

**MR. TIM OSBORNE
DIRECTOR, GML, LTD.**

**TESTIMONY BEFORE THE HOUSE FINANCIAL SERVICES
SUBCOMMITTEE ON DOMESTIC AND INTERNATIONAL MONETARY
POLICY, TRADE, AND TECHNOLOGY**

**“U.S.-RUSSIA ECONOMIC RELATIONSHIP: IMPLICATION OF THE
YUKOS AFFAIR”**

October 17, 2007

INTRODUCTION

I wish to thank Subcommittee Chairman Gutierrez and Ranking Member Paul for convening this hearing today. I respectfully request that my full written statement be entered as part of the record.

My name is Tim Osborne and I am a Director of GML, Ltd. (“GML”), formerly known as Group Menatep, Ltd. GML is a diversified financial holding company, established in 1997, and it at one time owned strategic stakes in a number of Russian companies, including YUKOS Oil Company (“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. GML is the majority shareholder in Yukos, holding approximately 51 percent of Yukos equity capital through wholly owned subsidiaries. Yukos was the largest privately owned energy company in Russia prior to its expropriation by the Russian Government.

The directors of GML are 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. These market principles embraced by GML and its leadership are unfortunately not the norm in the Russian marketplace. American investors, as well as investors worldwide, should be alarmed at the lack of investor protection and corporate governance in Russia.

Let me be clear, the Yukos case is about the improper and illegal persecution and seizure of legitimate individual corporate and private assets for the political and financial benefit of the Russian state.

The past four years have seen a veritable onslaught against GML, its holdings, and its shareholders by Russian authorities, against the backdrop of a profound retreat in democratic developments in Russia. This includes the abandonment of the rule of law, collapse of an independent judiciary as well as a breakdown of corporate governance, investor protections and business transparency.

Beyond the obvious problems faced by the direct targets of the Russian authorities, American minority shareholders in Yukos have lost \$6 billion. The Russian government has made clear that the expropriation of their investment is acceptable and permissible collateral damage.

The impact of these events on American investors is dire, and will continue to be going forward if it goes unchecked. It’s a tragic irony that I am testifying virtually on the four year anniversary of the arrest and imprisonment of Mikhail Khodorkovsky, a

founding shareholder of GML and the senior executive of Yukos, and his business partner, Platon Lebedev.

I would like to call your attention to four universal principles held dear to free and open markets worldwide, which as illustrated by the conduct of the Russian Government towards Yukos and GML, are being set aside in Russia to the detriment of investors and financial stakeholders in the U.S. and abroad. They are:

- Transparency in capital markets;
- Maximizing shareholder value;
- Protecting investors; and
- Adherence to the rule of law.

TRANSPARENCY IN THE CAPITAL MARKETS

Free, open and transparent capital markets are an essential element of the freedom required for buyers and sellers in any marketplace to trade with confidence. The better the information, the more efficient the market. Public disclosure of all material information is a basic ingredient of an efficient market. It is what separates investing from roulette - and if Russia restricts the flow of information about publicly owned companies, American investors will be playing Russian roulette with their financial future.

Unfortunately, this is what is happening in Russia today. Russia has large companies that interest investors around the world, but many of them are owned, in whole or in part, by the government. And if all that investors can buy is a minority share in such a government controlled enterprise, and if critical information about the controlling shareholder and ultimate parent is restricted by that very government, a key component of a genuine market is missing. Not only that, but a key component of investor protection is missing as well.

Yukos was the first Russian company comprehensively to adopt Western standards of corporate governance, transparency and shareholder rights including the preparation of consolidated financial statements in compliance with U.S. generally accepted accounting principles (GAAP). Yukos hired leading American consultants, such McKinsey & Company and Pricewaterhouse Coopers (PwC), to advise senior management. In addition, Yukos advanced the hiring of experienced professional corporate managers and the election of independent members of the board of directors.

In 2001, Yukos American Depository Receipts (ADRs) began trading over the counter in the U.S. market and by 2003 U.S. investors, including state pension funds and individuals, held approximately 15% of the shares in Yukos. Moreover, in 2003, Yukos was preparing to go public in the United States. Preliminary submissions had been made to the SEC, and under Mr. Khodorkovsky's leadership, Yukos was prepared to accept the stringent reporting, disclosure, and internal control requirements under the Sarbanes-Oxley Act of 2002. These requirements are recognized to be the broadest investor

protections in the world, and a company engaged in misconduct does not voluntarily expose itself to such scrutiny.

Nothing better illustrates a lack of transparency than the statements of the Russian authorities surrounding the government's so-called tax enforcement campaign against Yukos. Since the beginning of the tax enforcement campaign, the Russian Government has repeatedly stated that its objectives were simply the even-handed execution of Russian law. On numerous occasions, the Russian Government stated it had no intention of destroying or bankrupting Yukos, and that the state had no plan to re-nationalize Yukos' assets and resources. The Russian Government publicized that it was receptive to a negotiated settlement of the tax issues.

