ARBITRATION INSTITUTE OF THE

STOCKHOLM CHAMBER OF COMMERCE

ANATOLIE STATI, GABRIEL STATI, ASCOM GROUP S.A.,

AND TERRA RAF TRANS TRAIDING LTD.

Claimants

v.

REPUBLIC OF KAZAKHSTAN,

Respondent

CLAIMANTS' REPLY MEMORIAL ON JURISDICTION AND LIABILITY

May 7, 2012

KING & SPALDING
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1. Anatolie Stati, Gabriel Stati, Ascom Group S.A. ("Ascom"), and Terra Raf Trans Traiding ("Terra Raf") (collectively, "Claimants") respectfully submit their Reply Memorial on Jurisdiction and Liability in this arbitration proceeding against the Republic of Kazakhstan ("Kazakhstan," "Respondent," the "Government," or the "State") under the Energy Charter Treaty ("ECT" or "Treaty").[1] Pursuant to Procedural Order No. 4, Claimants' Reply on Quantum is reserved for a subsequent submission.

I. PRELIMINARY STATEMENT

2. In their Statement of Claim, Claimants laid out a detailed account of government corruption, abuse of power, and utter disregard for international obligations. In reliance on Kazakhstan's solemn commitments under international law, Claimants invested more than US$ 1 billion breathing new life into previously-neglected oil and gas fields, and constructing a state-of-the art LPG Plant that Kazakhstan itself described as having "great regional and industrial importance for development of the region."[2] But just as those investments matured and began to generate returns, Kazakhstan launched a targeted campaign of intimidation and harassment designed to pressure Claimants into selling their investments to the state-owned oil company at a firesale price. Kazakhstan went so far as to *imprison* a senior KPM employee on patently bogus criminal charges, and to threaten other employees with the same fate, in furtherance of its strong arm tactics. When its plan failed — because Claimants defiantly refused to give in to Kazakhstan's pressure — the government simply seized the investments, deciding to take its chances in arbitration.

3. Perhaps most shocking, this plan originated from the highest level of the Kazakhstan government, namely, President Nazarbayev himself. That fact would sound far-fetched if it were not admitted, but Kazakhstan concedes that President Nazarbayev personally issued the order that led to the expropriation of Claimants' investments.[3]

4. In its Statement of Defense, Kazakhstan attempts to shroud its violations of international law in a cloak of legitimacy by focusing on each minute detail in isolation rather

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[1] All defined terms in this Reply shall be understood to have the same meaning as in Claimants' Statement of Claim, unless otherwise specified.

[2] Acts on Unscheduled Inspection of TNG from Geology Committee, July 16, 2010, at "Commissions Conclusions" ¶ 4, C-315.

[3] Statement of Defense ¶ 19.22.

than the totality of its conduct as a whole. It argues that its extraordinary campaign of inspections was perfectly normal, and that its subsequent actions were appropriate responses to the information it discovered under arcane, Delphic, and often-misstated provisions of its own domestic law. These arguments, however, crumble under the weight of the evidence. Kazakhstan did not discover any wrongdoing by Claimants' companies, much less violations that would justify the extraordinary actions that followed. Viewing Kazakhstan's conduct in its entirety, it is evident that Kazakhstan's objective from the start was to devalue Claimants' investments by making it virtually impossible for Claimants to operate or sell the businesses, so that Claimants would sell to Kazakhstan at a firesale price. Moreover, Kazakhstan also anticipated this arbitration from the beginning, and cloaked its actions under mystifying interpretations of domestic laws and regulations in order to create an appearance of normalcy and legitimacy.

5. Furthermore, Kazakhstan has continued its blatant disregard for its obligations under international law in its conduct of this arbitration. Kazakhstan consistently attempts to obstruct this Tribunal's consideration of Claimants' claims by raising utterly baseless arguments, flatly misstating facts and law, and engaging in procedural misconduct of the worst kind.

A. Kazakhstan's Arguments in This Arbitration Are a Continuation of Its Conscious Strategy to Acquire Claimants' Investments Without Fair Compensation

6. Apart from its admission that President Nazarbayev personally issued the order that led to the expropriation of Claimants' investments, Kazakhstan's 350-page Statement of Defense contests nearly every factual and legal assertion in the Statement of Claim. This is not simply thorough advocacy. It is part of a conscious effort to swamp and overwhelm the Tribunal with minute details in order to distract attention from Kazakhstan's own motives and behavior.

7. Kazakhstan argues that its decision to launch a coordinated, multi-agency investigation of KPM and TNG was a reasonable response to President Voronin's letter to President Nazarbayev raising questions about the character and conduct of Claimant Anatolie Stati. Kazakhstan then portrays all of its subsequent actions — the reversal of its pre-emptive rights waiver, the imposition of new taxes in derogation of its contractual stability obligations, the criminal prosecution and trial of Mr. Cornegruta, and ultimately the direct expropriation of KPM and TNG — as simply the natural and inevitable consequences of the facts revealed in

those investigations. Kazakhstan hopes that through the sophistry of focusing on each small fact individually, the Tribunal will lose sight of the fact that Kazakhstan launched the investigations for the precise purpose of acquiring Claimants' investments for less than fair value.

8. The best evidence of this fact is the gaping chasm between the facts that Kazakhstan purportedly uncovered in those investigations and its subsequent response. Kazakhstan did not find evidence supporting President Voronin's scurrilous insinuations that Mr. Stati is engaged in corrupt political activity or funnels money to terrorist groups. (Indeed, it is not clear that Kazakhstan even looked into those issues and it certainly has presented no evidence supporting such allegations.) Rather, at most, Kazakhstan's investigations discovered only minor technical irregularities that in no way justified Kazakhstan's reaction.

9. For instance, Kazakhstan devotes twenty pages of its Statement of Defense to various arguments that Claimants' investments in KPM and TNG were "illegal."[4] It then attempts to use those purported facts: (1) to defend its retroactive reversal of its waiver of pre-emptive rights with respect to Claimants' acquisition of TNG;[5] (2) to explain why potential purchasers lost interest in Claimants' investments;[6] and (3) to contest this Tribunal's jurisdiction.[7] But even assuming that all of Kazakhstan's illegality allegations were true (and as shown below in Section II C and D, they are not), Kazakhstan nowhere identifies any "illegality" more serious than bureaucratic technicalities (*i.e.*, failure to file the right forms to get the right approvals at all the right times). Kazakhstan does not argue that it had any basis to reject the share transfers if the right consents had been requested at the right times. Moreover, Kazakhstan actively ignored these purported "illegalities" for years, until it initiated its harassment campaign against Claimants.

10. The same is true of the arrest and trial of Mr. Cornegruta for allegedly operating a "main pipeline" without a license. Even putting aside the utter absurdity of the charge and all of the due process violations in the trial, there is simply no rational relationship between the alleged crime and the penalties imposed on Mr. Cornegruta and KPM. Kazakhstan has not articulated

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4 Statement of Defense at 77-96.

5 Statement of Defense ¶¶ 13.43 - 13.47.

6 Statement of Defense ¶¶ 16.3, 16.10(b).

7 Statement of Defense ¶¶ 9.25 - 9.26.

any reason why KPM was not qualified to obtain a main pipeline license, nor has it explained how the operation of the alleged main pipeline caused any harm to anyone. Under Kazakhstan's own theory, this is simply another instance of failing to jump through ever-evolving bureaucratic hoops to obtain the correct license. Such a minor offense cannot possibly justify a four-year prison term (a punishment normally reserved for violent offenses), or a fine equal to all of the revenues generated from all of KPM's productive activity.

11. Likewise, the manner in which Kazakhstan ultimately terminated the Subsoil Use Contracts shows that the purported reasons for that action were pretextual. Kazakhstan based the termination of the three Subsoil Use Contracts on some or all of eight alleged contract violations.[8] Many of the alleged violations concerned minor issues such as the failure to file certain reports and the ubiquitous allegation of operating trunk pipelines without a license.[9] None of those alleged breaches involved dangerous conditions or an imminent threat of any kind. Yet, Kazakhstan gave the companies just *five days* to respond to the violation notices and cure the alleged breaches. Such an impossibly short cure period demonstrates that Kazakhstan's only objective was to create the appearance of legal justification for seizing the investments, not actually to ensure compliance with the contracts.

12. Moreover, just nine months earlier (in September 2009), the MEMR had concluded that there were no contractual grounds to terminate the Subsoil Use Contracts.[10] Numerous other ordinary government audits and inspections had reached the same conclusion for years.[11] Nothing material changed in the operations of KPM and TNG between all those

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[8] Notice of infringement of obligations under the Borankol Subsoil Use Contract No. 305 from MOG to KPM, July 14, 2010, C-2, Notice of infringement of obligations under the Tolkyn Subsoil Use Contract No. 210 from MOG to TNG, July 14, 2010, C-6, and Notice of infringement of obligations under Subsoil Use Contract No. 302 from MOG to TNG, July 14, 2010, C-7.

[9] Notice of infringement of obligations under the Borankol Subsoil Use Contract No. 305 from MOG to KPM, July 14, 2010, C-2, Notice of infringement of obligations under the Tolkyn Subsoil Use Contract No. 210 from MOG to TNG, July 14, 2010, C-6, and Notice of infringement of obligations under Subsoil Use Contract No. 302 from MOG to TNG, July 14, 2010, C-7. Indeed, Kazakhstan included the trunk pipeline issue in the notice of violation for Contract 302 even though TNG operated no pipelines on Contract 302 property. *See* Notice of infringement of obligations under Subsoil Use Contract No. 302 from MOG to TNG, July 14, 2010, C-7.

[10] Letter from MEMR to the Ministry of Industry and Trade of the Republic of Kazakhstan, September 28, 2009, C-294.

[11] For example, *see* the results of MEMR's unscheduled inspections of KPM on May 22-25 of 2007 that "confirm[ed] the lawfulness and legality of conducting all oil operations on Borankol field on the part of" KPM. Report on results of MEMR's unscheduled inspections of KPM on May 22-25 of 2007, C-316.

previous audits and inspections that did not result in termination of the Subsoil Use Contracts and the inspections in July 2010 that did. It simply is not plausible that KPM and TNG transformed from good, lawful operators into recalcitrant violators over a matter of months, all while knowing that they were under intense government scrutiny.

13. Rather, it is plain from all these facts that Kazakhstan launched its investigations of KPM and TNG precisely to find pretexts for terminating their Subsoil Use Contracts. When it did not find any, it simply created reasons out of whole cloth.

14. Nor is there any serious doubt that the objective of Kazakhstan's harassment campaign was to pressure Claimants to sell their investments (or a substantial stake therein) to state-owned KazMunaiGaz at a significant discount to fair market value.[12] Since the early 2000s, President Nazarbayev has stated repeatedly and publicly that Kazakhstan had been too generous to foreign investors in the subsoil use licenses that Kazakhstan granted in the 1990s. Its stated strategy now is to favor production-sharing arrangements in which Kazakhstan retains a partial stake through KazMunaiGaz.

15. Moreover, while Kazakhstan publicly maintained that it would honor its earlier contracts, its practice has been quite to the contrary. As explained further below and in the expert opinion of Professor Scott Horton, Kazakhstan has become adept at pressuring foreign investors to sell equity stakes to KazMunaiGaz through a combination of Financial Police investigations, baseless criminal allegations, fines, and tax threats. Kazakhstan makes it essentially impossible to continue normal operations, and then makes it known that the sale of a substantial equity stake to KazMunaiGaz would resolve the company's various legal difficulties. Kazakhstan has run this "playbook" on foreign investors — and especially, investors in 100% foreign-owned projects — time and again.[13]

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[12] KazMunaiGaz Exploration & Production JSC is majority-owned and controlled by KazMunaiGaz National Company, which is wholly owned and controlled by Kazakhstan. *See* Project Zenith Indicative Offer of KazMunaiGaz at 2, C-19. In 2008-2010, KazMunaiGaz NC's chairman was Timur Kulibayev, the son-in-law of President Nazarbayev. *See* KazMunaiGaz Annual Reports of 2008, 2009, and 2010, C-317, C-318, C-319. Unless circumstances require distinguishing between them, Claimants refer to KazMunaiGaz Exploration & Production JSC and KazMunaiGaz National Company collectively as "KazMunaiGaz."

[13] For further explanation of Kazakhstan's harassment "playbook," *see generally* Expert Report of Scott Horton, dated May 7, 2012 (hereinafter "Horton Report").

16. That is precisely what happened here. KazMunaiGaz (or other companies controlled by Kazakhstan) had made overtures to buy KPM and TNG in the past, but Claimants had rebuffed those offers. During the first phase of Project Zenith in July 2008, however, Claimants solicited a bid from KazMunaiGaz, and provided substantial information about KPM and TNG's operations and prospects in the investment memorandum and due diligence report.[14] The chronology of events that unfolded next is as follows:

September 25, 2008	• KazMunaiGaz submits an indicative offer for the companies' assets of US$ 754 million, which was less than half the highest offer and well below the average of the indicative bids.
October 14, 2008	• President Nazarbayev issues the investigation order.
November 11, 2008	• The Financial Police issue a finding that KPM does not have a main pipeline license, paving the way for the criminal trial and US$ 145 million fine on KPM.
December 18, 2008	• Kazakhstan reverses its pre-emptive rights waiver as to TNG, and issues a press release alleging forgery and fraud in connection with the registration of TNG.
February 10, 2009	• Kazakhstan assesses US$ 62 million in back taxes, disregarding stabilization guarantees in the Subsoil Use Contracts.
April 29, 2009	• Kazakhstan arrests KPM's general director and subsequently freezes KPM's assets.
June 2009	• KazMunaiGaz asserts that the fair market value of KPM and TNG is zero, but offers to buy the companies for US$ 50 million and to deal with the companies' debt separately (without specifying how). The debt was approximately US$ 550 million at the time, and hence, KazMunaiGaz's offer suggests a maximum value of US$ 600 million if KPM had assumed all of the debt.

In other words, KazMunaiGaz made a below-average bid for Claimants' investments in the first round of Project Zenith, then after more than six months of sustained government harassment, offered over US$ 150 million less. This is the Kazakhstan playbook to the letter.

[14] Project Zenith – Vendor Due Diligence by KPMG, August 29, 2008, C-69 and Project Zenith – Information Memorandum, August 2008, C-70.

17. Moreover, when Claimants rejected KazMunaiGaz's lowball offer in June 2009, Kazakhstan simply turned up the pressure. It interfered in the trial of Mr. Cornegruta to ensure a guilty verdict, then sentenced him to four years in Kazakhstan's notoriously dangerous prison system as punishment. It continued to threaten the same fate for KPM and TNG's other directors. It engineered a massive fine against KPM (which was not even a party to the criminal trial) that was large enough to bankrupt the company and provide a ground for seizing its assets. And it continued to interfere with the day-to-day operations of the businesses, including more inspections and audits, asset seizures, and apparent interference with TNG's access to gas markets that choked the company's cash flows. Then, in November 2009, KazMunaiGaz made another bid to buy the companies, this time attempting to circumvent the Claimants by negotiating with the companies' note-holders, and then offering even less to the Claimants than it had offered in June 2009.[15]

18. Despite all this, Claimants continued to resist Kazakhstan's coercion, and ultimately found a Kazakhstan-based buyer for the companies. In February 2010, Claimants signed an agreement to sell their Kazakhstan investments to the Cliffson company for more than US$ 920 million — which was nearly 70% higher than KazMunaiGaz's lowball offer in June 2009. And that presented a dilemma for Kazakhstan. Cliffson was owned by the wealthy and politically connected Assaubayev family. In the course of those negotiations, it became clear to all involved (and no doubt to Kazakhstan as well) that Claimants intended to bring arbitration claims against Kazakhstan once the sale closed for the diminution in the sale price caused by Kazakhstan's harassment campaign. Thus, Kazakhstan faced the prospect of either allowing the companies to slip out of its hands or exercising its pre-emptive rights (which would have required it to match Cliffson's offer), while still facing arbitration claims for the diminution in value. Kazakhstan delayed approval of the transaction for several months with requests for additional details and documentation, but Claimants submitted everything the Government requested in June 2010. Within a week, on June 29, 2010, Kazakhstan launched the final inspection blitz that led to the outright seizure of the companies on July 21, 2010. Kazakhstan apparently concluded that if it was going to face arbitration claims anyway, it might as well take the assets for free and posture a termination basis for the coming arbitration fight.

[15] Lungu Statement ¶ 62; Stati Statement ¶ 38.

19. This tale of conspiracy coordinated at the highest levels of government might seem contrived if it were not both a familiar pattern of behavior in Kazakhstan and admitted in this case that President Nazarbayev was personally involved. But viewed in the context of all the facts, this is a far more plausible explanation than Kazakhstan's suggestion that this was just the normal operation of law in Kazakhstan. Only Kazakhstan knows precisely why it chose this path: a favor to a regional ally, punishment for a 100% foreign-owned company that had refused purchase overtures in the past, an old-fashioned money grab, or some combination of all three. But it is beyond serious dispute that it occurred.

20. Indeed, Kazakhstan's own documents and admissions in this proceeding confirm that it did. In September 2009, the MEMR wrote a letter to the Ministry of Industry and Trade that frankly discussed options for government acquisition of the assets of KPM and TNG.[16] The MEMR rejected a "gratuitous transfer" because "there were no owners' proposals on gratuitous alienation of the company's assets."[17] The MEMR likewise concluded that "premature termination of contracts" was not an option because "there are no direct grounds to terminate contracts since there are no facts established by law of non-fulfillment of contractual and/or working program obligations," and any contractual disputes could be "sent for review to the Arbitration Institute of the Stockholm Chamber of Commerce."[18] Thus, the MEMR settled on a strategy to acquire the companies through negotiation.[19]

21. Kazakhstan admits that this letter shows that it was evaluating a "solution" to the "problems" posed by Claimants' companies, and that the "solution" was "undoubtedly the transfer of KPM and TNG into state control."[20] According to Kazakhstan, however, the letter only shows that it settled on a plan to acquire the assets in negotiations. Kazakhstan asks, "is it in any way sinister or indicative of unlawful intentions to consider acquiring those assets?"[21]

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[16] Letter from MEMR to the Ministry of Industry and Trade of the Republic of Kazakhstan, September 28, 2009, C-294.

[17] Letter from MEMR to the Ministry of Industry and Trade of the Republic of Kazakhstan, September 28, 2009, C-294.

[18] Letter from MEMR to the Ministry of Industry and Trade of the Republic of Kazakhstan, September 28, 2009, C-294.

[19] Letter from MEMR to the Ministry of Industry and Trade of the Republic of Kazakhstan, September 28, 2009, C-294.

[20] Statement of Defense ¶ 19.26(d).

[21] Statement of Defense ¶ 19.26(d).

What Kazakhstan leaves out, however, is that Claimants *rejected* its offers to buy their companies because the offers were too low.[22] It does not require a great leap of reason to see that Kazakhstan simply revisited the option of premature termination when Claimants continued to resist its harassment campaign and ultimately obtained a buyer, deciding to take its chances in arbitration rather than match the Cliffson offer under its statutory pre-emptive rights and face arbitration claims anyway.

B. Kazakhstan's Obstructionist Conduct in This Arbitration Is the Final Step of Its Strategy to Acquire Claimants' Investments Without Fair Compensation

22. Kazakhstan's deplorable conduct in this arbitration reveals why Kazakhstan ultimately decided to take its chances in arbitration. Kazakhstan does not take its obligations in arbitration any more seriously than its other international legal obligations. Rather, Kazakhstan hopes it can railroad this Tribunal, just like it tried to railroad Claimants, with a barrage of obstructionism, procedural misconduct, and outright deceit.

23. Kazakhstan's procedural misconduct began in early 2011, when Kazakhstan requested the suspension of the arbitration for three months to allow for a settlement negotiation period in order to comply with the "waiting period" requirement in Article 26 of the ECT. Although Claimants believed they had satisfied that requirement already, and knew that the stay very likely would result only in delaying an award in this case, they nevertheless accepted Kazakhstan's proposal in an additional good faith effort to resolve the dispute. As Claimants feared, those negotiations were not successful. Now, however, Kazakhstan argues that the Tribunal lacks jurisdiction because Claimants failed to satisfy the waiting period requirement in Article 26, cynically ignoring the fact that it requested and obtained a three-month stay precisely for that purpose. Plainly, Kazakhstan's only reason for requesting that stay was to delay the proceedings.

24. Kazakhstan's other objections to this Tribunal's jurisdiction also are part of its strategy of obstructionism. In its scorched-earth approach to this case, Kazakhstan raises at least five distinct objections to jurisdiction, each with numerous subparts, that range from simply meritless to patently ludicrous. An example of the latter is its unprecedented argument that the

[22] *See* Section IV.B, *infra*.

arbitration agreement in the ECT is void because of an interpretation of the Russian text that only Kazakhstan (if anyone) can even comprehend.[23] Kazakhstan then presses the Tribunal to bifurcate these minor jurisdictional issues into a separate preliminary hearing, plainly in an effort to delay the ultimate reckoning in this case.

25. Kazakhstan continues this obstructionism in its approach to witnesses and documents. Kazakhstan submitted only four fact witness statements that totaled eight substantive pages and provided mostly conclusory statements on just four topics.[24] Buried in its exhibits, however, Kazakhstan included over twenty letters, reports, and other statements addressing a wide range of topics that were plainly created specifically for this case.[25] These "sleeper" witness statements are not documentary evidence; they present testimonial evidence, including expert testimony, disguised as exhibits. Moreover, those documents do not meet all the requirements for witness statements under Article 4(5) of the IBA Rules on the Taking of Evidence in International Arbitration, such as inclusion of the curriculum vitae of the witness, an affirmation of truth, and signatures. Thus, Kazakhstan plainly hoped to present the bulk of its case without submitting its witnesses for cross-examination, and only agreed to do so when Claimants moved to strike the exhibits otherwise.[26]

26. Moreover, Kazakhstan has egregiously withheld relevant documents in contravention of both this Tribunal's procedural orders and widely-observed practice in international arbitration. Importantly, Kazakhstan did not produce any of the backup documents and data that its experts prepared or relied upon in their reports (including the numerous "sleeper" expert reports that were submitted as exhibits). Article 5(2)(e) of the IBA Rules require such documents to be submitted with the reports, and it is nearly universal practice in international arbitration to do so. Kazakhstan, however, refused to produce its experts' documents based on the unprecedented, and patently ridiculous, argument that parties may only

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[23] Incredibly, Kazakhstan goes even further in its March 12, 2012 submission to the Tribunal, arguing that "the entire treaty shall be recognized null and void" because of this supposed inconsistency in the reference to the Stockholm Chamber of Commerce in the Russian text of the arbitration agreement. Respondent's Comments to the Claimants' Letters of February 16 and 17, 2012, ¶ 2.5.2, C-320.

[24] *See* Karmakov Statement (Kazakhstan's reliance on the Russian text of the ECT); Rakhimov Statement (the criminal trial of Mr. Cornegruta); Turganbayev Statement (the scope of the Financial Police's investigations); Zakharov Statement (the Blagovest letter).

[25] *See* Claimants' Letters to Tribunal, December 8, 2011 and January 5, 2012, C-321 and C-322.

[26] *See* Respondent's Comments to Claimant's Letters of February 16 and 17, 2012, C-320.

request disclosure from other "parties," and not from experts employed or retained by parties.[27] The Tribunal rightly rejected this argument, and ordered the production of these documents by February 17, 2012.[28] Kazakhstan again failed to produce these documents, however, requiring Claimants to submit another request to the Tribunal. The Tribunal again ordered Kazakhstan to produce these documents by April 2, 2012 or risk the Tribunal drawing adverse inferences regarding Kazakhstan's evidence. Only then, under threat of evidentiary sanction, did Kazakhstan disclose its expert documents that should have been disclosed with its expert reports more than four months earlier.

27. Furthermore, the volume of documents that Kazakhstan willfully withheld from Claimants is massive. When Claimants finally received these documents on April 5, 2012 — just eleven days before Claimants' Reply Memorial was originally due — Kazakhstan had produced more than 17,000 documents (comprising more than 30,000 pages). Moreover, nearly all of those documents were in Russian, thus making it even more important that they be produced in a timely fashion. These tactics are a transparent attempt to obstruct Claimants' preparation of their case and force Claimants to seek extensions that result in delays to the procedural schedule.

28. Kazakhstan attempts to justify this conduct with assertions that Claimants have not produced the same documents. That assertion is false, and Kazakhstan's counsel knows it is untrue. When they served their expert reports with their Statement of Claim on May 18, 2011, Claimants delivered a CD containing all the documents relied on by FTI and three DVDs containing all the models and other data relied on by Ryder Scott. In fact, Kazakhstan cites documents produced on those discs in its Statement of Defense,[29] and the documents that Kazakhstan produced on April 5, 2012 included some of Ryder Scott's own documents from those discs.

29. Unfortunately, that is not Kazakhstan's only fabrication in this proceeding. Its Statement of Defense is riddled not only with exaggerations and implausible inferences, but also

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[27] *See* Reply to Claimants' Request for Disclosure of Documents, December 15, 2011, at 6-7, C-323.

[28] *See* Procedural Order No. 2.

[29] Statement of Defense ¶¶ 9.59, 14.8, 14.15 (citing Exhibits 44 and 68 to FTI's Report, May 17, 2011).

with outright misstatements of fact and law. These are discussed at length throughout this Reply, but a few illustrative examples include:

- Kazakhstan cites the 1995 Law on Licensing for its argument that KPM and TNG did not properly amend their subsoil use licenses, but fails to inform the Tribunal that "subsoil use" was excluded from the list of activities regulated by the Law on Licensing by Order of the President No. 2720 dated December 23, 1995;[30]

- Kazakhstan argues that the MEMR was the Competent Authority, rather than the Kazakhstan Agency on Investment, when KPM sought and the Agency on Investment confirmed that its consent was not required with respect to Ascom Group's acquisition of a 62% share of KPM. This is simply wrong, as the very evidence that Kazakhstan cites for this proposition confirms;[31]

- Kazakhstan misquotes or mistranslates the 1994 Law on Foreign Investments (Exhibit R-210) by adding the word "International" before "Chamber of Commerce in Stockholm," in order to make the statute more consistent with its baseless interpretation of the arbitration provision in the Russian-language version of the ECT;[32] and

- Kazakhstan misquotes the definition of a trunk pipeline in Article 1(14) of the Law on Oil, adding the word "storage" to make the definition seem more applicable to KPM's pipelines (which transported oil to its storage facilities).[33]

Given how much of Kazakhstan's case is premised on its interpretation of its own domestic laws, Kazakhstan's outright misrepresentations of the domestic legal regime applicable to Claimants' investments should be of paramount concern.

30. This conduct goes beyond zealous advocacy in a contentious arbitration. Kazakhstan seeks to obscure the truth from this Tribunal and make it as costly, time-consuming, and difficult as possible for Claimants to obtain justice, in furtherance of its strategy of harassment and intimidation. Indeed, if Kazakhstan can bully or mislead this Tribunal into an award favoring Kazakhstan — or even an award for Claimants that undervalues damages — then

[30] Reply Memorial Section II.D.2.e.

[31] "Sleeper" witness statement of Ms. V.I. Lebed, "Information about the license and competent authorities of the Republic of Kazakhstan in period from 1997 to present," R-17.

[32] Law of the Republic of Kazakhstan "On Foreign Investments" No. 266- XIII, Article 17 and 27, December 27, 1994, R-210.

[33] *See* Reply Memorial Section III.C.1.a.

Kazakhstan will have accomplished its objective of seizing Claimants investments for less than fair value, and also can discourage other foreign investors from resisting its coercion in the future based on hope of obtaining redress in arbitration.

31. This Tribunal should not countenance Kazakhstan's outrageous conduct in this arbitration or the underlying dispute. For all the reasons stated herein and in Claimants' Statement of Claim, the Tribunal should find in favor of Claimants, award all the damages requested, and grant Claimants a full award of costs.

II. THE TRIBUNAL HAS JURISDICTION OVER THIS DISPUTE

32. The Tribunal's jurisdiction over this dispute arises from Article 26 of the ECT (Settlement of Disputes between an Investor and a Contracting Party).[34] Article 26(4)(c) of the ECT reads as follows in the English authentic text of the Treaty:

> In the event that an Investor chooses to submit the dispute for resolution under subparagraph (2)(c), the Investor shall further provide its consent in writing for the dispute to be submitted to: . . .
>
> an arbitral proceeding under the Arbitration Institute of the Stockholm Chamber of Commerce.[35]

33. The language of Article 26 is clear that the Arbitration Institute of the Stockholm Chamber of Commerce ("SCC") is the proper forum for this dispute.

A. Kazakhstan Consented to the Submission of Disputes under the ECT to the Arbitration Institute of the Stockholm Chamber of Commerce

34. In its Statement of Defense, Kazakhstan advances the unprecedented contention that "there has been an improper reference to the Swedish Chamber of Commerce" in Article 26(4) of the ECT, and that accordingly "the Arbitral Tribunal should decline jurisdiction."[36] Kazakhstan and one of its "sleeper" experts argue that the Russian language version of the ECT refers to the International Court of Arbitration of the International Chamber of Commerce as the

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[34] Energy Charter Treaty art. 26, *opened for signature* December 17, 1994 (entered into force April 16, 1998), *in* Energy Charter Secretariat, THE ENERGY CHARTER TREATY AND RELATED DOCUMENTS (2004) (hereinafter "Energy Charter Treaty" or "ECT"), C-1.

[35] *Id*. art. 26.

[36] Statement of Defense Section 6.

dispute settlement body, and that the city of Stockholm is merely indicated as the seat of arbitration.[37] This argument is wrong.

35. The Russian version refers to the "Arbitration institute of the international chamber of commerce in Stockholm." This is a clear reference to the Arbitration Institute of the SCC, regardless of the words "international" and "in." This was perfectly understood by the Russian-speaking Contracting Parties to the ECT.

36. The English, French, German, Italian, and Spanish versions of the ECT, which are all authentic versions,[38] unambiguously refer to the Arbitration Institute of the SCC. Kazakhstan admits this,[39] and this alone is sufficient to find that the SCC is the proper forum.

37. Yet even if the language of the Treaty were not clear, Kazakhstan's attempt to evade its consent to submit disputes under the ECT to the Arbitration Institute of the SCC fails upon a proper application of the rules on the interpretation of plurilingual treaties set out in the Vienna Convention on the Law of Treaties (the "Vienna Convention"). Kazakhstan altogether fails to apply these rules of customary international law, but instead relies on a handful of commercial arbitration cases that are neither relevant nor support Kazakhstan's argument.

1. The Russian Version of the ECT Is Not Controlling

38. Kazakhstan's argument that the Russian version of the ECT prevails over the five other authentic versions[40] violates the core principle of interpretation of plurilingual treaties, which is the rule of treaty unity. That rule is enshrined in Article 33(3) of the Vienna Convention, which provides that "[t]he terms of the treaty are presumed to have the same meaning in each authentic text."[41] As Ian Sinclair explained: "while the treaty may be plurilingual in expression, it remains a single treaty with a single set of terms."[42]

39. Similarly, the International Law Commission states:

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[37] Statement of Defense Section 6 and "Sleeper" Expert Opinion of L.Y. Ivanov, R-75.

[38] ECT art. 50, C-1.

[39] Statement of Defense ¶¶ 6.37, 6.38.

[40] Statement of Defense ¶¶ 6.33 *et seq.*

[41] Vienna Convention on the Law of Treaties art. 33(3), *opened for signature* May 23, 1969 (hereinafter "Vienna Convention"), C-203.

[42] Ian Sinclair, THE VIENNA CONVENTION ON THE LAW OF TREATIES 148-49 (2nd ed., Manchester University Press 1984), C-324.

> [I]n law there is only one treaty—one set of terms accepted by the parties and one common intention with respect to those terms—even when two authentic texts appear to diverge… the treaty remains a single treaty with a single set of terms…
>
> The unity of the treaty and of each of its terms is of fundamental importance in the interpretation of plurilingual treaties and it is safeguarded by combining with the principle of equal authority of authentic texts the presumption that the terms are intended to have the same meaning in each text. **This presumption requires that every effort should be made to find a common meaning for the texts before preferring one to another.**[43]

40. Because each text of the ECT is equally authentic, this Tribunal must consider that the terms of each text are intended to have the same meaning. Kazakhstan admits that all versions except the Russian version refer to the Stockholm Chamber of Commerce.[44] Even if Kazakhstan's interpretation of the Russian version were correct, the text of the five other authentic versions must capture the intended common meaning, which is that disputes may be referred to the SCC. The lone outlier – the Russian version – either contains a mistake in drafting or translation, but in either event must be interpreted to conform to the five others.[45]

41. Moreover, Article 33(4) of the Vienna Convention establishes how the Tribunal should resolve a difference in meaning between two or more versions of a plurilingual treaty.[46] It provides, in relevant part:

> when a comparison of the authentic texts discloses a difference of meaning which the application of articles 31 and 32 does not remove, the meaning which best reconciles the texts, having regard to the object and purpose of the treaty, shall be adopted.

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[43] Report of the International Law Commission on the Work of Its Eighteenth Session, *reprinted in* [1966] 2 Y.B. Int'l. L. Comm'n. 224-25, U.N. Doc A/CN.4/Ser.A/1966/Add.1 (emphasis added), C-325. *See also* Expert Opinion by Professor Adnan Amkhan Bayno, May 6, 2012 (hereinafter "Amkhan Opinion"), Section 4.2.

[44] Statement of Defense ¶¶ 6.37, 6.38.

[45] *See* Amkhan Opinion ¶ 149.

[46] Mark E. Villiger, COMMENTARY ON THE 1969 VIENNA CONVENTION ON THE LAW OF TREATIES 461 (Martinus Nijhoff Publishers 2009) ("Article 33 is today generally viewed as reflecting a rule of customary international law…."), C-326; *LaGrand Case (Ger. v. U.S.)*, Judgment, 2001 I.C.J. Rep. 466, ¶ 101 (June 27) ("[P]aragraph 4 of Article 33 of the Vienna Convention on the Law of Treaties, which in the view of the Court again reflects customary international law."), C-327.

42. As summarized in a recent treatise on the law of treaties, when divergent meanings could be said to exist, "[t]he role of Article 33 is precisely to rehabilitate or maintain the unity of meaning of a multilingual treaty."[47] The only way to do that is to interpret the Russian version of the ECT in a manner that conforms to the five other authentic versions.

2. Kazakhstan's Analysis of Article 26 in the Russian Language Is Unavailing

43. Notwithstanding its clear understanding of what Article 26 means, Kazakhstan relies on a hyper-literal parsing of Russian words to make its case that the SCC is not the proper forum here.

44. It contends, among other arguments, that the use of capitalization affects the meaning, in that "Arbitration institute" with a capital "A" refers to the International Court of Arbitration of the International Chamber of Commerce based in Paris (with an office in Stockholm).[48] There is no support for that argument,[49] but there is evidence to the contrary. The list of state-investor disputes published on the official website of the ECT refers (in Russian) to the (capital "A") "Arbitration institute of international chamber of commerce in Stockholm" as a forum for SCC cases.[50]

45. Nor is the use of the word "international" determinative of the meaning. In Russian language publications, the SCC is often referred to as an international chamber of commerce. For example, both ways of referring to the SCC (*i.e.*, with and without the word "international") are used in publications of a prominent Russian specialist in the energy sphere, Dr. Andrey A. Konoplyanik, who served as Deputy Secretary General of the Energy Charter Secretariat between 2002 and 2008.[51]

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[47] THE VIENNA CONVENTIONS ON THE LAW OF TREATIES – A COMMENTARY 870, 872 (Oliver Corten & Pierre Klein eds., Oxford University Press 2011), C-328.

[48] Statement of Defense ¶¶ 6.7, 6.10.

[49] Although the interpretation of the ECT is a legal question, Kazakhstan only provided an opinion from a Russian linguist, Mr. Ivanov. (*See* "Sleeper" Expert Opinion of L.Y. Ivanov, R-75) Kazakhstan's linguistic interpretation is unpersuasive.

[50] Investor-State Dispute Settlement Cases from the Energy Charter website, *available at* http://www.encharter.org/index.php?id=213&L=1 (last visited April 4, 2012), C-329.

[51] List of publications by Dr. Konoplyanik, *available at* http://www.encharter.org/index.php?id=333 (last visited April 4, 2012), C-330.

46. Kazakhstan also suggests that the words "in Stockholm" mean the seat of arbitration, rather than the arbitral forum. There is no support for that contention, and the context of Article 26(4)(c) indicates that "in Stockholm" refers to the location of the "International chamber of commerce" rather than the seat of arbitration. The other arbitration options under Article 26(4)—ICSID, ICSID Additional Facility, and *ad hoc* arbitration under the UNCITRAL Rules—do not specify the seat of arbitration. Moreover, there is an entirely separate paragraph discussing the seat of arbitration (Article 26(5)(b)). It would not be logical or consistent with the structure of the treaty for the Contracting Parties to specify the seat for one arbitration option but not for any of the others, and to include that lone reference in the section on arbitral forum rather than the section devoted to the seat of arbitration.

47. Further, a number of official documents of Kazakhstan refer to the SCC as the "Chamber of Commerce in Stockholm." For instance, the bilateral investment treaty ("BIT") between Kazakhstan, Belgium, and Luxemburg refers to the "Chamber of Commerce in Stockholm."[52] That treaty also refers to the "International Chamber of Commerce in Paris." In both cases "in" refers to the location of the chambers of commerce, not the seat of arbitration. Similarly, the Egypt-Kazakhstan BIT refers to the "rules of International Arbitration Institution of the Chamber of Commerce in Stockholm" and to the "President of International Arbitration Institution of the Chamber of Commerce in Stockholm" as the appointing authority.[53] This shows that "in Stockholm" relates to the institution rather than to the seat of arbitration, and that Kazakhstan commonly use the words "in Stockholm" to refer to the SCC.

48. The Law of Kazakhstan on Foreign Investment also provides for arbitration proceedings under the "Arbitration Institute of the Chamber of Commerce in Stockholm"

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[52] Agreement Between the Government of the Republic of Kazakhstan, on the one hand and the Belgo-Luxemburg Economic Union, on the other hand, on the Reciprocal Promotion and Protection of Investments, April 16, 1998, art. 10 (entered into force on February 6, 2001) ("As long as this requirement is not met, each Contracting Party agrees that the dispute shall be submitted to arbitration pursuant to the Rules of the Additional Facility of the I.C.S.I.D.; the Arbitral Court of the International Chamber of Commerce in Paris; the Arbitration Institute of the Chamber of Commerce in Stockholm."), C-331.

[53] Agreement between Government of Arab Republic of Egypt and Government of Kazakhstan on Promotion and Protection of Investment, February 14, 1993, arts. 9(2), 9(3) (entered into force August 8, 1996), C-332.

(paragraph 2(c) of Article 27),[54] which further confirms that "in Stockholm" is a wording frequently used when referring to the SCC.

3. The Legal Support Upon Which Kazakhstan Relies Is Unavailing

49. The commercial arbitration cases Kazakhstan relies upon do not support its conclusion that Article 26(4)(c) of the ECT refers to ICC arbitration in Stockholm. Those cases involved arbitration clauses with different wording. For instance, the arbitration clause examined in Exhibit R-82 contained the phrase "Rules of Arbitration of the International Chamber of Commerce," which is the common way to refer to the ICC Rules (*see* the standard ICC arbitration clause published by the ICC).[55] The arbitration clauses mentioned in Exhibits R-84 and R-85 referred clearly to ICC arbitration — without any ambiguity as to the institution (since they used the wording "International Chamber of Commerce" or "ICC"). Moreover, the references in those clauses to ICC arbitration in a city other than Paris made it logical in those contexts to interpret the city as a reference to the seat of arbitration rather than the location of the institution.

50. Kazakhstan has not cited a single other instance when an ECT Contracting Party interpreted Article 26(4)(c) of the ECT as referring to an arbitral institution other than the SCC.[56] To Claimants' knowledge, no respondent state has ever made such a preposterous argument. Rather, the practice of Contracting Parties, including that of Russian-speaking states, uniformly supports the conclusion that Article 26(4)(c) refers to the SCC.

51. In addition, the publications of the ECT Secretariat consistently refer to Article 26 of the ECT providing for SCC arbitration, not ICC arbitration.[57] No state has objected to those publications (to Claimants' knowledge). Kazakhstan does not contend otherwise.

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[54] Law of the Republic of Kazakhstan "On Foreign Investments" No. 266- XIII, Article 17 and 27, December 27, 1994, R-210.

[55] Standard ICC arbitration clause published by the ICC, C-333.

[56] Regarding Kazakhstan's fallacious and absurd argument that the arbitration agreement violates the *jus cogens* principle of sovereign equality of States, Claimants refer Respondent and the Arbitral Tribunal to Professor Amkhan's explanations. *See* Amkhan Opinion ¶¶ 150-159.

[57] *See*, *e.g.*, Energy Charter Secretariat, THE ENERGY CHARTER TREATY – A READER'S GUIDE 53, C-264.

52. It is thus unsurprising that, in all SCC arbitrations involving Russian-speaking states brought under the ECT to date, the respective tribunals accepted jurisdiction. The respondent states in those cases were Kyrgyzstan and Tajikistan, where Russian is an official language, and Ukraine and Latvia where Russian is widely used in practice. None of those respondent states — nor the arbitral tribunals in those cases — raised any doubt as to whether Article 26(4)(c) referred to the SCC.[58]

B. Claimants Complied With the Three Month "Waiting Period" Requirement under Article 26(2) of the ECT

53. Article 26 of the ECT provides, in relevant part, that:

> (1) Disputes between a Contracting Party and an Investor of another Contracting Party . . . shall, if possible, be settled amicably.
>
> (2) If such disputes can not be settled according to the provisions of paragraph (1) within a period of three months from the date on which either party to the dispute requested amicable settlement, the Investor party to the dispute may choose to submit it for resolution. . . .

[58] *Petrobart Ltd. v. Kyrgyz Republic*, SCC Arb. No. 126/2003, Award, March 29, 2005 (hereinafter "*Petrobart* Award"), C-204; *Nykomb Synergetics Technology Holding AB v. Latvia*, SCC Arb. No. 118/2001, Award, December 16, 2003 (hereinafter "*Nykomb* Award"), C-281; *Limited Liability Company Amto v. Ukraine*, SCC Arb. No. 80/2005, Award, March 26, 2008 (hereinafter "*Amto* Award"), C-334; *Al-Bahloul v. Tajikistan*, SCC Case No. V (064/2008), Partial Award on Jurisdiction and Liability, September 2, 2009 (hereinafter "*Al-Bahloul* Partial Award"), R-181. We also note that, in addition to these cases, two ECT arbitrations are currently pending under the auspices of the SCC against states in which Russian is widely used: *Mercuria Energy Group Ltd. (Cyprus) v. Poland* and *Remington Worldwide Ltd. (UK) v. Ukraine*. *See* list of ECT arbitrations, with an indication of the arbitration forum, *available at* http://www.encharter.org/index.php?id=213 (last visited March 27, 2012), C-335. Legal authorities also fully support the conclusion that Article 26(4)(c) refers to the SCC. *See*, *e.g.*, Ilias Bantekas, *International Oil and Gas Dispute Settlement and its Application to Kazakhstan*, *in* OIL AND GAS LAW IN KAZAKHSTAN: NATIONAL AND INTERNATIONAL PERSPECTIVES 225, 239 (Ilias Bantekas *et al.* eds., Kluwer Law International 2004), C-336. Kazakhstan has not cited a single authority stating otherwise (leaving aside the "Sleeper" "Expert" Opinion (R-75) it produced in this arbitration, which suffers the same flaws as Kazakhstan's Statement of Defense). One illustration is the Kazakh law research system "Paragraph," which is the most widely used and most trusted research system for Kazakh law, and which Kazakhstan itself has used in this arbitration as the source for some of the authorities it produces. In this research system, when one opens a law, there are hyperlinks related to particular paragraphs or words. If one follows the link, it leads you to related legal documents. When one opens the Russian language version of the ECT in "Paragraph," there is an hyperlink related to the phrase "Arbitration institute under the international chamber of commerce in Stockholm," which, when one clicks on it opens the SCC Rules of Arbitration. In short, the leading Kazakh law research system supports the conclusion that Article 26(4)(c) of the ECT provides for SCC arbitration. *See* Screen shots of the ECT and hyperlinks in the "Paragraph" system, C-337.

54. Kazakhstan contends in its Statement of Defense that "the requirement of 'cooling-off period' [under Article 26(2)] was not met by the Claimants" and that the "Arbitral Tribunal accordingly does not have jurisdiction."[59] Kazakhstan is incorrect. Satisfaction of the "waiting period" is not a bar to jurisdiction,[60] but in any event, Claimants complied with the waiting period in this case.

1. The "Waiting Period" Requirement Under Article 26(2) of the ECT Is Not a Bar to the Tribunal's Jurisdiction

55. The attempt at amicable settlement mentioned in Article 26(2) of the ECT is of a procedural nature, and not of a jurisdictional nature as contended by Kazakhstan. Therefore, even if it had not been complied with, it would not a bar to this Tribunal's jurisdiction over the present dispute.

56. The vast majority of arbitral tribunals called upon to decide on jurisdictional objections relating to a claimant's alleged failure to comply with a so-called "waiting period" have characterized the waiting period as a procedural matter, rather than a jurisdictional requirement. They have retained jurisdiction notwithstanding alleged failures to comply with the procedure. Procedural economy dictates that solution. Denying jurisdiction on the basis of a failure to comply with a "waiting period" would simply force a claimant to re-start proceedings a few months later, which would neither be cost-effective nor in either party's interest.

57. As summarized by Professors Dolzer and Schreuer:

> The view that periods foreseen for negotiations are not of a jurisdictional nature is preferable. By the time the tribunal makes a decision on this issue, any waiting period is likely to have elapsed.

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[59] Statement of Defense Section 7.

[60] *See Maffezini v. Spain*, ICSID Case No. ARB/97/7, Decision on Jurisdiction, January 25, 2000 (hereinafter "*Maffezini* Decision on Jurisdiction"), ¶ 97 ("While a dispute may have emerged, it does not necessarily have to coincide with the presentation of a formal claim."), C-338; *Link-Trading Joint Stock Co. v. Moldova*, UNCITRAL, Award on Jurisdiction, February 16, 2001 (hereinafter "*Link-Trading* Award on Jurisdiction"), ¶ 6 at 5 (The tribunal found that the formal complaint sent by the claimant "represented the culmination, not the inception, of the dispute."), C-339. *See also Consorzio Groupement L.E.S.I.- DIPENTA v. Algeria*, ICSID Case No. ARB/03/08, Award, January 10, 2005 (hereinafter "*L.E.S.I.* Award"), Section II, ¶ 32 (iv), C-340. Also relevant is the ICJ's holding in the *Nicaragua* case that the negotiations described by the dispute-resolution clause need not include mention or discussion of the underlying treaty itself: "In the view of the Court, it does not necessarily follow that, because a State has not expressly referred in negotiations with another State to a particular treaty as having been violated by conduct of that other State, it is debarred from invoking a compromissory clause in that treaty." *Case Concerning Military and Paramilitary Activities in and against Nicaragua (Nicar. v. U.S.)*, 1984 I.C.J. Rep. 392, 428-29, ¶ 83 (Nov. 26), C-341.

> Under these circumstances, insistence on the compliance with the waiting period before the institution of proceedings would make little sense and would merely compel the claimant to start proceedings anew.[61]

In his recent treatise on investment arbitration, Professor Douglas takes the same view as Professors Dolzer and Schreuer on this issue.[62]

58. In the *Lauder* case, the tribunal found that the claimant had failed to comply with a six-month waiting-period under the applicable BIT by filing its Request for Arbitration 17 days after the notice letter.[63] The tribunal did not consider that this failure was a bar to its jurisdiction. The tribunal retained jurisdiction, stating:

> [T]he Arbitral Tribunal considers that this requirement of a six-month waiting period of Article VI(3)(a) of the Treaty is not a jurisdictional provision, *i.e.* a limit set to the authority of the Arbitral Tribunal to decide on the merits of the dispute, but a procedural rule that must be satisfied by the Claimant... As stated above, the purpose of this rule is to allow the parties to engage in good-faith negotiations before initiating arbitration. …
>
> To insist that the arbitration proceedings cannot be commenced until 6 months after the … Notice of Arbitration would, in the circumstances of this case, amount to an unnecessary, overly formalistic approach which would not serve to protect any legitimate interests of the Parties.
>
> Therefore, the Arbitral Tribunal holds that the requirement of the six-month waiting period in Article VI(3)(a) of the Treaty does not preclude it from having jurisdiction in the present proceedings.[64]

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[61] Rudolf Dolzer & Christoph Schreuer, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW 248-49 (Oxford University Press 2008), C-219. *See also* Martina Polasek, *The Consultation Period Requirement in Investment Treaties as a Matter of Jurisdiction, Admissibility or Procedure*, 23(1) News from ICSID 14, 16 (2006) ("While few cases have indicated that the requirement to consult and negotiate is a matter of jurisdiction or admissibility, several have qualified it as a matter of procedure."), C-342.

[62] Zachary Douglas, THE INTERNATIONAL LAW OF INVESTMENT CLAIMS 159-60 (Cambridge University Press 2009) ("The answer is that it clearly goes to the seisin of the tribunal rather than jurisdiction. It would be extraordinary, for instance, if the court at the seat of arbitration could entertain an application to quash the tribunal's award because it deemed the dispute to have arisen too early, or ruled that any negotiation was futile in light of the host state's conduct. And yet that would be the consequence of characterizing the issue as one of jurisdiction."), C-343.

[63] *Lauder v. Czech Republic*, UNCITRAL, Final Award, September 3, 2001 (hereinafter "*Lauder* Award"), ¶¶ 186-89, C-344.

[64] *Lauder* Award ¶¶ 187, 190-91, C-344.

59. In *Wena v. Egypt*, in accepting the respondent's offer to withdraw its objection to jurisdiction based on Wena's alleged failure to comply with the three-months waiting period under the applicable BIT, the tribunal viewed the requirement as procedural.[65] Likewise, in the *SGS v. Pakistan* case, the tribunal held:

> Tribunals have generally tended to treat consultation periods as directory and procedural rather than as mandatory and jurisdictional in nature. Compliance with such a requirement is, accordingly, not seen as amounting to a condition precedent for the vesting of jurisdiction. … Finally, it does not appear consistent with the need for orderly and cost-effective procedure to halt this arbitration at this juncture and require the Claimant first to consult with the Respondent before re-submitting the Claimant's BIT claims to this Tribunal.[66]

60. In *Bayindir v. Pakistan*, the tribunal also held that the claimant's failure to comply with a waiting period under the applicable BIT did not affect its jurisdiction. It stated:

> The Tribunal agrees with the view that the notice requirement does not constitute a prerequisite to jurisdiction. Contrary to Pakistan's position, the non-fulfilment of this requirement is not "fatal to the case of the claimant" … As Bayindir pointed out, to require a formal notice would simply mean that Bayindir would have to file a new request for arbitration and restart the whole proceeding, which would be to no-one's advantage ...
>
> Along the lines of the award rendered in *Lauder v. The Czech Republic*, the Tribunal is prepared to find that preventing the commencement of the arbitration proceedings until six months after the … notification would, in the circumstances of this case, amount to an unnecessary, overly formalistic approach which would not serve to protect any legitimate interests of the Parties and hold "that the six-month waiting period in [the BIT] does not preclude it from having jurisdiction in the present proceedings."[67]

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[65] *Wena Hotels, Ltd. v. Egypt*, ICSID Case No. ARB/98/4, Decision on Jurisdiction, June 29, 1999 (hereinafter "*Wena* Decision on Jurisdiction"), Section VII, 41 I.L.M. 881, 891 (2002), C-345.

[66] *SGS Société Générale de Surveillance S.A. v. Pakistan*, ICSID Case No. ARB/01/13, Decision on Jurisdiction, August 6, 2003 (hereinafter "*SGS* Decision on Jurisdiction"), ¶ 184 (footnote omitted), C-346.

[67] *Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. (Scedil) v. Pakistan*, ICSID Case No. ARB/03/29, Decision on Jurisdiction, November 14, 2005 (hereinafter "*Bayindir* Decision on Jurisdiction"), ¶¶ 100, 102 (footnotes omitted), R-208.

61. In *Occidental v. Ecuador*, the tribunal noted Ecuador's own acknowledgment at the hearing that "this is not an objection to jurisdiction that has fared extremely well in many cases," as well as Claimant's argument that the waiting-period requirement need not be respected if attempts at a negotiated solution have proven futile.[68] The Tribunal found that "attempts at reaching a negotiated solution were indeed futile in the circumstances," and as a result, it rejected Ecuador's objection.[69]

62. Most recently, in the *Paushok* case, the tribunal held, with reference to the *SGS v. Pakistan* and *Lauder v. Czech Republic* decisions, that "*[a]rguendo*, even if they had failed to abide by the negotiating period, this would not go to jurisdiction, as that delay has long expired."[70]

63. In view of the above, the jurisprudence by investment treaty tribunals on "waiting periods" is, with rare exceptions, consistent in characterizing "waiting" periods as procedural requirement which do not affect jurisdiction. As stressed by the tribunal in the *Bayindir v. Pakistan* case, a tribunal should not depart from a consistent list of case authority unless there are compelling reasons to do so.[71] Kazakhstan has not pointed to any such compelling reasons in the present case. There are none.

64. Should the Tribunal consider that the requirement to observe a "waiting period" is not a procedural requirement, the most appropriate alternative characterization would be to regard the requirement as one of admissibility, not of jurisdiction.[72] In the *Western NIS* case

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[68] *Occidental Petroleum Corp. v. Ecuador*, ICSID Case No. ARB/06/11, Decision on Jurisdiction, September 9, 2008 (hereinafter "Occidental Decision on Jurisdiction"), ¶¶ 91-92, C-347.

[69] *Id.* ¶ 94, C-347.

[70] *Paushok v. Mongolia*, UNCITRAL, Award on Jurisdiction and Liability, April 28, 2011 (hereinafter "*Paushok* Award"), ¶ 220, C-348.

[71] *Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. v. Pakistan*, ICSID Case No. ARB/03/29, Award, August 27, 2009 (hereinafter "*Bayindir* Award"), ¶ 145 ("The Tribunal is not bound by previous decisions of ICSID tribunals. At the same time, it is of the opinion that it should pay due regard to earlier decisions of such tribunals. The Tribunal is further of the view that, unless there are compelling reasons to the contrary, it ought to follow solutions established in a series of consistent cases, comparable to the case at hand, but subject of course to the specifics of a given treaty and of the circumstances of the actual case. By doing so, it will meet its duty to seek to contribute to the harmonious development of investment law and thereby to meet the legitimate expectations of the community of States and investors towards certainty of the rule of law.") (footnote omitted), C-349.

[72] Martina Polasek, *The Consultation Period Requirement in Investment Treaties as a Matter of Jurisdiction, Admissibility or Procedure*, 23(1) News from ICISD 14, 16 (2006) ("The decisions in *WNISEF and SGS v. Philippines* … imply that the tribunals in those cases had the power to suspend the proceedings while the

relied on by Kazakhstan in its correspondence with Claimants,[73] the tribunal found that the claimant had not given notice to the respondent as required under the applicable BIT.[74] The tribunal however concluded that this defect could be cured by a suspension of the proceeding for the duration of the "waiting period."[75] In doing so, the tribunal effectively treated the requirement as one of admissibility, not jurisdiction.

65. Kazakhstan disregards the well-established line of case law on this issue and relies on a distinctly minority view espoused in two cases, *Murphy Oil v. Ecuador* and *Burlington v. Ecuador*.[76] Those cases are distinguishable from the present case on the facts, notably insofar as they did not involve a stay of the arbitration for the parties to conduct settlement negotiations.

2. Claimants Had Complied With the "Waiting Period" Requirement at the Time They Filed Their Request for Arbitration

66. As explained in their Statement of Claim and subsequent correspondence, Claimants had complied with the "waiting period" requirement at the time they filed their Request for Arbitration on July 26, 2010.[77]

67. The "waiting period" runs from the date on which Kazakhstan became aware of the dispute, not from the date on which Claimants formalized their claims, as Kazakhstan seems to contend. Tribunals have repeatedly favored a non-formalistic approach to this issue. As a recent example, the *Paushok* tribunal found that the claimant had abided by a six-month negotiating period requirement based on "uncontested evidence that, as early as May 2006 and on numerous occasions subsequently, Claimant Paushok raised with senior officials, ministers

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impediment to hearing the case was being rectified. A tribunal which would conclude that it has no jurisdiction would have no such power."), C-342.

73 Letters from Curtis, Mallet-Prevost, Colt & Mosle to King & Spalding, January 18 and February 6, 2011, C-350 and C-351. *Western NIS Enterprise Fund v. Ukraine*, ICSID Case No. ARB/04/2, Order, March 16, 2006 (hereinafter "*Western* NIS Order"), C-352.

74 *Western NIS* Order ¶¶ 5-6, C-352.

75 *Western NIS* Order ¶¶ 7-8, C-352 .

76 Letters from Curtis, Mallet-Prevost, Colt & Mosle to King & Spalding, January 18 and February 6, 2011, C-350 and C-351.

