; or,
- if the detention is the result of proceedings which were clearly unfair and this appears to be connected with political motives of the authorities.¹⁶

In the cases of Khodorkovsky, Lebedev and others affiliated with Yukos and Group Menatep, all of whom are accused of non-political crimes, *e.g.*, tax evasion, the last three criteria are the most strongly indicative of the status of these defendants as political prisoners. Each of the criteria is discussed further below.

Detention Disproportionate to Offense Charged

Under the third criterion, Khodorkovsky, Lebedev and others affiliated with Yukos and Group Menatep Limited should be held to be political prisoners because the manner in which Khodorkovsky and Lebedev were arrested, as well as their continued detention and treatment, are disproportionate to the non-violent economic crimes with which they are charged. Russia's prolonged arbitrary detention of these individuals is a

¹⁵ EUR. PARL. ASS., *Resolution 1359: Political Prisoners in Azerbaijan* (January 27, 2004).

¹⁶ EUR. PARL. ASS. Committee on Legal Affairs and Human Rights, *Political Prisoners in Azerbaijan*, Doc. No. 9826, App. 1 (June 6, 2003).

violation of international law, and, particularly with respect to Khodorkovsky, has been declared by PACE as a corroborated and serious shortcoming of the Russian proceedings.¹⁷

The European Court of Human Rights (“ECHR”) has described the prohibition on arbitrary detention contained in the European Convention of Human Rights to require release once detention ceases to be reasonable, and has ruled that the judicial officer before whom the arrested person appears must review the circumstances mitigating for or against detention, to decide by reference to legal criteria whether there are reasons to justify detention, and to order release if there are no such reasons.¹⁸ Furthermore, according to the ECHR, “continued detention can be justified in a given case only if there are specific indications of a genuine requirement of public interest which, notwithstanding the presumption of innocence, outweigh the rule of respect for individual liberty laid down in Article 5 of the Convention”¹⁹ The same prohibition against arbitrary detention is contained in the Universal Declaration of Human Rights (“Universal Declaration”)²⁰ and the International Covenant on Civil and Political Rights (“ICCPR”)²¹ Even under Russian criminal law, I understand, pretrial detention is supposed to be exceptional, and is only sanctioned if it is impossible to find alternative means to guarantee appearance at trial.²²

In five hearings dealing with Lebedev’s detention (July 3, August 28, October 28, and December 23, 2003, and June 23, 2004) and four hearings respecting Khodorkovsky’s detention (October 25 and December 23, 2003, and March 19 and June 23, 2004), the court determined, and appellate courts upheld, that the defendants should continue to be detained.

These determinations were defective because they failed to address whether less extreme measures than detention could balance the defendants’ rights to pretrial release against the interests of the judicial system as Russian, international, and U.S. law require. Khodorkovsky and Lebedev have been charged only with economic crimes and there has been no allegation of continuing crimes, yet they are being treated as posing serious threats to society and have now been in prison for 15 months and 19 months respectively.

Discrimination in Detention and Prosecution

¹⁷ EUR. PARL. ASS., *Circumstances Surrounding the Arrest and Prosecution of Leading Yukos Executives*, Res. No. 1418 at ¶ 8 (January 25, 2005) (Appended hereto as Exhibit 2).

¹⁸ *Aquilina v. Malta*, Eur. Ct. H.R., April 29, 1999, ¶ 47.

¹⁹ *Kalashnikov v. Russia*, Eur. Ct. H.R., July 15, 2002, ¶ 114; *see also I.A. v. France*, Eur. Ct. H.R., September 23, 1998, ¶ 102.

²⁰ G.A. RES. 217A, U.N. Doc. A/810, at art. 9 (1948) (hereinafter Universal Declaration).

²¹ International Covenant on Civil and Political Rights, 999 U.N.T.S. 171, at art. 9(1) (1967) (hereinafter “ICCPR”).

²² Russian Code, Article 108 (“[t]aking into custody as a measure of restriction shall be applied by the court towards the suspect or the accused of committing crimes, for which the criminal court envisages the punishment in the form of the deprivation of freedom for a term of over two years, *if it is impossible to apply a different, milder measure of restriction.*” (emphasis added)).

