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UKRAINE v. RUSSIA AND THE Kleptocrats

The Legal Route to Recover Ukraine's Losses

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Cover photo credit: Reuters/Yannis Behrakis. Ukrainians look at a "Wanted" notice for fugitive Ukrainian President Viktor Yanukovych, plastered on the window of a car used as a barricade, near Kyiv's Independent Square, February 24, 2014.

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TABLE OF CONTENTS

INTRODUCTION

The invasion and annexation of Crimea and the occupation of parts of eastern Ukraine in 2014 by the Russian Federation should serve as a wake-up call to members of the Atlantic Alliance. Over the course of the last decade, Russia has begun to pull away from the post-Cold War settlement and, indeed, from the Helsinki Accords. We have seen Russia invade, then de facto annex parts of Georgia in 2008, twice threaten Europe with gas cut-offs in 2006 and 2009, and deploy cyber warfare against Estonia in 2007. More broadly, the Alliance is now facing a significant military build-up against it from the Russian Federation, waves of cyber-attacks, as well as the use of corrupt financial flows to build allies in the West and weaken Western resolve to act. On top of this, the Russian state has launched an all-out disinformation campaign to project its worldview across Europe and beyond. The consequences for Ukraine of modern Russian foreign policy have been particularly harsh: The pro-Russian elite has stolen substantial assets from the country, and in invading Ukraine, the Russian Federation has caused substantial damage to individuals, businesses, and the state.

This paper looks specifically at how the law can be deployed to support Ukraine in recovering assets stolen by the regime of former President Viktor Yanukovych and further, how Ukraine might seek to recover its losses incurred by the occupation and invasion of Crimea and eastern Ukraine. Finding effective ways of reclaiming a substantial part of the state assets stolen during the Yanukovych presidency (2010-14), as well as obtaining damages due to the losses of war, annexation, and occupation would both help Ukraine and individual Ukrainians recover from the impact of a corrupt *kleptocracy* and war, and deliver justice to those who have suffered substantial losses over the last two years.

Part one of this paper considers the issues surrounding the prospects for recovery of state-owned assets stolen by the previous regime, examining in particular the possibilities in alternative legal mechanisms, such as plea agreements to encourage asset surrender. Part two considers the options for obtaining redress from the Russian Federation for the liabilities incurred by Ukraine flowing from invasion, occupation, and annexation. Part three outlines how the West should support Ukraine in its efforts to recover assets and seek reparations for the occupation. The paper identifies in particular the advantage for Kyiv in establishing in detail the extent of its losses and having those losses verified by a credible international accounting board.

ASSET RECOVERY

During the Yanukovych administration, corruption accelerated and significant plundering of Ukrainian state finances occurred. This first section examines the scale of that theft and considers the options for recovery.

There have been large scale thefts of public assets across the globe from Haiti to the Philippines to Egypt and beyond. The World Bank conservatively estimates that approximately $20-40 billion of public assets from developing countries are stolen annually.[1] By way of highlighting how difficult it is to recover such assets, the World Bank estimates that only $5 billion has been recovered in the last fifteen years.[2]

The theft of public assets in Ukraine has escalated over the last decade, with some estimates of as much as $100 billion worth of public assets stolen during the Yanukovych administration alone.[3] Since independence, Ukraine has had an increasing problem with oligarchs, together with the political elite, plundering the energy markets and stealing public assets. The escalation over the last decade and a half can be demonstrated in Transparency International's Corruption Perception Index: Ukraine slid from its position at number 83 in 2001, to 122 on the eve of the Orange Revolution, to 134 on the election of Yanukovych, and then to 142 at his fall.[4]

Despite the perceived promises of the Orange Revolution to curtail corruption and bring transparency and accountability to public institutions, former President Viktor Yushchenko's administration failed to deliver. In fact, corruption became ever more pervasive under Yushchenko, as his government members fell into bickering, and the energy sector—the source of pervasive corruption—went unreformed. For example, Yushchenko recognized that differential pricing between consumer and industrial gas prices was a major source of corruption via supply diversion from the consumer to industrial sectors; however, this abuse was not remedied until the post-Euromaidan government of Arseniy Yatsenyuk abolished the pricing regime in April 2015.[5] Instead, as noted above, during the interim years under Yanukovych, corruption spread beyond the extensive position it had acquired under previous administrations.

To claw back the assets stolen during Yanukovych's tenure, one first needs to know what devices were used to mask the thefts. Such a discussion will help assess how difficult it will be to recover the assets and will allow an estimate of how much was stolen.

How Yanukovych's Regime Stole from Ukraine: Value-added tax (VAT) and Procurement Fraud

There were two key types of fraud undertaken by the Yanukovych administration and its supporters.

VAT Fraud: Legitimate businesses that have overpaid value-added taxes often find that no refund will be paid unless the money is "shared" with public officials. The required bribe can be hidden as shipping or registry fees,[6] and may run as high as 18-20 percent of the refund claim, according to the US Securities and Exchange Commission.[7] The percentage lost in bribery is thought to have grown even higher during Yanukovych's presidency.[8] The former head of the Ukrainian tax service estimated in April 2014 that VAT fraud under Yanukovych cost

1 "The World Bank's calculation is likely an underestimate because it does not capture the full societal effect of corruption on domestic economies and public institutions." Kevin M. Stephenson, Larissa Gray, Ric Power, Jean-Pierre Brun, Gabrielle Dunker, and Melissa Panjer, *Barriers to Asset Recovery: An Analysis of the Key Barriers and Recommendations for Action*, (Washington, DC: World Bank, 2011).

2 Ibid.

3 Guy Faulconbridge, Anna Dabrowska, and Stephen Grey, "Prosecutor: Yanukovych's 'Mafia' Government Stole up to $100 Billion from Ukraine and Some of It Is Funding Rebels," *Reuters,* April 30, 2014, http://www.businessinsider.com/r-toppled-mafia-president-cost-ukraine-up-to-100-billion-prosecutor-says-2014-30.