77 Request for Arbitration ¶¶ 109-110; Statement of Claim ¶¶ 38-40; and letter from King & Spalding to Curtis, Mallet-Prevost, Colt & Mosle, February 2, 2011, C-353.

and even the President of Mongolia the issue of the negative impact of the [windfall profit tax] upon GEM and investors in the gold mining industry."[78]

68. In the present case, Claimants raised on numerous occasions with Kazakh officials prior to initiating this arbitration the facts at the core of the present dispute, as well as their intention to submit the present dispute to international arbitration.[79] They did so from at least March 2009 onward, some 15 months before filing their Request for Arbitration. Those efforts were futile, and Kazakhstan studiously ignores them in its Statement of Defense.

69. Tribunals have emphasized that compliance with "waiting periods" is not required where it would have been futile. This was re-affirmed most recently by the tribunal in the *Abaclat* case.[80]

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[78] *Paushok* Award ¶¶ 218-19, C-348.

[79] Statement of Claim ¶¶ 38-39. *See* also Letter from Ascom and Terra Raf to President Nazarbayev, May 7, 2009, C-43.

[80] *Abaclat and Others (Case formerly known as Giovanna a Beccara and Others) v. Argentine Republic*, ICSID Case No. ARB/07/5, Decision on Jurisdiction and Admissibility, August 4, 2011 (hereinafter "*Abaclat* Decision on Jurisdiction and Admissibility"), ¶¶ 563-66, C-354:

> In addition, even if it considered the present circumstances not sufficient to comply with the consultation requirement of Article 8(1) BIT, this would still not constitute a hurdle to the admissibility of Claimants' claims for the following reason:
>
> In the view of the Tribunal, the consultation requirement set forth in Article 8(1) BIT is not to be considered of a mandatory nature but as the expression of the good will of the Parties to try firstly to settle any dispute in an amicable way:
>
> — This derives first from the wording of Article 8(1) BIT which provides that consultations should be conducted "*en la medida del possible*" or "*per quanto possibile*," *i.e.*, "to the extent possible." Indeed, Article 8(1) BIT is not drafted in any way as to impose the consultation requirements upon the Parties under any circumstances. It only refers to the possibility of such amicable settlement talks, whereby such term is to be reasonably understood as referring not only to the technical possibility of settlement talks, but also to the possibility, i.e. the likelihood, of a positive result.
>
> — It also derives from the general purpose and aim of such provision, which is to allow amicable settlement where such settlement is wanted and supported by both Parties. Where one or both Parties did not have the good will to resort to consultation as an amicable means of settlement, it would be futile to force the Parties to enter into a consultation exercise which is deemed to fail from the outset. Willingness to settle is the *sine qua non* condition for the success of any amicable settlement talk.
>
> As such, the Tribunal considers that a potential non-compliance with the consultation requirement set forth in Article 8(1) BIT would simply express that the premises for an amicable settlement were not given because one or both of the Parties were not willing to give the dispute an amicable end. As such, it could not be considered to constitute *per se* a hurdle to the admissibility of the claim, thereby preventing any other dispute resolution means provided in Article 8 BIT to come to play.
>
> (d) Conclusion

70. Similar to the wording of the treaty in the *Abaclat* case, Article 26 of the ECT requires that the dispute be settled amicably "if possible." Kazakhstan's conduct prior to the commencement of this arbitration including its steadfast unwillingness to address Claimants' grievances, discuss a resolution, or alter its course of conduct (which resulted in a total expropriation of Claimants' investments), demonstrates that it was not possible to settle this dispute amicably. The (one) failed settlement meeting which took place in 2011, during the settlement period subsequently agreed by the parties, did nothing to alter that conclusion.[81]

3. Claimants Agreed To Stay the Arbitration in February 2011 In Order to Give Kazakhstan An Additional Three Month Period

71. As explained above, the "waiting period" provision in the ECT is not a jurisdictional requirement, and even if it were, Claimants complied with it before filing their Request for Arbitration. Nevertheless, if any doubt remains, Claimants indisputably satisfied the "waiting period" requirement through their agreement to a suspension of the arbitration for three months in 2011.

72. In early 2011, Kazakhstan requested the suspension of the arbitration expressly to allow a negotiation period in order to comply with Article 26 of the ECT. Claimants denied that they had failed to comply with the "waiting period" requirement, but nevertheless accepted Kazakhstan's proposal to suspend the arbitration in an additional good faith effort to resolve the dispute (even though the stay resulted in substantial delays to the procedural calendar).[82] As acknowledged by Kazakhstan in its Statement of Defense, "the parties agreed and the Arbitral

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> In conclusion and in (partial) response to Issue No. 4, the Tribunal holds that the prior consultation requirement set forth in Article 8(1) BIT does not constitute an impediment to the admissibility of Claimants' claims. In particular: . . .
>
> (iii) Even if Claimants were considered not to have fulfilled this requirement, this non-compliance would simply express that the premises for an amicable settlement were not given and cannot be interpreted as constituting a hurdle to the admissibility of Claimants' claims.

[81] The *Lauder* case further offers an example of a tribunal taking into consideration the conduct of the parties after the filing of the notice of arbitration, and whether they had then been willing to engage into negotiations, in determining whether a requirement to observe a "waiting period" had been complied with. The *Lauder* tribunal indeed noted that had the respondent been willing to engage in negotiation with the claimant, it could have done so after the filing of the notice of arbitration, which in that case it had not. *Lauder* Award ¶¶ 184-91, C-344. In the present case, the fact that settlement negotiations took place after the arbitration was commenced and failed a fortiori shows that pre-arbitration negotiations would have been futile.

[82] Letters from King & Spalding to Curtis, Mallet-Prevost, Colt & Mosle, January 24 and February 2, 2011, C-355 and C-353.

Tribunal awarded by consent on 22 February 2011, a stay of the proceedings with the intention of providing a window for settlement… Procedurally, therefore, the provisions of Article 26(2) have now been met."[83] By agreement of the parties, the Tribunal suspended the arbitration from February 16 to May 16, 2011.[84] During that period, Claimants attempted settlement negotiations, which resulted in Kazakh officials attending one meeting in London on March 10, 2011. The meeting led nowhere, and the arbitration therefore proceeded at the expiry of the suspension period.

73. Having demanded and agreed to the suspension of the arbitration for the express purposes of complying with the "waiting period" in Article 26 of the ECT,[85] it is preposterous for Kazakhstan now to contend that the Tribunal has no jurisdiction over the dispute because Claimants failed to comply with the "waiting period" in Article 26.[86]

74. Kazakhstan's own statements belie its recent contention that Claimants' alleged initial failure to comply with a "waiting period" requirement is an incurable defect.[87] In its January 18, 2011 letter to the Tribunal, Kazakhstan expressly stated that the suspension of the arbitration for three months would ensure compliance with the "waiting period" requirement of Article 26(2) of the ECT. At the time, Kazakhstan stated:

> [W]e propose that the Tribunal order Claimants to engage in amicable settlement discussions as required by Article 26 of the ECT, and that ***the proceedings be suspended during the three-***

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83 Statement of Defense ¶¶ 7.2, 7.3.

84 Email from King & Spalding to the Arbitral Tribunal, February 14, 2011, C-356; email from King & Spalding to the Arbitral Tribunal, February 16, 2011, C-357; and email from the Arbitral Tribunal, February 22, 2011, C-358. The suspension of the arbitration lasted 3 months.

85 Letter from Curtis, Mallet-Prevost, Colt & Mosle to the Arbitral Tribunal, January 18, 2011, C-350; letter from King & Spalding to Curtis, Mallet-Prevost, Colt & Mosle, January 24, 2011, C-355; email from the Arbitral Tribunal, February 1, 2011, C-359; letter from King & Spalding to Curtis, Mallet-Prevost, Colt & Mosle, February 2, 2011, C-353; and letter from Curtis, Mallet-Prevost, Colt & Mosle to King & Spalding, February 6, 2011, C-351.

86 Statement of Defense ¶ 7.4.

87 Letters from Curtis, Mallet-Prevost, Colt & Mosle to King & Spalding, January 18 and February 6, 2011, C-350 and C-351. *Western NIS* Order ¶¶ 4-10, C-352. *See also Wena* Decision on Jurisdiction Section VII, 41 I.L.M. at 891, C-345, in which the tribunal, in accepting the respondent's offer to withdraw its objection to jurisdiction based on Wena's alleged failure to comply with the three months waiting period under the applicable BIT, similarly envisaged that such a failure could in any event have been rectified. It stated as follows: "As Respondent appropriately noted, even if these procedural objections were granted, they could have been easily rectified and would have had little practical effect other than to delay the proceedings." *Wena* Decision on Jurisdiction Section VII, 41 I.L.M. at 891, C-345.

> ***months period in satisfaction of that jurisdictional requirement***. We offer this as a practical solution that best serves the interests of the parties notwithstanding the fact that this jurisdictional defect could result in dismissal after full briefing and hearing on the merits.[88]

75. Kazakhstan cannot now in good faith contend that the parties' agreed suspension did not cure any alleged failure by Claimants to comply with the "waiting period." Nor has Kazakhstan cited any authority to support its contention that a tribunal should deny jurisdiction where a party did not comply with a "waiting period" prior to commencing arbitration, but where the parties agreed thereafter to suspend the arbitration in order to satisfy the procedural requirement. In particular, the two minority, outlier cases cited by Kazakhstan (*Murphy v. Ecuador* and *Burlington v. Ecuador*) did not involve any stay of the arbitration by agreement of the parties for the duration of the "waiting period" to hold settlement negotiations. In the two cases that considered the possibility of a suspension of proceedings (*Western NIS* and *Wena*), the tribunals accepted that such a suspension could cure an initial failure to comply with a "waiting period."

C. Claimants Are "Investors" Within the Meaning of the ECT

76. In its Statement of Defense, Kazakhstan contends that this Tribunal has no jurisdiction *ratione personae* because "[n]one of the Claimants have demonstrated that they are 'investors' under the ECT."[89] That is wrong.

77. The ECT defines "Investor" as follows:

> "Investor" means:
>
> (a) with respect to a Contracting Party:
>
> (i) a natural person having the citizenship or nationality of or who is permanently residing in that Contracting Party in accordance with its applicable law;
>
> (ii) a company or other organization organized in accordance with the law applicable in that Contracting Party.[90]

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[88] *See also* Letter from Curtis, Mallet-Prevost, Colt & Mosle to King & Spalding, February 6, 2011 (emphasis added), C-351.

[89] Statement of Defense Section 8.

78. The Tribunal's jurisdiction is governed by the express terms of the Treaty.[91] Kazakhstan cannot be allowed to add requirements to the jurisdiction of this Tribunal that are not found in the text of the treaty, which is effectively what Kazakhstan attempts to do with this objection.[92] Each of the four Claimants qualifies as an "investor" within the definition set forth in the ECT.

1. Anatolie Stati and Gabriel Stati

79. Under the ECT, "Investor means… (i) a natural person having the citizenship or nationality of ***or*** who is permanently residing in that Contracting Party in accordance with its applicable law."[93] Mr. Anatolie Stati and Mr. Gabriel Stati each hold the nationality of Moldova and Romania. Moldova and Romania are Contracting Parties to the ECT.[94] Messrs. Anatolie and Gabriel Stati are therefore qualified "Investors" under the ECT. That is the end of the inquiry.

80. With respect to Mr. Gabriel Stati, Kazakhstan argues that "the fact of citizenship [of Moldova and Romania] is not confirmed by any documents. No passport copies [have] been provided."[95] In its Statement of Claim, however, Claimants provided copies of Gabriel Stati's Moldovan and Romanian identification cards, as well as Mr. Anatolie Stati's Moldovan and Romanian identification cards and passports.[96] Kazakhstan argues that "Claimants have not proved that the aforementioned documents confirm citizenship."[97] As recently emphasized by

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90 ECT art. 1(7), C-1.

91 *Saluka Investments B.V. v. Czech Republic*, UNCITRAL, Partial Award, March 17, 2006 (hereinafter "*Saluka* Partial Award"), ¶ 193, C-259.

92 Amkhan Opinion ¶¶ 40, 72-73; *Saluka* Partial Award ¶ 241, C-259. *See also Yukos Universal Ltd. (Isle of Man) v. Russian Federation*, PCA Case No. AA 227, Interim Award on Jurisdiction and Admissibility, November 30, 2009 (hereinafter "*Yukos* Interim Award"), ¶¶ 413-17, C-360; *Hulley Enterprises Ltd. (Cyprus) v. Russian Federation*, PCA Case No. AA 226, Interim Award on Jurisdiction and Admissibility, November 30, 2009 (hereinafter "*Hulley* Interim Award"), ¶¶ 413-17, C-361; and *Veteran Petroleum Ltd. (Cyprus) v. Russian Federation*, PCA Case No. AA 228, Interim Award on Jurisdiction and Admissibility, November 30, 2009 (hereinafter "*Veteran* Interim Award"), ¶¶ 413-17, C-362.

93 ECT art. 1(7) (emphasis added), C-1.

94 Date of the ECT's entry into force for Moldova, Romania, and Kazakhstan, C-28.

95 Statement of Defense ¶ 8.62(a).

96 Anatolie Stati's Moldovan and Romanian identification cards and passports, C-29; Gabriel Stati's Moldovan and Romanian identification cards, C-30.

97 Statement of Defense ¶ 8.62(a).

the tribunal in the *Al-Bahloul* case, a copy of a passport or of other official documents (e.g., a certificate of naturalization) is *prima facie* proof of nationality, and is sufficient to establish the nationality of a claimant where "there is nothing in the record casting doubt on the authenticity or validity of these documents."[98] Moreover, tribunals have concluded that identification cards are equally probative as passports on issues of nationality.[99] Regardless, Claimants submit copies of Mr. Gabriel Stati's Moldovan and Romanian passports with this Reply.[100] Accordingly, it is established that both Anatolie Stati and Gabriel Stati are nationals of a Contracting Party — actually of two, Moldova and Romania — and therefore qualify as "investors" within the meaning of Article 1(7) of the ECT.[101]

81. Kazakhstan's other arguments that Anatolie Stati and Gabriel Stati are not "investors" are either wrong or irrelevant.[102] First, Kazakhstan's contention that Mr. Anatolie Stati's residence is "at best unclear," because his Moldovan identification card states that he permanently resides in Moldova while his Romanian passport states that he permanently resides in Romania[103] is both inaccurate and irrelevant. It is inaccurate because neither his Moldovan identification card nor his Romanian passport contains the phrase "permanent residence." They only mention "residence," and Mr. Anatolie Stati has "residences" in both countries. The point is irrelevant because the definition of investor under Article 1(7) of the ECT requires either "citizenship or nationality" *or* that the individual be "permanently residing" in a Contracting Party to qualify as an "investor" of the Contracting Party. Kazakhstan does not dispute that Mr. Anatolie Stati holds Moldovan and Romanian nationality, and he is a permanent resident of Moldova. He therefore satisfies Article 1(7) of the ECT (in multiple respects).

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98 *Al-Bahloul* Partial Award ¶¶ 129-31, R-181.

99 *See*, *e.g.*, *Champion Trading Co. v. Egypt,* ICSID Case No ARB/02/9, Decision on Jurisdiction, October 21, 2003 (hereinafter "*Champion Trading* Decision on Jurisdiction"), ¶ 3.4.1, at10, C-363. *See also* Law No. 1024-XIV of the Republic of Moldova regarding nationality of the Republic of Moldova, art. 5, June 2, 2000 ("Citizenship of the Republic of Moldova shall be proven with the identity card, passport," etc.), C-364.

100 Gabriel Stati's Moldovan and Romanian passports, C-365.

101 It being specified that Anatolie Stati and Gabriel Stati's control or ownership of investments in Kazakhstan is not an element of the definition of "investor" under Article 1(7) of the ECT. It pertains to the definition of "investment," which is discussed in Section II.D below. *See* Statement of Defense ¶¶ 8.59, 8.62. *See also* Amkhan Opinion ¶ 82.

102 They are also contrary to Kazakhstan's own internal documentation, which identifies Anatolie Stati as an "investor." *See* Order from the Financial Police to the MEMR, October 20, 2008, C-9.

103 Statement of Defense ¶ 8.56 fn. 64.

82. Second, to the extent that Kazakhstan's jurisdictional objections relating to Anatolie Stati and Gabriel Stati pertain to the legality of their investments, they are misplaced. The legality of an investment has no bearing on whether an individual qualifies as an "investor" under Article 1(7) of the ECT. That is plain from the text of Article 1(7).[104]

83. Third, Kazakhstan's contention that because "Ascom is not an investor, Anatolie Stati also cannot be considered as an indirect investor in the meaning of the ECT"[105] is a *non sequitur*, and of no relevance to the definition of "investor" under the ECT. Ascom qualifies as an "investor" under the ECT on its own, as demonstrated below. Even if it did not, the ECT protects indirect investments,[106] and does not require that any intermediary company qualify as an "investor" for an indirect owner to be an "investor."[107]

84. Fourth and finally, Kazakhstan's argument that "Anatolie Stati does not have the capacity to act as an investor in the Republic of Kazakhstan"[108] is also beside the point. Nothing in the definition of "investor" under Article 1(7) of the ECT requires that the individual qualify as an "investor" within the meaning of the national law of the host state.[109] Kazakhstan's attempt to add its own self-serving requirement to the definition of "investor" under the ECT is unavailing.

2. Ascom

85. Kazakhstan's contention that "[t]he claimants have failed to demonstrate that Ascom is incorporated in Moldova"[110] is wrong. Claimants produced the Certificate of Incorporation of Ascom in Moldova as an exhibit to their Request for Arbitration and to their Statement of Claim.[111] Kazakhstan does not contest the authenticity of that document, which it

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104 Statement of Defense ¶ 8.57. In any event, the legality of Messrs. Stati's investments is discussed in Section II.D, *infra*.

105 Statement of Defense ¶ 8.59.

106 *See* Reply Memorial Section II.D.1 below.

107 Amkhan Opinion ¶ 82.

108 Statement of Defense ¶ 8.60. Because it is irrelevant, Claimants take no position on the accuracy of Kazakhstan's "capacity" argument, other than to state that it is suspect at best.

109 Amkhan Opinion ¶¶ 79-80. *See Saluka* Partial Award ¶ 241, C-259; *Yukos* Interim Award ¶¶ 413-17, C-360; *Hulley* Interim Award ¶¶ 413-17, C-361, and *Veteran* Interim Award ¶¶ 413-17, C-362.

110 Statement of Defense ¶ 8.7(b).

111 Ascom's Certificate of Incorporation, Exhibit 6 to the Request for Arbitration and C-31.

either overlooked or deliberately ignored when preparing its Statement of Defense. Furthermore, in October 2008, the Kazakh Financial Police acknowledged that "ASCOM-SA is registered with the address: Republic of Moldova, city Chişinău, 2005, boulevard Renaşterii, 22/2,"[112] a fact that Kazakhstan also ignores in its Statement of Defense. Ascom's Certificate of Incorporation evidences that Ascom is a company organized in accordance with the laws of Moldova. Accordingly, Ascom is an "investor" within the meaning of Article 1(7) of the ECT.

86. Kazakhstan next argues that "Ascom never gained clean title to the shares of KPM" and that "Ascom is not legitimately listed as a member of KPM."[113] Those allegations contradict the Financial Police's own finding, in October 2008, that "ASCOM SA … owns 100% of the participation share in 'Kazpolmunai LLP.'"[114] Nevertheless, even if Kazakhstan's assertions were true (and they are not, as discussed in Section II.D below), those allegations are irrelevant to whether Ascom meets the definition of investor in Article 1(7), which contains no language concerning the technicalities of the acquisition of an investment.

87. Lastly, Kazakhstan objects to this Tribunal's jurisdiction with respect to Ascom on the basis of Article 17 of the ECT, the so-called "[denial] of benefits" provision.[115] Kazakhstan contends that because Ascom is incorporated in Moldova and controlled by a Romanian national, Anatolie Stati, Ascom falls within the denial of benefits provision in Article 17. Kazakhstan's reliance on Article 17 is misplaced and its arguments should be rejected.

88. Kazakhstan fails to analyze the mechanism under Article 17 and how it has been consistently interpreted by arbitral tribunals. Article 17 of the ECT provides:

> Each Contracting Party reserves the right to deny the advantages of this Part to:
>
> (1) a legal entity if citizens or nationals of a third state own or control such entity ***and*** if that entity has no substantial business activities in the Area of the Contracting Party in which it is organized.[116]

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[112] *See* Letter from B. Paritov, Financial Police, to R. Ibraimov, Financial Police, October 30, 2008, C-366.

[113] Statement of Defense ¶ 8.7.

[114] *See* Letter from B. Paritov, Financial Police, to R. Ibraimov, Financial Police, October 30, 2008, C-366.

[115] Statement of Defense ¶¶ 8.8-8.10.

[116] ECT art. 17 (emphasis added), C-1.

89. Based on its plain meaning, "this Part" refers to Part III of the ECT. Article 17 thus leaves unaffected the dispute resolution provision (Article 26) of the ECT, which is located in Part V, not Part III.[117] It follows that Article 17 of the ECT does not concern jurisdiction, but, rather, the merits of a dispute. The first tribunal that addressed whether an issue raised under Article 17(1) could deprive the Tribunal of jurisdiction, *Plama v. Bulgaria*, relied on that very reasoning to conclude that it could not.[118] The tribunal in the *Yukos* case adopted the reasoning of the *Plama* tribunal and similarly held that Article 17 of the ECT pertained to the merits of the dispute and did not affect the tribunal's jurisdiction.[119] Accordingly, Kazakhstan's arguments based on Article 17 go to the merits, not jurisdiction.

90. Regardless, even as to the merits, Article 17 is of no help to Kazakhstan, because it only applies if a state invoked that provision to deny benefits to an investor before the state breached the Treaty or a dispute otherwise arose.[120] In its tortured discussion of Article 17, Kazakhstan seems to consider that the article applies automatically and retroactively.[121] That is not the case.

91. Article 17 provides for a "right to deny" the benefits of Part III of the ECT to an entity. The plain text of Article 17 does not provide for an automatic denial of benefits. This "right" is only triggered if first exercised by the host state, as arbitral tribunals consistently have held.[122] Kazakhstan neither proves nor contends that it exercised its right to deny benefits under Article 17 to Ascom. Thus, Article 17 is completely irrelevant to this case.

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117 *See* Amkhan Opinion ¶ 183.

118 *Plama Consortium Ltd. v. Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction, February 8, 2005 (hereinafter "*Plama* Decision on Jurisdiction"), ¶¶ 146-49, 151, R-32.

119 *Yukos* Interim Award ¶ 441, C-360.

120 Amkhan Opinion ¶¶ 162-165.

121 Statement of Defense ¶¶ 8.8-8.10.

122 *Plama* Decision on Jurisdiction ¶¶ 155, 158 ("[T]he existence of a 'right' is distinct from the exercise of that right. . . . a Contracting Party has a right under Article 17(1) ECT to deny a covered investor the advantages under Part III; but it is not required to exercise that right; and it may never do so."), R-32; *see also Yukos* Interim Award ¶ 456 ("Article 17(1) does not deny *simpliciter* the advantages of Part III of the ECT—as it easily could have been worded to do—to a legal entity if the citizens or nationals of a third State own or control such entity and if that entity has no substantial business in the Contracting Party in which it is organized. It rather 'reserves the right' of each Contracting Party to deny the advantages of that Part to such an entity. This imports that, to effect denial, the Contracting Party must exercise the right.") (emphasis in original), C-360.

92. Moreover, even if Kazakhstan's arguments in this arbitration could be deemed to be an exercise of its right to deny benefits under Article 17, the denial of benefits would only have a prospective effect, and thus would have no bearing on Claimants' claims in the present case.[123]

93. Additionally, even if the Tribunal were to find that Kazakhstan exercised its right to deny benefits under Article 17 and that this exercise can be retroactive, Article 17(1) still would not apply in the present case because the two elements of that article are not met: (i) that a legal entity be owned or controlled by citizens or nationals of a third state ***and*** (ii) that that entity has no substantial business activities in the Area of the Contracting Party in which it is organized.[124]

94. Regarding the first element, Kazakhstan contends that a State party to the ECT — Romania in the present case — is a "third state" for the purpose of the ECT.[125] That is incorrect. As explained by Professor Amkhan, "the term 'third state' in Article 17(1) refers only to states that are not parties to the ECT."[126] The plain text of Article 17(1) of the ECT distinguishes between a Contracting Party and a third State, as do several other articles of the ECT.[127] Romania is a party to the ECT; it is not a "third state."

95. The second element of Article 17(1) is also missing. Ascom is incorporated under the laws of Moldova, where it has its headquarters. Like many oil and gas companies, Ascom operates in countries other than where it has its headquarters. Thus, while its operational subsidiaries were located in Kazakhstan, its board of directors and management (including Messrs. Stati, Lungu, and Pisica) direct and control Ascom from its headquarters in Chisinau, Moldova.

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123 *Plama* Decision on Jurisdiction ¶¶ 162, 164, R-32; *see also Yukos* Interim Award ¶¶ 458-59, C-360.

124 *Plama* Decision on Jurisdiction ¶ 143, R-32; see also *Yukos* Interim Award ¶ 460, C-360. *See also* Amkhan Opinion ¶¶ 166-168.

125 Statement of Defense ¶¶ 8.9-8-10.

126 *See* Amkhan Opinion ¶ 172.

127 *See*, *e.g.*, ECT art. 1(7). That conclusion is further supported by the Vienna Convention, which defines a third State as "a State not a party to the treaty." Vienna Convention art. 2(1)(h), C-203. *See also* Amkhan Opinion ¶¶ 172-176. *Yukos* Interim Award ¶¶ 538, 542, 544, 546, C-360. *See also*, *Plama* Decision on Jurisdiction ¶ 170 ("Under Article 17(1)'s first limb, the question is whether the Claimant is a legal entity owned or controlled 'by citizens or nationals of a third state.' A 'third state' being a non-Contracting State under the ECT…."), R-32.

3. Terra Raf

96. Kazakhstan contends that this Tribunal does not have jurisdiction over Claimant Terra Raf because the ECT does not apply to Gibraltar, where Terra Raf is incorporated.[128]

97. The ECT applies to Gibraltar by way of Article 45(1) of the ECT, which addresses provisional application of the Treaty. Article 45(1) states:

> Each signatory agrees to apply this Treaty provisionally pending its entry into force for such signatory in accordance with Article 44, to the extent that such provisional application is not inconsistent with its constitution, law or regulations.[129]

98. Kazakhstan does not contend that the provisional application of the ECT to Gibraltar would be "inconsistent with [the] constitution, law or regulations" of the United Kingdom or Gibraltar. Nor does Kazakhstan deny the consequences of the provisional application of the ECT, namely that an investor of the state applying the ECT provisionally may avail itself of the protections offered by Part III of the ECT and of Article 26 of the ECT.[130] Kazakhstan's jurisdictional objection relating to Terra Raf is limited to the question of whether the ECT applies provisionally to Gibraltar.

99. The parties do not dispute that the United Kingdom made an express Declaration when it signed the ECT on December 17, 1994, to extend the provisional application of the ECT to Gibraltar. The United Kingdom's Declaration stated:

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[128] Statement of Defense Section 8. In fact, Kazakhstan actually disputes that Terra Raf is "validly" incorporated in Gibraltar, but it has ignored, or at least not contested the authenticity of, Terra Raf's certificate of incorporation that Claimants produced. Terra Raf's Certificate of Incorporation, Exhibit 11 to the Request for Arbitration and C-32. *See also* Terra Raf's Certificate of Incorporation, July 5, 2011, C-367.

Further, in its Request for Document Production, Kazakhstan claims that Terra Raf could not carry out "any investment business or controlled activity in or from within Gibraltar except under section 8 of [the Financial Services Act]." (Respondent's Request for Document Production, Request No. 79.) Claimants assume that Respondent refers to the Financial Services (Investment and Fiduciary Services) Act 1989 since the Financial Services Act 1987 does not exist and the Financial Services Act 1998 was repealed as of November 1, 2007. Contrary to Kazakhstan's contentions, Terra Raf is not required to hold a license for "investment business" pursuant to Gibraltar laws. The Financial Services (Investment and Fiduciary Services) Act defines "investment" as financial instruments (for instance, shares, debentures, securities, long term insurance contracts) and "investment business" as the act of dealing or arranging deals in "investments." Terra Raf does not engage in "investment business" in Gibraltar or abroad; it does not deal or arrange deals pertaining to TNG's shares. *See* Financial Services (Investment and Fiduciary Services) Act 1989, Schedules 1 and 2, C-368.

[129] ECT art. 45(1), C-1.

[130] *Yukos* Interim Award ¶¶ 394-98, C-360.

> The Government of the United Kingdom of Great Britain and Northern Ireland declares that with respect to its signature of the Energy Charter Treaty, provisional application under Article 45(1) shall extend to the United Kingdom of Great Britain and Northern Ireland and to Gibraltar.[131]

100. Kazakhstan argues that "Provisional application of the ECT will cease: (a) by virtue of the Treaty coming into force pursuant to Article 45(1); or (b) by virtue of a written notification pursuant to Article 45(3)(a)" and that "the provisional application was de facto terminated on that date in respect of the United Kingdom and all sovereign territories of the UK, including Gibraltar."[132]

101. That argument disregards the ECT's specific clauses governing provisional application and its termination, which do not provide for "*de facto*" termination. Rather, Article 45(3)(a) of the ECT provides that:

> Any signatory may terminate its provisional application of this Treaty by written notification to the Depository of its intention not to become a Contracting Party to the Treaty . . . [133]

No such written notification has been made with respect to Gibraltar.

102. Termination of provisional application by written notification to the Depository is not only expressly required by the ECT, but it was endorsed by the *Petrobart v. Kyrgyzstan* tribunal. The *Petrobart* Tribunal is the only tribunal to date that has considered the applicability of the ECT to Gibraltar. It stated:

> The Arbitral Tribunal considers that . . . according to the text of the Treaty provisional application ceases if it is terminated either by a special notification under Article 45(3)(a) of the Treaty or by transition from provisional application to a corresponding and final legal commitment resulting from the entry into force of the Treaty. It could indeed be expected that the United Kingdom, if it wished the provisional application of the Treaty to Gibraltar to be terminated as a result of a ratification not including Gibraltar, should have made this clear by making a notification in line with

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[131] United Kingdom's declaration under Article 45(1) of the ECT, December 17, 1994, C-34. As explained by Professor Amkhan, "[t]here is no separate 'territorial application' provision for provisional application under Article45, and this declaration accordingly has no express basis in the ECT." Amkhan Opinion ¶ 244.

[132] Statement of Defense ¶ 8.38.

[133] ECT art. 45(3)(a), C-1.

> Article 45(3)(a) or a declaration in some other form in connection with the ratification. In the Arbitral Tribunal's opinion, the fact that the ratification, for political or other reasons, did not include Gibraltar does not justify the conclusion that the United Kingdom intended to revoke the application of the Treaty to Gibraltar on a provisional basis. It may be observed that what is at issue here is not only the rights of investors from Gibraltar in other states but also the protection of foreign investors in Gibraltar.
>
> The Arbitral Tribunal therefore finds that the Treaty continues to apply on a provisional basis to Gibraltar despite the fact that the United Kingdom's ratification does not cover Gibraltar.[134]

The Svea Court of Appeal declined to annul the award rendered by the tribunal in *Petrobart*, finding that the tribunal had dealt with the issue of its jurisdiction correctly.[135] Professor Amkhan confirms that "[p]rovisional application is in principle subject to no other terminal date than eventual entry into force, unless there is an express declaration of the kind referred to in Article 45(3) – which is not the case here."[136]

103. Kazakhstan's attempt to distinguish *Petrobart* on the grounds that the investments in that case were made prior to the United Kingdom's ratification of the ECT, while in the present case they were made after, is misplaced.[137] The timing of the investment was not a consideration in the *Petrobart* tribunal's reasoning, which solely concerned the analysis of Article 45 and the regime to terminate provisional application under that article, *i.e.*, a notification under Article 45(3). The text of Article 45 does not indicate that when an investor made its investment should be of any relevance to termination of provisional application. The question turns solely on whether the United Kingdom or Gibraltar has made a declaration to terminate provisional application of the ECT to Gibraltar. Neither has done so.

104. Kazakhstan's contention that "the terms of the UK's ratification document were clear notice that the UK intended to end the application of the ECT to Gibraltar" is wrong.[138] The UK ratification does not refer to Gibraltar at all, and cannot therefore constitute notice of a

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134 *Petrobart* Award at 62-63, C-204.

135 *Petrobart Ltd. v. Kyrgyz Republic*, Case No. T 3739-03, Svea Court of Appeal, April 13, 2006, 13 ICSID Rep. 369, 376 (2008), C-369.

136 Amkhan Opinion ¶ 248.

137 Statement of Defense ¶ 8.48.

138 Statement of Defense ¶ 8.48.

fact it does not even mention.[139] Additionally, the United Kingdom's notification actually indicates that Gibraltar intends to ratify the ECT later.[140] The *Note Verbale* does not say that the United Kingdom terminates the provisional application of the ECT for Gibraltar. Quite to the contrary, it indicates that ratification by the United Kingdom and by Gibraltar will be dissociated in time, and that Gibraltar does plan to seek ratification of the ECT in the future, leaving intact the provisional application of the ECT to Gibraltar in the meantime.

105. This interpretation is supported by Article 40(2) of the ECT on the application of the treaty to overseas territories, which provides that "Any Contracting Party may at a later date [*i.e.*, later than at the time of signature, ratification, acceptance, approval or accession], by a declaration deposited with the Depository, bind itself under this Treaty with respect to other territory specified in the declaration. In respect of such territory the Treaty shall *enter into force* on the ninetieth day following the receipt by the Depository of such declaration."[141] Article 40(2) expressly contemplates the possibility of a dissociation between the date of entry into force for the state (the United Kingdom) and an overseas territory (Gibraltar). Transposed to Article 45(1), this means that "entry into force" under Article 45(1) can be read as referring to entry into force for the state on the one hand (the United Kingdom) and for its overseas territory on the other hand (Gibraltar), to the extent both are not simultaneous.

106. Furthermore, the Members' page of the Energy Charter Secretariat website does not mention the United Kingdom's *Note Verbale* dated July 27, 2004, nor any termination of the provisional application of the ECT with respect to Gibraltar.[142] This contrasts with the page for the Russian Federation, which contains the end date of the Russian Federation's provisional application of the ECT ("Provisional application till 18 October 2009 incl.") and mentions that:

> On 20 August 2009 the Russian Federation has officially informed the Depository that it did not intend to become a Contracting Party to the Energy Charter Treaty and the Protocol on Energy Efficiency and Related Environmental Aspects. In accordance with Article 45(3)(a) of the Energy Charter Treaty, such notification

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139 United Kingdom's Instrument of ratification, C-370.

140 United Kingdom's Note Verbale No. 2004/184 addressed to the Depositary of the ECT, July 27, 2004, R-51.

141 ECT art. 40(2) (emphasis added), C-1.

142 *See* Energy Charter, Charter Members and Observers, United Kingdom, *available at* http://www.encharter.org/index.php?id=427#c1364 (last visited April 4, 2012), C-371.

> results in Russia's termination of its provisional application of the ECT and the PEEREA upon expiration of 60 calendar days from the date on which the notification is received by the Depository.[143]

107. In conclusion, the provisional application of the ECT to Gibraltar has not been terminated and Terra Raf has standing to bring a claim as a qualifying "investor" in the present arbitration.

108. In the alternative, should the Tribunal conclude that the ECT ceased to apply provisionally to Gibraltar by virtue of Article 45, the ECT in any event applies to Gibraltar on the basis that Gibraltar is part of the European Community (now European Union), which is itself a party to the ECT.[144]

109. Gibraltar's parliamentary reports (Hansards) show that Gibraltar considers that the ECT applies to it on that basis. Gibraltar's Chief Minister stated as follows during a question session before Parliament in 2008:

> The Government decided not to proceed with the [Energy Charter Treaty] Bill following advice from the United Kingdom that it was unnecessary for the Treaty to be extended to Gibraltar. We were advised that it was sufficient that the Treaty is listed as a Community Treaty by virtue of the EC Act. Under the provisions of that Act, any Treaty listed by the UK as a Community Treaty, automatically achieves the same status in Gibraltar.[145]

110. Pursuant to Article 52 of the Treaty on the European Union and Article 355 of the Treaty on the Functioning of the European Union,

> Gibraltar as 'a European territory' falls within the Area of the European Union for the purposes of the ECT. And since the European Union is a Contracting Party to the ECT; it follows therefore that a company registered in Gibraltar is an Investor of a Contracting Party for the purposes of Article 1(7) of the ECT.[146]

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[143] *See* Energy Charter, Charter Members and Observers, Russia, *available at* http://www.encharter.org/index.php?id=414#c1338 (last visited April 4, 2012), C-372.

[144] *See* Energy Charter, Charter Members and Observers, European Community (now part of the EU) and Euratom, *available at* http://www.encharter.org/index.php?id=410#c1330 (last visited April 4, 2012), C-373.

[145] Question and Answer No. 1094 of 2008, Gibraltar Hansards of Questions, at 562, C-374.

[146] Amkhan Opinion ¶¶ 259; 250-258. *See also* European Communities Act 1972 (An Act to Make Provision in Connection with the Inclusion of Gibraltar within the European Communities) arts. 2.(1)(o) and 3.(1),

111. In view of the above, whether by provisional application pursuant to Article 45 of the ECT or because Gibraltar is part of the European Community – or both – the ECT applies to Gibraltar, and Terra Raf is a qualified "Investor" under the Treaty.

112. While there should be no doubt that Terra Raf is a qualified "Investor" under the ECT, the issue is of little ultimate relevance, because Terra Raf is owned and controlled by Messrs. Anatolie and Gabriel Stati and the ECT protects their indirect investments in Kazakhstan through Terra Raf.

D. Claimants' "Investments" Are Protected By the ECT

113. In its Statement of Defense, Kazakhstan contends that Claimants have "failed to assist the Arbitral Tribunal in assessing, on any more than a cursory basis, whether or not the alleged investments constitute investments attracting protection under the ECT."[147] Kazakhstan's arguments regarding Claimants' investments are factually incorrect, and they misconstrue the requirements of the ECT.

1. Claimants Made "Investments" As Defined Under Article 1(6) of the ECT

114. Kazakhstan argues that Claimants' investments lack the "characteristics" of an investment identified by three arbitral tribunals in the cases of *Salini v. Morocco*, *Phoenix v. Czech Republic*, and *Bayindir v. Pakistan*.[148] The flaw in that argument is that none of those disputes involved the meaning of "investment" under the ECT, and each of those cases were decided by ICSID tribunals applying Article 25 of the ICSID Convention. Thus, the "characteristics" of investments espoused by those tribunals are irrelevant to the present case.

115. Nevertheless, Kazakhstan urges this Tribunal to adopt the "*Salini* test," as further applied by the *Phoenix v. Czech Republic* and the *Bayindir v. Pakistan* tribunals,[149] to examine whether this dispute concerns an "investment." That "double-barreled test" requires establishing

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December 21, 1972, *available at* http://www.gibraltarlaws.gov.gi/articles/1972-18o.pdf (last visited March 30, 2012), C-375.

147 Statement of Defense ¶ 9.1.

148 Statement of Defense ¶ 9.5, ¶ 9.15, ¶ 9.27.

149 *Phoenix Action Ltd v. Czech Republic*, ICSID Case No. ARB/06/5, Award, April 15, 2009 (hereinafter "*Phoenix* Award"), ¶ 74 *et seq.*, R-31. *See also Bayindir v. Pakistan* Decision on Jurisdiction, which contains a subsection on "Investment under Article I(2) of the BIT" under the BIT and a separate one "Investment under Article 25 of the ICSID Convention." *Bayindir* Decision on Jurisdiction at 30 *et seq*., R-208.

an investment under both the applicable investment treaty and the ICSID Convention. The so-called "*Salini* test" has been the subject of considerable debate and criticism, and it has been held inapplicable to non-ICSID cases.

116. In the words of the *White Industries v. India* tribunal:

> As regards the so-called "*Salini Test*" for what constitutes an investment, this test was developed in order to determine whether an "investment" had been made for the purposes of the ICSID Convention...
>
> The present case, however, is not subject to the ICSID Convention. Consequently, the so-called *Salini Test*, and Douglas' interpretation of it, are simply not applicable here. Moreover, it is widely accepted that the "double-check" (namely, of proving that there is an "investment" for the purposes of the relevant BIT *and* that there is an "investment" in accordance with the ICSID Convention), imposes a higher standard than simply resolving whether there is an "investment" for the purposes of a particular BIT.[150]

117. The present case has not been brought under the ICSID Convention. The only relevant and applicable definition of "investment" here is the one found in Article 1(6) of the ECT.

118. Kazakhstan has not cited a single ECT case in which a tribunal required that the investment meet the *Salini* criteria in addition to complying with the definition of "investment" under Article 1(6) of the ECT. To Claimants' knowledge, no such case exists. Rather, ECT tribunals have invariably assessed whether the investor made an "investment" as defined in the ECT.[151] There is no basis to apply criteria outside of the ECT to the question of whether Claimants made a valid "investment," as Kazakhstan urges.[152]

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[150] *White Industries Australia Ltd. v. India*, UNCITRAL, Final Award, November 30, 2011 (hereinafter "*White Industries* Award"), ¶¶ 7.4.8-7.4.9 (emphasis in original), C-376. Other cases have refused to consider additional requirements that were not found in the relevant and applicable BIT. *See, e.g.*, *Saluka* Partial Award ¶¶ 203, 210-211, C-259; *Paushok* Award ¶ 205, C-348.

[151] *See*, *e.g.*, *Petrobart* Award at 69-70, C-204; *see also Al-Bahloul* Partial Award ¶¶ 133-46, R-181

[152] *See* Amkhan Opinion ¶¶ 93-96; 101-102.

119. Claimants' investments clearly fall within the definition of "Investment" in the ECT. Under Article 1(6) of the ECT, "Investment" includes:[153]

> every kind of asset, owned or controlled directly or indirectly by an Investor and includes:
>
> (a) tangible and intangible, and movable and immovable, property, and any property rights such as leases, mortgages, liens, and pledges;
>
> (b) a company or business enterprise, or shares, stock, or other forms of equity participation in a company or business enterprise, and bonds and other debt of a company or business enterprise;
>
> (c) claims to money and claims to performance pursuant to contract having an economic value and associated with an Investment;
>
> …
>
> (e) Returns;
>
> (f) any right conferred by law or contract or by virtue of any licenses and permits granted pursuant to law to undertake any Economic Activity in the Energy Sector.

120. KPM[154] and TNG[155] are energy companies that held Subsoil Use Contracts and Subsoil Use Licenses from Kazakhstan for the exploration and production of hydrocarbons.[156] Claimants' tangible and intangible holdings in Kazakhstan included ownership of oil and gas wells, drilling equipment, gathering pipelines, treatment and storage facilities, vehicles, offices, an LPG plant, equity interests in KPM and TNG, and contractual rights conferred by Kazakhstan to KPM and TNG under the Subsoil Use Contracts and Licenses for the Borankol field, the

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153 *See* Amkhan Opinion ¶ 87.

154 *See* Articles of Association of KPM, May 13, 2005, C-36; KPM's Certificate of Incorporation, May 13, 2005, C-37.

155 *See* Articles of Association of TNG, May 16, 2005, C-39; TNG's Certificate of Incorporation, May 16, 2005, C-40.

156 License for the right to use subsoil issued to KPM, series MG No. 309-D (oil), May 23, 1997, Appendix 3 and Contract No. 305, C-45; License for the right to use subsoil issued to TNG, series MG No. 242-D (oil), December 4, 1997 and Contract No. 210, C-52; License for the right to use subsoil issued to TNG, series MG No. 243-D (oil), December 4, 1997 and Contract No. 302, C-53.

Tolkyn field, and the Contract 302 Properties.[157] These are "any investment associated with an economic activity in the energy sector" for the purpose of Article 1(6),[158] and they are encompassed by subcategories (a), (b), (c), (e), and (f) of Article 1(6).

121. Moreover, while irrelevant to the definition of "investment" under the ECT,[159] it is worth noting that Claimants' investments resulted from substantial financial contributions.[160] Kazakhstan alleges that Claimants failed to pay for their acquisition of KPM and TNG.[161] Claimants fully paid the agreed purchase price for KPM's and TNG's shares[162] and made all required investments in accordance with the working programs.[163] In post-acquisition investments,[164] Claimants exceeded the minimum working programs, both for investment values

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[157] *See* Statement of Claim ¶¶ 43-50. As for Kazakhstan's misconstrued argument that "Claimants are required to demonstrate that each of the alleged investment was made after the date the ECT came into force" or "that the matters affecting the investment occurred after the Effective Date," the ECT entered into force on April 16, 1998 for Moldova, Romania, and Kazakhstan and Claimants' made their first investment in Kazakhstan in December 1999. *See* Statement of Defense ¶¶ 9.19-9.20; Statement of Claim ¶¶ 28, 46; Amkhan Opinion ¶ 89.

[158] *See* Amkhan Opinion ¶¶ 89-91.

[159] *See* Amkhan Opinion ¶ 101.

[160] Even if a "contribution" requirement applies, it is not clear that there is any requirement that the "contribution" be substantial. The "substantial" threshold was not mentioned in *Salini v. Morocco*, and is not in accordance with the preparatory works of the ICSID Convention, which show that propositions to limit the coverage of the ICSID Convention to investments of a certain size had been rejected during the negotiations. As stated by the tribunal in *Saba Fakes v. Turkey*, "small investments are covered by the ICSID Convention in the same way as large investments. An investment can be large or small, or it can be profitable or unprofitable, or it can contribute or not to the economic development of a country. All those propositions make sense and neither the size nor the profitability or the usefulness of investments are included in the ordinary meaning of the word." *Saba Fakes v. Turkey*, ICSID Case No. ARB/07/20, Award, July 14, 2010 (hereinafter "*Saba Fakes* Award"), ¶ 112 fn 73, C-377.

[161] Statement of Defense ¶¶ 9.29-9.30; 14.1-14.5.

[162] Second witness statement of Grigore Pisica, May 6, 2012 (hereinafter "Second Pisica Statement") ¶¶ 13, 17, 23, and 25. Excerpt from the Register of KPM's shareholders, January 25, 2000, C-378. Wire transfers from Ascom to Telwin Limited, Testep Enterprises, and Maraday Business, Aksai's shareholders, between October 28, 1999 and July 18, 2000, for the acquisition of 62% of KPM, C-379. *See* also, Brokerage Agreement between Ascom and Telwin Limited, September 1, 1999, C-393. Decision of Aksai, the sole shareholder of Camestix OU, to have the Share Purchase Agreement for 38 % of KPM signed between Ascom and Camestix OU, November 23, 2004, C-380; Share Purchase Agreement between Ascom and Camestix OU for 38% of KPM, November 25, 2004, C-381; Wire transfers from Ascom to Camestix OU for US$ 9 million, November 26 and December 14, 2004, C-382. *See* also, Wire transfers from Ascom to TNG and Kaihar, May 31, 2000, C-383.

[163] Wire transfers from Ascom and Terra Raf to KPM for the period from February 2000 to June 2004 for a total amount of US$ 14,166,558, C-384.

[164] Statement of Defense ¶¶ 9.31; 14.6-14.7.

and financial obligations, as recognized by the MEMR in February 2010.[165] Contrary to Kazakhstan's current allegations, the MEMR concluded that Claimants had invested US$ 473 million in KPM and US$ 640 million in TNG, a total in excess of US$ 1.1 billion, between 2000 and the end of 2009.[166] Likewise, Claimants completed 90% of their LPG Plant and invested, on their behalf and on behalf of Vitol, in excess of US$ 208.5 million in the LPG Plant.[167]

122. Having invested in excess of US$ 1.1 billion in Kazakhstan over nearly a decade, Claimants' investments would easily satisfy the "*Salini* test" even if that test were relevant (which, for the reasons, explained above, it is not).

123. Finally, it is worth nothing that the definition of "investment" in the ECT is broader than in many other investment treaties.[168] Thomas Wälde noted the breadth of the definition of "investment" under the ECT as follows:

> The dispute must relate to an 'investment' (Art. 26(1)), defined in Art. 1(6) in the widest possible way. The definition in the ECT encompasses virtually any right with a financial value ("asset"), including contractual claims for money and performance. . . . If the claimant chooses the ICSID tribunal (rather than a Stockholm or ad-hoc UNCITRAL tribunal), it will have to comply not only with the low-threshold requirements for an "investment" under Art. 1(6), but also on the—possibly—higher threshold of Art. 25 of the ICSID Convention.[169]

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[165] Reports of the MEMR on Unscheduled Inspection for KPM and TNG, February 5 and 6, 2010, C-385 and C-386. *See also* Letters from the MEMR to KPM and TNG, October 7, 2005 (stating that KPM had invested US$ 118.3 million and TNG US$ 137.5 million as of July 1, 2005), C-387.

[166] Report of the MEMR on Unscheduled Inspection for KPM, February 6, 2010, Section VII, C-385 and Final page of Report of the MEMR on Unscheduled Inspection for TNG, February 5, 2010, C-386. (If one deducts taxes and administrative expenses, Claimants' investments amount to US$ 463 million in TNG and US$ 309 million in KPM, a total of US$ 772 million).

[167] May 17, 2011 FTI Report ¶ 16.6; Tristan Oil Consolidated Audited Financial Statements, September 30, 2008, at 10, Exhibit F-28 to May 17, 2011 FTI Report.

[168] Amkan Opinion ¶¶ 86-88, 91.

[169] Thomas W. Wälde, *Investment Arbitration Under the Energy Charter Treaty: An Overview of Selected Key Issues Based On Recent Litigation Experience*, *in* ARBITRATING FOREIGN INVESTMENT DISPUTES: PROCEDURAL AND SUBSTANTIVE LEGAL ASPECTS 193, 231-32 (Norbert Horn & Stefan M. Kröll eds., Kluwer Law International 2004), C-388. *See* Juliet Blanch, Andy Moody & Nicholas Lawn, *Investment Dispute Resolution and the Energy Charter Treaty*, *in* INVESTMENT PROTECTION AND THE ENERGY CHARTER TREATY 1, 10 (Graham Coop & Clarisse Ribeiro eds., JurisNet, LLC 2008) ("In contrast to ICSID, there are no additional jurisdictional requirements where an Investor submits its dispute to either UNCITRAL or SCC Arbitration."), C-389; *see also*, as summarized by Dolzer & Schreuer, "[m]ost bilateral treaties contain a general phrase defining investment (such as 'all assets') and several group of illustrative categories. No special problems will

124. Similarly, the *Yukos*, *Veteran*, and *Hulley* tribunals found that "[t]he breadth of the definition of Investment in the ECT is emphasized by many eminent legal scholars. ... The Tribunal reads Article 1(6)(b) of the ECT as containing the widest possible definition of an interest in a company. . . . "[170]

125. Kazakhstan's contention that the "real" investor in KPM and TNG is Tristan Oil, and not Claimants — because the majority of the financing of KPM and TNG came from Tristan Oil[171] — has no legal basis. There is no "origin of capital" language in the ECT's broad definition of "Investment." In the words of the *Paushok* tribunal, "[*w*]hether *most of the money used in* the creation and *the development of [the investment companies]* was borrowed or *originated from Claimants themselves is irrelevant* for the purpose of jurisdiction."[172]

126. Moreover, the ECT protects investments that are not only directly owned, but also investments that are indirectly owned or controlled.[173] This is plain from the text of Article 1(6) of the ECT, which refers expressly to "every kind of asset, ***owned or controlled*** directly or ***indirectly*** by an Investor."[174] This is not disputed by Kazakhstan.[175] It is therefore sufficient for

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arise if the investment in question is covered by one of the illustrative categories." Rudolf Dolzer & Christoph Schreuer, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW 63 (Oxford University Press 2008), C-219.

170 *Yukos* Interim Award ¶ 430 (footnote omitted), C-360; *Veteran* Interim Award ¶ 477 (footnote omitted), C-362; *Hulley* Interim Award ¶ 429 (footnote omitted), C-361. *See also* for another illustration in a non-ICSID case, *Mytilineos Holdings SA v. State Union of Serbia & Montenegro and Republic of Serbia*, UNCITRAL, Partial Award on Jurisdiction, September 8, 2006 (hereinafter "*Mytilineos* Partial Award"), ¶¶ 117-18 ("this latter *ratione materiae* test for the existence of an investment in the sense of [Article 25 of the] ICSID Convention is one specific to the ICSID Convention and does not apply in the context of *ad hoc* arbitration provided for in BITs an alternative to ICSID. In the present *ad hoc* arbitration under the UNCITRAL Rules one would therefore have to conclude that the only requirements that have to be fulfilled in order to confer *ratione materiae* jurisdiction on this Tribunal are those under the BIT."), C-390; and *Nykomb* Award ¶¶ 4.3.3-4.3.4, at 38 (in which the tribunal only referred to the definition of "investment" under [Article 1(6) of the] ECT, without any mention of the *Salini* criteria), C-281.

171 Statement of Defense ¶¶ 14.8-14.12.

172 *Paushok* Award ¶ 205 (emphasis added), C-348.

173 *See* Amkhan Opinion ¶¶ 86-88.

174 ECT art. 1(6) (emphasis added), C-1. *See also Al-Bahloul* Partial Award ¶¶ 142, 146, R-181; Energy Charter Secretariat, THE ENERGY CHARTER TREATY – A READER'S GUIDE at 20-21, C-264; *Azurix Corp v. Argentine Republic*, ICSID Case No ARB/01/12, Decision on the Application for Annulment, September 1, 2009 ("*Azurix* Decision on Annulment"), ¶ 94 (tribunal stating that "[a]lthough assets of ABA would as a matter of law belong to ABA and not to Azuriz, Azurix nonetheless had, by virtue of its controlling shareholding in ABA 'interests in the assets' of ABA [. . .], and through that shareholding indirectly controlled those assets. Assets of Azurix would also be an 'investment' of Azurix for the purposes of the BIT. Additionally, the legal and contractual rights of ABA [. . .], including the rights [. . .] under the Concession, being indirectly controlled by Azurix through its majority shareholding in ABA [. . .] would similarly be 'investments' of Azurix for the purposes of the BIT."), C-254.

an investor to either "own ***or*** control" the investment, either directly or indirectly, for the investment to qualify for protection under the ECT.

127. Kazakhstan correctly states that "[t]he Claimants are required to demonstrate that the alleged investment is either owned or controlled (either directly or indirectly) by an investor under the ECT."[176] Claimants plainly did that in their Request for Arbitration and Statement of Claim.[177] Nevertheless, for ease of reference, Claimants briefly summarize the situation once more.

128. Ascom, a joint-stock company incorporated under the laws of Moldova,[178] directly owned 100% of KPM and thus controlled the assets of KPM.[179] Mr. Anatolie Stati has directly owned and controlled 100% of Ascom since the date of its incorporation.[180] Mr. Anatolie Stati thus indirectly owned and controlled KPM and its assets.

129. Terra Raf, a limited liability company incorporated under the laws of Gibraltar,[181] directly owned 100% of TNG and thus controlled the assets of TNG.[182] Terra Raf was incorporated on March 1, 1999, by Southbridge Services Limited and Cresmount Services Limited.[183] On January 27, 2000, Messrs. Anatolie and Gabriel Stati acquired Terra Raf's two

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175 Statement of Defense ¶ 9.18.

176 Statement of Defense ¶ 9.18.

177 Request for Arbitration ¶¶ 10-13; 16-22; Statement of Claim ¶¶ 42-51. *But see* Respondent's Comments Regarding Documents Produced by Claimants, March 12, 2012, Requests Nos. 73-77; 81-82.

178 *See* Reply Memorial Section II.C.2.

179 *See* KPM's Articles of Association bearing the stamp of the Department of Justice for the Mangystau Region of the Republic of Kazakhstan, art. 1.3, May 13, 2005, C-36; Register of KPM's Shareholders No. 1397, December 15, 2004, C-50. *See also* Letter from B. Paritov, Financial Police, to R. Ibraimov, Financial Police, October 30, 2008, C-366.

180 *See* Lists of Ascom shareholders as at September 2, 2002, October 15, 2008, and February 15, 2010, C-391, C-35, and C-392.

181 *See* Reply Memorial Section II.C.3.

182 *See* TNG's Articles of Association bearing the stamp of Department of Justice for the Mangystau Region of the Republic of Kazakhstan, art. 1.3, May 16, 2005, C-39; Register of TNG's Shareholders, May 7, 2002, C-59; Sale and Purchase Agreements between Ascom, Kainar Ltd. LLP, Dobro PKF LLP, and Anavi LLP, May 17, 2000, C-54; Sale and Purchase Agreements between Gheso JSC and Ascom, March 11, 2002, C-55; Sale and Purchase Agreements between Gheso JSC and Kainar Ltd. LLP, April 30, 2002, C-56; Sale and Purchase Agreements between Gheso JSC and Dobro PKF LLP, May 3, 2002, C-57; Sale and Purchase Agreements between Gheso JSC and Anavi LLP, May 3, 2002, C-58; Sale and Purchase Agreement between Gheso and Terra Raf, May 12, 2003, C-60.

