

## Russian Government Ordered to Pay \$50 billion

By Boris J. Steffen, MM, CPA, ASA, ABV, CDBV – September 16, 2014

On July 18, 2014, a Tribunal in the Permanent Court of Arbitration in The Hague unanimously held that the Russian Federation had taken a series of actions that effectively resulted in the expropriation of the interests of GML subsidiaries Hulley Enterprises Limited, Yukos Universal Limited, and Veteran Petroleum Limited (which together held 70.5 percent of the shares) in defunct OAO Yukos Oil Company (Yukos). Consequently, in the largest international arbitration award in history, the Russian Government was ordered to pay damages of approximately \$50 billion, on top of legal fees of \$60 million.

Each damages expert submitted two reports. The claimants' expert, using discounted cash flow, comparable company and comparable transactions analyses, and assuming that all of respondent's actions violated the governing Energy Charter Treaty, concluded that the claimants should be compensated for the value of their shares as of November 21, 2007, the day Yukos was delisted, assuming that Yukos had merged with oil company Sibneft, been listed on the NYSE, and that the claimants would have received dividends from 2004 through November 2007. The total was brought forward to a date near the claimants' last submission to the Tribunal with pre-award compound interest at a rate of LIBOR plus four percent, which resulted in damages of approximately \$114 billion.

Respondent's damages expert did not offer a damages valuation of his own, but focused on explaining why the claimants' expert's reports were not useful. The respondent's damages expert's criticisms included that the valuation date chosen by the claimants' expert was arbitrary and artificially inflated damages, and that he:

- ignored causation and the degree to which Yukos' conduct might have added to the loss,
- corrected errors in his DCF analysis such that the result was unchanged, indicating that it was "reverse engineered,"
- included major international oil companies in his comparable company analysis that were not comparable to Yukos,
- assumed events that never occurred and were speculative and overstated, and
- erred in applying inflation, export duty and mineral extraction tax rates.

The Tribunal determined the date of expropriation to be December 19, 2004, the first date on which the series of the respondent's actions were found to result in a significant and irreversible diminution of the claimants' investment. As the respondent's expropriation was deemed illegal, however, the Tribunal, in rejecting the respondent's ex ante approach, concluded that the claimants could also choose the date of the award

(June 30, 2014) as the valuation date for damages purposes because they were entitled to restitution on that date, as well as compensation for any shortfall, given that even if Yukos' value had declined, the claimants could have sold it for a higher value at an earlier date but for the expropriation.

The Tribunal calculated the claimants' damages as equal to the value of their shares as of each valuation date, plus the value of the dividends they would have received up to each valuation date, plus pre-award simple interest thereon. The Tribunal rejected the claimants' use of compound interest, as well as its expert's assumptions regarding Yukos' listing on the NYSE and merger with Sibneft as uncertain and speculative, and found the claimants' damages valuation analyses to be unreliable due to errors, lack of comparability, and its expert's admission that the discounted cash flow analysis was influenced by personal, pre-determined views of an appropriate amount. The Tribunal consequently deemed "most tenable" a "corrected" comparable company analysis that it deduced from the oral testimony of the respondent's expert as the best available estimate of Yukos value on November 21, 2007. To adjust Yukos' value to the dates of expropriation and award, the Tribunal multiplied it by a factor representing the change in the RTS Oil and Gas Index between November 21, 2007 and each date.

The value of lost dividends was set by the Tribunal "in the exercise of its discretion" considering the claimants' expert's calculations of free cash flow to equity, "corrections" thereto by the respondent's expert, and the Tribunal's perceptions of risks associated with higher taxes, Yukos' dividend policy and complex offshore structure. To calculate interest, the Tribunal rejected Libor as discredited, the yield on Russian sovereign bonds issued in USD as excessive, and the U.S. Prime Rate as inappropriate lacking evidence the claimants had to borrow as a consequence of the expropriation. Instead, the Tribunal adopted a return on investment approach and used the average yield of ten-year U.S. Treasury bonds from January 1, 2005 to May 2014 to calculate simple pre-award interest. Damages as of December 19, 2004 totaled \$21.988 billion, and at June 30, 2014, \$66.694 billion. Concluding that the claimants' were entitled to the higher amount as the expropriation was illegal, while finding the claimants' misconduct contributed to the damages they suffered by 25 percent, the Tribunal reduced the damages award to \$50,020,867,798.

**Keywords:** expert witnesses, litigation, Yukos

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*Originally published by the ABA Section of Litigation, Expert Witnesses Committee, in News & Developments, September 16, 2014, © 2014 by the American Bar Association.*