4 Corruption Perception Index, Transparency International, annual ratings are available at http://www.transparency.org/research/cpi/overview.

5 "Interview with Reza Moghadam: Ukraine Unveils Reform Program with IMF Support," *International Monetary Fund*, April 30, 2014, http://www.imf.org/external/pubs/ft/survey/so/2014/NEW043014A.htm.

6 See, for example, the subsidiary of Archer Daniel Midlands who paid $54 million in fines to the US Department of Justice for paying such bribes to obtain recovery of legitimately owed VAT payments. "ADM Subsidiary Pleads Guilty to Conspiracy to Violate the Foreign Corrupt Practices Act," *US Department of Justice,* December 20, 2013, http://www.justice.gov/opa/pr/adm-subsidiary-pleads-guilty-conspiracy-violate-foreign-corrupt-practices-act.

7 "SEC Charges Archer-Daniels-Midland Company with FCPA Violations," *US Securities and Exchange Commission,* December 20, 2013, https://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540535139.

8 Oliver Bullough, "Looting Ukraine: How East and West Teamed Up to Steal a Country," *Legatum Institute*, July 17, 2014.

Ukraine an astounding *one-quarter* of its entire annual budget.[9] This would mean that VAT fraud alone was responsible for greater losses each year than Ukraine received in soft loans from the International Monetary Fund ($17 billion).

Procurement Fraud: The state procurement budget is approximately $12 billion annually.[10] Oleska Shalaisky—a member of the *Nashi Groshi* (Our Money) anticorruption project—has estimated that the scale of fraud amounts to 30 percent of Ukraine's procurement budget each year.[11] The fraud was often quite simplistic: Firms connected to elite insiders put in bids, and outside competitors were encouraged to leave the tender or they were given absurd justifications for disqualification.

VAT and procurement fraud have been the largest sources of stolen funds. Some estimates place the scale of the theft at upwards of $30 billion a year, based on the size of the procurement budget and VAT refunds.[12]

A conservative estimate of the amount stolen through VAT and procurement fraud stands at over $60 billion (US) during the three year period of Yanukovych's presidency. And this is before any other types of theft of state assets are taken into account.

Even if the VAT and procurement fraud is overestimated by 50 percent, these two sources of fraud alone would have drained $10 billion a year from state resources, totalling more than $30 billion over Yanukovych's years in office. These figures give some sense of the scale of theft from the Ukrainian state. The World Bank estimates that $20-40 billion is stolen through corruption each year in the entire world. The theft of Ukrainian state assets is thus in a class of its own.[13]

VAT and procurement fraud represent worthwhile targets for investigators, because they generate conspicuous paper trails that investigators, regulators, and lawyers can follow to work out the nature of the fraud and trace the participants.

How to Recover Losses: The Plea Agreement Option?

Asset recovery can be time consuming, legally complicated, and expensive.[14] It is worth considering whether there are alternatives that can be deployed in parallel or in place of a major asset recovery operation. For example, in Georgia after the Rose Revolution of 2003, the new Georgian government realized that it only had state revenues of approximately $700 million, and so developed a plea bargaining system, which encouraged former officials to disgorge assets in return for immunity. (Plea bargaining was introduced in Georgia in 2004 and refined in 2005 and 2009 through amendments to the Code of Criminal Procedures.[15]) These legal procedures, which were akin to lustration, targeted individuals in the inner circle of former President Shevardnadze, and were carried out publically: The arrests of officials and the charges brought against them were recorded. In exchange for cooperation with the investigation and reimbursement of state funds, individuals accused of corruption and public theft could avoid a public trial. According to Transparency International's report, "the basis for a plea agreement was the defendant's consent to cooperate with the prosecution, admit the charges against him, and provide the investigation with truthful information and/or evidence of a serious crime or a crime committed by a high official, thus

9 Ivan Verstyuk and Vladyslav Golovin, "New Tax Man Wants to Turn Ukraine into an Investment Bank," *Kyiv Post*, April 22, 2014.

10 Because of the fall in value of the local currency against the dollar figures and incomplete records figures given are only approximate. Petro Poroshenko's government has set out on a course to introduce a much more credible and transparent procurement system. See One, "Public Procurement Transparency Generates 12% Savings of Public Funds," http://www.one.org/international/follow-the-money/case-studies/public-procurement-transparency-generates-12-savings-of-public-funds/.

11 Bullough, "Looting Ukraine," p. 11. See also *Anti-Corruption Reforms in Ukraine: Round 3 Monitoring of the Istanbul Anti-Corruption Action Plan* (Paris: OECD, 2015), which suggested that as much as 75 percent of procurement funds were embezzled during the Yanukovych years.

12 Guy Faulconbridge, Anna Dabrowska, and Stephen Grey, "Toppled 'Mafia President' Cost Ukraine up to $100 Billion Prosecutor Says," *Reuters*, April 30, 2014; Anton Moiseienko, "Stolen Asset Recovery: The Case of Ukraine," *Jurist*, December 2, 2014.

13 Aside from the theft by the Russian elites, see Karen Dawisha, *Putin's Kleptocracy, Who Owns Russia?* (New York: Simon & Schuster, 2014).

14 For example, take the case of Franz Sedelmayer who has been seeking to recover assets seized by the Russian state in 1992. It took nineteen years for Sedelmayer to obtain any recovery against Russian assets. Andrew Higgins, "Beating Russia at Its Own Long Game," *New York Times*, February 9, 2015, http://www.nytimes.com/2015/02/10/world/europe/once-friendly-with-putin-german-goes-to-court-over-seized-assets.html?_r=0. The Ukrainian government can deploy greater resources and intelligence support than any individual, and assets have to be found in different jurisdictions, frozen where possible, and court proceedings completed, including lengthy appeal, before there is any effective recovery. In Sedelmayer's case, Swedish Supreme Court ruled in his favor in 2011, but it took another three years for the assets to be seized, sold at auction, and the proceeds transferred to him.

