

# Russia's Interference in the US Judiciary

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## EXECUTIVE SUMMARY

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Under President Vladimir Putin, lawlessness has taken over the Russian state, including its law enforcement branch. A multitude of Russian state agencies collude in criminal activities to the material benefit of the officials involved. These crimes are supported by the top echelons of the government, most notably by Putin himself; they involve state enterprises, the Central Bank of Russia, the Deposit Insurance Agency, and all law enforcement bodies, including the Investigative Committee, the Prosecutor General's Office, the Ministry of Interior, and the prison service. These state officials also cooperate with organized criminals and professional private lawyers.

Russian state power legitimizes this lawlessness and gives it an official state sanction. This makes it easier for these actors to successfully use the United States legal system, which tends to give foreign governments the benefit of the doubt in legal cases. Thus, the Kremlin has exploited the US judicial system to advance the Russian state's corrupt corporate raiding and expropriation schemes. The US Congress and Department of Justice need to address this exploitation of the US judiciary for nefarious purposes and act decisively to safeguard US democratic institutions.

More broadly, Russian state agencies and their proxies are using the international judicial system to their advantage. This report focuses on the United States, but Russian authorities pursue similar activities in many countries. Red Notices issued by Interpol on the basis of flawed Russian evidence are common and many countries have received requests from Russian legal

authorities to enforce their judgments. In the US judiciary, three particular problems stand out: the generous provisions for opening a discovery case, the minimal statutory requirements for bankruptcy proceedings, and the enforcement of Russian court verdicts without considering the pervasiveness of corruption within the Russian judicial and law enforcement systems.

The United States has two important legal acts that can help it to target corrupt and lawless Russian officials. In December 2012, the US Congress adopted the *Sergei Magnitsky Rule of Law Accountability Act*, which sanctions forty-nine Russian officials.<sup>1</sup> In December 2016, the US Congress adopted the *Global Magnitsky Human Rights Accountability Act*, which sanctions violators of human rights around the globe. These are critical pieces of legislation, and the designation of additional sanctions targets is justified.

Additional measures are needed to stop the Russian state's misuse of the US judicial system. The House and Senate Judiciary Committees should hold hearings about these cases of malpractice and Congress should consider legislation on the basis of such hearings. The Department of Justice or the State Department should establish a coordination office that would liaise with US courts; it would be a central site where victims of abuse by corrupt governments could submit evidence. The Department of Justice needs to issue clear guidelines to the courts regarding how to assess the validity of foreign justice systems. Such guidelines could be based on the State Department's annual human rights report.<sup>2</sup>

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1 Russia and Moldova Jackson-Vanik Repeal and Sergei Magnitsky Rule of Law Accountability Act of 2012, Pub. L. No. 112-208 (2012). [https://www.treasury.gov/resource-center/sanctions/Programs/Documents/pl112\\_208.pdf](https://www.treasury.gov/resource-center/sanctions/Programs/Documents/pl112_208.pdf).

2 US Department of State, *Human Rights Report*, 2017, <https://www.state.gov/j/drl/rls/hrrpt/>.

# INTRODUCTION

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Recent revelations regarding Russia's influence on the 2016 United States presidential election are alarming, but it is important to understand that this was not an isolated incident. Russia's meddling in the election was merely the latest manifestation of its longstanding practice of infiltrating and exploiting Western institutions. The National Intelligence Council characterized Russia's actions as representative of a "longstanding desire to undermine the US-led liberal democratic order ... which Putin and other senior Russian leaders view as a threat to Russia and Putin's regime."<sup>3</sup> That regime—a kleptocracy in which money and power are inextricably intertwined, controlled, doled out, and stripped away by its leader, the newly reelected President Vladimir Putin—has never been more aggressive in its attempts to manipulate and misuse Western institutions.

Putin has systematically extended full control over the Russian state, all of its agencies, and its state-owned companies. He has expanded his power to the whole nation and economy, establishing an authoritarian kleptocracy or "mafia state." The combined aims of this system are to extend the influence of Putin and his close loyalists, which have become the ruling elite, and to maximize their wealth.

This system stands in sharp contrast to the Western rule of law, but it utilizes the Western financial and legal systems to its own benefit. Since the Russian authoritarian system cannot guarantee property rights, even its rulers export capital on an industrial scale, often by illegal means. Subsequently, this "mafia state," which itself abides by few laws, utilizes the international legal system not only to safeguard the wealth of its own elite, but also to repress and seize the property of its political opponents.

This process of expropriation and political repression has its own logic. It starts with Russian state officials or Putin's personal associates taking over a private enterprise in Russia illegally, often with the help of official

law enforcement agencies. Occasionally, the former owners are arrested and jailed, but many are let go in Russia and a number of them flee abroad. If the fleeing entrepreneurs protest too loudly, Russian state agents tend to go after them for their own enrichment. They may issue a Russian arrest order, which is sent bilaterally to many countries and to Interpol, which habitually issues an international arrest order, referred to as a Red Notice. Eventually, the Russian state may exploit the US judicial system to reach their targets, undermining the rule of law both in Russia and in the United States. The judicial agents of the Russian state are highly skilled. They use specific US legal instruments, such as discovery and bankruptcy, to reach their victims.

The goal of this report is to draw the attention of the US Department of Justice, the judiciary, and officers of US courts about these efforts to turn the US justice system into a tool of Russian government officials. Members of Congress and the Department of Justice should take measures to halt this insidious assault on the US judiciary and combat this threat to US democratic institutions.

This paper begins with an overview of how Putin seized authoritarian control of the Russian state and its main institutions. It continues with a discussion of the evolution of corporate raiding and government expropriation, followed by an assessment of how the Russian courts help Russia's kleptocracy and how Russia uses Interpol for its illicit aims. Then, the bulk of this paper outlines how the Kremlin and its proxies have misused and continue to exploit the US courts, with examples of the various tactics employed.

These examples corroborate a recent warning from a former high-level official within the Department for Homeland Security who argued that "[we] need to broaden the focus beyond elections. Our courts are at risk, too. ... The Kremlin playbook here is easy to envision, but our strategy to counter it has yet to be built."<sup>4</sup> Some policy recommendations are provided in the conclusion.

<sup>3</sup> *Assessing Russian Activities and Intentions in Recent US Elections*, Intelligence Community Assessment 2017-01D, January 6, 2017, [https://www.dni.gov/files/documents/ICA\\_2017\\_01.pdf](https://www.dni.gov/files/documents/ICA_2017_01.pdf).

<sup>4</sup> Suzanne Spaulding, "Don't overlook the Kremlin's threats to our courts," *Washington Post*, October 30, 2017, [https://www.washingtonpost.com/opinions/dont-overlook-the-kremlins-threats-to-our-courts/2017/10/30/f1e656aa-bd8e-11e7-959c-fe2b598d8c00\\_story.html?utm\\_term=.6a0d59f01752](https://www.washingtonpost.com/opinions/dont-overlook-the-kremlins-threats-to-our-courts/2017/10/30/f1e656aa-bd8e-11e7-959c-fe2b598d8c00_story.html?utm_term=.6a0d59f01752).

# PUTIN'S CONSOLIDATION OF AUTHORITARIAN STATE CONTROL

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Russia is no law-abiding state. Since Vladimir Putin became president of Russia in 2000, he has developed the Russian state apparatus into a full-fledged authoritarian kleptocracy—that is, a state that steals money and private enterprises from its citizens, as late Professor Karen Dawisha analyzed in her book, *Putin's Kleptocracy*. Dawisha documented how Putin had been deeply involved in organized crime as early as 1991.<sup>5</sup> Needless to say, he has only grown more brazen as he has accumulated power.

Step by step, Putin seized control over the Russian state. As chairman of the Federal Security Service (FSB, formerly known as the KGB) in 1998-1999, he took firm control of the secret police. As prime minister from August 1999 until the end of that year, he gained significant control over the state administration. One of his first decisions after having been inaugurated as president in May 2000 was to alter Russia's federal institutions to be able to build up his "vertical of power" over the regions, which had been relatively autonomous. The regional governors would no longer sit on the Federal Council, Russia's senate, and in practice the senators became dependent on the Kremlin. In the fall of 2004, Putin fully subordinated the regions by abolishing elections of regional governors, making them subject to his indirect appointment.<sup>6</sup>

Another of Putin's early actions as president in 2000 was to have the leading oppositional media tycoon, Vladimir Gusinsky, prosecuted and arrested for his "misappropriation of funds." The obvious aim was to take over Gusinsky's outstanding television channel, NTV. Putin exploited the fact that Gusinsky had taken a loan from the state gas giant Gazprom, calling the loan and forcing Gusinsky to sell NTV for a pittance to Gazprom. Gusinsky was allowed to leave the country within a couple of days in July 2000. A few months later, the other big media tycoon, Boris Berezovsky, fled the country and was forced to relinquish control of his television company, ORT, for a trifle. By 2003, the last

independent television channel was closed and the independent media landscape had significantly shrunk.<sup>7</sup>

Putin also endeavored to seize full control over law enforcement agencies. In April 2001, he appointed his own minister of interior, securing his command over the ordinary police. One of his early statements was to carry out a judicial reform that he called the "dictatorship of law." In December 2001, the Kremlin promulgated a package of laws on judicial reform. They improved the financing of the courts and the status of judges, but also ensured that judges became dependent on the central executive rather than on regional governors. Thus, Putin has had full executive control over the ordinary court system since 2002.<sup>8</sup>

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"Since Vladimir Putin became president of Russia in 2000, he has developed the Russian state apparatus into a full-fledged authoritarian kleptocracy."

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In October 2003, Putin had the richest man in Russia, Mikhail Khodorkovsky, arrested for tax fraud. Rosneft, the state oil company, confiscated Khodorkovsky's Yukos Oil over the course of two years for its own benefit. Khodorkovsky served ten years in Russian prisons before he was allowed to leave Russia. In that one strike against the strongest and most daring tycoon, Putin secured his position of power over the rising entrepreneurial class.

At the same time, Putin ousted Prime Minister Mikhail Kasyanov and the head of the presidential administration, Aleksandr Voloshin, top officials whom he had inherited from President Boris Yeltsin's administration; they

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5 Karen Dawisha, *Putin's Kleptocracy: Who Owns Russia?* (New York: Simon & Schuster, 2014).

6 Anders Åslund, *Russia's Capitalist Revolution: Why Market Reform Succeeded and Democracy Failed*, (Washington: Peterson Institute for International Economics, 2007).

7 Ibid.

8 Peter H. Solomon, Jr., "Putin's Judicial Reform: Making Judges Accountable as well as Independent," *East European Constitutional Review* 11, no. 1/2 (2002): 117-12; Brian D. Taylor, "Law Enforcement and Civil Society in Russia," *Europe-Asia Studies* 58, no. 2 (2006): 193-213.



Rosneft, the state oil company, confiscated Khodorkovsky's Yukos Oil over the course of two years for its own benefit. *Photo credit:* Wikipedia/Korovkin 84 (<https://creativecommons.org/licenses/by-sa/4.0/deed.en>).

were considered to have been sympathetic to the country's big businessmen. Thus, Putin successfully gained full control over the state administration. The proof of Putin's consolidation of political power was that the parliamentary elections in December 2003 and presidential elections in March 2004 were no longer competitive.

Gradually, Putin took direct personal control of the big state companies. His technique was to appoint his loyal assistants as powerful chief executives, beginning in May 2001 with the ousting of the management of Gazprom, the state gas monopoly. He appointed Aleksei Miller, one of his assistants from St. Petersburg, as Gazprom's chief executive, and Miller remains in this position to this day despite the company's disastrous financial development.

As late as 2002, the Russian government made a failed attempt to privatize the state-owned oil company Rosneft, but everything changed with the Yukos affair and the arrest of Khodorkovsky in October 2003. Officially, however, Putin insisted on the need

for further privatization. Time and again during the Yukos affair, Putin publicly insisted that he opposed its nationalization and that he was detached from the legal process, although it was evident that the daily proceedings were dictated by the Kremlin.

In the fall of 2006, however, Putin abruptly changed his position. Without real public discussion, the Kremlin started merging entire industrial sectors into conglomerates with near monopolies. Although the government had successfully taxed the oil rents of private oil companies, the Kremlin preferred to channel these rents through state enterprises. Two vast military-industrial companies, the United Aircraftbuilding Corporation and the United Shipbuilding Corporation, were created.