183 *See* Terra Raf's Certificate of Incorporation and Memorandum of Association, March 1, 1999, C-33.

sole shares from its previous owners, a transaction that the former directors of Terra Raf approved.[184] On the same date as their acquisition, Messrs. Anatolie and Gabriel Stati replaced the former directors as Terra Raf's new directors.[185] In September 2004, Messrs. Anatolie and Gabriel Stati increased their shares to a thousand each, with each receiving an additional 999 shares.[186] Terra Raf's certificate of incorporation clearly name Messrs. Anatolie and Gabriel Stati as directors and sole shareholders.[187] Mr. Anatolie Stati and Mr. Gabriel Stati thus each directly own and control 50% of Terra Raf and each indirectly owned and controlled 50% of TNG and its assets.

2. The ECT Does Not Require That "Investments" Be Made In Good Faith or In Accordance With Domestic Law

130. In its Statement of Defense, Kazakhstan also urges this Tribunal to assess the validity of an investment by determining whether the investments were made in good faith and in accordance with Kazakh law.[188] While Claimants' investments were made in good faith and in accordance with Kazakh law, the ECT contains no such requirements. If the Contracting Parties to the ECT had wanted to include a reference to national law in the definition of "investment," they would have done so, as they did with respect to the definition of "investor" in Article 1(7) of the ECT.

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184 *See* Share Certificates Nos. 5 and 6, January 27, 2000, C-394 and C-395.

185 *See* Terra Raf's Certificate of Incorporation, November 22, 2007, listing Messrs. Anatolie and Gabriel Stati as appointed directors since January 27, 2000, Exhibit 11 to the Request for Arbitration, C-396. This is only "confusing" to Kazakhstan, *see* Respondent's Comments Regarding Documents Produced by Claimants, March 12, 2012, Request No. 73, because it is trying to create a storm in a teacup.

186 *See* Share Certificates Nos. 7 and 8, September 23, 2004, C-397 and C-398.

187 *See* Terra Raf's Certificate of Incorporation, November 22, 2007, Exhibit 11 to the Request for Arbitration, C-396; Terra Raf's Certificate of Incorporation, July 5, 2011, C-367.

188 Statement of Defense ¶¶ 9.36-9.87. These two criteria form part of the *Salini* test as amended by the *Phoenix* tribunal, which as argued above, is not applicable to the present case. *Phoenix* Award ¶ 114, R-31. The only other criterion of the *Salini* test that Kazakhstan argues is not met by Claimants' investments is that of "contribution." Statement of Defense ¶¶ 9.27-9.31. Kazakhstan relies on the *Bayindir v. Pakistan* and *MHS v. Malaysia* cases, but the *Bayindir* tribunal did not apply that criterion in its analysis of whether there was an "investment" under the applicable BIT. *Bayindir* Decision on Jurisdiction at 30-37, R-208. And the *MHS* tribunal did not reach the discussion of "investment" under the applicable BIT, having concluded that there was no "investment" under Article 25(1) of the ICSID Convention (which led to the annulment of that award by an ICSID *Ad Hoc* Committee). *Malaysian Historical Salvors Sdn, Bhd v. Malaysia*, ICSID Case No. ARB/05/10, Decision on the Application for Annulment, April 16, 2009 (hereinafter "*Malaysian Historical* Decision on Annulment"), ¶¶ 61, 83, C-399. It would be particularly inappropriate to apply this criterion under the ECT, which expressly provides that the definition of "investment" covers assets that are "owned or controlled" by a qualifying investor, and explains that neither "ownership" nor "control" requires a contribution of any kind. *See* Understanding (3) with respect to Article 1(6) for the interpretation of "control," C-1.

131. A similar argument was made and rejected in the ICSID case of *Saba Fakes v. Turkey.* That tribunal explained:

> the principles of good faith and legality cannot be incorporated into the definition of Article 25(1) of the ICSID Convention without doing violence to the language of the ICSID Convention: an investment might be 'legal' or 'illegal,' made in 'good faith' or not, it nonetheless remains an investment. The expressions 'legal investment' or 'investment made in good faith' are not pleonasms, and the expressions 'illegal investment' or 'investment made in bad faith' are not oxymorons.
>
> While a treaty should be interpreted and applied in good faith, this is a general requirement under treaty law, from which an additional criterion of 'good faith' for the definition of investments, which was not contemplated by the text of the ICSID Convention, cannot be derived.
>
> As far as the legality of investments is concerned, this question does not relate to the definition of 'investment' provided in Article 25(1) of the ICSID Convention and in Article 1(b) of the BIT.[189]

Nor does it relate to the definition of "investment" in the ECT.

132. Tribunals have insisted that even when the applicable treaty requires that an investment be made in accordance with domestic law, it does not follow that *any* violation of domestic law, however minimal or irrelevant, precludes jurisdiction. The *Saba Fakes* tribunal explained

> it would run counter to the object and purpose of investment protection treaties to deny substantive protections to those investments that … violate domestic laws that are unrelated to the very nature of investment regulation. In the event that an investor breaches a requirement of domestic law, a host State can take appropriate action against such investor within the framework of its domestic legislation. However, unless specifically stated in the investment treaty under consideration, a host State should not be in a position to rely on its domestic legislation beyond the sphere of investment regime to escape its international undertakings vis-à-vis investments made in its territory.[190]

[189] *Saba Fakes* Award ¶¶ 112-14, C-377.

[190] *Saba Fakes* Award ¶ 119, C-377.

133. Furthermore, the tribunals that have rejected jurisdiction on grounds of illegality have done so when an investment amounted to fraud. For example, in *Phoenix*, the tribunal concluded that the claimant had abused the system of ICSID investment arbitration by restructuring its investment after the dispute arose to disguise what was "in essence domestic investments. ... [as] international investments for the sole purpose of access to" BIT and ICSID protection.[191] Similarly, in the *Plama* case, the tribunal found that the investment was "the result of a deliberate concealment amounting to fraud, calculated to induce the Bulgarian authorities to authorize the transfer of shares to an entity that did not have the financial and managerial capacity required to resume the operations of the Refinery."[192]

134. Here, by contrast, Kazakhstan's claims of illegality are entirely based on hyper-technical, minute formalities of Kazakh corporate law in relation to corporate formation, registration, transfer, and reorganization. Those allegations are meritless – as explained further below – but in any event come nowhere close to the fraud at issue in the few treaty cases, such as *Phoenix* and *Plama*, in which tribunals have dismissed claims on the basis of illegality. Hyper-technical, formalistic allegations of "illegality" have been uniformly rejected in treaty cases. For example, the tribunal in *Tokios Tokeles v. Ukraine* found that:

> [G]overnmental authorities of the Respondent registered the Claimant's subsidiary as a valid enterprise in 1994, and, over the next eight years, registered each of the Claimant's investment in Ukraine, as documented in twenty-three Informational Notices of Payment of Foreign Investment. The Respondent now alleges that some of the documents underlying these registered investments contain defects of various types, some of which relate to matters of Ukrainian law. Even if we were able to confirm the Respondent's allegations, which would require a searching examination of minute details of administrative procedures in Ukrainian law, to exclude an investment on the basis of such minor errors would be inconsistent with the object and purpose of the Treaty. In our view, the Respondent's registration of each of the Claimant's investments indicate that the "investment" in question was made in accordance with the laws and regulations of Ukraine.[193]

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[191] *Phoenix* Award ¶ 144, R-31.

[192] *Plama Consortium Ltd. v. Bulgaria*, ICSID Case No. ARB/03/24, Award, August 27, 2008 (hereinafter "*Plama* Award"), ¶ 135, C-400.

[193] *Tokios Tokelés v. Ukraine*, ICSID Case No. ARB/02/18, Decision on Jurisdiction, April 29, 2004 (hereinafter "*Tokios* Decision on Jurisdiction"), ¶¶ 85-86 (footnotes omitted), C-401.

135. Kazakhstan repeatedly inspected and approved the corporate structures of KPM and TNG over many years. It failed to allege that anything about KPM's or TNG's corporate structures was "illegal" or "improper" prior to this arbitration. That, too, suffices to reject Kazakhstan's formalistic claims of "illegality" in this case.

136. The *Saluka* tribunal considered the host state's repeated acknowledgements of the investment in question, which led it to reject the state's jurisdictional objection. It stated:

> [T]he Tribunal notes that, throughout the events giving rise to this arbitration, the Czech authorities have never questioned either the legality of the original transaction by which Nomura acquired the IPB shares, or the legality of Saluka's subsequent ownership of them: on the contrary, the Czech authorities took many steps explicitly acknowledging Saluka's status as properly the owner of those shares after October 1998.[194]

137. *Tokios Tokeles* and *Saluka* show that, even when the definition of investment requires that investments be made in accordance with domestic law, minor technicalities — particularly technicalities that the state itself disregarded — will not preclude jurisdiction.

138. As shown in the sections that follow, all of Kazakhstan's allegations of "illegal" corporate formation are contrived and meritless. But even if they were accurate, those alleged "illegalities" were at most minor technicalities — *i.e.*, failure to file all the right registrations and obtain all the right approvals in a complex and ever-changing regulatory scheme. The minor nature of those alleged defects is confirmed by the fact that Kazakhstan never once challenged the legality of Claimants' investments, and in fact explicitly approved those investments, prior to its decision to expropriate in October 2008. Kazakhstan does not even allege illegalities remotely approaching the level of fraud and intentional misconduct that prevented jurisdiction in the *Phoenix* and *Plama* cases, the sole support on which it relies.

a. The State Never Challenged the Legality of Claimants' Investments Before Its Expropriation Campaign Began

139. Kazakhstan argues that KPM and TNG violated Kazakh law applicable to the companies' establishment and issuance and transfer of shares. In fact, when describing the alleged violations, Respondent uses the word "illegal" so often that the Tribunal might wonder if

[194] *Saluka* Partial Award ¶ 217, C-259.

KPM and TNG did anything "legally" during their decade-long corporate existence. Indeed, it is surprising how many Kazakh state authorities never noticed any such "illegalities" over the many years that KPM and TNG operated successfully, with state authorities all the while issuing official acts, accepting their taxes, conducting routine audits, and supporting their substantial investments in the national economy.

140. Of course, the truth is that Kazakhstan invented those alleged "illegalities" as part of its campaign of indirect expropriation, commenced by President Nazarbayev in October 2008, and in its more recent efforts to escape jurisdiction in this arbitration. Kazakhstan never once attempted to challenge the registration, reorganization, and/or issuance and transfer of shares in KPM or TNG in domestic court proceedings, or impose any other liability for the supposed violations, in the years prior to October 2008. Indeed, Kazakhstan did not make the vast majority of those "illegality" allegations at any time prior to filing its Statement of Defense.

141. In particular, Kazakhstan never relied upon any of its current allegations of "illegality" in order to terminate the Subsoil Use Contracts. Even supposing that any of the purported violations could have served as a legal ground for termination of the Subsoil Use Contracts (and they could not have), Kazakhstan did not base its July 2010 termination of the Contracts on such grounds, and cannot retroactively rely upon them now.

b. KPM Was Validly Formed and Existing Under Kazakh Law

i. KPM's Formation Can No Longer Be Challenged

142. Kazakhstan argues that KPM failed to timely submit documents required for state registration of its initial issuance of shares and therefore: (a) "KPM was never legally formed;"[195] and (b) subsequent transactions with respect to those shares were "invalid."[196] Even if the founders of KPM (who were not Claimants) failed to timely submit such documents, that did not result in "illegal formation" *per se*. Rather, any such failure merely gave Kazakh officials the right to challenge the legality of KPM's formation before the Kazakh courts. Kazakhstan, however, never did so, and by the time of the transfer of shares to Claimants, the requirement for state registration had been abolished.

[195] Statement of Defense ¶ 13.7.

[196] Statement of Defense ¶ 13.4(e).

143. In its Statement of Defense, Kazakhstan refers to Article 16 of the Kazakhstan Law on Securities Market,[197] which provides an obligation for a newly established joint-stock company to submit documents for state registration of its initial share issuance within three months after its registration as a legal entity. Kazakhstan asserts that "KPM was never legally formed" because "KPM did not submit these documents for registration at the time it was created."[198] Kazakhstan neglects to mention, however, that the same paragraph of Article 16 provides that in the event of a violation of this requirement, the "competent authority has a right to file a lawsuit in court to claim such company's reorganization or liquidation."[199] That never occurred.

144. Article 157 of the Civil Code of Kazakhstan is the basic provision on invalid transactions under Kazakh law.[200] Contrary to rules on the same subject matter in other jurisdictions, the Kazakh Civil Code "does not divide invalid transactions into void and voidable transactions . . . "[201] Thus, under Kazakh law, there is no such concept as a transaction that was void *ab initio*.[202] Rather, as follows from Article 157(1) of the Civil Code, all transactions remain valid until voided by a court.[203] Article 157(1) of the Civil Code expressly states in this regard:

> In case of violations of the requirements made to the form, content, or participants of a transaction and also to the freedom of their expression of will, a transaction may be declared invalid on suit of interested persons, the appropriate state body, or the public prosecutor.[204]

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197 Law No. 77-1 on Securities Market, art. 16, March 5, 1997, R-7.

198 Statement of Defense ¶ 13.7.

199 Law No. 77-1 on Securities Market, art. 16, March 5, 1997, R-7. *See* Expert Report of Professor Peter B. Maggs, May 5, 2012 (hereinafter "Maggs Report") ¶¶ 32-33.

200 Maggs Report ¶¶ 19-20.

201 Professor Yuri Bassin, *in* CIVIL CODE OF THE REPUBLIC OF KAZAKHSTAN (GENERAL PART), COMMENTARY (ed. M.K. Suleymenov & Yu. G. Bassin, 1998), Vol. 1, at 350-351, C-402. *See* also Maggs Report ¶ 20.

202 Maggs Report ¶ 20.

203 Maggs Report ¶¶ 20-21.

204 Article 157(1) of the Kazakh Civil Code, C-403. Kazakhstan quotes Article 157(8) of its Civil Code — in a typical *non sequitur* — without explaining that "invalid transactions" need to be declared invalid by a court decision. *See* Statement of Defense ¶ 13.4(g).

145. Kazakhstan has not pointed to any claims (and Claimants are aware of none)[205] brought by state authorities to challenge KPM's formation on the basis of its failure to register the initial share issuance. Moreover, under Article 178(1) of the Kazakh Civil Code, the statute of limitations for such claims is three years.[206] Article 180(1) of the Kazakh Civil Code provides that the statute of limitations commences to run from the date a person knew or should have known of a violation.[207] Kazakhstan knew or should have known that KPM failed to comply with any filing technicality once the three-month time limit lapsed.[208] Pursuant to Article 179(3) of the Kazakh Civil Code, expiration of the statute of limitations precludes further claims on that ground.[209] Therefore, as of June 24, 2000,[210] the legality of the formation of KPM on the ground of its failure to timely register its initial issuance of shares could not be challenged as a matter of Kazakh law.

ii. Transactions With KPM's Shares Were Valid

146. Kazakhstan also contends that Ascom's acquisitions of KPM shares in 1999 and 2004 were "illegal" because KPM's shares were not registered, and "transactions involving shares that were issued but not registered in accordance with Kazakh law are invalid."[211] Kazakhstan fails to mention, however, that joint-stock companies were exempted from any obligation to register their initial issuance of shares in 1998, before the transactions at issue here.

147. In July 1998, Article 16 of the Kazakh Law on Securities Market regarding registration of shares was substantially amended.[212] After that amendment, joint-stock companies (except for banks and some other specific types of companies not applicable here)

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205 *See* Second Pisica Statement ¶ 5.

206 *See* Maggs Report ¶¶ 23; 34.

207 *See* Maggs Report ¶ 25. Article 180(2) of the Kazakh Civil Code provides that with respect to obligations which have a statutory term for their performance, the statute of limitations commences to run from the date when the relevant time limit for performance expires, C-403.

208 *See* Maggs Report ¶ 34.

209 *See* Maggs Report ¶ 26.

210 KPM was registered on March 24, 1997; the statutory time limit to register the issuance of shares was 3 months; and the statute of limitation is 3 years. *See* also, Maggs Report ¶ 34.

211 Statement of Defense ¶ 13.4(f).

212 Law of the Republic of Kazakhstan No. 282-1 "On Amendments to Certain Legislative Acts of the Republic of Kazakhstan on Questions Related to Joint-Stock Companies," July 10, 1998, C-404. Maggs Report ¶¶ 36-37.

were released from the obligation to register their initial share issuance.[213] Closed joint-stock companies were also released from registration of their subsequent share issues.[214]

148. In August 1998, to implement this amendment, the Kazakh National Securities Commission established an interim procedure under which an issuance of shares not subject to state registration required a national identification number.[215] Pursuant to that procedure, in order to obtain an identification number, an issuer had to provide a set of documents for review by the National Securities Commission.[216] After completing its review, the National Securities Commission could either assign a national identification number, or refuse to do so if its review of the submitted documents revealed any violation of law by the issuer.[217] The procedure did not provide a time period within which an issuer was required to obtain this identification number.

149. Ascom first acquired shares in KPM in December 1999, *i.e.*, after the obligation to register the initial issuance of shares no longer applied to KPM.[218] On January 24, 2000, KPM obtained a national identification number with respect to the initial issuance of its shares.[219] The National Securities Commission accepted KPM's application for an identification number without mention of the failure to register the initial issuance of shares. If "any irregularities existed …, the National Securities Commission was under a duty to notify KPM of these irregularities instead of assigning the number."[220] Therefore, KPM's initial issuance of shares duly complied with Kazakh law from at least that moment forward.

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213 Therefore, the reference by Kazakhstan to Article 17 of the Law on Securities Markets pursuant to which "securities issues that do not appear in the State Register of Securities Issues of the Republic of Kazakhstan are invalid" is irrelevant for KPM's shares as this procedure was not applicable to KPM. *See* Statement of Defense ¶ 13.4(d). Maggs Report ¶ 36.

214 *See* Maggs Report ¶ 37.

215 Order of the Kazakhstan National Securities Commission No. 144 "On Interim Procedure for Assignment of Identification Numbers to Certain Types of Shares Emissions," August 14, 1998, C-405. Maggs Report ¶ 38.

216 Order of the Kazakhstan National Securities Commission No. 144 "On Interim Procedure for Assignment of Identification Numbers to Certain Types of Shares Emissions," art. 1, August 14, 1998, C-405; Maggs Report ¶ 38.

217 Order of the Kazakhstan National Securities Commission No. 144 "On Interim Procedure for Assignment of Identification Numbers to Certain Types of Shares Emissions," arts. 1-2, August 14, 1998, C-405; Maggs Report ¶ 39.

218 Certificate of State Registration of KPM, December 13, 1999, R-12.

219 Letter from the National Securities Commission to KPM, January 24, 2000, C-406.

220 Maggs Report ¶¶ 38-40.

iii. KPM Is a Commercial Company

150. Kazakhstan further alleges that KPM was initially established as a non-profit organization, and was re-registered into a commercial company on December 13, 1999 in violation of Kazakh law.[221] KPM, however, has always been a commercial company, and the supposed re-registration as a commercial entity was nothing more than Kazakhstan's correction of its own clerical error.

151. First, KPM plainly was created as a commercial company at the time of its formation. Article 1.5 of KPM's Foundation Agreement explicitly states that "KPM is a commercial organization."[222] KPM provided copies of its Charter and Foundation Agreement for purposes of its registration, as evidenced by the stamp from the Kazakh registration authorities on the cover page.[223] As explained by Professor Maggs, Claimants' expert on Kazakh corporate law, "if the registration authorities had correctly performed their obligations, they would have registered KPM as a 'commercial organization.'"[224]

152. Moreover, under Kazakh law,[225] a charter of a non-profit organization has to contain certain provisions related to the non-profit goals of the company. KPM's Charter contains no such provisions, and thus it would have been impossible to register KPM as a nonprofit company.

153. Additionally, under Kazakh law, the main criterion that defines a company as non-commercial is the fact that such company "does not derive profits as a main business activity and does not distribute profits among its participants."[226] Article 1.7 of KPM's Foundation Agreement explicitly provides that "the main goal of KPM's operations is to obtain profit by means of conducting activities envisaged by its Charter and this Agreement."[227]

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221 Statement of Defense ¶¶ 13.3, 13.10-13.15.

222 1997 Charter of KPM, C-407.

223 1997 Charter of KPM and 1997 Foundation Agreement, C-407 and C-408. *See also* Maggs Report ¶ 30.

224 Maggs Report ¶¶ 30-31.

225 Maggs Report ¶ 28 citing Kazakh Civil Code art. 41.

226 Kazakh Civil Code art. 34(1), C-403.

227 KPM Foundation Agreement art. 1.7, C-408.

154. KPM has been engaged in commercial activity since its establishment, as Kazakhstan was always aware. KPM obtained its Subsoil Use License in May 1997, more than two years prior to the alleged reorganization. Annex No. 2 to KPM's Subsoil License explicitly states that KPM's main area of business is "execution of prospecting, exploration, development and exploitation of oil and gas fields in capacity as of the investor and the contractor, as well as ***commercial and any other activities*** allowed under the existing legislation of the Republic of Kazakhstan."[228] Kazakhstan thus granted KPM a license to conduct operations that are decidedly for profit long before its supposed reorganization into a commercial company. Indeed, Contract No. 305 — which was concluded in March 1999, also prior to the alleged reorganization — provides expressly that:

(1) the Borankol field shall be returned to the Republic of Kazakhstan if it is deemed to lack any commercial viability;[229]

(2) KPM can "keep revenues resulting from export and sale of Hydrocarbons outside the Republic of Kazakhstan;"[230]

(3) KPM's founders "may elect to receive his share of net income and recover investment in kind;"[231] and

(4) KPM can "export the return on investment as well as its pure income in accordance with provisions of this Contract and any other sums according to applicable legislation."[232]

Thus, Kazakhstan always expected KPM to conduct commercial activities, generate income, and repatriate that income to its foreign owners.

155. Claimants have no knowledge of the alleged December 1999 re-registration as a commercial entity, or the documents submitted by Respondent that supposedly evidence that reorganization (Exhibits R-9, R-12, and R-13).[233] The probative value of those documents is highly doubtful because they are not self-explanatory, and Kazakhstan submits them without any

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228 KPM's Subsoil Use License (emphasis added), at 28, C-45

229 Contract No. 305 art. 4.3, C-45.

230 Contract No. 305 art. 7.1.18, C-45.

231 Contract No. 305 art. 15.9.2, C-45.

232 Contract No. 305 art. 7.1.19, C-45.

233 Second Pisica Statement ¶ 20.

explanation of how the documents are maintained or what they mean.[234] Even assuming that those documents indeed reflect a change in KPM's classification in some Kazakh registry from "non-commercial" to "commercial," Respondent presents no evidence that Claimants were even aware of that change, much less the cause of it. They were not.[235] In light of the fact that KPM always had been a commercial entity, as repeatedly recognized by Kazakhstan, it is likely that any such change was simply the correction of a clerical error in Kazakhstan's own registry.[236]

c. KPM and TNG Do Not Lack Any Required Consents of the Licensing and Competent Authorities for the Transfers of Shares to Claimants

156. Kazakhstan asserts that Claimants' acquisitions of KPM and TNG shares were illegal because they failed to obtain written consents from the Licensing Authority and the Competent Authority, as required by Article 53 of the 1995 Petroleum Law.[237] This argument fails because at the time of the share transfers at issue, the licensing regime had been abolished, and thus consent from the Licensing Authority was no longer required. Moreover, Kazakh law required consent of the Competent Authority only for transfers of subsoil use rights from one user to another, not transfers of shares in a subsoil user. Additionally, in an abundance of caution, Claimants twice sought consent for transfers of shares in KPM and TNG, and either received consent or were told that it was not required. Only after Kazakhstan commenced its expropriation campaign in October 2008 did Kazakhstan contend that those share transfers lacked the required consents.

157. In August 1999, Kazakhstan abolished its dual licensing and contracting system with respect to subsoil use and moved to a contract-only system of subsoil use ("1999

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234 For instance, these registration records as of March 1997 and December 1999 include a reference to a Business Identification Number ("BIN"), which was only introduced in Kazakhstan in January 2007. *See* Law No. 223-III on National Registers of Identification Numbers, arts. 1, 9, January 12, 2007, C-409.

235 Second Pisica Statement ¶ 20.

236 Maggs Report ¶¶ 29-30. Regardless, even if Kazakhstan were correct that such a re-registration occurred in December 1999, that fact would not mean that Claimants' investments are illegal for purposes of evaluating jurisdiction in this matter. On Kazakhstan's own evidence, state authorities registered such reorganization without objection, and did not challenge that reorganization for nearly twelve years. Thus, the statute of limitations for any such challenge has expired. *See* Kazakh Civil Code art. 178(1), C-403.

237 Statement of Defense ¶¶ 13.21, 13.27.

Amendments Law").[238] Pre-existing subsoil use licenses remained in force and their "suspension, revocation, termination, and invalidation" were still governed by the 1996 Subsoil Use Law in force prior to the 1999 Amendments Law.[239] The 1999 Amendments Law effectively "froze" the licenses, which could only be suspended or withdrawn—but not amended—by the state authorities.[240] Thus, only the subsoil use contracts could reflect amendments to the terms of a subsoil user's rights and obligations.

158. The 1999 Amendments Law also resulted in a number of sweeping changes to various legislative acts that largely eliminated references to a Licensing Authority and its powers. In particular, those amendments deleted Article 7 of the 1996 Subsoil Law (*Transfer of Subsoil Use Rights*), which had empowered the Government of Kazakhstan to issue and amend licenses for subsoil use.[241] Additionally, Article 8(1) of the 1996 Subsoil Law, which previously stated that the Competent Authority "submits to the Licensing Authority proposals for revocation of a License or making amendments thereto," was amended to provide that the "[Competent Authority] issues consents for transfer of Subsoil Use Rights."[242] Likewise, the amendments substituted the Competent Authority for the Licensing Authority in Article 14 of the 1996 Subsoil Law, which thereafter provided:

> The transfer of Subsoil Use Rights by the subsoil user to another party, made either against payment or for free, including by contributing to the charter capital of a new legal entity, except for the transfer of the subsoil use right as collateral, shall be permitted only with the consent of the Competent Authority [authorized government body].[243]

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[238] Law on Amendments and additions to certain legislative acts of the Republic of Kazakhstan relating to subsurface use and the conduct of petroleum operations in the Republic of Kazakhstan, August 11, 1999 and effective from September 1, 1999 (hereinafter "1999 Amendments Law"), C-410; Maggs Report ¶¶ 41-55.

[239] Law of the Republic of Kazakhstan art. 2(3), August 11, 1999, R-21; Statement of Defense ¶ 13.49; Maggs Report ¶ 53.

[240] M.K. Suleymenov & E.B. Osipov, "Review of the Legislative Base for Investments in Oil and Gas Sector of the Republic of Kazakhstan," quoted in Maggs Report ¶ 55 ("Therefore, according to the new legislation, changes are introduced not in the license; they are made in the contract. And it will be enough.").

[241] 1999 Amendments Law, C-410.

[242] *Id.*

[243] *Id.* Maggs Report ¶¶ 49, 51.

159. All of Claimants' acquisitions of shares in KPM and TNG occurred after the elimination of the licensing regime and authority.[244]

160. Moreover, as quoted above, Article 14 of the 1996 Subsoil Law only required consent of the Competent Authority when a subsoil user transferred its subsoil rights to another party.[245] It did not require such consent for a transfer of shares in a subsoil user from one shareholder to another.[246]

161. Kazakhstan, however, relies on Article 53 of the 1995 Petroleum Law rather than Article 14 of the Subsoil Law. The 1995 law provided:

> Contractor can transfer to a physical person or legal entity or international organization all or part of its rights and obligations under the [subsoil use] agreement, including by means of alienation of a majority stake of shares, only upon written consent of a Licensing and Competent Authorities . . .[247]

162. While that statute technically existed when the share transfers in question occurred, it did not apply as a result of Kazakh laws governing the hierarchy of statutory acts.[248] Under Article 6(2) of the Law of the Republic of Kazakhstan on Normative Legal Acts, in the event of a contradiction between provisions of statutory acts of the same level, "the provisions of the act enacted later should prevail."[249] The 1996 Subsoil Use Law and the 1995 Petroleum Law are on the same level, and thus the later enacted 1996 Subsoil Use Law controls.[250] Under Article 14 of the 1996 law, consent was only required for a transfer of subsoil rights from one user to another.[251]

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244 Second Pisica Statement ¶¶ 12, 23.

245 Maggs Report ¶ 51.

246 Maggs Report ¶ 59.

247 1995 Law on Oil art. 53(1), C-411.

248 Maggs Report ¶¶ 10-14.

249 Law of the Republic of Kazakhstan on Normative Legal Acts, art. 6(2), March 24, 1998, C-412. Maggs Report ¶ 12.

250 Maggs Report ¶ 50.

251 *See* Maggs Report ¶¶ 47, 51, and 59. Moreover, Article 37 of the 1996 Subsoil Use Law provided that "The rights and obligations of a Licensee may be assigned to any other entity in accordance with Article 14 of this Law." *See* 1996 Subsoil Use Law art. 37, C-413.

163. In short, Article 53 of the 1995 Petroleum Law was an anachronism after the enactment of the 1996 Subsoil Use Law, and particularly after the 1999 Amendments Law that abolished the licensing regime. This was confirmed in December 2004 when Article 53 was amended to be consistent with the 1996 Subsoil Use Law by deleting references to (i) "transfer… by means of alienation of a majority stake of shares" and (ii) "consent of … a Licensing Authority" (which no longer existed).[252] Kazakhstan is therefore wrong in asserting that Claimants' acquisitions of KPM and TNG shares were illegal because they failed to obtain written consents as required by Article 53 of the 1995 Petroleum Law.

164. In light of the confusion in these provisions,[253] however, KPM and TNG twice sought consent for share transfers They either received consent or were informed that no consent was required.

165. First, KPM submitted a request to the Agency of the Republic of Kazakhstan on Investment ("Agency on Investment") for consent with respect to Ascom Group's acquisition of a 62% share of KPM on November 18, 1999.[254] This was the first acquisition conducted by Claimants with respect to KPM or TNG. The Agency on Investment answered:

> In response to your request to provide a consent for inclusion of Ascom S.A. in the structure of shareholders of ZAO SP Kazpolmunai with a 62% share, including rights provided in the contract, we note the following.
>
> Decision on change in shareholding structure is within the competence of a general shareholders' meeting.[255]

166. Kazakhstan attempts to dismiss this fact with the assertion that "up until 2003 ... the competent authority was the MEMR," and thus, Claimants had "liaised" with an entity that was not the competent authority.[256] That is simply untrue. As noted in Respondent's own evidence on this point, "[v]arious state bodies acted as the Competent Body at different periods

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[252] *See* 1995 Law on Oil, art.53, C-411.3 as amended by Law No. 2-III of the Republic of Kazakhstan "On introduction of amendments and additions to some legislative acts of the Republic of Kazakhstan concerning subsoil use and performance of oil operations in the Republic of Kazakhstan," C-414.

[253] Second Pisica Statement ¶¶ 9-10.

[254] Letter No. 01-37 from the Agency on Investment to KPM, November 19, 1999, C-47; Second Pisica Statement ¶ 10.

[255] Letter No. 01-37 from the Agency on Investment to KPM, November 19, 1999, C-47.

[256] Statement of Defense ¶¶ 13.19, 13.20.

of time."[257] Following Resolution 474 of the Government of the Republic of Kazakhstan on April 26, 1999, the Competent Authority was the Agency on Investment.[258] The MEMR was not even created until December 13, 2000, and only then were the Agency on Investment's functions relating to subsoil use transferred to the MEMR.[259]

167. Second, in February 2007, the State requested that TNG apply for consent for the 2003 transfer of TNG shares from Gheso to Terra Raf.[260] Although TNG disagreed that such consent was required, TNG complied because there was no reason to think that consent would be declined. On February 20, 2007, the Appraisal Commission, which had responsibility for deciding requests for alienations of subsoil use agreements, issued a ruling expressly finding that there was no deadline within which TNG had to seek approval for the transfer of shares from Gheso to Terra Raf, and expressly allowing the transfer.[261]

168. Remarkably, Kazakhstan denies that it granted consent to the transfer from Gheso to Terra Raf on the grounds that Exhibit 134 is an "internal government document," and that Claimants have provided no evidence that the document was "legitimately shared with it."[262] That is simply not true. TNG received Exhibit 134 from the MEMR precisely because it was the document granting the permission for the share transfer that TNG had sought.[263] Regardless, Exhibit 134 clearly shows that the appropriate governmental body did consent to the share transfer. Moreover, when Kazakhstan later retroactively reversed its permission for the transfer as part of its indirect expropriation campaign, the MEMR's own press release acknowledged that

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257 "Sleeper" witness statement of Ms. V.I. Lebed, "Information about the license and competent authorities of the Republic of Kazakhstan in period from 1997 to present," at 3, R-17.

258 "Sleeper" witness statement of Ms. V.I. Lebed, "Information about the license and competent authorities of the Republic of Kazakhstan in period from 1997 to present," at 4, R-17.

259 "Sleeper" witness statement of Ms. V.I. Lebed, "Information about the license and competent authorities of the Republic of Kazakhstan in period from 1997 to present," at 4-5, R-17.

260 Letter from the MEMR to TNG, February 13, 2007, C-132.

261 Excerpt from the Minutes of Meeting of the Appraisal Commission, February 20, 2007, C-134. *See* also First Witness Statement of Grigore Pisica, May 17, 2011 (hereinafter "First Pisica Statement") ¶ 27.

262 Statement of Defense ¶ 13.47(c)(iii).

263 Letter from the MEMR to TNG attaching the Minutes of Meeting of the Appraisal Commission, February 21, 2007, C-415.

it had "annulled the earlier issued permit" that TNG had received for the share transfer in February 2007, conceding that approval had, in fact, been granted.[264]

d. The Reorganizations of KPM and TNG into LLPs Were Lawful

169. In its Statement of Defense, Kazakhstan also argues that the reorganizations of KPM and TNG from joint-stock companies into limited liability partnerships in 2005 were illegal because Claimants were not the lawful shareholders, and therefore were not entitled to conduct the reorganization.[265] That argument is meritless.

170. The sole basis for Kazakhstan's argument that Claimants were not the lawful shareholders of KPM and TNG at the time of the reorganizations into LLPs, is the various alleged "illegalities" already discussed (*i.e.*, improper registration at formation, improper conversion to a commercial entity, and improper consent for share transfers). Claimants have demonstrated that all of those allegations are baseless, and that Ascom and Terra Raf were the lawful shareholders of KPM and TNG (respectively) when the reorganization occurred.[266] In addition, as explained by Professor Maggs, pursuant to Article 157(1) of the Kazakh Civil Code,

> Kazakhstan law has no "domino theory" applicable to a chain of transactions, each of which depends on the validity of the previous transaction. In general, a court finding of invalidity of the first transaction in the chain does not automatically invalidate later transactions in the chain. Rather every transaction in the chain remains valid until voided by court action.[267]

171. Moreover, pursuant to Article 45(4) of the Kazakh Civil Code,[268] reorganization of a legal entity is deemed completed upon state registration. As evidenced by certificates of

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264 Press release circulated on Interfax from the MEMR, December 18, 2008, C-141.

265 Statement of Defense ¶¶ 13.23-13.26; 13.30-13.33.

266 Moreover, under Kazakh law, rights to shares can be proven by an extract from the records of the share register. (Law of the Republic of Kazakhstan No. 78-1 "On Registration of Transactions with Securities in the Republic of Kazakhstan," art. 26(2), March 5, 1997, C-416.) The extracts from the records of the share registers at the relevant time demonstrate that Ascom and Terra Raf were the sole shareholders of KPM and TNG respectively. *See* Extract from the register of shareholders No. 1397, December 12, 2004 and extract from the register of shareholders No. 83/01, May 28, 2003, C-50 and C-418.

267 Maggs Report, ¶ 21.

268 Kazakh Civil Code art. 45(4), C-403.

state registration issued in May 2005,[269] Kazakh authorities duly registered the reorganizations of KPM and TNG into LLPs at that time. If there had been any reason to deny the reorganization, Kazakh authorities undoubtedly would not have registered them.

172. Kazakhstan never challenged the validity of the reorganizations in question prior to filing its Statement of Defense. The statute of limitations for bringing such claims is three years, and thus has long expired.[270] Accordingly, even if the reorganizations were invalid because of the alleged defects in the formation and registration of KPM and TNG – which is not the case – this is yet another stale technicality that Respondent never challenged when it had the ability to do so.

e. KPM's and TNG's Subsoil Use Rights Were Valid

173. Kazakhstan also claims that amendments and addenda to KPM's and TNG's subsoil use contracts were invalid because the companies failed to amend their subsoil licenses at the same time.[271] This argument suffers from several fatal flaws.

174. First, the Law on Licensing, dated April 17, 1995, that Kazakhstan relies upon for its argument was not applicable to subsoil use licenses. "Subsoil use" was excluded from the list of activities regulated by the Law on Licensing by Order of the President No. 2720 dated December 23, 1995.[272]

175. Shortly thereafter, on January 27, 1996, the new Subsoil Use Law was enacted. The 1996 Subsoil Use Law provided that subsoil use was subject to licensing in accordance with special procedures to be detailed by the competent authorities. That procedure was detailed by Resolution of the Government No. 1017 "On Procedure for Subsoil Use Licensing in Kazakhstan" dated August 16, 1996.[273]

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[269] KPM's and TNG's Certificates of Incorporation, C-37 and C-40. *See* also, Supplement No. 5 to KPM's Contract No. 305, C-45; Supplement No. 7 to TNG's Contract No. 210, C-52; and Supplement No. 4 to TNG's Contract No. 302, C-53.

[270] Kazakh Civil Code 178(1), C-403; Maggs Report ¶ 23.

[271] Statement of Defense ¶¶ 13.58-13.63.

[272] Order of the President No. 2720, December 23, 1995, C-419.

[273] Resolution of the Government No. 1017 "On Procedure for Subsoil Use Licensing in Kazakhstan," August 16, 1996, R-164.

176. The subsoil licenses of KPM and TNG were issued in May and December 1997 respectively, *i.e.*, after the procedures described above took effect. The earlier 1995 Law on Licensing therefore did not apply to the issuance and amending of KPM's and TNG's subsoil use licenses.

177. Additionally, in August 1999, Kazakhstan abolished its dual licensing and contracting system with respect to subsoil use and moved to a contract-only system.[274] Kazakhstan correctly asserts that the 1999 Amendments Law did not abolish the subsoil rights created by pre-existing licenses when it abolished the licensing system. Kazakhstan misleads the Tribunal, however, when it argues that those pre-existing licenses could and should have been amended.[275] In fact, amendments to subsoil use licenses were effectively replaced by amendments to subsoil use agreements after the 1999 Amendments Law.[276]

178. Because the effect of the 1999 Amendments Law and the relationship between the licenses and subsoil use agreements were not entirely clear, in December 1999, KPM applied to the Competent Authority for an explanation of these issues.[277] The Agency on Investment, which was the Competent Authority at the time (as described in Section II.D.2.c above), informed KPM that:

> Due to the changes and amendments introduced into the Law of Kazakhstan "On Subsoil and Subsoil Use" dated August 11, 1999, licenses for subsoil use shall no longer be issued; no changes or amendments shall be introduced to licenses issued earlier.[278]

179. The Agency on Investments was not only the Competent Authority, but also served as the liaison between the Contractor or subsoil user and the Licensing Authority. Pursuant to the Subsoil Use Contracts[279] and the Subsoil Use Law (as in force before the 1999

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274 1999 Amendments Law, C-410. *See* Maggs Report ¶¶ 41-46.

275 Statement of Defense ¶ 13.49.

276 Maggs Report ¶¶ 47-59.

277 Letter from KPM to the Agency on Investments, December 23, 1999, C-49; Second Pisica Statement ¶¶ 14-15.

278 Letter No. 3-199 from the Agency on Investments to KPM, January 18, 2000, C-420; Second Pisica Statement ¶ 15.

279 Contract No. 305 arts. 7.3.2, 7.4.2, C-45; Contract No. 210 arts. 6.3.2, 6.4.2, C-52; Contract No. 302 arts. 6.3.3 and 6.4.2, C-53.

Amendments Law),[280] the Competent Authority was responsible for applying to the Licensing Authority for any required amendments to the Subsoil Use Licenses.[281] The subsoil user was neither obliged nor authorized to directly seek amendments to its Subsoil Use Licenses from the Licensing Authority.[282] Therefore, by its letter of January 18, 2000, the Agency on Investments was informing KPM that it would not apply to the Licensing Authority to amend the Subsoil Use License.[283]

180. The Government of Kazakhstan subsequently reaffirmed this point in minutes of a meeting dated May 14, 2002:

> [D]ue to abolishment of licensing system with respect to provision of subsoil use rights pursuant to Law of the Republic of Kazakhstan dated August 11, 1999 … amendments to conditions of subsoil use shall be made by amendments to respective Subsoil Use Contracts upon agreement between a subsoil user and the Competent Authority, acting within its powers, ***without making amendments to subsoil use licenses*** issued earlier.[284]

181. The MEMR also confirmed this position to the Financial Police in early December 2008, toward the beginning of Kazakhstan's coercion campaign:

> Law of the Republic of Kazakhstan No. 467 of August 11, 1999 abolished the licensing system for granting subsoil use rights.
>
> Therefore, the Ministry of Energy and Mineral Resources of the Republic of Kazakhstan did not amend the subsoil use licenses of TOO SP Kazpolmunay and TOO Tolkynneftegaz.[285]

182. Therefore, TNG and KPM violated no provision of Kazakh law when making amendments to their subsoil use contracts without amending the respective subsoil use licenses. The Subsoil Use Contracts of TNG and KPM were valid at all times, as amended.

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[280] 1996 Subsoil Use Law art. 8(1)(6), C-413.

[281] Maggs Report ¶ 57.

[282] Maggs Report ¶¶ 58.

[283] Second Pisica Statement ¶ 15.

[284] Minutes of Governmental meeting No. 17-23/I-404, May 14, 2002 (emphasis added), C-421. *See also* Second Pisica Statement ¶ 16.

[285] Letter from the MEMR to the Financial Police, December 4, 2008, C-422.

f. Waiver of State's Pre-emptive Rights

183. Kazakhstan argues in its Statement of Defense that "[a]s a result of the various share transfers being illegal for the reasons set out above, any attempts to rectify the issues after December 2004 would have also required the Claimants to apply to the Republic for a waiver from the state of its pre-emptive right to purchase KPM and TNG," which Claimants failed to do.[286] This argument is severely flawed for numerous reasons.

184. To begin with, Kazakhstan had no pre-emptive rights at the time any of the transactions occurred (the last transaction was the acquisition by Ascom of the remaining 38% shareholding in KPM in November 2004). The State's pre-emptive right to acquire shares in subsoil users arose on December 8, 2004 pursuant to the enactment of Law No. 2-III, which amended Article 71 of the 1996 Subsoil Use Law.[287] The amended Article 71 gave Kazakhstan a pre-emptive right with respect to newly concluded subsoil use agreements as well as to those concluded prior to enactment of Law No. 2-III. The law, however, only applied to *prospective*, transactions.[288] Thus, while the pre-emptive right applied to KPM and TNG prospectively, it did not require them to obtain a waiver for share transfers that occurred prior to December 2004.

185. The transfers of shares in TNG and KPM all took place prior to the enactment of the pre-emptive right legislation, and that legislation did not enable Kazakhstan to retroactively exercise a pre-emptive right. The MEMR confirmed this in minutes of its expert commission:

> [W]e hereby inform you that this article [71 of 1996 Subsoil Law] was amended on December 1, 2004 by part III by Law No. 2-III . . . while the investigated transaction was concluded in May 2003.
>
> According to article 4(1) of the Civil Code of the Republic of Kazakhstan, civil normative acts do not have retroactive value and apply only to the relationships occurred after their coming into force.[289]

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[286] Statement of Defense ¶¶ 13.22, 13.23, 13.34.

[287] Law No. 2-III of the Republic of Kazakhstan "On introduction of amendments and additions to some legislative acts of the Republic of Kazakhstan concerning subsoil use and performance of oil operations in the Republic of Kazakhstan," art. 1, December 1, 2004, R-19. Maggs Report ¶ 60.

[288] Maggs Report ¶¶ 62-64.

[289] Excerpt from the Minutes of Meeting of the Appraisal Commission, February 20, 2007, C-134.

186. Kazakhstan asserts that it was entitled to invoke its pre-emptive rights to the earlier transactions on the basis that any attempts to cure the various alleged defects in the approval of those transfers after December 2004 would trigger its ability to exercise a pre-emptive right. But Kazakhstan cites absolutely no legal basis for that argument, and there is none. As explained above, there were no defects in the transfers of shares in TNG and KPM to cure, either before or after December 2004. Moreover, even if it had been necessary for KPM and TNG to obtain consent to their share transfers after December 2004, the transfers themselves nonetheless occurred before December 2004. Kazakhstan's pre-emptive rights under Article 71 applied to transfers themselves, not to approvals of transfers that might have been required by other laws.

187. Moreover, Claimants twice obtained waivers of pre-emptive rights from Kazakhstan. First, in 2007, when Claimants planned an IPO on the London Stock Exchange, they applied for a waiver of the State's pre-emptive right with respect to shares to be transferred to an affiliated entity.[290] Claimants obtained the waiver of the State's pre-emptive right in due course.[291] This is not disputed by Kazakhstan.[292]

188. Second in February 2007, the State requested that TNG retroactively apply for permission for the 2003 transfer of TNG ownership to Terra Raf.[293] Although TNG did not believe it was required, TNG complied with the request. The State granted its permission for the transfer, accompanied by an explicit ruling that the May 12, 2003 transfer of TNG ownership from Gheso to Terra Raf was proper and the State's pre-emptive right did not apply.[294]

189. In December 2008, after commencing its campaign of harassment and coercion, Kazakhstan informed TNG that it revoked its waiver of pre-emptive rights granted in February

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[290] Letters from KPM and TNG to the MEMR, December 6, 2007, C-135 and C-423.

[291] Letters from the MEMR to KPM and TNG, December 29, 2007, C-139.

[292] Statement of Defense ¶ 13.47(f).

[293] Letter from the MEMR to TNG, February 13, 2007, C-132; Letter from TNG to the MEMR, February 19, 2007, C-424.

[294] Letter from the General Prosecutor's Office to the MEMR, February 21, 2007, C-133; Excerpt from the Minutes of Meeting of the Appraisal Commission, February 20, 2007, C-134. *See also* Letter from the MEMR to TNG, March 6, 2007 (stating that TNG "duly complies with license provisions and contractual obligations" and that "the Ministry does not have any claims within its competence related to the activity of [TNG]."), C-425.

2007.[295] On the same day, it issued a press release announcing the cancellation of the waiver, and accusing Claimants of fraud and forgery in obtaining the waiver.[296] Kazakhstan, however, has never presented a shred of evidence to support those allegations.

190. Moreover, Kazakhstan never acted on those allegations — no doubt because it knew it could not prove them. It did not attempt to seek judicial enforcement or initiate legal proceedings based on the alleged fraud and forgery. It did not even include the alleged fraud, forgery, and failure to obtain the pre-emptive rights waiver among the bases for its termination of the Subsoil Use Agreements in July 2010. Clearly, Kazakhstan's only objective in retroactively revoking its waiver and making its very public accusations was to cast a cloud on Claimants' title to TNG, making it impossible for Claimants to sell the business.

3. Kazakhstan Has Put Forward No Evidence of Claimants' Alleged "Bad Faith"

191. In a final attempt to convince the Tribunal that it does not have jurisdiction over this dispute, Kazakhstan lobs general, unsupported accusations of "bad faith" at Claimants. Those accusations are highly ironic, given the facts of this dispute and the manner in which Kazakhstan has conducted itself in this arbitration.

192. Specifically, Kazakhstan argues that Claimants' investments in Kazakhstan should not be treated as "investments" for the purposes of the ECT, because (i) proceeds from those investments were used to fund terrorist activities in South Sudan; (ii) KPM and TNG guaranteed bonds issued by Tristan Oil, which "diverted" money from Kazakhstan, somehow indicating a lack of good faith; and (iii) Claimants tried to illegally sell an investment they did not legally own in the "Project Zenith" process.

193. Each of those accusations is frivolous.[297] The "evidence" Kazakhstan submits in support of its allegations of bad faith boils down to unsubstantiated statements made by a

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[295] Notice letter from the MEMR to TNG, December 18, 2008, C-140.

[296] *See* Press release circulated on Interfax from the MEMR, December 18, 2008, C-141.

[297] Claimants do not dispute that good faith is a general principle of international law. As explained in their Statement of Claim, Kazakhstan's bad faith conduct breached its obligations towards Claimants' investments under the ECT. However, as mentioned above, the principle of good faith is not one of the elements of the definition of "investment" under Article 1(6), and Claimants' alleged bad faith should be examined by this Tribunal with the merits of the case, not as a jurisdictional matter. *See* Statement of Defense ¶ 9.46; Statement of Claim ¶ 345.

disgruntled former-employee in the context of a wrongful termination lawsuit, and the defamatory letter from President Voronin of Moldova, a political opponent of Mr. Stati, asking President Nazarbayev of Kazakhstan to investigate Mr. Stati. Aside from those documents, Kazakhstan points to its own mischaracterization of Claimants' case to suggest that Claimants have admitted the "bad faith" claims raised against them. Kazakhstan's misstatements will be addressed throughout this memorial, but with respect to its claims of bad faith in particular, the Tribunal should note that Kazakhstan either has submitted no proof of its arguments of bad faith, or its arguments are irrelevant because they do not amount to bad faith.

194. First, neither Kazakhstan in this case, nor President Voronin of Moldova elsewhere, has ever shown any evidence to support their claims that Mr. Stati funded terrorist groups in South Sudan.[298] In reality, Mr. Stati's investments in South Sudan are normal, commercial investments in the oil and gas industry.[299] Mr. Stati has contributed enormously to the well-being of the population of South Sudan by making substantial investments in oil and gas exploration and by building schools, a hospital, medical clinics, and means of transportation in the region where his investments are located.[300]

195. In relation to the terrorist allegation, Kazakhstan observes that it is "noteworthy and unusual that Claimants' misconduct was acknowledged at such a high political level."[301] In reality, the only thing that President Voronin's letter shows is that Moldova's former autocratic President had a political axe to grind with Mr. Stati, one of Moldova's most prominent businessmen and pro-democracy supporters. Voronin and fellow autocrat Nazarbayev teamed up to undermine Mr. Stati's investments in one country and his pro-democracy movement in the other.

196. Kazakhstan's claim with respect to the bonds that KPM and TNG guaranteed for Tristan Oil is simply puzzling. Claimants do not deny that KPM and TNG guaranteed bonds for Tristan Oil. But that is completely irrelevant to the question of whether KPM and TNG are valid investments under the ECT, and the bonds themselves show no evidence of bad faith on the part

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298 In fact, Moldova published a list of known terror-suspects, and unsurprisingly, Mr. Stati has never appeared on it. *See* List of Terrorist Suspects of Moldova, C-426.

299 Second Stati Statement ¶ 46.

300 *Id.*

301 Statement of Defense ¶ 9.49.

of Claimants. Kazakhstan contends that by guaranteeing the bonds, KPM and TNG diverted money from Kazakhstan, which it argues, is somehow "contrary to the objectives" of the ECT.[302] One can only guess as to Kazakhstan's point. There is no bad faith in having investment companies guarantee financial obligations, and in any event, the bonds in question raised funds for investment in Kazakhstan.

197. Kazakhstan's allegation with respect to bad faith in relation to "Project Zenith" is no more convincing. That argument is merely a repeat of Kazakhstan's claims that Claimants did not legally own KPM and TNG, and as a result, they allegedly could not legally offer to sell those companies. As discussed above, Kazakhstan's arguments that Claimants were not the legal owners of KPM and TNG are frivolous. In correspondence with Claimants, Kazakh officials acknowledged Ascom's 100% ownership of KPM and Terra Raf's 100% ownership of TNG, and in fact, Kazakhstan never questioned the validity of those investments before this arbitration commenced.[303] As 100% owners of the companies, Claimants were completely within their rights to offer those companies for sale. It is Kazakhstan who acted in bad faith and in breach of the ECT by interfering with Project Zenith and making the sale of KPM and TNG impossible.

E. Claimants' Claims Are Admissible Under the ECT

198. In its Statement of Defense, Kazakhstan also contends that certain of Claimants' claims are not admissible on the ground that "[t]he Arbitral Tribunal's ability to consider these claims [*i.e.*, claims under Articles 10 and 13 of the ECT] is limited by Article 18, paragraph 2 of the ECT."[304]

199. Article 18(2) of the ECT provides:

> Without affecting the objectives of promoting access to energy resources, and exploration and development thereof on a commercial basis, the Treaty shall in no way prejudice the rules in Contracting Parties governing the system of property ownership of energy resources.

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[302] Statement of Defense ¶ 9.5.

[303] Kazakhstan has refused to produce a legal due diligence report prepared for KazMunaiGaz when it was considering the acquisition of KPM and TNG notwithstanding the Tribunal's order that the due diligence report be produced, presumably because the report makes no mention of alleged "illegalities." *See* Respondent's Comments in accordance with section 6.2 of Procedural Order No. 2, February 17, 2012, Request No. 12.

[304] Statement of Defense Section 11, ¶ 11.4.

200. Kazakhstan alleges that it is clear from Article 18(2) that the provisions of the ECT – including the dispute resolution clause – do not apply to issues related to a State's rules governing the system of property ownership of energy resources.[305] Respondent contends that, pursuant to Article 18(3) and 18(4), "facilitating access to energy resources through, *inter alia*, licenses and contracts forms part of the system of property ownership."[306] Therefore, according to Kazakhstan, the Tribunal has no jurisdiction to hear claims relating to Kazakhstan's right to audit KPM and TNG, the operation of trunk pipelines, the tax proceedings, the enforcement proceedings, the refusal to extend the period of the Contract 302 Properties, and direct expropriation.[307] These assertions are ludicrous.

201. Kazakhstan's contention that Article 18 limits Contracting Parties' obligations under Part III of the ECT has no merit, and Kazakhstan does not cite a single legal authority or case in which its interpretation of Article 18(2) has been accepted.

202. First, the plain text of Article 18 (Sovereignty over Energy Resources) does not limit in any way the obligation of Contracting Parties under Part III. It merely re-states the well established principle of sovereignty over natural resources.[308]

203. Second, Kazakhstan fails to mention Declaration No. V (appended to the ECT) and the Chairman of the ECT Conference's Statement at the Adoption Session for the ECT on 17 December 1994.

204. Declaration No. V states:

> The representatives declared that Article 18(2) shall not be construed to allow the circumvention of the application of the other provisions of the Treaty.[309]

205. The Chairman's Statement explains:

> Finally, I note that the representatives of Norway supported by the representatives of … *Kazakhstan, Moldova*… have declared that the Treaty shall be applied and interpreted in accordance with

[305] Statement of Defense ¶¶ 11.1, 11.4.

[306] Statement of Defense ¶ 11.20.

[307] Statement of Defense ¶¶ 11.29-11.

[308] *See* ECT art. 18(1), C-1. *See also* Amkhan Opinion ¶¶ 190-196.

[309] Final Act of the European Energy Charter Conference, Declarations, no. V, at 30, C-1.

> generally recognized rules and principles of observance, application and interpretation of treaties as reflected in Part III of the Vienna Convention on the Law of Treaties of 25 May 1969. ***In particular in the context of Article 18(2) they recalled that a party may not invoke the provisions of its internal law as justification for its failure to perform a treaty.*** The Treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.[310]

206. Declaration No. V was made by all the signatory states to the ECT (including Kazakhstan, Moldova, Romania, and the United Kingdom), and "can accordingly be viewed in much the same manner as the Understandings; that is, as reflecting the signatories' interpretation of a particular provision of the ECT and as part of the Treaty's context" for the purpose of Article 31(1) of the Vienna Convention (recalled in substance in the last sentence of the Chairman's Statement reproduced above).[311]

207. This Declaration No. V — the only Declaration made by all ECT signatories — was made precisely to preclude the argument Kazakhstan puts forward in this arbitration, namely that Article 18(2) entitles a state to evade its obligations under Part III of the ECT.[312] Kazakhstan's position in relation to Article 18(2) upon adoption of the ECT, as noted in the Chairman's Statement, was that a state "may not invoke the provisions of its internal law as justification for its failure to perform a treaty."

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[310] Chairman's Statement at Adoption Session on December 17, 1994, at 157-58 (emphasis added), C-1.

[311] Thomas Roe & Matthew Happold, SETTLEMENT OF INVESTMENT DISPUTES UNDER THE ENERGY CHARTER TREATY 20 (Cambridge University Press 2011), C-427.