15 "Plea Bargaining in Georgia: Negotiated Justice," *Open Society Georgia Foundation*, December 15, 2010, http://www.transparency.ge/sites/default/files/post_attachments/Plea%20Bargaining%20in%20Georgia%20-%20Negotiated%20Justice.pdf.

Ex-Ukrainian President Yanukovych's extensive collection of cars and motorcycles in Mezhyhirya, Yanukovych's former residence. *Photo credit*: Deepstereo/Flickr.

contributing to the resolution of the case. Under such circumstances, the prosecutor had the right to petition the Court for a verdict without trial."[16] These deals quickly netted the Georgian state assets of over $1 billion.[17]

Such an approach is also possible in Ukraine. It may be better to get back a substantial proportion of plundered assets even at the cost of foregoing any imprisonment of corrupt officials, who will continue to enjoy visa-free access to the European Union (EU) and the United States. Letting corrupt officials escape prosecution and allowing them to keep some assets is obviously not an ideal outcome. However, the Ukrainian state can obtain assets needed to repair the economy, provide support to its people, and defend the nation. A complicating factor is that Ukraine has a far greater problem of judicial corruption and efficiency than what faced Georgia in the early years after the Rose Revolution. Effective domestic legal reform and drawing on foreign jurisdictions for assistance in the corruption investigations may be a better option in developing a credible legal response.

Ukraine and the West should not start off by simply offering legal immunity to former members of the Yanukovych regime. The approach here is drawn instead from the game theory analysis used by US and European prosecutors. Game theory strategies have been extremely successful in breaking open international price-fixing rings: The starting point is to create a credible sense of threat.[18] This will require more than sanctions against former members of the regime, their entourage, advisers, and supporters. It involves first carrying out a detailed investigation to identify everyone who participated and benefited from the theft undertaken by the

16 Ibid.

17 Leonid Bershidsky, "Thankless Job? Try Fighting Graft in Ukraine," *Bloomberg View*, March 31, 2015, http://www.bloombergview.com/articles/2015-03-31/thankless-job-try-fighting-graft-in-ukraine.

18 Christopher Leslie, "Trust, Distrust and Antitrust," *Texas Law Review,* vol. 82, no. 3 (2004) *et seq.* In 1993 the US Department of Justice (DOJ) introduced a new "leniency program" based upon observations from game theory. The leniency program offered one member of an international price-fixing cartel legal immunity from criminal charges for its executives and immunity from fines. The existence of a credible threat, very heavy fines, and criminal sanctions by the DOJ, combined with an offer of immunity has triggered significant numbers of leniency applicants coming forward and resulted in the busting of dozens of cartels. Leniency programs have now been copied worldwide by competition authorities, particularly with great success in the European Union.

regime. The next step involves prohibiting all of the beneficiaries and participants in the theft of Ukrainian state assets from travelling to the EU and the United States.[19] The third step is to initiate asset recovery operations, identifying where assets can be frozen, and thus demonstrating the reform program's capability and commitment. Ukraine could further bolster that commitment by entering into a litigation funding agreement, either with loan funders or other governments as discussed below. A funding agreement would signal to investigative targets that they will have to spend many years trying to protect their assets against investigation and seizure. In parallel, US, EU, and Ukrainian prosecutors would enhance their efforts not only to seize assets, but also to extradite the beneficiaries and participants in the theft of Ukrainian assets. Increasing the number of notifications to Interpol, requesting red notices (for arrest), and publicizing the names and details of those believed to have stolen state assets would be effective. Bounties for whistle-blowers based on credible information as to the location and movement of corrupt assets could also be provided to assist investigators.

Once a substantial threat to the beneficiaries and participants has been established, then plea agreements could be utilized. The participant or beneficiary would be required to surrender a very large proportion of the stolen assets in order to obtain the plea agreement.[20] In return, the beneficiaries of a plea agreement would have criminal charges dropped, red notices lifted, and be given the right to travel freely and reside in the EU, United States, and Ukraine.

Those involved in the theft of Ukrainian state assets then, will face a major dilemma. They can stay out of Ukraine, the EU, and the United States, most likely by remaining within the Russian Federation. Greater use of Interpol red notices will make it difficult even to leave the Russian Federation. It would be difficult for corrupt officials to hide and protect their assets against well-funded investigators.[21] They would also have to calculate the stability of the current Russian regime and its potential to protect them over the long term. Alternatively, they can do a deal with the West and Ukraine. The benefits—at least for some beneficiaries and participants in the theft of Ukrainian state assets—will weigh in the direction of seeking a plea agreement.[22]

It would be difficult for corrupt officials to hide and protect their assets against well-funded investigators.

Ukraine, the United States, and the EU would have to discuss how the structure of the plea agreement would work. Common law countries are familiar with the concept of a plea agreement. In some cases, the United States may have jurisdiction where payments involving stolen assets are cleared through American banks. In such cases, a plea agreement can be arranged under federal law and approved in federal district court. EU and Ukrainian authorities need only recognize and support the deal set out in the plea agreement. A similar situation may also play out in respect to nonprosecution agreements under English law.[23] It will, however, depend on the nature of the case and the movement of assets as to how a plea agreement can be structured in respect to jurisdiction, governing law, and substantive terms.