Six state corporations were also established that were formally nongovernmental organizations. The three most important were the armaments company Russian Technologies (Rostec); Vnesheconombank (VEB), the former Soviet foreign trade bank; and Rosatom, the former Soviet ministry of atomic energy. Since these

corporations were technically private, this was the biggest privatization that Russia experienced. The Russian political scientist Vadim Volkov assessed that the assets transferred to these nongovernmental organizations amounted to \$80 billion, and the government itself added \$36 billion of fresh capital.<sup>9</sup>

State capitalism comes in many forms. It can be competitive or focused on development, but the Russian variety seems particularly economically inefficient and dysfunctional. Joshua Kurlantzick has eloquently summed up its peculiarities: “In Russia, state companies throttle any potential private-sector competitors. Under Putin, the Kremlin has allowed just one or two state firms to dominate nearly every leading industry, with each company staffed by Putin loyalists. Companies that have resisted state takeover have been sacked with enormous tax bills until they sell out. Many of the most promising young entrepreneurs in Russia simply have fled the country.”<sup>10</sup>

This perverse state capitalism serves not the Russian nation but its top officials and their close associates. Russia has systematically developed the tool of confiscating private enterprises to the benefit of state officials and their friends on a massive scale, a process which in Russian is called *reiderstvo*. *Reiderstvo* literally means corporate raiding, but is actually the theft of enterprises, which differs from the Western meaning of corporate raiding.

This practice is carried out on an extraordinary scale in Russia. In December 2015, Putin himself confessed how dire the situation was in his annual address to the Russian Federal Assembly:

“During 2014, the investigative authorities opened nearly 200,000 cases of so-called economic crimes. But only 46,000 of 200,000 cases were actually taken to court, and 15,000 cases were thrown out during the hearings. Simple math suggests that only 15 percent of

all cases ended with a conviction. At the same time, the vast majority, over 80 percent, or specifically, 83 percent of entrepreneurs who faced criminal charges fully or partially lost their business—they got harassed, intimidated, robbed, and then released. This certainly isn’t what we need in terms of a business climate. This is actually the opposite, the direct destruction of the business climate. I ask the investigative authorities and the prosecutor’s office to pay special attention to this.”<sup>11</sup>

Putin’s words suggested that he intended to change policy and discipline the law enforcement agencies, but in fact he did nothing about them. In 2014, 212,316 criminal cases had been opened against businessmen, but that number surged to 255,250 in 2015. Putin clearly permitted the “law enforcers” to enrich themselves at the cost of Russia’s private enterprises.<sup>12</sup>

As Jordan Gans-Morse concluded in his thorough empirical study of property rights in Russia, the country reversed itself, moving from enforcing a certain degree of the rule of law to engaging in “state predation.” In the early 1990s, organized crime had ruled, but it was defeated in the mid-1990s and a relative rule of law took hold in the early 2000s. Since then, Russia’s precarious rule of law has given way to state predation.<sup>13</sup> According to Gans-Morse, Russia’s legal defense of property rights was at its best between 1999 and 2003.<sup>14</sup>

The essence of Putin’s rule is that he is not working for the Russian state or nation, but for a relatively narrow circle of loyalists. He has gained control over the state, its enterprises, and its law enforcement. Putin and his allies tap the state and its companies for money, which they then transfer to multiple layers of shell companies in offshore havens around the world, as was outlined in the Panama Papers. These schemes do nothing to improve the Russian state; they purely benefit Putin and his loyalists.

9 Vadim Volkov, “Russia’s New ‘State Corporations’: Locomotives of Modernization or Covert Privatization Schemes?” *PONARS Eurasia Policy Memo*, no. 25 (August 2008).

10 Joshua Kurlantzick, *State Capitalism: How the Return of Statism Is Transforming the World* (New York: Oxford University Press, 2016), 42.

11 Vladimir Putin, “Presidential Address to the Federal Assembly” (speech, Moscow, December 3, 2015). <http://en.kremlin.ru/events/president/news/50864>.

12 Elizaveta Bazanova et al., “Vladimir Putin vnov’ poobeshchal biznesu zashchitu ot pravookhranitelei” (“Vladimir Putin Once Again Promised Business Defense against Law Enforcers”), *Vedomosti*, June 20, 2016.

13 Jordan Gans-Morse, *Property Rights in Post-Soviet Russia: Violence, Corruption, and the Demand for Law* (New York: Cambridge University Press, 2017), 189.

14 Ibid, 191.

# CORPORATE RAIDING OR GOVERNMENT EXPROPRIATION

Corporate raiding (*reiderstvo*), the unlawful seizure of private assets by the Kremlin, has been the norm in Russia since the beginning of Putin's reign. As Gans-Morse puts it: "If the 1990s were a period of lawlessness during which the state was too weak to protect honest businesspeople from criminals and unscrupulous competitors, then the threat in recent years often has emanated from within the state itself."<sup>15</sup>

Time after time, Putin has seized private companies under bogus pretexts, and, with the assistance of corrupt law enforcement officials and judges, redistributed the assets to the Russian state or to well-connected friends and associates. His many subordinates do the same. The Russian government has demonstrated a common course of conduct in its unlawful seizure of private businesses across all sectors for unjust political, financial, and personal gain. It is not that one or a few law enforcement agencies have gone awry; they are all engaging in the same practices, sometimes in competition over the loot, sometimes in collusion.

Two cases of Russian misuse of judicial powers stand out: the confiscation of Yukos oil company and the Magnitsky affair. Before the Yukos case began in 2003, many believed that Putin was genuinely interested in developing the rule of law. The persecution of Yukos highlighted his true intentions: to use the full spectrum of state judicial bodies to the benefit of the state and his cronies. The Yukos affair was followed by illustrative Russian state actions abroad. While the Magnitsky affair was carried out on a much smaller scale, it also clearly exemplifies the various criminal elements and the international scope that typically characterize *reiderstvo*. The Yukos and Magnitsky examples are also the most well-known and best researched cases of Russian miscarriages of justice.

## The Confiscation of Yukos Oil Company

In 2003, the Yukos Oil Company was Russia's largest oil producer. However, on October 25, 2003, the government arrested Yukos's then-chief executive officer, Mikhail Khodorkovsky. Khodorkovsky was prosecuted on charges of tax evasion and fraud, and ultimately convicted and sent to prison. The Kremlin-manufactured bankruptcy of Yukos followed, as well as the pre-meditated seizure of its assets by state-owned oil company Rosneft through rigged bankruptcy auctions.<sup>16</sup>

On February 19, 2003, Putin held his annual meeting with a group of oligarchs in the Kremlin. The Kremlin had chosen "corruption" as the theme, and Putin declared that he wanted "to liquidate the very basis of corruption."<sup>17</sup> Mikhail Khodorkovsky, chief executive officer of Yukos oil company, then Russia's largest oil producer, was present. He responded that the state-owned oil company Rosneft had bought the small oil company Severnaya Neft for \$600 million, while a former deputy minister of finance had bought it for \$7 million only two years earlier—implicitly accusing the Rosneft management of corruption. Enraged, Putin retorted that Khodorkovsky had no business to complain about corruption "having made their billions, they spend tens, hundreds of millions of dollars to save their billions. We know how this money is being spent—on what lawyers, PR campaigns, and politicians it is going, and on getting questions like these asked."<sup>18</sup>

In July 2003, Khodorkovsky's first deputy, Platon Lebedev, was arrested, and on October 25, Khodorkovsky himself was arrested. The original legal complaint was the privatization of one subordinate company, the fertilizer plant Apatity (now called Phosagro and owned by Putin cronies). Eventually, however, the prosecutor general prosecuted Khodorkovsky and Yukos for major

15 Jordan Gans-Morse, "Threats to Property Rights in Russia: From Private Coercion to State Aggression," *Post-Soviet Affairs* 28, no. 3 (2012): 278.

16 Stanley Reed, "\$50 Billion Awarded in Breakup of Yukos," *New York Times*, July 28, 2014, [www.nytimes.com/2014/07/29/business/international/yukos-shareholders-awarded-about-50-billion-in-court-ruling.html](http://www.nytimes.com/2014/07/29/business/international/yukos-shareholders-awarded-about-50-billion-in-court-ruling.html).

17 Vladimir V. Putin, "Vstupitel'noe slovo na vstreche s predstavitel'yami Rossiskogo soyuza promyshlennikov i predprinimatelei" ("Introductory remarks at the meeting with representatives of the Russian Union of Industrialists and Entrepreneurs"), February 19, 2003. <http://kremlin.ru/events/president/transcripts/21881>.

18 Peter Baker and Susan Glasser, *Kremlin Rising: Vladimir Putin's Russia and the End of Revolution* (New York: Scribner, 2005), 282; Steven Lee Myers, *The New Tsar: The Rise and Reign of Vladimir Putin* (New York: Knopf, 2015), 220-1.



Mikhail Khodorkovsky, former CEO of YUKOS oil major, stands behind bars during his trial in Moscow's Meshchansky district court, September 24, 2004. Photo credit: REUTERS/Viktor Korotayev.

tax crimes. Yukos had utilized domestic regional tax havens, but that was legal tax planning. In May 2005, Khodorkovsky was sentenced to nine years in prison for tax evasion. In 2007, new charges were brought against Khodorkovsky for embezzlement and money laundering, supposedly for having stolen oil for which they had not paid taxes, and his prison sentence was extended to

eleven years. Several other Yukos managers were sentenced to prison or fled abroad.<sup>19</sup>

Putin repeatedly claimed to stay outside of the judicial process and to oppose the nationalization of Yukos, but the obviously-rigged legal proceedings suggested that he plotted the company's confiscation from the outset.<sup>20</sup> The tax authorities seized the company and sold off its parts to Rosneft for a pittance, starting with its main oil field, Yuganskneftegaz, which was sold at a bargain price to a single unknown bidder in a farcical executive auction before Christmas on December 19, 2004.<sup>21</sup> The next day, Rosneft acquired the shell company.

In December 2013, Putin pardoned Khodorkovsky, as an apparent gesture of good will before the Sochi Winter Olympics. Khodorkovsky immediately departed from Russia. However, once he became politically active in the West, Russian prosecutors opened a new case against him, accusing Khodorkovsky of allegedly murdering the mayor of Nefteyugansk in June 2008.

On July 18, 2014, an arbitral tribunal in The Hague unanimously concluded that Russia had breached its international obligations under the Energy Charter Treaty by destroying Yukos and appropriating its assets. The Hague tribunal found that "the auction of Yuganskneftegaz, Yukos Oil's primary oil production subsidiary, was rigged" and amounted to "a devious and calculated expropriation" by Russia; the tribunal ordered Russia to pay more than \$50 billion to Yukos's former shareholders.<sup>22</sup> A Dutch local court revoked this verdict, but the case continues in a higher Dutch court.

By jailing the biggest and most independent tycoon in Russia, Putin put all of the country's big businessmen in their place. Global condemnation of the injustice done to Yukos and its executives did not prevent the Putin regime from using the episode as a blueprint for seizing and nationalizing other Russian energy companies in subsequent years. "In 2000, majority state-owned companies produced 10 percent of oil output; by 2008, they produced 42 percent,"<sup>23</sup> according to Gans-Morse.

19 Stephen Fortescue, *Russia's Oil Barons and Metal Magnates* (New York: Palgrave MacMillan, 2006), 121-148.

20 Vladimir V. Putin, "Remarks by President Vladimir Putin on Yukos Affair at Government Meeting," *RTR Vesti Program - Federal News Service*, October 27, 2003.

21 Thane Gustafson, *Wheel of Fortune: The Battle for Oil and Power in Russia* (Cambridge, MA: Belknap Press of Harvard University Press, 2012), 345.

22 *Hulley Enterprises Limited. v. The Russian Federation*, PCA Case No. AA 226, Final Award, ¶¶ 5, 757, 1037 1041 (Jul. 18, 2014), <https://www.italaw.com/sites/default/files/case-documents/italaw3278.pdf>. The arbitral panel's award subsequently was vacated for jurisdictional reasons: Russia never agreed to be bound by the arbitration regulations of the Energy Charter Treaty, under which Yukos brought suit.