[312] Amkhan Opinion ¶¶ 197-200. *See* Craig S. Bamberger, principal legal adviser to the negotiations, stated: "I expressed concern to the Conference management team that this provision could be construed in such a manner as to undermine rights and obligations set out in the Treaty, and it developed that other members of the legal committee shared my concern. It apparently was considered too late to reopen the language of the Treaty, but our initiative led to renewed negotiations, the upshot of which was the addition to the draft Final Act of the Conference of a 'Declaration,' 'that Article 18(2) shall not be construed to allow the circumvention of the application of the other provisions of the Treaty.' It will be noted that this was, uniquely, a 'Declaration' made in the names of all of the national and European Communities representatives participating in the concluding plenary session of the European Energy Charter Conference." Craig S. Bamberger, *The Negotiation of the Energy Charter Treaty*, *in* INVESTMENT PROTECTION AND THE ENERGY CHARTER TREATY at xlviii (Graham Coop & Clarisse Ribeiro eds., JurisNet, LLC 2008), C-428.

208. This is further confirmed by recourse to supplementary means of interpretation, such as the *travaux préparatoire*.[313] As Professor Amkhan concludes,

> Article 18(2) in no way deprives the present Arbitral Tribunal of its jurisdiction to hear the Claimants' claims, nor does it provide justifiable grounds for allowing Contracting Parties the opportunity to breach their core obligations under Articles 10 and 13 of the ECT. The Respondent's assertion effectively 'guts' the ECT of its substance.[314]

209. There is accordingly no merit to Kazakhstan's objection under Article 18(2) of the ECT.

III. IN OCTOBER 2008, KAZAKHSTAN IMPLEMENTED ITS PLAN TO EXPROPRIATE CLAIMANTS' INVESTMENTS

A. President Nazarbayev's October 2008 Order Launched an Inspection Assault that Interfered With Claimants' Ability to Manage and Control Their Investments

210. Kazakhstan does not dispute that on October 14, 2008, President Nazarbayev gave an order to investigate Mr. Anatolie Stati, which prompted wide-scale investigations of KPM and TNG.[315] Instead, Kazakhstan attempts to justify its conduct as a prudent response based on its "international obligations" and "its national interests" in investigating corruption.[316] That contention cannot withstand scrutiny. Everything about those investigations — including their number, scope, intensity, subject matter, purported findings, and most importantly, how Kazakhstan used those purported findings — demonstrates a plan coordinated at the highest levels of the Kazakhstan government to create pretexts for the seizure of KPM and TNG under the guise of legitimate State action.[317]

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313 Amkhan Opinion ¶¶ 201-212.

314 Amkhan Opinion ¶ 211.

315 Statement of Defense ¶ 18.6.

316 Statement of Defense ¶ 18.7(i).

317 As stated in the Statement of Claim, President Voronin claimed that President Nazarbayev, in fact, requested that Voronin send his letter so that Nazarbayev could begin his campaign against the Claimants' investments under an illusion of legitimacy. *See* Statement of Claim ¶ 75; *see also* Interview of former President Voronin during the television program "In Depth" on PROTV Chisinau, January 24, 2011, C-78. Claimants dispute Kazakhstan's characterization of Voronin's remarks, Statement of Defense ¶¶ 18.11-18.14, and submit that the video speaks for itself.

211. First, Voronin's letter provided no legitimate basis for investigating Mr. Stati because Voronin's allegations had nothing to do with Kazakhstan, and would not have amounted to criminal behavior even if true. The gist of Voronin's thinly-veiled political attack was that Mr. Stati — a supporter of the pro-democracy, anti-Voronin movement in Moldova — used profits generated from his investments in Kazakhstan to fund investments in Southern Sudan and political opponents of Voronin in Moldova.[318] Mr. Stati has never made a secret of his company's oil and gas investments in Southern Sudan (which have long been touted on Ascom's website), and those investments did not violate any sanctions.[319] Moreover, Kazakhstan had no legitimate interest in whether Mr. Stati used the profits of his investments to support pro-democracy political opponents of Voronin in Moldova. Both the ECT and the subsoil use contracts held by KPM and TNG protected Mr. Stati's right to freely expatriate the profits from those investments.[320] Thus, Kazakhstan's only legitimate response to Voronin's letter was to ignore it.

212. Indeed, by November 1, 2008, the Financial Police had discovered that Mr. Stati had left Kazakhstan in 2007, and it wrote to the Deputy Prime-Minister of Kazakhstan to inform him of that fact.[321] If Kazakhstan had been reacting rationally to a legitimate concern regarding Mr. Stati, Kazakhstan's investigation of him should have ended then.

213. Second, Kazakhstan did not investigate the actual allegations contained in Voronin's letter. Instead, Kazakhstan used the letter as a pretext to investigate the routine operations of KPM and TNG.[322] On October 24, 2008, the chief inspector of the Financial Police reported that "with respect to the established companies under the control of A. Stati,

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318 *See generally*, Statement of Defense Section 18.

319 *See* Second Witness Statement of Anatolie Stati, dated May 7, 2012 ¶ 46. Voronin's letter does not even assert that Mr. Stati's investments in Southern Sudan violated international sanctions. It merely stated that Mr. Stati invested in *areas* "that are subject to sanctions by international organizations, in particular the U.N." The UN's sanctions, however, were an arms embargo and freezes on assets and travel of specific persons and entities designated as involved in the Sudanese civil war. *See* UN Security Council Summary of Sudan Sanctions, C-429. None of those sanctions, or any others applicable to Mr. Stati, precluded ordinary economic investment in Southern Sudan.

320 *See, e.g.*, ECT art. 14(1); *see* Contract No. 210 § 11.3, C-52; *see also* Contract No. 302 § 11.3, C-53.

321 *See* Letter from Ibraimov to Deputy Prime-Minister of Kazakhstan, November 1, 2008, C-600.

322 Kazakhstan claims, incorrectly, that Nazarbayev's order amounts to a directive to the Deputy Prime Minister and the Financial Police to investigate Mr. Stati, and not to investigate his companies. Nazarbayev's order clearly directs those bodies "to thoroughly check the work of the company and to decide on its future work in the interests of the country." (emphasis added), C-8.

inspections regarding the completeness of payment of taxes, compliance with labor legislation, environmental protection, and in the sphere of subsoil use and industrial safety have been conducted."[323] He then requested to extend the inspection term until December 16, 2008, so that more inspections of the companies could take place.[324] None of those investigations had anything to do with the allegations in Voronin's letter. In fact, in May 2009, the Kazakh Financial Police expressly determined that Mr. Stati could "not be held liable for performance of illegal business activities" with respect to his companies in Kazakhstan.[325]

214. Nevertheless, the number and scope of the investigations ordered and carried out as a result of Nazarbayev's instruction amounted to a full-scale assault on KPM and TNG. As explained in the Statement of Claim, in November 2008 alone, more than seven ministries carried out weeks-long inspections of KPM and TNG.[326] The Financial Police played a pivotal role in that assault by orchestrating the multitude of inspections, insisting that its officers attend all of the inspections, interrogating employees, and ordering the seizure of thousands of company records.[327]

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323 Report from D. Turganbaev of Financial Police, October 24, 2008, C-430

324 *Id*.

325 Order on Refusal to Initiate a Criminal Case Against A. Stati, May 18, 2009, C-431.

326 *See* Statement of Claim ¶ 76; *see also, e.g.,* Letter from Ministry of Energy to Financial Police, October 24, 2008, C-432; Letter from Financial Police to Geology and Subsoil Use Committee of MEMR, October 28, 2008, C-433; Resolution from Financial Police on inspection of KPM by National Bank of Kazakhstan, October 28, 2008, C-434; Resolution from Financial Police for inspection of TNG by Geology Committee, October 28, 2008, C-435; Resolution from Financial Police for a complete tax audit of KPM, October 28, 2008, C-436; Resolution from Financial Police for Inspection of KPM's Work Safety Conditions by the Ministry of Emergency Situations, October 28, 2008, C-437; Financial Police Report Regarding Compliance with Licensing and Contractual Conditions, October 30, 2008, C-438; Letter from V. Vesnin of the Ministry of Emergency Situations to R. Ibraimov of the Financial Police, undated letter, C-439; Letter from Ibrahimov, Financial Police, to Committee of Customs Control, November 7, 2008, C-440; Letter from Financial Police to Agency for Regulation of Natural Monopolies, November 12, 2008, C-441; Letter from Ibrahimov, Financial Police, to Mr. Kennebayev, Customs Control, November 12, 2008, C-442; Letter from MEMR to Financial Police regarding exports of KPM and TNG, November 14, 2008, C-443; Letter from MEMR to Financial Police regarding Acts of Inspection of TNG, November 18, 2008, C-445; Resolution for examination of TNG by the Customs Control Department, November 18, 2008, C-446; Order from Financial Police for a Comprehensive Tax Inspection of KPM, November 28, 2008, C-447.

327 *See, e.g.*, Letter from R. Ibrahimov to the Minister of Energy and Mineral Resources, October 20, 2008, C-444; *see also* Letter from Ministry of Energy to Financial Police, October 24, 2008, C-432; Letter from Financial Police to Geology and Subsoil Use Committee of MEMR, October 28, 2008, C-433; Order of Financial Police to the Geology Committee, October 28, 2008, C-12; Letter from the Financial Police to the Ecology Committee, October 28, 2008, C-13; Resolution from Financial Police on inspection of KPM by National Bank of Kazakhstan, October 28, 2008, C-434; Resolution from Financial Police for inspection of TNG by Geology Committee, October 28, 2008, C-435; Resolution from Financial Police for a complete tax audit of KPM,

215. The number, scope, and intensity of the inspections were so great that they substantially interfered with Claimants' ability to manage and operate their investments. Former General Director for TNG, Alexandru Cojin, describes those inspections as "like nothing our companies had experienced before. They were not typical agency inspections, which were usually predictable and normally occurred annually."[328] In fact, KPM and TNG had already been the subject of routine, annual inspections in 2008, which did not result in any allegations that KPM and TNG operated illegally.[329] Mr. Cojin explains that, unlike the routine inspections, the Financial Police-orchestrated inspections waged in late 2008 consisted of the following:

> [T]he Financial Police essentially "moved in" to KPM and TNG. Two to four Financial Police officers worked at [KPM and TNG] so frequently from October 2008 to February 2009, and they requested so much information, that they required separate office space at the companies during that time. Their presence was intimidating to our staff, and the fact that they poured over KPM's and TNG's files from the companies' beginning unnerved our employees and made it impossible for them to carry out their normal business functions. During that time, approximately

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October 28, 2008, C-436; Resolution from Financial Police for Inspection of KPM's Work Safety Conditions by the Ministry of Emergency Situations, October 28, 2008, C-437; Financial Police Report Regarding Compliance with Licensing and Contractual Conditions, October 30, 2008, C-438; Letter from V. Vesnin of the Ministry of Emergency Situations to R. Ibraimov of the Financial Police, undated letter, C439; Letter from Ibrahimov, Financial Police, to Committee of Customs Control, November 7, 2008, C-440; Letter from Financial Police to Agency for Regulation of Natural Monopolies, November 12, 2008, C-441; Letter from Ibrahimov, Financial Police, to Mr. Kennebayev, Customs Control, November 12, 2008, C-442; Letter from MEMR to Financial Police regarding exports of KPM and TNG, November 14, 2008, C-443; Letter from MEMR to Financial Police regarding Acts of Inspection of TNG, November 18, 2008, C-445; Resolution for examination of TNG by the Customs Control Department, November 18, 2008, C-446; Order from Financial Police for a Comprehensive Tax Inspection of KPM, November 28, 2008, C-447; Summons to Witnesses from the Financial Police, December 24, 2008, C-654; Letter from KazMunaiGaz to Deputy Minister of Energy and Mineral Resources, December 25, 2008, C-604; Financial Police Seizure of Documents from TNG regarding commercial agreements, December 26, 2008; C-605; Financial Police Seizure of Documents from TNG regarding construction of pipeline, December 26, 2008, C-606; Letter from Financial Police to KPM requesting documents, January 22, 2009, C-607; Protocol from Financial Police for Seizure of TNG's documents, January 23, 2009, C-608; Protocol of Seizure of KPM's Documents, February 24, 2009, C-609; Protocol of Seizure of KPM's Documents, March 3, 2009, C-610; Report of Seizure of TNG's documents, March 3, 3009, C-611; Record of Seizure of TNG's Documents, March 4, 2009, C-612; Seizure of TNG's documents, March 26, 2009, C-613; Request for Original Documents from TNG, March 27, 2009, C-614; Letter No. 471 from KPM to Financial Police, March 30, 2009, C-615; Request for Original Documents from TNG, March 30, 3009, C-616; Letter from Financial Police Requesting Documents from KPM, April 22, 2009, C-617; Request from Financial Police for Costs of Oil and Condensate, April 6, 2009, C-618; Document Request from Financial Police to KPM, May 15, 2009, C-668.

328 Second Witness Statement of Alexandru Cojin, April 24, 2012 (hereinafter "Second Cojin Statement") ¶ 12.

329 *See* Second Cojin Statement ¶ 13.

> 80% of the accounting and finance staff in particular were devoted to responding to requests from the Financial Police.[330]

216. Kazakhstan argues that there was nothing unusual about the number or scope of inspections of KPM and TNG and that the inspections were within the average statistical number of inspections of companies in Kazakhstan.[331] That contention is unsubstantiated and difficult to take seriously. Kazakhstan presents no detail of how it calculates its "average," or what it deems to be an "inspection" for purposes of comparison to the scope and intensity of the KPM and TNG inspections. KPM and TNG certainly had never experienced an assault of inspections like those that commenced in October 2008, and it is difficult to believe that other foreign investors in Kazakhstan routinely endured the Orwellian probing from the Financial Police and its minions that Claimants' suffered after Nazarbayev's directive.

217. Furthermore, the Financial Police's insistence on being included in the onslaught of inspections was both telling and illegal. To its credit, at least one agency — the National Bank of Kazakhstan — refused to permit Financial Police representatives to attend its inspection. In November 2008, Mr. Akyshev, Deputy Chair of the Bank, wrote that "the inclusion of the Financial Police officers among the auditors is not possible"; that audits conducted by the National Bank involve bank and commercial secrets; and "the Financial Police officers [are not] entitled to participate in the inspections carried out by other state entities."[332]

218. None of the other agencies, however, had the nerve to stand up to the Financial Police. The Financial Police attended most of the investigations, with the clear purpose of controlling the direction of the inspections and ensuring that the more diffuse and autonomous agencies reached the Financial Police's desired conclusions in their inspection reports. Ominously, the Financial Police insisted that the concluding report from the Geology Committee inspection contain a "finding" that KPM did not have a license to operate main pipelines.[333] As

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330 Second Cojin Statement ¶ 12.

331 Statement of Defense ¶¶ 19.9 – 19.16; *see also* Exhibits R-118 and R-33. Indeed, Kazakhstan's chart of inspections is unreliable if for no other reason than it is incomplete. For example, it does not include inspections carried out in 2008 by the National Bank of Kazakhstan, the Ministry for Environmental Protection, or the Agency for the Regulation of Natural Monopolies.

332 Letter from D. Akyshev of National Bank of Kazakhstan to Financial Police, undated, C-15.

333 Reports on the results of the unscheduled inspection regarding compliance with the legislation on oil, subsoil and subsoil use, and contract obligations of KPM and TNG, November 11, 2008, C-86 and C-87.

Mr. Cojin explains, "the Financial Police insisted that that phrase be included and refused to complete the inspection process unless the report was signed as written. Since we would risk the suspension of operations if we refused to cooperate with the conclusion of the inspection, and because the statement was not inaccurate, we agreed to sign that report."[334]

219. Less than a week later, on November 17, 2008, the Financial Police relied upon that "finding" to conclude, in a classic non-sequitur, that because (i) KPM operated a pipeline and (ii) KPM did not have a license to operate a trunk pipeline, then (iii) the pipeline it operated must be a trunk pipeline. Based on this sophism, the Financial Police signaled its real goal by ordering the Tax Committee to calculate the total value of allegedly illegal profits KPM had earned from its use of the 17.9 kilometer pipeline. That order stated:

> **[I]t has been established that [KPM] has been operating . . . an oil pipeline of 17,896 meters long. . . .**
>
> **[KPM] does not have a state license for operation of <u>trunk</u> gas-, oil- and oil products pipelines.**
>
> **Based on the above . . . [it is] ORDERED [that you]:**
>
> **. . . obtain a conclusion on the amount of income gained as a result of carrying out activity without a license . . .**
>
> . . . [and] empower experts from the Tax Committee . . . to conduct an inspection [and consider] . . .
>
> - what is the amount of profit gained by [KPM] as a result of transportation and subsequent sale of its crude oil through the oil products pipeline belonging to [KPM]
>
> - what is the amount of profit gained by [KPM] as a result of transportation and subsequent sale of crude oil received from [TNG] through the pipeline belonging to [KPM][335]

220. While the Financial Police had clearly seized on a strategy to place pressure on Claimants to divest their Kazakh investments, the Financial Police were admittedly unqualified to make a determination as to whether KPM and TNG were operating "trunk" pipelines -- the linchpin of that strategy. This lack of qualifications was candidly acknowledged by the Financial

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[334] Second Cojin Statement ¶ 16.

[335] Order from Financial Police to the Tax Committee, November 17, 2008, C-89.

Police in a communication in late November or early December 2008, wherein Mr. Kalmurzayev, the head of the Financial Police, informed the Deputy Prime Minister of Kazakhstan that: **"It is ascertained that [KPM] and [TNG] are operating trunk oil and gas pipelines without respective licenses."** [336] Mr. Kalmurzayev concluded his letter by noting that additional inspections would continue and by stating, "Currently, in the absence of a conclusion by a competent authority, it is impossible to make a lawful procedural decision in respect of this case." [337] Clearly, the Financial Police knew that it was not the competent authority to conclude whether the pipeline was in fact a "trunk" or "main" pipeline,[338] and so it needed legal endorsement of its "finding."

221. Undeterred by its admitted lack of qualifications to determine whether KPM and TNG in fact operated "trunk" pipelines, and despite multiple objections and complaints from KPM and TNG,[339] the Financial Police proceeded with its inspections so that it could calculate the amount of money Kazakhstan stood to gain from its planned criminal prosecution. While inspections were ongoing in late 2008 and early 2009, the Financial Police ordered the calculation of the alleged "illegal" profits that KPM and TNG had earned.[340] It "found" that

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[336] Letter from Financial Police to Deputy Prime Minister of Kazakhstan, dated as received on December 10, 2008, C-448.

[337] Letter from Financial Police to Deputy Prime Minister of Kazakhstan, dated as received on December 10, 2008, C-448.

[338] The terms "trunk pipeline" and "main pipeline" are synonymous, and are often used interchangeably in the oil and gas industry (including by many of the documents and witnesses in this case). Accordingly, this Memorial uses the terms "trunk" and "main" pipeline interchangeably, and intends no distinction between them.

[339] *See, e.g.*, Complaint No. 154 of TNG to Ministry of Justice regarding acts of Financial Police, January 19, 2009, C-620; Complaint No. 155 of TNG to MEMR, January 19, 2009, C-621; Complaint No. 156 of TNG to Financial Police, January 19, 2009, C-622; Complaint No. 157 of TNG to General Prosecutor, January 19, 2009, C-623; Complaint No. 111 of KPM to General Prosecutor, January 19, 2009, C-624; Complaint from KPM and TNG to Prosecutor, January 20, 2009, C-626; Complaint from KPM to Transport Prosecutor, January 20, 2009, C-627; Letter from Transport Prosecutor forwarding KPM's and TNG's Complaints, January 21, 2009, C-628; Correspondence between KPM and Kazakh authorities regarding illegality of inspections and seizures, January - February 2009, C-629; Correspondence between TNG and Kazakh authorities regarding illegality of inspections and seizures, January - February 2009, C-630; Letter from KPM and TNG to President Nazarbayev, March 24, 2009, C-631.

[340] *See* Decision on provision of conclusion regarding amount of profit gained by KPM, November 17, 2008, C-89; *see also* Letter from Financial Police to Tax Committee, November 18, 2008, C-449; Statement determining the income received as a result of transportation and further sale of oil for KPM and TNG, November 19, 2008, C-450 (*see also* C-202); Statement determining the income received as a result of transportation and further sale of oil for TNG, November 19, 2008, C-202; Resolution on the appointment of a judicial and economic examination, November 20, 2008, C-451; Expert Opinion on forensic expert examination, November 28, 2008, C-452; Trunk pipeline report, December 2, 2008, C-85; Resolution on the preliminary investigation, January 14, 2009, C-453.

KPM and TNG earned more than 79.5 billion tenge (over US$ 650 million) from operating alleged main pipelines without a license, a sum exceeding all of KPM's and TNG's oil and gas production revenues from 2005 to 2007. Thus, it is clear that key to the Financial Police's inspection assault that commenced in October 2008 was to find some basis on which to create an exorbitant financial claim against the companies and to ensure that some "competent authority" reached the same (false) conclusion regarding KPM's and TNG's pipelines so that Kazakhstan could move forward with its scheme to take over the companies.

222. Kazakhstan eventually found its "competent authority" in the form of the Aktau Court, which participated in orchestrating a sham trial against KPM and its General Director, Mr. Cornegruta. As the facts show, however, it was the Financial Police who concocted the "main pipeline" strategy much earlier, nearly as soon as the investigations began.[341] The trial was the critical step linking the inspection assault that was launched in October 2008 to the direct expropriation of KPM and TNG in July 2010. As discussed in Section III.C, that trial was improper in a number of respects, amounting to a denial of justice, and it was directly tied to Voronin's letter and Nazarbayev's resulting order.[342]

223. Well before the arrest and trial took place, however, Kazakhstan's harassment campaign had undermined Claimants' ownership rights over their investments and effected a substantial loss of control over the management and operation of those investments. The impact the inspections had on KPM and TNG was even acknowledged in a personal instruction from President Nazarbayev to internal government agencies. He wrote: " . . . **[A]s a result of inspections by law enforcement [bodies]** it took place a full stop of trades (oil and gas extraction) and the construction of the [LPG Plant], compressor stations and gas gathering units."[343] Thus, Kazakhstan's assertion in its Statement of Defense that the inspections had no impact is nonsense.

224. As Claimants have shown, impeding KPM's and TNG's operations was part of Kazakhstan's plan to take over KPM and TNG, which it initiated in October 2008. As the

[341] In addition to the foregoing discussion, *see* Order Initiating Criminal Proceedings, December 15, 2008, C-632.

[342] *See* Indictment of Mr. Cornegruta, June 26, 2009, C-454.

[343] Personal Instruction from the President of Kazakhstan at 3, November 19, 2009, C-23.

Tribunal will recall, the letter from Blagovest is clear evidence of that plan.[344] It explicitly states that "establishing control over TNG and KPM" while excluding the investors' rights to international arbitration, among other factors, would "resolve the question of nationalization of the assets posed [by Kazakhstan] in 2008."[345] Kazakhstan's only "defense" to that letter is that Mr. Zakharov, who issued it, "had no clear idea of what he was offering[,]" but signed it after being promised payment for his "service" in transferring the companies into State control.[346] Thus, Kazakhstan argues that the Blagovest letter is no evidence of a plan because Mr. Zakharov did not read it carefully and hoped to make money from it. At most, that admission only proves that Mr. Zakharov, while prescient of Kazakhstan's intended plan, was careless and potentially corrupt. The substance of the letter — which Kazakhstan notably does not dispute — speaks for itself and reveals Kazakhstan's plan to seize control of KPM and TNG.

225. Moreover, the Tribunal will recall the September 2009 letter from the MEMR to the Ministry of Industry and Trade that confirms Kazakhstan's desire to acquire control of Claimants' companies, which it viewed as strategic assets.[347] Indeed, Kazakhstan admits that it had been considering a "solution" to the "problem" of Claimants' companies, and that the "solution" was "***undoubtedly the transfer of KPM and TNG into state control***."[348] According to Kazakhstan, that letter only shows that it "dismissed the option of gratuitous transfer and considered the risks then perceived to pertain to the termination of contracts at that time" — *i.e.*, the fact that "disputable matters, in cases of their emergence, shall be sent for review to the Arbitration Institute of the Stockholm Chamber of Commerce" — and then decided to initiate negotiations to "acquire" KPM and TNG.[349] In other words, Kazakhstan wanted to take control

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344 Statement of Claim ¶ 308 (citing Letter from Blagovest President to MEMR, February 7, 2010, C-23).

345 Letter from Blagovest President to MEMR, February 7, 2010 at 1, C-23.

346 Statement of Defense ¶¶ 18.17.

347 Letter from MEMR to the Ministry of Industry and Trade of Republic of Kazakhstan, September 28, 2009, C-294. *See also* Resolution of the Government of Kazakhstan No. 1072 of October 18, 2010 "On approval of the Program for the development of oil and gas industry in the Republic of Kazakhstan for 2010 - 2014, C-455; List of investment projects in Mangystau region subject to monitoring in 2011 approved by Akim of Mangystau region, C-456; List of major projects in Kazakhstan that require investment, Kazakh Embassy in Israel, C-457; Letter from the MEMR to TNG regarding assets of strategic importance, September 23, 2009, C-655.

348 Statement of Defense ¶ 19.26(d) (emphasis added).

349 Statement of Defense ¶ 19.26(f); Letter from MEMR to the Ministry of Industry and Trade of Republic of Kazakhstan, September 28, 2009, C-294.

of the companies all along and it recognized that it would be impossible to do that unilaterally without violating Claimants' rights and subjecting itself to international responsibility.

226. In its Statement of Defense, Kazakhstan feigns innocence. It rhetorically asks, "is it in any way sinister or indicative of unlawful intentions to consider acquiring those assets?"[350] What Kazakhstan leaves out, however, is that Claimants had already *rejected* KazMunaiGaz's offer to buy their companies because the offered price was too low, and in fact agreed to sell the companies to another buyer (Cliffson) for a price hundreds of millions of dollars more than state-owned KazMunaiGaz was prepared to offer.[351] Within just days of Claimants' submission of their final request for approval of that sale, Kazakhstan initiated the final inspection blitz that led to the ultimate seizure of the companies. It does not require a great leap of reason to see that Kazakhstan chose to simply terminate the contracts and seize the assets after discovering that its harassment campaign had not succeeded in forcing Claimants to sell their investments to KazMunaiGaz at a lowball price, thereby deciding to take its risks in arbitration. The 2009 letter, among other evidence, puts the lie to any suggestion that the termination of KPM and TNG's contracts was the consequence of breaches discovered in normal audits and investigations. Rather, acquiring Claimants' investments was the purpose all along.

B. In Addition to Assaulting Claimants with Inspections, Kazakhstan Conjured New Allegations to Harass Claimants and Interfere with Their Investments

227. As explained in the Statement of Claim and above, the inspections waged against KPM and TNG greatly interfered with Claimants' ability to operate those companies, intimidated and frightened employees, and resulted in baseless accusations against the companies. But Kazakhstan's assault on KPM and TNG did not stop there. During the same time period, Kazakhstan also harassed Claimants by reviving stale or settled allegations, raising new allegations, and further interfering with Claimants' ability to manage their investments.

1. Kazakhstan Published Defamatory Allegations of Fraud Against Claimants and Reversed Its Prior Waiver of Pre-emptive Rights

228. On the heels of Nazarbayev's order, on December 18, 2008, the MEMR issued a press release accusing Claimants of having altered documents in order to defraud the State of its

[350] Statement of Defense ¶ 19.26(d).

[351] *See* Section IV.B(2)(d), *infra*.

pre-emptive right to purchase the companies.[352] Kazakhstan also publicly asserted that Claimants' ownership of TNG was illegal and that "errors" in TNG's organization and registration "compromise state interests."[353] On the same day, the MEMR retroactively revoked its pre-emptive rights waiver to the 2003 transfer of TNG to Terra Raf.[354] That decision was a total about-face, because Kazakhstan had twice before approved Claimants' transfer of ownership of TNG.[355]

229. Despite the inflammatory accusations that Kazakhstan proclaimed publicly — harming the market value of Claimants' investments and impeding Claimants' ability to sell them — Kazakhstan never brought domestic actions against Claimants, KPM, or TNG based on those allegations. Even now, in its Statement of Defense, Kazakhstan provides no evidence that the State had any legitimate ground to revoke its waiver or accuse Claimants of forgery and illegality.[356] Instead, it merely claims that it had unspecified "concerns" about allegedly forged documents and "suspicions" as to the legality of TNG's ownership and conduct.[357] As a result, Kazakhstan maintains that it "had clear legal grounds to investigate the transfer and conclude it was illegal."[358]

230. Kazakhstan's position succinctly articulates the absence of the rule of law in Kazakhstan: If Kazakhstan had *bona fide* suspicions that TNG's ownership or conduct were illegal, it should have initiated domestic proceedings to prove those allegations. To the contrary,

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352 Press release circulated on Interfax from the MEMR, December 18, 2008, C-141. TNG raised its concern about the negative effects that publication was having on its business and reputation to the MEMR. *See* Letter from TNG to the MEMR, February 24, 2009, C-619.

353 Press release circulated on Interfax from the MEMR, December 18, 2008, C-141.

354 *See* Notice letter from the MEMR to TNG, December 18, 2008, C-140.

355 As explained in Section III.D.2.f, Kazakhstan did not have pre-emptive rights with respect to the transfer of TNG from Gheso to its affiliate Terra Raf, and therefore, Claimants were not required to obtain Kazakhstan's permission for the transfer. When Kazakhstan requested that Claimants retroactively seek permission in 2007, Claimants complied and Kazakhstan approved the transfer. Letter from the General Prosecutor's Office to the MEMR, February 21, 2007, C-133; Excerpt from the Minutes of Meeting of the Appraisal Commission, February 20, 2007, C-134. Additionally, Kazakhstan approved Claimants' plan to include TNG in an IPO on the London Stock Exchange. Letters from MEMR to KPM and TNG, December 29, 2007, C-139; Letter from the Anti-Monopoly Agency, June 16, 2008 (approving the purchase of 100% of TNG and KPM by Tristan Oil), C-458.

356 Statement of Defense ¶¶ 13.47(d)-(f).

357 Statement of Defense ¶ 13.47(e).

358 Statement of Defense ¶ 13.47(d)(i).

Kazakhstan never raised any claims of TNG's alleged illegality in domestic proceedings (nor did it include those allegations as grounds for terminating TNG's Subsoil Use Contracts in July 2010).[359] It simply publicized its alleged "suspicions" as fact, which served its purpose of raising doubts among the public — including potential buyers of KPM and TNG — as to the companies' legal footing, without giving KPM and TNG any opportunity to dispute the charges.

2. Kazakhstan Assessed Millions of Dollars of Illegal Taxes Against Claimants and Embroiled Them in Months-Long Tax Audits

231. In addition to defaming Claimants and unjustifiably reversing its position on its pre-emptive rights waiver, Kazakhstan exploited the inspections it had ordered of KPM and TNG to conjure claims for taxes and duties against the companies. As explained in the Statement of Claim, Kazakhstan abused its tax laws and subjected Claimants to gross mistreatment when it (i) improperly assessed alleged corporate back taxes in the amount of US$ 62 million against KPM and TNG;[360] (ii) imposed illegal export duties against KPM and interfered in court proceedings to overturn the court's finding that those taxes were illegal;[361] and (iii) conducted a 13-month audit of KPM and TNG with respect to transfer pricing.[362]

232. Kazakhstan's general response to those three matters in its Statement of Defense is merely to claim that it is not a violation of the ECT to impose taxes on foreign investors. Whether Kazakhstan is precluded from imposing general tax measures in the exercise of its sovereign powers, however, is utterly beside the point. Regardless of its right to impose legitimate taxes, Kazakhstan is prohibited from abusing its taxation powers by using them unfairly, as a tool to harass Claimants and undermine their control of their investments. That is

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359 Even if a legitimate concern existed, Kazakhstan could not revoke a waiver that was not required under Kazakh legislation at the time. *See* Reply Memorial Section II.D.2.f.

360 *See* Statement of Claim ¶¶ 156-160.

361 *See* Statement of Claim ¶¶ 161-171. According to Kazakhstan, customs duties do not fall within the definition of taxes and are therefore "outside the scope of Article 21 of the ECT and may not be the subject-matter of arbitration." *See* Statement of Defense ¶ 30.32. Since Kazakhstan acknowledges that custom duties are outside the scope of Article 21of the ECT (as provided for in Article 21(7)(d) of the ECT), they can clearly be the subject of an ECT arbitration. *See* Amkhan Opinion ¶¶ 222.

362 *See* Statement of Claim ¶¶ 172-174.

precisely what occurred from late 2008 onward, and Kazakhstan cannot hide behind its taxation powers to shield itself from international responsibility for its wrongful acts.[363]

233. Kazakhstan does not dispute that it assessed US$ 62 million against KPM and TNG in February 2009 as a result of its audit from November 2008 to February 2009. Instead, Kazakhstan claims that the imposition of those corporate back taxes was a legitimate exercise of State powers, which was ultimately sanctioned by a court.[364] That is a mischaracterization of the facts. In reality, the US$ 62 million assessment resulted from the Tax Committee's (incorrect) finding that KPM and TNG had improperly amortized drilling expenses from 2005 to 2007, a finding that clearly contradicted a previous State tax assessment as well as the express amortization rates agreed in the companies' contracts.[365] Far from being sanctioned by a court, that dispute was on-going. Before the courts could issue a final decision in the litigation, however, Kazakhstan initiated bankruptcy proceedings against KPM (in January 2010)[366] and took over KPM and TNG (in July 2010). In the meantime, the spurious US$ 62 million claim against KPM and TNG devastated the companies' financial situation and deterred potential buyers from acquiring Claimants' investments.

234. In addition to the improper assessment of US$ 62 million in back taxes, Kazakhstan extorted millions from KPM in improper export duties.[367] Kazakhstan claims that the export duty charges were issued but then withdrawn, and thus never imposed or paid.[368] That is another blatant misrepresentation. In the period from August through October 2008, Kazakhstan imposed a new and illegal Crude Oil Export Tax on KPM, which KPM paid under

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[363] Similarly, Kazakhstan cannot rely on Article 21 of the ECT to shield itself now from its international liability. *See* Statement of Defense ¶¶ 30.2-30.5 and 30.12-30.41 "Taxation Measures" under the ECT are specifically defined as "any provision" of tax treaties and of domestic tax law. ECT art. 21(7)(a), C-1. Amkhan Opinion ¶¶ 216-218. Thus, the ECT only excludes from the purview of its dispute resolution mechanism domestic tax laws and tax treaties, not all measures pertaining to a State's taxation powers. (Claimants note the special procedure created by Article 21(5) of the ECT with respect to expropriatory taxes. *See* ECT art. 21(5), C-1.) Therefore, Kazakhstan can be held liable for its harassing and illegal tax measures in this case.

[364] *See* Statement of Defense ¶¶ 30.48-30.53.

[365] *See* Statement of Claim ¶¶ 156-160.

[366] *See* Bankruptcy Notice, January 26, 2010, C-157.

[367] Statement of Claim ¶¶ 161-171. Witness Statement of Alexandru Condorachi, May 12, 2011 (hereinafter "First Condorachi Statement"), ¶¶ 34-37.

[368] Statement of Defense ¶¶ 30.54-30.59.

protest in order to avoid imperiling its crude oil exports.[369] KPM concurrently commenced a legal action challenging the imposition of the duties and, on November 19, 2008, the court ruled that the Government's imposition of export duties was illegal because it was contrary to specific exemptions contained in Contract No. 305.[370] In its Statement of Defense, Kazakhstan essentially admits that this court decision was correct.[371]

235. The parties dispute the amount KPM paid under protest and whether Kazakhstan ultimately refunded the amount that KPM provisionally paid. While Kazakhstan provides no evidence supporting its claim that KPM only paid US$ 700,000, nor that it refunded any of the money KPM paid,[372] Claimant's position, which the evidence supports, is that KPM paid US$ 12.77 million, of which Kazakhstan only refunded US$ 2.6 million.[373] Therefore, Kazakhstan unlawfully withheld in excess of US$ 10 million in export duties from KPM.

236. In addition, Kazakhstan introduced a new tax provision in January 2009, which replaced the Crude Oil Export Tax with a Rent Tax for Export, but clearly stated that crude oil exports subject to the Rent Tax would be exempt from the Crude Oil Export Tax.[374] KPM paid the newly applicable Rent Tax on its crude oil exports for January 2009, but the Financial Police asserted that KPM had failed to pay the (clearly inapplicable) Crude Oil Export Tax for its

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369 *See* Letter from the Financial Police to the Executive Secretary of the Ministry of Finance, November 25, 2008, C-162.

370 *See* Decision of the Board of Appeal of the Mangystau Regional Court, December 23, 2008, C-161.

371 Statement of Defense ¶¶ 30.56. Kazakhstan claims that this decision was subsequently "cancelled on procedural grounds." However, the Regional Customs Committee challenged that first instance decision, which was overturned, and the imposition of more than US$ 10 million on KPM became final on December 23, 2008. Decision of the Board of Appeal of the Mangystau Regional Court, December 23, 2008, C-161. KPM subsequently appealed that decision, but the appeals were dismissed. *See* Statement of Claim ¶ 165. Ironically, on October 2, 2008, the Regional Customs Committee concluded that KPM was not liable for export duties pursuant to its Subsoil Use Contract. Kazakhstan's inconsistent position on this issue did not end there. On March 31, 2010, the Central Customs Committee confirmed that, contrary to a prior notification (Notices from the Regional Customs Committee to KPM and TNG, February 24, 2010, C-44) and the court decisions, both KPM and TNG were not liable for export taxes pursuant to their Subsoil Use Contracts. First Witness Statement of Alexandru Condorachi, May 12, 2011 (hereinafter "First Condorachi Statement") ¶ 37; Letters from the Central Customs Committee to KPM and TNG, March 31, 2010, C-130.

372 Statement of Defense ¶ 30.57.

373 *See* Tristan Oil Annual Report for the year 2009, at 14 and F-26, R-37.6. KPM made 5 payments of 290,100,000 tenge, 290,162,000 tenge, 330,500,000 tenge, 305,169,186 tenge, and 316,540,000 tenge on August 25, September 2, 9, and 17, and October 9, 2008. Kazakhstan only reimbursed the last payment. *See* Letter from the Central Bank of Kazakhstan, February 23, 2012, attaching payment orders of August 25, September 17, and October 9, 2008, C-459; Wire transfer, September 2, 2008, C-460.

374 First Condorachi Statement ¶ 34.

January 2009 exports. That dispute embroiled KPM in yet another round of court proceedings.[375] KPM refused to pay the unlawful tax and fought the measures in local court, despite considerable pressure from the Financial Police. As KPM's counsel, Mr. Condorachi explains, "in early July 2010, the Financial Police once again interviewed Mr. Cornegruta in jail regarding this matter and threaten[ed] to add a couple of years to his [prison] sentence [if KPM did not pay the disputed tax]."[376] The court did not issue a ruling before Kazakhstan seized KPM and TNG in late July 2010.

237. In its Statement of Defense, Kazakhstan mentions yet another export tax dispute that purportedly derives from its imposition of additional duties against KPM in September 2010.[377] Claimants cannot respond to Kazakhstan's assertions regarding that dispute, nor to the merits of any such assessment that may have occurred, however, because Kazakhstan had taken over KPM and transferred control to KazMunaiTeniz before the tax in question was imposed.

238. A final example of how Kazakhstan used its inspections to treat Claimants unfairly and to interfere with and usurp Claimants' control of their investments relates to a dispute over transfer pricing. From November 7, 2008, to December 29, 2009, Kazakhstan conducted a 13-month audit of KPM and TNG regarding transfer pricing by the companies.[378] Kazakhstan contends that the audit was legal and lawfully conducted,[379] but provides no support for that contention. Kazakhstan does not dispute that the audit by the Tax Committee involved the review of thousands of documents within KPM's and TNG's offices over more than a year,[380] and it essentially admits that it directly expropriated KPM and TNG before the legal claims related to the transfer pricing dispute could be appealed through Kazakh courts.[381] Nevertheless, the fact that Kazakhstan failed to raise <u>any</u> issue of transfer pricing when it notified KPM and TNG of the alleged contract violations on which it purportedly based its expropriation

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375 Statement of Defense ¶¶ 30.54-30.59.

376 First Condorachi Statement ¶ 37.

377 Statement of Defense ¶ 30.58.

378 *See* Statement of Claim ¶¶ 172-74.

379 *See* Statement of Defense ¶¶ 30.60-30.66.

380 *See* First Condorachi Statement ¶ 33.

381 *See* Statement of Defense ¶ 30.65.

of July 2010 strongly suggests that the transfer pricing dispute was, like the other tax disputes, completely baseless.

239. While contrived, the various tax "violations" served Kazakhstan's purpose of interfering with KPM's and TNG's daily business activities, undermining the value of the companies, and impeding Claimants' ability to use, control, and/or dispose of their investments.

3. Kazakhstan Refused to Execute Its Promised Extension of Claimants' Contract 302

240. Kazakhstan also substantially interfered with Claimants' investments by refusing to officially extend the exploration period under Contract No. 302, despite its clear commitment to Claimants that it would do so. Kazakhstan's failure to formalize that extension precluded Claimants from pursuing exploration activities and proving the full value of the Contract 302 Properties, which in turn prevented Claimants from marketing those properties.[382]

241. On April 9, 2009, the MEMR granted "the extension of the exploration period … for a period of 2 years, until 03/30/2011."[383] The MEMR's consent was accompanied by the minutes of the meeting of the Expert Commission of the MEMR for Subsoil Users, which acknowledged that:

> Additional time is needed to complete the drilling of deep wells in the Munaibai East and Bakhyt areas and to conduct a comprehensive and detailed survey of the contract area in order to obtain sufficient information for its assessment.
>
> Therefore, the Committee deems it possible to extend the exploration period under Contract 302 dated 31 July 1998 for two years until 30 March 2011 in accordance with article 43.1 of the Law of the Republic of Kazakhstan On Subsoil and Subsoil Use in order to complete the drilling of deep wells in the Munaibai East and Bakhyt areas and to conduct a comprehensive and detailed survey of the contract area to obtain sufficient information for its assessment.[384]

Despite its promise to do so, however, Kazakhstan refused to execute the contract addendum that was required to formalize the extension of the exploration period.

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382 *See* Statement of Claim ¶¶ 175-79.

383 *See* Statement of Claim ¶ 178. Letter from the MEMR to TNG, April 9, 2009, C-27 and R-163.1.

384 Minutes No. 7 of the Meeting of the Expert Commission for Subsoil Users, April 2, 2009, R-163.2.

242. Kazakhstan's only justification for that failure is an assertion that Claimants could not expect an automatic grant of such an extension and that it had "no obligation" to grant one.[385] That assertion *might* have some merit if the MEMR had not issued its approval in April 2009. In light of that approval, however, Kazakhstan's assertions in its Statement of Defense are meritless, because Kazakhstan ***had already agreed*** to extend the exploration period. The mere fact that Kazakhstan was not obliged to agree to extend the exploration period does not justify its bad faith refusal to execute the contract extension ***after it had agreed*** to extend the exploration period.

243. Further, Kazakhstan contends that Claimants should not have relied on an approval from the MEMR because it was not the "competent authority" that could approve the requested extension. That is untrue. The Kazakh Law on Oil explicitly states that the MEMR is the competent authority.[386] The MEMR's April 9, 2009, letter therefore constitutes the required consent of the competent authority under Contract No. 302 and the Law on Oil.[387]

244. Importantly, without the executed addendum, Claimants were prohibited from performing further exploration activities. The MEMR assured TNG that it would execute the addendum by July 2, 2009.[388] TNG repeatedly requested the execution of Addendum No. 9 in the fall and winter of 2009,[389] and instead of fulfilling its commitment, Kazakhstan strung Claimants along for months with promises that execution would be forthcoming. For example,

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385 Statement of Defense ¶¶ 14.27-14.28. In this respect, the "sleeper" witness statement of R. Aldashev, the Director of the Subsoil Use Contracts and Production Sharing Agreements Department of the MOG, is of no probative or evidentiary value as it fails to indicate the reasons for refusal of extension of exploration periods. *See* "Sleeper" Witness Statement of R. Aldashev, Information on Review by Competent Authority of Requests from Subsoil Users for Extension of Exploration Period under Subsoil Use Contracts, R-165. Respondent has refused to provide any supporting documents in relation to that exhibit, contrary to the Tribunal's orders.

386 Law on Oil art. 29, R-211. *See* also "Sleeper" Witness Statement of V. I. Lebed regarding competent bodies and licensors: establishment, replacement, period of operation, at 4-5, R-17 (stating that the MEMR had the "function to prepare and execute subsoil use contracts.")

387 Contract No. 302 arts. 3.3, 6, C-53; Law on Oil art. 29, R-211.

388 *See* Statement of Claim ¶ 178. Letter from the MEMR to TNG, April 9, 2009, C-27 and R-163.1. Contrary to Kazakhstan's contentions, TNG was not required (and could not) amend the License for Subsoil Use for Contract No. 302 pursuant to the enactment of the August 11, 2009 Amendment Law abolishing the licensing system for subsoil use. *See* Statement of Defense ¶ 14.32(d). Kazakhstan claims that Claimants should have sought an extension pursuant to Article 27 of Decree No. 1017 concerning the Approval of Regulations concerning the Licensing of the Subsurface Use in the Republic of Kazakhstan of August 16, 1996, R-164. However, the Decree was repealed as of January 21, 2000 as indicated in Kazakhstan's exhibit R-164.

389 *See*, *e.g.*, Letters from TNG to the MEMR, September 17 and December 28, 2009, C-169 and C-170.

on January 14, 2010, Kazakhstan invited TNG to attend a meeting with the MEMR to execute the addendum,[390] but when TNG's representatives arrived at the MEMR on January 21, 2010, they were informed that the meeting had been cancelled.[391] Instead, the MEMR conducted an unscheduled audit of KPM and TNG regarding their subsoil use obligations between January 25 and February 6, 2010. Although the MEMR concluded that KPM and TNG were in compliance with their contractual obligations and with the legislation of the Republic of Kazakhstan,[392] it never executed the promised addendum. Thus, Claimants were left in limbo regarding the Contract No. 302 Properties.

245. Kazakhstan knows that its refusal to extend Contract No. 302 in bad faith amounts to a breach of its international legal obligations to Claimants. It even argues in its Statement of Defense that "expropriation of the asset occurred in 2009."[393] That is because failure to execute the addendum as promised prevented Claimants from continuing drilling test wells and proving reserves after March 30, 2009, and therefore, Claimants were unable to market and sell the Contract 302 Properties. But that is not the full story, because Kazakhstan's refusal to extend the exploration period was part and parcel of its plan to take over Claimants' investments that was commenced in 2008. As explained in the Statement of Claim and in Section VI.B, below, Kazakhstan's conduct well before 2009 amounted to indirect expropriation as a result of the magnitude of its interference with Claimants' ability to use, manage, control, and sell their investments.

C. Kazakhstan Fabricated the Grounds for a Criminal Prosecution

246. As discussed above, Kazakhstan had determined by late 2008 that it needed legal endorsement of the Financial Police's fabricated claim that KPM and TNG operated "trunk" or "main" pipelines without a proper license. It obtained that endorsement by investigating and prosecuting the General Director of KPM, Mr. Sergei Cornegruta, in a sham trial that centered on the "main" pipeline allegations. The trial and conviction of Mr. Cornegruta were critical steps in Kazakhstan's plan to take over KPM and TNG.

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390 Letter from the MEMR to KPM and TNG, January 14, 2010, C-461.

391 Letter from TNG to the MEMR, February 16, 2010, C-462.

392 Reports of the Ministry of Energy and Mineral Resources for KPM and TNG, February 6, 2010, C-385 and C-386.

393 Statement of Defense ¶ 14.34.

247. The investigation and trial of Mr. Cornegruta are quintessential examples of a denial of justice under international law. Kazakhstan fabricated the substantive grounds on which its conviction was based and violated multiple criminal procedural rules and notions of due process along the way. The facts show that (i) there was no legal basis for the finding that KPM, at Mr. Cornegruta's direction, operated a main pipeline without a license;[394] (ii) Kazakhstan interfered in the trial process to ensure that the court would render a guilty verdict; and (iii) Kazakhstan ensured that the court would impose an astronomical, illegal penalty as a result of the conviction that would pave the way for Kazakhstan to directly expropriate KPM and TNG and formally transfer those companies into the control of State-owned KazMunaiGaz.

1. No Legal or Factual Basis Existed for Kazakhstan's "Reclassification" of KPM's and TNG's Field Pipelines as "Trunk" Pipelines

248. As Claimants explained in their Statement of Claim,[395] Kazakhstan manufactured criminal charges against KPM and TNG by arbitrarily "reclassifying" four segments of KPM's and TNG's in-field gathering systems as "main" or "trunk" pipelines, and claiming that KPM and TNG did not hold licenses to operate those "main" pipelines. In its Statement of Defense, Kazakhstan purports to "restate and expand [up]on the reasoning recorded in the judgment of the Kazakh court" in Mr. Cornegruta's criminal trial.[396] In fact, Kazakhstan presents entirely new factual and legal arguments in an attempt to retroactively justify its spurious conclusion that KPM and TNG owned and operated "trunk" pipelines. Kazakhstan's explanations were unconvincing then and remain so now.

249. Kazakhstan first attempts to rewrite the story by alleging that the finding that KPM and TNG operated "main" pipelines post-dated the accusations leveled by the Financial

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394 Kazakhstan argues that "at present," KazMunaiTeniz (which took control of KPM and TNG following their seizure in July 2010) operates the pipelines under a trunk pipeline license, presumably to support its (incorrect) argument that every company in Kazakhstan operating similar pipelines has such a license. Statement of Defense ¶ 25.4. According to Kazakhstan's own evidence, however, KazMunaiTeniz obtained that license in April 2011. *See* License Issued to KazMunaiTeniz, April 29, 2011, R-136. Kazakhstan's careful choice of wording that KazMunaiTeniz has such a license "at present," and its failure to present evidence of any earlier trunk pipeline license, strongly suggests that KazMunaiTeniz operated the pipelines in question for 9 months before receiving that license and at no time has Kazakhstan investigated KazMunaiTeniz for generating illegal profits from the operation of those pipelines without a license.

395 Statement of Claim ¶¶ 79-120.

396 Statement of Defense ¶ 23.6.

Police.[397] That is a fabrication. Following President Nazarbayev's order, in November 2008, the Financial Police participated in the unscheduled audit of KPM and TNG conducted by the Geology Committee (upon the Financial Police's order), which concluded that the companies were in compliance with their legal, regulatory, and contractual obligations.[398] In the course of this audit, the Financial Police established an unsurprising and uncontested fact: KPM and TNG did not hold licenses to operate a "main" pipeline (because, of course, they did not operate one).[399] Shortly thereafter, however, on November 17, 2008, the Financial Police reclassified certain segments of KPM's and TNG's gathering pipelines as "main" pipelines.[400] The Financial Police sought an "expert" opinion from the Ministry of Justice confirming their "finding" on February 9, 2009, three months after "reclassifying" segments of KPM's and TNG's pipelines.[401]

250. In their Statement of Claim, Claimants showed that neither KPM nor TNG has ever owned or operated a "main" pipeline.[402] KPM's and TNG's in-field oil and gas gathering systems were designed, constructed, and operated to deliver oil, gas, and condensate from the well-heads to the on-site processing facilities and then either to storage tanks (oil and condensate) or directly to a main transportation pipeline (gas).[403] As KPM's and TNG's Technical Director, Mr. Romanosov, explains, Kazakhstan's reclassification of segments of KPM's and TNG's gathering systems defied logic:

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397 Witness Statement of Arman [Testemirovich] Rakhimov, November 2, 2011 (hereinafter "Rakhimov Statement") ¶ 4; Witness Statement of Turganbayev Daniyar Mukhanovich, November 2, 2011 ¶ 5 (hereinafter "Turganbayev Statement"). Messrs. Rakhimov and Turganbayev both state: "Pre-investigation has shown that Kazpolmunai LLP had an 18-km oil pipeline. During investigation, a forensic expert from the Center for Forensic Examination of the Ministry of Justice gave an opinion that the pipeline was a main pipeline."

398 Reports on the results of the unscheduled audit of off-schedule check of performance of the legislation of the Republic of Kazakhstan about oil, subsoil and subsoil use, and contract obligations of KPM and TNG, November 11, 2008, C-86 and C-87.

399 Reports on the results of the unscheduled audit of off-schedule check of performance of the legislation of the Republic of Kazakhstan about oil, subsoil and subsoil use, and contract obligations of KPM and TNG, November 11, 2008, C-86 and C-87. First Witness Statement of Alexandru Cojin, May 12, 2011 (hereinafter "First Cojin Statement"), ¶¶ 4-5.

400 *See* Order of the Financial Police to the Tax Committee regarding KPM, November 17, 2008, C-89; Report from the Tax Committee to the Financial Police regarding TNG, November 19, 2008, C-202.

401 Order from the Financial Police to the Ministry of Justice, February 9, 2009, C-109.

402 Statement of Claim ¶¶ 79-87; 98-106.

403 *See* Statement of Claim ¶ 55. First Witness Statement of Victor Romanosov, May 12, 2011 (hereinafter "First Romanosov Statement"), ¶¶ 4-23.

> There are multiple differences between internal-use field pipelines like KPM's and TNG's and main pipelines like the KazTransOil main oil and the Central Asia Center main gas pipelines. Fundamentally, in-field pipelines and main pipelines differ greatly in lengths and diameters, mainly because they have different purposes. Main pipelines are used to carry oil (or gas) for multiple users over a very long distance, while field pipelines are used within a smaller area to carry oil (or gas) from the well heads, through the treatment facilities, and to storage facilities, before it is transferred to a main pipeline or another means of transport. Furthermore, a main pipeline requires multiple connections so that multiple users can inject oil or gas into it. KPM's and TNG's reclassified pipelines only linked one component of our processing facilities to another component of our facilities, or to the metering station, and they had no connections into them.[404]

251. For the KPM gathering system, the segment of field (or contractor's) pipeline that the State arbitrarily chose to reclassify as a "trunk" pipeline extended from the Borankol field oil processing facility, which separates oil from water, to the storage tanks located near the Opornaya station.[405] For the TNG gathering system, the segments that the State arbitrarily chose to reclassify were (i) two parallel segments of gas field pipelines that ran from the Borankol gas processing facility, which separates gas from condensate, to the delivery point into the Central Asia-Center main pipeline and (ii) a segment of condensate field pipeline that run from the Borankol gas processing facility to the storage tanks for condensate at Opornaya station.[406] The diagram below shows in red the segments that the State reclassified:[407]

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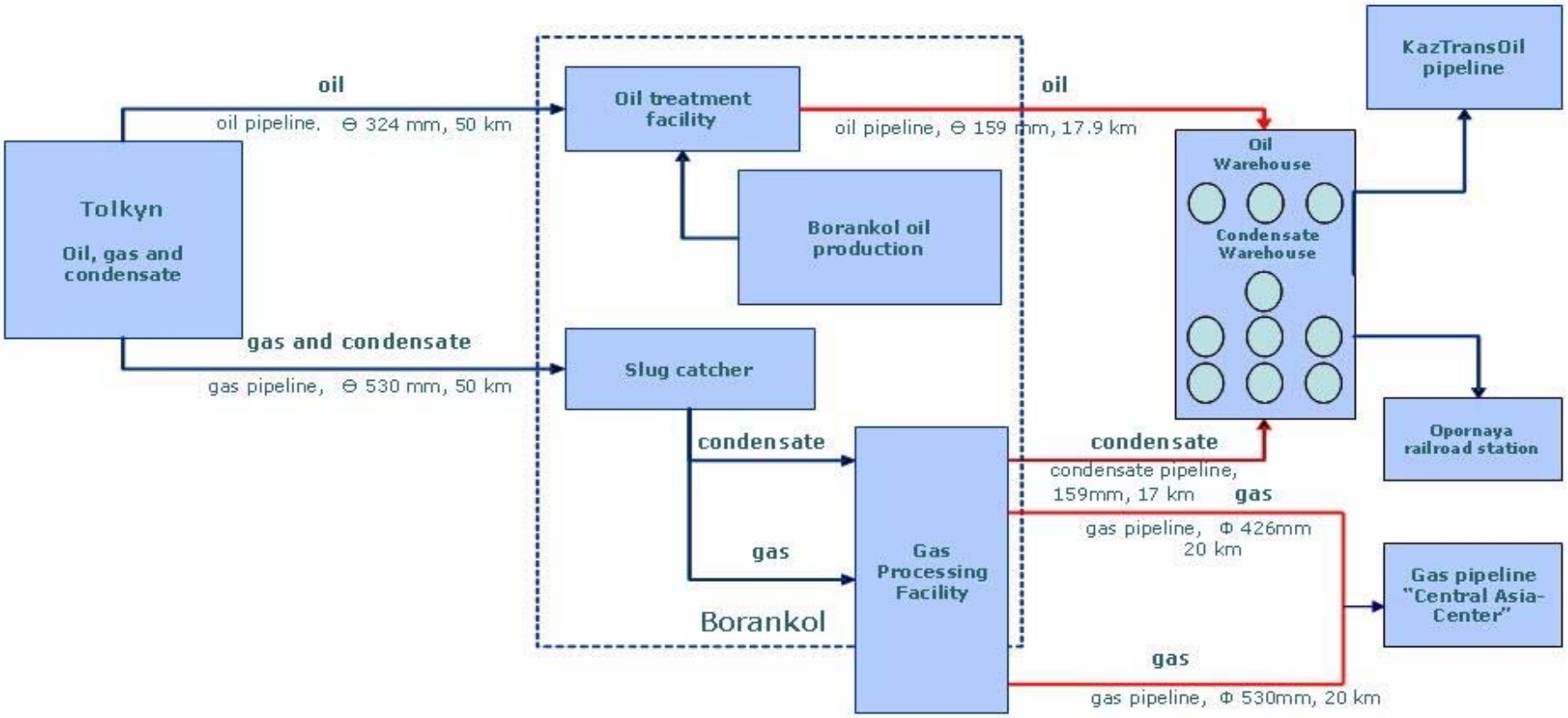
[404] Second Witness Statement of Victor Romanosov, April 13, 2012 (hereinafter "Second Romanosov Statement"), ¶ 15.