As for assets stolen from Ukraine, Ukraine clearly will have jurisdiction. Nonetheless, civil law systems such as Ukraine are usually less familiar and less comfortable with plea agreements. In addition, there is the ongoing obstacle of the credibility, ineffectiveness, and corruption of the legal system. One issue for consideration is whether Ukraine can adapt its legal procedures to make such agreements easier to reach. In addition, cooperation will be required between regulators in several jurisdictions to make a plea agreement system work, including a central

19 Sanctions so far have only been focused upon senior members of the regime, who most likely did benefit from the theft of state assets. As far as the author is aware sanctions either in terms of assets or travel bans have not been imposed on the basis purely of the theft of state assets.

20 The plea agreement would be voidable should the investigators subsequently discover that not all assets had been disclosed. If such a term were exercised, the party would lose the rights to reside in the EU and United States, face confiscation of all assets held in the West, and face prosecution.

21 For fear of losing assets to Russian predators, much of the stolen asset base will not actually be located in the Russian Federation. Some of the assets will be held in China and the Middle East. But for reasons of legal security a significant proportion will still be held in the West, usually though in off shore accounts and other locales where there is little banking transparency.

22 Plea agreements would be sought initially by legal representatives on behalf of the beneficiaries.

23 A non-prosecution agreement is similar to a US plea agreement. Because of the significance of London as a financial center and the role of the British Overseas Territories, the United Kingdom may well find itself with a major role in this process.

filing and agreement system, recognition of pleas, and associated travel and visa rights.

In sum, there are a range of political, jurisdictional, and procedural issues here that are worth exploring further with Ukrainian authorities. Although plea agreements may be seen by some critics as unpalatable, they could bring significant immediate benefits to the Ukrainian state.

Ukraine's Willingness to Seek Recovery

Is the Ukrainian government willing to support plea agreements and major asset recovery? The current administration has signalled a willingness to pursue some anticorruption measures; A new anticorruption agency has been established, an inter-departmental working group now can expedite asset recovery under the auspices of the Office of the President, and a one-stop shop for collating information and liaising with foreign agencies has been proposed. On the other hand, the assets recovered in the first half of 2015 amounted to just under 8,000 hryvnia, approximately $400.[24]

The reticence to put rhetoric into action in support of asset recovery is vividly illustrated by the Andriy Portnov case. Portnov, an adviser to former President Viktor Yanukovych, had his assets frozen by the European Union after the Maidan Revolution in March 2014. However, in late October 2015, the EU General Court annulled the decision against Portnov, because the only evidence provided to the authorities was a letter simply reciting the allegation of misappropriation of funds.[25] EU sanctions have been lifted already in a number of cases because of the failure of the government in Kyiv to provide sufficient evidence to maintain such sanctions in place.[26]

There is concern that a significant part of Ukraine's administration is still tied to past corrupt practices, profiting from them, and emulating those practices in new forms. In such circumstances, there would likely be heavy resistance to any major asset recovery campaign, since it would threaten valuable revenue streams, political standing, and potentially send malefactors to jail.[27] This is no small issue in seeking to recover Ukraine's lost state assets. While most of the assets are outside the country, foreign lawyers and investigators will need the cooperation of the Ukrainian state administration and courts, and will need access to a significant amount of internal intelligence and documentation. A further concern is that the failure to deal with domestic corruption may reduce the incentive for Western governments to assist Ukraine's asset recovery operation.

Another major issue for consideration is what happens to recovered assets once they are returned to Ukraine. In order to reassure a domestic audience that the assets will not be lost or stolen and to encourage foreign cooperation, Ukraine needs to consider creating a mechanism with international supervision that will guarantee recovered assets are put to good use and that a proper accounting is done. The Ukrainian Anti-Corruption Action Center (AntAC) has, for instance, proposed that $3 million in funds seized from former Prime Minister Pavlo Lazarenko should be allocated by the Ukrainian Justice Department to the Kyiv-Mohyla University to set up an anticorruption research and surveillance center. AntAC is also now seeking a much greater chunk of the seized Lazarenko money, approximately $200 million, in order to establish a foundation supporting a range of Ukrainian social needs, including a children's hospital.[28]

If assets are going to be recovered on any scale, cooperating governments must be assured that the returned assets will be genuinely allocated for the public good. Hence, as a part of the overall asset recovery scheme, Ukraine will have to establish, with international support, a credible program for the utilization of such assets.

24 Olena Goncharova, "Lawmakers Press for Agency to Speed Recovery of Stolen Assets," *Organized Crime and Corruption Reporting Project,* September 2, 2015, https://www.occrp.org/en/daily/4358-ukraine-lawmakers-press-for-agency-to-speed-recovery-of-stolen-assets.

25 Case of Portnov v. Council (T-290/14), not yet reported, October 26, 2015. Five other members of the former regime have also challenged EU freezing orders. In all of these cases, the only evidence was a letter of March 2014 from Ukraine's Prosecutor-General's Office. Lack of detail and specificity resulted in the EU General Court discharging the freezing orders. No appeals were sought by the EU Council to the European Court of Justice.

26 Laurence Norman and Nick Shchetko, "EU Scales Back Ukraine Sanctions," *The Wall Street Journal*, March 6, 2015, http://www.wsj.com/articles/eu-scales-back-ukraine-sanctions-1425642916.

27 This view is further reinforced by the domestic failure to clamp down on corruption, which despite rhetoric and new laws has seen little change. See, for example, Anne Applebaum, "Ukraine's Second Front," *Slate*, October 29, 2015, http://www.slate.com/articles/news_and_politics/foreigners/2015/10/ukraine_is_fighting_two_wars_its_fight_against_corruption_may_matter_as.html.

28 Open Society Justice Initiative, "Repatriating Stolen Assets: Opportunities for Development Funding," *Open Society Foundations*, July 27, 2015, https://www.opensocietyfoundations.org/sites/default/files/repatriating-stolen-assets-background-20150727.pdf.