23 Gans-Morse, *supra* note 3, 279.

## The Magnitsky Affair

One of the most well-known and best-investigated cases of Russian miscarriage of justice was that of the lawyer Sergei Magnitsky. Magnitsky accused Russian officials from various state agencies of having stolen \$230 million from tax authorities through a fraudulent tax refund. Instead of investigating his claims, those officials charged Magnitsky for their own crime.<sup>24</sup> The Magnitsky affair illustrates Russia's lawlessness, the illusory nature of private rights, and Russian state officials' methods of embezzlement.

By the end of the 1990s, William Browder, founder and manager of the investment firm Hermitage Capital Management, was one of the largest foreign investors in Russia. Initially, Browder was an outspoken supporter of Putin, claiming that he wanted to develop the rule of law in Russia. Browder was an activist investor, advocating for improved corporate governance in state companies, including Gazprom. In late 2005, however, he fell out of favor and was refused an entry visa into Russia.<sup>25</sup>

In June 2007, dozens of police officers raided Hermitage's Moscow offices. They unlawfully seized documents and used them to transfer ownership of Hermitage's holding companies to another entity. They obtained sham judgments that became the basis for a scheme to defraud Russian taxpayers by pocketing \$230 million of fraudulent tax refunds.<sup>26</sup> When one of Browder's Russian tax attorneys, Sergei Magnitsky, discovered this criminal scheme, he notified the Russian authorities. Rather than pursuing the criminal perpetrators, the Russian authorities charged Hermitage and its attorneys with tax fraud. They arrested Magnitsky, perversely charging him with the fraud that he had uncovered. In 2009, at the age of thirty-eight, he was beaten to death while in pre-trial detention in Moscow's Butyrka prison.<sup>27</sup>

Thanks to Browder's substantial research, we know more about the Magnitsky affair than about any other case, and it clearly illustrates how various Russian state

agencies cooperated in the crime. The two lead agencies were the Russian tax authorities and the Ministry of Interior, but other agencies, including the Investigative Committee, the Prosecutor General's Office, and the prison authorities, working in tandem with an organized crime group and a couple of top-notch Russian private lawyers, were also closely involved. Their cooperation in this scheme amounted to a full-fledged state mafia.<sup>28</sup>

The Magnitsky affair drew heavy global criticism. In December 2012, the US Congress adopted the *Sergei Magnitsky Rule of Law Accountability Act* (the Magnitsky Act) to spotlight the absence of the rule of law in Russia and to sanction human rights violators. Its preamble recognizes that "Sergei Magnitsky's experience ... appears to be emblematic of a broader pattern of disregard for the numerous domestic and international human rights commitments of the Russian Federation and impunity for those who violate basic human rights and freedoms."<sup>29</sup>

The Magnitsky Act authorized sanctions imposed by the US Treasury on individuals involved in the original tax scheme uncovered by Magnitsky or linked to his detention, death, and cover-up, as well as those who are guilty of other human rights violations or complicit in the Russian government's repression of human rights. As of December 2017, a total of forty-nine Russian culprits have been sanctioned. One of them is the head of the Investigative Committee and Putin's law school friend from St. Petersburg, Alexander Bastrykin.<sup>30</sup> It is no secret that Putin is greatly upset over the Magnitsky Act.

In December 2016, the US Congress adopted the *Global Magnitsky Human Rights Accountability Act* (the Global Magnitsky Act), and one year later the US Treasury named the first targets of sanctions. The only Russian on that list was Artem Chaika, son of the Russian Prosecutor General Yuri Chaika.<sup>31</sup> In a film made by the anti-corruption activist Aleksey Navalny in December 2015, young Chaika had been exposed as a major organized criminal who used his father's subordinates to extort innocent victims and take their enterprises.<sup>32</sup>

24 Bill Browder, *Red Notice: A True Story of High Finance, Murder, and One Man's Fight for Justice* (New York: Simon & Schuster, 2015).

25 Clifford Levy, "An Investment Gets Trapped in Kremlin's Vise," *New York Times*, July 24, 2008, <http://www.nytimes.com/2008/07/24/world/europe/24kremlin.html>.

26 Ibid.

27 Browder, *Red Notice*.

28 US Department of the Treasury, "Treasury Targets Individuals Involved in the Sergei Magnitsky Case and Other Gross Violations of Human Rights in Russia," Press Release, December 20, 2017, <https://home.treasury.gov/news/press-releases/sm0240>.

29 Magnitsky Act § 402(a)(12).

30 US Department of the Treasury, "Treasury Targets Individuals Involved in the Sergei Magnitsky Case."

31 "United States Sanctions Human Rights Abusers and Corrupt Actors Across the Globe," US Department of the Treasury, December 21, 2017, <https://home.treasury.gov/news/press-releases/sm0243>.

32 "Chaika. An investigative documentary by the Anti-Corruption Foundation," YouTube video, posted by Aleksey Navalny, January 26, 2016, <https://www.youtube.com/watch?v=3eO8ZHfV4fk>.



The Central Bank of Russia has been “destroying good banks” to accomplish illicit goals, namely political retribution, state-sanctioned extortion, and unlawful self-enrichment. Wikipedia/Ludvig14 (<https://creativecommons.org/licenses/by-sa/4.0/deed.en>).

In December 2017, the US adopted a novel stand. It sanctioned a couple of lawyers in the private sector, Yulia Mayorova and Andrei Pavlov, who have repeatedly represented Russian government agencies abroad to extract information and financial rewards.<sup>33</sup> While seemingly working for the Russian government, they participate in the Russian international extortion racket. Both of these highly-skilled lawyers have worked extensively on cases in US courts.

Meanwhile, it has become clear that the Magnitsky loot had been transferred to much higher levels in the Russian government than was initially understood.

With the help of the Panama Papers, the Organized Crime and Corruption Reporting Project (OCCRP) even traced a payment of \$800,000 to Putin's cellist childhood friend, Sergey Roldugin, who clearly held offshore funds for Putin, as coming from an offshore company that was used to steal the Magnitsky loot.<sup>34</sup>

### Other Examples of Corporate Raiding

Corporate raiding is not a rarity; it has become standard procedure in Russia. This report focuses on big and well-documented cases that reached the US judicial system, but thousands of small and medium-sized

<sup>33</sup> US Department of the Treasury, “Treasury Targets Individuals Involved in the Sergei Magnitsky Case.”

<sup>34</sup> Paul Radu, “Russia: The Cellist and the Lawyer,” *OCCRP*, April 26, 2016, <https://www.occrp.org/en/panamapapers/russia-the-celist-and-the-lawyer/>.

enterprises have also been taken over by state authorities or their friends with the support of the Russian law enforcement system. Some of those smaller cases deserve mention.

For example, one of the early tycoons was Kakha Bendukidze, an ethnic Georgian. He developed Russia's largest heavy-engineering group, OMZ, with large privatized factories in Yekaterinburg and St. Petersburg. In 2004, after the Georgian Rose Revolution, Bendukidze became Minister of Economy to President Mikheil Saakashvili, who strongly opposed Putin.<sup>35</sup> Soon afterwards, Bendukidze was forced to sell OMZ to Gazprom at a price that he considered to be merely 40 percent of the market price.<sup>36</sup>

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“Putin’s expropriation of many Russian banks appears to have furthered the financial interests of his cronies at the expense of those who do not enjoy his favor.”

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One of the biggest producers of titanium in the world is VSMPO-AVISMA. In 2006, after a highly successful privatization and revival of the company, its two dominant owners were compelled to sell their shares at a price they considered too low to then-Rosoboronexport, which later became a part of Rostec.<sup>37</sup> Rostec, or Russian Technologies, is a state corporation managed since its founding in 2007 by Sergei Chemezov, one of Putin’s close KGB friends from the 1980s.

Another case involves the company Euroset, which in 2008 was Russia’s biggest retail seller of mobile phones and accessories; it had a total of 5,000 outlets throughout the former Soviet Union. Euroset’s main owner, Evgeny Chichvarkin, had built the company himself, but had become too well-known and lacked the necessary political protection for a businessman of his stature. He was forced to sell to the well-connected billionaire Alexander Mamut. When he refused to accept this fate and tried to engage in opposition politics against Putin, he was forced to flee the country for London within forty-eight hours.<sup>38</sup>

Since 2013, the Kremlin has also focused on consolidating and nationalizing the banking sector; at present, nearly 70 percent of Russian bank assets belong to banks under government control.<sup>39</sup> Moreover, about 500 banks have lost their licenses since the middle of 2013.<sup>40</sup> Most of the withdrawals of banking licenses by the Central Bank of Russia (Russia’s primary bank regulator) might be justified due to a lack of capital or legal violations, but quite a few of these cases, especially those of medium-sized banks, have amounted to corporate raiding. Putin’s expropriation of many Russian banks appears to have furthered the financial interests of his cronies at the expense of those who do not enjoy his favor.<sup>41</sup> In many cases, the Central Bank of Russia has been “destroying good banks” to accomplish illicit goals, namely political retribution, state-sanctioned extortion, and unlawful self-enrichment.<sup>42</sup>

The important point about corporate raiding is that the Russian state regularly targets companies that lack sufficient political cover. The aim is to enrich not the state but its leading servants, as often a state company is used as a conduit for the private enrichment of Russia’s top officials.

35 David M. Herszenhorn, “Kakha Bendukidze Dies at 58; Pushed Post-Soviet Market Change,” *New York Times*, November 15, 2014.

36 Kakha Bendukidze, personal communication, March 2014.

37 Neil Buckley and Arkady Ostrovsky, “Putin’s Allies Turn Russia into a Corporate State,” *Financial Times*, June 18, 2006. <https://www.ft.com/content/138ae38e-fef1-11da-84f3-0000779e2340>.

38 Gans-Morse, *Property Rights in Post-Soviet Russia*, 86; Maria Pils, “Russian banker Mamut buys phone retailer Euroset,” Reuters, September 22, 2008.

39 “Rescues of Russian banks allow state to tighten its grip on sector,” *Financial Times*, Sep. 27, 2017, <https://www.ft.com/content/6c83034a-a2b4-11e7-9e4f-7f5e6a7c98a2>.

40 Andrey Ostroukh, Polina Nikolskaya and Tatiana Voronova, “Russian central bank head says banking cleanup more than half complete,” Reuters, February 2, 2018, <https://www.reuters.com/article/russia-banks-cbank/update-2-russian-central-bank-head-says-banking-cleanup-more-than-half-complete-idUSL8N1PS1UH>.

41 “Russia’s largest private bank is rescued by the central bank,” *Economist*, Aug. 31, 2017, [www.economist.com/news/finance-and-economics/21727915-run-deposits-sparked-fears-contagion-russias-largest-private-bank](http://www.economist.com/news/finance-and-economics/21727915-run-deposits-sparked-fears-contagion-russias-largest-private-bank).

42 “Russia’s largest private bank is rescued by the central bank.”

# THE ROLE OF RUSSIAN COURTS IN RUSSIA'S KLEPTOCRACY

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Russia's judiciary is complicit in and facilitates the entrenchment of authoritarianism and kleptocracy. As noted by Freedom House: "The judiciary lacks independence from the executive branch."<sup>43</sup> The State Department's 2017 Investment Climate Statement for Russia states that "Russia's judicial system remains heavily biased in favor of the state, leaving investors often with little recourse in the event of a legal dispute with the government. High levels of corruption among government officials compound this risk."<sup>44</sup> As a result, government authorities and insiders can rely on selective, baseless prosecutions to opportunistically attack political opponents and seize business interests.

