Federal *Arbitrazh* Court, Tomsk Oblast, 7 July 2010, Case No. A67-1438/2010[1]

Parties:	Petitioner: Yukos Capital S.A.R.L. (Luxemburg) Respondent: OAO Tomskneft VNK (Russian Federation)
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Subject matters:	– due process and address of communications – public policy and sham arbitration
Commentary Cases:	[7]-[12] = ¶ 511 (no proof of communication of arbitration documents); [13]-[23] = ¶ 524 (sham arbitration); [24] = ¶ 505; [25]-[26] = ¶ 513; [27] = ¶ 306; [28] = ¶ 301

Summary

Enforcement of an ICC award was denied because (i) the Russian defendant did not receive part of the correspondence relating to the arbitration, in particular, the notification of the arbitration hearing and (ii) because the parties to the ICC arbitration were both companies of the Yukos Group and ultimately fully controlled by the same company; hence, they did not have an economic interest to the arbitration when a simple transfer of funds would have sufficed to repay the loans at issue. The arbitration was found to be a sham and part of an illegal scheme set up by the Yukos Group to avoid tax liabilities and expropriation by the Russian government.

On 20 April 2004, 27 July 2004 and 4 August 2004, Yukos Capital S.A.R.L. (Yukos Capital) entered into three loan agreements with OAO Tomskneft VKN (Tomskneft), under which Yukos Capital lent certain amounts to Tomskneft. Both companies belonged to the Yukos Group. On 2 November 2005, the parties concluded supplementary agreements to the original loan agreements, which modified the original

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choice-of-jurisdiction clause and provided for arbitration of disputes at the International Court of Arbitration of the International Chamber of Commerce (ICC).

Yukos Capital commenced ICC arbitration in Paris against Tomskneft and ZAO Yukos EP (Yukos EP), Tomskneft's controlling company, as provided for in the loan agreements and the supplementary agreements. Yukos EP participated in the arbitration, Tomskneft did not. On 12 February 2007, an ICC sole arbitrator found in favor of Yukos Capital and directed Tomskneft to pay Yukos Capital a total of RUB 7,254,218,987, US$ 275 225,84, UK£ 52 964,84 and interest on part of this sum. Yukos Capital sought enforcement of the ICC award in the Russian Federation.

The Federal *Arbitrazh* (Commercial) Court of Tomsk Oblast denied enforcement on violation of due process and public policy grounds. It noted at the outset that the *Arbitrazh* Court Procedure Code of the Russian Federation (the *Arbitrazh* Procedure Code) allows *arbitrazh* courts to deny enforcement of foreign arbitral awards on certain grounds; enforcement can also be denied on the grounds provided for in an international treaty to which the Russian Federation is a party (such as the 1958 New York Convention) and in the Federal Law on International Commercial Arbitration of the Russian Federation.

The court first granted Tomskneft's argument that enforcement should be denied under Art. V(1)(*b*) of the Convention and its corresponding provision in the Russian Law on Arbitration, because Tomskneft was not properly notified of the arbitration. The court noted that correspondence relating to the arbitration was sent to Tomskneft both at its registered address in Tomsk Oblast and care of Yukos EP in Moscow. On 20 June 2006, Yukos EP ceased to act as Tomskneft's executive organ when Tomskneft's executive powers were transferred to another company of the Yukos Group, ZAO Yukos RM. As a consequence, held the court, unless it was proved that correspondence had been sent to Tomskneft directly, the sending of correspondence to Yukos EP was no proof, after 20 June 2006, that correspondence was also received by Tomskneft. The court concluded on the evidence that there was no proof that Tomskneft had received notice of, inter alia, the timetable of the arbitration, the date for the hearing and the closing of the proceeding. Hence, enforcement should be denied for lack of proper notification.

The court also granted Tomskneft's contention that recognition and enforcement of the ICC award would violate the public policy of the

Russian Federation. It reasoned that Yukos Capital was fully owned by Yukos International UK B.V., which in turn was fully owned by Yukos Finance B.V., a company fully owned by OAO NK Yukos. Also, at the relevant time, OAO NK Yukos was the sole shareholder of Tomskneft. Thus, when the loan agreements and the supplementary agreements were concluded, and during the arbitration proceedings, both Yukos Capital and Tomskneft were fully controlled by OAO NK Yukos (this was also the case in respect of Yukos EP).