OCCUPATION LIABILITIES

Ukraine has suffered losses not just from large-scale theft by its own elites, but also losses from invasion and occupation. This section of the paper considers how far it would be possible for Ukraine to recover damages for the losses it has suffered. For instance, would it be possible to link and indeed sequester Russian state-owned assets in the West to pay for the mounting liabilities arising from the occupation of Crimea and eastern Ukraine? While it is clear that the Russian Federation is responsible for aiding and assisting the invasion and occupation of Ukraine, it is difficult to obtain compensation for a host of practical and technical reasons, as noted infra. Nevertheless, there are a number of ways forward that could bring a degree of redress. The argument in this section is that it would be worthwhile for Ukraine to undertake a credible accounting for the losses suffered as a result of invasion, occupation, and war in order to have some verified financial damages to settle with the Russian Federation as part of a final settlement.

Legal liability for the invasion and occupation of Crimea and eastern Ukraine is difficult for Moscow to deny.[29] The United Nations (UN) Charter proclaims in Article 2(4) that:

> "All Members shall refrain in international relations from the threat or use of force against the territorial integrity or political independence of any state, or in any other manner inconsistent with the purposes of the United Nations."[30]

On March 2014, the UN General Assembly condemned the invasion of Ukraine as a serious breach of public international law in Resolution 68/262. Aggressive war and occupation are plainly illegal, as established by General Assembly Resolution 29/3314 of 1974, in particular prohibits "sending by or on behalf of a state of armed bands, groups, irregular or mercenaries which carry on acts of armed force against another state of . . . gravity as to amount to the acts listed above."[31]

While the Russian Federation has expended enormous efforts to obscure and deny its actions in respect to the occupation and annexation of Crimea and the invasion of eastern Ukraine, none of Russia's arguments have credibility in the cold light of a courtroom. Crimea is an integral part of Ukraine in public international law, and the invasion and annexation is unlawful. Historical arguments about the history of the region do not change this, nor do claims about the "inherent Russian nature" of Crimea.[32] The territory of a member state of the United Nations was invaded, occupied, and annexed by another member of the United Nations in breach of Article 2(4), without warrant of the Security Council and in breach of custom, practice, and case law. Equally, although Moscow has attempted to hide its operations in eastern Ukraine, there is growing and ample evidence of direct Russian support—military and financial—for the ongoing war.[33] Given the extensive Russian direction and control of operations, provision of weaponry, and financing in eastern Ukraine, it is difficult to see how its actions do not constitute invasion and waging a war of aggression against Ukraine.[34]

Crimea is an integral part of Ukraine in public international law, and the invasion and annexation is unlawful.

29 The overwhelming evidence of Russian financing, organization, and control of the so-called rebels in eastern Ukraine makes it difficult for Russia to deny its state responsibility. For evidence of the scale of Russian financing, control, and direction, see Boris Nemtsov, *Putin. War. An Independent Expert Report* (Moscow, Russia: Free Russia Foundation, May 2015), p. 70; Maksymilian Czuperski, John Herbst, Eliot Higgins, Alina Polyakova, and Damon Wilson, *Hiding in Plain Sight: Putin's War in Ukraine*, Atlantic Council, September 2015.

30 United Nations Charter, June 26, 1945, http://www.un.org/en/sections/un-charter/chapter-i/index.html.

31 According to Article 3(g) of the UN General Assembly 29/3314 of 1974, the acts listed above include invasion, bombardment, and attack by land, sea, or air.

32 On the basis of length of historical control of Crimea, one could argue that Turkey as the successor in title to the Ottoman Empire has a far better claim to Crimea than the Russian Federation.

33 Nemtsov and Wilson et al., op. cit.

34 The difficulty for the Russian Federation is that the International Court of Justice in *Nicaragua* made it clear that there was no general right of intervention in law for a state to intervene militarily in assisting a political opposition in another state. *Case Concerning Military and Paramilitary Activities in and against Nicaragua* (*Nicaragua v. United States), Vol. IV,* 1986, Judgment, June 27, 1986. To do so to the extent the Russian Federation has done in Ukraine, constitutes a breach of Article 2(4).

Constitution of Ukraine. *Photo credit*: torange.biz.

The Russian state has manifestly breached Article 2(4) of the United Nations Charter. The key question is how Ukraine realistically can obtain recovery for the losses it has suffered. Resolutions of the UN General Assembly and a ruling from the International Court of Justice might be possible pathways; but there are prior steps to be taken.

The first step is to provide an accounting for the liabilities that Ukraine has suffered. The Ukrainian government should consider setting up a reparations office—perhaps with international participation—to provide an authoritative accounting of Russia's liabilities for its illegal acts in occupying Crimea and eastern Ukraine. The losses would include death and personal injury; the direct economic losses of residents of the occupied areas; property losses of roads, bridges, airports, power stations, and railway lines; damage to businesses; and losses of state and private property removed to Russia. Further damages would also include extraction of mineral resources, coal, oil, and gas from Ukrainian territory. The government should consider setting up an international accounting board, which would seek to verify and certify all claims put together by the reparations office.

This is not some theoretical exercise. In the first place a credibly verified accounting of the losses can be used in any settlement negotiations with the Russian Federation. Ultimately there will be a peace agreement that includes a settlement of all claims. The verified losses will provide Ukraine with a powerful additional weapon in negotiating final terms.

Preparing a thorough accounting of losses also serves as an effective strategy in other ways: A verified list of Ukraine's losses and Russia's liability—approved by an international accounting board—would serve as a further disincentive to invest in Russia. The liabilities are likely to be very large, easily surpassing the Russian National Welfare Fund, which stands at approximately $80 billion.[35] A credibly verified and internationally certified accounting of Ukrainian losses would raise concerns on the capital markets as to the financial fragility of the Russian Federation. International capital markets may react to the publication of Russian liability figures by downgrading the rouble and increasing interest rates on Russian debt and credit default swaps.