[405] Expert Opinion of the Ministry of Justice, February 13, 2009, C-110. *See also* First Romanosov Statement ¶¶ 11-13; Second Romanosov Statement ¶¶ 8-9.

[406] First Romanosov Statement ¶¶ 16-18; Second Romanosov Statement ¶¶ 8, 10.

[407] First Romanosov Statement ¶ 23; Second Romanosov Statement ¶ 8.


Tolkyn
Oil, gas and condensate
oil
oil pipeline, Θ 324 mm, 50 km
gas and condensate
gas pipeline, Θ 530 mm, 50 km
Oil treatment facility
Borankol oil production
Slug catcher
condensate
gas
Gas Processing Facility
Borankol
oil
oil pipeline, Θ 159 mm, 17.9 km
Oil Warehouse
Condensate Warehouse
KazTransOil pipeline
Opornaya railroad station
condensate
condensate pipeline, 159mm, 17 km
gas
gas pipeline, Φ 426mm 20 km
Gas pipeline "Central Asia-Center"
gas
gas pipeline, Φ 530mm, 20 km

To anyone familiar with the industry, there is simply no way that the reclassified segments of KPM's and TNG's in-field pipelines could be considered "trunk" or "main" pipelines.

a. No Legal Basis Existed for Kazakhstan's "Reclassification" of KPM's and TNG's Field Pipelines as "Trunk" Pipelines

252. In its Statement of Defense, Kazakhstan seeks to defy logic and common sense by claiming that "[t]he question of whether the pipelines operated by KPM and TNG are field or trunk pipelines is a matter of the ***correct application*** of the relevant Kazakh legislative instruments."[408] In other words, Kazakhstan argues that this is purely a legal issue. Even if that highly dubious assertion were correct, Kazakhstan has not correctly applied the legal definition of "main pipelines" — and it certainly did not do so prior to this arbitration, during its malicious prosecution of Mr. Cornegruta. Rather, its Statement of Defense misrepresents the applicable Kazakh legal provisions in a futile attempt to retroactively justify its conduct.[409]

253. Articles 1(17) and 1(18) of the Law on Oil of the Republic of Kazakhstan in force in 2008 refer generally to "oil and gas pipelines" and the "construction and/or operation of oil and gas pipelines,"[410] but the Law on Oil only specifically defines one type of pipeline, namely a "main [or trunk] pipeline." As explained by Claimants' legal expert, Professor Maidan Suleymenov – Kazakhstan's highly pre-eminent authority on oil and gas legislation – "the 1995 Law on Oil defines trunk oil pipelines as a subtype of oil and gas pipelines."[411] Professor Suleymenov was the head of the working group that drafted the 1995 Law on Oil, the 1996 Law on Subsoil Use, the 1995 Law on Licensing, and the amendments to those laws in August 1999 and December 2004, as well as other laws in the foreign investment and oil and gas areas.[412]

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408 Statement of Defense ¶ 23.6.

409 For the avoidance of doubt, Claimants maintain their claim that the reclassification of pipeline segments of both KPM and TNG and the ensuing criminal charges against KPM, TNG, and their General Managers constitute violations of the ECT. *See* Statement of Defense ¶¶ 21.15, 23.3 ("the Claimants only rely on the Republic's actions in relation to one pipeline (the 18km KPM oil pipeline (KPM pipeline) to assert that there have been substantive breaches of the ECT."). To the extent Claimants refer to KPM's in-field pipelines only, their arguments are applicable *mutas mutandis* to TNG's reclassified pipelines.

410 Kazakh Law on Oil No. 2350, arts. 1(17) and 1(18), June 28, 1995 (in force in 2008), C-80. *See* Suleymenov Report ¶¶ 45-46.

411 Suleymenov Report ¶¶ 40, 45.

412 Kazakhstan contends that "it is not apparent that [Prof. Suleymenov] has particular expertise in the area of Subsoil law." *See* Statement of Defense ¶ 26.16. Professor Suleymenov is highly qualified to provide expertise on the Law on Oil, the Law on Subsoil Use, and the Law on Licensing. In 1993, the Kazakh Vice-President

254. The first sentence of Article 1(14) of the Law on Oil in force in 2008 defines "main pipeline" as:

> an engineering facility, consisting of a linear pipeline part and related aboveground facilities, service lines, remote control and communication facilities designated for the transportation of oil ***from the contractor's pipeline to points of transshipment to another mode of transport or points of processing or consumption***.[413]

255. KPM's reclassified oil pipeline and TNG's reclassified condensate pipeline ran from the field processing facilities to the oil and condensate storage tanks.[414] KPM's and TNG's oil and condensate were first stored before being delivered from their storage tanks to the KazTransOil main pipeline or to transport by railway.[415] The reclassified segments of the KPM and TNG pipelines were therefore clearly "contractor's pipelines" under the aforementioned definition, and plainly did not constitute "main pipelines" under the relevant law.[416]

256. Kazakhstan knows this, and therefore has mischaracterized the legislation to confuse the Tribunal and justify its acts against KPM and TNG. Kazakhstan claims that Article 1(14) of the Law on Oil defines a "trunk pipeline [as] an engineering structure intended for

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established a working group under his direction to draft and finalize the Law on Oil, which was adopted on June 28, 1995. Similarly, Professor Suleymenov drafted the Law on Subsoil Use of January 27, 1996 (which was largely modeled on the Law on Oil) and the Law on Licensing of April 17, 1995. He is a member of the Board of the Kazakhstan Petroleum Lawyers' Association. *See* Professor Suleymenov's resume attached to his Report and Suleymenov Report, Section III. *See also* Olga Chentsova, *Kazakh Legislation on Subsurface Use*, *in* OIL AND GAS LAW IN KAZAKHSTAN: NATIONAL AND INTERNATIONAL PERSPECTIVES 123, 125-28 (Ilias Bantekas *et al.* eds., Kluwer Law International 2004), C-463.

413 Kazakh Law on Oil No. 2350, art. 1(14), June 28, 1995 (in force in 2008) (emphasis added), C-80. Kazakhstan erroneously quotes Article 1(14) of the Law on Oil in force before amendments of August 11, 1999 and not as of 2008. Kazakh Law on Oil No. 2350, art. 1(14), June 28, 1995 (in force before 1999), R-23. *See* Statement of Defense ¶ 21.7(a). *See* Suleymenov Report ¶¶ 42-44.

414 Even Kazakhstan's "sleeper" witness, Deputy Prosecutor General of Kazakhstan Kravchenko, does not include "storage" in the definition of main pipeline. "Sleeper" Witness Statement of the Deputy Prosecutor General of the Republic of Kazakhstan, Mr. Kravchenko, November 2011, R-139. Storage of the oil and condensate is a necessary prerequisite as (i) the oil needed to be checked and adjusted to meet the requirements of the main pipeline (temperature, water and sulfur content, density, and saturated vapor pressure) and (ii) KPM and TNG only had scheduled slots to inject the oil into the real main pipelines and transfer the condensate on railway trucks. *See* Second Romanosov Statement ¶¶ 9-10.

415 Second Romanosov Statement ¶¶ 9-10. *See* Contracts regarding transhipment of oil to railway transport at Opornaya station, R-132. The Chief of Aktau Territorial Department acknowledged that KPM's and TNG's oil was first stored before "further transfer of products to the system of main pipelines" during the enforcement actions in February 2010. Order from Chief of Aktau Territorial Department, February 26, 2010, C-79.

416 Suleymenov Report ¶ 54.

transportation of commercial oil from the places of production (from Contractor's pipeline) to the places of (i) transshipment into a different means of transport; (ii) processing; (iii) consumption; ***(iv) storage***."[417] The statute, however, does not refer to storage at all. Kazakhstan misrepresents the law by adding the term "storage" to its interpretation of the statute in its Statement of Defense. As Professor Suleymenov concludes, "[s]ince KPM's reclassified segment of the KPM Pipeline goes from the oil treatment facility to the oil storage facility, … such reclassified segment of pipeline cannot be a trunk pipeline."[418]

257. Kazakhstan also asserts for the first time in its Statement of Defense that the reclassified KPM and TNG pipelines carried oil from the contractor's pipeline to places of transshipment into other means of transport or consumption.[419] That is also incorrect. By law, and as a matter of fact and logic, a main pipeline transports oil or gas from different points of collection from multiple producers over a very long distance to another means of transport (tankers, for instance), to a refinery, or to the end consumer.[420] KPM's and TNG's reclassified pipelines did not function that way. The reclassified segments of oil and condensate pipelines carried oil and condensate to storage tanks, which are hardly another means of transport, processing, or consumption.[421]

258. In fact, TNG's system of gathering pipelines included another segment of field pipeline that ***did*** carry products from the storage tanks to "another mode of transport," namely the Opornaya rail station. Kazakhstan, however, never contended (prior to this arbitration) that this final segment in TNG's system was a "main" pipeline. Rather it only contended that the segments *leading up to* that segment were "main" pipelines.[422] The diagram below shows what Kazakhstan contemporaneously contended in relation to which segments of KPM's and TNG's in-field systems were "main" pipelines:

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417 Statement of Defense ¶¶ 21.7, 23.11, 23.12.

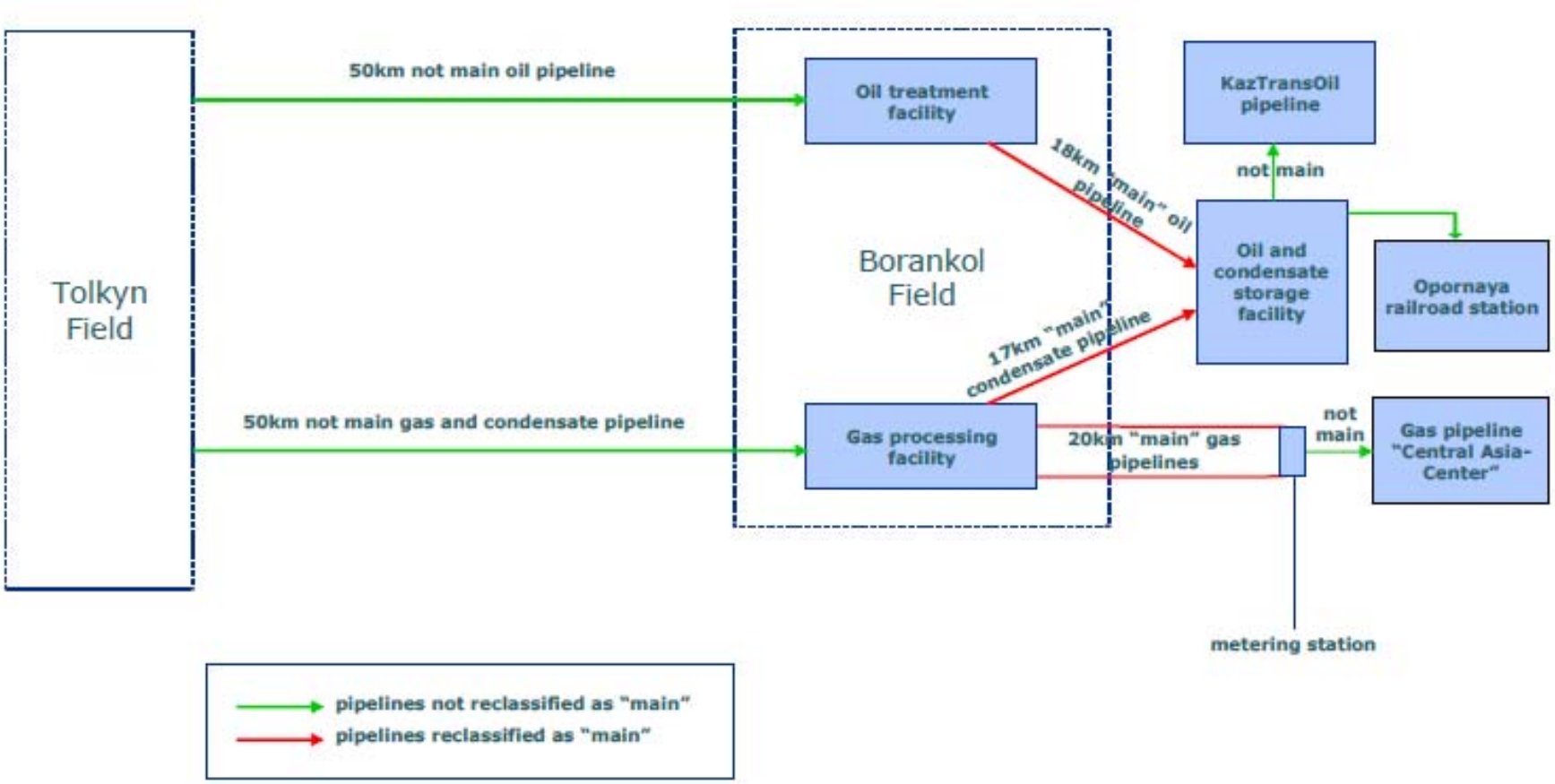
418 Suleymenov Report ¶ 54 (emphasis omitted).

419 Statement of Defense ¶ 21.8(h)(v).

420 Second Romanosov Statement ¶ 15.

421 Second Romanosov Statement ¶¶ 9-10. *See* Contracts regarding the transfer of ownership for oil at the point of entry into the trunk pipeline, R-133.

422 *See* First Romanosov Statement ¶¶ 16-18. *See, contra,* Statement of Defense ¶¶ 21.8(g)(ii) and 24.7(b).


Tolkyn Field
50km not main oil pipeline
Oil treatment facility
Borankol Field
18km "main" oil pipeline
KazTransOil pipeline
not main
Oil and condensate storage facility
Opornaya railroad station
17km "main" condensate pipeline
50km not main gas and condensate pipeline
Gas processing facility
20km "main" gas pipelines
not main
Gas pipeline "Central Asia-Center"
metering station
pipelines not reclassified as "main"
pipelines reclassified as "main"

259. Obviously, a pipeline system will not contain a "main" segment followed by an in-field, contractor's segment – which underscores the absurdity of Kazakhstan's reclassification. Contrary to Kazakhstan's allegations in its Statement of Defense,[423] prior to this arbitration, Kazakhstan did not reclassify as "main" pipelines the final segments of TNG's and KPM's in-field systems, running from the storage tanks (or metering station) to the Opornaya rail station or the true "main" pipelines (the KazTransOil and Central Asia-Center pipelines).[424] Only now, once the obvious absurdity of its contemporaneous reclassifications has been demonstrated to an international tribunal, has Kazakhstan argued that the final segments in KPM's and TNG's in-field systems were also "main" pipelines.

260. Kazakhstan's new argument regarding those final segments is also wrong. They are not "main" pipelines either for the simple reason that they are operated by "contractors," and "contractor's pipelines" are not "main" as a matter of law. The KazTransOil and Central Asia-Center pipelines (to which those final segments connected) are the only pipelines in the diagram above that meet the statutory definition of a "trunk" pipeline.

261. In short, in order to criminally convict KPM's in-country manager – thereby providing a basis for a devastating penalty against KPM – Kazakhstan arbitrarily reclassified certain segments of Claimants' pipelines as "main." But in their zeal, the Kazakh authorities made a ridiculous error: they forgot to reclassify as "main" the final in-field segments that connected the alleged "main pipelines" segments to the real "main" pipelines.[425] Kazakhstan has belatedly tried to reclassify those final in-field segments in its Statement of Defense, but that has only served to underscore the absurdity of the entire exercise.

262. Kazakhstan also grasps at straws by arguing that because ownership of oil was transferred from KPM to buyers at the point of entry into the actual main pipeline, KPM's 17.9 kilometer pipeline is a "main" pipeline.[426] The point at which ownership of oil is transferred, however, is not a factor in the legal definition of "main" pipelines. The law defines a pipeline as "main" if it transports oil to a point of "consumption," not the point of "transfer of legal

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423 *See* Statement of Defense ¶¶ 21.8(g)(ii) and 24.7(b).

424 Expert Opinion of the Ministry of Justice, February 13, 2009, C-110. First Romanosov Statement ¶¶ 16-18.

425 Suleymenov Report ¶¶ 50-52.

426 Statement of Defense ¶ 21.8(h)(v).

ownership to a consumer." Transfer of ownership is a purely commercial arrangement, which simply does not equate with "consumption" of oil.

263. Another glaring flaw in Kazakhstan's reasoning on this matter is its failure to consider the second sentence of Article 1(14) of the Law on Oil. That sentence explicitly states that "[p]ipelines operating in the gathering main mode shall not be referred to as main pipelines."[427] The second sentence of Article 1(14) distinguishes main pipelines from "gathering" pipelines.[428] This second sentence was introduced to clarify the kinds of pipelines that are not main pipelines. *A fortiori*, gathering and contractor pipelines, such as those that Kazakhstan reclassified in this case, are not main pipelines.[429]

264. Moreover, under the Law on Oil, pipelines other than main pipelines are included in the definition of "petroleum operation" and/or oil "production."[430] Article 1(24) of the Law on Oil defines "production" as:

> Any operation related to the extraction of oil to the surface and which includes:
>
> the construction and operation of subsurface and surface industrial equipment and facilities, ***including from the contractor's pipeline for the transportation of oil from the place of production to the place of transfer to a main pipeline and/or to a different type of transport…***[431]

265. The production of hydrocarbons is performed in a single technological process, which, in accordance with the Law on Oil and the Law on Subsoil Use, includes the contractor's transportation of hydrocarbons from the wellheads to the point of transfer into a main pipeline or another mode of transport.[432] As explained by Professor Suleymenov,

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427 Kazakh Law on Oil No. 2350 art. 1(24), June 28, 1995 (in force in 2008), C-80.

428 Suleymenov Report ¶¶ 46-47.

429 Suleymenov Report ¶ 47.

430 Kazakh Law on Oil No. 2350, art. 1, June 28, 1995 (in force until December 2004), R-23 (Petroleum Operation is defined as "all types of work relating to the Exploration, Production and storage of Petroleum as well as its pumping by pipeline transport, associated with them in a single technological cycle."). Kazakh Law on Oil No. 2350 art. 1(24), June 28, 1995 (in force in 2008), C-80. *See* Suleymenov Report ¶¶ 25-32.

431 Kazakh Law on Oil No. 2350 art. 1(24), June 28, 1995 (in force in 2008) (emphasis added), C-80.

432 Second Romanosov Statement ¶¶ 9-11.

> [T]he oil production process is a single technological process, which, in conformity with the 1995 Law on Oil and the 1996 Law on Subsoil, includes in-process transportation from the place of extraction to the place of transfer of oil into a trunk pipeline and/or other means of transportation. This single technological process of production is reflected in the Contract No. 305 and in the approved working programs, which are part of the Contract. In-process transportation by KPM is carried out in accordance with Contract No. 305, the working programs, and other project documents approving the technological process of oil production, and is performed by means of both in-process oil pipelines (field pipelines, gathering pipelines, and so on) and other means of transportation.[433]

Thus, any pipelines involved in the production process are, by definition, not main pipelines. Professor Suleymenov analyzes whether from a design, construction, and operational perspective, KPM's reclassified pipeline is part of a single technological process.[434] He concludes that

> the KPM Pipeline Segment is intended for pumping oil from the OTF on the Borankol field to the OSF in the mode of gathering pipeline. It is part of a single technological process of approved petroleum operations under License No. 309 and Contract No. 305, and is ***not a trunk pipeline***.[435]

266. Kazakhstan also argues, for the first time in its Statement of Defense, that KPM's and TNG's Subsoil Use Contracts (and Licenses) do not cover operation of pipelines because they do not mention that specific activity in their definition of "production."[436] Those contracts, however, authorized KPM and TNG to conduct "petroleum operations," and the operation of in-field pipelines was specifically included in the definition of "petroleum operation" under the previous iteration of the Law on Oil, which applied when KPM's and TNG's Subsoil Use Contracts were executed.[437] The operation of in-field pipelines was later included in the

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[433] Suleymenov Report ¶ 32.

[434] Suleymenov Report ¶¶ 33-39.

[435] Suleymenov Report ¶ 39 (emphasis in original). *See also* Legal Opinion of Mr. Suleymenov, July 2, 2009, C-108 [KPM's reclassified pipeline, "is included in the single technological process of oil [production] and it is not an oil main pipeline."].

[436] Statement of Defense ¶ 21.5(i) and (j).

[437] *See* Suleymenov Report ¶¶ 25-31. Kazakh Law on Oil No. 2350, art. 1, June 28, 1995 (in force until December 2004), R-23. In any event, the operation of pipelines was implicitly included in the definition of production prior to its 2004 amendment.

definition of "production," rather than "petroleum operation," when the Law on Oil was amended in December 2004.[438] Thus, at all times, operation of in-field pipelines was expressly permitted under the law, as part of the very activity covered by KPM's and TNG's Subsoil Use Contracts.[439]

267. In addition to the clear terms of the Law on Oil, Kazakh law provides yet another basis for concluding that KPM's and TNG's segments of pipelines are not "main" pipelines, which Kazakhstan neglects to mention in its Statement of Defense. Services for transportation of oil and gas by main pipelines are considered natural monopolies in accordance with Article 4(1)(1) of the Law on Natural Monopolies and Regulated Markets ("Law on Natural Monopolies").[440] As such, they are regulated exclusively by the Agency for the Regulation of Natural Monopolies. As explained by Professor Suleymenov, "a natural monopoly is a state of a commodity market … where the creation of competitive conditions for the satisfaction of demand for a certain type of services … is impossible or is economically impractical due to technological factors of production and/or provision of such services."[441]

268. The Agency for the Regulation of Natural Monopolies, however, never regulated any of KPM's and TNG's pipelines – no doubt because those pipelines only served KPM's and TNG's own gathering needs, and not the monopolistic functions of transporting other contractors' oil over long distances (*i.e.*, the function of a main pipeline). Professor Suleymenov explains that "[d]ue to the short length of the reclassified KPM Pipeline Segment and, thus, the possibility of using alternative means for oil transportation, such as tank trucks, at similar or at least at bearable costs," KPM's reclassified pipeline (and, by extension, TNG's reclassified pipelines) could not be and were not considered main pipelines under the Law on Natural Monopolies because "the conditions for a natural monopoly for transportation of oil from the Borankol field to the oil storage facility at Opornaya station are not fulfilled."[442] For this reason

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438 Law No. 2-III on Introduction of amendments and additions to some legislative acts of the Republic of Kazakhstan concerning subsoil use and performance of oil operations in the Republic of Kazakhstan, December 1, 2004, R-129.

439 Suleymenov Report ¶ 31.

440 Law No. 272 on Natural Monopolies and Regulated Markets, art. 4(1)(1), July 9, 1998, C-464. Suleymenov Report ¶ 57.

441 Suleymenov Report ¶ 59.

442 Suleymenov Report ¶ 60.

as well, it would have been legally incoherent to consider KPM's and TNG's reclassified pipelines as main pipelines, which no doubt is why the Agency for the Regulation of Natural Monopolies – the Kazakh agency with the greatest interest in determining whether those pipelines were "main" – never did.

b. No Factual Basis Existed for Kazakhstan's "Reclassification" of KPM's and TNG's Field Pipelines as "Trunk" Pipelines

269. Of course, contrary to Kazakhstan's unsupported position that this is "purely a legal question," an actual determination of whether a pipeline is "in-field" or "main" involves factual considerations that turn on technical issues of oil and gas production. For example, it is relevant to determine, as Professor Suleymenov has done, whether the pipeline in question is part of a single technological process of production.[443] Kazakhstan admitted that a technical analysis was required when the Financial Police issued its order for an "expert" opinion by the Ministry of Justice:

> Within criminal investigation, it was ***necessary to perform forensic-construction and technical expert examination of oil pipeline*** "Oil Treatment Plant - Commodities and Raw Material Base, Opornaya station" of 18000 meters long.[444]

Further, in its Statement of Defense, Kazakhstan recognized that the expert examination made by the Ministry of Justice (the sole expert opinion relied on by the Kazakh courts during Mr. Cornegruta's trial) was of a technical nature.[445] Respondent also relies on "normative legal acts of a lower level," which define the rules of technological design and technical operation of main pipelines.[446] Similar regulations exist for the design, construction, commissioning, and operation of in-field pipelines. Kazakhstan concedes that such regulations can "give helpful guidance."[447] Accordingly, facts about the design, construction, commissioning, inspection, and use of the pipelines are plainly relevant to whether they in fact were "main" pipelines.

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[443] Suleymenov Report ¶¶ 32-39. Claimants also disagree with Respondent's assertion that "it is impossible to draw the line between field and trunk pipelines by technical characteristics." *See* Statement of Defense ¶ 21.4(f) and (g).

[444] Order from the Financial Police to the Ministry of Justice, February 9, 2009, C-109.

[445] Statement of Defense ¶ 21.4(b). Expert Opinion of the Ministry of Justice, February 13, 2009 (emphasis added), C-110.

[446] Statement of Defense ¶ 21.7 n.128.

[447] Statement of Defense ¶ 23.14.

270. At each stage of the design, construction, and commissioning of KPM's and TNG's alleged "main" pipelines, KPM and TNG obtained the requisite state authorizations and permits and held the requisite licenses.[448] The reclassified pipelines had been inspected numerous times by various agencies and ministries of Kazakhstan, including the agencies responsible for emergency situations, fire control, state standards, ecology, sanitary standards, subsoil use, and reserve, in the course of annual complex audits, single-agency controls, and commissioning inspections.[449] As explained by Mr. Romanosov, the "State authorities were regularly (in fact, almost constantly) present on the fields."[450] If there had been any legitimate concerns that the pipelines were "main" in accordance with Kazakh law, it would surely have been noted earlier.

271. Pursuant to the Subsoil Use Licenses for Contracts No. 305 and No. 210, KPM and TNG were licensed to conduct exploration, development, production, treatment, transportation, and trading of hydrocarbons activities.[451] Likewise, pursuant to Contract No. 305, petroleum operations include all works related to exploration, production, sale, as well as storage and pumping by pipelines or other kind of transport, connected with the former in a single technological process.[452] KPM and TNG owned and operated their in-field pipelines as part of a single technological process.[453] Those licenses gave KPM and TNG the right to operate the pipelines in question, which are an integral part of the single technological production process.[454]

272. Furthermore, KPM and TNG designed and built their subsequently reclassified pipelines in accordance with Kazakh laws, regulations, and norms, with the authorization and approval of the competent Kazakh authorities.[455] In 2002, the State Inspection for Emergency

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448 *See* Kazakhstan's allegations to the contrary in its Statement of Defense ¶ 23.19(c). Claimants do not dispute that the operation of a main or trunk pipeline requires a license and that Claimants never held such a license. (*See* Statement of Defense ¶ 21.3).

449 First Romanosov Statement ¶ 26; Second Romanosov Statement ¶ 12.

450 Second Romanosov Statement ¶ 12.

451 KPM and TNG Subsoil Use Licenses, arts. 1.7, 1.8, C-45 and C-52.

452 Contract No. 305, art. 1(20), C-45. Although Contract No. 210 does not include an identical provision, it states that: "Production means all works and operations performed for purpose of extraction of hydrocarbons to the surface." Contract No. 210, art. 1(9), C-52.

453 Second Romanosov Statement ¶ 11.

454 Suleymenov Report ¶ 68.

455 *See* Second Romanosov Statement ¶¶ 12-13.

Situations, the Fire Safety Supervising Agency, the State Sanitary Surveillance Department, the Ministry of Environmental Protection for the Mangystau Region, the State Inspection for Architecture and Construction, and NIPI Neftegaz approved the commissioning of KPM's 18-kilometer pipeline.[456] No mention was ever made of that pipeline being a "main" pipeline.

273. In addition, according to Kazakh standards, a pipeline under 50 kilometers in length cannot be a main pipeline.[457] Since KPM's and TNG's reclassified pipelines are less than 20 kilometers long, they cannot be considered main pipelines.[458]

274. Following the 2002 commissioning of the pipelines and the treatment and storage facilities, KPM and TNG were required to obtain a license for operation of hazardous objects in accordance with the Law on Licensing.[459] A Subsoil User, in addition to its Subsoil Use License, is only required to hold licenses for specific types of activities listed in the Law on Licensing.[460] Professor Suleymenov explains that "the operation of a non-trunk, field contractor's pipeline in itself is not subject to separate licensing, and KPM would only need a separate license to ensure the safety of industrial, high-risk activities (which it obtained)."[461] KPM and TNG applied for the appropriate licenses, and the MEMR, as the competent authority, issued the requisite licenses in September 2002.[462] Similarly, on August 5, 2005, the MEMR re-

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For KPM, *see*: Borankol Raw Materials Base Project prepared by NIPI Neftegaz, 2001, C-465; Report from the State Expert Review of Projects, April 25, 2001, C-470; Borankol Working Programs for 2001 and 2002, C-466 and C-467. Suleymenov Report ¶¶ 71-79.

For TNG, *see:* Agreement between the Agency of the Republic of Kazakhstan on Investments and TNG, March 16, 2000, C-52; Agreement between the MEMR and TNG, May 28, 2002 and Supplement to Contract No. 201 between the MEMR and TNG, December 19, 2003 (*See* Contract No. 201, C-52); Tolkyn Working Program for 2002, C-468.

456 Decision of the Working Group on the commissioning of KPM's pipeline, March 4, 2002, C-469. Second Romanosov Statement ¶ 13 ("Likewise, the national design institute designed TNG's field condensate pipeline and two gas pipelines, which were commissioned in May 2003 for the field condensate pipeline and one gas pipeline and in November 2006 for TNG's other gas pipeline.").

457 Suleymenov Report ¶ 56.

458 Suleymenov Report ¶ 56.

459 Law No. 2200 of the Republic of Kazakhstan "On Licensing," April 17, 1995, R-24. Suleymenov Report ¶¶ 75-76.

460 Letter from the MEMR to KazakhTurkMunay, May 13, 2002, C-471. The MEMR confirms that since KazakhTurkMunay holds a Subsoil Use License, it has the right to engage in certain activities, including "the operation of pipelines without obtaining any additional license for a separate kind of activity." Suleymenov Report ¶ 75.

461 Suleymenov Report ¶ 83.

462 Licenses issued to KPM and TNG, September 26, 2002, C-81 and C-82.

issued the requisite licenses to KPM following its reorganization as a limited liability partnership.[463] Again, nobody considered the KPM pipeline segment as "main" or "trunk" in the context of those approvals.

275. On January 11, 2007, the Republic of Kazakhstan adopted a new Law on Licensing, which added new activities into the law for which licenses were required.[464] On June 19, 2007, President Nazarbayev issued a Presidential decree that transferred authority for licensing the operation of trunk pipelines from the MEMR to the Agency for the Regulation of Natural Monopolies.[465] The MEMR (later called the Ministry of Oil and Gas or "MOG") remained the licensing authority for activities relating to production and to operation of pipelines other than trunk pipelines.[466] KPM and TNG requested re-issuance of their existing licenses pursuant to the new Law on Licensing.[467] On May 29, 2008, the MEMR re-issued to KPM and TNG their licenses for various operations, including "oil, gas, and oil products production" pursuant to the adoption of the 2007 Law on Licensing.[468] Like KPM's 2005 license, the companies' 2008 licenses constituted the requisite approvals that KPM and TNG needed to continue operating their field pipelines, including those that Kazakhstan arbitrarily reclassified six months later.[469]

276. Kazakhstan also contends for the first time in its Statement of Defense that because KPM's and TNG's pipelines extended beyond their Contract Area, the reclassified pipelines were "trunk" pipelines.[470] Kazakhstan appears to argue that since KPM and TNG were allowed to explore for and extract oil pursuant to Contracts No. 305 and No. 210 only within their respective Contract Areas, any accessory to oil production that extended outside of those areas could not fall within the definition of "production." That argument is specious.

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463 Licenses issued to KPM and TNG, August 5, 2005, C-83 and C-84.

464 Law No. 214 on Licensing, January 11, 2007, C-116 and R-24. Suleymenov Report ¶ 77.

465 Decree No. 346 of the President of the Republic of Kazakhstan "on further improvement of the system of State administration of the Republic of Kazakhstan," June 19, 2007, R-128. Suleymenov Report ¶ 84.

466 Suleymenov Report ¶ 84.

467 Suleymenov Report ¶ 79.

468 Licenses issued to KPM and TNG, May 25, 2008, C-472 and C-473. Suleymenov Report ¶¶ 79-80.

469 Suleymenov Report ¶¶ 80-83.

470 Statement of Defense ¶¶ 21.5(k)-(n), 21.6(c), 21.7(b)(iii), 21.8(e) and (h), 23.9, 24.5, 24.8(c), and 24.9(a).

277. The alleged restriction for a contractor's pipeline to remain within the Contract Area is not mentioned in the Law on Oil, the Law on Subsoil Use, or any other Kazakh law or regulation. Furthermore, Contracts No. 305 and No. 210 expressly provide that KPM and TNG had the right to build and operate production facilities within and ***outside*** their Contract Areas.[471] And as Professor Suleymenov explains, "[t]he Contract Area has no relevance at all for the classification of a pipeline as a trunk pipeline or any other kind of pipeline."[472]

278. If Kazakhstan's contention had any merit, hundreds of oil and gas producing companies[473] would be operating "main" pipelines, since the vast majority of Contract Areas are located some distance away from main pipelines or other means of transport (such as railway or tankers).[474] However, as Claimants explained in their Statement of Claim,[475] Kazakhstan only reclassified the KPM and TNG gathering systems as "main." It did not reclassify the virtually identical gathering systems that are owned and operated by many other oil and gas companies throughout Kazakhstan.

279. For instance, KazakhTurkMunai operates two pipelines that are virtually identical to KPM's reclassified pipelines. But even though KazakhTurkMunai lacks a main pipeline license, Kazakhstan has not brought criminal charges against its general director. Kazakhstan argues that both of KazakhTurkMunai's pipelines are "classified as field pipelines,"[476] but that only proves Claimants' point. KazakhTurkMunai runs one of its pipelines from its oil processing facilities on the West Yelemes field to a connection point in the KazTransOil main

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471 Contract No. 305, arts. 7.1.4, 7.1.5, C-45 and Contract No. 210, arts. 6.1.3, 6.1.4, 6.1.10, C-52.

472 Suleymenov Report ¶ 49.

473 From the evidence Kazakhstan has presented, it appears that no more than 21 companies hold licenses to operate trunk pipelines in Kazakhstan. The Government's assertion that "over 100 enterprises" hold such license is clearly false, because many of the companies it references only hold licenses issued by the Agency for the Regulation of Natural Monopolies for activities *relating* to "trunk" pipelines, such as maintenance and repair, but not necessarily their operation. *See* Statement of Defense ¶¶ 21.12(d), 23.19(l); "Sleeper" witness statement from the Agency for the Regulation of Natural Monopolies to the MOG, July 20, 2011, R-137. Once again, Kazakhstan has failed to provide any supporting documents in relation to that "exhibit," contrary to the Tribunal's order.

474 Second Romanosov Statement ¶ 17.

475 Statement of Claim ¶ 87; First Romanosov Statement ¶ 32.

476 Statement of Defense ¶¶ 21.10, 23.19(e)-(h). Letter from KazakhTurkMunai to the MOG, October 19, 2011, R-135.1.

pipeline that is located next to KPM's connection point.[477] KazakhTurkMunai's Yelemes pipeline leaves its Contract Area, runs through KPM's Contract Area (the Borankol field), exits KPM's Contract Area intersecting KPM's and TNG's reclassified pipelines, before reaching the connection point into the KazTransOil main pipeline.[478] KazakhTurkMunai's pipelines are certainly "outside the Contract Area of their respective Subsoil Contracts,"[479] and should therefore also be considered main pipelines if Kazakhstan's position were correct. This is just one example that Claimants know well because the pipeline in question crosses KPM's Contract Area.[480] It is in fact very common for contractors' field pipelines to extend beyond their contract areas, and Kazakhstan presents no evidence to the contrary.[481] There is no actual difference between the pipelines of KPM and KazakhTurkMunai (or many other operators), which demonstrates that Kazakhstan's different treatment is arbitrary and unwarranted.

280. Mr. Romanosov illustrates this point:

> Kazakhstan's claim that a pipeline that extends outside a subsoil user's Contract Area is a main pipeline is unfounded because the pipelines owned by most oil companies extend outside their Contract Areas. Otherwise, how can they connect to the main pipeline? Oil and gas fields are usually located some distance away from the actual main pipelines. For instance, I can describe the layout of the oil field pipeline operated by our neighbor, KazakhTurkMunai. Its in-field pipeline was built before our reclassified pipelines were built. Its pipeline runs through KPM's Contract Area and intersects our in-field pipelines. KazakhTurkMunai's in-field pipeline extends far beyond its Contract Area. Yet no one has ever claimed that it was a "main" pipeline.[482]

281. Kazakhstan also contends, without providing any support for its assertion, that "field pipeline may in no circumstances be used for rendering the services for oil transport to third organizations."[483] This is also a new argument conjured up for the purposes of this

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[477] Letter from KazakhTurkMunai to the MOG, October 19, 2011, R-135.1; Second Romanosov Statement ¶ 17.

[478] Second Romanosov Statement ¶ 17.

[479] Statement of Defense ¶ 23.19(h).

[480] Second Romanosov Statement ¶ 17.

[481] Second Romanosov Statement ¶ 17.

[482] Second Romanosov Statement ¶ 17.

[483] Statement of Defense ¶¶ 21.17, 21.2(c), 21.7, 21.8(f) and (h), 22.9, 23.13, 24.6, 24.8(d), and 24.9(c). *See also*,

arbitration. In the criminal proceeding, Kazakhstan only raised the fact that KPM transported TNG's oil to assess the amount of "illegal profits" allegedly received by KPM.[484] Kazakhstan never argued that this fact was relevant to whether the pipelines qualified as "main" pipelines in the first place. As Professor Suleymenov explains, "the fact that KPM transported oil for TNG is of no consequence" because Kazakhstan's argument is unsupported in Kazakh law.[485] Moreover, it is common in the industry for one contractor to transport another contractor's oil and gas through its field pipelines because contractors often have arrangements to use each other's in-field processing facilities. As Mr. Romanosov explains,

> [S]haring treatment facilities and field transportation is common in the oil and gas industry because some companies are too small or produce too little for it to be efficient to build their own treatment facilities and field pipelines to link to main pipelines or other means of transportation. Moreover, when an oil company does not produce enough hydrocarbons to justify the construction of treatment and storage facilities and related infrastructure, the Kazakh authorities will not authorize their construction. This is also why TNG and KPM shared processing facilities and related infrastructure. TNG used KPM's processing facilities to treat its relatively small volumes of oil, and KPM used TNG's gas processing facilities to treat its relatively small volumes of condensate and associated gas. That is a common practice, of which Kazakhstan is fully aware, and Kazakhstan never claimed that KPM or TNG was not authorized to do it.[486]

c. Competent Authorities and Experts Confirmed that KPM's and TNG's Reclassified Pipelines Were Not Main Pipelines

282. During Mr. Cornegruta's criminal trial and with its Statement of Claim, Claimants provided numerous opinions authored by competent Kazakh authorities and experts in the oil and

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"Sleeper" Witness Statement of the Deputy Prosecutor General of the Republic of Kazakhstan, Mr. Kravchenko, November 2011, R-139.

484 Decision of the Aktau City Court, September 18, 2009, C-117.

485 Suleymenov Report ¶¶ 63-64.

486 Second Romanosov Statement ¶ 14. *See also* Rashid Gaissin, *Regulation of Oil and Gas Transportation by Pipelines in Kazakhstan*, *in* OIL AND GAS LAW IN KAZAKHSTAN: NATIONAL AND INTERNATIONAL PERSPECTIVES 311, 315 (Ilias Bantekas et al. eds., Kluwer Law International 2004) ("Connecting pipelines are designed for one or particular group of oil fields. Regimes of third party access may differ. Generally these connecting pipelines are built within a programme of field development and are not so sophisticated as trunk (main) pipelines."), C-474.

gas industry explaining that KPM's and TNG's reclassified pipelines were not main pipelines.[487] Kazakhstan attempts to dismiss these expert opinions by asserting that "these consultants are not qualified to opine on the issue."[488] Kazakhstan's abrupt and unjustified dismissal of the "[c]onclusions of the Claimants and its experts in this field" is purportedly because they "do not correspond the reality"[489] — a reality that Kazakhstan has eschewed for the past four years.

283. On November 19, 2008, KPM and TNG obtained confirmation from the Ministry of Emergency Situations, the state authority responsible for the supervision and control of industrial safety of in-field and main pipelines,[490] which stated:

> Taking into account the aforementioned [Articles 1(14) and 1(24) of the Law on Oil], ***all pipelines operated by your enterprise***, from the place of extraction ***to the point of transferring the hydrocarbons to the oil and gas main pipelines are not main pipelines***.
>
> We would also like to communicate that ***the extraction of oil*** (crude oil, gas condensate, and natural gas) to the surface, ***treatment and transportation of oil to the place of transfer into a main pipeline and (or) another means of transport form a single technological process of oil production.***[491]

284. In January 2009, two Kazakh scientific, research, and design institutes of oil and gas confirmed that the reclassified pipelines owned by KPM and TNG were part of a single technological production process and were, therefore, not main pipelines. These two institutes are the only holders of licenses issued by the Republic of Kazakhstan for the design and engineering of oil and gas pipelines, including trunk oil and gas pipelines.[492]

285. The Kazakh Scientific, Research, and Design Institute of Oil and Gas, a division of the Kazakh Institute of Oil and Gas of the National Oil Company, KazMunaiGaz, opined on January 5, 2009, that the reclassified pipelines owned by KPM and TNG "do **not** belong to the

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487 *See* Statement of Claim ¶¶ 98-106.

488 Statement of Defense ¶ 28.3.

489 Statement of Defense ¶ 21.5(h).

490 Second Condorachi Statement ¶ 6].

491 Letters from the Ministry of Emergency Situations to KPM and TNG, November 19, 2008, C-90 and C-91.

492 NIPIneftegaz (*available at* http://www.nipi.kz) and KazNIPImunaygas (available at http://www.kaznipi.kz), C-475 and C-476.

category of **main** pipelines and are designated to **ensure** the process of hydrocarbons **production**."[493]

286. The other Kazakh institute, the Scientific Research and Design Institute of Oil and Gas Industry of NIPI Neftegaz, which had designed the single technological production process, including the reclassified pipelines, reached the same conclusion. It found that:

> the pipeline transporting marketable oil from the [central oil treatment plant] to the cargo and raw materials base ***are classified as in-field pipelines***.[494]

287. Likewise, the National Scientific and Research Center on Industrial Safety Issue of the Ministry of Emergency Situations, which is responsible for the safety of trunk and non-trunk pipelines,[495] confirmed that KPM's and TNG's reclassified pipelines were not main pipelines. Pursuant to the Law on Oil, the regulations, and technical norms on trunk pipelines, on January 8, 2009, the Ministry of Emergency Situations concluded:

> [The KPM reclassified] pipeline, 17 km long, with the diameter of 159 mm is a ***field pipeline***.
>
> The operation of the mentioned pipeline relates to the ***single technological process of oil production***.
>
> ****
>
> ***The Tolkynneftegas pipelines:***
>
> 1) Gas condensate pipeline OGEF-GaGCTP [from the Tolkyn field to the oil treatment facility] with the diameter of 530 mm and length of 50 km;

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493 Letters from the Kazakh Scientific, Research, and Design Institute of Oil and Gas of the Kazakh Institute of the National Oil Company KazMunaiGaz to KPM and TNG, January 5, 2009 (emphasis added), C-99 and C-100.

494 Letters from the Kazakh Scientific, Research, and Design Institute of Oil and Gas of the NIPI Neftegaz to KPM and TNG, January 9, 2009 (emphasis added), C-101 and C-102.

495 Kazakhstan asserts that the issuance of such opinions "falls beyond the scope of the Ministry of Emergency Situations." *See* Statement of Defense ¶ 21.5(f) fn 125. However, the Ministry of Emergency Situations is the competent authority of the Republic of Kazakhstan for security of trunk and non-trunk pipelines pursuant to the Law on Industrial Safety at Dangerous Manufacturing Facilities and the Law on Natural and Man-made Emergency Situations. The National Scientific and Research Center on Industrial Safety Issue of the Ministry of Emergency Situations carried out its expert review "on the basis of the Certificate of the right to perform works in the area of industrial safety No. 0006, issued on 4 April 2007 by the Committee for state control over emergency situations and industrial safety of the [Ministry of Emergency Situations] of the [Republic of Kazakhstan]." *See* Reports from the National Scientific and Research Center on Industrial Safety Issue of the Ministry of Emergency Situations for KPM and TNG, January 8, 2009, at 1, C-103 and C-104.

> 2) Gas pipeline GaGCTP-Final separator [from the oil treatment facility to the delivery point into the trunk pipeline] with the diameter of 530 mm and length of 20 km;
>
> 3) Gas pipeline GaGCTP-Final separator [from the oil treatment facility to the delivery point into the trunk pipeline] with the diameter of 426 mm and length of 20 km;
>
> 4) Gas condensate pipeline GaGCTP-CRMB [from the oil treatment facility to the storage tanks] with the diameter of 159 mm and length of 20 km ***are field pipelines***.
>
> The operation of the mentioned pipelines relates to the ***single technological process of gas and gas condensate production***.[496]

288. The Russian Science and Research Institute for the Construction and Operation of Pipelines and Energy Facilities[497] issued two expert opinions confirming that KPM's and TNG's reclassified pipelines were not "main" pipelines. This Russian Institute, the largest oil and gas institute in Moscow, authored the construction regulations for pipelines, including main pipelines, of the Soviet Union, which were subsequently adopted and applied in Kazakhstan.[498] In addition, among the five experts, Mr. Rozhdestvenski had actually participated in the drafting of these regulations.[499]

289. On April 13, 2009, the Russian Science and Research Institute for the Construction and Operation of Pipelines and Energy Facilities, concluded that the pipelines at issue "are ***not main pipelines***" and "are used in carrying out ***oil operations***, and particularly the

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[496] Reports from the National Scientific and Research Center on Industrial Safety Issues of the Ministry of Emergency Situations for KPM and TNG, January 8, 2009 (emphasis added), C-103 and C-104.

[497] Kazakhstan attempts to cast aspersions on the credibility of expert opinions of the Russian Science and Research Institute for the Construction and Operation of Pipelines and Energy Facilities (Statement of Defense ¶ 21.5(f) fn 126). The construction standards for Russia and Kazakhstan are very similar (as evidenced by the numerous references to SNiPs in the various design and construction documents relating to KPM's and TNG's pipelines. SNiPs are Russian standards.). In addition, Respondent's tortured argument with respect to the interaction between a joint-stock company and a limited liability company is pointless. As evidenced on the website of the Russian Science and Research Institute for the Construction and Operation of Pipelines and Energy Facilities, the limited liability company is a subsidiary of the joint-stock company. *See* http://en.vniist.ru/corp/157.htm (last visited on April 12, 2012), C-477.

[498] Pisica Statement ¶ 17. *See* Letter of the Russian Science and Research Institute for the Construction and Operation of Pipelines and Energy Facilities, August 25, 2009, C-107.

[499] Pisica Statement ¶ 17. *See* Letter of the Russian Science and Research Institute for the Construction and Operation of Pipelines and Energy Facilities, August 25, 2009, C-107.

work on the oil extraction."[500] In a supplementary expert opinion on August 25, 2009, the Russian institute confirmed that KPM's reclassified pipeline was a "***field pipeline***" and that the unfounded report of the Kazakh Ministry of Justice "cannot serve as a ground to consider [KPM's reclassified pipeline] as a main pipeline."[501]

290. Finally, the Department for Direct Investments in Subsoil Exploitation, the Department for Development of Oil Industry, and the Inspection Department for Geology and Subsoil Exploitation of the MEMR conducted an unscheduled complex audit of KPM and TNG between January 25 and February 6, 2010.[502] The MEMR concluded that KPM and TNG were in compliance with the legislation of the Republic of Kazakhstan, including with respect to the reclassified pipelines. It wrote:

> The crude oil treatment and pumping facility (…) of Borankol and the raw material base station (…) belong to the ***single technological process of the crude oil extraction system*** in accordance with Contract No. 305 of March 30, 1999 and License series MG No. 309-D of May 23, 1997.
>
> ****
>
> The production capacities installed for hydrocarbon production (stock of wells, in-field production system, associated gas recovery systems), facilities for treatment of natural gas, gas condensate and oil (…), ***gas transportation (gas- and oil pipelines), storage (tanks) and loading of products (a pumping unit, loading ramps for railway transport)***, as well as systems for using waste water, all of these elements **being part of a single technological process/complex of extracting hydrocarbons, are in full compliance**…[503]

291. Kazakhstan's reclassification of TNG's and KPM's pipelines as main pipelines squarely contradicts the legal, factual, and technical opinions of its own authorities. Nevertheless, that arbitrary reclassification was the sole basis for arresting KPM's General

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[500] Reports from the Russian Science and Research Institute for the Construction and Operation of Pipelines and Energy Facilities for KPM and TNG, April 13 and April 15, 2009 (emphasis added), C-105 and C-106.

[501] Report from the National Scientific and Research Center on Industrial Safety Issues of the Ministry of Emergency Situations of Kazakhstan for KPM, August 25, 2009 (emphasis added), C-107.3.

[502] Reports of the Ministry of Energy and Mineral Resources for KPM and TNG, February 5 and 6, 2010, C-385 and C-386.

[503] Reports of the Ministry of Energy and Mineral Resources for KPM and TNG, February 5 and 6, 2010 (emphasis added), C-385 and C-386.

Director, Mr. Sergei Cornegruta (as well as seeking the arrest of three other managers); finding him guilty of a crime and sentencing him to four years of prison; and assessing an illegal and confiscatory financial penalty against KPM.

2. Kazakhstan Interfered in Mr. Cornegruta's Trial to Ensure the Court Would Render a Guilty Verdict

292. As Claimants have already demonstrated,[504] Kazakhstan's arrest and prosecution of Mr. Cornegruta was a complete sham. His guilt and the judgment in his trial were foregone conclusions. The Financial Police had conjured the grounds for his arrest — including the financial windfall Kazakhstan stood to gain as a result of a guilty verdict — months before the arrest actually occurred or a trial could be held. Mr. Cornegruta himself realized that Kazakhstan had already decided his fate well before the judge heard his case. In a June 2009 petition to the Financial Police to stop the investigation against him, Mr. Cornegruta wrote:

> Dear Senior Investigator Rahimov!
>
> It is not easy to write a petition for the suspension of criminal action to you who actually initiated it, although not because you wished to do so. It is even more difficult to write this knowing beforehand that you will refuse to grant my request.
>
> However, I believe that you will consider my petition from a professional point of view and you will present in the decision to refuse my request well-grounded arguments in favor of your illegal decision.[505]

Unfortunately, the Financial Police refused to halt the investigation, and the court rendered a guilty verdict — without any evidence that Mr. Cornegruta operated a main pipeline without a license, and without considering any of the evidence that proved Mr. Cornegruta's innocence.[506]

293. Because no independent and impartial court could have possibly arrived at the plainly erroneous legal conclusion that Mr. Cornegruta operated a main pipeline without a license, the question is squarely presented: how did the Aktau City Court reach that conclusion? The answer, which should be plain to any observer of Kazakhstan's political and legal processes

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[504] *See* Statement of Claim Section IV.B(4); *see also, e.g.*, Motion to Stop Criminal Proceedings, July 30, 2009, C-601; Request to court to terminate proceedings against Mr. Cornegruta, September 19, 2008, C-656.

[505] Request from Mr. Cornegruta to Stop Criminal Proceedings, June 15, 2009, C-478.

[506] *See* Judgment, September 18, 2009, C-117; *see also* Malinovsky Opinion at Section 3.6, 3.7.

(as discussed further in Section IV.A *infra*), is that Kazakhstan's executive branch interfered in the proceeding to ensure that the court would find Mr. Cornegruta guilty. As a result, due process and criminal procedure violations permeated the arrest, prosecution, and trial.

294. Two key facts are telling about Mr. Cornegruta's prosecution. First, chief among the materials supporting the grounds for Mr. Cornegruta's prosecution were President Voronin's letter to President Nazarbayev and President Nazarbayev's corresponding order to investigate Mr. Stati's investments.[507] Second, the method of Mr. Cornegruta's detention — *i.e.*, prison without bond — was severe when compared to the charge.[508] Under Kazakh law and predominant practices worldwide, prison detention is reserved for violent crimes, not economic crimes.[509] Kazakhstan clearly used Nazarbayev's order to treat Mr. Cornegruta harshly, as a state would treat a suspect of a political crime who threatened state interests (or the interests of its rulers).[510]

295. As Professor Aleksey Malinovsky, a pre-eminent expert on Russian, Kazakh, and comparative criminal law, who has reviewed Mr. Cornegruta's available case file, explains:

> [I]t is quite obvious that grounds for initiating criminal cases for economic crimes must arise from direct discovery of attributes of the economic crime, and that discovery is likely to come from the authorities that have information and knowledge of the facts leading to such crimes, such as the financial police or prosecution authorities. The grounds for initiating the case against Mr. Cornegruta are suspect because they were not discovered by the financial police or commenced through a complaint to the prosecutor's office, and instead were alleged from outside the country.

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[507] *See* President Nazarbayev's Investigation Instructions, October 14, 2008, C-8; indictment of Mr. Cornegruta, June 26, 2009, C-454; *see also* Request from Mr. Cornegruta to Stop Criminal Proceedings, June 15, 2009, C-478; Malinovsky Opinion at 19-20.

[508] In fact, Mr. Cornegruta petitioned for his release from prison pending his trial, but to no avail. *See* Request to court not to detain Mr. Cornegruta, April 28, 2009, C-633; Petition for Change of Preventative Measure, April 30, 2009, C-657. *See also* Complaint to Regional Prosecutor regarding Illegal Arrest of Mr. Cornegruta, May 20, 2009, C-658.

[509] Malinovsky Opinion at 17 (explaining that the punishment is "contrary to current world practice of punishment for economic crimes, which has mostly abandoned the imposition of actual imprisonment on economic criminals. Instead, punishment for such crimes usually consists in the payment of a fine and the seizure of property.").

[510] Malinovsky Opinion at 17.

> If there were legitimate grounds on which to accuse S. Cornegruta of the economic crime of illegal entrepreneurial activity, the Indictment would have clearly stated them.
>
> My analysis of the contents of the request sent by the President of the Republic of Moldova to the President of the Republic of Kazakhstan and of the actual political situation of the specific historic period leads me to conclude that the President of Moldova wanted to deprive the oppositionist A. Stati of his oil business in the Republic of Kazakhstan, and that the President of Kazakhstan complied. It is clear to me that this was the actual political grounds for initiation of the criminal case, which explains the prosecutive bias of the investigation and the court evidenced by multiple violations of provisions of substantive and procedural laws of Kazakhstan, as well as principles of international law.[511]

296. Further, Professor Malinovsky explains that Kazakhstan essentially substituted an accusation against Mr. Anatolie Stati for a reason to prosecute Mr. Cornegruta, which is a violation of fundamental principles of criminal law. He states that "according to the principle of personal responsibility for guilty acts, a criminal case on the grounds of an alleged illegal act of one person (A. Stati) cannot be initiated against another person (S. Cornegruta)." By conflating the two, Kazakhstan made clear that its criminal proceeding had nothing to do with Mr. Cornegruta's own conduct, but was part of Kazakhstan's larger plan to take over Mr. Stati's investments.

297. Professor Scott Horton, who is an expert on the political and judicial systems in Kazakhstan and other CIS countries, also finds it telling that the investigation that led to Mr. Cornegruta's prosecution originated from the "top down," rather than the "bottom up." As he explains:

> Bottom-up action, which starts with routine regulatory inspections, the notation of violations, the issuance of citations and opportunities to cure, and then escalates to more extreme remedies — ultimately including possible cancellation of rights or forfeiture — is more easily reconciled with a sovereign's claims of routine enforcement action. .... By contrast, when the decision to challenge an investor appears to originate at or near the apex of the political structure, there is greater reason to suspect a dirigiste process and confiscatory intent. In such cases, ordinary-course administrative process appears to have been circumvented, and an ultimate

[511] Malinovsky Opinion at 20.