Similarly, application of the second criterion suggests Khodorkovsky and Lebedev are political prisoners. Independent observers have described the Russian case against Yukos and its former executives as “a case of highly selective law enforcement,” and have added that the prosecutors and the courts are “highly politicized.”²³ Based on the investigation of its Rapporteur, PACE has resolved that these defendants have been, “in violation of the principle of equality before the law-- arbitrarily singled out by the authorities.”²⁴

The crimes with which they are charged, to the extent that the charges are even cognizable, relate to the privatization of state-owned assets, tax evasion, and fraud. Khodorkovsky and Lebedev are being prosecuted for these alleged offenses while other individuals who engaged in similar alleged conduct have been left unscathed. As PACE has noted, “the allegedly abusive practices used by Yukos to minimize taxes were also used by other oil and resource companies operating in the Russian Federation which have not been subject to a similar tax reassessment, or its forced execution, and whose leading executives have not been criminally prosecuted.”²⁵

Unfair Proceedings

Lastly, application of the third criterion supports a finding that Khodorkovsky, Lebedev, Pichugin and others affiliated with Yukos and Group Menatep are political prisoners because the proceedings are devoid of fairness and have not been held before an open, independent, and impartial tribunal, with defendants enjoying unrestricted rights to counsel.

The Universal Declaration provides, “[e]veryone is entitled in full equality to a fair and public hearing by an independent and impartial tribunal, in the determination of his rights and obligations and any criminal charge against him.”²⁶ It further provides, “[e]veryone charged with a penal offence has the right to be presumed innocent until proved guilty according to law in a public trial at which he has had all the guarantees necessary for his defense.”²⁷ The ICCPR and the European Convention provide for the same rights.²⁸

In the proceedings against Khodorkovsky and Lebedev, the Russian authorities’ restriction of public access to pre-trial proceedings, interference with defense lawyers, and the manner in which evidence is presented against the accused, have been declared by PACE as corroborated and serious shortcomings of the Russian proceedings.²⁹

²³ Organization for Economic Cooperation and Development, *Economic Survey Russian Federation 2004*, available at http://www.oecd.org/document/62/0,2340,en_2649_201185_32474302_1_1_1_1,00.html

²⁴ EUR. PARL. ASS., *Circumstances Surrounding the Arrest and Prosecution of Leading Yukos Executives*, Res. No. 1418 at ¶ 9 (January 25, 2005) (Appended hereto as Exhibit 2).

²⁵ *Id.* at ¶ 10.

²⁶ Universal Declaration, at Art. 10.

²⁷ Universal Declaration, at Art. 11(1).

²⁸ European Convention at art. 6.

²⁹ EUR. PARL. ASS., *Circumstances Surrounding the Arrest and Prosecution of Leading Yukos Executives*, Res. No. 1418 at ¶ 8 (January 25, 2005) (Appended hereto as Exhibit 2).

Right to an Independent Tribunal

Most of the pre-trial detention hearings of the Yukos defendants were held in the Basmany Court in Moscow, whose judges are regarded by many independent observers as taking instructions from the Kremlin.³⁰

The U.S. State Department has found that the Russian judiciary is “seriously impaired by a shortage of resources and corruption, and still subject to influence from other branches of Government.”³¹ There is substantial question over whether the courts will independently hear the cases against Khodorkovsky, Lebedev and their colleagues. The performance of the courts in the repeated denial of bail for the defendants, the refusal to allow an independent medical evaluation of Lebedev (who was in the hospital at the time of his arrest and is believed to suffer from hepatitis and other illnesses), and the fact that the same judge was assigned the Khodorkovsky and Lebedev cases (which were initially separate trials), as well as other facts, call into question the independence of the court that will try these defendants.

Right to Open and Public Proceedings

PACE has declared the “unjustified restrictions on the publicity of certain court proceedings” involving Khodorkovsky, Lebedev and others affiliated with Yukos and Group Menatep as a serious violation by Russian authorities of applicable human rights standards.”³²

As discussed above, the pretrial hearings against Khodorkovsky and Lebedev took place in closed sessions of the Basmany Court, and sometimes even defense attorneys were excluded. Meanwhile, Pichugin’s entire trial has been held *in camera* and most of the evidence in the case has been classified.

Denial of the Assistance of Counsel

Restrictions on the ability of the lawyers for Khodorkovsky, Lebedev and others affiliated with Yukos and Group Menatep Limited to meet with their clients, denial of access of Lebedev’s lawyers to the court room during a hearing, and the search and

³⁰ Anna Neistat (Director of the Moscow office of Human Rights Watch), *Russia: Yukos Trial Begins Amidst Rights Rollback* (on the trials of Mikhail Khodorkovsky and Platon Lebedev, “if it’s anything like most trials in Russia it is unlikely to showcase the judiciary’s independence. More likely, defense arguments will be downplayed, most of its motions overturned, and the outcome will have little to do with the hearing and a lot with executive will”), *available at*, <http://www.hrw.org/english/docs/2004/06/16/russia8852.htm>.