Contrarily, the Russian Government refused to discuss or negotiate a settlement. They froze Yukos' assets, eliminating Yukos' cash resources to pay taxes. With Yukos under siege, the Russian Government initiated actions with several banks to push Yukos into bankruptcy. As a final blow, the Russian Government organized the process to ensure that most of Yukos' major assets were transferred to Russian state-owned enterprises.

A few simple numbers provide the context for the absurdity of the Russian authorities' tax claims. Yukos had already paid \$15 billion in taxes for the period of 2000 through 2003, on total gross income for that period of \$29 billion. Thus, the taxes paid amounted to approximately 52% of gross income. Beyond that amount, the Russian authorities alleged that Yukos owed an additional U.S. \$27 billion for that period, bringing Yukos' total tax liability for the period to over U.S. \$42 billion, greater than 100% of the company's gross income. This is not taxation. This is confiscation.

The Russian authorities' false charges and misleading information, including the government's true motive to eliminate Yukos as a competitor for Russian state-owned enterprises, obstruct the transparency that investors and efficient markets demand.

MAXIMIZING SHAREHOLDER VALUE

Another essential ingredient of a genuinely free market is marketplace actors who make decisions based on economic motives of profit and loss. This assures that the market will perform its most critical function — allocating resources efficiently across the economy. But governments act for reasons of national interest, which — while important — can be very different. So by pursuing political and strategic concerns instead of purely economic motives, government owned companies can distort the proper functioning of markets. Shareholders will naturally wonder whether actions are taken because of an economic rationale or because of political calculations.

Conversely, if a company is owned by shareholders, and not by the government, then the normal workings of shareholder democracy will ensure that the business is run in their economic interest. It is a powerful check against corporate management becoming

complacent or — much worse — corrupt. Private shareholders insisting on their economic rights is the best way to establish corporate accountability and efficiency.

In the United States and other Western markets, majority shareholders are not allowed to act without a rational business purpose to maximize value for all shareholders, including minority shareholders. American securities law embraces a set of rights and investor protections for all shareholders in order to protect their financial interests.

However, in Russia today, a majority state-owned enterprise is often compelled to act in furtherance of the Kremlin's political and strategic objectives. For example, Rosneft, the Russian state-owned oil giant, entered the capital markets in 2006 through the sale of global depository receipts on a London Exchange, which are sold over the counter to American investors. Rosneft's prospectus of July 2006 quite literally states, "the Russian Government, whose interests may not coincide with those of other shareholders, controls Rosneft and may cause Rosneft to engage in business practices that do not maximize shareholder value."

In addition to the setting aside of shareholder interests in Russian publicly owned companies, the Russian authorities may take action against a corporate manager who doesn't act in the best interests of the Russian Government's political and economic objectives. As a Director of GML, I have personally endured a series of threatening actions by the Russian authorities in retaliation for exercising my fiduciary duties to maximize shareholder value.

In response to my efforts to protect GML holdings, including Yukos assets, the Russian authorities have launched a criminal investigation directed at me and three former senior Yukos executives who are U.S. citizens. Actions by the Russian authorities to bully and intimidate me for acting in accordance with my fiduciary duties undermines the interests and rights of U.S. investors in Yukos. You can be assured that I will not be deterred in this regard.

In today's Russia, the pressures on business to champion the Russian Government's interests, above all others, is immense and quite real. PwC served as Yukos' auditor for the period 1995 through 2004. PwC had always stood by the accuracy and reliability of Yukos' financial statements. However, beginning in the latter part of 2006, the Russian Government initiated a campaign against PwC in order to discredit its work for Yukos. In particular, the Russian authorities initiated actions to invalidate the prior Yukos auditing contracts, terminate longstanding auditing relationships with other Russian companies, and questioned the future licensing of PwC as an auditor in Russia. The authorities also charged PwC with tax evasion and accused PwC of assisting Yukos in tax evasion. This was an attempt by the Russian authorities to intimidate PwC and relent in its defense of Yukos' audits.

Sadly, the Russian authorities were successful. Notwithstanding its unequivocal statements as late as December 2006, in a press release issued in June of 2007, PwC withdrew all audit opinions for Yukos. Subsequently, it appears that PwC has received more favorable treatment in the Russian courts and in its dealings with Russian

authorities and state-owned enterprise clients. Moreover, PwC's license to practice as an auditor in Russia has been renewed.