Russian courts regularly aid and abet government-sanctioned seizures of private assets. As one recent report noted, "fraud charges [against business owners] ... are a common tool of both politically motivated and non-political, corruption-driven prosecution in Russia," and "courts often issue guilty verdicts without establishing whether any party has suffered damages from the defendant's actions."<sup>45</sup> Even if a guilty verdict does not follow—a statistical improbability given that less than 0.5 percent of criminal trials resulted in acquittals in 2016—long-term imprisonment or house arrest typically occurs, leaving the business susceptible to bankruptcy, a hostile takeover, or raiding.<sup>46</sup>

Russian courts readily issue rulings that attempt to legitimize and justify naked government-sanctioned expropriation and misconduct. Russia's judiciary facilitated the government-led scheme to take over Yukos oil company, imprison Mikhail Khodorkovsky and his fellow executives, and claim that these actions were legitimate. Russian courts affirmed the government's

claims of more than \$20 billion in tax assessments against Yukos, thus manufacturing a justification for the seizure of its assets and the resulting transfer of Yukos's key asset, Yuganskneftegaz, to Rosneft. In May 2005, a show trial was initiated in which Khodorkovsky was tried, convicted, and sentenced. The Hague tribunal later found that the Russian courts "bent to the will of Russian executive authorities to bankrupt Yukos, assign its assets to a state-controlled company, and incarcerate a man who gave signs of becoming a political competitor."<sup>47</sup> Five years later, in December 2010, the government brought new charges against Khodorkovsky while he was still serving his first sentence, and obtained yet another conviction.

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"Russian courts regularly aid and abet government-sanctioned seizures of private assets."

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The courts played a particularly callous role in the Magnitsky case. On July 11, 2013—four years after he died in jail—Sergey Magnitsky was found guilty of tax evasion in the first posthumous conviction in Russian history.<sup>48</sup> A Russian court also issued a guilty verdict against William Browder. By contrast, Russian courts have repeatedly rejected efforts by the Magnitsky family's lawyer, Nikolai Gorokhov, to bring those responsible for Magnitsky's death to justice. On March 21, 2017, the day before he was due to appeal a lower court's refusal to reopen the investigation into the cause of

43 *Russia – 2018*, Freedom House, <https://freedomhouse.org/report/freedom-world/2018/russia>.

44 "2017 Investment Climate Statements – Russia," Bureau of Economic and Business Affairs, US Department of State, <http://www.state.gov/e/eb/rls/othr/ics/investmentclimatestatements/index.htm?year=2017&dliid=269946>.

45 Leonid Ragozin, "When Russian Officials 'Nightmare' Your Business, You Can Lose Everything—Even Your Life," Bloomberg, January 29, 2018, <https://www.bloomberg.com/news/features/2018-01-29/when-russian-officials-nightmare-your-business-you-can-lose-everything-even-your-life>.

46 Ibid. See also David Satter, *Russia's Abuse of Interpol*, Russia Studies Centre Policy Paper no. 6 (2015), [www.henryjacksonsociety.org/wp-content/uploads/2015/07/Russias-Abuse-of-Interpol.pdf](http://www.henryjacksonsociety.org/wp-content/uploads/2015/07/Russias-Abuse-of-Interpol.pdf); US Department of State, "2016 Investment Climate Statements – Russia," [www.state.gov/e/eb/rls/othr/ics/investmentclimatestatements/index.htm?year=2016&dliid=254409](http://www.state.gov/e/eb/rls/othr/ics/investmentclimatestatements/index.htm?year=2016&dliid=254409) (showing that of 200,000 economic crime cases initiated in Russia in 2014, 75 percent never went to court, but over 80 percent of individuals who were cleared still lost their business, and concluding that "[t]here is little recourse for Russian businesses caught in the legal system.").

47 *Hulley Enterprises Limited*, *supra* note 5, ¶¶ 636, 639, 1583.

48 See *US v. Prevezon* Complaint at ¶¶ 64, 66, 72.



Butyrka Prison, where Russian authorities beat Sergei Magnitsky to death during pre-trial detention in 2009. *Photo credit:* Wikipedia/Staniislav Kozlovskiy (<https://creativecommons.org/licenses/by-sa/3.0/deed.en>).

Magnitsky's death, Gorokhov mysteriously fell out of the fourth-story window of his apartment building.<sup>49</sup> He survived and denied that his fall was an accident. Two months later, he appeared in court, arguing for the reversal of the lower court's decision. The court denied his appeal, despite being presented with new evidence:

messages between Andrey Pavlov, the attorney who "orchestrat[ed] the false claims used in the \$230 million tax fraud"<sup>50</sup> and Oleg Urzhumtsev, the investigator initially tasked with examining the crimes uncovered by Magnitsky, who then shifted the investigation to target Magnitsky.<sup>51</sup>

49 Clare Sebastian, "Magnitsky lawyer: Will 'fight for justice' despite risk to life," *CNN*, Jul. 25, 2017, <https://www.cnn.com/2017/07/25/politics/russian-lawyer-magnitsky-nikolai-gorokhov/index.html>.

50 115th Congress, 1st sess. Congressional Record Volume 163, no. 208, S8170 (statement of Senator Cardin).

51 Michael Weiss, "Russian Lawyer Nikolai Gorokhov Thrown from Window Was a Witness for the US Government," *The Daily Beast*, Mar. 23, 2017, <https://www.thedailybeast.com/russian-lawyer-nikolai-gorokhov-thrown-from-window-was-a-witness-for-the-us-government>.

# RUSSIAN USE OF INTERPOL TO ADVANCE ITS KLEPTOCRACY

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Russia's efforts to advance its kleptocracy do not stop at its borders. Russia has repeatedly co-opted Interpol in its unjust pursuit of those individuals who were able to escape Russia. The long-time Moscow correspondent David Satter has written a telling paper with many examples of how the Russian government has pursued innocent refugees through Interpol.<sup>52</sup> Russia regularly requests that Interpol subject its targets to a Red Notice, which enables an individual's arrest, detention, and potential extradition. The consequences range from detention and asset seizures to travel bans. Interpol issues thousands of Red Notices each year, but with its small secretariat of 190 members, it does so with little scrutiny, circulating them to all member countries and ordering the arrest of identified wanted people purely on the basis of domestic warrants.

Interpol's constitution requires a domestic warrant to be issued first, and it strives to safeguard against misuse by "repressive regimes to persecute their political opponents. However, in practice, Interpol is dependent on the honesty of its member countries to make sure that that it is pursuing only genuine criminals."<sup>53</sup> Russia abuses this trust. As a recent report by the Center for Strategic and International Studies, "The Kremlin Playbook," emphasizes, "Russia's strategy seeks to co-opt and suborn Western democratic institutions and governance" and "exploits the inherent weaknesses within [them]"<sup>54</sup>—in this instance, the general deference accorded to domestic criminal warrants.

Examples of misuse are many. When media tycoon Vladimir Gusinsky dared to complain about how he was being targeted, Russia issued an international arrest order, which Interpol dismissed as politically motivated.

Even so, Gusinsky was arrested, first in Spain in 2000 and then in Greece in 2003, on the basis of bilateral Russian orders for his arrest. This has become a standard Russian state trick. Numerous individuals who worked with Yukos Oil prior to its seizure have fallen victim to this practice; one of them had to endure two months of confinement in a maximum-security prison before being released.<sup>55</sup> Russian law enforcement authorities have repeatedly had Red Notices put out for Browder in various legal cases; the Kremlin has submitted five separate Red Notice requests<sup>56</sup> and Browder has been detained on six occasions, most recently in Spain in May 2018.<sup>57</sup>

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"Russia's brazen attempts to co-opt the broader institutions of Western democracies is exemplified by a recent scandal involving the judicial system in Cyprus."

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Russia's brazen attempts to co-opt the broader institutions of Western democracies is exemplified by a recent scandal involving the judicial system in Cyprus. Though it is a European Union member state, Cyprus has increasingly fallen under Russian influence. In November 2017, the private emails of Eleni Loizidou, the deputy attorney general of Cyprus, were leaked to the public, exposing her zealous cooperation with Russian officials in their efforts to extradite Russian and Cypriot citizens.<sup>58</sup> Loizidou, who has since been

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52 David Satter, *Russia's Abuse of Interpol*, Russia Studies Centre Policy Paper no. 6 (2015), available at <http://www.henryjacksonsociety.org/wp-content/uploads/2015/07/Russias-Abuse-of-Interpol.pdf>.

53 Ibid.

54 Heather A. Conley, James Mina, Ruslan Stefanov, and Martin Vladimirov, *The Kremlin Playbook*, CSIS, October 2016, [https://csis-prod.s3.amazonaws.com/s3fs-public/publication/1601017\\_Conley\\_KremlinPlaybook\\_Web.pdf](https://csis-prod.s3.amazonaws.com/s3fs-public/publication/1601017_Conley_KremlinPlaybook_Web.pdf).

55 Ibid.

56 Sarah Wildman, "Bill Browder, Putin's loudest critic, just got his visa back," *Vox*, October 25, 2017, <https://www.vox.com/world/2017/10/25/16543216/william-browder-putin-magnitsky-visa-interpol>.

57 Hannah Strange, "British Putin Critic Bill Browder Released after Arrest in Spain," *Telegraph*, May 30, 2018, <https://www.telegraph.co.uk/news/2018/05/30/british-putin-critic-bill-browder-tweets-has-arrested-spain/>.

58 Stephanie Kirchgaessner, "Senior Cyprus prosecutor allegedly offered private advice to Russians," *Guardian*, Nov. 29, 2017, <https://www.theguardian.com/world/2017/nov/29/cyprus-prosecutor-allegedly-offered-advice-russia-officials-eleni-loizidou>.



Natalia Veselnitskaya has lobbied for the repeal of the Magnitsky Act and in court defended the real estate company Prevezon, which laundered the proceeds of the tax fraud exposed by Magnitsky. *Photo credit: REUTERS/Kommersant Photo/Yury Martyanov.*

suspended from her position pending the conclusion of an investigation, requested Russia's support for her candidacy to the important European Court of Human Rights in exchange for her clandestine advice

and assistance.<sup>59</sup> The emails show Loizidou's attempts to directly intervene on behalf of Russian interests in several cases. Rather than deny her complicity with Russian interference in the Cyprus courts, Loizidou has launched a smear campaign against Browder, claiming that he is responsible for leaking her emails as retaliation for her criticism of Interpol's decision to deny Russia's requests for a Red Notice targeting him.<sup>60</sup>

Recent coverage of Russian lawyer Natalia Veselnitskaya's activity in the United States offers another example of Russia utilizing Western institutions to advance the Kremlin's agenda. Veselnitskaya was thrust into the spotlight after she was reported to have offered incriminating information about Hillary Clinton as "part of Russia and its government's support for" then-presidential candidate Donald Trump.<sup>61</sup> At the same time, Veselnitskaya was also lobbying for the repeal of the Magnitsky Act, organizing screenings in Washington, DC, of a Russian documentary that attempts to discredit Browder and exonerate the perpetrators of the fraudulent scheme that resulted in Magnitsky's death.<sup>62</sup>

Veselnitskaya has also defended the real estate company Prevezon against the US Attorney's Office for the Southern District of New York in *US v. Prevezon Holdings Ltd.* The US government sought to seize proceeds of the tax fraud exposed by Magnitsky that had been laundered through various transactions before ending up in New York. Veselnitskaya represented Prevezon and Prevezon's owner, Russian citizen Denis Katsyv,<sup>63</sup> who were accused of receiving portions of the fraudulently obtained proceeds and investing them in New York real estate. The case was settled out of court after Prevezon agreed to pay a fine of \$6 million, which Veselnitskaya celebrated as her triumph.<sup>64</sup>

59 Stelios Orphanides, "Leaked emails expose Cypriot attorney's links to Russia, Politis reports," *Cyprus Business Mail*, November 26, 2017, <http://cyprusbusinessmail.com/?p=55407>.

60 Ibid.

61 Max Greenwood, "Russian lawyer who met with Trump Jr. was in touch with top Russian prosecutor," *Hill*, July 14, 2017, <http://thehill.com/policy/national-security/342109-russian-lawyer-who-met-with-trump-jr-was-in-touch-with-top-russian>.

62 Ibid.

63 See, e.g., Hearing Tr., *US v. Prevezon Holdings Ltd.*, no. 13-cv-06326 (S.D.N.Y. Dec. 23, 2015), Dkt. 515; Veselnitskaya Decl., *US v. Prevezon Holdings Ltd.*, no. 13-cv-06326 (S.D.N.Y. Jan. 5, 2016), Dkt. 508; Cymrot Decl., *US v. Prevezon Holdings Ltd.*, no. 13-cv-06326 (S.D.N.Y. Nov. 18, 2015), Dkt. 422-35.