35 For details of the fund see: Sovereign Wealth Institute, "National Welfare Fund," http://www.swfinstitute.org/swfs/national-welfare-fund/.

Russia's international liability may be based on Article 69 of the 1977 First Additional Protocol of the Geneva Convention, which imposes responsibility for meeting the needs of the population on the occupying power; as well as requiring respect for the right to life (under Article 2) and the right to home and family life (under Article 8) under the European Convention on Human Rights (ECHR).[36] In addition, the ECHR establishes a right to property and pro tanto, a right to redress for loss and injury flowing from invasion and occupation. Article 2(4) of the UN Charter (referenced above) also prohibits the aggressive use of force and provides a basis for redress.

Additionally, Ukraine can point to the responsibility of Russia through civil arbitration claims. For instance, Naftogaz may be able to bring counter-claims in its Stockholm arbitration case against Gazprom, since Naftogaz has had to provide gas in the occupied territories.[37] Russia, thence, would run the risk of a ruling by an international tribunal that it was, indeed, the occupier.

Ukraine could also engage in strategic litigation in international and national venues, raising the issue of Russia's de facto occupation of eastern Ukraine and seeking damages for the harm. Assuming the identity of the claimant and the terms of the contract warrant, Ukraine could also set off claims made by Russian-linked claimants with counter claims based on liabilities accrued from occupation and invasion.[38]

The second approach is to develop the two principal cases brought by Ukraine against the Russian Federation concerning the ongoing occupation of Crimea and eastern Ukraine.[39] Both these cases are brought under the state to state jurisdiction clause contained in Article 33 of the European Convention on Human Rights.[40] An applicant state cannot offer a general claim for invasion and occupation; rather, it must frame a case based on specific Convention guarantees. This is not a difficult hurdle in light of the armed intrusion into eastern Ukraine: Russia's intervention has violated ECHR provisions on the right to life, unlawful imprisonment, the right to home and family life, and the right to property.

In addition, there is precedent for bringing such a case in the European Court on Human Rights, namely, the case of *Cyprus v. Turkey*, connected to the Turkish invasion and occupation of northern Cyprus in 1974.[41] In a judgment rendered on December 4, 2014, the Grand Chamber of the Strasbourg Court found that Turkey is obliged to pay the government of Cyprus 30 million euros for nonpecuniary damages suffered by the relatives of 1,456 missing persons and 60 million euros for nonpecuniary damages suffered by enclaved residents of the Karpas peninsula.[42] Although the claim was brought by Cyprus, the damages were intended to compensate for the damages suffered by individuals. Though it may be difficult to obtain payment from Turkey, under Article 46 of the European Convention, the Committee of Ministers can consider measures to ensure compliance with the judgment.[43]

Likewise, the two cases brought by Ukraine could provide a means to recover losses suffered as a result of invasion and occupation. The best approach would be to bring a series of cases each linked to different types of claimants and linked to specific Convention rights. Losses suffered by internally displaced persons and by families of missing persons could be brought as separate actions. So, too, the damages incurred by business owners and the losses to local authorities could be separately

36 Protocol Additional to the Geneva Conventions of 12 August 1949, and relating to the Protection of Victims of International Armed Conflicts (Protocol I), June 8, 1977, Article 69, International Committee of the Red Cross, https://treaties.un.org/doc/Publication/UNTS/Volume%201125/volume-1125-I-17512-English.pdf; European Convention on Human Rights, June 1, 2010, Article 8, Right to respect for private and family life, p. 10, http://www.echr.coe.int/Documents/Convention_ENG.pdf.

37 Currently Naftogaz and Gazprom are locked in an arbitration hearing before the Stockholm arbitration tribunal over the price and scale of gas debts from contracts over the past decade. A decision is expected in 2016.

38 In most common law jurisdictions, the concept of set off assumes that the defendant asserting set off has to demonstrate that the debt owed is in the hands of a party that is legally identical to the plaintiff who is seeking to enforce a debt against the defendant. Set off can also be substantially affected by the terms contained in the contract.

39 The two principal cases are *Ukraine v. Russia*, Application No. 20958/14, March 13, 2014 and *Ukraine v. Russia,* Application No. 42410/15, August 27, 2015.

40 ECHR, op. cit, p. 20.

41 See *Cyprus v. Turkey,* Application No. 25781/94, May 12, 2014.

42 The Strasbourg Court has ordered far greater amounts in damages. The largest so far awarded was in the Yukos case (*OAO Neftyanaya Kompaniya Yukos v. Russia,* Application No. 14902/04, July 31, 2014). The award in that case was €1.8 billion.

43 Article 46 of the Convention was introduced as an amendment by protocol 14 of the ECHR, adopted in 2010. Under Article 46, should a Contracting State fail to abide by a ruling of the ECHR, after serving a formal notice on the state concerned, the Committee of Ministers of the Council of Europe on a two-thirds vote of Contracting States can transfer the case to the ECHR to consider whether the state in question has failed to comply with the terms of the original judgment. If the Court so finds it refers the case back to the Committee of Ministers to consider the measures to be taken. So far this procedure has never been used. It is also unclear what steps the Committee of Ministers would or could take after a second court ruling.

pleaded. This approach would provide greater identity and profile for the various claims available to Ukraine, proceeding first with the simpler cases that can be put together expeditiously, speeding up the recovery process, and demonstrating that the government is taking steps to recover damages for its citizens. This case-by-case approach also protects the government from the catastrophic prospect that some procedural failure might defeat or diminish an all-encompassing damages case. Nonetheless, undertaking a major accounting operation is worthwhile in assisting Ukraine with a sizeable claim or series of claims before the Strasbourg Court.