> outcome may have been dictated. Moreover, the weaker the rule-of-law traditions of a state, and the greater the accumulation of power in the hands of the executive, the more this maxim holds.[512]

298. Thus, the undisputed fact that Mr. Cornegruta's prosecution was the result of the investigation order of President Nazarbayev (a very strong executive in a state with a weak rule-of-law tradition), rather than an administrative process involving the agencies responsible for regulating pipelines, compels serious doubts about the foundation for the charges and the fairness of the proceedings.

299. Moreover, the evidence shows that Kazakhstan in fact ensured that Mr. Cornegruta would not receive a fair trial. Mr. Cornegruta's defense centered on the very simple and indisputable fact that KPM did not operate a main pipeline. That fact was supported by a multitude of Kazakh governmental, legal, and industry specialists, as described in the previous section.[513] Therefore, Mr. Cornegruta could not be guilty of "illegal entrepreneurial activity" of operating a main pipeline without a license. In his defense, Mr. Cornegruta relied on the analyses of KPM's pipeline from four oil and gas industry experts that had inspected KPM's pipelines in January 2009, all of which concluded that KPM's 17.9-kilometer pipeline was not a main pipeline.[514]

300. Unbeknownst to Mr. Cornegruta until months later, Kazakhstan's chief investigator had issued a statement on May 18, 2009, concluding that those expert opinions were not admissible in the court case.[515] The judge presiding over the trial was not obliged to accept the conclusion of the investigator, however. In fact, the judge was obliged to independently consider the evidence herself to determine admissibility as well as the merits of the evidence, and could not satisfy that duty by relying on the opinion of the prosecution's investigator.[516]

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[512] Horton Report ¶ 167.

[513] Request from Mr. Cornegruta to Stop Criminal Proceedings, June 15, 2009, C-478.

[514] Those were the reports of the Department of Emergency Situations for Mangystau Oblast; the Scientific Research Centre for Technical Safety in Oil & Gas Industry, Geology in Oil & Gas; National Scientific Research & Design Institute of Oil & Gas; and the KZ Scientific Research and Design Institute of Oil & Gas.

[515] Indictment of Mr. Cornegruta, June 26, 2009, at 19, C-454.

[516] Malinovsky Opinion Section 3.7.

Nevertheless, she accepted the investigator's conclusion without reviewing the expert reports herself and deemed them inadmissible.[517]

301. The judge's decision violated multiple provisions of the Kazakh Criminal Code, which requires a court to independently review all evidence supporting the accused person's innocence. As Professor Malinovsky explains, "the court must in each case independently determine whether a violation [regarding the submission of evidence] exists and, if so, what that violation is. Instead of correcting the error made by the investigator when it unreasonably considered the [] evidence [supporting Mr. Cornegruta's innocence] inadmissible, the court, by failing to independently assess the evidence, repeated the error."[518]

302. Mr. Cornegruta relied on two additional reports from renowned experts. The first was a legal analysis of the Law on Oil performed by the very author of that law, Professor Maidan Suleymenov, Claimants' expert in this arbitration. Professor Suleymenov concluded that KPM's pipeline was not a main pipeline as a matter of law.[519] The second report was from the Pan-Russian Scientific Research Institute for Construction and Operation of Petroleum Pipelines, an agency that promulgates the technical standards for the oil and gas energy sector in Central Asia.[520] That report also concluded that KPM's 17.9-kilometer pipeline was not a main pipeline.

303. The presiding judge, however, also rejected those opinions before considering them.[521] The reason for that rejection was an unfounded claim that the authors had not verified their reports because they were not present at the trial, although there was no requirement under Kazakh law that they be present.[522] The judge's rejection of those reports violated multiple provisions of the Kazakh Criminal Code, which states that any legally-obtained evidence may be admitted and requires that both incriminating and exculpatory circumstances be analyzed in the case.[523] The reports from Professor Suleymenov and the Russian Institute were duly notarized

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[517] *See* Malinovsky Opinion Section 3.7.

[518] Malinovsky Opinion at 25.

[519] Judgment of Aktau City Court, September 18, 2009, at 9, C-117.

[520] Judgment of Aktau City Court, September 18, 2009, at 9, C-117.

[521] Judgment of Aktau City Court, September 18, 2009, C-117; Malinovsky Opinion at 24-26.

[522] Malinovsky Opinion at 25.

[523] Malinovsky Opinion at 25-26.

and authenticated.[524] There was no basis to reject them as "unverified." As Professor Malinovsky explains, the documents "complied with all requirements applicable to written evidence" under Kazakh law.[525]

304. He concludes that

> Refusal of the court to analyze evidence given by witnesses of the defense . . . and written evidence supporting the defense constitutes a major violation of the adversarial principle and the principle of equality of the parties in a criminal proceeding. . . Refusal of the court to analyze evidence supporting the defense resulted in the court acting as a prosecuting agency by taking the side of the prosecution, which is expressly prohibited [under Kazakh law]….[526]

305. To make matters worse, the judge did not announce her decision to reject the expert reports submitted in support of Mr. Cornegruta's defense until the judge issued her final decision on Mr. Cornegruta's guilt.[527] Therefore, Mr. Cornegruta was convicted of a crime without the knowledge that the court had not admitted any of his exculpatory evidence. Consequently, he had no opportunity to object to or seek reconsideration of the judge's decision to disregard the numerous expert reports submitted as part of his defense.

306. In additional to violating international norms and standards of due process, the judgment against Mr. Cornegruta and KPM also violated Kazakh law and due process, as Professor Malinovsky explains:

> [B]y refusing to analyze evidence of the witnesses of the defense and written evidence supporting the accused, the court violated [the provision of Kazakh law that states] a judgment must contain an aggregate description of evidence, on which the conclusions of the court are based, as well as reasons why other evidence was rejected. The court is not entitled to render a judgment of conviction unless all pleas supporting the accused are evaluated and all doubts regarding the guilt of the accused are eliminated.[528]

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524 Malinovsky Opinion at 25.

525 Malinovsky Opinion at 25.

526 Malinovsky Opinion at 25.

527 *See* Judgment of Aktau City Court, September 18, 2009, C-117; *see also* Appeal, October 1, 2009, C-659; Appeal, October 5, 2009, C-660.

528 Malinovsky Opinion at 26.

307. With respect to testimony submitted by witnesses of fact in Mr. Cornegruta's defense, the court's judgment did not contain any explanation of why that testimony was rejected. In fact, the primary evidence that the court cited as support for its guilty verdict was an "expert" report from an official of the Ministry of Justice, whose background was in engineering and construction, rather than law. The defense team had filed a motion on July 30, 2009, objecting to the admissibility of that report.[529] The judge summarily rejected the motion the day after it was filed.[530] Mr. Cornegruta's objection to that "expert" opinion was well-founded, however, because it was riddled with its own procedural and due process violations.

308. First, the report was issued at the direction of the Financial Police investigator, who decided that an "independent" expert should assess KPM's pipeline.[531] That expert was appointed from the Ministry of Justice (the "MOJ expert"). The investigator's instructions to the MOJ expert, however, made clear that the resulting report was anything but independent. Rather than requesting his opinion on whether KPM's 17.9-kilometer pipeline was a "main" pipeline, the investigator instructed the MOJ expert that it had already "ascertained" that KPM operated "trunk pipelines without required license" and "gained illegal profit in the total amount exceeding 41.1 billion tenge" and instructed the expert to confirm that the 17.9-kilometer pipeline was a main pipeline, under threat of criminal prosecution for failure to conclude accurately.[532] The Financial Police gave the MOJ expert the materials he would need to arrive at that conclusion, and the MOJ expert did not consider any materials or industry standards that would have supported a contrary conclusion, including in particular the four reports that KPM had transmitted to the Financial Police confirming that KPM did not operate a main pipeline.[533] As Mr. Condorachi explains:

> [T]he [MOJ expert] report listed the written materials that the MOJ expert used to arrive at his conclusion, which confirmed that the MOJ expert had not assessed all the available and relevant materials, because he only listed four documents. Two of those

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529 Motion Objecting to Expert Report and Criminal Proceeding, July 30, 2009, C-669.

530 Order Rejecting Defense Petitions, July 31, 2009, C-602. *See also* Remarks on Expert's Opinion, June 10, 2009, C-661; Audit of Forensic Economic Evaluation by UTA Auditors, September 9, 2009, C-603.

531 Order from the Financial Police to the Ministry of Justice, February 9, 2009, C-109.

532 Order from the Financial Police to the Ministry of Justice, February 9, 2009, C-109.

533 *See* Expert Opinion of the Ministry of Justice, February 13, 2009, C-110; *see also* Second Condorachi Statement ¶ 5.

> four documents did not even concern main pipelines. Notably, the MOJ expert did not take into account the two reports from the [bodies within the Ministry of Emergency Situations], or the two reports from the research and design institutes, which concluded that KPM's pipelines were not main pipelines. Since the Financial Police were in possession of those reports when it appointed the MOJ expert, there is no reason why the MOJ expert would not have had access to them. The Financial Police should have provided those conclusions to the MOJ expert, and he should have included them in his analysis.[534]

The MOJ "expert," therefore, conveniently declined to consider any evidence that would have demonstrated the truth, which was that KPM did not, in fact, operate a main pipeline.

309. Moreover, the MOJ expert was appointed to perform his "analysis" on February 9, 2009, and he concluded his opinion on February 13, 2009, a mere four days later.[535] The expert never visited KPM's pipeline himself and never conducted an independent analysis, but instead relied only on what the Financial Police provided to him.[536] Mr. Cornegruta and everyone else at KPM were unaware that the expert report had been ordered until May 2009, and thus had no opportunity to present information for the "expert" to consider.

310. The second (and final) piece of "evidence" that the court relied on was a letter written by Mr. Cornegruta in June 2008, which the prosecution distorted to claim was a "confession" that KPM operated a main pipeline. A review of the context of that letter reveals that it was nothing of the sort.[537]

311. The 2007 Law on Licensing added new activities into the law for which licenses were required, some of which were not clearly explained. For example, the law listed general activities summarized as "projecting and operation of mining, petrochemical, chemical, petroleum and gas processing productions, operation of items for storage of gas, petroleum and petroleum products, main gas pipelines, petroleum pipelines, petroleum products pipelines."[538]

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534 Second Condorachi Statement ¶ 5.

535 Order from the Financial Police to the Ministry of Justice, February 9, 2009, C-109; Expert Opinion from Ministry of Justice, February 13, 2009, C-110.

536 *See* Second Romanosov Statement ¶ 16; *see generally* Second Condorachi Statement.

537 *See* Letter from KPM to the Agency for Regulation of Natural Monopolies, June 13, 2008, C-115; *see* Second Condorachi Statement ¶ 7.

538 Law on Licensing, art. 12(2), R-24.

Included in that general category were several sub-types of activity, such as "production of . . . petroleum, gas, [and] petroleum gas liquids," "operation of main gas pipelines, petroleum pipelines, petroleum products pipelines," and "operation of equipment, facilities of tubing stations, reservoir parks and linear part of main gas, petroleum products pipelines, as well as technological equipment and wells of underground gas storage facilities."[539] Many activities in the oil and gas production processes seemingly fall into one or more of those sub-activities and therefore appeared to require a license. Similarly, some of these subtypes combined multiple, unrelated activities in the same category. Most importantly, one subtype combined the use of equipment and compression facilities of tank farms (which is part of the oil production process) with the operation of main oil and gas pipelines (which is not).

312. Companies that held licenses when the new Law on Licensing was issued were required to seek re-issuance of those licenses from the competent authorities, according to the new activities that were listed in the law. To conform their existing licenses to the new law, KPM and TNG submitted requests for re-issuance of those licenses to the MEMR,[540] and in May 2008, the MEMR sent renewed licenses for oil and gas production activities, which included operating in-field pipelines.

313. The MEMR also wrote to KPM on May 26, 2008, directing KPM to apply to the Agency for the Regulation of Natural Monopolies for other licenses it may need, as a result of the Presidential decree that split the licensing authority between the two ministries.[541] Because the new Law on Licensing was unclear, KPM was not sure whether it needed an additional license from the Agency for the Regulation of Natural Monopolies, or whether the MEMR's re-issuance of KPM's 2005 license was sufficient. Because the MEMR had instructed KPM to do so, and because KPM wanted to ensure that it was in compliance with relevant laws, on June 13, 2008, KPM's General Director Mr. Cornegruta wrote to the Agency for the Regulation of Natural Monopolies to request approval of its production activities.

314. In his letter, Mr. Cornegruta requested "re-isssuance" of KPM's 2005 license for every subtype of activity that might apply to KPM, and he simply quoted the description of the

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539 Law on Licensing, art. 12(2), R-24.

540 *See* Letters from KPM to MEMR, including Explanatory Note and Payment for Re-issuance of Licence, May 5, 2008, C-662.

541 Letter from D. Ismagulov of the MEMR to KPM, May 26, 2008, C-545.

various subtypes from the legislation. As noted above, one of those sub-types of activity referenced several different production processes, some of which applied to KPM (use of equipment and compression facilities of tank farms) and some of which did not (use of main pipelines).[542] Mr. Cornegruta was not listing all of the activities that KPM conducted; rather, he was merely quoting the new law. At most, Mr. Cornegruta's letter showed a good-faith effort to comply with confusing new legislation by submitting an over-inclusive request for re-licensing.

315. The Agency for the Regulation of Natural Monopolies' response subsequently clarified some of the confusion created by Kazakhstan's poorly-drafted legislation, explaining that the type of activity listed in KPM's 2005 license did not give rise to a need for re-issuance of that license with a new sub-type of activity as a result of the change in the law on licensing.[543] It further stated that if KPM wanted to apply for a license for activities including the operation of main pipelines, KPM would need to submit an application for such a license, in compliance with eligibility requirements for that activity.[544]

316. Importantly, after this clarification, KPM did ***not*** submit an application to operate a main pipeline because it did not operate a main pipeline.[545] If Mr. Cornegruta's letter was indeed a request for a main pipeline license and an admission that KPM operated a main pipeline (as Kazakhstan argues), then his failure to renew that request after the Agency for the Regulation of Natural Monopolies explained the actual requirements shows just as well that Mr. Cornegruta did not believe that KPM operated a main pipeline. Of course in truth, Mr. Cornegruta's June 13, 2008 letter was not an admission of anything at all. It was simply a good faith — albeit over-inclusive — attempt to comply with a confusing new law. [546]

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[542] In fact, Mr. Cornegruta forwarded the same materials that it had originally sent to the MEMR, and which resulted in re-issuance of KPM's license regarding its petroleum production activities.

[543] Letter from the Agency for the Regulation of Natural Monopolies to KPM, July 14, 2008, C-480.

[544] Letter from the Agency for the Regulation of Natural Monopolies to KPM, July 14, 2008, C-480. Indeed, it was clear that KPM was not requesting a new license, but instead was only requesting re-issuance of its existing license modified in accordance with the new law, because, with that letter, KPM submitted payment for the fee for re-issuance of existing licenses, and not the fee required to be submitted with a request for a new license. *See* Letter from KPM to the Agency for Regulation of Natural Monopolies, June 13, 2008 (with enclosures), C-115; *see also* Resolution No. 610, July 19, 2007, C-667; Kazakh Law on Budgets, 2008, 2009-2011, C-484.

[545] To the contrary, *see* Letter from KPM to the Agency for the Regulation of Natural Monopolies, August 5, 2008, C-663.

[546] Statement of Claim ¶¶ 115-117; *see also* Second Condorachi Statement ¶ 7.

317. Nevertheless Kazakhstan seized on Mr. Cornegruta's June 13, 2008, letter during his trial, portraying it as a "confession" that KPM operated a main pipeline and was requesting a license to continue doing so. Thus, Mr. Cornegruta's conviction was exclusively based on a biased "expert" opinion and an innocuous letter sent in the midst of changing legal regulations. There is no way an independent and impartial judge could have possibly reached a guilty verdict based on that evidence.

318. The Kazakh court carried out the final step in its denial of justice when it rendered its guilty verdict against Mr. Cornegruta in September 2009. In that decision, the court sentenced Mr. Cornegruta to four years in prison and assessed a sum of US$ 145 million against *both* Mr. Cornegruta and KPM.

319. While the verdict against Mr. Cornegruta was deplorable, equally shocking was the inclusion of KPM in the sentence. KPM had not been a party to the case, and under Kazakh law, legal entities cannot be subject to criminal prosecution. As Professor Malinovsky explains:

> According to article 14 of the Criminal Code of the Republic of Kazakhstan ("Persons subject to criminal liability"), only a sane natural person who has reached the age established by the Code is subject to criminal liability. . . . [That provision] must be construed literally and may not be extended to legal entities. . . .
>
> Analysis of both the general and the specific provisions of the Criminal Code of the Republic of Kazakhstan shows that no provision establishes criminal liability for actions taken by legal entities. . . . That approach is fully justified, since it logically corresponds to the fundamental provision of article 14 [] establishing criminal liability for natural persons only.
>
> As a matter of comparison, I note that in other countries, where a legal entity can be a subject of a criminal offense, criminal codes specifically define both the lists of criminal acts that can be imputed to legal entities and the lists of punishments that can be imposed on legal entities by courts for those offenses. Such provisions are well elaborated, for example, in the Criminal Code of France.[547]

The Criminal Code of Kazakhstan, by contrast, contains no such provision. In Kazakhstan, it is simply not possible to convict a company of a crime.

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[547] Malinovsky Opinion at 2-3.

320. True to form, Kazakhstan tries to justify its illegal criminal verdict against KPM with yet another legal fabrication. It claims that, under a theory it calls "quasi-criminal responsibility," KPM could have rightly been the subject of a criminal conviction. The problem with Kazakhstan's theory, however, is that no such notion exists in Kazakh law. Kazakhstan's legal "expert," Mr. G.S. Maulenov, claims that the notion of "quasi-criminal responsibility" can be "recognized indirectly" since it is "not directly provided for in [the] criminal legislation."[548] That is incorrect. As Professor Malinovsky explains, "the opinion of expert G.S. Maulenov contradicts the current criminal legislation of Russia, Kazakhstan, and other countries, and his Expert Report is contrary to criminal legal doctrine. . . . Since the Criminal Code of Kazakhstan contains no provisions establishing quasi-criminal liability of legal entities, there is no grounds to support an argument that such liability exists in Kazakhstan."[549]

321. In fact, two years ago the Kazakh Financial Police proposed amending the Criminal Code to add a provision that would recognize criminal liability for legal entities, but that suggestion was met with such vehement opposition that it was shelved.[550] In February of this year, the Financial Police announced that it had changed its position on the draft law, and would no longer press for its adoption.[551] In light of those facts, it is astounding that Kazakhstan tells the Tribunal in its Statement of Defense that Kazakh law recognizes criminal liability for legal entities. Regardless, it is simply not possible to "indirectly" recognize a criminal sanction that is not provided in the criminal code without violating a fundamental principle of criminal law: "*Nulla poena sine lege*" (there can be no penalty without law).[552]

322. Even if Kazakhstan's theory of quasi-criminal responsibility had any truth — which it does not — the court judgment against KPM would still amount to a travesty of due process and proper procedure.[553] KPM was not named as a party to the proceeding, nor was it permitted to participate in the trial. KPM attempted to appeal the unexpected judgment against

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548 Expert report of Maulenov on Quasi-criminal responsibility of legal entities in Kazakhstan, R-140 at 1.

549 Malinovsky Opinion at 5-6.

550 Malinovsky Opinion at 6-7.

551 Malinovsky Opinion at 6-7.

552 Malinovsky Opinion at 5-6.

553 Malinovsky Opinion at 6-7, 19.

it, but Kazakhstan did not permit it to do so.[554] Thus, at a minimum, Kazakhstan's judgment against KPM violated the following basic rights of KPM: (i) its right to a trial, including its right to a fair trial;[555] (ii) its right to judicial protection;[556] (iii) its rights to present its case and to a defense;[557] (iv) its right to equal protection before the law;[558] and (v) its right to not be arbitrarily deprived of its property.[559] As a result, Kazakhstan's judgment against KPM amounts to an extraordinary denial of justice, and no reliance upon an unrecognized notion of "quasi-criminal responsibility" under Kazakh law could possibly cure those fundamental defects.

323. Of course, there was only one reason why KPM was named in the judgment in Mr. Cornegruta's case. That reason was as practical as it was illegal:[560] Kazakhstan needed to execute the penalty of US$ 145 million against KPM in order to be in a position to seize its assets, freeze its bank accounts, and ultimately take over both KPM and TNG. As Claimants have demonstrated, that is precisely what Kazakhstan did.

3. Kazakhstan Concocted an Arbitrary and Illegal Penalty to Pave the Way for Its Direct Expropriation of KPM and TNG

324. Not only did Kazakhstan ensure a guilty verdict and wrongfully name KPM in the sentence; it also ensured that the penalty assessed against KPM would be so large that KPM

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554 *See* KPM's Complaint to Court regarding challenge of initiation of execution proceedings, January 21, 2010, C-635; KPM's Claim to Court regarding challenge of enforcement order, January 22, 2010, C-636; KPM's Claim of Appeal, January 25, 2010, C-481; KPM's Claim to court regarding challenge of court's refusal to reinstate term for claim of appeal, February 8, 2010, C-637; KPM's Request to court to suspend enforcement order, February 16, 2010, C-638; KPM's Claim of Appeal, February 25, 2010, C-640; KPM's complaint to court regarding actions of enforcement officers, March 5, 2010, C-641; KPM's Complaint to court regarding challenge of court decision of Feb. 26, 2010 and enforcement order, March 5, 2010, C-568; KPM's Claim of Appeal, March 26, 2010, C-670; KPM's complaint to court regarding violations in course of enforcement procedures, April 9, 2010, C-569; KPM's Claim of Cassation, May 11, 2010, C-642; KPM's Claim to court to challenge evaluation reports with respect to its property, June 18, 2010, C-643; KPM's complaint to court regarding actions of state executors, June 18, 2010, C-644; KPM's Request to Head of State Executors, June 22, 2010, C-645; KPM's Complaint to court regarding challenge of decision of state executors, June 25, 2010, C-646; KPM's Complaint to court regarding challenge of decision on public sale of property, June 25, 2010, C-570.

555 *See, e.g.*, Constitution of Kazakhstan, art. 77(3), C-482; *see also* Malinovsky Opinion at 3, 7, 19.

556 *See, e.g.*, Constitution of Kazakhstan, art. 13, C-482; *see also* Malinovsky Opinion at 19.

557 *See, e.g.*, Constitution of Kazakhstan, art. 13, 77(3)(4), C-482; *see also* Malinovsky Opinion at 19.

558 *See, e.g.*, Constitution of Kazakhstan, art. 13, 77, C-482; *see also* Malinovsky Opinion at 19.

559 *See, e.g.*, Constitution of Kazakhstan, art. 6, C-482; *see also* Malinovsky Opinion at 19.

560 By naming KPM in the judgment without KPM having ever been a party to the proceeding, Kazakhstan altogether denied due process rights to KPM. Malinovsky Opinion at 19.

never could pay it, providing Kazakhstan "cover" to ultimately seize the company in purported satisfaction of the judgment. It is not a coincidence that the court imposed a monetary penalty using the same calculation that the Financial Police had used to falsely report KPM's "illegal profits" nine months earlier, because the trial of Mr. Cornegruta and assessment of the fine against KPM were part of Kazakhstan's strategy to expropriate Claimants' investments.[561]

325. Kazakhstan should not have imposed any criminal judgment on KPM because, as explained above, KPM was not—and under Kazakh law, could not have been—charged with the crime or named in the original criminal proceeding.[562]

326. But even if the penalty had been assessed against Mr. Cornegruta alone, it would have been illegal. According to the prosecutor and court, the figure of US$ 145 million represented the "illegal profits" Mr. Cornegruta earned as a result of operating a main pipeline. There are several glaring problems with that calculation.

327. First, the amount of the fine should have been limited to the profit that Mr. Cornegruta earned from the alleged illegal activity. The crime of illegal entrepreneurial activity contains similar elements to the crime of embezzlement. Because the purpose of the criminal sanction is to punish individuals who *themselves* profited from illegal activity, the judgment imposed should have only been directed at recovering any funds that Mr. Cornegruta had illegally gained.[563] As the court record indicates, there was no evidence that Mr. Cornegruta received any revenues from the alleged illegal activity.[564] He had never pocketed a dime. No funds were found in his bank accounts and there was no finding that he had misappropriated or embezzled any of KPM's revenues.[565]

328. Second, the 17.9-kilometer pipeline that the court found to be illegal was just a small component of KPM's total production operations. The vast majority of KPM's profits

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561 *See* Resolution on the Preliminary Investigation Conducted by a Group of Investigators, January 14, 2009, C-453.

562 Malinovsky Opinion at 2-7. The proper way to accuse KPM of operating a main pipeline without a license was to initiate administrative or civil proceedings against KPM. As Mr. Condorachi explained in his First Witness Statement, Kazakhstan did initiate administrative proceedings against KPM, which were themselves illegal, and which were ultimately closed without resolution. *See* First Condorachi Statement ¶ 30.

563 Malinovsky Opinion at 16, 18.

564 Malinovsky Opinion at 16.

565 Malinovsky Opinion at 16.

were generated by activities that no one even contended were illegal, such as the exploration, production, storage, and marketing of oil. As Mr. Condorachi explains:

> KPM does not generate any revenue by transporting its oil through the 17.9 kilometer pipeline. KPM's revenue comes from the ultimate sale of processed and refined oil. KPM did generate some revenue as a result of operating its 17.9 kilometer pipeline, however, in the form of a service fee when it transported oil through that pipeline for TNG. The forensic economic evaluation made calculations of both KPM's overall revenue for sales of oil and its revenue from services provided to TNG. If anything, only the latter could have made up the court's judgment, but the court incorrectly concluded that both figures, added together, amounted to the "illegal" profits.[566]

329. Professor Malinovsky explains that, under Kazakh criminal law, "revenue received from the part of operations that are legal must be excluded from the calculation of illegal profits."[567] A fair calculation of the profit earned from the supposedly illegal use of the 17.9-kilometer pipeline would have been equivalent to what a licensed main-pipeline operator would charge to transport oil 17.9 kilometers. Based on KPM's historical transportation costs (*e.g.*, when it paid KazTransOil to transport oil and gas on the actual main pipeline), a pipeline operator would have charged around US$ 60,000 to transport all of KPM's oil and gas 17.9 kilometers throughout 2002-2008.[568] A calculation of the actual revenue that KPM generated by operating its 17.9 kilometer pipeline (*i.e.*, the service fee that TNG paid to KPM for transporting its oil through the pipeline) from 2005-2007 amounted to approximately US$ 30,000.

330. Kazakhstan is fully aware of the gross miscalculation that it made. When it first calculated the alleged "illegal" profit of KPM in November 2008, the Tax Committee determined the "income received from transportation ***and subsequent sale*** of oil and petroleum products through [the 17.9] oil-products pipeline" from 2005-2007.[569] In its conclusions, the Tax

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[566] Second Condorachi Statement ¶ 8.

[567] Malinovsky Opinion at 10 (emphasis added). He further explains that revenue that was taxed enjoys a presumption of legality. Under Kazakh law, any recovery of truly illegal profits must be decreased by the amount of taxes that had been paid on those profits. Kazakhstan completely ignored that requirement of its calculation, which leads Professor Malinovsky to conclude that Kazakhstan failed to prove crucial elements of the crime alleged.

[568] Pisica Statement ¶ 20.

[569] Conclusion on determination of income received from transportation and subsequent sale of oil by KPM and TNG, November 19, 2008, C-450.

Committee clearly distinguished between the "cost of transported goods" (*i.e.*, the value of the oil that passed through the pipeline and was subsequently sold), which comprised 41.77 billion tenge of the 41.8 billion tenge total (approximately US$ 348 million), and the "cost of services" (*i.e.*, the ***profit*** KPM earned from transporting TNG's oil through the pipeline), which made up the small remaining fraction of the total.[570] Similarly, when Kazakhstan's independent "expert" calculated the alleged "illegal profits" that KPM had earned from 2005-2007, it categorized its findings as "***income from sales of the end product***" — which amounted to 41.16 billion tenge — and "***income derived [from] providing services of crude oil transport***" — which amounted to less than 4.8 million tenge (approximately US$ 31,000).[571]

331. The Ministry of Justice followed the same logic when it calculated the amount of "illegal" profit for which Mr. Cornegruta was allegedly responsible. It found that the income received from "transport and further sale of oil and condensate" during the time that Mr. Cornegruta was General Director amounted to 21.67 billion tenge (approximately US$ 145 million) and that the income received from "services provided to third parties for transport of oil and condensate through the oil pipeline" was a mere 1,935,547 tenge (approximately US$ 13,000).

332. Thus, the "illegal profits" for which the non-party KPM was ultimately held liable in Mr. Cornegruta's case were more than eleven thousand times greater than KPM's actual profits from its use of the alleged "main" pipeline. That kind of miscalculation can only be deliberate. If Kazakhstan were interested in accurately assessing the revenue KPM "illegally" earned through operation of the alleged "main" pipeline, it could not have assessed more than a US$ 13,000 fine against Mr. Cornegruta or KPM. Instead, Kazakhstan seized upon the highest figure presented to it — the figure pre-ordained by the Financial Police months earlier — and assessed a US$ 145 million judgment against both Mr. Cornegruta and KPM.

333. Third, the US$ 145 million penalty that the court imposed on KPM comprised the total revenue that KPM had earned from its oil production while Mr. Cornegruta was its General Director. It was not the profit KPM earned from operating its 17.9 kilometer pipeline. Revenue

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[570] *See* Conclusion on determination of income received from transportation and subsequent sale of oil by KPM and TNG, November 19, 2008, C-450.

[571] Expert Report on Economic Examination, November 28, 2008, C-452.

does not equate to profit. A substantial portion of KPM's revenue went to pay salaries, taxes, and other operating costs of KPM that never made it into the pocket of KPM (much less the pocket of Mr. Cornegruta) as profit. The Kazakh Criminal Code requires the calculation of profit, not revenue, in relation to the crime in question.[572] By using a "revenue" rather than a "profit" figure, in violation of the applicable legal provision, the Kazakh court ensured it would render the verdict pre-ordained by the Financial Police.

334. There were at least two reasons for Kazakhstan's deliberate miscalculation. First, the crime of "illegal entrepreneurial activity" under Article 190(2)(b) of the Kazakh Criminal Code requires a finding that the accused derived "especially large revenue" from his misconduct.[573] The term "especially large revenue" corresponds to a specific figure established in the law, which at the time that Mr. Cornegruta was prosecuted, was benchmarked at a minimum of 2,336,000 tenge.[574] In other words, Kazakhstan had to show that Mr. Cornegruta derived more than 2,336,000 tenge as a result of his illegal activity before he could be found guilty under Article 190(2)(b). As shown above, the actual "profit" that KPM earned from its use of the 17.9 kilometer pipeline during Mr. Cornegruta's tenure was only 1,935,547 tenge. Thus, Kazakhstan needed a higher figure to justify its conviction.

335. The second reason that Kazakhstan inflated the calculation of "illegal profits" was more straightforward. It was simply so that neither Mr. Cornegruta nor KPM would have any hope of satisfying the judgment, which would enable Kazakhstan to seize the companies. And that is precisely what Kazakhstan accomplished. The Financial Police had calculated the higher figure of more than 41 billion tenge for KPM's operations, 21.6 billion of which could be allocated to the time period when Mr. Cornegruta was General Director, well before the court rendered its guilty verdict.[575] Kazakhstan used that early calculation to seize KPM's and TNG's assets.[576] On April 30, 2009, the Financial Police issued no fewer than 10 orders for the

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[572] Kazakhstan claims that Article 190(2)(b) of the Criminal Code, which served as the basis for the Judgment, requires the calculation of "revenue" rather than "profit." Statement of Defense ¶ 26.26(b)(ii). As KPM's attorney, Mr. Condorachi, explains, however, that is incorrect. *See* Second Condorachi Statement ¶¶ 9-15.

[573] Kazakh Criminal Code, art. 190, R-58; *see also* Malinovsky Opinion at 9.

[574] Kazakh Criminal Code, art. 190, R-58; *see also* Kazakh Law on Budgets, 2008, 2009-2011, art. 8(4), C-484.

[575] *See, e.g.*, Conclusion on determination of income received from transportation and subsequent sale of oil by KPM and TNG, November 19, 2008, C-450.

[576] Notice from Financial Police to KPM and TNG regarding Sequestration of Property, May 15, 2009, C-485.

sequestration of property, which resulted in freezing KPM's and TNG's shares,[577] KPM's Subsoil Use Contract No. 305,[578] TNG's Subsoil Use Contract No. 210,[579] Contract No. 302,[580] KPM's field oil pipeline,[581] TNG's field gas pipeline,[582] TNG's condensate pipeline,[583] and other property of the companies', such as their motor vehicles.[584] Those orders prevented KPM and TNG from selling or depreciating the value of those assets. On May 19, 2009, the Financial Police ordered KPM and TNG to provide a valuation of all the property that it had seized,[585] which indicated that it knew a judgment would be rendered against KPM and that it planned to execute that judgment by acquiring KPM and TNG.

336. As with the four-year prison sentence for Mr. Cornegruta, the sheer disconnect between the calculation of "illegal profits" and the alleged crime demonstrates that the trial was nothing more than a farce. The operation of a main pipeline without a license is a minor regulatory violation at most, not a violent crime or even a significant property crime. If KPM truly had operated such a pipeline, it could have obtained the requisite license by submitting a proper application and paying the cost of the application fee, which was approximately 11,680 tenge (less than US$ 80).[586] Kazakhstan simply cannot articulate any reason why the failure to file the right application and pay a nominal fee justifies a four-year prison sentence and US$ 145 million fine.

337. Kazakhstan never would have imposed such outrageous penalties but for its goal to seize Claimants' investments. And that is precisely what Kazakhstan did. Kazakhstan had

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577 Order to arrest all shares of KPM, April 30, 2009, C-486; Order to arrest all shares of TNG, April 30, 2009, C-487; Minutes of the arrest of KPM's shares, May 13, 2009, C-488; Minutes of the arrest of TNG's shares, May 13, 2009, C-489.

578 Order to arrest KPM's Contract No. 305, April 30, 2009, C-490.

579 Order to arrest TNG's Contracts No. 210 and No. 302, April 30, 2009, C-491.

580 *Id*.

581 Order to arrest KPM's pipeline, April 30, 2009, C-492; Minutes of the arrest of KPM's pipeline, May 13, 2009, C-493.

582 Order to arrest TNG's gas pipeline, April 30, 2009, C-494; Minutes of the arrest of TNG's pipeline, May 13, 2009, C-495.

583 Order to arrest TNG's condensate pipeline, April 30, 2009, C-496.

584 Order to arrest KPM's motor vehicles, April 30, 2009, C-497; Minutes of the arrest of KPM's motor vehicles, May 13, 2009, C-498; Order regarding arrest of KPM's property, May 13, 2009, C-499.

585 Letter from Financial Police to KPM requesting value of arrested property, May 19, 2009, C-500.

586 *See* Resolution No. 610, July 19, 2007, C-667; Kazakh Law on Budgets, 2008, 2009-2011, C-484.

already ensured that KPM's and TNG's assets would remain frozen until its illegal verdict against KPM was issued. After the judgment was confirmed on appeal, in December 2009 and January 2010, Kazakhstan issued writs of execution against KPM for the full amount of US$ 145 million.[587] Kazakhstan seized KPM's bank accounts and issued more than a dozen additional orders for funds to satisfy that judgment,[588] rendering it impossible for Claimants to effectively operate their company.

D. Kazakhstan Directly Expropriated KPM and TNG

1. Kazakhstan's Direct Expropriation of KPM and TNG in July 2010 Was Unlawful

338. Kazakhstan concedes that it unilaterally terminated KPM's and TNG's three Subsoil Use contracts in July 2010, but it purports to justify that act by claiming that it unilaterally terminated Claimants' subsoil use contracts in accordance with Kazakh law.[589] That explanation is misplaced because Kazakhstan cannot hide behind its domestic law to escape international liability. It is also highly misleading because Kazakhstan did not, in fact, fulfill the requirements of its domestic law. Furthermore, Kazakhstan neglects to mention that it had changed the grounds on which unilateral contract termination could occur in its Law on Subsoil and Subsoil Use less than one month before the final inspections of KPM and TNG took place. Kazakhstan relies on the amended law to suggest that its actions were proper, when in fact its termination of Claimants' contracts violated both KPM's and TNG's domestic legal rights and Kazakhstan's Treaty obligations.

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587 *See* Writ of Execution, December 29, 2009, C-119; *see also* Writ of Execution, January 5, 2010, C-501.

588 *See* Seizure of KPM's bank accounts, January 10, 2010, C-121; Order of Recovery of 21.6 billion tenges and seizure of motor vehicles, January 22, 2010, C-122; Notice of Recovery of 21.6 billion tenges, January 25, 2010, C-123; Instruction to conduct an inventory of KPM's property, January 25, 2010, C-124; Order of attachment of property, February 23, 2010, C-125; Order prohibiting KPM from moving its property, February 23, 2010, C-298; Arrest of KPM's funds maintained at KazTransOil and the Department of Customs Control, February 26, 2010, C-502; Resolution for seizure of pipeline and storage tanks, February 26, 2010, C-79; Order for KPM to pay 21.6 billion tenges, March 1, 2010, C-503; Order Seizing KPM's Property, March 15, 2010, C-126; Order for transfer of KPM's funds from Mangystau court's deposit account, March 15, 2010, C-504; Order for transfer of KPM's funds from Mangystau court's deposit account, March 18, 2010, C-505; Order for transfer of KPM's funds from Mangystau court's deposit account, April 28, 2010, C-506; Notice of arrest of KPM's extracted hydrocarbons, May 11, 2010, C-507; Order to sell all of KPM's property, June 9, 2010, C-199; Repeated Warning to KPM to pay 21.6 billion tenges, June 15, 2010, C-201.

589 Statement of Defense at 224-42.

339. In 2010, Kazakhstan ordered two rounds of inspections to assess KPM's and TNG's compliance with their contract obligations. The first commenced in January 2010.[590] At that time, the Law on Subsoil and Subsoil Use would have permitted unilateral termination of Claimants' contracts before their expiration only in the following situations:

> (1) when the contractor refuses to eliminate the reasons that led to the decision on suspension of exploration, production, . . . facilities . . ., or does not eliminate the reasons within the period sufficient for elimination thereof; . . .
>
> (3) it is impossible to eliminate the reasons that led to the suspension of subsurface use operations;
>
> (4) when the contractor substantially violates obligations set forth by the contract or work programme; [or]
>
> (5) when the contractor is declared bankrupt . . .;[591]

340. Thus, under the former Law on Subsoil and Subsoil Use, unilateral termination could only occur after (i) Kazakhstan had issued a decision on suspension of operations that the contractor could not or did not remedy; (ii) a finding of "substantial violations"; or (iii) the contractor's bankruptcy. Kazakhstan found no violations that would permit it to unilaterally terminate Claimants' contracts as a result of its January 2010 inspections and the contracts remained in force.

341. Thereafter, in June 2010, Kazakhstan conveniently amended its Law on Subsoil and Subsoil Use. In the new version of June 24, 2010, which entered into force on July 6, 2010, Kazakhstan could unilaterally terminate contracts in the following two situations:

> (1) when the subsurface user within the set period does not cure the two breaches of obligations established by the subsurface contract or project documents; [or]
>
> (2) when the subsurface user transfers its subsurface use right . . . without the consent of the competent authority, except for cases when such consent is not required . . .

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590 *See* Statement of Claim ¶ 196.

591 Law on Subsoil and Subsoil Use No. 2828, January 27, 1996, with amendments introduced as of Feb. 13, 2009, art. 45-2(2), C-508. In fact, that provision provides for nine different scenarios under which Kazakhstan could unilaterally terminate a contract; only those that could be argued to have applied to Claimants are addressed here.

> A breach of the contract terms that was fully cured by the subsurface user within the term set in the notice from the competent authority shall not be a basis for early unilateral termination of the contract.[592]

342. Thus, under the new law, Kazakhstan could terminate contracts whenever a contractor failed to cure two or more contract violations — with no requirement that they be "substantial" — within a "set period." Moreover, the law did not specify how long that "set period" should be.

343. Less than a week after the amended law was passed, on June 29, 2010, Kazakhstan ordered its second round of unscheduled inspections of KPM and TNG to assess compliance with their subsoil use contract obligations.[593] The notices explained that inspections would take place between June 29 and July 29, 2010.[594] It was as a result of those inspections that Kazakhstan unilaterally terminated Claimants' contracts, but Kazakhstan did not comply with its own laws in carrying out those inspections.

344. The Kazakh Law on Private Business governs how lawful inspections must take place. In normal practice, government agencies inspect a company and provide their conclusions and remarks from the inspections in "Acts of Inspection," which officially end the inspection and constitute the results of the inspection.[595] The company managers are entitled to append their own remarks to the Acts of Inspection, which may include objections to the conclusions reached by the inspection bodies.[596] If the company managers have no objection to the inspection results, the company must issue a plan for addressing any violations included in the Acts to the competent authority within three days.[597] The companies that are subject to inspections have the right to appeal the inspection results that are included in the Act.[598]

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592 Amended Law on Subsoil and Subsoil Use, C-509.

593 *See, e.g.*, C-180, C-181, C-185.

594 *Id*.

595 Law on Private Business, July 17, 2009, with amendments as of April 2, 2010, cl. 38, C-510.

596 Law on Private Business, July 17, 2009, with amendments as of April 2, 2010, cl. 38(15), C-510.

597 Law on Private Business, July 17, 2009, with amendments as of April 2, 2010, cl. 38(17), C-510.

598 Law on Private Business, July 17, 2009, with amendments as of April 2, 2010, cl. 40(1)(3), C-510.

345. As stated above, on June 29, 2010, Kazakhstan notified KPM and TNG that inspections would take place. During the following two weeks, more than a dozen government Agencies arrived at KPM's and TNG's offices to conduct inspections.

346. On July 14, 2010, Kazakhstan, through the Ministry of Oil and Gas, sent notices to KPM and TNG that contained a litany of alleged contract violations that had never before been raised. Those notices ordered KPM and TNG to respond to those allegations by July 19, 2010, or risk termination of their subsoil use contracts. Those notices were issued, however, *before* the inspecting authorities presented the results of their inspections in the final "Acts of Inspection" to KPM and TNG, and therefore, *before* KPM or TNG could review the inspection results, raise objections, or appeal the results. For example, the Ministry of Oil and Gas and the Department for Emergency Situations drafted their Act of Inspection on July 15, 2010;[599] the Geology Committee drafted its Act of Inspection on July 16, 2010;[600] and the Committee for Technical Regulation and Metrology drafted its Act of Inspection on July 20, 2010.[601] KPM and TNG did not sign those Acts and had raised objections to the State's allegations of contract violations by July 19, 2010.[602] Therefore, the inspections themselves were never officially concluded, and in any event, KPM and TNG were not given an opportunity to appeal the results of those inspections before Kazakhstan terminated their contracts on July 21, 2010.

347. TNG's General Director at the time, Mr. Eduard Calancea, explains that the allegations of contract violations — nearly all of which had never been raised before — were highly suspect:

> First, if Kazakhstan really considered that the companies were in violation of their contracts, it should have noted the violations in

[599] Act on Results of Inspection of KPM from Department of Emergency Situations, July 15, 2010, C-647; Act on Results of Inspection of TNG from Department of Emergency Situations, July 15, 2010, C-648; Act on the Unscheduled Inspection Regarding the Fulfilment of Contractual Obligations of KPM from the Ministry of Oil and Gas, July 15, 2010, C-649; Act on the Unscheduled Inspection Regarding the Fulfilment of Contractual Obligations of TNG from the Ministry of Oil and Gas, July 15, 2010, C-650.

[600] Act on Unscheduled Inspection of KPM by the Geology Committee, July 16, 2010, C-651; Act on Unscheduled Inspection of TNG by the Geology Committee, July 16, 2010, C-315.

[601] Act on Results of Inspection of KPM, June-July, 2010 from Ministry of Industries and New Technologies, July 20, 2010, C-652; Act of Results of Inspection of TNG, June-July, 2010 from the Ministry of Industries and New Technologies, July 20, 2010, C-653.

[602] Kazakhstan's suggestion that KPM and TNG did not respond to its July 14, 2010 notices on time is false. *See* Statement of Defense ¶¶ 31.53-31.54. KPM and TNG both mailed and faxed their July 19, 2010 responses so that Kazakhstan would receive them by its deadline. *See* Proof of Receipt of July 19, 2010 responses, C-511.

> the concluding reports to its inspections (called Acts of Inspections), which the company representatives are required to sign. The Acts of Inspection would ensure that the companies were notified of the inspection results and would permit them to challenge the results or submit a plan to remedy the violations. Instead of following that procedure, however, Kazakhstan sent notifications alleging the contract violations to KPM and TNG on July 14, 2010, which was before Kazakhstan had concluded its final inspections or issued the Acts of Inspection. Without allowing the companies an opportunity to dispute the allegations, Kazakhstan demanded that the companies respond with explanations for the claimed violations by July 19, 2010. Although KPM and TNG did not receive Kazakhstan's notifications claiming contract violations until July 16, 2010, we submitted responses on time and met Kazakhstan's unfair deadline of July 19, 2010.
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> Second, Kazakhstan's allegations were essentially groundless. For example, Kazakhstan accused TNG of failing to provide information regarding the execution of its Work Programs and failing to provide annexes regarding the training of employees. Those contentions were false, as we explained in the response that TNG submitted to Kazakhstan on July 19, 2010. However, I thought it was telling that Kazakhstan did not allege that TNG was in violation of its Work Program or training requirements, but merely that TNG had not provided documentation regarding those issues. It was clear to me that Kazakhstan was looking for something that it could use to claim that its termination of our contracts was justified, no matter how baseless or outlandish it was.
>
> Regardless of their dubious nature, Kazakhstan used the allegations of contract violations to unilaterally terminate [the contracts].[603]

348. Kazakhstan argues that its actions were proper because, as stated in the new Law on Subsoil and Subsoil Use, it found more than two contract violations that neither KPM nor TNG remedied within the five day time period set in the July 14, 2010 notices.[604] But Kazakhstan has not shown that (i) the provisions of the new Law properly amended or replaced the termination provisions contained in the contracts or (ii) granting KPM and TNG only five

[603] Calancea Statement ¶¶ 4-6.

[604] Statement of Defense Section 31.

days to cure more than two dozen violations, the merits of which were in dispute, was lawful or reasonable.

349. Kazakhstan's explanation as to why it could not give KPM and TNG more time to respond demonstrates that the entire exercise was a farce. Kazakhstan argues that it could not grant "an extensive time period for submission of the response to the Notices" because: (1) KPM and TNG had a "strategic role" in the region's economy (including the allegation that "all produced gas is supplied to JSC 'MAEK-Kazatom' covering 80% of the demand of the power plant"); and (2) wage arrears and staff reductions might have resulted in "social tensions."[605] Both of those arguments are nonsense. To begin with, KPM and TNG did not deliver all of their gas to MAEK-KazAtom; that assertion is simply wrong.[606] More importantly, there had never been any interruptions in gas deliveries to MAEK-KazAtom, and none of the alleged violations in the Notices concerned conditions that might have led to interruptions.[607] Moreover, any staff reductions and wage arrearages resulted directly from Kazakhstan's freezing orders, asset seizures, and other harassment.[608] If these truly had been Kazakhstan's concerns, it would have left the companies alone to operate smoothly and successfully as they had for years prior to October 2008.

350. Kazakhstan further contends that KPM's and TNG's July 19, 2010, responses were "inadequate and failed to address the violations revealed."[609] But that is a matter that would have been decided only after Kazakhstan permitted KPM and TNG to appeal the results of inspection as provided in the Law on Private Business. Under that law, Kazakhstan should have given KPM and TNG an opportunity to raise objections to the inspection results and to appeal those results before any official notification of violations could be issued. Only upon KPM's and TNG's failure to cure those violations within a reasonable time period could Kazakhstan have unilaterally terminated the contracts in accordance with its own law. Instead, Kazakhstan completely violated its own procedure for inspecting KPM and TNG and notifying the

605 Statement of Defense ¶ 31.52.

606 *See* Second Lungu Statement ¶¶ 2-6; FTI Report of May 17, 2011 ¶ 5.19, Table 3 (summarizing TNG's domestic gas sales).

607 *See* Notice of infringement of obligations under the Tolkyn Subsoil Use Contract No. 210 from MOG to TNG, July 14, 2010, C-6.

608 Calancea Statement ¶ 2.

609 Statement of Defense ¶ 31.121.

companies of purported violations, and it eviscerated any meaningful opportunity for KPM and TNG to dispute the merits of the alleged violations or cure any legitimate violations that were found to exist.

351. Moreover, the manner in which Kazakhstan unilaterally terminated KPM's and TNG's contracts violated other provisions of Kazakh law. For example, Kazakhstan completely disregarded Article 129(4) of the new Law on Subsoil and Subsoil Use, which preserved the terms of licenses and contracts that, like those belonging to KPM and TNG, were issued and signed before the introduction of the new Law in July 2010. In terminating the contracts, Kazakhstan ignored the procedure for termination established in the contracts.[610] Because Kazakhstan's actions were improper under its own law, KazMunaiGaz and KazMunaiTeniz's takeover and operation of the companies violated KPM's and TNG's exclusive rights to explore for and produce oil and gas in their licensed territories.

352. Nevertheless, even if the manner in which Kazakhstan unilaterally terminated Claimants' contracts could be seen to fall within the strict terms of the new Law on Subsoil and Subsoil Use, it does not follow that Kazakhstan lawfully expropriated or provided fair treatment to Claimants' investments under the Treaty. As explained in Sections VI, *infra*, it obviously did not.

2. Claimants Did Not Retain Rights Over KPM and TNG

353. Kazakhstan claims that no expropriation occurred in July 2010 because (i) the property is not formally recorded in the register of State property and (ii) Claimants have somehow — against all logic — retained rights over their Kazakh investments. The first point is immaterial as a matter of international law, as discussed in Section VI *infra*. The second point is news to Claimants, and even if true (which Claimants deny), it has no effect on whether Kazakhstan has breached the ECT.

354. Kazakhstan's letters to KPM and TNG explicitly stated that Claimants' subsoil use contracts were terminated and that, " . . . due to the unilateral termination of the contract[s] from 00 hrs. 00 min. of July 22, 2010, all products produced on the enterprise are transferred to

[610] MNG Order No. 255, July 21, 2010, C-189; *see also* Stenograph of Conference Call of July 22, 2010, C-190.

the ownership of the Republic of Kazakhstan."[611] That is a clear indication that Kazakhstan expropriated not only KPM's and TNG's contracts, but also their rights to oil and gas produced at their facilities.

355. Furthermore, the termination notices faxed to KPM and TNG on July 22, 2010 clearly stated that KPM's and TNG's contractual territories were "transferred" from KPM and TNG to temporary possession and use by KazMunaiGaz until the transfer of property to a new subsoil user.[612] Kazakhstan further declared that if KPM and TNG did not participate in the formal transfer, then the Ministry of Oil and Gas would act as their agents and transfer the property itself. That is precisely what Kazakhstan did. As Mr. Calancea explains, representatives from the Ministry of Oil and Gas and KazMunaiGaz

> confirmed that, effective as of July 21, 2010, Kazakhstan had terminated KPM's and TNG's subsoil use contracts and had transferred the contract territories and would further transfer all of the companies' property into "trust" management by KazMunaiGaz. They confirmed that the trust agreement was executed between the Ministry of Oil and Gas and KazMunaiGaz on July 21, 2010.[613]

Mr. Calancea further explains that Kazakhstan's proposals for resolving Claimants' objections to its seizures were illusory:

> Under the terms drafted by Kazakhstan, KPM and TNG would have had to develop the fields at their own expense, and the products from field development (oil, gas, and condensate) would have been the property of the state.
>
> After KPM and TNG refused that offer, KazMunaiGaz counter-proposed that KPM and TNG agree to the transfer of their assets to KazMunaiGaz, while KPM, TNG, and their shareholders would remain responsible for the companies' debts and liabilities. Additionally, Kazakhstan offered no compensation for the transferred assets. Furthermore, the proposal contained a clause that stated the property would remain under trust management until the rights could be transferred to a new subsoil user. That provision indicated to us that Kazakhstan had no plans to return the rights to the shareholders; it was merely an attempt to obtain the

[611] Letters No. 14-05-5199 and 14-05-5200 from the MOG to KPM and TNG, C-191 and C-192.

[612] *See, e.g.*, C-191, C-192, C-5.

[613] Calancea Statement ¶ 8.

> shareholders' approval of Kazakhstan's actions. Needless to say, the shareholders did not agree to Kazakhstan's proposals.[614]

356. As a result, Kazakhstan gave KazMunaiGaz/KazMunaiTeniz possession and control over KPM's and TNG's assets,[615] 900 employees of KPM and TNG resigned and were re-hired by KazMunaiGaz,[616] and all of KPM's and TNG's revenues were transferred to a State-controlled bank account.[617] Additionally, Kazakhstan declared that Claimants' LPG Plant, which fell outside the scope of their subsoil use contracts and exploration and production activities, had also been transferred into State control.[618] Claimants therefore dispute Kazakhstan's contention that "the LPG Plant was never part of the property that was transferred to KazMunaiGaz on trust management and therefore it still remains the property of TNG."[619] It is clear that KazMunaiGaz considers the LPG Plant a valuable asset over which it maintains control to this day, and it has expressed plans for the future use of the LPG Plant.[620]

357. Kazakhstan cannot deny that since July 2010, KazMunaiGaz/KazMunaiTeniz has maintained control of and has operated KPM and TNG. Kazakhstan even admits that it granted new licenses to KazMunaiTeniz with respect to the oil and gas production activities that KPM and TNG once carried out.[621] Nevertheless, Kazakhstan relies on its own convoluted asset-transfer process to try to avoid responsibility for taking Claimants' property without compensation. According to Kazakhstan, Claimants will be paid the value of their property from the reimbursement costs that a new subsoil user is obliged to pay to Kazakhstan.[622] Kazakhstan then adds insult to injury by suggesting that Claimants' initiation of this international arbitration

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614 *Id*. ¶¶ 10-11.

615 Order No. 255 of the Ministry of Oil and Gas, July 21, 2010, C-189; Letter No. 20-05-5150 from MOG to KPM, July 21, 2010, C-3; Letter No. 20-05-5151 from MOG to TNG, July 21, 2010, C-4.

616 Order No. 588 regarding Staff, from TNG, July 21, 2010, C-188.

617 Stenograph of the telephone conversation of July 22, 2010, C-190.

618 Media article, "'Tolkynneftegaz' was denied the right to build Borankol Gas Processing Plant," www.zakon.kz, July 21, 2010, C-187; *see also* First Witness Statement of V. Romanosov.

619 Statement of Defense ¶ 31.152.

620 "Application of the need for trained workforce; Projects included in the map of industrialization for 2012-2014," identifying the Borankolsky gas processing plant, Mangystau, Beineu district, Borankol, C-583.

621 State License Issued to KazMunaiTeniz, April 29, 2011, R-136.

622 Statement of Defense ¶ 31.64.

proceeding has prevented Kazakhstan from compensating them because Kazakhstan cannot transfer the property to a new subsoil user while this case is pending.[623]

358. Kazakhstan has provided no evidence showing how the commencement of arbitration proceedings has restricted it from transferring Claimants' assets to a new subsoil user, nor that it must rely on the new subsoil user to compensate Claimants.[624] Meanwhile, Kazakhstan continues to benefit from the substantial investments Claimants made in KPM and TNG by having oil and gas production and exploration carried out, on a "temporary" basis, until the elusive new subsoil user can be found. Kazakhstan cannot avoid its duty to compensate Claimants for an illegal taking by relying on an esoteric notion in its own law.

359. The fact remains that Kazakhstan has made no offer or attempt to compensate Claimants, despite the parties' agreement to suspend the arbitral proceeding for three months precisely to enable settlement discussions to take place. Even after the proceedings resumed there has been nothing to prevent Kazakhstan from compensating Claimants for the investments that it illegally expropriated, if it had any good faith intention to actually do so.

360. Claimants were not obliged to agree to or participate in the process for transferring their property to State control[625] and were completely within their rights to dispute Kazakhstan's actions before an arbitral tribunal as contemplated in the ECT.

IV. KAZAKHSTAN'S HARASSMENT CAMPAIGN WAS PART OF A FAMILIAR PATTERN OF CONDUCT AIMED AT SEIZING CLAIMANTS' INVESTMENTS UNDER THE APPEARANCE OF LEGITIMACY

361. Regardless of its motives, Kazakhstan's campaign of harassment and ultimate expropriation of Claimants' investments violated its obligations under international law (as discussed further in Section VI, *infra*). But understanding Kazakhstan's motives, and the fact

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623 *See*, *e.g.*, Statement of Defense ¶¶ 31.63; 31.89; 31.166.

624 This argument does not follow from Article 61(2) of the Subsoil Law, which obligates a new subsoil user to reimburse the costs effected by the former subsoil user *to Kazakhstan*.