64 Mike Eckel, "US Seeks Court Order To Enforce \$6 Million Prevezon Settlement," *RFERL*, November 16, 2017.

# ABUSE OF US COURTS BY THE RUSSIAN GOVERNMENT, ITS REPRESENTATIVES, AND PROXIES

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Russia has also found ways to exploit American judicial institutions, having developed systematic routines to manipulate US courts to unwittingly support the Kremlin's campaign of expropriation and political persecution. While Russia's efforts to "hack" the US electoral process and other democratic institutions have been well documented, its efforts to commandeer the US judiciary for nefarious purposes has received far less attention. In using American courts to achieve their ends, the Kremlin and its proxies have identified a number of specific legal claims and procedures that are most susceptible to abuse.

The Russian state entities vary from state companies to state agencies, but they tend to use the same methods to exploit the US judicial system, often employing the same lawyers. Three US laws are particularly popular among Russian state actors with regard to manipulating the system: Title 28 of the US Code § 1782 on judiciary and judicial procedure, Chapter 15 of the US Bankruptcy Code, and actions for recognition or enforcement of Russian judgments.

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"In using American courts to achieve their ends, the Kremlin and its proxies have identified a number of specific legal claims and procedures that are most susceptible to abuse."

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## Actions Filed Under Title 28 of the US Code § 1782

Under Title 28 of the US Code § 1782 on judiciary and judicial procedure, a party interested in a foreign proceeding may apply for judicial assistance from a US federal district court to obtain discovery from

any person found in the US. Given the generally liberal standards applicable to discovery in US courts, Section 1782 actions have become commonplace in support of legal actions overseas, and Russian entities have repeatedly made such filings during the last ten years. In essence, Section 1782 applications have been weaponized by the Kremlin and its proxies, having become their favorite tool in the illegal harassment, extortion, and expropriation of private companies and assets.

## Yukos Applications<sup>65</sup>

In 2009, Promneftstroy (PNS)—a subsidiary of state-owned Rosneft that was spun off to aid the illicit Yukos takeover—applied for Section 1782 discovery from Daniel Feldman, the former secretary of the Yukos Oil board of directors, for use in Dutch proceedings regarding the allegedly fraudulent auction of a Yukos Oil subsidiary. PNS filed its Section 1782 motion approximately one week after its attempt to receive discovery was rejected by the Dutch appeals court. PNS served "vast documentary requests" that did "not focus on Feldman's personal or business affairs, but focus[ed] almost exclusively on the business practices, litigation, financial statements, bank accounts, calendars, and even personnel changes of Yukos Finance, its subsidiaries, and related companies."<sup>66</sup>

The US court rejected PNS's application on technical grounds, arguing that it would "interfere[e] with Dutch discovery policy," "nearly all the documents that the subpoena seeks [were] also in the possession of parties to the foreign proceeding," and the subpoena was overly "broad by any standard."<sup>67</sup> The court, however, did not consider the underlying corrupt expropriation of Yukos or PNS's role in the unlawful seizure of the company when it made its decision.

After several years of further litigation, PNS submitted another Section 1782 application in connection with

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<sup>65</sup> *In re Application of OOO Promneftstroy*, No. M 19-99(RJS), 2009 WL 3335608 (S.D.N.Y. Oct. 15, 2009) (Sullivan, J.), and *In re Application of OOO Promneftstroy*, 134 F. Supp. 3d 789 (S.D.N.Y. 2015) (Koetl, J.)

<sup>66</sup> 2009 WL 3335608 at \*4.

<sup>67</sup> *Ibid* at 7-10.

the same Dutch proceedings in 2015, this time seeking discovery from Eric Wolf, an associate of former Yukos shareholder Leonid Nevzlin. The US court was given another opportunity to analyze the underlying illegal expropriation of Yukos's assets by the Russian government, which by this time was substantiated by the Hague tribunal's ruling and highlighted by Wolf in his filings to the court. However, because there were no technical grounds for dismissal, the court was not swayed by the evidence of rampant corruption by the Russian Federation and PNS's affiliates. The court thus authorized discovery against Wolf under Section 1782.

### FKP Sojuzplodimport vs. SPI Group

SPI Group is a multinational alcoholic beverage group active in the production, sale, and distribution of more than 380 brands sold across more than 170 markets. It is best known for producing Stolichnaya vodka. VZAO-SPI was formerly a state-owned company called VVO Sojuzplodoimport (VVO) that was privatized in 1992. The company's current shareholder, Yuri Shefler, acquired VZAO-SPI five years after it had been privatized while financially distressed. Shefler turned the company around, making SPI one of the most successful and largest spirits companies in the world.<sup>68</sup>

For nearly a decade, the Russian government maintained that the transformation of VVO-SPI and its subsequent acquisition by Shefler were entirely legal. The Moscow Registration Chamber had approved the charter of VZAO-SPI, which explicitly stated that VZAO-SPI was the successor of VVO-SPI. But it wound up becoming one of the first cases of expropriation under Putin.

In 2000, just after he had taken power, Putin and his associates set their sights on SPI. Prior to 2000, the Russian government not only supported the company in protecting its trademark rights in Russia and abroad, but in 1994 restored the previously canceled Stolichnaya Russian trademarks in the name of the company. The company's success posed a challenge to its domestic competitors, some of which were linked to close Putin allies. To expropriate SPI, Putin signed a presidential order in March 2000 directing the Russian government to "take urgent measures to reinstate and protect the state's rights over the intellectual property in the area of production and circulation of vodka products, and to identify and bring legal actions against the persons involved in the infringement of those rights."

Consequently, a Russian court invalidated the provision of VZAO's charter that stated that it was the universal legal successor of VVO. Some ten days later, on October 26, 2001, the Deputy Minister of Agriculture sent a request to Rospatent (the Russian patent office) to deprive SPI Group of its Russian trademarks. Rospatent moved with unusual speed, transferring the trademarks to an agency of the Russian Federation on the same day as the request. Subsequently, the Kremlin gave control of Stolichnaya and other trademarks to a newly-created state-owned enterprise called FKP Sojuzplodoimport (FKP, also referred to as Federal Treasury Enterprise or FTE).

Since 2002, the Kremlin, acting through FTE, has embarked on a mission to seize the Stolichnaya and certain other SPI-owned trademarks throughout the world. To make its case more credible in Western courts, the Kremlin fabricated criminal charges against Shefler and sought his extradition from both the United Kingdom and Switzerland; both refused to grant extradition, finding that the Russian charges were baseless and politically motivated. In the process, Shefler was granted asylum in Switzerland. He has also been granted UK citizenship. To date, SPI has managed to successfully fend off Russia's legal attacks, with one exception, the Netherlands. SPI's most recent legal victory came on October 31, 2017, when a court in Brazil rejected Russia's claims and held SPI to be the lawful owner of the trademarks.

In 2004, FTE filed a case in the US District Court for the Southern District of New York, accusing SPI and its exclusive distributors of trademark infringement. The case was dismissed twice: in 2006 on legal grounds related to US trademark law, which was later reversed by the Second Circuit Court of Appeals, and again in 2011 on procedural grounds related to FTE's lack of standing, later affirmed by the Second Circuit and ending the case. A second case was then filed by FTE, and Moscow Distillery Cristall, in 2014, in which FTE claimed it had cured its standing problem through a new purported assignment of rights from the Russian Federation. This Case was also dismissed by the District Court in favor of SPI, only to be later reversed by the Second Circuit on a ruling that the act of state doctrine precluded review of the illegality of FTE's purported assignment from the Russian Federation under Russian law.

In early November 2017, SPI obtained an order from a discovery master that requires FTE to provide SPI

<sup>68</sup> "Stirred and shaken: The Adventures of a Soviet Vodka Brand," *World Trade Mark Review*, November 2017, <http://www.worldtrademarkreview.com/account/register/?ReturnUrl=http://www.worldtrademarkreview.com/Magazine/Issue/13/Features/Shaken-and-stirred-the-adventures-of-a-soviet-vodka-brand>; Ambrigio Visconit, "SPI Group v. FKP Sojuzplodoimport," *Global Legal Chronicle*, December 18, 2017.

with certain documents held by several agencies of the Russian Federation, which FTE has failed to provide. Discovery in the case is currently stayed until FTE complies with this order; the stay also stops other activity in the case. If and when the case comes to trial, the stakes will be high, as the US accounts for about 45 percent of all sales of Stolichnaya vodka.

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### “Chapter 15 of the US Bankruptcy Code allows a representative of a foreign insolvency proceeding to bring an ancillary action in the United States.”

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#### Application of Deposit Insurance Agency

In late 2017, the Russian Deposit Insurance Agency (DIA) filed two nearly identical Section 1782 applications against former Probusinessbank co-owners Sergey Leontiev and Alexander Zheleznyak, who fled to the US following the revocation of their bank's license by the Central Bank of Russia and the seizure of its assets by the Russian government. Leontiev moved to quash the Section 1782 subpoena, arguing that the DIA's application was orchestrated by Andrey Pavlov of the Moscow law firm Quorum, the very same Russian lawyer who “played a central role orchestrating the false claims used in the \$230 million tax fraud that Sergei Magnitsky uncovered” and who was placed on the Magnitsky list of sanctioned individuals.<sup>69</sup>

Leontiev further argued that because the DIA had retained and compensated Pavlov and his law firm

to choreograph the DIA's efforts to expropriate Probusinessbank's assets and the personal assets of its shareholders, allowing the discovery the DIA sought would have the effect of enriching Pavlov, in violation of the Magnitsky Act. As is discussed in greater detail later in this report, the timing of the DIA's Section 1782 applications indicates that they were part of a coordinated effort to use the US courts to harass and further extort assets from the former Probusinessbank owners. Each of these 1782 actions is still pending.

#### Actions Filed Under Chapter 15 of the US Bankruptcy Code

Chapter 15 of the US Bankruptcy Code allows a representative of a foreign insolvency proceeding to bring an ancillary action in the United States.<sup>70</sup> If the basic statutory requirements are met, the US bankruptcy court must recognize the foreign insolvency proceeding under Chapter 15.<sup>71</sup> The representative of the foreign proceeding can then ask the US bankruptcy court to be entitled to pursue broad discovery.

Chapter 15 proceedings can easily be abused, as the requirements for initiating a Chapter 15 case are minimal,<sup>72</sup> US jurisdiction can be established easily and gerrymandered,<sup>73</sup> and recognition of a foreign proceeding by the US bankruptcy court is mandatory once the minimal statutory requirements are met.<sup>74</sup> Once a foreign proceeding has been recognized under Chapter 15, the foreign representative can conduct wide-ranging discovery concerning the property and affairs of the debtor.<sup>75</sup>

Theoretically, courts can rein in abuses under Chapter 15, but they have been hesitant to do so. Although Chapter 15 enables courts to reject actions “manifestly contrary to [US] public policy,”<sup>76</sup> the “public policy exception has been narrowly construed.”<sup>77</sup> Courts have been generally

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69 Sen. Rep. no. 163-208, at S8170 (Dec. 20, 2017); see also 2012 Sergei Magnitsky Rule of Law and Accountability Act, Pub. L. no. 112-208, 126 Stat. 1496, 1504 (2012).

70 Jay Lawrence Westbrook, “Chapter 15 at Last,” *American Bankruptcy Law Journal* 79, no. 3 (2005): 713, 726.

71 See 11 U.S.C. §§ 1502, 1517, 1520, 1521.

72 11 U.S.C. § 1515; see also *In re Globo Comunicacoes E Participacoes S.A.*, 317 B.R. 235, 249 (S.D.N.Y. 2004).

73 See, e.g., *In re Octaviar Admin. Pty Ltd*, 511 B.R. 361, 372-74 (Bankr. S.D.N.Y. 2014) (finding “property in the form of claims and causes of action” and “property in the United States in the form of a retainer [held by counsel]” sufficient in Chapter 15 case); *In re Berau Capital Res. Pte Ltd.*, 540 B.R. 80, 82 (Bankr. S.D.N.Y. 2015) (“cases have identified bank accounts, ... as satisfying the ‘property in the United States’ [] requirement.”).

74 See 11 U.S.C. § 1517; see also *In re Millard*, 501 B.R. 644, 647, 652 (Bankr. S.D.N.Y. 2013) (“[T]he bad faith that is alleged to exist is not a legal basis for disregarding the statutory requirements for recognition.”).

75 11 U.S.C. § 1521(a)(4); see e.g., *In re Octaviar Admin. Pty Ltd*, 511 B.R. 361, 365 (Bankr. S.D.N.Y. 2014).