There will be difficulties with enforcement of any award. The procedure under Article 46 of the ECHR would require the Council of Europe's Committee of Ministers[44] to send a second case to the Court, if and when, Russia fails to comply with the Court's initial ruling.[45] If the Court rules that Russia has not abided by the initial ruling, then the case is referred back to the Committee of Ministers to consider the measures to be taken. Only then could Ukraine take its own judicial measures.

Article 46 only came into force in 2010 and has not yet been deployed. It is also unclear what measures, following a second ruling, the Committee of Ministers would consider. One approach for Ukraine and its allies to examine would be to promote the idea of enforcing any ruling via the establishment of a compensation commission. This could mirror the establishment of the United Nations Compensation Commission (UNCC). The UNCC was created to pay for losses arising from the Iraqi invasion of Kuwait. The commission collected an estimated 25-30 percent of Iraqi oil revenues and then disbursed the funds to individuals and companies that had suffered as a result of the invasion.[46] However, there is a profound difficulty: The authority of the UN Security Council would need to be deployed to create a UN Compensation Commission for Ukraine, and Russia's veto power in the Security Council makes the creation of such a Commission highly unlikely.

There is a possible alternative in seeking to have the General Assembly use its power under the precedent of the "Uniting for Peace" resolution deployed during the Korean War, and on several occasions since that time. Under Articles 11 and 12 of the UN Charter, the General Assembly previously has undertaken measures that mimic the power of the Security Council on occasions when the Council was thwarted by threatened "super power" vetoes.[47]

Alternatively, as suggested above, Ukraine can pursue its claim through the European Court of Human Rights and prove the human rights violations and financial losses suffered in the conflict with Russian troops and Russian sponsored military operatives. If Russia should fail to comply with a second ruling under Article 46, Ukraine could work with its allies to develop the case for a European equivalent of the UNCC to be established.[48] A European UNCC could freeze Russian state-owned assets and even divert Russian energy flows across Europe, in order to pay off any damage award against the Russian state.[49]

44 The parent body of the ECHR system is the Council of Europe, which consists not just of EU Member States but all European states including Russia (the only European state not a member of the Council is Belarus). The Committee of Ministers of the Council has responsibility for the support, amendment process of the ECHR, and ultimately execution of rulings of the Strasbourg Court.

45 Until President Putin's return to the Presidency in 2012 and the subsequent radicalisation of the Russian state, the Russian Federation had demonstrated a willingness to ultimately comply with ECHR rulings. Once cases arrived in Strasbourg, the Presidential Administration would adopt a settlement strategy to ensure that a significant number of cases would be withdrawn and would ultimately pay the fines levied against it. However, that willingness to engage with the ECHR process has significantly diminished. This was signalled in December 2015 by new Russian legislation, which gives the Russian Constitutional Court the power to overrule ECHR rulings if they conflict with the Russian Constitution. It is therefore likely that any rulings obtained against the Russian Federation would result in no cooperation from the arms of the Russian state. This does not affect the international liability of the Russian Federation, but it clearly makes enforcement more difficult. See Alexei Trochev, *All Appeals Lead to Strasbourg: Unpacking the Impact of the European Court of Human Rights on Russia*, University of Wisconsin Legal Research Paper no. 1082 (2009); William E. Pomeranz, *Uneasy Partners: Russia and the European Court of Human Rights,* Human Rights Brief 19, no 3 (2012); and BBC, "Russia Passes Law to Overrule European Human Rights Court," *BBC World Report,* December 4, 2015, http://www.bbc.com/news/world-europe-35007059.

46 For a discussion of the operation of the UNCC see, Francis E. McGovern, "Dispute Systems Design: The United Nations Compensation Commission," *Harvard Negotiation Law Review,* vol. 14, (Winter 2009), pp. 171-194.

47 UN Charter, op. cit.

48 There are a number of ways of seeking to enforce any ECHR rulings. First, clearly this is a ECHR ruling and the primary responsibility for enforcement is in the hands of the Council of Europe. However, if that proves to be politically impossible or impractical, a possible alternative approach would be to seek to enforce the ECHR ruling via the European Union system. This would probably involve creating a special form of sanction regime focused on the energy flows emanating from the Russian Federation. There are a range of technical issues which would have to be agreed before such steps could be taken.

49 One could argue that given European dependence on Russian oil and gas flows, the European states could never countenance a European UNCC diverting the revenues of Russian energy flows to Ukraine. However, as the European Commission stress tests in 2014 indicated, very few EU Member States are, in fact, heavily dependent on the Russian Federation. Furthermore, the EU's energy liberalisation and single market programs are in the process of providing alternative routes for energy

Ukrainians protest against corruption and for European Union membership in Kyiv's central square during the Maidan Revolution of Dignity in 2014. *Photo credit*: streetwrk.com/Flickr.

At one level this proposal looks bold. However, as Judges Vučinić and Pinto de Albuquerque said in the *Cyprus v. Turkey* case,

> "those member States that wage war, invade or support foreign armed intervention in other member States must pay for their unlawful actions and the consequences of their actions, and the victims, their families and the States of their nationality have a vested and enforceable right to be duly and fully compensated by the responsible warring State. War and its tragic consequences are no longer tolerable in Europe and those member States that do not comply with this principle must be made judicially accountable for their actions without prejudice to political consequences."[50]

Furthermore, accounting for the losses that Ukraine has suffered so far in a credible, internationally supervised process, submitting those details as part of the application to the Strasbourg Court, and then arguing for a European compensation commission on the model of the UNCC will place immense additional pressure on the Russian Federation to settle the case. This will demonstrate to the world the legitimacy of the Ukrainian case for compensation.

supply for all EU states. In addition, the developing global liquid natural gas market; prospects for shale; natural gas in the eastern Mediterranean, Kurdistan, Iran, and Central Asia provide Europe with significant alternative sources of supply. Furthermore, as Russia's problems with financing, pricing, and volumes on the proposed Power of Siberia, which has now been subject to delays that will take its development beyond 2020 indicate, the Russian Federation has difficulties in finding an alternative market in China to Europe.