PROTECTING INVESTORS

The issue of protecting the interests of American investors, particularly individual investors, is an important principle of our free market economic system, regardless of whether the protection is for investments in the U.S. domestic market or overseas markets. U.S. shareholders, investors, institutional investors, consumers and others must be protected as Russia is an emerging market where U.S. investment will occur more and more often. It is therefore increasingly important to minimize the risk to U.S. citizens. Russia is a growing segment of the U.S. and global economies and there must be a rule of law that will support investment in Russia and the protection of U.S. investor rights. How will fund managers address their responsibility to shareholders when Russian companies such as Rosneft openly state that the interests of shareholders may be a secondary priority?

The protection of U.S. investor rights is the central issue in the 2005 civil lawsuit filed by several American shareholders of Yukos ADRs. The holders of Yukos ADRs lost approximately \$6 billion, several of whom filed suit against the Russian government and Russian oil companies on the basis that investors were protected by U.S. securities laws. The claim against state-owned energy firms, Gazprom and Rosneft, among others, stated that the defendants violated U.S. securities laws by "falsely assuring" publicly that the Russian government would not renationalize Yukos. This example clearly demonstrates how U.S. investors are at risk.

Another example that highlights the present anxiety and importance of protecting U.S. investors in the Russian market is recent action by the California Public Employees' Retirement System ("CalPERS"). CalPERS, which provides pension fund, healthcare and other retirement services for approximately 1.5 million California public employees, is the largest pension fund in the United States. At the behest of California's State Comptroller, CalPERS was asked to review its investments in Chevron and BP over concerns about the potential purchase of expropriated Yukos assets in state auctions and related litigation. In the end, none of the companies had participated in an auction of Yukos assets.

ADHERENCE TO THE RULE OF LAW

There is a very important role for government in ensuring free, open, and efficient markets. The rule of law is a necessary ingredient. A share in a company is a property right, and it must be enforceable in law. So, we need honest, independent courts and a tough, independent regulator. But, when the courts are responsive to political pressure, and the regulator and the regulated are one and the same, there is an inherent conflict of interest. The role for government is tough, independent, and neutral policeman — not player and referee at once.

Respect for the rule of law in Russia is a principle in jeopardy. A perfect example is the manipulation of the Russian courts by Russian authorities in furtherance of their campaign against GML and Yukos. Each time the Russian authorities' allegations have come before an independent court outside of Russia, the court has found the allegations to be substantively deficient, or politically motivated.

For example, on August 13, 2007, the Swiss Federal Supreme Court recorded its finding as to the existence of political motivation of the Russian authorities. The Court concluded the factual record clearly established that the criminal proceedings against Mr. Khodorkovsky and others related to Yukos was orchestrated by the powers that be in Russia for political reasons. The Court rejected the Russian Government's request for mutual assistance. Courts in London and the Government of Lithuania have reached the same conclusion and denied extradition requests for ex-Yukos executives who fled to London.

In the United States, we find another example. A Federal District Court dismissed securities claims against Yukos, its management and GML for misrepresentations concerning Yukos' tax compliance filed by three Yukos shareholders as a class action based on charges filed in Russia. A key basis for the dismissal was that plaintiffs failed to allege sufficient facts to demonstrate that Yukos, et al., violated Russian tax laws or knew or should have known that the company's tax strategy was illegal.

Another area where Russia is failing to adhere to the rule of law is international treaties. GML has filed a claim under the Energy Charter Treaty ("ECT"), a 51 nation agreement to establish a regime for energy disputes. Although the Russian government signed the treaty and is therefore bound by its provisions, Russia has failed to honor its commitment. Under the ECT, GML is seeking compensation for the Russian Government's unlawful seizure of Yukos in a \$29 billion (minimum) arbitration, the largest commercial arbitration in history.

Finally, it is important to remember the human dimension of the Yukos affair and the impact it has had on everyone associated with the company, most notably Mikhail Khodorkovsky and Platon Lebedev, but including former Yukos employees, defense lawyers and managers of the Yukos assets, who have all been subjected to varying degrees of abuse and harassment.

All of these events beg the crucial question: From an American investor perspective, how could you have confidence in your ability to enforce your property right in a Russian publicly owned company without an independent judiciary to serve as arbiter of your claim?

CONCLUSION

The Yukos affair is a dark cloud hanging over the ability of American investors to invest in Russia with confidence. It is important to remember that Yukos is not alone –

the protection of company and investor rights is a concern for other entities operating in Russia. All you have to do is read the papers to see stories about how the law is being selectively applied to foreign and domestic firms in Russia.

I believe there must be a change of course in Russia with significant economic and political reforms, such that American investors can become confident that their rights and interests will be protected according to internationally recognized standards of corporate governance, business transparency and the rule of law. Unfortunately, Russia is heading in the wrong direction, as I can personally attest. The Russian authorities continuing attacks on Yukos and GML is a case study in the potential dangers and perils for companies and investors trying to navigate in Russia today.

Thank you again for convening this important hearing and I welcome your questions.