76 11 U.S.C. § 1506.

77 H.R. Rep. no. 109-31(1), at 109 (2005) reprinted in U.S.C.C.A.N. 88, 172; see also *In re Ephedra Prods. Liab. Litig.*, 349 B.R. 333, 336 (S.D.N.Y. 2006) (explaining narrow public policy exception).



Sberbank, a major actor involved in unlawful activities carried out by Russian state entities. Photo credit: ©Alex Florstein Fedorov, Wikimedia Commons.

unwilling to find violations of US public policy in the Chapter 15 context.<sup>78</sup> Likewise, while Section 305 of the Bankruptcy Code allows courts to suspend or dismiss a Chapter 15 case if “the purposes of [C]hapter 15 ... would be best served by such dismissal or suspension,”<sup>79</sup> no court seems to have used this provision to dismiss a case because of a debtor’s bad faith.

### The Case of Sergey Poymanov

Until 2011, Sergey Poymanov was the majority shareholder of OJSC Pavlovskgranit (P-Granit), a company engaged in granite mining and production.<sup>80</sup> In 2008, Poymanov consolidated the ownership of P-Granit through his company Pavlovskgranit-Invest (PG-Invest) and, for this purpose, had PG-Invest obtain a RUB 5.1 billion (\$215 million) loan from a branch of the Russian government-owned Sberbank. PG-Invest repaid part of this loan. However, due to the 2008 global financial crisis, P-Granit was forced to ask for a restructuring of the terms of its loan repayment.

Although P-Granit had been valued at 13 billion rubles, PG-Invest was told that its loan could be restructured only if 50 percent of P-Granit was transferred to an affiliate of Sberbank in exchange for a nominal fee. Poymanov rejected this extortive offer, as well as a similar one from his main competitor, Yuri Zhukov. As a result, Sberbank accelerated the loan and obtained a Russian court judgment for the entire amount outstanding under the loan. The creditor then obtained from an appraiser, partially owned by the son of the local Sberbank manager and an associate of Zhukov, an artificially low valuation of P-Granit, which enabled a Sberbank affiliate to acquire over 50 percent of P-Granit’s shares. These shares were then transferred to entities purportedly linked to Zhukov.

The chain of events that followed resulted in the involuntary bankruptcies of PG-Invest and P-Granit. Ultimately, Poymanov was declared bankrupt in July 2016. Throughout this progression, Poymanov filed dozens of complaints in Russian courts seeking to

<sup>78</sup> “Public policy objections to recognition are frequently made and almost always rejected[.] ... Even demonstrable bad faith by the debtor, imputed to the liquidator, was not sufficient ... in *In re Creative Finance Ltd.*, 543 B.R. 498, 515-516 (Bankr. S.D.N.Y. 2016).” 8 Collier on Bankruptcy ¶ 1517-4 n. 13 (16th ed. 2016).

<sup>79</sup> 11 U.S.C. § 305.

<sup>80</sup> See Complaint, PPF Management LLC v. Sberbank, no. 16-cv-09139 (S.D.N.Y. Jan. 6, 2017), Dkt. 9. The factual account set out in this paragraph is based on the contents of this complaint.

protect his assets, but all were denied. Instead, multiple criminal investigations were initiated against Poymanov with help from Artem Chaika.<sup>81</sup>

In November 2016, Poymanov assigned his claims for damages arising out of this corporate raiding scheme to a newly-formed entity, PPF Management LLC (PPF). PPF filed a complaint in the Southern District of New York against Sberbank, Zhukov, and numerous other participants in this scheme, seeking \$750 million in damages.<sup>82</sup> On March 3, 2017, the receiver in Poymanov's Russian bankruptcy proceedings, Aleksey Bazarnov (a defendant in the PPF action), commenced a Chapter 15 case in the bankruptcy court in the same federal district.<sup>83</sup> Bazarnov asked the court to recognize the Russian bankruptcy action and to enter an automatic stay in the PPF action. PPF objected on numerous grounds. PPF's overarching argument was that Bazarnov, the Russian bankruptcy proceedings, and the Chapter 15 action were all part of the *reiderstvo* to which Poymanov fell victim, and thus should not receive the benefits available in a US bankruptcy court.

With its objection to the petition for recognizing the Russian bankruptcy action, PPF submitted expert reports on the topic of corporate raiding in Russia. The expert testified that

"bankruptcy and the abuse of the bankruptcy process in Russia [is] one of the fundamental elements of corporate raiding" (102:23-25);

"most pervasive ... are the problems of submitting fraudulent documents, of engaging in malicious prosecutions—prosecutions that are repeated and extended, where a case against an individual is started, then stopped, then another one begins" (103:14-20);

"the criminals have been brought much more under the control of Putin and the oligarchs, and they now work primarily for them. So they are part of the raiding process, but they are not the ones that initiate the raids anymore" (104:5-9);

"when citizens go to use the commercial courts, or to use arbitration, if there is a Russian governmental entity that is involved in the case, then they have basically no chance of satisfaction of their complaints" (105:3-7).<sup>84</sup>

Nevertheless, the court rejected the argument that recognizing the Russian bankruptcy action would violate US public policy and assigned minimal weight to this testimony.<sup>85</sup> PPF's counsel attempted to highlight the role of *reiderstvo* in the corrupt seizure of private assets in Russia, but to no avail. Instead, the judge responded: "If I accept that, doesn't that mean that the courts here should never grant recognition to a Russian proceeding because we don't know whether this corporate rating [sic] infects" particular proceedings; the judge refused "to second guess the conduct of the Russian bankruptcy proceeding."<sup>86</sup> Shortly thereafter, the court issued an order recognizing the Russian bankruptcy proceeding, and later stayed PPF's lawsuit.<sup>87</sup>

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"The principles of international comity require that the US enforce judgments by foreign courts, but there are exceptions."

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The court's analysis in *Poymanov* exemplifies the American judiciary's hesitancy to recognize the endemic corruption of Russia's courts and illustrates that the Russian legal system plays an essential role in the Kremlin-orchestrated expropriation of private assets both for state and private gain.

### Actions for Recognition and/or Enforcement of Russian Judgments

American courts have "a long-standing tradition of permitting the enforcement of foreign country money judgments."<sup>88</sup> The principles of international comity require that the US enforce judgments by foreign courts,

81 "Global Magnitsky Act," US Department of the Treasury.

82 Complaint, PPF Management v. Sberbank, No. 16-cv-09139 (S.D.N.Y. Jan. 6, 2017), Dkt. 9.

83 Verified Petition, *In re Poymanov*, No. 17-10516 (Bankr. S.D.N.Y. Mar. 3, 2017), Dkt. 2.

84 Hearing Tr., *In re Poymanov*, No. 17-10516 (Bankr. S.D.N.Y. 2017), Dkt. 51.

85 *In re Poymanov*, 51 B.R. 24, 39 (Bankr. S.D.N.Y. 2017).

86 Hearing Tr. at 33:19-23, 38:12-14, *In re Poymanov*, No. 17-10516 (Bankr. S.D.N.Y. 2017), Dkt. 69.

87 *In re Poymanov*, 580 B.R. 55 (2017).

88 *Bridgeway Corp. v. Citibank*, 45 F. Supp. 2d 276, 285 (S.D.N.Y. 1999), *aff'd*, 201 F.3d 134 (2d Cir. 2000) (internal citations and quotation marks omitted).



The Kremlin has weaponized elements of the US judicial system and process to further its own ambitions. *Photo credit: Wikipedia/ Andrey Korzun (<https://creativecommons.org/licenses/by-sa/4.0/>).*

but there are exceptions. In theory, a US court “must satisfy itself of the essential fairness of the judicial system under which the [foreign] judgment was rendered.”<sup>89</sup> However, in practice, courts have usually given foreign justice systems the benefit of the doubt in deciding to enforce their judgments.<sup>90</sup> Nevertheless, in the past, courts have declined to enforce foreign judgments on due process grounds when presented with extensive evidence of a foreign judiciary’s corruption.

Increasingly unanimous research about Russia paints a dismal picture of its courts. For instance, the US State Department’s 2017 Report on Human Rights Practices states, “[Russian] law provides for an independent judiciary, but judges remained subject to influence from the executive branch, the armed forces, and other security forces, particularly in high-profile or politically sensitive cases, as well as corruption. The outcomes of some trials appear predetermined.”<sup>91</sup> Moreover, the

“judge typically agrees with the investigator’s position and dismisses defense referrals or complaints.”<sup>92</sup>

Yet despite ample evidence that Russian courts are corrupted by and captive to the interests of the Kremlin and its cronies, US courts continue to take Russian judgments seriously, even when presented with evidence of due process violations and political persecution employed by Russian actors.

### Sberbank v. Traisman

Between 2007 and 2009, Sberbank issued three loans to a Russian company called Sealand, a shopping center developer and operator, whose board of directors included Yuri Traisman. Sealand defaulted in April 2013 and soon thereafter declared bankruptcy. Sberbank sued Traisman in Russian court, claiming that he had guaranteed the loans, and sought repayment from

<sup>89</sup> Restatement (Third) of Foreign Relations Law of United States § 482, comment b (1987).

<sup>90</sup> See, e.g., *PT United Can Co. v. Crown Cork & Seal Co.*, 138 F.3d 65, 73 (2d Cir. 1998).

<sup>91</sup> *Russia 2017 Human Rights Report*, US Department of State, 13, <https://www.state.gov/documents/265678.pdf>.

<sup>92</sup> *Ibid.*

Traisman personally.<sup>93</sup> Traisman maintained that he had never signed personal guarantee agreements, and that his signatures on the guarantee agreements produced by Sberbank had been forged.

Simultaneously, Traisman's wife, Nelly, brought an action in the Koptevo District Court of Moscow seeking to invalidate the guarantees as forgeries. Upon Nelly's request, the court appointed an expert to examine the signatures on the guarantees submitted by Sberbank.<sup>94</sup> Traisman was in Connecticut and unable to provide in-person samples, so he mailed to the court notarized signatures and documents that he had signed around the time that the guarantees were purportedly executed. The court-appointed expert stated that half of the signatures displayed on the guarantees definitively were not Traisman's; the expert's opinion as to the other half was inconclusive. After Sberbank objected and appealed, the Moscow City Court reversed the lower court's grant of Nelly's request, at which point the presiding lower court judge was inexplicably replaced with another judge, who refused to consider Nelly's claims and dismissed them.<sup>95</sup>

Traisman's counsel challenged the validity of the three guarantees on his behalf in the Balashikha District Court of the Moscow region. Sberbank relied on three handwriting expert reports, all based on out-of-court examinations, in support of its position, as well as the appellate decision in Nelly's case. After reviewing the expert report from Nelly's case and travel records showing that Traisman was not in Russia when the guarantees were executed, the court ordered Traisman to appear in court to provide a handwriting sample. Traisman again did not appear in court, submitting a letter from his doctor, explaining that Traisman's health prevented him from traveling to Moscow, and a notarized and apostilled set of signatures. The court refused to order an examination of these signatures, despite the health-related justification for Traisman's absence. Instead, the court inferred that Traisman was evading an in-court examination, dismissed the expert conclusion from Nelly's action for its reliance on an out-of-court sample, and entered judgment for Sberbank. The appellate court upheld the "evasion" finding and

the negative inference against Traisman and affirmed the judgment for Sberbank.<sup>96</sup>

In February 2014, Sberbank sued Traisman in federal court in Connecticut, seeking a money judgment for the amount he purportedly owed under the three guarantees. Curiously, even after the Russian court ruled in favor of Sberbank, Sberbank did not explicitly seek recognition of the Russian judgment, but instead alleged Traisman's liability. When Traisman objected, Sberbank argued that Traisman was barred from re-litigating his defenses under claim and issue preclusion.<sup>97</sup>

Traisman countered with numerous arguments, including the fact that claim and issue preclusion were inapplicable under Russian law, and described in detail the sequence of events in the Russian actions involving him and his wife. He also provided the court with a declaration from the former Sberbank executive who purportedly executed the guarantees on Sberbank's behalf, in which the executive disclaimed any recollection of signing the guarantees and questioned the genuineness of the signatures attributed to him.<sup>98</sup>

Despite Traisman's argument that the Russian actions deprived him of an opportunity to fully and fairly litigate his claims and defenses, the district court sided with Sberbank, recognizing and affording preclusive effect to the Russian court's ruling on the validity of the guarantees.<sup>99</sup> The court acknowledged that there are exceptions to the general policy of recognizing and enforcing foreign judgments, such as "if the judgment was rendered under a system without impartial tribunals or procedures compatible with due process of law," but ignored the evidence of widespread corruption in the Russian judiciary and found such exceptions inapplicable in this case. On appeal, the Second Circuit upheld the lower court's ruling on this issue.<sup>100</sup>

### Yuri Stepanchenko and the Contents of his Citibank Account

Yuri Stepanchenko was a prominent real estate developer and, for a period of time, also a senator in the governing body for his home region of Primorsky Krai.<sup>101</sup>

93 Arkhipov Decl. ¶¶ 13-15, *Sberbank v. Traisman*, 14-cv-00216 (D. Conn. Apr. 22, 2015), Dkt. 138-2.

94 Ibid. ¶¶ 13-20, 54-58.

95 Ibid. ¶¶ 68-91.

96 Ibid. ¶¶ 104-138.

97 Def. Br., *Sberbank v. Traisman*, 14-cv-00216 (D. Conn. Apr. 22, 2015), Dkt. 138.

98 Status Report, at 1, *Sberbank v. Traisman*, 14-cv-00216 (D. Conn. Oct. 6, 2015), Dkt. 168.

99 *Sberbank v. Traisman*, 2015 WL 8712581, \*4-5 (D. Conn. Dec. 17, 2015).