In May 2004, the Moscow *Arbitrazh* Court – which directed OAO NK Yukos to pay taxes and fines totaling a sum in excess of RUB 99 billion – found that OAO NK Yukos had set up an illegal financial structure involving the companies of the Yukos Group. Under this structure, concluded the Tomsk Oblast court, the loans given by Yukos Capital to Tomskneft in fact concerned money previously withdrawn from Tomskneft in the context of a transfer pricing scheme. Hence, the loan agreements in respect of which the ICC award was rendered were an illegal arrangement entered into by two parties – Yukos Capital and Tomskneft – which were both wholly controlled by OAO NK Yukos and had no economic reason to settle their dispute by ICC arbitration when a simple transfer of funds would have sufficed. Hence, the dispute between the parties was simulated and enforcement of the award would violate public policy.

The court then denied the other claims raised by Tomesckneft: (i) that the supplementary agreements containing the ICC arbitration clause were invalid; (ii) that the arbitral procedure was not in accordance with the agreement of the parties because the case was heard by a sole arbitrator and the sole arbitrator allegedly did not apply the substantive law agreed by the parties; (iii) that Yukos Capital did not abide by the three-year time limit to seek enforcement of the award and (iv) that the request for enforcement was signed by an unauthorized person. The court concluded that the evidence of the case proved otherwise in respect of all the above claims.

Excerpt

I. BACKGROUND

[1] "The award dated 12 February 2007 of the International Court of Arbitration at the International Chamber of Commerce in case No. 14202EBS [the ICC award], rendered by sole arbitrator Robert Briner,

directed OAO Tomskneft VNK [Tomskneft] to pay Yukos Capital S.A.R.L. (Yukos Capital) the following amounts:

(i) RUB 2,300,000,000, plus 9% between 20 July 2004 and the date of the arbitral award, plus damages of RUB 2,300,000 per day from 1 December 2005 until the date of the arbitral award;
(ii) RUB 1,240,000,000, plus 9% between 20 July 2004 and the date of the arbitral award, plus damages of RUB 1,240,000 per day beginning 1 December 2005 until the date of the arbitral award;
(iii) RUB 810,000,000, plus 9% between 5 August 2004 and the date of the arbitral award, plus damages of RUB 810,000 per day beginning 1 December 2005 until the date of the arbitral award;
(iv) fees and expenses of the sole arbitrator and administrative expenses of the ICC in the amount of US$ 153,622;
(v) legal and other expenses incurred by [Yukos Capital] in the amount of US$ 121,603.28 and UK£ 52,964.84;
(vi) simple interest at a rate of 9% on all sums ordered to be paid in the arbitral award, beginning on the date of the arbitral award and ending on the date payment is completed.

[2] "When Tomskneft did not comply with the arbitral award, Yukos Capital applied to the *Arbitrazh* (Commercial) Court of Tomsk Oblast (at the debtor's seat), requesting recognition of the ICC award and an enforcement order to collect RUB 7,254,218,987, US$ 275 225,84, UK£ 52 964,84 and simple annual interest at the rate of 9% on RUB 4,350,000,000, beginning 12 February 2007 until the day the debt is paid, from Tomskneft in favour of Yukos Capital.... Written representations provide justification of Yukos Capital's request....
[3] "Tomskneft responded to this request by challenging the recognition and enforcement of the foreign arbitral award on the following grounds:

(1) Tomskneft did not have the opportunity to present its case due to the improper notification of the [arbitration] hearing, which is a ground for refusing recognition and enforcement of the arbitral award under Art. 244.1(2) of the *Arbitrazh* Court Procedure Code of the Russian Federation (the *Arbitrazh* Procedure Code) and Art. V(1)(*b*) of [the 1958 New York Convention];
(2) The supplementary agreements to the loan agreements, which changed the jurisdiction over disputes arising from the loan agreements

in favor of the ICC, are invalid; pursuant to Art. V(1)(*a*) of the Convention, this is a ground for refusing recognition and enforcement of the foreign arbitral award;
(3) The composition of the arbitral tribunal was not in accordance with the agreement of the parties; pursuant to Art. V(1)(*d*) of the Convention, this is a ground for refusing recognition and enforcement of the foreign arbitral award;
(4) The arbitral tribunal made its award on the claim without applying the substantive law agreed to by the parties and without applying the substantive law of any state; as a result, the arbitral procedure was not in accordance with the parties' agreement. Pursuant to Art. V(1)(*d*) of the Convention, this is a ground for refusing recognition and enforcement of the foreign arbitral award, because the arbitral procedure was not in accordance with the parties' agreement in respect of the procedural requirement [that the arbitral tribunal] apply the law chosen by both parties. Also, this was not in accordance with the applicable arbitration rules;
(5) The claimant let the time limit for seeking enforcement of the arbitral award expire; pursuant to Art. 244.1(6) of the *Arbitrazh* Procedure Code, this is a ground for refusing recognition and enforcement of the foreign arbitral award;
(6) The recognition and enforcement of the foreign arbitral award would violate the public policy of the Russian Federation; pursuant to Art. 244.1(7) of the *Arbitrazh* Procedure Code and Art. V(2)(*b*) of the Convention, this is a ground for refusing recognition and enforcement of the foreign arbitral award;
(7) Yukos Capital's request to recognize and enforce the foreign arbitral award was signed by an unauthorized person; hence, the request should be rejected without examination pursuant to Art. 148.1(7) of the *Arbitrazh* Procedure Code....

[4] "At the hearing before the court, the claimant's representative insisted upon the recognition and enforcement of the foreign arbitral award on the grounds set forth in the request. Representatives of Tomskneft objected to the recognition and enforcement of the foreign arbitral award on the grounds set forth in the response to the request."

II. ANALYSIS

[5] "Having examined the case materials and heard the parties' representatives, this Court does not deem that Yukos Capital's request should be granted.
[6] "Pursuant to Art. 244.2 of the *Arbitrazh* Procedure Code, a court may refuse to recognize and enforce a foreign arbitral award, in full or in part, on the ground provided for in Art. 244.1(7) (enforcement of the decision of the foreign court would violate the public policy of the Russian Federation) and Art. 239.4 (the court refuses issuing an exequatur due to defects in formation of the tribunal and violations in the proceedings) of the same Code, which allows [a court] to refuse to issue an order for the mandatory enforcement of a decision rendered in international commercial arbitration, unless an international treaty of the Russian Federation provides otherwise. Pursuant to Art. 239.2(4) of the *Arbitrazh* Procedure Code, a court may refuse to issue an order for the mandatory enforcement of an award made in international commercial arbitration on the grounds provided for in an international treaty of the Russian Federation and in the Federal Law on International Commercial Arbitration."

1. Due Process

[7] "According to Art. V(1)(*b*) of the Convention, recognition and enforcement of an arbitral award may be refused, at the request of the party against whom it is invoked, if that party furnishes to the competent authority proof that, inter alia, the party against whom the award was made was not duly notified of the appointment of the arbitrator or of the arbitration proceedings or was otherwise unable to present its case;
[8] "According to Art. 36.1(1) of the Law of the Russian Federation dated 7 July 1993 No. 5338-1 on International Commercial Arbitration, recognition and enforcement of an arbitral award, irrespective of the country in which it is made, may be refused, at the request of the party against whom it is invoked, only if that party furnishes to the competent court, where recognition and enforcement of the award is sought, proof that the party against whom the award is invoked was not duly notified of the appointment of the arbitrator ~~arbitration~~ or of the arbitration proceedings or was otherwise unable to present its case.
[9] "According to the ICC award, [Yukos Capital] does not contest that Tomskneft was not present during the legal proceedings in this case. According to the award, correspondence to the defendant parties

was sent by the sole arbitrator to Yukos EP by fax and DHL courier, and to Tomskneft by DHL.