625 In this respect, Kazakhstan mistakenly suggests that Claimants must prove that its draft agreements regarding the asset transfer was unacceptable. *See* Statement of Defense ¶ 31.157. Aside from Claimants' fundamental objection to the purpose of the draft agreements, which was to formalize the transfer of their property to KazMunaiGaz, the terms of the agreements were principally unacceptable because they only transferred KPM's and TNG's operations and subsoil rights, and not the companies' debts, to KazMunaiGaz. *See* R-200. Claimants were neither willing to agree to Kazakhstan's transfer of their assets, which they considered unlawful, nor to remaining liable for the companies' debts.

that Kazakhstan's harassment campaign here is part of a familiar pattern of conduct designed to seize investments under the appearance of legitimacy, eliminates any shred of credibility remaining in Kazakhstan's arguments that it did nothing more than evenhandedly apply its regulatory laws to violations by KPM and TNG.

362. To the contrary, all of Kazakhstan's conduct after October 14, 2008, was part of a coordinated plan to acquire Claimants' investments for less than fair market value while insulating Kazakhstan from international arbitration claims. This plan had three main components: (1) assaulting the operating companies with inspections, taxes, criminal charges, and other harassment that made it impossible to continue profitable operations; (2) offering to buy the companies at a firesale price through state-owned KazMunaiGaz; and (3) preventing Claimants from selling the companies to anyone else. If Claimants had succumbed to the pressure and sold to KazMunaiGaz, the sale agreement no doubt would have required Claimants to waive any arbitration claims against Kazakhstan. When they did not agree to sell to KazMunaiGaz, and in fact found another buyer willing to pay more than KazMunaiGaz, Kazakhstan simply seized the companies under the pretext of contract violations that it now asserts in defense of this arbitration.

363. Sadly, Claimants are not the first victims of this scheme. As described below, Kazakhstan has run this "playbook" of harassment to coerce investors, and enrich powerful Kazakhs, many times before. In this section, Claimants discuss: (1) Kazakhstan's history of using harassment and intimidation to coerce investors; and (2) how Kazakhstan used these tactics here in an effort to coerce Claimants to sell their investments to state-owned KazMunaiGaz at a firesale price, and when that failed, to seize those investments under the appearance of legitimacy

A. The "Kazakhstan Playbook"

364. Since the mid-2000s, Kazakhstan has made no secret of its view that the terms of the subsoil use licenses that it had granted in the 1990s were too generous to foreign investors.[626] Many of the changes to Kazakhstan's oil and gas laws in the 2000s, including the 2004 pre-emptive rights legislation[627] and the 2005 law requiring KazMunaiGaz-NC to have a minimum

[626] Horton Report ¶ 64.

[627] Law No. 2-III of the Republic of Kazakhstan "On introduction of amendments and additions to some legislative

50% interest in any new offshore production sharing agreements,[628] were aimed at keeping more of the value of mineral rights for Kazakhstan in deals with international investors.

365. While Kazakhstan publicly maintained that it would honor the terms of its prior agreements, its conduct was to the contrary. It actually had an unstated goal to claw back some of the value it had negotiated away to foreign investors in earlier deals. It did this by attempting to renegotiate contracts with foreign investors, and by acquiring interests in foreign-owned companies through KMG at a discount to fair market value.[629] If foreign investors did not go along voluntarily, Kazakhstan brought pressure in the form of harassing inspections, outrageous tax assessments, criminal prosecutions, fines, etc. As explained by Professor Scott Horton, an expert on legal regimes and political structures in former Soviet jurisdictions:

> [T]ax authorities and other regulators [in Kazakhstan] have been tasked to approach investors very aggressively in an effort to address the perceived unfairness of the deals struck with foreign investors in the republic's early years. The Financial Police have apparently been tasked a key role in implementing government policies designed to reverse these past "errors." Using methods similar to those often employed in neighboring Russia, the Kazakh government has become adept at harassing foreign companies with a barrage of fines, criminal allegations, and tax threats until it is able to extract from them whatever concessions it desires. Sometimes the tactics employed are designed to achieve a material modification of the economic essence of the transaction. On other occasions their intention seems rather more confiscatory, geared to driving the foreign investor away and seizing its investment.[630]

366. Thus, this "playbook" of harassment methods directed toward Claimants has been all too common in Kazakhstan is recent years. While the details differ from case to case, the playbook typically involves some common elements.

367. First, the Financial Police often play a prominent role. Created sixteen years ago by presidential decree, the agency has wide ranging powers to "preempt, investigate, and

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acts of the Republic of Kazakhstan concerning subsoil use and performance of oil operations in the Republic of Kazakhstan," art. 1, December 1, 2004, R-19.

628 Law of July 8, 2005 Concerning Production Sharing Agreements (Contracts) When Conducting Offshore Petroleum Operations, art. 5(1), C-512.

629 Horton Report ¶ 64.

630 Horton Report ¶ 64.

prosecute economic, financial and corruption crimes and violations."[631] There is considerable evidence, however, that the Financial Police are closely controlled by President Nazarbayev.[632] Thus, the Financial Police are the President's instrument to coordinate multi-agency investigations and to ensure that other more independent agencies reach the desired conclusions.

368. Second, Kazakhstan's actions are carried out under the color of law, and often with the involvement of the courts. Like the Financial Police, Kazakhstan's judiciary is dominated by the executive. As Professor Horton explains:

> Kazakhstan's rule-of-law traditions are extremely weak, and even President Nazarbayev has acknowledged that judicial independence and integrity is a weak point for his country.[633] Independent analysts, even those generally favorable to Kazakhstan, have generally been more blunt. "The law does not provide for an independent judiciary," summarizes the current [U.S.] State Department Human Rights Report.[634]

369. Moreover, the use of criminal allegations and prosecutions puts enormous pressure on investors:

> The escalation of a commercial dispute into the arena of criminal justice greatly enhances the bargaining position of the state. First, it allows for dramatic pressure against individuals, who recognize that they may be held for protracted periods in investigative detention and subjected to aggressive interrogation in a country with a reputation for jailhouse torture and abuse and for ill-explained deaths in detention, which has no independent judiciary, and in which a conviction is a foregone conclusion in any case taken to trial. Second, it ratchets up pressure on those arrested to turn on their employer and provide information that may lead to the "discovery" of crimes or regulatory infractions, even when none were legitimately detected before. Criminal investigators offer immunity for employees who turn on an employer in this fashion. Third, the disruption produced by the criminal case can paralyze a business and bring it grinding to a halt. This can occur by distracting senior management from performing their jobs,

631 Horton Report ¶ 6.

632 Horton Report ¶¶ 62-64.

633 Opening Address of President Nursultan Nazarbayev to the Conference "Struggle Against Corruption & Good Governance as a Condition for Economic and Social Development of East Europe and Central Asia," Sept. 16, 2009, at 6, C-513.

634 Horton Report ¶ 38.

> through the seizure of business records which make the continuation of work all but impossible, through raids and searches of business premises which demoralize employees and stop work at critical junctures. The prosecution of a criminal case can thus destroy a business, even if no conviction results.

Thus, while the involvement of the judiciary may lend the appearance of normalcy and legitimacy to Kazakhstan's actions, it actually is just another tool through which the executive branch ensures a predetermined outcome.

370. Third, Kazakhstan invariably makes it clear that the renegotiation of a contract or the sale of a substantial equity stake to KMG (or another Kazakhstan-owned entity) will make all these problems go away. In at least four other cases since the mid-2000s, Kazakhstan has employed similar tactics against other foreign investors in the oil and gas sector in order to renegotiate the transaction or seize the investment outright. Professor Horton summarizes these examples as follows:

> a. Tengizchevroil LLC, probably Kazakhstan's most prominent energy sector company and a joint venture between Chevron, Exxon, LukArco and KMG, was charged with "illegal entrepreneurship" for producing more oil than Kazakhstani authorities had anticipated ("unauthorized overproduction").
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> b. Agip KCO, the operator of Kazakhstan's largest offshore oilfield, was accused of a US$ 110 million fraud in a highly publicized speech delivered by a Financial Police officer at a conference, and was forbidden to offer any public defense to the charges, all occurring in the context of a Kazakh press for a larger share and more high-profile role in development of the project.
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> c. Karachaganak Petroleum Operating BV, then the largest wholly foreign oil and gas operation in Kazakhstan, was accused of a variety of ecological, immigration law and tax infractions, including a claim of "illegal entrepreneurship" by the Financial Police, which asserted that it "illegally earn[ed] US$ 708 million in 2008… profit[ing] from oil output that was not approved by the state."
>
> d. Caratube International Oil Company, a Lebanese-owned oil and gas company, had been raided repeatedly by the Financial Police, its senior officers interrogated and threatened with criminal prosecution and its assets seized following revocation of licenses and permits.

> Each of these cases concluded either in the seizure of control of investment assets by Kazakhstan or in a fundamental modification for Kazakhstan's benefit of the transactional economics surrounding the development of the underlying natural resource deposit.[635]

371. For these reasons, numerous observers have dubbed Kazakhstan's political system an "advanced kleptocracy or a 21st-century dictatorship."[636] There appear to be two main motives for this conduct.

372. First, President Nazarbayev uses these tactics to enhance the personal wealth and power of himself and his allies. The Freedom House *Nations in Transit* 2009 report states that "[a] narrow circle of kin, clients, and powerful financial groups and a limited stratum of government officials, technocrats, and entrepreneurs have benefited the most from Kazakhstan's resource wealth and economic growth."[637] One clear beneficiary of this scheme is President Nazarbayev's son-in-law, Timur Kulibayev. Professor Horton explains:

> The Kulibayevs' rise to power and wealth cannot be detached from their position as the daughter and son-in-law of President Nazarbayev. Those within the inner circle of "the family" appear to operate in virtual detachment from the country's legal regime, including formal systems of regulation and accountability, while they enjoy the President's favor. Instead, they are often able to manipulate the levers of state power in an unseen or nearly unseen way to effect their business or personal objectives. They frequently use this leverage for commercial gain—either to take control of assets outright or to pressure a target into a position of perceived vulnerability from which the target cannot refuse a fire-sale bargain.[638]

Consequently, Kulibayev has amassed a fortune estimated at well over US$ 1 billion and has assumed positions of great influence as Chairman of KMG and JSC National Welfare Fund Samruk-Kazyna, a powerful holding company through which the Kazakhstani state wields control over a large array of holdings in the financial, natural resources and manufacturing

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635 Horton Report ¶¶ 186-187.

636 Horton Report ¶ 77.

637 Horton Report ¶ 78 and exhibits cited therein.

638 Horton Report ¶ 37.

sectors.[639] In the words of the U.S. Ambassador to Kazakhstan (in a leaked cable), Kulibayev is "the ultimate controller of 90% of the economy of Kazakhstan."[640]

373. Second, Kazakhstan frequently uses this harassment playbook to weaken political opponents of President Nazarbayev by eliminating their sources of income.[641] That precise motive seems unlikely here. While Mr. Stati participated in pro-democratic politics in Moldova, he never participated in Kazakhstan politics at all, and never gave President Nazarbayev any reason to view him as a political adversary. The fact that Moldovan President Voronin viewed Mr. Stati as an adversary, however, nonetheless is relevant here because it made Claimants vulnerable. As Professor Horton explains, when dealing with large multinational corporations from influential countries:

> Kazakhstan had to deal not only with the investors and their well-prepared professionals, lawyers and tax accountants, but also with foreign diplomats who backed the investments of their nationals, frequently weighing in directly with Nazarbayev through diplomatic notes and pressing the issue when high-level political figures visited Kazakhstan or when Nazarbayev traveled abroad to European and North American capitals. In light of Voronin's obvious hostility to Stati, however, Stati and his investments would have presented a nearly irresistible target—a foreign investment with a government that not only failed to stand behind it, but which virtually seemed to be inviting a contest.[642]

Against this backdrop, it is easy to see Kazakhstan's conduct for what it was: a concerted attempt to coerce Claimants to sell their successful investments to KazMunaiGaz (or some other company owned by Timur Kulibayev) at a firesale price.

B. Kazakhstan's Harassment Campaign Was a Concerted Attempt to Coerce Claimants to Sell to KazMunaiGaz at a Firesale Price

1. Kazakhstan's Attempt to Coerce Claimants to Sell to KazMunaiGaz

374. Long before 2008, Claimants were approached by companies controlled by Timur Kulibayev with offers to purchase some or all of their Kazakhstan investments. This began

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639 Horton Report ¶ 33.

640 Horton Report ¶ 35 and exhibits cited therein.

641 Horton Report ¶ 78.

642 Horton Report ¶ 172.

around 2004, after Claimants' investments were mature and beginning to generate returns.[643] Claimants consistently rebuked those offers.

375. In 2004, Claimants had discussions with GazImpex, a gas-exporting company controlled by Mr. Kulibayev, about a potential sale of a 35% stake in TNG.[644] The companies had a number of discussions about the valuation of TNG, but were never able to reach agreement because GazImpex's valuation differed wildly from TNG's.[645] As confirmed in a memo from the GazImpex project manager to Mr. Kulibayev, Claimants valued TNG at US$ 567 million, but GazImpex valued the company at only US$ 27.8 - $32.9 million — *a difference of 1700 - 2000 percent*.[646] History obviously proved Claimants correct; TNG's profit in subsequent years greatly exceeded GazImpex's valuation (*e.g.*, over US$ 126 million in 2008 alone).[647] While perhaps GazImpex's ridiculously low valuation was just bad business savvy, it seems more likely that this was Mr. Kulibayev's first attempt to acquire Claimants' investments at a bargain price.

376. In 2007, Claimants again had discussions about the sale of TNG to a company controlled by Mr. Kulibayev.[648] The company involved in those discussions was KazRosGas, which is a joint venture between KazMunaiGaz and Gazprom (the Russian national gas company) formed for the purpose of exporting Kazakhstan gas to Russia.[649] Those discussions originally involved a potential sale of TNG's gas to KazRosGas, but it soon became clear that KazRosGas was more interested in acquiring a 50% stake in TNG.[650] On February 21, 2007, Terra Raf sent KazRosGas a letter noting its interest in acquiring a stake in TNG, and asking KazRosGas to send a written offer.[651] Over the next six weeks, KazRosGas sent three letters

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643 Second Stati statement ¶ 1.

644 Second Stati statement ¶ 1.

645 Second Stati statement ¶ 1.

646 GazImpex Explanatory Note Regarding Purchase of a Share Quota in TNG, September 15, 2004, C-514. That memorandum also reflected a valuation by KazMunaiGaz of only US$ 22.2 - $39.6 million.

647 Second Stati statement ¶ 1; 2009 Annual Report and Audited Financial Statements of Tristan Oil Ltd., Exhibit 68 to May 17, 2011 FTI Report, at F-131.

648 Second Stati statement ¶ 2.

649 Second Stati statement ¶ 2; KazRosGas Legal Status (from www.kazrosgas.org website), C-515.

650 Second Stati statement ¶ 2.

651 Terra Raf Letter to KazRosGas, February 27, 2007, C-516.

reiterating its interest in acquiring a stake in TNG, and requesting a meeting.[652] Shortly thereafter, Terra Raf wrote back to KazRosGas stating that it had changed its mind about potentially selling a share in TNG.[653] As Mr. Stati explained in that letter, Terra Raf had determined that selling a share in TNG could trigger Kazakhstan's pre-emptive right to acquire the interest, and consequently, had decided not to sell a partial stake in TNG to anyone.[654] The message could not have been plainer that Claimants did not want to be in business with the Kazakhstan government (*e.g.*, KazMunaiGaz).

377. In the summer of 2008, when Claimants decided to market their investments for sale in Project Zenith, they included KazMunaiGaz among the potential purchaser targets.[655] Claimants did not have the same reservations about selling 100% of their interests to KazMunaiGaz since they would not be in business together thereafter.[656] RenCap sent KazMunaiGaz the Information Memorandum and the KPMG Vendor Due Diligence presentation, both of which contained substantial details about the companies and their assets.[657]

378. On September 25, 2008, KazMunaiGaz submitted an indicative offer for KPM and TNG (minus the Contract 302 properties, which were to be carved out) of US$ 754 million.[658] KazMunaiGaz's offer was the third-lowest indicative offer, less than half the highest indicative offer (KNOC's offer of US$ 1.55 billion), and more than 25% below the average of all eight indicative offers (US$ 1.05 billion).[659]

379. Less than three weeks after KazMunaiGaz submitted its lowball indicative offer, President Nazarbayev issued his order to investigate Claimants' companies.[660] That timing alone supports a strong inference that President Nazarbayev issued his order to help tip the scales in

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652 KazRosGas Letter to Terra Raf, March 5, 2007, C-517; KazRosGas Letter to Terra Raf, March 16, 2007, C-518; KazRosGas Letter to Terra Raf, April 3, 2007, C-519.

653 Undated Terra Raf Letter to KazRosGas, C-520.

654 Undated Terra Raf Letter to KazRosGas, C-520; Second Stati Statement ¶ 2.

655 Overview of Project Zenith Non-binding Offers, at 6, C-17.

656 Second Stati statement ¶ 3.

657 *See* Project Zenith Information Memorandum, C-17; Project Zenith Vendor Due Diligence by KPMG, C-69.

658 Project Zenith Indicative Offer of KazMunaiGaz, C-19.

659 May 17, 2011 FTI Report at 107.

660 Nazarbayev Investigation Order, C-8.

KazMunaiGaz's favor in the Project Zenith. The events that unfolded over the next 20 months make that inference extremely clear.

380. First, in the months immediately following Nazarbayev's investigation order, KPM and TNG were hit with a barrage of investigations, false accusations, exorbitant tax assessments, and criminal prosecutions, including:

- On November 11, 2008, the Financial Police's issuance of a finding that KPM did not have a main pipeline license, paving the way for the criminal trial and US$ 145 million fine on KPM;[661]
- On December 18, 2008, the MEMR's reversal of its pre-emptive rights waiver as to TNG, and issuance of a press release alleging forgery and fraud in connection with the registration of TNG;[662]
- On February 10, 2009, the assessment of US$ 62 million in back taxes, disregarding stabilization guarantees in its Subsoil Use Contracts;[663] and
- On April 29, 2009, the arrest of KPM's general director.[664]

381. Additionally, Kazakhstan's harassment campaign caused a liquidity crisis at the companies in the spring and summer of 2009 that further ratcheted up the pressure on Claimants. Due to falling energy prices, KPM and TNG's revenues had been under pressure since the fall of 2008.[665] Claimants attempted to obtain a bridge loan to provide additional working capital in connection with their decision to put the companies on the market, and on December 5, 2008, Credit Suisse sent Claimants a term sheet for a US$ 150-175 million facility.[666] Claimants and Credit Suisse already had conducted significant negotiations for the loan, and by December 5, Credit Suisse indicated that it was nearly ready to execute the term sheet.[667] On December 18, 2008, however, Credit Suisse sent Mr. Lungu of Ascom the MEMR's press release accusing Terra Raf of forgery and fraud, and stated, "[w]ould appreciate some colour on the [State's

661 *See* Reply Memorial Section III.A.

662 *See* Reply Memorial Section III.B.1.

663 *See* Reply Memorial Section III.B.2.

664 *See* Statement of Claim Section IV.B.4.

665 Second Lungu Statement ¶ 7.

666 Second Lungu Statement ¶ 7; Indicative Term Sheet from Credit Suisse, December 5, 2008, C-521.

667 Second Lungu Statement ¶ 7; Indicative Term Sheet from Credit Suisse, December 5, 2008, C-521.

accusations]."[668] In follow-up discussions, Credit Suisse informed Claimants that it would not provide the bridge loan until Claimants resolved their disputes with the Kazakhstan government.[669]

382. Without that additional working capital, KPM and TNG's cash position became very tight in early 2009. Moreover, Kazakhstan exacerbated that liquidity problem by choking off TNG's access to gas markets. In the fall of 2008, TNG's largest non-local customer — Kemikal, a company controlled by Mr. Kulibayev — inexplicably failed to post bank guarantees that were part of its required payment terms.[670] Because Kemikal had an erratic payment history, TNG chose not to renew that contract without the bank guarantees in place (and in fact, ended up pursuing Kemikal until June of 2009 to acquire the last of Kemikal's overdue payments).[671] When local demand declined in the spring of 2009, however, the absence of the Kemikal contract left TNG with a shortage of demand.[672] TNG approached KazRosGas about purchasing its excess gas for export, but KazRosGas never responded.[673] TNG had previously sold gas for export through KazRosGas and GasImpex (both companies that were controlled by Mr. Kulibayev), and those companies had made a substantial profit on those contracts.[674] Thus, the decision of KazRosGas not to export TNG's gas in the spring of 2009 seems suspiciously like a conscious attempt to choke off TNG's revenues at a critical time.[675]

383. This liquidity crisis reached its peak in June 2009, when KPM and TNG owed significant tax payments as well as loan repayments to Tristan needed to fund Tristan's coupon payments to noteholders.[676] Not coincidently, KazMunaiGaz returned at exactly that time to make another lowball offer for the companies. KazMunaiGaz knew the predicament that KPM and TNG were in. As a result of the "re-evaluation" of TNG that the MEMR ordered in March,

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668 Second Lungu Statement ¶ 7; December 18, 2008 email from Antanas Petrosius to Artur Lungu, C-670.

669 Second Lungu Statement ¶ 7.

670 Second Lungu Statement ¶ 6.

671 Second Lungu Statement ¶ 6.

672 Second Lungu Statement ¶ 6; Second Stati Statement ¶¶ 41-42.

673 Second Stati Statement ¶¶ 41-42.

674 Second Stati Statement ¶ 42.

675 Second Stati Statement ¶ 42.

676 Second Stati Statement ¶ 43; Second Lungu Statement ¶ 9.

KazMunaiGaz received access to the complete Project Zenith data room — including KPM and TNG financials — in April 2009.[677] Then, in June 2009, KazMunaiGaz offered only US$ 50 million for Claimants' equity interests and indicated that it would "deal separately" with the companies' debts, without providing any further detail.[678] Even assuming that KazMunaiGaz intended to pay face value for the US$ 550 million in outstanding debt (which seems unlikely, based on KazMunaiGaz's offer of 25 cents on the dollar to the Tristan noteholders in November 2009), the total value of KPMG's "offer" had decreased to at most US$ 600 million — which was at least US$ 150 million less than its indicative offer from September 2008. It is no coincidence that KazMunaiGaz showed up with this opportunistic offer at just the right time. This is the Kazakhstan harassment playbook at work.

384. Claimants were only able to weather the liquidity storm in the summer of 2009 by obtaining emergency bridge financing from a group of venture capitalists (the "Laren Facility"). The terms of the Laren Facility were terrible for Claimants (35% interest on a $60 million note, plus the issuance of $111 million of new Tristan notes).[679] Because of the substantial risks to lenders created by Kazakhstan's harassment campaign, those were the best terms that Claimants could obtain.[680] They had no choice but to accept those terms while they continued to try to sell the companies to Total and KNOC in the summer of 2009.[681]

385. After Claimants rejected KazMunaiGaz's lowball offer in June 2009, Kazakhstan simply turned up the pressure. It interfered in the trial of Mr. Cornegruta to ensure a guilty verdict, then sentenced him to four years in Kazakhstan's notoriously dangerous prison system as a punishment.[682] It continued to threaten the same fate for KPM and TNG's other directors.[683] It engineered a massive fine against KPM (who was not even a party to the criminal trial) that was large enough to bankrupt the company and provide a ground for seizing its assets.[684] And it

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677 Lungu Statement ¶ 44.

678 Second Lungu Statement ¶ 9.

679 Second Stati Statement ¶ 43; Second Lungu Statement ¶ 10.

680 Second Lungu Statement ¶ 10.

681 Second Stati Statement ¶ 43.

682 *See* Reply Memorial Section III.C.2.

683 First Cojin Statement ¶ ¶ 13-22; Stejar Statement ¶ 24.

684 *See* Reply Memorial Section III.C.3.

continued to interfere with the day-to-day operations of the businesses, including more inspections, audits, and asset seizures.[685]

386. Following all of this, in November 2009, KazMunaiGaz made yet another bid to buy the companies, offering even less than it had offered in June 2009. As explained in the Statement of Claim, KazMunaiGaz invited Claimants to a meeting in Amsterdam. When Mr. Stati and Mr. Lungu arrived, they met representatives of Tristan's main note-holders leaving a meeting with KazMunaiGaz.[686] The note-holder representatives said that KazMunaiGaz had just offered them 25 cents on the dollar for their interests, which they had refused.[687] Thereafter, KazMunaiGaz offered Claimants US$ 20 million for their equity interests, which Claimants also refused.[688] In short, after a full year of sustained harassment, KazMunaiGaz offered a fraction of what it had bid for the assets in its indicative offer in Project Zenith, and even less than it had offered in June 2009.

387. Around the same time, Mr. Kulibayev made another attempt to buy KPM and TNG through a different company, the Starleigh Group, without disclosing his involvement. Like KazMunaiGaz's offer in June 2009, Starleigh offered US$ 50 million for Claimants' equity interests plus a buyout of the note-holders. Claimants declined this offer as well. At the time, Claimants' only contacts at Starleigh were with a Mr. Arvind Tiku and with technical personnel from the Mittal Group (the London-based business of Lakshmi Mittal).[689] Because this offer was so similar to KazMunaiGaz's earlier offer, however, Claimants suspected that Mr. Kulibayev was involved. Claimants subsequently confirmed that Starleigh is a joint venture between Mr. Kulibayev and Mittal, and that Mr. Tiku is a business associate of Mr. Kulibayev.[690] Thus, the Starleigh offer was yet another attempt by Mr. Kulibayev to acquire Claimants' investments on

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685 *See* Reply Memorial Section III.D.

686 Lungu Statement ¶ 62; Stati Statement ¶ 38.

687 Lungu Statement ¶ 62; Stati Statement ¶ 38.

688 Lungu Statement ¶ 62; Stati Statement ¶ 38.

689 Second Lungu Statement ¶ 11; Email from Denis Khromov to Artur Lungu confirming Mittal visit to Bucharest, October 30, 2009, C-522.

690 Letter from Merix International Ventures Ltd. to Credit Suisse, October 23, 2008, C-523. This letter refers to a financing arrangement between Credit Suisse and Merix International, a British Virgin Islands entity widely understood to be owned by Mr. Kulibayev. The letter confirms as much, and also states that Starleigh is a joint venture between Merix and Mittal. In late 2010, reports circulated in the financial press that Mr. Kulibayev and Mr. Tiku were joint targets in a money laundering investigation by Swiss authorities. Horton Report ¶ 34.

the cheap, and also to create the appearance of fair value by pretending to be an arms length third party that was unconnected to the Kazakhstan government.

388. Finally, despite all of Kazakhstan's harassment, Claimants were able to find a buyer for KPM and TNG in February 2010, the Cliffson Company. Cliffson was owned by the Aussabayevs, a wealthy Kazakh family that owned mining company KazakhGold (and which had recently sold a majority stake in that business).[691] On February 13, 2010, Claimants signed an agreement to sell their Kazakhstan investments to Cliffson for US$ 277 million plus the assumption or satisfaction of all related debts. As will be discussed in the damages submission, the total value of that offer to Claimants exceeded US$ 920 million.

389. On April 12, 2010, Claimants submitted applications for approval of the Cliffson sale, and waiver of Kazakhstan's pre-emptive rights, to the Ministry of Oil and Gas and Ministry of Industry and Technology, respectively.[692] On April 30, 2010, the Ministry of Oil and Gas responded by: (1) requesting additional information regarding the terms of the transaction and the financial and technical abilities of Cliffson; (2) noting that based on Kazakhstan's seizures of the companies' assets, transfers of the shares of KPM and TNG were forbidden; and (3) concluding that the transaction would only be approved if KPM and TNG satisfied the requirements necessary to release the attachment of their shares.[693] On June 1, 2010, the Ministry of Oil and Gas sent an additional request to KPM and TNG for voluminous amounts of additional information regarding the transaction (in a 2-page, single-spaced list for each company).[694]

390. On June 23, 2010,[695] Claimants provided everything that Kazakhstan had reasonably requested in its April 30 and June 1 letters, including:

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691 Second Stati Statement ¶ 27.

692 Letter from KPM to Ministry of Oil and Gas, April 12, 2010, C-524; Letter from KPM to Ministry of Industry and Technologies, April 12, 2010, C-525; Letter from TNG to Ministry of Oil and Gas, April 12, 2010, C-526; Letter from TNG to Ministry of Industry and Technologies, April 12, 2010, C-527.

693 Letter from Ministry of Oil and Gas to KPM, April 30, 2010, C-528; Letter from Ministry of Oil and Gas to TNG, April 30, 2010, C-529.

694 Letter from Ministry of Oil and Gas to KPM, June 1, 2010, C-530; Letter from Ministry of Oil and Gas to TNG, June 1, 2010, C-531.

695 Cover letter from KPM to Ministry of Oil and Gas, June 23, 2010, C-532; cover letter from TNG to Ministry of Oil and Gas, June 23, 2010, C-533. Although the typed date on these letters is June 12, 2010, they are hand-dated June 23, 2010, and bear that fax date as well.

- Information on the current execution of contract and license terms;
- Analysis of fulfillment of conditions of the working programmes from 1999-2010;
- 2009 financial statements for on Tristan Oil Ltd., KPM, and TNG;
- Information on issuance of US$ 111 million in additional Tristan notes;
- Information on the cumulative debt position of Tristan, KPM, and TNG as of December 31, 2009;
- Information regarding Kazakhstan's claims;
- Information on environmental restrictions and associated gas recovery program;
- Information on the existing infrastructure;
- Geological information; and
- Information regarding arrangements for transportation and sale of oil and gas.[696]

391. Kazakhstan never responded.[697] Rather, less than a week later, it initiated the final inspection blitz that led to the ultimate expropriation of Claimants' assets on July 22, 2010. *See* Section III.D, *supra*.

392. In retrospect, it is easy to see why. By that time, Claimants had made it clear that they intended to bring arbitration claims against Kazakhstan for the diminution in value of their investments once the sale to Cliffson closed. Mr. Stati himself had made this clear in his letter to President Nazarbayev on May 8, 2009.[698] Furthermore, this had been an issue of concern to Kazakhstan throughout its harassment campaign. The MEMR's September 28, 2009 letter to the Ministry of Industry and Trade noted the risk of arbitration as one of the reasons why it would be

[696] Second Lungu Statement ¶ 13. This information was sent from KPM and TNG's field offices in Kazakhstan, and much of its was provided on CDs. Accordingly, Claimants lost access to their copies of most of this information when Kazakhstan seized their investments on July 22, 2010.

[697] Second Lungu Statement ¶ 13.

[698] C-43.

better to obtain KPM and TNG through an acquisition rather than a premature termination of the Subsoil Use Contracts.[699]

393. Moreover, in negotiations with Cliffson, Claimants demanded provisions to preserve their international arbitration claims against Kazakhstan for the diminution in value of Claimants' investments.[700] While Claimants did not think that was legally necessary, Claimants requested such a term in an abundance of caution because of Kazakhstan's pre-emptive rights and role in approving the transaction.[701] Cliffson initially responded that the proposed amendment was a "deal-breaker," and the parties seemed to be at an impasse for several days.[702] On 12 February 2010, however, Cliffson's lawyers approached Claimants with an offer to break the impasse. Cliffson's lawyers represented that "the family"—presumably referring to the Assaubayev family—would use their influence with the Kazakhstan government to obtain the release of Mr. Cornegruta from prison if Claimants agreed to drop the arbitration amendment.[703] Mr. Stati was reluctant to remove the proposed amendment, but ultimately agreed because any possibility of freeing Mr. Cornegruta from his wrongful confinement was too important to pass up.[704] Thus, the proposed amendment was not included in the final Cliffson Agreement.[705] In turn, Cliffson agreed in a side letter agreement that it would:

> Do our best to obtain within three months of the signing of the Cliffson Agreement the following: (i) the release of Serghei Cornegruta, the General Manager of KPM, from prison within three months of the signing of the Cliffson Agreement and permit his return to Republic of Moldova from the Republic of Kazakhstan, and (ii) the dropping of any and all administrative, civil and criminal charges and investigations against the former General Managers of KAZPOLMUNAY LLP, namely Salagor Constantin and Spasov lurie respectively as well as against former General Manager of TOLKYNNEFTEGAZ LLP, namely Alexandru Cojin; and (iii) the dropping by the Republic of Kazakhstan's authorities of any and all existing charges and

699 C-294

700 Second Stati Statement ¶ 31.

701 Second Stati Statement ¶ 31.

702 Second Stati statement ¶ 31.

703 Second Stati statement ¶ 31.

704 Second Stati statement ¶ 31 .

705 Second Stati statement ¶ 31.

> investigations against any of the Sellers, Group Companies and/or any of their employees or personnel or the like, and (iv) the refraining by the Republic of Kazakhstan's authorities to commence any new charges and investigations against any of the Sellers, Group Companies and/or any of their employees or personnel or the like. For the purpose of this side letter, "charges and investigations" shall include any administrative, civil, fiscal, criminal or any other proceedings, charges, investigations, convictions, judgments, controls or the like. Failure of the Buyer to achieve the above shall give the Seller the right to proceed with appropriate remedies.[706]

394. Notwithstanding Claimants' agreement to drop the amendment (which Claimants always viewed as an extra, unnecessary precaution against an incorrect argument that the Cliffson sale somehow waived its claims against Kazakhstan), this exchange made clear that Claimants intended to bring arbitration claims against Kazakhstan for the diminution in value of their investments once the Cliffson deal closed. That left Kazakhstan with four options:

- Waive its pre-emptive rights and approve the sale, which would allow Cliffson to obtain the assets and Kazakhstan would still face arbitration claims by Claimants for the diminution in value;

- Disapprove the sale outright, which would leave the assets in Claimants' hands and Kazakhstan would still face arbitration claims for the harassment campaign and the baseless interference with alienation;

- Exercise its pre-emptive rights, which would obtain the assets for Kazakhstan but Kazakhstan would have to match Cliffson's offer and would still face arbitration claims by Claimants for the diminution in value; or

- Seize the assets under a pretext of termination, which would obtain the assets for Kazakhstan for free and provide a termination argument for arbitration.

395. It is not hard to see why Kazakhstan chose the path it did. But just because its decision was rational does not make it legal. It was not.

[706] Side Letter Agreement, February 13, 2010, C-534

2. Kazakhstan's Arguments That It Did Not Interfere With Claimants' Sale of Their Investments Are Wrong

396. Kazakhstan argues that Claimants were unable to sell their investments due to financial or technical reasons having nothing to do with Kazakhstan's harassment campaign.[707] This argument is implausible on its face and belied by the facts. In addition to completely interfering with Claimants' ability to use, manage, and enjoy their investments, Kazakhstan's conduct made it impossible for Claimants to sell their companies, as they had planned to do starting from mid-2008.

a. Phase I of Project Zenith

397. Kazakhstan argues that because Claimants decided to sell KPM and TNG in the summer of 2008, before the start of Kazakhstan's inspection assault and harassment campaign, that Claimants' decision had nothing to do with Kazakhstan's misconduct.[708] That argument misses the point. Claimants do not contend that Kazakhstan's actions motivated their initial decision to market their investments for sale. Rather, Claimants decided to explore a sale in the summer of 2008 for business reasons, and they attracted substantial interest from numerous bidders before Kazakhstan's harassment campaign began.[709] The key fact, however, is that none of those interested bidders was willing to follow through with a transaction ***after*** Kazakhstan commenced its targeted harassment of KPM and TNG in October of 2008. Kazakhstan attempts to refute this simple fact by misstating the chronology of relevant events, and with unsupported assertions that the once-interested bidders lost interest for reasons having nothing to do with Kazakhstan's conduct.

398. Kazakhstan asserts that the majority of potential bidders decided not to make a bid for reasons unrelated to governmental harassment or interference, such as the global economic crisis, perceived lack of transport links, and other reasons outlined in a presentation by Renaissance Capital to Claimants.[710] All of those factors, however, existed in September 2008 when Renaissance Capital presented the results of the first phase of Project Zenith to Claimants,

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[707] Statement of Defense ¶¶ 16.1-16.11.

[708] Statement of Defense ¶ 16.1.

[709] Statement of Claim ¶¶ 69-71.

[710] Statement of Defense ¶ 16.7.

well before Kazakhstan's harassment campaign began.[711] It is true, and hardly surprising, that many of the companies that Renaissance Capital contacted in the summer of 2008 were not interested in these investments for a myriad of their own reasons. The significant fact, however, is that despite the global economic crisis and other reasons that some companies declined to participate in Project Zenith, eight bidders did show serious interest in Claimants' investments in the summer of 2008.

399. Kazakhstan offers no factual support for its implication that eight serious bids out of 129 companies contacted is unusually low, nor has Kazakhstan shown that the information available to the eight companies that submitted indicative offers was in any way inaccurate or incomplete. Kazakhstan asserts that:

> To mask the illegalities of its purchase of KPM and TNG the Claimants failed to provide accurate information on how it came to own the companies and the various issues surrounding the transfers and re-organisations. This is clear from the exhibits the Claimants have disclosed alone which show that neither the Vendor Due Diligence (Exhibit C-69) nor the Information Memorandum (Exhibit C-70) gave sufficient information on the Claimants' purchase which enable bidders to come to the conclusion that the Claimants' acquisitions were illegal, the various transfer of KPM and TNG was [sic] illegal, the reorganisation of TNG and KPM as LLPs was illegal, and the fact that they did not have licenses for use of subsurface resources and transportation of crude oil.[712]

400. This is a nonsensical argument because there were no such facts to disclose. As demonstrated in the Statement of Claim and in this Reply, Claimants' acquisition and reorganization of KPM and TNG were legal, and the companies had valid licenses for all the activities they conducted.[713] It was not until Kazakhstan retroactively reversed its waiver of pre-emptive rights with respect to Terra Raf's purchase of TNG and publicized allegations of fraud—in December 2008, as part of Kazakhstan's targeted harassment campaign—that there was any question about the legal status of Claimants' investments. That question, however, arose solely because of the wrongful conduct of Kazakhstan. So while Kazakhstan is correct that concerns about the legal status of Claimants' investments would be material to potential

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[711] C-17.

[712] Statement of Defense ¶ 16.3.

[713] *See also* Reply Memorial Section II.D.2.

purchasers, that fact goes only to prove Claimants' point that Kazakhstan's invention of such concerns in December of 2008 as part of its harassment campaign naturally would and did adversely affect the interest of potential bidders for Claimants' investments.

b. Phase II of Project Zenith

401. Kazakhstan also misstates the significance of the fact that "[o]f the 7 bidders which the Claimants contacted as a result of them making indicative non-binding offers during the first phase of Project Zenith, 5 of them decided to not take part in the supposed second phase which commenced only 2 months later - without even looking at the data room."[714] Kazakhstan concludes from this fact that "[t]heir independent decision to not take part had nothing to do with the Republic."[715] This fact, however, shows exactly the opposite. Those five companies had made serious indicative offers in the first round of Project Zenith just months before, but lost all interest in the transaction without even examining the data room. That suggests that some change in circumstances ***having nothing to do with the data room*** caused them to lose interest in the investments. Two things that had changed in the interim were:

> (1) Kazakhstan's retroactive reversal of its waiver of pre-emptive rights with respect to Terra Raf's purchase of TNG based on unsupported allegations of forgery and fraud, which Kazakhstan publicized in a press release on December 18, 2008;[716] and
>
> (2) Kazakhstan's assessment of approximately US$ 62 million in alleged back taxes and penalties, in blatant disregard of its stabilization guarantees in Claimants' subsoil use contracts.

402. Moreover, the fact that two companies (Turkish Petroleum Corporation and PSA Energy Holding SPC) withdrew from the bid process after examining the data room does not support Respondent's speculation that they may have seen "further and/or different information to what it had been given in the Information Memorandum (Exhibit C-70) and Vendor Due-Diligence (Exhibit C-69)."[717] Their withdrawal from the bidding does not cast any doubt on the accuracy of the information provided to bidders in the first phase of Project Zenith or the

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[714] Statement of Defense ¶ 16.10(a).

[715] Statement of Defense ¶ 16.10(a).

[716] *See* Press release circulated on Interfax from the MEMR, December 18, 2008, C-141.

[717] Statement of Defense ¶ 16.10(b).

reliability of the phase one indicative offers as evidence of the value of the companies. Kazakhstan's further speculation that these companies withdrew from the bidding because "by this point [they] may have discovered the illegalities relating the Claimants' acquisitions and transfers of KPM and TNG" is spurious.[718] As noted above, it is impossible that these companies withdrew after discovering actual illegalities regarding Claimants' acquisition of TNG and KPM because there were no such illegalities to discover. It is possible that these two potential bidders withdrew from Project Zenith after learning of Kazakhstan's *allegations* of such illegalities, which Kazakhstan publicized in a press release on December 18, 2008. But since those allegations were wholly unfounded and a part of Kazakhstan's targeted harassment campaign, this possibility only supports Claimants' position that the harassment campaign had its intended effect of deterring potential bidders for Claimants' investments.

403. Additionally, the remaining two bidders who had made indicative offers in the first phase of Project Zenith—Total and KNOC—withdrew from the bidding process only after speaking with Kazakh authorities. Total never expressly gave any reason why it was not proceeding with the bid process.[719] Its withdrawal letter merely stated, "We have now finalized our assessment. Despite a long exchange of information and discussion, Total E&P Activites Petrolieres do not desire to proceed further with Zenith Project including Tabyl Block."[720] As explained in the Statement of Claim, Total's failure to give any real explanation and all the surrounding circumstances make it seem very likely that Total withdrew due to Kazakhstan's ongoing harassment claim and its effect on the companies. At the management presentation to Total in February of 2009, Total's personnel were interested and optimistic about the project.[721] They did not indicate any serious concerns about the technical or geological conditions of the properties with Claimants' technical staff at that meeting, and the legal status of Claimants' investments did not even come up.[722] The Total representatives, however, made clear that they would have to talk to Kazakh authorities before Total would be willing to move forward with a

[718] Statement of Defense ¶ 16.10(b).

[719] Letter from Total E&P to Renaissance Capital, July 24, 2009, C-296.

[720] Letter from Total E&P to Renaissance Capital, July 24, 2009, C-296.

[721] Second Stati Statement ¶ 22.

[722] Second Stati Statement ¶ 22.

binding offer.[723] Only after speaking to Kazakh authorities did Total withdraw from the bidding.[724] Under these circumstances, Total's vague statements when it withdrew from the bidding—with no further discussion or negotiation, which would be normal if the reasons had in fact been technical or financial—makes Total's explanation appear like a pretext to avoid making statements that could strain its relationship with Kazakhstan.

404. Total's reluctance to be frank about the real reasons it decided not to pursue the acquisition of KPM and TNG is understandable, in light of its significant economic investment in Kazakhstan. Since 1992, Total has held a sizeable stake in the North Caspian Operating Company, a consortium founded to develop the Kashagan field (the fifth largest oil field in the world).[725] KazMunaiGaz also is a co-venturer in the North Caspian Operating Company.[726] Furthermore, in 2009, Total concluded an agreement with KazMunaiGaz for a partnership to develop the Khvalynskoye field.[727] It is entirely consistent with Claimants' position in this arbitration that Total would pursue a partnership with KazMunaiGaz in 2009 rather than whole ownership of TNG and KPM, because 100% foreign ownership is now disfavored by Kazakhstan, and a partnership with state-owned KazMunaiGaz would insulate Total from the kind of harassment experienced by Claimants. Moreover, Total's understandable reluctance not to jeopardize its longstanding investment in the North Caspian Operating Company, and its negotiations with KazMunaiGaz over the Khvalynskoye field, explain why Total would be very diplomatic about the reasons it declined to make a binding offer for Claimants' investments

405. Claimants' experience with KNOC was similar. KNOC resumed its interest in acquiring Claimants' investments in July of 2009, and Claimants conducted a management presentation for KNOC in Bucharest. As with Total, KNOC's representatives did not raise any serious concerns about the technical or geological conditions of the properties with Claimants' technical staff at that meeting, and the legal status of Claimants' investments did not even come

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723 Second Stati Statement ¶ 22.

724 Second Stati Statement ¶ 22.

725 Total Press Release, October 6, 2009, C-535; May 17, 2011 FTI Report ¶ 4.12; NCOC Co-Venturers (from NCOC website at www.ncoc.kz), C-536.

726 NCOC Co-Venturers (from NCOC website at www.ncoc.kz), C-536.

727 Total Press Release, October 6, 2009, C-535.

up.[728] KNOC, however, was only willing to proceed with a binding offer after speaking with Kazakh authorities.[729] Claimants never heard from KNOC again.[730]

406. Notably, Kazakhstan has not presented any witness to dispute that its personnel met with representatives of Total and KNOC, and persuaded them not to pursue the acquisition. Instead, Kazakhstan has presented letters from Total and KNOC, as well as similar letters from KazMunaiGaz and OMV Aktiengesellschaft, that purport to state the reasons why those companies did not make an offer for Claimant's investments.[731] The Tribunal should disregard these letters entirely unless Kazakhstan designates the authors as witnesses and presents them for cross-examination. Claimants cannot verify the authenticity of these letters, much less the accuracy of the assertions therein. Even assuming these letters are authentic communications from the purported authors, they all are dated between August to October of 2011, and plainly were solicited by Kazakhstan for this arbitration. The letters are addressed to the Executive Secretary of the Kazakhstan Ministry of Oil and Gas, and reference letters sent by the Ministry in May through July 2011 requesting information about the companies' indicative offers in Project Zenith. Kazakhstan has not produced the letters it sent to Total, KNOC, or OMV, but it did produce the letter it sent to KazMunaiGaz (after the Tribunal ordered it to do so).[732] Far from being a neutral request for objective facts, the Ministry's letter makes clear that it is seeking information that will be "useful to dismiss the action," and that will "enable us to work out a maximum possible strong position in the Arbitration."[733] Moreover, the Ministry's letter states that it is seeking "information concerning the reasons for discontinuation of the purchase of the Parties' assets based on results of the due diligence and evaluation."[734] Thus, the Ministry essentially dictated what it wanted in response — *i.e.*, a statement that the reasons for

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728 Second Stati Statement ¶ 23.

729 Second Stati Statement ¶ 23.

730 Second Stati Statement ¶ 23.

731 Letter of NC KazMunaiGaz, October 21, 2011, R-41; Letter of KNOC, August 12, 2011, R-41.2; Letter of OMV E&P regarding project Zenith, August 12, 2011, R-41.2; Letter of Total E&P Activités Pétrolières, August 23, 2011, R-41.4.

732 Letter from Ministry of Oil & Gas to KazMunaiGaz, October 7, 2011, C-537.

733 Letter from Ministry of Oil & Gas to KazMunaiGaz, October 7, 2011, C-537.

734 Letter from Ministry of Oil & Gas to KazMunaiGaz, October 7, 2011, C-537.

discontinuation of the purchase of Claimants' assets was based on the results of the due diligence evaluation.

407. Furthermore, all four companies that purportedly authored these letters have significant ongoing ties and investments in Kazakhstan. KazMunaiGaz is a state-owned oil and gas company, and is headed by Timur Kulibayev, the son-in-law of President Nazarbayev. As noted above, Total has substantial ongoing investments in Kazakhstan. Likewise, both KNOC and OMV have sizeable investments in Kazakhstan as well.[735]

408. Moreover, far from supporting Kazakhstan's position, the letter from KazMunaiGaz actually demonstrates how Kazakhstan's harassment campaign did undermine the alienability of Claimants' investments. KazMunaiGaz identifies six facts that it supposedly discovered when it conducted due diligence on the data room in March of 2009 that reduced its valuation of TNG and KPG:

> (1) a US$ 95 million loan received by an affiliated company (Montvale) and secured by participation interests in TNG and KPM;
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> (2) a US$ 60 million loan received by an affiliated company (Laren) and secured by participation interests in TNG and KPM;
>
> (3) "other risks related to claims from Kazakhstan's government authorities";
>
> (4) US$ 531.1 million in notes issued by Tristan and secured by participation interests in TNG and KPM;
>
> (5) the asserted fact that in 2008-2009, TNG and KPM "dramatically increased their hydrocarbons production volumes which resulted in a decline of reservoir pressure. This could have been evidence of the shareholder's deliberate and intentional actions which, in turn, could have resulted in an irreversible loss of significant volumes of recoverable hydrocarbons and in an increase of capital expenditures on drilling new wells (US$ 15 mln. each)"; and
>
> (6) the fact that during 2009, Casco — an affiliate of TNG and KPM that provided all service work to the companies in the field — demobilized and moved its primary equipment out of Kazakhstan.[736]

Two of these assertions are simply inaccurate — specifically, issues (1)[737] and (5).[738]

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[735] KNOC Kazakhstan (from www.knoc.co.kr), C-538; OMV Group Kazakhstan (from www.omv.com), C-539

[736] R-41.

409. The other four issues, however, all are direct results of the Respondent's harassment campaign. As described above, the US$ 60 million Laren loan (issue 2), and the issuance of US$ 111.1 million in additional Tristan notes in connection with that loan (issue 4), were only necessary because of Kazakhstan's harassment campaign. Moreover, the third issue referenced by KazMunaiGaz — the "other risks related to claims from Kazakhstan's government authorities" — refers presumably to the tax, duty, and criminal fine liabilities imposed wrongly on KPM and TNG as part of Respondent's harassment campaign. Additionally, the final factor mentioned by KazMunaiGaz — Claimants' removal of Casco from the field in 2009 — resulted directly from Kazakhstan's harassment campaign. Because of the cash flow shortfall discussed above, and the increasingly hostile investment environment, Claimants prudently reduced their drilling and workover activities in Kazakhstan and removed Casco personnel from the country.[739]

410. In short, it is true that any potential buyer examining KPM and TNG in 2009-2010 would have seen declining cash flows, increasing government liabilities, and operational challenges going forward. But those declining fortunes resulted directly from Kazakhstan's conduct, not from any declines in KPM's and TNG's intrinsic worth.

411. Furthermore, Kazakhstan has refused to produce several highly relevant attachments to KazMunaiGaz's letter, despite this Tribunal's specific instruction to do so. That letter expressly states that it enclosed four third party reports — a legal diligence report, a finance and tax diligence report, and two asset appraisal reports (from September 2008 and June

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[737] The US$ 95 million "loan" received by Montvale actually was just a trade payable that was owed to Vitol for prepayments for oil and gas deliveries that KPM and TNG sold through Montvale. This prepayment term was disclosed to KazMunaiGaz and other potential bidders in the first phase of Project Zenith. *See* Project Zenith – Vendor Due Diligence by KPMG, August 29, 2008, at 16, C-69.

[738] KPM's production of hydrocarbons did not increase in 2008 at all. Rather, its production remained more-or-less constant throughout its operations. *See* May 15, 2011 Ryder Scott Report, Ex. 6. TNG did increase production at Tolkyn in 2008, primarily because it entered into a new gas sales agreement with an industrial customer (Kemikal) and because it opened a new pipeline from the Tolkyn field to its gas processing facilities at Borunkol. *See* May 15, 2011 Ryder Scott Report, Ex. 6. KazMunaiGaz's assertion that this is "evidence of the shareholder's deliberate and intentional actions," which KazMunaiGaz insinuates without explanation was wrongful, is simply baseless. In fact, the Kazakhstan Ministry of Energy and Mineral Resources dictated to TNG what its annual production targets were, and TNG's production volumes in 2008 were very close to that target mandated by Respondent. This issue will be discussed at further length in Claimants' quantum submission on May 28, 2012.

[739] Second Stati Statement ¶¶ 40, 45.

2009).[740] Kazakhstan, however, has refused to produce any of those documents without any justification, and even though they are likely to be highly probative of the very issue for which Kazakhstan presents the KazMunaiGaz letter — namely, KazMunaiGaz's valuation of Claimants' investments. The Tribunal would be well justified in inferring from Kazakhstan's groundless concealment of this evidence that it does not support Kazakhstan's position on the value of Claimants' investments, and in fact shows that KazMunaiGaz's real valuation of those assets was significantly higher than it contends in the letter it created for use in this arbitration.

412. Kazakhstan also attempts to dismiss the effect of its actions on KNOC, Total, and the other Phase 2 Project Zenith companies with the curious argument that those bidders dropped out of the process before Kazakhstan levied the US$ 145 million against KPM:

> Chronologically every bidder [in Project Zenith] except Cliffson Company, the Kazakh owned Starleigh and the state owned KazMunaiGaz withdrew from the process before KPM was legitimately fined USD 145m in accordance with Kazakh law for operating a trunk pipeline by the Aktau City Court on 18 September 2009. . . . It is difficult to see how any of the other alleged legal actions of the Republic would have impacted on a bidder's decision and therefore deterred them from making a bid.[741]

If this argument is to be taken seriously, it demonstrates a disturbing lack of awareness of the impact of Kazakhstan's actions on the willingness of foreign investors to invest in Kazakhstan. Long before the Aktau City Court issued its fine on September 18, 2009, Kazakhstan had:

- Retroactively reversed its waiver of pre-emptive rights with respect to Terra Raf's acquisition of TNG, and publicly accused Claimants of fraud and forgery;
- Assessed millions of dollars in back taxes, blatantly disregarding its contractual stabilization guarantees; and
- Jailed KPM's general director on charges that could be leveled against most oil and gas producers in Kazakhstan.

413. It should be obvious that foreign investors will be deterred from investing in an environment in which the government freely disregards its legal obligations, and will go so far as

[740] R-41.

[741] Statement of Defense ¶ 16.10(e).

to jail an employee on scurrilous charges, to suit its own interests. Moreover, even if potential bidders thought that they might be immune from similar treatment, they can (and did) use these circumstances as leverage to drive down their bids for Claimants' investments.

c. KazMunaiGaz and Starleigh Gas Offers

414. Kazakhstan also argues that the KazMunaiGaz and Starleigh offers (in June and November of 2009, respectively) show that, after taking into account the debt owed to bondholders and the "legitimate fine imposed on KPM, the companies were not worth very much (if they were worth anything at all)."[742] Kazakhstan both miscalculates the true value of the KazMunaiGaz and Starleigh offers, and ignores the fact that KazMunaiGaz and Starleigh were connected to the Kazakh government and attempting to take advantage of Claimants' weakened position as a result of the harassment campaign.

415. First, both KazMunaiGaz and Starleigh valued the equity interests in the companies at US$ 50 million, and indicated that they would "deal separately" with the companies' debts.[743] It is not clear exactly how KazMunaiGaz and Starleigh expected to "deal" with those debts, but KazMunaiGaz and Starleigh could not reasonably have expected that the companies' arms-length creditors would just walk away from over US$ 500 million in claims. The willingness of KazMunaiGaz and Starleigh to assume those debts, in addition to paying US$ 50 million for the equity interests, suggests that they actually valued the companies' assets much higher than the valuation of US$ 161-169 million put forward by Kazakhstan and Deloitte in this proceeding.[744]

416. Second, the KazMunaiGaz and Starleigh offers were significantly below the true fair market value of Claimants' investments because those companies were attempting to take advantage of Claimants' weakened position caused by Kazakhstan's harassment campaign. Fair market value is widely understood to mean the price that a willing buyer would pay a willing

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742 Statement of Defense ¶ 16.10(f).

743 Second Lungu Statement ¶¶ 9, 11.

744 As explained in Section III.D, Respondent expropriated Claimants' assets but did not assume any of its debts. Claimants remain liable for the debts they incurred and guaranteed in connection with the operations of TNG and KPM. Accordingly, the quantum of compensation in this case should be calculated based on the value of those assets, not the value of Claimants' equity interests (*i.e.*, assets minus liabilities).

seller when neither party is under pressure to enter the transaction.[745] Respondent's harassment campaign, however, did create pressure on Claimants to sell, as both KazMunaiGaz and Starleigh well understood. As noted above, KazMunaiGaz is the state-owned company headed by Mr. Timur Kulibayev (the son-in-law of President Nazarbayev), and the company that ultimately obtained Claimants' investments when Kazakhstan seized them in July 2010. Mr. Kulibayev also owned half of Starleigh.[746] Under those circumstances — knowing that Claimants were under desperate pressure to sell, and that Kazakhstan could obtain the investments for KazMunaiGaz without any payment through expropriation — neither KazMunaiGaz nor Starleigh had any incentive to offer fair market value for Claimants' investments. As Mr. Stati explains:

> I felt that both Starleigh and KazMunaiGaz, which were both controlled by Mr. Kulibayev and consequently had direct connections to President Nazarbayev, were clearly taking advantage of the position that Kazakhstan had put us in. They knew that Kazakhstan would not permit a sale to any non-state entity, and they consequently felt free to offer very little for my investments.[747]

417. In summary, contrary to Kazakhstan's argument, the Starleigh and KazMunaiGaz offers do not show that the companies were worth very little. They suggest that even parties in a position to take advantage of Kazakhstan's harassment campaign, and ultimately benefit directly from Kazakhstan's outright expropriation in July 2010, valued Claimants' investments many times higher than the value Kazakhstan puts forward in this proceeding.

d. The Cliffson Offer

418. The terms of the Cliffson offer in February 2010 compel the same conclusion. Cliffson offered US$ 267 million for all of the equity interests in TNG, KPM, and Tristan.[748]

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[745] May 17, 2011 FTI Report ¶ 1.4.