100 *Sberbank v. Traisman*, no. 16-1505 (2d Cir. Apr. 11, 2017) (summary order).

101 Grover Decl. ¶¶ 5-6, *In re Contents in Citibank Account*, no. M18-981 (S.D.N.Y. Aug. 3, 2010), Dkt. 31.

However, in 2007, he became the target of an investigation by Russian criminal authorities because of allegations of fraud, money laundering, and the misuse of government funds. Shortly before being indicted in December 2007, Stepanchenko fled Russia and settled in New York.<sup>102</sup>

Stepanchenko explained that he left the country because the allegations against him were politically motivated and he feared he would not receive a fair investigation or trial in Russia. According to press reports, efforts were made to pressure Stepanchenko's wife to return to Russia through threats to put their young daughter, who had remained in Russia with her grandmother, into an orphanage.<sup>103</sup> Sergei Darkin, the governor of Primorsky Krai with a reputed criminal background, visited Stepanchenko in New York. Darkin had ensured that Stepanchenko's six-year-old daughter could not leave Russia. He threatened Stepanchenko and demanded that Stepanchenko transfer hundreds of millions of dollars to him.<sup>104</sup>

The harassment of Stepanchenko also included a request for his extradition, submitted to the US Department of Justice in April 2008, but Stepanchenko was able to remain in New York. In December 2009, Stepanchenko was arrested on allegations that he had violated his immigration status, and four forfeiture seizure warrants were issued for approximately \$2 million of his assets. Stepanchenko remained detained at the Immigration and Customs Enforcement Detention Center for fifty-one days before being released.<sup>105</sup>

Presented with the option to either charge Stepanchenko under US law or deport him, US law enforcement authorities investigated Stepanchenko and released him, thus enabling him to remain on US soil. After Russia had Stepanchenko flagged by Interpol as a fugitive from justice, Interpol reviewed the materials relating to the charges against him and removed him from its list.<sup>106</sup>

Russia's manipulation of the US justice system to further pursue Stepanchenko did not end there. In March

2010, a Russian court issued five restraining orders for assets belonging to Stepanchenko and his wife. The Department of Justice certified that they were in accordance with federal law and obtained a court order to restrain the property frozen by the Russian court.<sup>107</sup> The Stepanchenkos sought dissolution of the US court's asset freeze order. If not for a technicality based on the interpretation of the Civil Asset Forfeiture Reform Act, the US court would have recognized and upheld the restraining order, notwithstanding the crucial fact that Stepanchenko was exonerated by Interpol and US law enforcement agencies.<sup>108</sup>

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“Under Putin's rule, power and wealth in Russia are distributed among a select group of loyal Kremlin insiders, not all of whom are officially affiliated with the Russian government.”

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### Misuse of US Courts by Kremlin Proxies

An expert at the European Council on Foreign Relations, Kadri Liik, recently wrote, “[f]or the Kremlin, corruption has been a reliable means of keeping control over all meaningful elites... It is the basis of much upward mobility in Russia ... and access to illicit wealth is the reward as well as a guarantee of continuing loyalty.”<sup>109</sup> Under Putin's rule, power and wealth in Russia are distributed among a select group of loyal Kremlin insiders, not all of whom are officially affiliated with the Russian government. This form of “crony capitalism” rewards certain Russian businessmen, but only so long as they advance Putin's interests.<sup>110</sup>

In recent years, these Kremlin proxies have exploited US courts by pursuing superficially legitimate lawsuits with a

102 *In re Contents in Citibank Account*, 759 F. Supp. 2d 281 (S.D.N.Y. 2010).

103 Larisa Saenko, “Interpol said no to the deputy from Primorie,” *Kommersant*, March 2, 2016, <http://www.kommersant.ru/doc/29277447>.

104 Grover Decl. ¶¶ 14, *In re Contents in Citibank Account No.*, Co. M18-981 (S.D.N.Y. Aug. 3, 2010), Dkt. 31.

105 *Ibid.* ¶¶ 12-17.

106 Saenko, “Interpol said no to the deputy from Primorie.”

107 *In re Contents in Citibank Account*, 759 F. Supp. 2d at 283.

108 *In re Contents in Citibank Account*, 759 F. Supp. 2d at 288.

109 Kadri Liik, “Putin and the FIFA Scandal,” *European Council on Foreign Relations*, May 29, 2015, [http://www.ecfr.eu/article/commentary\\_putin\\_and\\_the\\_fifa\\_scandal3043](http://www.ecfr.eu/article/commentary_putin_and_the_fifa_scandal3043).

110 See Anders Aslund, “Russia's Neo Feudal Capitalism,” *Project Syndicate*, April 27, 2017, [www.project-syndicate.org/commentary/russia-neofeudal-capitalism-putin-by-anders-aslund-2017-04?barrier=accessreg](http://www.project-syndicate.org/commentary/russia-neofeudal-capitalism-putin-by-anders-aslund-2017-04?barrier=accessreg)

two-part purpose: perpetrating global harassment campaigns against the Kremlin's enemies, while seeking to enrich themselves through bad faith claims made possible by the Russian state's abuse of disfavored individuals and their businesses. These lawsuits by Kremlin proxies are almost always part of a larger coordinated attack involving Russian government agencies, bogus criminal charges invented by Russian prosecutors, and judgments from sham trials overseen by corrupt Russian courts.

### Smagin v. Yegiazaryan

Ashot Yegiazaryan, a former Russian politician and member of the Russian Duma, fell out of favor with the Putin regime around 2005.<sup>111</sup> Shortly afterward, he came under pressure from his then-business partners, including Putin ally Suleiman Kerimov, to relinquish his financial interest in the Moskva Hotel. Yegiazaryan resisted and, due to continuing threats, ultimately fled Russia in 2010, fearing for his and his family's safety.<sup>112</sup>

On April 6, 2018, Kerimov was designated by the US Treasury “for being an official of the Government of the Russian Federation. Kerimov is a member of the Russian Federation Council.” On November 20, 2017, Kerimov was detained in France and held for two days. He is alleged to have brought hundreds of millions of euros into France—transporting as much as 20 million euros at a time in suitcases, in addition to conducting more conventional funds transfers – without reporting the money to French tax authorities. Kerimov allegedly launders the funds through the purchase of villas and was also accused of failing to pay 400 million euros in taxes related to villas.”<sup>113</sup> Kerimov stands out as a prime example of Putin's mixture of state and shady business.

After leaving Russia, Yegiazaryan filed a claim in the London Court of International Arbitration (LCIA) against Kerimov. The Russian authorities then instituted a criminal action against Yegiazaryan based on a complaint submitted by Victor Smagin, a businessman characterized as a “government fixer” in the Russian media.<sup>114</sup>

Smagin alleged that Yegiazaryan engineered and put into action a scheme to misappropriate Smagin's interest in a shopping center, 50 percent of which belonged to Yegiazaryan. The group of Russian law enforcement officials charged with conducting this investigation included five individuals placed on the Magnitsky list: Aleksey Droganov, Viktor Grin, Andrei Krechetov, Oleg Lugunov, and Andrei Strizhov.<sup>115</sup>

In addition to initiating criminal proceedings, Smagin also managed to freeze Yegiazaryan's interest in the shopping center. He filed a claim against Yegiazaryan in the LCIA, seeking damages for Yegiazaryan's alleged misappropriation of Smagin's assets. Yegiazaryan denied that he had signed the underlying arbitration agreement, and his denial was corroborated by an expert who concluded that Yegiazaryan's signature was forged. Even so, the LCIA issued an order in Smagin's favor, which was upheld by UK courts over Yegiazaryan's challenges.<sup>116</sup>

In December 2014, Smagin asked a federal court in California to confirm the LCIA award and issue an order preventing Yegiazaryan from transferring any funds. After extensive motion practice, the district court ultimately granted Smagin's request in March 2016, thereby confirming the LCIA award, and entered a \$93 million judgment in Smagin's favor.<sup>117</sup> Eight months later, in November 2016, Smagin requested and obtained an injunction that effectively froze \$115 million held in the account of a Liechtenstein trust, which Yegiazaryan had settled with the funds he recovered in his arbitration with Kerimov. Finally, a year later, Smagin returned to the district court, seeking a turnover order that would require Yegiazaryan to direct the trustee to transfer the judgment in full to Smagin. The district court once again ruled in Smagin's favor, but the Ninth Circuit issued a stay pending appeal, which was recently briefed and is awaiting oral argument.<sup>118</sup>

Throughout the extensive trial and appellate-level briefing, Yegiazaryan put forth substantial evidence

111 Yegiazaryan Decl. ¶ 4-5, *Smagin v. Yegiazaryan*, 17-cv-06126 (C.D. Cal. Nov. 14, 2017), Dkt. 24.

112 These warnings included threats to behead his children, and one of Yegiazaryan's relatives was killed in 2010 in what he believes was a message directed to him. *Id.* ¶¶ 6-10.

113 “Treasury Designates Russian Oligarchs, Officials, and Entities in Response to Worldwide Malign Activity,” US Department of the Treasury, <https://home.treasury.gov/news/press-releases/sm0338>.

114 Alexander Kuzmin, “Construction just started,” *Versia*, Oct. 5, 2017, <https://versia.ru/kak-vitalij-smagin-vybival-iz-ashota-egiazaryana-dengi-sulejmana-kerimova-i-budut-li-realizovany-developerskie-proekty-centuriona> [rus]. This report is corroborated by evidence of Smagin's cooperation with Kerimov, a Putin crony. See Cohen Decl. at 64-72, *Smagin v. Yegiazaryan*, 17-cv-09764 (C.D. Cal. Jan. 27, 2015), Dkt. 21-3.

115 Memo of Points, at 4, *Smagin v. Yegiazaryan*, 17-cv-09764 (C.D. Cal. Sep. 29, 2015), Dkt. 37.

116 Memo of Points, at 4, *Smagin v. Yegiazaryan*, 17-cv-09764 (C.D. Cal. Sep. 29, 2015), Dkt. 5-7.

117 See Opening Br., *Yegiazaryan v. Smagin*, 2017 WL 6001593, No. 17-56467 (9th Cir. Nov. 30, 2017).

118 *Ibid.*

showing Smagin's role in the Russian government's persecution of Yegiazaryan and the bad faith tactics employed in pursuing his assets, but to no effect. Alarming, the fact that Smagin's initial criminal complaint was taken up by a group of government officials who had participated in the Magnitsky affair, which involved trumped-up and retaliatory criminal charges, appears not to have influenced the decision-making process of the California federal courts.