[10] "The agreement dated 29 September 1998, No. EP-240-1/5, concluded between Tomskneft and Yukos EP on the transfer of the powers of [Tomskneft's] executive organs ... was terminated on 20 June 2006. By an agreement concerning the transfer of the powers of [Tomskneft's] sole executive organ dated 20 June 2006, No. PM06-553/116, the powers of the sole executive organ of Tomskneft were transferred to ZAO Yukos RM, as confirmed by the extract of decision No. 2 of 2 June 2006 of Tomskneft's sole shareholder, OAO NK Yukos.... Neither from the text of [the ICC award] nor from Yukos EP's letter of 20 March 2006 ... does it appear that Yukos EP or Tomskneft were informed of the possibility that correspondence would be sent to [Tomskneft] at an address other than its registered address (23 Burovikov Street, Strezhevoy, Tomsk Oblast). The fact that Yukos EP wrote its letter [of 20 March 2006] on its own stationery, which stationery contained Yukos EP's address (31a Dubininskaya Street, Moscow, 1150543, Russian Federation), does not by itself confirm the above possibility. Thus, the fact that the correspondence [relating to the ICC arbitration] was received by Yukos EP after 20 June 2006 is no proof that [this correspondence] was received by Tomskneft.

[11] "The case materials do include a receipt from DHL and statements of correspondence delivery confirming that Tomskneft received the correspondence sent to its address on 27 June 2006 and 21 July 2006 ..., which contained the list of outstanding issues .... [However,] the evidence of the case does not include a proof that the timetable [for the arbitration] – as well as the notification of the date of the hearing in Europe, for instance, Paris on 9 August 2009 ..., the notification of the confirmation of the outstanding issues of 21 August 2006 ..., [the notification] of the timetable of 24 August 2006 ..., of Procedural Order No.1 of 29 September 2006 ..., of Procedural Order No.2 of 23 November 2006 ..., of the closing of the proceedings and the review [by the ICC Court] of 20 December 2006 ... – were sent to Tomskneft's address. According to the correspondence between Tomskneft and the ICC Secretariat, invoices, other confirmation of postal delivery and other evidence confirming the sending and/or delivery (receiving) by Tomskneft of letters dated 10 November 2006, 23 November 2006, 4 December 2006 and 20 December 2006 are missing from the materials of case No. 14202EBS.... According to a letter dated 31 May 2010 ... from the Tomsk office of ZAO DHL

International, sent to the address of Tomskneft, no information concerning the delivery of the correspondence addressed to Tomskneft by the ICC in the period from 15 December 2006 to 5 January 2007 is available because the period for storing delivery records (three years) has expired.

[12] "Thus, Tomskneft has proved that it was not properly notified of the arbitration proceedings, including the time and place of the hearing (Procedural Order No.2), so that it was unable to present its defense. This is a sufficient ground on which to refuse recognition and enforcement of the foreign arbitral award."

2. Public Policy

[13] "The Court grants, on the following grounds, [Tomskneft's] claim that recognition and enforcement of the ICC award would violate the public policy of the Russian Federation.

[14] "According to the extract from the Luxembourg Register of Commerce and Companies ..., (i) the sole partner of [Yukos Capital] is Yukos International UK B.V.; (ii) the sole shareholder of Yukos International UK B.V. from 8 June 2000 to 19 April 2005 was Yukos Finance B.V. ... and (iii) the sole partner of Yukos Finance B.V. was OAO NK Yukos.... Thus the system of 100% inter-company participation of these entities is as follows: OAO NK Yukos – Yukos Finance B.V – Yukos International UK B.V. – Yukos Capital. At the same time, OAO NK Yukos owned 100% of the shares in Tomskneft.... OAO NK Yukos retained control over its affiliates, including Tomskneft, until 4 August 2006

[15] "Thus, during the period when the loan agreements (dated 20 April 2004 (No. 02-07), 27 July 2004 (No. 05-07) and 4 August 2004 (No. 08-07)) and the supplementary agreements thereto (of 2 November 2005) ... were being concluded, and during the period when [Yukos Capital] was arbitrating before the ICC, OAO NK Yukos fully dictated the activity of Yukos Capital, Tomskneft and Yukos EP, which were all under its control.