³¹ U.S. Department of State, *Country Reports on Human Rights Practices: Russia* at Introduction (February 25, 2004), *available at* <http://www.state.gov/g/drl/rls/hrrpt/2003/27861.htm>.

³² EUR. PARL. ASS., *Circumstances Surrounding the Arrest and Prosecution of Leading Yukos Executives*, Res. No. 1418 at ¶ 8(vi) (January 25, 2005) (Appended hereto as Exhibit 2); *but see Lebedev v. Russia*, Eur. Ct. H.R., Application No. 4493/04 (November 25, 2004).

seizure of documents from a lawyer's office have been declared by PACE as examples of additional serious shortcomings in the proceedings against the defendants.³³

Attorneys for Yukos have had their offices searched and files seized and, Svetlana Bakhmina, deputy general counsel of Yukos, has been arrested. Just this month the British Law Society and the International Bar Association called upon Russian authorities to release Ms. Bakhmina.

Russian Motivations

As my testimony has now outlined, the tax charges against Yukos and the criminal cases against Khodorkovsky and Lebedev brought by Russian authorities are not about the pursuit of justice or the tracking down of a corporate scofflaw. These actions of the Russian government are about something quite different. They are means to an end, and that end is the solidification of power by the persons currently in charge of the Russian government through the elimination of economic and political competition.

It is easier to see this when one focuses on what Group Menatep was trying to accomplish in its approach to business. In a nutshell, it was an approach in which the company treated its assets as belonging to its shareholders, not to any government, individual, or grouping, including management. Given this focus, Group Menatep had to be both transparent and extremely competitive. Its major energy asset, Yukos, competed directly against major state-owned energy companies, such as the oil company Rosneft, the pipeline company Transneft, and the gas company Gazprom. Yukos became an effective and aggressive competitor to state owned companies, and was on its way to becoming a partner with non-Russian oil firms. The vision of a substantial Western presence in the Russian oil industry deeply disturbed the Russian government. In fact, the actions against Khodorkovsky, Lebedev, and their associates derailed the proposed acquisition of Sibneft by Yukos and scuttled the purchase of a substantial block of Yukos stock by a major U.S. oil company. In addition, Yukos' production and distribution decisions, based on market forces, have often clashed with the dictates of the Russian state as it attempts to control access to its energy resources to curry international favor or to punish countries that had fallen from grace with the current Russian authorities.

Because Yukos was focusing on meeting its obligations to its international shareholders, regardless of their location, Yukos had a number of serious disputes with the oil company Rosneft, the only Russian domestic oil company wholly-owned by the Russian state. Yukos's relations with Rosneft deteriorated significantly in 2002 and 2003, and Rosneft appears to have played an important role in the initiation of the persecution of the Yukos officials. As I have already mentioned, it was Rosneft that ended up acquiring Yuganskneftegas when it absorbed Baikal Finance Group, the front company that had purchased Yuganskneftegas.

³³ EUR. PARL. ASS., *Circumstances Surrounding the Arrest and Prosecution of Leading Yukos Executives*, Res. No. 1418 at ¶ 8 (January 25, 2005) (Appended hereto as Exhibit 2).

Yukos had also clashed with Transneft, the wholly state-owned pipeline company responsible for the distribution of 93% of all oil produced in Russia. The Russian government's control of Transneft has enabled it to maintain control, through quotas and other mechanisms, of oil distribution both domestically and internationally, and to collect taxes and fees on oil production, transport and export. The Russian government has used the distribution channels of oil and gas as a strong foreign policy tool, particularly in its dealings with its neighbors in the former Soviet Union and Eastern Bloc countries. Ukraine gets most of its energy from Russia and the Russian government provides discounted sales of oil and gas to the central Asian republics as a means of maintaining influence in these countries. Therefore, when Yukos challenged Transneft proposed plans for pipelines, it was in fact challenging a vital aspect of Russian foreign policy. For example, after the Russian authorities rejected a proposal for a pipeline to Murmansk, intended to facilitate oil exports to the West, Khodorkovsky announced his intent for Yukos to privately finance and construct the line.