50 Paulo Pinto de Albuquerque and Nebojša Vučinić, "Case of Cyprus v. Turkey," Judgment, *European Court of Human Rights*, May 12, 2014.

CONCLUSION: WHAT THE WEST SHOULD DO TO SUPPORT UKRAINE

In respect to the theft of state assets during the Yanukovych administration, it is clear that asset recovery will be a complicated process, requiring law firms in different jurisdictions, forensic accountants, and investigators. A multi-jurisdictional recovery operation over several years could easily cost $50 million in professional fees per year. There are a number of options to consider in financing such an operation:

One approach would be to seek funding from litigation funds that invest in cases.[51] They advance the funds to investigate, bring actions, and seize assets. In turn, they are compensated with a percentage of the recovery. It is possible to structure this so that funding sponsors are paid a greater amount in the first round of recoveries and subsequently receive a smaller percentage of what is recovered.

An alternative approach would be to link a global recovery campaign to funding for Ukraine. If the EU and the United States are willing to provide Ukraine with an additional $20 billion to underpin the country's economic reform, the agreement could require that Ukraine pursue a global recovery of the assets and resources purloined by the Ukrainian elite. The first call on recovered monies would be to pay down the $20 billion loan. $500 million of the loan could be set aside to pay for the professional fees involved in recovering the assets—though that figure should be substantially less since there is an economy of scale in asset recoveries.

The option of linking future loans to asset recovery has a number of potential advantages: It should make it easier to obtain further funding from Western governments. It also creates a common interest with Western governments in ensuring that recovery takes place. It also would make it easier for asset-recovery investigators to work with Western governments in recovery of the lost assets.

Critics of this approach to compensation for stolen state assets and for the losses of occupation may argue that such an approach is an expensive distraction. Members of the former Ukrainian regime cannot be forced to pay, and Russia will not pay. They can quite reasonably point to the Yukos case where despite awards in the Strasbourg Court of $1.8 billion and awards in The Hague Permanent Court of Arbitration of $50 billion, no damages have yet been paid by Russia. The Russian Federation has shown no interest in paying for its misdeeds and is clearly ready to argue every legal point in every court across the EU and beyond.

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The Yukos shareholders have faced the difficult, expensive, and time-consuming task of identifying Russian state-owned assets, launching cases, obtaining freezing orders where possible, seeking an initial ruling and then rulings on appeal, until a final ruling in local supreme courts permits the actual seizure of assets. Equally, in *Cyprus v. Turkey,* it took twenty years after the original invasion to proceed with the case, and a further two decades to obtain a ruling in the plaintiff's favor. Even after the ruling in favor of Cyprus, no offer of payment has emanated from Ankara.

Thus, it is undeniable that asset recovery is extremely time-consuming and expensive; furthermore, it will not result in assets being recovered in a short time frame. ECHR legal processes are lengthy, and even when judgment has been obtained, there are also significant difficulties with recovery.

Nonetheless, there are compelling reasons to move forward with both asset recovery and ECHR proceedings in this case. There are several potential advantages for Kyiv. Taking action will have positive political and tactical effects in Ukraine's ongoing disputes with Russia. Politically, it demonstrates to the international community that Ukraine intends

51 Over the last decade the City of London has developed a sophisticated market in litigation funding. For further details see the Association of Litigation Funders, http://associationoflitigationfunders.com.

to defend fully its interests as a sovereign state. It also demonstrates to the Ukrainian people that, however long it takes, the government intends to seek justice and redress against the looters and occupiers of the nation.

In addition, there are significant short-term gains from such a forward-leaning posture. A major, well-financed attempt at recovery is likely to see the recouping of some assets in the first stage of the recovery operation. It also may be possible to develop, with EU and US cooperation, a sufficiently credible threat of visa bans, travel restrictions, investigations, and prosecutions so that at least some former members of the regime are willing to accept a plea agreement in return for a substantial disgorgement of assets. Employing an international accounting board to verify the substantial losses suffered by the Ukrainian state and its citizens as a result of Russia's invasion, annexation, and occupation of eastern Ukraine will bring short-term benefits even absent short-term recovery. At the very least, an internationally verified account of Russian liabilities will be considered by ratings agencies and the financial markets in judging the creditworthiness of, and interest rates to be applied to the debt of, the Russian state. In addition, those internationally verified liabilities may be used as set-off or counter claims in proceedings involving the Russian Federation and entities controlled by the Russian Federation. One example is a potential counter-claim by Naftogaz in respect of the claims made against Gazprom in the ongoing Stockholm arbitration case.

In the longer term, seeking recovery against the Russian state for liabilities arising from invasion will fundamentally protect Ukraine's legitimate interests. The scale of assets stolen from Ukraine, even if recovery takes a decade or more, will make a difference to the finances of the state. An accounting of the losses caused by the invasion will provide the backbone of the case for compensation in any overall settlement of the disputes between Ukraine and Russia. The accounting of losses may be part of a general settlement, offset by additional financial support for Ukraine from the international community, seizure of Russian state-owned assets in the West, or a mixture of settlement, financial support, and seizure.

The overall claim of this paper is that Ukraine has an opportunity to use the rules of public international law, the legal regimes of its allies and domestic law to recover its property, protect its rights, and obtain compensation for the substantial damage that followed from the invasion. The law can be deployed to assert Ukraine's rights as a sovereign state and reinforce the principle that breaches of the UN Charter Article 2(4) and the acts of kleptocrats will result in transgressors being faced with paying in full measure for losses that they have imposed on the innocent.

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