[16] "On the date of providing the loans [by Yukos to its affiliates] WERE THE LOANS PAID OUT ON 28 MAY 2004? , the *Arbitrazh* (Commercial) Court of Moscow on 28 May 2004 rendered a decision in case No. A40-17669/04-109-241, directing OAO NK Yukos to pay over RUB 99 billion in taxes and fines.... This decision was not

disturbed by the decree of the Presidium of the Supreme *Arbitrazh* Court of the Russia Federation dated 4 October 2005, No. 8665/04....
[17] "However, instead of complying with the [Moscow] court's order and repaying OAO NK Yukos's state debts , monetary funds accumulated on the accounts of foreign legal entities [controlled by Yukos] were transferred as loans to the central procurement company of the OAO NK Yukos Group (including Tomskneft), with the aim of encumbering the fixed assets of OAO NK Yukos to non-resident companies controlled by OAO NK Yukos. These facts are supported by the findings of the Moscow *Arbitrazh* Court's decision of 28 April 2005 in case No. A40-4338/05-107-9/A40-7780/05-98-90, following a 2003 tax inspection of OAO NK Yukos, in which it is stated:

> 'monetary funds belonging to the Yukos Group are accumulated by and remain deposited in the accounts of non-resident dependant companies in non-resident banks. To carry out major payments of the Yukos Group organization, funds belonging to the Yukos Group are transferred from accounts in non-resident banks into Russian banks via numerous inter-payments, including promissory notes, at the necessary time in order to make payments in transactions of real interest to OAO NK Yukos. Inter-payments between the resident organisations of the Group are in the majority of cases carried out within one business day and are carried out using internal bank transactions. As a rule, at the beginning of that day, during which large payments are made, including payments for petrol (petrochemicals) and promissory notes, the participants do not have enough monetary funds to carry out the payment.' ....

When there was transfer pricing within the Group, OAO NK Yukos's money was first withdrawn through transfer prices and then returned in the form of loans for financing activity of one or other enterprise. According to the court's decision, this financial structure was illegal and was also intended to withdraw money from oil-extracting companies.
[18] "Thus, the financial activity of Yukos Capital aimed at giving loans took place at the expense of money previously withdrawn from Tomskneft in the context of transfer pricing. It follows that the loan agreements in respect of which the foreign arbitral award was rendered in fact covered Tomskneft's repayment of funds illegally withdrawn from Tomskneft itself via transfer prices to the benefit of other

enterprises of the holding company, including Yukos Capital. Similar conclusions are contained in the extract from the bill of indictment of criminal case No. 18/432766-07....

[19] "[Yukos Capital] itself – in its petition for appeal against the decision of the Amsterdam court [of first instance] of 28 February 2008[2] concerning interim measures of protection in the context of the proceedings for enforcement of the award which directed OAO NK Rosneft (the legal successor of Yuganskneftegaz) to pay debts under similar loan agreements – confirms that the supplementary agreements to the loan agreements (including those with Tomskneft), which changed the jurisdiction over disputes, were executed by instruction from the management of OAO NK Yukos with the aim of reserving the assets of OAO NK Yukos for 'legitimate shareholders' and avoiding 'the expropriation of assets by the Russian Federation'....

[20] "In light of the fact that the claimant and the respondent in the dispute at the ICC were not independent economic or legal subjects, but were wholly controlled by one and the same entity (OAO NK Yukos), there was no economic reason for their approaching the ICC in order to resolve their dispute. There was nothing to prevent the management of OAO NK Yukos from simply re-transferring the monetary funds transferred in the loan agreement, and interest accumulated on them, from Tomskneft to [Yukos Capital]. It thus follows that the dispute between the parties was actually simulated from the outset in order to 'legitimize' demands made on Tomskneft when OAO NK Yukos would lose control over it and to encumber one of the fixed assets by providing the loans [to OAO NK Yukos's affiliates]to the benefit of the non-resident companies controlled by the management of OAO NK Yukos.