The most significant conflict between Transneft and Yukos had been over the construction of pipelines to China and Japan. While Yukos had been championing a proposed pipeline to China, Transneft had for many years stated its intention to build a much longer pipeline from Eastern Siberia to a Pacific export point to serve the Pacific Rim market. Both China and Japan actively lobbied the Russian government over the pipeline route and it appears that in the end, both countries got at least a part of what they wanted. It was recently announced that the pipeline will stretch to the Pacific, bypassing China. However, Rosneft, using the assets of Yuganskneftegas, recently signed a long-term oil supply agreement with the Chinese. The Japanese and Chinese have returned the favors bestowed upon them by the Russian government with pledges of financing for the development of Russia's energy sector.

The largest company in Russia is the state controlled gas giant, Gazprom. Gazprom has viewed Yukos as a threat to its gas monopoly and also wants to break into the oil business. Yukos is perceived as a threat to Gazprom because of its ability to produce gas cheaper than Gazprom and also because Yukos was exploring the idea of building a pipeline to the Arctic Ocean where its gas could be liquefied at a terminal and exported to Europe. Such a project would place Yukos in competition with Gazprom in the sale of gas to Europe and allow Yukos to completely bypass Gazprom's pipelines.

While I have outlined above the economic and geopolitical motivations of the Russian government in targeting Yukos, it is important to note that just because the Russian government has been successful in hobbling Yukos, this does not mean that the government is finished in its quest to gain control of Russian oil fields and pipelines. This is clearly seen in last week's declaration by the Russian government that only companies that are majority owned by Russians will be allowed to participate in tenders for oil and mineral rights. As the state's control over the Russian oil industry grows, decisions in the industry will become less and less about market forces and, instead, will be increasingly driven by Russia's international policy aspirations.

The Russian authorities have also been motivated to move against Yukos in its attempt to silence political opponents of the current regime. The Russian authorities

considered Khodorkovsky, Lebedev and their colleagues to be ideological and political opponents. Khodorkovsky was seen as a potential future political threat to the current government due to his economic support of liberal candidates for the Duma and the Presidency. As chairman of Yukos, he engineered reforms that brought transparency, corporate governance, Western management and global investments. By contrast, the current Administration favors increased state control of the economy and the subordination of political and economic institutions to the will of the executive. The arrest of Lebedev was seen as a warning to Khodorkovsky to step down and/or flee Russia as had other persecuted oligarchs. Instead of heeding this warning, Khodorkovsky continued to openly criticize the Russian authorities and, despite many opportunities to do so, refused to go into exile.

Prior to his arrest and incarceration, Khodorkovsky was an active critic of Russia's current President and funded opposition parties, including the Union of Rightist Forces (SPS) and Yabloko. In addition, Khodorkovsky had many allies in the Duma and it was rumored that he was in favor of limiting the power of the Russian presidency by moving the country towards a parliamentary democracy.³⁴ He was also widely believed to have political aspirations himself, including the Russian presidency. Khodorkovsky's role in opposition politics was expressly cited in the U.S. State Department's 2003 Human Rights Report which stated that "[o]pposition parties, particularly those receiving funding from some so-called oligarchs, were seriously hampered by the investigation and arrest of Yukos President Mikhail Khodorkovsky, a step widely believed to have been prompted, at least in part, by the considerable financial support he provided to opposition groups."³⁵

While it is hard to determine whether the Russian government has gone after Lebedev and Khodorkovsky to get at the assets of Yukos, or if the campaign against Yukos was an attempt to weaken Khodorkovsky, the end result is that the government has used its ongoing investigation of Yukos as leverage against Lebedev and Khodorkovsky in their criminal proceedings. The tax case against Yukos has never been about the reclamation of taxes, but instead has been a naked attempt to destroy Group Menatep, its shareholders, and Yukos, thereby eliminating a major source of support for Khodorkovsky and also renationalizing strategic assets.

These cases are part of a continuing pattern of the consolidation of power by the Kremlin. The Kremlin now controls the press, and to a great degree, the Russian energy sector.

GROUP MENATEP RESPONSE

³⁴ Dr. Martha Brill Olcott, *The Energy Dimension in Russian Global Strategy, Vladimir Putin and the Geopolitics of Oil*, The James A. Baker III Institute for Public Policy, October 2004.

³⁵ U.S. Department of State, *Country Reports on Human Rights Practices: Russia* at § 3 (February 25, 2004), available at <http://www.state.gov/g/drl/rls/hrrpt/2003/27861.htm>.