Similarly, Smagin's bad faith was manifested in his brazen attempts at double recovery against Yegiazaryan. Yegiazaryan has repeatedly referenced the freeze on his Russian assets—which was ordered by a Russian court at Smagin's request, applies to Yegiazaryan's interest in the shopping center at issue in the underlying dispute, and which Smagin himself has valued at over \$300 million—as indicative of Smagin's plan to obtain a double recovery both in and outside of Russia.<sup>119</sup> When a Cypriot court that had also granted Smagin's asset freeze request learned that Smagin had failed to mention the existence of this Russian asset freeze, it vacated its prior order and reprimanded Smagin for lacking the "good faith and honesty which is expected of litigants."<sup>120</sup> In federal court in California, Smagin again failed to disclose this fact initially, yet his lack of candor never stopped the district court from ruling in his favor.<sup>121</sup>

### Avilon v. Leontiev

In August 2015, the Central Bank of Russia revoked the operating license of the privately-owned Probusinessbank, seized its assets, and forced it into bankruptcy. The scheme to deliver the bank's assets to the Kremlin's inner circle has been led by Andrey Pavlov.<sup>122</sup>

In the two years preceding Probusinessbank's seizure by the Kremlin, the bank's independent auditor issued clean audits stating that the bank complied with the central bank's rules and regulations and that its finances were stable.<sup>123</sup> The central bank itself, which was responsible for regularly monitoring Probusinessbank, issued a report stating that the bank was financially sound only two months before it was seized and the Russian Deposit Insurance Agency (DIA) was appointed as temporary administrator.



Suleiman Kerimov pressured Ashot Yegiazaryan to relinquish his financial interests. *Photo credit:* Wikipedia/Hlebushek (<https://creativecommons.org/licenses/by-sa/4.0/deed.en>).

Shortly after gaining control of Probusinessbank, the DIA began to divide up and redistribute the bank's assets to financial institutions favored by the Kremlin, including Binbank, which was handed assets from Probusinessbank valued at approximately 25 billion rubles (over \$400 million). Even more egregious, assets from Probusinessbank were diverted into the DIA's own subsidiary bank, the Russian Capital Bank. In October 2015, a Russian bankruptcy court found only a minor shortfall between Probusinessbank's total assets and liabilities, nearly half of which could be accounted for by the unlawful transfer of the bank's assets to the DIA's own accounts.<sup>124</sup> Binbank collapsed in the fall of 2017 and left a financial hole of billions of dollars.

<sup>119</sup> Memo of Points, at 5-6, 14, *Smagin v. Yegiazaryan*, 17-cv-09764 (C.D. Cal. Sep. 29, 2015), Dkt. 37.

<sup>120</sup> *Ibid.* at 6.

<sup>121</sup> *Vitaly Smagin V. Ashot Yegiazaryan*, No. 16-55502 (9th Cir. 2018). <https://law.justia.com/cases/federal/appellate-courts/ca9/16-55502/16-55502-2018-05-18.html>.

<sup>122</sup> Resp. Br., *In re Application of Deposit Insurance Agency*, 17-mc-00414 (S.D.N.Y. Jan. 16, 2018), Dkt. 10.

<sup>123</sup> Resp. Br., *In re Application of Deposit Insurance Agency*, 17-mc-00414 (S.D.N.Y. Jan. 16, 2018), Dkt. 8.

<sup>124</sup> *Ibid.* at 9-10.



Clandestine financial transactions, facilitated by Kamo Avagumyan, benefited the family members of Russian Prosecutor General, Yuri Chaika (pictured). *Photo credit: REUTERS/Sergei Karpukhin.*

Despite the conclusion by the Investigative Committee of the Russian Federation in 2015 that there was no evidence that a crime had occurred and no basis for criminal charges against any of the shareholders or managers

of Probusinessbank, Russian authorities commenced criminal proceedings in 2016 against Probusinessbank's co-founders, Leontiev and Zheleznyak, along with other bank executives. Victor Grin, the deputy prosecutor general overseeing the criminal proceedings against former Probusinessbank executives in Russia, is also on the Magnitsky list and subject to US sanctions.<sup>125</sup>

In October 2016, the two responsible deputy governors of the central bank were sacked in a hushed-up scandal. One of the new deputy governors of the central bank was Alexander Torshin, who had previously been accused by the Spanish authorities of money laundering.<sup>126</sup> On April 6, 2018, he was targeted by the US Treasury.<sup>127</sup> It is rather extraordinary, and indicative of the Russian law enforcement system, that somebody could be appointed a deputy governor of any central bank after he has been accused by a foreign country of money laundering.

A second, related case is ongoing against Leontiev. Between 2008 and 2011, Russian investors with deep ties to the Russian government, Karen Avagumyan and Avilon Automotive Group—a luxury car company co-owned by Avagumyan's father, Kamo, and Alexander Varshavsky, Avilon's president—entered into loan agreements and promissory notes with Russian and Cypriot finance companies, many of which were guaranteed by Probusinessbank.<sup>128</sup>

After the unlawful seizure of Probusinessbank in 2015, Varshavsky sought repayment of the loaned funds from Leontiev in his personal capacity, leading a campaign of harassment against the bank's shareholders while the DIA plundered Probusinessbank's assets in the sham bankruptcy proceeding. Leontiev, who fled Russia in 2015 in fear for his family's safety, brought an action in federal court in New York in 2016, and obtained a declaration from the court that he did not owe a debt to Varshavsky. While this action was pending, Avilon and Karen Avagumyan sued Leontiev in a New York state court, seeking to recover \$60 million from Leontiev in his personal capacity based on the same claims at issue in the federal court.<sup>129</sup>

Avilon reportedly has received at least \$286 million worth of state contracts from Russian government agencies, including from the Russian Prosecutor General Yuri

<sup>125</sup> Ibid. at 13.

<sup>126</sup> Anna Nemtsova, "What's the Truth About the NRA's Man in Moscow?" *The Daily Beast*, February 23, 2018.

<sup>127</sup> "Treasury Designates Russian Oligarchs," US Department of the Treasury.

<sup>128</sup> *Avilon Automotive Group v. Leontiev*, Index No. 656007/16.

<sup>129</sup> Def. Br. at 13-20, *Avilon Automotive Group v. Leontiev*, no. 656007/16 (Sup. Ct. N.Y. Cty. May 16, 2017), Dkt. 110.

Chaika's office.<sup>130</sup> Kamo Avagumyan has been involved in clandestine financial transactions with members of Putin's inner circle, such as a hotel development, which investigative journalists discovered is co-owned by Artem Chaika and the wife of a former Russian deputy general.<sup>131</sup> Furthermore, Avagumyan's other son, George, works under Prosecutor General Chaika as the deputy head of the division charged with "supervision of compliance with laws protecting the interests of the state and the society."<sup>132</sup>

In October 2017, the state court case was dismissed.<sup>133</sup> In his opinion, the judge chastised Aylon and Avagumyan for their "blatant misuse of the federal forum," declaring that "[t]his court will not continue to countenance the misallocation of judicial resources plaintiffs seek by transporting [this] ... dispute from federal court to state court."<sup>134</sup> The decision in the Aylon case is a rare instance in which a US court has recognized the potential abuse of the US judicial system by Russian actors with ties to the Kremlin. As discussed above,

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"The Kremlin will continue its unrelenting assault on its targets, including its attempts to directly manipulate and exploit the US justice system."

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however, attacks by Kremlin proxies are often part of a larger coordinated effort by the Russian state. In this instance, following the court's dismissal of Aylon's and Avagumyan's claims, the DIA filed its Section 1782 applications, in which it requested discovery that echoes the requests made in both the Varshavsky and Aylon cases.<sup>135</sup> Even when the efforts of proxies like Varshavsky and Avagumyan fail, the Kremlin will continue its unrelenting assault on its targets, including its attempts to directly manipulate and exploit the US justice system.

130 "Commissioners Call on Administration to Add Two Putin Cronies to Russia Report," *Helsinki Commission Chair*, CSCE, January 17, 2018, [www.csce.gov/international-impact/press-and-media/press-releases/](http://www.csce.gov/international-impact/press-and-media/press-releases/).

131 Shaun Walker, "The Luxury Hotel, the Family of the Top Moscow Prosecutor and Russia's Most Notorious Gang," *Guardian*, December 12, 2015, <https://www.theguardian.com/world/2015/dec/13/alexei-navalny-yuri-chaika>.

132 Dmitry Velikovsky, "Cars, Connections, and Contracts in Putin's Russia," *OCCRP*, July 27, 2017, <https://www.occrp.org/en/investigations/6773-cars-connections-and-contracts-in-putin-s-russia>.

133 *Aylon Automotive Group v. Leontiev*, no. 656007/16, 2017 WL 4422593 (Sup. Ct. N.Y. Cty. 2017).

134 *Ibid.* at \*3-5.

135 Resp. Rep. Br. at 13-14, *In re Application of Deposit Insurance Agency*, 17-mc-00414 (S.D.N.Y. Mar. 13, 2018), Dkt. 23.

## CONCLUSION AND RECOMMENDATIONS

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**T**he aim of this report is not to litigate specific cases, but to show a pattern of high-level lawlessness in Russian state agencies and how these lawless actors exploit the US judiciary. The Kremlin has taken advantage of US courts to advance its corrupt corporate raiding and expropriation schemes. This began long before Russia insinuated itself into the US electoral process and revelations of Russia's sophisticated cyber-attacks became public.

The whole array of Russian state agencies colludes in criminal activities to the detriment of private Russian companies and to the material benefit of the officials involved. These crimes are supported at the highest levels of government, notably by Putin himself, as is evident from his vociferous criticism of the Magnitsky Act, which is specifically designed to support the rule of law in Russia.

In the cases above, unlawful or legally-dubious activities carried out by various Russian state entities have been presented. The actors involved include Sberbank and other state enterprises, the Central Bank of Russia, and the Deposit Insurance Agency, as well as all law enforcement bodies like the Investigative Committee, the Prosecutor General's Office, the Ministry of Interior, and the prison service. These state officials are also cooperating with organized criminals as well as skillful private lawyers.

Russian state agencies and their proxies are exploiting the international judicial system to their advantage. Although this report focuses on the United States, Russian authorities pursue similar activities in many countries. Cyprus is a favorite Russian playground. Red Notices issued by Interpol on the basis of flawed Russian evidence are incredibly common and many countries have received requests from Russian legal authorities to enforce their judgments. The SPI Group that holds the Stolichnaya trademarks had similar cases initiated against them in relation to more than 22 countries.

In the US judiciary, three particular problems stand out: the generous provisions for opening a discovery case, the minimal statutory requirements for bankruptcy

proceedings, and the enforcement of Russian court verdicts without considering the pervasiveness of corruption within the Russian judicial and law enforcement systems.

The US Congress and Department of Justice need to address this exploitation of the US judiciary for nefarious purposes and act decisively to safeguard US democratic institutions. Interpol Red Notices do not appear to raise any problems in the US, but they do negatively affect US citizens and residents when traveling abroad. David Satter has sensibly suggested that "Interpol should enhance the transparency of the provision of information about a subject of a Red Notice" and that Red Notices should be automatically deleted for people given asylum.<sup>136</sup>

The US has two useful legal acts already in place, the Magnitsky Act and the Global Magnitsky Act. In the future, the designation of additional sanctions targets through these acts is both necessary and justified. However, further measures are needed to stop the Russian state's misuse of the US judicial system. The House and Senate Judiciary Committees should hold hearings about these malpractices and Congress should consider legislation on the basis of such hearings.

Additionally, the Department of Justice or the State Department should establish a coordination office that would liaise with US courts. The office would be a central site where victims of abuse by corrupt governments could submit their evidence. The Department of Justice needs to issue clear guidance to the courts with assessments of the validity of foreign justice systems, which could be based on the State Department's annual human rights report.<sup>137</sup>

Putin has turned Russia into an authoritarian kleptocracy that aims to enrich his privileged circle. In this system, crime is not an aberration, but the standard. The best understanding is that an organized crime gang led by Putin has taken over the commanding heights of the Russian state.<sup>138</sup> The US and other Western governments and institutions may not be able to stop this takeover, but they must avoid colluding with it, whether intentionally or unintentionally.

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<sup>136</sup> Satter, *Russia's Abuse of Interpol*.

<sup>137</sup> *Human Rights Report*, US Department of State.

<sup>138</sup> Dawisha, *Putin's Kleptocracy*.

## ABOUT THE AUTHOR

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