[21] "These conclusions are also evident from Yukos EP's position during the arbitration proceedings: giving the appearance of participation in the proceedings and raising unjustified objections.

[22] "Consequently, the arbitration proceedings were simulated with the aim of creating the appearance of legal grounds for shifting the

2.Similar loan agreements between Yukos Capital and another company of the Yukos Group, OJSC Yuganskneftegaz (which later became OAO Rosneft) led to an award of the International Commercial Arbitration Court at the Chamber of Trade and Industry of the Russian Federation and to enforcement proceedings in the Netherlands. The decision of the Amsterdam Court of Appeal in this case is reported in Yearbook XXXIV (2009) at pp. 703-705 (Netherlands no. 31); the appellate decision of the Dutch Supreme Court is reported in this Yearbook XXXV (2010) at pp. 000-000 (Netherlands no. 000).

monetary claims to Tomskneft following the loss of control over it by OAO NK Yukos.

[23] "Thus, [the ICC award] cannot be recognized and enforced on the grounds provided for in Art. 244.7(1) of the *Arbitrazh* Procedure Code, Art. V(2)(*b*) of the Convention and Art. 36.2(1) of the Law of the Russian Federation dated 7 July 1993 No. 5338-1 on International Commercial Arbitration."

3. Other Grounds

[24] "This Court does not accept [Tomskneft's] claim that the supplementary agreements to the loan agreements, which changed the jurisdiction over the disputes arising from the loan agreements in favor of the ICC, are invalid. There is no evidence in the case materials that the power of attorney dated 26 July 2005 No. UEP-86/05 in the name of David Andrew Godfrey ... had been withdrawn by Tomskneft on the date the supplementary agreements were signed (2 November 2005). The fact alone that company regulations were breached through the signing of said agreements is not adequate grounds to declare them invalid.

[25] "This Court rejects [Tomskneft's] claim that the composition of the arbitral authority was not in accordance with the agreement of the parties. In a letter dated 20 March 2006 ..., Yukos EP communicated that it did not object to the case being heard by a sole arbitrator and that this did not contradict the provisions of Art. 8 of the ICC Rules....

[26] "This Court does not deem that Tomskneft's claim that the arbitrator made an award without applying the substantive law agreed on by the parties and without applying any substantive law whatsoever, as a result of which the arbitral procedure was not in accordance with the agreement of the parties, contradicts the legal opinion [made by an expert and included in the case materials] ... In making this decision, the Court takes into account the fact that Tomskneft did not supply evidence of the foreign arbitral award having been made without applying the substantive law of New York, USA.

[27] "This Court rejects Tomskneft's claim that [Yukos Capital] missed the deadline for presenting the arbitral award for enforcement. The request to recognize and enforce the foreign arbitral award was sent on 5 February 2010, as is confirmed by the date on the envelope ..., and arrived in the office of the *Arbitrazh* Court of Tomsk Oblast on 8 February 2010, as is confirmed by the stamp on the request.... In

accordance with Art. 246.2 of the *Arbitrazh* Procedure Code, a foreign arbitral award may be presented for mandatory enforcement no later than three years from the date of it comes into force. As the award was made on 12 February 2007, the three-year period for submitting the request to the *Arbitrazh* Court had not expired.

[28] "This Court rejects Tomskneft's claim that Yukos Capital's request to recognize and enforce the foreign arbitral award was signed by a person who did not have the authority to sign it, and that as a consequence [the request] should be denied without examination pursuant to Art. 148.7(1) of the *Arbitrazh* Procedure Code. The authority of A. V. Skvorotsov to sign the statement of claim is confirmed by power of attorney dated 21 January 2010 ... and the authority of Daniel Fieldman to issue power of attorney for the entity Yukos Capital is confirmed by the extract of the Luxembourg Register of Commerce and Companies and by Yukos Capital's Articles of Association...."

III. CONCLUSION

[29] "Thus, Yukos Capital's request to recognize and enforce the foreign arbitral award shall not be granted.

[30] "In accordance with Art. 110.1 of the *Arbitrazh* Procedure Code, judicial expenses fall to Yukos Capital."

(....)