The Board of Group Menatep has made every possible good faith effort to reach an amicable settlement with the Russian authorities. To that end, we asked the former Prime Minister of Canada, Jean Chretien, to act as an intermediary in opening discussions with the Russian government. Prime Minister Chretien met with President Putin in the Kremlin on July 5th of last year. Also present at the meeting was Alexei Miller, president of Gazprom. Over lunch, the President agreed that his government would review in good faith any proposals by Yukos to resolve the tax and other legal issues then outstanding. Prime Minister Chretien had numerous subsequent telephone conversations with President Putin and wrote him several letters. More than 50 proposals to resolve the outstanding claims against Yukos were sent, some of them directly to President Putin's office. All of these efforts yielded no response from the Russian government. After several months, we could only conclude that the Government's campaign against the company had nothing to do with legitimate tax collection or fair minded prosecution of alleged financial crimes, and instead serves the Government's political ends, which were, and remain, the expropriation of Yukos and the destruction of Group Menatep and its shareholders.

Any hopes that the Yukos affair would be settled in a reasonable and legal fashion were finally crushed last December, when the Government ordered the sale of Yuganskneftegaz, Yukos' largest and most valuable oil production arm, as detailed above. None of the money realized by the sale will go to Yukos or its shareholders. Ostensibly it will be used to repay the inflated tax arrears and arbitrary penalties which the Russian Government imposed on Yukos to justify the sale in the first place. Indeed, every effort to appeal the tax assessments and other proceedings against Yukos in the Russian courts has been summarily denied except one, when a brave judge did rule against a particularly egregious government decision; in that one case, the judge was quickly dismissed and his ruling overturned.

As a result, on February 9 of this year, Group Menatep proceeded to file a claim against the Russian Federation under the terms of the 1994 Energy Charter Treaty. Group Menatep's claims are based on the Russian Federation's failure to protect the company's investments in Russia, and specifically the expropriation of Yuganskneftegaz. The claims seek compensation of approximately US\$ 28.3 billion. Under the terms of the Treaty, breaches by the Russian Federation of its international obligations entitle the Claimants to the payment of prompt, adequate and effective compensation. Under Article 26 of the Energy Charter Treaty, disputes can be referred to international arbitration if they are not settled amicably between the disputing parties within 3 months of a notification of claim. The Claimants delivered original notifications to the Russian Federation on November 2, 2004. Since then, the Russian Federation has totally ignored the notifications and has failed to settle amicably the dispute.

Group Menatep will pursue the ECT claim and all other available legal remedies in jurisdictions around the globe, using all means at our disposal. Our objective is to protect the company's remaining assets, seek compensation for the losses Group Menatep has incurred in the Russian Federation and demonstrate to the world that Yukos, Group Menatep and its shareholders have been the victims of an illegal, politically motivated

campaign by the Russian Government outside the bounds of accepted international norms, behavior and custom.

IMPACT ON THE U.S.

The detrimental impact of the “Yukos affair” has been widely reported in the media, as have its repercussions for Russia’s relations with the West. Not only have U.S. shareholders -- including public pension funds -- been directly and negatively impacted, but the actions of the Russian authorities show a flagrant disregard for rule of law, as the circumstances around the auction of Yuganskneftegas clearly demonstrate. Along with my remarks, I am submitting for the record today a handful of media reports on the Yuganskneftegaz auction that refer to the “farcical” nature of the Russian authorities’ conduct (*Financial Times*, December 20, 2004). As a majority owner in Yukos, Group Menatep has seen the value of its stake plummet.

In my role as a Director of Group Menatep, I have duties and obligations to the the company. Investors rely on the integrity of the company itself and on its public filings with securities regulators. But they also rely on the political and legal systems in the countries in which such companies operate, for if rule of law is not followed and property rights are not protected in a country, the whole international system for attracting and protecting foreign investment breaks down.

The U.S. has been a leader in the development of this international system, and has worked to bring Russia into it through economic agreements designed to protect investors from such risks as expropriation of their assets by state authorities. These include the United States’ *Treaty with the Russian Federation Concerning the Encouragement and Reciprocal Protection of Investment* which expressly is designed to protect American investors from such risks in Russia, and which provides as follows in relevant part:

Investments shall not be expropriated or nationalized either directly or indirectly through measures tantamount to expropriation or nationalization ("expropriation") except for a public purpose; in a nondiscriminatory manner; upon payment of prompt, adequate and effective compensation; and in accordance with due process of law and the general principles of [nondiscriminatory] treatment. . . .³⁶

Despite Russia's signing this treaty in Washington on June 17, 1992, the treaty did not go before the Russian Duma for serious consideration of its ratification under Russian law until 2003, and it has yet to be ratified.

This treaty is clearly intended to protect U.S. investments in Russia including securities of a Russian company held by U.S. nationals. By our estimates, approximately

³⁶ *Treaty with the Russian Federation Concerning the Encouragement and Reciprocal Protection of Investment*, TIAS 11471, at Art. III(1); Treaty Doc. 102-33 (June 17, 1992).

15 percent of Yukos' shares are owned by U.S. nationals. Accordingly, regardless whether the Duma has ratified the treaty, Russia's expropriation and nationalization of Yukos would appear to constitute a failure by Russian authorities to comply with the treaty obligation that Russian representatives undertook in 1992.³⁷ These actions have directly harmed U.S. nationals whose interests were protected in theory by that treaty.

I do not know whether the U.S. government is concerned about this apparent violation by Russia of its duties to the U.S. under the Bilateral Investment Treaty or the fact that Russia has failed to ratify this treaty after nearly 15 years. While the issue of whether private individuals have remedies available to them under the treaty notwithstanding its ratification status in Russia is currently being studied, it is clear that if the U.S. concludes that Russia is not living up to its responsibilities under the Treaty, or that Russia is not even taking seriously the practice of treaty making, it has a number of remedies available to it. These could include deferring decisions to grant Russia additional economic privileges, given its apparent inability or unwillingness to abide by one of the most basic provisions of a bilateral investment treaty-- the prohibition on expropriation without compensation.

Mr. Khodorkovsky was a leading proponent for Russia's integration into world markets, and particularly for closer ties with the U.S. and the West, another factor mentioned as a possible catalyst for his arrest. This sends a chilling signal to Russia's business leaders and discourages the sort of open and collaborative economic relationship that would be of mutual benefit to the U.S. and Russia.

As Mr. Theede explained, energy security is another critical factor in the "Yukos affair." The Russian Government's desire to renationalize energy assets held by Yukos was, in my personal view, an important motivating factor for the attacks on Group Menatep. Whereas under Mr. Khodorkovsky's leadership, Yukos was exploring new ways of cooperating with the U.S., including the diversification of Russian export markets through the construction of pipelines to supply both the east and west coasts of the United States, we now have a situation whereby these decisions will be made based on Russian foreign policy objectives and internal politics, not markets. Indeed, just this past week, the Russian Government announced that only majority owned Russian oil firms will be allowed to bid on exploration contracts later this year -- an announcement rightly seen as extremely worrisome by major news media and Western analysts alike.

U.S. REACTION

As I have previously mentioned, I am not an expert in foreign policy and would not presume to make recommendations on United States policy towards Russia. However, it is widely acknowledged by such experts that the attacks on Group Menatep and its leadership are selective and politically motivated. It is increasingly clear,

³⁷ I note that under Article 18 of the Vienna Convention on the Law of Treaties, May 23, 1969, 1155 U.N.T.S. 331, a State is obliged to refrain from acts which would defeat the object and purpose of a treaty it has signed pending ratification.

moreover, that the “Yukos affair” is not a one-off occurrence, but rather forms part of a concerted effort to reclaim state control over Russia’s energy sector for both strategic reasons and personal enrichment. It may be that the United States government finds expropriations, unfair arrests, prosecutions and trials, and consolidation of key sectors in Russia’s economy under state control to have national security implications. It is obvious that U.S. interests will continue to be dramatically affected until the Yukos “affair” is resolved in a manner consistent with international standards and rule of law.

A wide array of commentary points to the negative impact this matter is having on capital flight out of Russia, foreign investment into Russia and U.S.-Russia energy cooperation. U.S. minority shareholders in Yukos have also lost a great deal of money, among them public pension funds such as the State of Ohio.

Hearings such as these send an important signal to the Kremlin that the U.S. is closely watching its actions and is vitally concerned about rule of law, as well as property and human rights in Russia.

The upcoming Summit meeting of Presidents Bush and Putin will provide another opportunity for the United States to raise these concerns, and I would hope you will urge President Bush to send a strong signal when he meets with President Putin next week.

Given the current ominous trends in Russia, I note that many experts have called into question Russia’s accession to the WTO, its participation in the Group of Eight, and in particular its hosting of the G8 meeting in 2006. As rules based organizations and a grouping of the world’s leading democracies respectively, my personal experience has provided a stark example as to why the Russian Federation is not currently a suitable candidate for either.

I thank you for the opportunity to testify here today, and once again, am grateful for the interest and attention this matter is receiving.

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