[746] Second Lungu Statement ¶ 11; Letter from Merix International Ventures Ltd. to Credit Suisse, October 23, 2008, C-523.

[747] Second Stati Statement ¶ 26.

[748] Cliffson Sale Agreement § 3.1, C-540. Although the Cliffson Agreement also included Claimants' equity interest in Casco, the total amount of Cliffson's offer for the equity interests in all four companies was US$ 277 million. Cliffson agreed that US$ 10 million of that purchase price was attributable to Casco. *See* email confirming Cliffson's agreement (per Assaubayev Aydar Kanatovich) to Artur Lungu's proposed allocation of equity values in the Cliffson transaction, Email from Cliffson to A. Lungu, April 10, 2010, C-541. Thus, the value of the Cliffson offer attributable to the equity interests of TNG, KPM, and Tristan was US$ 267 million.

Additionally, however, Cliffson expressly agreed to assume all of those companies' liabilities, including (most significantly):

- All liabilities under the Tristan Note Indenture;
- All liabilities under the Laren Loan Facility;
- All liabilities under the trading arrangements with Vitol; and
- All liabilities under the Limozen Facility Agreement.[749]

In total, Cliffson agreed to assume more than US$ 655 million in liabilities. Combined with its offer of US$ 267 million for the equity interests, this places Cliffson's valuation of the assets that Respondent seized at more than US$ 920 million.

419. Moreover, as with Starleigh and KazMunaiGaz, Cliffson's offer was below the true fair market value of Claimants' investments because of the pressure to sell caused by Respondent's harassment campaign. Although Claimants believed their investments were worth far more than Cliffson offered, they accepted the offer (subject to their right to bring an arbitration claim for the diminution in value of their investments) because the cumulative effects of the Respondent's harassment campaign were making it increasingly difficult to operate the companies. Cliffson's offer, while significantly below fair value, was the only means for Claimants to extricate themselves from Respondents' harassment campaign, pay off the noteholders, and obtain some return on their investments. Mr. Stati explains:

> While we believed that Cliffson's offer was still well below the fair market value of my investments, we also knew that alternatives at that time simply did not exist. Not only had Kazakhstan effectively eliminated the pool of potential non-state buyers, but by the spring of 2010, Kazakhstan's campaign against me and my investments had advanced to the point that ordinary company operations by TNG and KPM were very nearly impossible.[750]

420. Additionally, like KazMunaiGaz and Starleigh, Cliffson used the fact of Claimants' vulnerability as a result of Kazakhstan's harassment campaign repeatedly and effectively in negotiations to drive down the price. Cliffson was well aware of the effect of

[749] Cliffson Sale Agreement § 2.1, C-540 and Schedule 6; Second Lungu Statement ¶ 12.

[750] Second Stati Statement ¶ 28.

Kazakhstan's actions on both Claimants' ability to sell the companies or to simply continue their operation.[751] During the negotiations, Cliffson's representatives stated on several occasions that Cliffson was the only company that would be permitted by Kazakhstan to buy TNG and KPM, emphasizing that this was so only because of the strong relationship between Cliffson's owners and President Nazarbayev.[752]

421. Thus, the Cliffson offer plainly demonstrates that Claimants' investments were worth quite a lot — over US$ 900 million, even after more than a year of Kazakhstan's constant harassment. Moreover, Kazakhstan cannot deny that it blocked that sale by withholding its approval and waiver of pre-emptive rights. As discussed above, Kazakhstan never gave a substantive response to Claimants' request for approval. Rather, it simply expropriated the assets outright.

422. Kazakhstan essentially admits as much in its Statement of Defense. Kazakhstan does not assert that it withheld approval of the sale based on any legitimate reasons (such as *bona fide* concerns about the financial or operating abilities of Cliffson). Rather, Kazakhstan asserts that "Claimants were, as a result of the illegalities set out above, unable to get permission so the transaction was bound to fall through."[753] But for all the reasons explained in Section III, *supra*, those alleged illegalities were a sham, designed to create a pretext for Kazakhstan to seize Claimants' investments without compensation.

V. GOVERNING LAW

A. The ECT and International Law Govern This Dispute

423. Instead of applying the rules of law set forth in the ECT and international law, Kazakhstan relies almost exclusively upon Kazakh law in its Statement of Defense.[754] Kazakhstan's reliance on its domestic law is thoroughly misplaced. Article 22(1) of the SCC Rules provides that:

> The Arbitral Tribunal shall decide the merits of the dispute on the basis of the law(s) or rules of law agreed upon by the parties.

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[751] Second Stati Statement ¶ 30.

[752] Second Stati Statement ¶ 30.

[753] Statement of Defense ¶ 16.10(i).

[754] Statement of Defense Section 10.

424. Claimants and Kazakhstan consented to arbitrate this dispute under the ECT, and the Treaty constitutes the "law(s) or rules of law" to which the parties agreed. By ratifying the ECT, Kazakhstan bound itself to abide by certain standards of conduct and to provide specific protections to foreign investors, including Claimants.[755] The legal standards reflected in the ECT comprise the *lex specialis* for this dispute.

425. More specifically, Article 26(6) of the ECT contains an express choice of law provision providing that the Tribunal "shall decide the issues in dispute in accordance with this Treaty and applicable rules and principles of international law."[756] Article 26(6) is the parties' expressly agreed choice of law for purposes of Article 22(1) of the SCC Rules. Accordingly, the Tribunal must apply the legal standards set forth in the ECT along with any applicable rules and principles of international law.

426. Kazakh domestic law simply has no role to play as a body of law to be applied by the Tribunal in judging the various issues before it. There is no agreement to apply Kazakh law, and there is no basis to do so under the ECT. At most, Kazakh law is relevant as a factual matter and provides factual context for some of the issues in dispute.[757] But it is irrelevant as a legal matter and may not displace the ECT and international law as the governing law agreed by the parties.

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[755] *See* Kazakhstan's Instrument of Ratification, October 18, 1995, C-542, where Kazakhstan committed to fulfill the ECT "rigorously and in good faith."

[756] ECT art. 26(6), C-1; Amkhan Opinion ¶¶ 35-36.

[757] *See* Amkhan Opinion ¶ 37. Even if Kazakh law were relevant as a legal matter – which it is not – the ECT has priority over national law under Kazakhstan's Constitution.

Article 4 of the Kazakh Constitution provides in relevant part:

1. The provisions of the Constitution, the laws corresponding to it, other regulatory legal acts, international treaty and other commitments of the Republic as well as regulatory resolutions of Constitutional Council and the Supreme Court of the Republic shall be the functioning law in the Republic of Kazakhstan. . . .

3. International treaties ratified by the Republic shall have priority over its laws and be directly implemented except in cases when the application of an international treaty shall require the promulgation of a law.

The Kazakh Constitution is available at: http://www.kazakhstan.orexca.com/kazakhstan_constitution.shtml (last visited on May 6, 2012), C-482.

B. The Role of Kazakh Law in the Current Dispute Is Limited

427. Furthermore, it is a well-founded principle that a state may not avoid liability under international law by relying upon its domestic law.[758] The primacy of international law over domestic law in the area of State responsibility is reflected in Article 27 of the Vienna Convention, which provides that "[a] party may not invoke the provisions of its internal law as justification for its failure to perform a treaty."[759] The rule is repeated in Article 3 of the International Law Commission's Articles on State Responsibility:

> The characterization of an act of a State as internationally wrongful is governed by international law. Such characterization is not affected by the characterization of the same act as lawful by internal law.[760]

428. A leading treatise on international law also makes the point explicitly:

> The law in this respect is well settled. A state cannot plead provisions of its own law or deficiencies in that law in answer to a claim against it for alleged breach of its obligations under international law.[761]

429. Professor Shaw explained this principle of international law as follows:

> The general rule with regard to the position of municipal law within the international sphere is that a state which has broken a stipulation of international law cannot justify itself by referring to its domestic legal situation. … The reasons for this inability to put forward internal rules as an excuse to evade international responsibility are obvious. Any other situation would permit international law to be evaded by the simple method of domestic legislation. . . . Accordingly, state practice and decided cases have established this provision and thereby prevented countries involved

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758 *See* Amkhan Opinion Section 3.2.

759 Vienna Convention art. 27, C-203.

760 International Law Commission Draft Articles on Responsibility of States for Internationally Wrongful Acts (hereinafter "ILC Articles"), art. 3 (adopted by the International Law Commission at its fifty-third session) (2001), C-160. International Law Commission's Articles on the Responsibility of States for Internationally Wrongful Acts, art. 3 and cmt. 8, Report of the International Law Commission, *reprinted in* [2001] II Y.B. Int'l. L. Comm'n. 26, 38, U.N. Doc. A/CN. 4/Ser. A/2001/Add.1 (hereinafter "ILC Articles & Commentary"), C-208.

761 Ian Brownlie, PRINCIPLES OF PUBLIC INTERNATIONAL LAW 34 (7th ed., Oxford University Press 2008), C-210. *See also* 1 OPPENHEIM'S INTERNATIONAL LAW 84-85 (Robert Jennings & Arthur Watts eds., 9th ed., Addison Wesley Longman Inc. 1996) (1905), C-543.

> in international litigation from pleading municipal law as a method of circumventing international law.[762]

430. International tribunals have routinely applied this rule.[763] For instance, in the *Treatment of Polish Nationals* case, the PCIJ observed:

> [A]ccording to generally accepted principles, a State cannot rely, as against another State, on the provisions of the latter's Constitution, but only on international law and international obligations duly accepted . . . [C]onversely, a State cannot adduce as against another State its own Constitution with a view to evading obligations incumbent upon it under international law or treaties in force.
>
> [T]he application of the Danzig Constitution may . . . result in the violation of an international obligation incumbent on Danzig towards Poland, whether under treaty stipulations or under general international law… However, in cases of such a nature, it is not the Constitution and other laws, as such, but the international obligation that gives rise to the responsibility of the Free City.[764]

431. Indeed, the ICJ, PCIJ, and arbitral tribunals alike have consistently held that provisions of municipal law cannot be invoked to evade a State's international obligations. In this regard, Sir Hersch Lauterpacht observed: "[T]he firmness with which the Court applied the 'generally accepted principle of international law' according to which the provisions of the municipal law of a State, including its Constitution, cannot prevail over its obligations under conventional or customary international law has been a frequent feature of its activity."[765]

432. Of particular relevance for the present case, investment treaty tribunals also have consistently rejected attempts by States to employ their municipal law to evade or defeat international treaty obligations.[766] For instance, in *SPP v. Egypt*, the Tribunal applied

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762 Malcolm N. Shaw, INTERNATIONAL LAW 124 (5th ed., Cambridge University Press 2003), C-211.

763 *See, e.g.*, *Case of the Free Zones of Upper Savoy and the District of Gex (Fr. v. Switz.)* Judgment, 1932 P.C.I.J. (ser. A/B) No. 46, at 167 (June 7) ("[I]t is certain that France cannot rely on her own legislation to limit the scope of her international obligations. . . ."), C-544; *Case Concerning Elettronica Sicula S.p.A. (ELSI)(U.S. v. It.)*, Judgment, 1989 I.C.J. Rep. 15, ¶¶ 73, 124 (July 20) (hereinafter "*ELSI* Judgment"), C-546.

764 *Treatment of Polish Nationals and Other Persons of Polish Origin or Speech in the Danzig Territory*, Advisory Opinion, 1932 P.C.I.J. (ser.A/B) No. 44, at 24-25 (Feb. 4), C-547.

765 Hersch Lauterpacht, THE DEVELOPMENT OF INTERNATIONAL LAW BY THE INTERNATIONAL COURT 332 (Grotius Publications Ltd. 1982), C-548.

766 *See*, *e.g.*, *Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentine Republic*, ICSID Case No. ARB/97/3, Decision on Annulment, July 3, 2002 (hereinafter "*Vivendi I* Decision on Annulment"), ¶¶ 102-

international law to reject Egypt's assertion that a particular decree and certain acts of its officials, upon which the claimants had relied, were invalid under Egyptian law.[767] The Tribunal found that Egypt's reliance on its domestic law for the purposes of determining its liability under international law was wholly misplaced:

> These Acts [of Egypt and its officials], which are now alleged to have been in violation of the Egyptian municipal legal system, created expectations protected by established principles of international law. A determination that these acts are null and void under municipal law would not resolve the ultimate question of liability for damages suffered by the victim who relied on the acts.[768]

433. In *Tecmed v. Mexico*, the Tribunal held that whether the disputed government measures were legal under Mexican law was irrelevant to the question of a treaty breach. After all, the Tribunal reasoned, the fact "[t]hat the actions of the Respondent are legitimate or lawful or in compliance with the law from the standpoint of the Respondent's domestic laws does not mean that they conform to [NAFTA] or to international law."[769] The *Tecmed* Tribunal concluded that "[a]n Act of State must be characterized as internationally wrongful if it constitutes a breach of an international obligation, even if the act does not contravene the State's internal law."[770]

434. In short, it is incontestable that a state may not invoke its domestic law to justify a violation of its international obligations. The Tribunal's task is to determine whether Kazakhstan violated the ECT and international law. Kazakhstan is not permitted to evade its international

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03, C-549; *Southern Pacific Properties (Middle East) Ltd. (SPP) v. Egypt*, ICSID Case No. ARB/84/3, Award, May 20, 1992 (hereinafter "*SPP* Award"), ¶¶ 81-85, 189, 207, C-550; *SGS Société Générale de Surveillance S.A. v. Pakistan*, ICSID Case No. ARB/01/13, Procedural Order No. 2, October 16, 2002, 18(1) ICSID Rev. – Foreign Inv. L.J. 293, 299-300 (2003) ("[A] State [cannot] plead its internal law in defence of an act that is inconsistent with its international obligations. Otherwise, a Contracting State could impede access to ICSID arbitration by operation of its own law.") (footnote omitted), C-551; *Wena Hotels, Ltd. v. Egypt*, ICSID Case No. ARB/98/4, Decision on Annulment, Feb. 5, 2002 (hereinafter "*Wena* Decision on Annulment"), 41 I.L.M. 933, 942, ¶ 50 (2002), C-552; *CMS Gas Transmission Co. v. Argentine Republic*, ICSID Case No. ARB/01/8, Award, May 12, 2005 (hereinafter "*CMS* Award"), ¶¶ 217, 222-25, C-65.

767 *SPP* Award ¶¶ 81-85, C-550.

768 *Id.* ¶ 83. *See Wena* Decision on Annulment ¶¶ 50, 53, C-552.

769 *Técnicas Medioambientales (Tecmed) S.A. v. Mexico*, ICSID Case No. ARB(AF)/00/2, Award, May 29, 2003 (hereinafter "*Tecmed* Award"), ¶ 120, C-209.

770 *Id.* ¶ 120 (citing James R. Crawford, THE INTERNATIONAL LAW COMMISSION'S ARTICLES ON STATE RESPONSIBILITY: INTRODUCTION, TEXT AND COMMENTARIES 84 (Cambridge University Press 2002)), C-209.

obligations to Claimants by contending that its subsoil use laws, its corporate laws, or any other domestic legal rule excused its conduct. If the Tribunal determines that Kazakhstan violated any of the substantive protections in the ECT or any applicable rule of international law, that is the end of the inquiry. No provision of Kazakh law may alter that conclusion.

435. At most, Kazakh law is relevant to this proceeding as a factual or contextual matter. As Sir Robert Jennings and Sir Artur Watts explained:

> From the standpoint of international law, a national law is generally regarded as a fact with reference to which rules of international law have to be applied, rather than as a rule to be applied on the international plane as a rule of law; and insofar as the International Court of Justice is called upon to express an opinion as to the effect of a rule of national law it will do so by treating the matter as a question of fact to be established as such rather than as a question of law to be decided by the court.[771]

436. International tribunals have consistently treated domestic law as a factual, rather than a legal matter.[772] In the *Polish Upper Silesia* case, the Permanent Court of International Justice observed that: "From the standpoint of International Law and the Court which is its organ, municipal laws are merely facts which express the will and constitute the activities of the States, in the same manner as do legal decisions or administrative measures."[773]

437. Contrary to Kazakhstan's contention in its Statement of Defense,[774] the choice-of-law clauses in the Subsoil Use Contracts do not alter this conclusion. These clauses are wholly irrelevant to the present dispute. Investment treaty case law is clear on this point.[775] For instance, the Annulment Committee in *Vivendi Universal v. Argentina* explained:

> [T]he Committee does not understand how, if there had been a breach of the BIT in the present case (a question of international

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[771] 1 OPPENHEIM'S INTERNATIONAL LAW 83 (Robert Jennings & Arthur Watts eds., 9th ed., Addison Wesley Longman Inc. 1996) (1905) (footnotes omitted),C-543.

[772] *See*, *e.g.*, *Texaco Overseas Petroleum Co. v. Libya*, Award, January 19, 1977 (hereinafter "*TOPCO* Award"), 17 I.L.M. 1, 26, ¶ 75 (1978) ("It is, indeed, a well-known principle that, with regard to international law, municipal law is a mere fact and that the act of a State which is irregular internationally cannot be affected by its legal character under municipal law within which the State acted."), C-553.

[773] *Case Concerning Certain German Interests in Polish Upper Silesia*, Judgment, 1926 P.C.I.J. (ser. A) No. 7, at 19 (May 25), C-554.

[774] Statement of Defense ¶¶ 10.8-10.9.

[775] *See* also Reply Memorial Section VI.F.

> law), the existence of [the choice-of-law provision] of the Concession Contract could have prevented its characterization as such. A state cannot rely on an exclusive jurisdiction clause in a contract to avoid the characterisation of its conduct as internationally unlawful under a treaty.[776]

438. Furthermore, even if the Tribunal were to consider the articles on applicable law of Contracts No. 305, 210, and 302 – which it should not – those articles would require the application of the ECT and international law:

> For the Contract as well as for other agreements signed on the basis of the Contract, the law of the State shall be applied, unless otherwise stated by international treaties to which the State is a party.[777]

439. Here the ECT states otherwise, and that is the end of the matter.[778]

C. Kazakhstan Cannot Justify Its Past Conduct Through "New" Arguments Under Kazakh Law

440. In its Statement of Defense, Kazakhstan does not only err by seeking to rely upon its domestic law excuse its Treaty breaches. It significantly compounds that error by relying on domestic legal arguments that it never made contemporaneously. Kazakh law is irrelevant as a governing law regardless, but it nevertheless bears noting that a substantial portion of Kazakhstan's arguments under its domestic law have been contrived for this proceeding. They were never raised contemporaneously. For instance, Kazakhstan presents new domestic legal arguments regarding:

- The alleged illegality of Claimants' investments in Kazakhstan, including the failure to timely register KPM's initial share issue, KPM's purported re-registration as a commercial company, the alleged lack of consents from the Licensing and Competent Authorities for transfers of shares; the "failure" to comply with the inexistent obligation to amend KPM's and

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[776] *Vivendi I* Decision on Annulment ¶¶ 103, 110, C-549. *See also Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentine Republic*, ICSID Case No. ARB/97/3, Award, August 20, 2007 (hereinafter "*Vivendi II* Award"), ¶ 7.3.10, C-253.

[777] Contract No. 305, art. 27.1, C-45; Contracts No. 210 and 302, art. 22.1, C-52 and C-53.

[778] *See* Prosper Weil, *The State, the Foreign Investor, and International Law: The No Longer Stormy Relationship of a Ménage à Trois,* 15(2) ICSID Rev.—Foreign Inv.L.J. 401, 411-12 (2000), C-555.

TNG's Subsoil Use Licenses, and the re-organization of KPM and TNG into LLPs;[779]

- Its assessment and imposition of improper export duties on KPM;[780]
- Its "reclassification" of segments of TNG's and KPM's field pipelines as "main" pipelines;[781]
- Its termination of the Subsoil Use Contracts on grounds that were never raised in July 2010.[782]

441. Needless to say, even if Kazakhstan were entitled to rely upon its domestic law to evade its Treaty obligations – which it most certainly is not – Kazakhstan would not be permitted to excuse its prior unlawful conduct by retroactively conjuring up new legal arguments that allegedly might have justified its prior conduct, but did not actually motivate its conduct at the relevant time.

442. The Tribunal in *Wena Hotels Ltd. v. Egypt* reached this exact conclusion.[783] Wena, a British company, had acquired long-term management leases on two hotel properties located in Cairo and Luxor. The lessor was the Egyptian Hotels Company ("EHC"), a state-owned company whose management was appointed and controlled by the Egyptian Ministry of Tourism. After disputes arose between Wena and EHC about their respective obligations under the leases, officials of the EHC seized both properties by force.[784]

443. Egypt's primary defense in the case was that its conduct was lawful because of Wena's alleged failure to comply with the lease agreements. Egypt reasoned that it could not have illegally expropriated the properties, because Wena had no contract rights to expropriate

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779 *See* Reply Memorial Section II.D.2.

780 *See* Reply Memorial Section III.B.2.

781 Kazakhstan acknowledged as much when it states in its Statement of Defense that it "restates and expands on the reasoning recorded in the judgment of the Kazakh court." *See* Statement of Defense ¶ 23.6. *See* Reply Memorial, Section III.C.1.

782 *See* Reply Memorial Section III.D.1.

783 *Wena Hotels Ltd. v. Egypt*, ICSID Case No. ARB/98/4, Award, December 8, 2000 (hereinafter "*Wena* Award"), 41 I.L.M. 896 (2002), C-216.

784 *Id.* ¶¶ 19, 28-50, C-216.

due to its failure to fulfill its obligations under the leases.[785] Egypt specifically argued that its seizures did not give rise to liability because it had been legally entitled to request the termination of the leases for default, even though it had not done so.[786] This is exactly the same "but we could have done it legally, even though we did not" argument that Kazakhstan makes in this proceeding by relying upon new arguments under its domestic law.

444. The *Wena* Tribunal rejected Egypt's attempt to retroactively excuse its seizures by arguing that Wena had failed to comply with the leases. Indeed, it refused to even rule on the question of which party had violated the leases, finding it unnecessary to resolve Wena's claims under the BIT.[787] The Tribunal then proceeded to determine that Egypt's seizures violated the expropriation, fair and equitable treatment, and full protection and security clauses of the UK-Egypt BIT.

445. Egypt subsequently made the Tribunal's refusal to reach a determination about whether Wena had existing rights under the leases at the time of seizure a prominent feature of its annulment application, arguing that the Tribunal had failed to state the reasons upon which its award was based in violation of Article 52(1)(e) of the ICSID Convention.[788] The *Wena* Annulment Committee rejected Egypt's claim.[789]

446. Similarly, in the *Siag v. Egypt* case, the tribunal rejected Egypt's novel attempts to retroactively justify its expropriation of Mr. Siag's investments under Egyptian law.[790] In 1989, Mr. Siag acquired a beachfront property in the Taba Region on the Sinai Peninsula and began development and construction of a tourist resort.[791] Starting in 1996, Egypt purported to expropriate Mr. Siag's property through two armed seizures and five governmental decrees.[792] In its decision on jurisdiction, the *Siag* tribunal held that Mr. Siag was not an Egyptian national

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785 *Id.* ¶ 19, C-216; *Wena* Decision on Annulment ¶ 84, C-552.

786 *Wena* Decision on Annulment ¶ 84, C-552.

787 *Wena* Award ¶ 19, C-216.

788 *Wena* Decision on Annulment ¶¶ 84-86, C-552.

789 *Wena* Decision on Annulment ¶¶ 84, 86, C-552.

790 *Siag v. Egypt,* ICSID Case No. ARB/05/15, Award, June 1, 2009 (hereinafter "*Siag* Award"), C-217.

791 *Id.* ¶¶ 18, 23-24, C-217.

792 *Id.* ¶¶ 33-84, C-217.

at all relevant times.[793] Egypt subsequently argued in the merits phase that since Mr. Siag had lost his Egyptian nationality, he was not entitled to own land in the Taba region pursuant to the Egyptian property laws, governing the ownership of land in the Sinai.[794] The tribunal rejected Egypt's argument on the basis that "Egypt may not invoke its municipal law to avoid liability for the unlawful expropriation."[795]

447. Egypt also argued that its expropriation was lawful because it was for the public purpose of exporting natural gas to Jordan.[796] The *Siag* tribunal rejected that argument since Egypt first expropriated the Property in 1996, but did not mention a "public purpose" until a presidential decree of 2002, some five years later.[797] The tribunal rejected each of Egypt's *ex post facto* arguments and found that "an illegal expropriation was carried out by Egypt, which may not be remedied by reference to Egyptian municipal law."[798]

448. Kazakhstan's new theories similarly ask the Tribunal to imagine that Kazakhstan had chosen to rely upon legal grounds that allegedly would have made its conduct legal under Kazakh domestic law, rather than adopt the outrageous and unlawful course of action that it actually employed. Beyond the fact that Kazakh domestic law cannot be used to excuse a Treaty breach, Kazakhstan's revisionist history is highly speculative and dubious. Kazakhstan has cited no principle of international law (and Claimants are aware of none) by which a State's blatantly unlawful conduct can be excused retroactively on the basis that the State supposedly could have accomplished the same end lawfully (but did not). The present Tribunal should refuse to entertain Kazakhstan's attempts to retroactively excuse its conduct. Whatever theories it now espouses, Kazakhstan cannot undo the fact that it blatantly violated the ECT and international law in its treatment of Claimants' investments.

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793 *Id.* ¶ 631, C-217.

794 *Id.* ¶ 484, C-217.

795 *Id.* ¶ 486, C-217.

796 *Id.* ¶ 429, C-217.

797 *Id.* ¶¶ 431-32, C-217.

798 *Id.* ¶ 487, C-217.

VI. KAZAKHSTAN VIOLATED ITS OBLIGATIONS UNDER THE ECT AND INTERNATIONAL LAW

A. Kazakhstan Directly Expropriated Claimants' Remaining Investments

449. As explained in Section III.D, *supra*, Kazakhstan directly expropriated Claimants' investments, including KPM's and TNG's contracts, their assets, and the rights with respect to those assets, in July 2010, when the Kazakhstan Prime Minister, the Minister of Oil and Gas, and the regional Governor arrived at KPM and TNG and publicly announced the unilateral termination of Claimants' Subsoil Use Contracts, Contract No. 302, and the transfer of KPM's and TNG's assets and operations into State control. In its Statement of Defense, Kazakhstan argues that Claimants' direct expropriation claim cannot succeed because (i) Claimants failed to pursue all available remedies; (ii) there was no formal transfer of title; and (iii) Kazakhstan's misconduct was actually a proper exercise of its regulatory powers. There is no merit to those arguments.

1. Claimants Were Not Required to Challenge Kazakhstan's Actions Under Local Law Before Commencing Arbitration

450. Kazakhstan contends "that an expropriation of contractual rights is not perfected unless an investor had the opportunity to address the host State's actions in a contractually agreed forum but did not do so."[799] Kazakhstan continues that "termination of a contract . . . does not amount to expropriation of the rights stemming from the contract as long as the loss of the rights is not . . . ultimately determined by the appropriate forum."[800] Kazakhstan concludes its argument as follows: "Thus, for all of the Claimants' contract-related claims, there was an effective remedy available. Instead of having KPM and TNG pursue this remedy, the Claimants . . . initiated the investment arbitration under the ECT."[801] Kazakhstan further argues that its "taking physical control of KPM's and TNG's assets" and operations "should have been addressed in the domestic courts which were open to Claimants."[802]

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[799] Statement of Defense ¶ 33.7.

[800] Statement of Defense ¶ 33.15.

[801] Statement of Defense ¶ 33.22.

[802] Statement of Defense ¶¶ 33.23 - 33.24.

451. Kazakhstan thus appears to argue that Claimants are precluded from bringing a claim of illegal expropriation under the ECT, as a result of Kazakhstan's unlawful contract terminations and taking of KPM's and TNG's assets and operations, unless or until KPM and TNG exhausted the dispute-resolution mechanisms available to them under their contracts and/or Claimants exhausted domestic remedies. Those arguments are wrong.

452. There is a fundamental distinction between Kazakhstan's obligations to Claimants as qualified "Investors" under the Treaty, including the duty not to expropriate Claimants' investments unlawfully, and Kazakhstan's obligations to KPM and TNG under the contracts, including the duty not to terminate those contracts in violation of the contracts' termination provisions or applicable law. The respective parties and causes of action are different in the two situations. In short, "[a] treaty cause of action is not the same as a contractual cause of action."[803] There would have been nothing preventing KPM and TNG, at least in a theoretical sense, from raising breach-of-contract claims against Kazakhstan while the Claimants commenced separate Treaty claims against Kazakhstan.[804] In fact, KPM and TNG have not lost the right to pursue their contract claims against Kazakhstan, and whether they did so at the time or do so in the future has no bearing on either Claimants' right to bring an expropriation claim under the Treaty or whether Kazakhstan's unlawful termination of the Subsoil Use Contracts and takeover of KPM and TNG amounted to a direct expropriation of Claimants' investments. Kazakhstan is mistakenly conflating two different types of legal claims, only one of which (Claimants' claims for Kazakhstan's breaches of the ECT) is before this Tribunal.

453. Furthermore, Kazakhstan appears to argue that the exhaustion of available remedies is a substantive, rather than jurisdictional, prerequisite to proving expropriation. The ECT contains no such requirement,[805] and investment arbitration case law affirms that no such requirement exists. In fact, one of the very decisions on which Kazakhstan relies, the *ad hoc* committee's annulment decision in *Helnan v. Egypt*, explicitly rejected any requirement to

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[803] *Helnan Int'l. Hotels A/S v. Egypt*, ICSID Case No. ARB/05/19, Decision on the Application for Annulment, June 14, 2010 (hereinafter "*Helnan* Decision on Annulment"), ¶ 63 (citing 1 OPPENHEIM'S INTERNATIONAL LAW 927 (Robert Jennings & Arthur Watts eds., 9th ed., Addison Wesley Longman Inc. 1996) (1905), C-543), C-556.

[804] Kazakhstan's own misconduct undermined that possibility, however, by seizing KPM and TNG and transferring their management to KazMunaiTeniz.

[805] *See* ECT art. 13, C-1.

pursue available remedies as an element of showing a Treaty breach. The *Helnan* Tribunal explained that to do so "would empty the development of investment arbitration of much of its force and effect, if, despite a clear intention of States parties not to require the pursuit of local remedies as a pre-condition to arbitration, such a requirement were to be read back in as part of the substantive cause of action."[806]

454. Similarly, Christoph Schreuer explains that

> [W]e should think twice before making the use of local remedies a constitutive element or substantive requirement of a violation of international standards.
>
> Further problems are likely to arise if it becomes generally accepted that local remedies must be attempted before international arbitration becomes available. For instance, it is unclear how such a requirement can be combined with a fork in the road provision in an applicable BIT.[807]

455. The ECT contains such a fork-in-the-road clause, which Kazakhstan has accepted.[808] Kazakhstan only consented to submit disputes under the ECT to international arbitration in cases where an investor had not already submitted the dispute for resolution "to the courts or administrative tribunals of the Contracting Party party to the dispute" or "in accordance with any applicable, previously agreed dispute settlement procedure."[809] Therefore, had Claimants (as opposed to KPM or TNG) decided to challenge Kazakhstan's direct expropriation of KPM and TNG before domestic courts, or had they otherwise brought this dispute before another available forum, they may have been precluded from bringing the present claim.[810] It is

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[806] *Helnan* Decision on Annulment ¶ 47, C-556. The Committee found that the arbitral tribunal's decision to the contrary amounted to a manifest excess of power.

[807] Christoph Schreuer, *Calvo's Grandchildren: The Return of Local Remedies in Investment Arbitration*, 4 Law & Prac. Int'l. Cts. & Trib. 1, 16, C-557.

[808] ECT art. 26, C-1.

[809] ECT arts. 26(2) and (3), Annex ID, C-1.

[810] Although Kazakhstan does not appear to suggest that Claimants are procedurally barred from raising their claims before they exhausted domestic remedies, it would not be able to avail itself of that argument either. For example, Newcombe and Paradell explain that "[o]ne of the significant procedural benefits of investor-state arbitration is that, under most IIAs, there is no need to exhaust local remedies." Andrew Newcombe & Luis Paradell, *Minimum Standard of Treatments*, *in* LAW AND PRACTICE OF INVESTMENT TREATIES: STANDARDS OF TREATMENT 233, 240 (Kluwer Law International 2009), C-558. Christoph Schreuer has been more direct, writing unequivocally that "[t]he exhaustion of local remedies is not a requirement of modern investment arbitration." Christoph Schreuer, *Calvo's Grandchildren: The Return of Local Remedies in Investment Arbitration*, 4 Law & Prac. Int'l. Cts. & Trib. 1, 16, C-557.

therefore particularly clear that no such requirement of exhausting available domestic remedies first can exist in the present case.

456. Moreover, Kazakhstan cannot argue that Claimants (or KPM or TNG for that matter) were required to submit breach of contract claims before domestic courts, because the contracts themselves preclude that option. Contracts No. 210 and 302 required that disputes be resolved as provided in the Kazakh Law on Foreign Investments.[811] That Law obliged the parties to *arbitrate* contract disputes *at the Stockholm Chamber of Commerce*.[812] Similarly, Contract No. 305 contained explicit dispute resolution provisions that mandated parties to submit disputes to the SCC.[813] Taking Kazakhstan's argument to its logical conclusion would mean that, in order for this Tribunal to determine whether unilateral termination of the contracts constitutes direct expropriation, KPM and TNG would first have to commence arbitration proceedings at the Stockholm Chamber of Commerce for another international tribunal to determine whether Kazakhstan's actions amount to a breach of contract under Kazakh law.[814] Such a two-step procedure would be absurd, and the cases to which Kazakhstan refers do not suggest otherwise.[815].

457. In any event, resort to local remedies, even if it could have occurred in the present case, would have been futile. The present case is not about a single "act of maladministration at the lowest level" amounting to expropriation, which a fair and impartial court system might be expected to remedy.[816] To the contrary, and as Kazakhstan itself explains:

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811 *See* Contracts No. 210 and 302, art.23.2, C-52 and C-53.

812 *See* Maiden Suleymenov, "Kazakh Oil and Gas Legislation and the Energy Charter Treaty," in OIL AND GAS LAW IN KAZAKHSTAN, Kluwer Law International (2004), C-336.

813 *See* Contract No. 305, art. 28.2, C-45.

814 Kazakhstan's argument that resort to other (domestic) remedies is warranted because "tribunals generally are less knowledgeable about domestic law than domestic courts" is, therefore, beside the point. Statement of Defense ¶ 33.15(c). Kazakhstan clearly preferred the SCC over its own courts when it entered into contracts with KPM and TNG.

815 *See, e.g.*, *Waste Management, Inc. v. Mexico*, ICSID Case No. ARB(AF)/00/3, Award, April 30, 2004 (hereinafter "*Waste Management* Award"), ¶¶ 174-75, C-234; *Parkerings-Compagniet AS v. Lithuania*, ICSID Case No. ARB/05/8, Award, September 11, 2007 (hereinafter "*Parkerings* Award"), ¶¶ 448-54, R-1; *Generation Ukraine, Inc. v. Ukraine*, ICSID Case No. ARB/00/9, Award, September 15, 2003 (hereinafter "*Generation Ukraine* Award"), ¶ 20.30, R-2.

816 Statement of Defense ¶ 33.15(b).

> The Republic sent notices to KPM and TNG on 21 July 2010, terminating Contracts 210 and 305 . . . ***The notices were based on order no 255 by the Ministry of Oil and Gas [which] had followed notification by the President of the Republic of Kazakhstan*** who had given an instruction that ceasing production at [KPM and TNG] . . . would have been impossible [because] they have a strategic importance for the region.[817]

458. Indeed, the Minister of Oil and Gas and the Prime Minister of Kazakhstan presided at Kazakhstan's public announcement that the contracts were terminated and that KPM's and TNG's assets, including the LPG Plant, were officially transferred to the State. Thus, the highest levels of Kazakhstan's government perpetuated the Treaty breach, and this was less than a year after Mr. Cornegruta and KPM had suffered an egregious denial of justice in Kazakhstan's court system. Claimants knew that no Kazakh court would overturn the expropriation ordered at the highest levels of Kazakhstan's government. Claimants therefore elected to bring this Treaty arbitration instead, as they were perfectly entitled to do as qualified investors under the ECT.

2. Kazakhstan Cannot Avoid a Finding of Expropriation Based on an Absence of Formal Transfer of Title

459. Kazakhstan further claims that no expropriation occurred because no formal transfer of title to the State took place.[818] It argues that formal transfer of title to the State or a third party nominated by the State is "the decisive element" for the Tribunal in finding a direct, as opposed to an indirect, expropriation.[819] That is wrong as a matter of law. As Claimants explained in their Statement of Claim, direct expropriation occurs whenever there is a compulsory transfer of title ***or*** an outright seizure of the property in question.[820] Here there is no dispute that Kazakhstan seized the property and assets of KPM and TNG. Consequently, Kazakhstan's convoluted explanations as to how it did not actually seize "title" to Claimants' investments are irrelevant.

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[817] Statement of Defense ¶ 31.129.

[818] Statement of Defense ¶¶ 34.2-34.8. Claimants dispute Kazakhstan's contention and note that, while irrelevant for purposes of expropriation under the ECT, Kazakhstan has not proved the present ownership of KPM and TNG and their assets under Kazakh law.

[819] Statement of Defense ¶¶ 34.3-34.4.

[820] Statement of Claim ¶ 250.

460. The *Santa Elena* case, on which Claimants rely for this (undisputed) principle of international law,[821] was cited with approval by the *Telnor v. Hungary* tribunal. It quoted the *Santa Elena* finding that "[t]here is ample authority for the proposition that a property has been expropriated when the effect of measures taken by the state has been to deprive the owner of ***title, possession, or access*** to the benefit and economic use of his property."[822] The *Metalclad* tribunal similarly found that expropriation includes "open, deliberate and acknowledged takings of property, ***such as outright seizure or formal or obligatory transfer of title*** in favour of the host State."[823] Likewise, the *Tecmed* tribunal explained, "[u]nder international law, [direct expropriation occurs] where the use or enjoyment of benefits related thereto is exacted or interfered with . . . ***even where legal ownership over the assets in question is not affected***. . . ."[824] Thus, there is no requirement that Kazakhstan must have received title to Claimants' investments in order for this Tribunal to find that a direct expropriation occurred.

461. Kazakhstan admits that Claimants' legal ownership of KPM and TNG and their assets *were* substantially affected and transferred to State control. It explains that "[u]pon termination of the Subsoil Use Contracts, the ownership rights of KPM and TNG automatically ceased to exist" and "the assets then had to be transferred to [State-owned KazMunaiGaz] so that they would be taken into trust management."[825] That alone is sufficient to establish expropriation. By Kazakhstan's own case, Claimants lost their contracts and all the assets of KPM and TNG. That is precisely the kind of taking the *Sempra* tribunal, on which Kazakhstan relies, had in mind when it held that a direct expropriation requires that "at least some essential component of the property right has been transferred to a different beneficiary."[826]

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821 It is, in fact, not true, as Kazakhstan contends, that the *Santa Elena* case was a case of indirect expropriation. It was clearly a case of direct expropriation. *See* Catherine Yannaca-Small, *'Indirect Expropriation' and the 'Right to Regulate' in International Investment Law* 15-16 (OECD Working Paper No. 2004/4, September 2004), C-559.

822 *Telenor Mobile Communications A.S. v. Hungary*, ICSID Case No. ARB/04/15, Award, September 13, 2006 (hereinafter "*Telenor* Award"), ¶ 65 (emphasis added), C-560.

823 *Metalclad Corp v. Mexico*, ICSID Case No. ARB(AF)/97/1, Award, August 30, 2000 (hereinafter "*Metalclad* Award"), ¶ 103 (emphasis added), C-226.

824 *Tecmed* Award ¶ 116 (emphasis added), C-209.

825 Statement of Defense ¶ 34.5.

826 Statement of Defense ¶ 34.3

3. Kazakhstan's Expropriation of Claimants' Assets Was Not a Proper Exercise of Its Regulatory Powers

462. In a final effort to avoid liability for directly expropriating Claimants' investments — including KPM's and TNG's contracts, subsoil rights, and property — Kazakhstan claims that the unilateral termination of the Subsoil Use Contracts and its takeover of the companies was merely a normal exercise of its regulatory powers.[827] That argument is fanciful. Kazakhstan's seizure of Claimants' investments was anything but a "normal" exercise of regulatory powers.

463. Kazakhstan claims that its expropriatory acts were regulatory because they were in accordance with its Subsoil Law of 2010, the purpose of which was "to balance the host State's legitimate interest in furthering the wealth and well-being of its population and the investors' legitimate interest in making a return on its investment."[828] Further, Kazakhstan contends that its regulatory powers under that Law require it to ensure that "investors [do not] take over the gas and oil production on a certain field forever but that production rights are tied to contracts which expire and have to be renegotiated regularly."[829]

464. Unilaterally terminating contracts and seizing rights and property are not the types of exercise of regulatory powers that normally exculpate a state from responsibility for harming investments protected by a treaty. *Prima facie* state measures comprising a lawful exercise of regulatory powers include taxation, trade restrictions, and/or measures of devaluation.[830] But the outright taking of rights and property from an investor and transferring it to a State company — even if on a "trust management" basis until a third subsoil user can be found — is altogether different from *regulating* an interest of the state.

465. Kazakhstan's actions, moreover, are completely at odds with its alleged interests as expressed in the Subsoil Use Law. By terminating the contracts and taking Claimants' investments, Kazakhstan did not "balance" Claimants' interest in seeing a return on their investments with Kazakhstan's interest in furthering its own wealth and well-being. That

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827 Statement of Defense ¶¶ 34.10 *et seq*.

828 Statement of Defense ¶ 34.12.

829 *Id*.

830 Ian Brownlie, PRINCIPLES OF PUBLIC INTERNATIONAL LAW 509 (6th ed., Oxford University Press 2003), C-561.

balance may have described the status quo ***before*** October 2008, when Claimants earned a return on their investment and Kazakhstan received tax revenues according to the framework agreed in the subsoil use contracts. After October 2008, however, there was no balance, as Kazakhstan progressively took everything and left Claimants with nothing. Moreover, Kazakhstan's actions had nothing to do with ensuring that Claimants' production rights were tied to contracts that expire. Claimants' production rights already were tied to contracts that expire, namely, the Subsoil Use Contracts, and those contracts had not expired. Kazakhstan's actions were aimed solely at expropriating the benefits of those production rights after Claimants had invested all the necessary time and money to make the fields productive.

466. Kazakhstan concludes its point by stating that "any actions under the Subsoil Law 2010 are thus regulatory in nature."[831] As described above, there is considerable doubt as to whether Kazakhstan's actions were in compliance with its Subsoil Law.[832] But in any event, Kazakhstan cannot merely point to its domestic law to "legalize" its expropriation by way of the "regulatory powers" doctrine, because Kazakhstan would still be required to compensate Claimants for such a taking.[833] As the U.S.-Iran Claims Tribunal stated:

> The Tribunal fully understands the reasons why the Respondent felt compelled to protect its interests through [its] transfer of management, and the Tribunal understands the financial, economic and social concerns that inspired the law pursuant to which it acted, but those reasons and concerns cannot relieve the Respondent of the obligation to compensate [the investor] for its loss.[834]

It is not disputed that Kazakhstan has paid no compensation to Claimants.

467. In sum, there can be no serious doubt that Kazakhstan directly expropriated Claimants' investments in July 2010. It issued formal notices to that effect, communicated the taking directly to Claimants' representatives, held a press conference at Claimants' property

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831 Statement of Defense ¶ 34.13.

832 *See* Section III.D, *supra*.

833 ECT art. 13, C-1.

834 *Phelps Dodge Corp. v. Iran*, Iran-U.S. Claims Tribunal Case No. 99, Award No. 217-99-2, March 19, 1986, 25 I.L.M. 619, ¶ 22 (1986) (quoting *Tippetts et al. v. TAMS-AFFA Consulting Engineers of Iran*, Iran-U.S. Claims Tribunal Case No. 7, Award No. 141-7-2, June 22, 1984 (hereinafter "*Tippetts* Award"), 6 Iran-U.S. Cl. Trib. Rep. 219, C-225), C-246.

announcing the takeover, admitted in its Statement of Defense that Claimants' assets were transferred into a State-managed "trust," and has not compensated Claimants. Thus, the Tribunal should have no trouble finding that those actions constitute an unlawful direct expropriation under the ECT and international law.

468. At the same time, it is critical to note that the direct expropriation of July 2010 was largely a formality, since Kazakhstan's misconduct from October 2008 onward had already amounted to an indirect expropriation of Claimants' investments. The July 2010 direct expropriation was only the final step in Kazakhstan's plan to take over Claimants' investments. That plan was decided upon and implemented as from October 2008. As discussed in the following sections, Kazakhstan is liable to Claimants for its October 2008—July 2010 campaign of indirect expropriation, as well as its failures during that period to provide the most constant protection and security to Claimants' investments, to treat Claimants' investments fairly and equitably, and not to impair Claimants' investments by arbitrary or unreasonable measures.

B. Kazakhstan Commenced a Campaign of Indirect Expropriation in October 2008

469. It is well-settled that a State can expropriate an investor's property indirectly, by depriving the investor of its rights or attributes of ownership, without physically seizing the property.[835] That is precisely what Kazakhstan accomplished as it carried out its October 2008 strategy to take over the assets and operations of KPM and TNG. Kazakhstan's defense in relation to Claimants' indirect expropriation case is two-fold. Kazakhstan claims that (i) again, its acts were merely an exercise of its regulatory powers; and (ii) Claimants were not deprived of their investments to an extent that warrants a finding of indirect expropriation.[836] The Tribunal should reject each of those contentions and hold that Kazakhstan's treatment of Claimants' investments over the October 2008-July 2010 period entailed an indirect expropriation.

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[835] *See, e.g.*, Statement of Claim, Section VII.A.

[836] Statement of Defense, Sections 33 and 35. To the extent that Kazakhstan also claims that exhaustion of local, or all available, remedies is a pre-requisite to a finding of indirect expropriation, Claimants vehemently disagree and refer the Tribunal to the previous section where that argument is addressed with respect to their direct expropriation claim.

1. Kazakhstan's Expropriatory Actions Were Not Regulatory in Nature

470. As with its direct expropriation of July 2010, Kazakhstan attempts to justify its expropriatory conduct over the October 2008-July 2010 period by claiming that its actions were a proper exercise of its regulatory powers.[837] That argument fails for the simple reason that Kazakhstan's actions amounting to an indirect expropriation during that period were not regulatory in nature. They did not stem from enactment of new laws or regulations or the legitimate enforcement of existing regulations, and they were not designed to maintain "public order, health, or morality."[838] Instead, they consisted of an egregious campaign of harassment and coercion designed to undermine and interfere with Claimants' management and control of KPM and TNG. The campaign involved a multitude of ministries led by the Financial Police, and it culminated in extraordinary denials of justice suffered by Mr. Cornegruta and KPM in the Kazakh courts. The campaign was carried out under an order from President Nazarbayev to investigate Mr. Stati. Far from being necessary to protect or promote a legitimate State interest, the Government's campaign intentionally interfered with Claimants' ability to manage, control, and dispose of their investments and was designed to force Claimants to sell KPM and TNG (or parts of the companies) to the State at bargain-basement prices.

471. As a result, the case law on which Kazakhstan relies in its Statement of Defense is inapposite, if not worlds removed from the case at hand. The cases cited by Kazakhstan concern states that took actual regulatory measures, which the respective complaining investors claimed were expropriatory, but which the respective tribunals found to be tied to a legitimate state interest. Thus, in *Tecmed*, Mexico refused to renew the claimants' landfill permit on environmental protection grounds, which the tribunal found to fall within the state's regulatory powers (but which the Tribunal nevertheless found to amount to expropriation).[839] Further, the *Glamis Gold* case involved application of the U.S.'s environmental protection laws, which were designed to promote public health and safety and therefore were proper regulatory measures;[840]

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837 Statement of Defense ¶¶ 35.11 *et seq*.

838 *See* Catherine Yannaca-Small, *'Indirect Expropriation' and the 'Right to Regulate' in International Investment Law* 7 (OECD Working Paper No. 2004/4, September 2004), C-559.

839 *Tecmed* Award ¶ 151, C-209.

840 *Glamis Gold, Ltd. v. United States,* UNCITRAL, Award, June 8, 2009 (hereinafter "*Glamis* Award"), ¶¶ 11, 731, 72, C-562.

the *Methanex* case dealt with a ban on the MTBE additive in gasoline, which was a necessary regulatory measure to maintain public health and safety;[841] and the *LG&E* tribunal found that a measure that has a social or general welfare purpose may be accepted when it proportionally addresses an established need.[842] Kazakhstan has not even articulated what public purpose was served by its complete devastation of Claimants' investments through its harassment campaign and denials of justice, much less demonstrated that its measures were necessary and proportional to achieve such a purpose.

472. Moreover, even if Kazakhstan could show a legitimate purpose for its so-called "regulatory" conduct, and that its conduct was necessary and proportional to achieving that purpose, Kazakhstan would still be required to pay compensation to Claimants for its expropriatory measures. As the *Santa Elena* tribunal held:

> Expropriatory environmental measures – no matter how laudable and beneficial to society as a whole – are in this respect, similar to any other expropriatory measures that a state may take in order to implement its policies: where property is expropriated, even for environmental purposes, whether domestic or international, the state's obligation to pay compensation remains.[843]

473. Thus, even if Kazakhstan's measures could be said to fall within the scope of normal, regulatory actions — which is vehemently denied — their devastating impact on Claimants' investments was to such a degree as to require compensation from Kazakhstan. Kazakhstan's failure to compensate Claimants alone establishes the unlawful nature of its indirect expropriation.

2. Kazakhstan Substantially Deprived Claimants of the Rights of Ownership of Their Investments

474. Kazakhstan also claims that it did not interfere with Claimants' investments to such a degree as to merit a finding of indirect expropriation.[844] It lists an unsubstantiated litany

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[841] *Methanex Corp. v. United States*, UNCITRAL, Final Award on Jurisdiction and Merits, August 3, 2005 (hereinafter "*Methanex* Award"), Part II, Chap. D, R-64.

[842] *LG&E Energy Corp. v. Argentine Republic*, ICSID Case No. ARB/02/1, Decision on Liability, October 3, 2006 (hereinafter "*LG&E* Decision on Liability"), ¶ 195, C-262.

[843] *Compañía del Desarrollo de Santa Elena, S.A. v. Costa Rica*, ICSID Case No. ARB/96/1, Final Award, February 17, 2000 (hereinafter "*Santa Elena* Award"), 39 I.L.M. 1317, 1328, ¶ 72 (2000), C-213.

[844] Statement of Defense ¶¶ 35.21 *et seq*.

of facts that it contends Claimants must prove to establish that an indirect expropriation took place.[845]

475. There is a generous amount of jurisprudence describing the kinds of acts that can amount to indirect expropriation, which is often defined as a substantial deprivation of the rights or attributes of ownership of an investment. The *PSEG v. Turkey* tribunal summarized examples of interference that constitute indirect expropriation. It said,

> [T]here must be some form of deprivation of the investor in the control of the investment, the management of day-to-day operations of the company, interfering in the administration, impeding the distribution of dividends, interfering in the appointment of officials and managers, or depriving the company of its property or control in total or in part.[846]

476. Those are precisely the forms of deprivation and impacts that resulted from Kazakhstan's mistreatment of KPM and TNG over the October 2008-July 2010 period. First, the Financial Police effectively commandeered KPM's and TNG's offices for months, from late October 2008 until March 2009, while they oversaw numerous inspections, intimidated employees, seized company documents, and prevented KPM's and TNG's personnel from carrying out their normal daily activities. Those inspections substantially interfered with the day-to-day management and operations of the companies.

477. Second, the arrest of KPM's General Director in April 2009, and the hunting of KPM's and TNG's other senior managers, deprived Claimants of their ability to manage their investments. Kazakhstan callously argues that the imprisonment of Mr. Cornegruta had no impact on the Claimants' ability to operate their companies. Despite the fact that the Kazakh court specifically found (as if such a fact were in doubt) that while Mr. Cornegruta was in jail he "could not fulfill any obligations related to the management of [KPM and TNG],"[847] his arrest and imprisonment also caused other high-level managers to flee the country. There is therefore

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[845] *See id*. In particular, Kazakhstan claims that Claimants must show the number of company employees; the kind of daily business each employee conducted; how much work Kazakhstan's specific requests required; how the requests were dealt with; and so on. There is no support for that claim.

[846] *PSEG Global Inc. v. Turkey*, ICSID Case No. ARB/02/5, Award, January 19, 2007 (hereinafter "*PSEG* Award"), ¶ 278, C-261.

[847] Order on Refusal to Satisfy Defender's Request, May 8, 2009, C-563.

no question that Kazakhstan substantially interfered with Claimants' ability to manage KPM and TNG.

478. Third, as discussed in Section III, *supra*, the cumulative effect of Kazakhstan's harassment campaign, including its refusal to execute its previously agreed extension of Contract No. 302, deprived Claimants of their ability to prove their reserves. Fourth, Kazakhstan's arbitrary reversal of its pre-emptive rights waiver, as well as its false announcements of "irregularities" at the companies and its later seizures of KPM's and TNG's assets, deprived Claimants of their ability to dispose of their investments.[848]

479. Investment tribunals have routinely found that substantial interference with an investor's ability to manage its investment entails indirect expropriation. For instance, there have been several treaty cases in which directors or managers were physically prevented from holding management positions in local companies, either because they fled from baseless criminal charges or were in fact arrested. The tribunals in those cases did not hesitate to conclude that the state's conduct amounted to expropriation.[849]

480. Each of the effects mentioned above materialized within six months of President Nazarbayev's October 14, 2008, order to investigate Claimants' companies. Kazakhstan argues now, in its Statement of Defense, that "it was the Claimants' own fault that the authorities started investigations" because "KPM and TNG repeatedly broke Kazakh law."[850] But Kazakhstan had never raised <u>any</u> allegation that KPM or TNG had violated the law before that date, and the companies had operated in Kazakhstan for years. The investigations were clearly nothing more than a pretext for Kazakhstan to conjure some ground on which it could prosecute Claimants' companies and ultimately gain control over them. Kazakhstan invented those grounds as early as November 2008, when the Financial Police reclassified the pipelines and ordered calculation of

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[848] *See* generally Reply Memorial Section IV.B.2. Specifically, Kazakhstan's refusal to waive its pre-emptive rights to KPM and TNG, coupled with its refusal to match the offers for sale that Claimants had received from third parties, prevented Claimants from selling their investments. Kazakhstan further undermined Claimants' ability to market their investments by assessing unfounded tax measures in excess of US$ 70 million, embroiling the companies in protracted litigation, and by refusing to execute its previously-agreed extension of Contract No. 302.

[849] *See, e.g.*, *Benvenuti & Bonfant v. Congo*, ICSID Case No. ARB/77/2, Award, August 8, 1980 (hereinafter "*Benvenuti* Award"), 21 I.L.M. 740, 758 ¶¶ 4.56-4.65 (1982), C-564; *Biwater Gauff (Tanzania) Ltd. v. Tanzania*, ICSID Case No. ARB/05/22, Award, July 24, 2008 (hereinafter "*Biwater* Award"), ¶¶ 503-20, C-270.

[850] Statement of Defense ¶ 35.14.

KPM's "illegal" profits (*i.e.*, all of its revenues over the previous several years). There should be no question that Kazakhstan's actions, which were carried out in bad faith, amount to indirect expropriation under the ECT and international law.

C. Kazakhstan Failed to Provide the Most Constant Protection and Security to Claimants' Investments

481. Kazakhstan misconstrues the "most constant protection and security" standard contained in Article 10(1) of the ECT in claiming that it has not breached that standard.[851] Kazakhstan's response to this claim amounts to three simple objections, which can be readily dismissed. First, Kazakhstan states that violation of the most constant protection and security provision should only be found in instances where the physical security of an investor or investment is at issue.[852] Second, Kazakhstan claims that because legal security is more appropriately dealt with under other treaty standards, especially the fair and equitable treatment protection, it should not be separately included in the most constant protection and security standard.[853] Third, Kazakhstan argues that this standard of protection only "obligates the host State to diligently implement reasonable mechanisms of protection" and "is not concerned with specific acts of the host State."[854] Each of those contentions is wrong.

482. First, while the "most constant protection and security" standard at one time was invoked for failure to provide physical protection to an investment, the standard today clearly encompasses legal security.[855] A number of investment treaty tribunals in recent years have applied the standard to the "legal" protection and security of an investment.[856] The Tribunal in *Biwater Gauff v. Tanzania*, approving the interpretation of the *Azurix v. Argentina* Tribunal, addressed this issue specifically. It explained:

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[851] ECT art. 10(1), C-1. *See* Statement of Defense ¶¶ 36.1-36.15.

[852] Statement of Defense ¶ 36.9.

[853] Statement of Defense ¶ 36.11.

[854] Statement of Defense ¶ 36.3.

[855] Statement of Claim ¶¶ 319-28 (and the cases cited therein).

[856] *See, e.g.*, *CME Czech Republic B.V. (Netherlands) v. Czech Republic*, UNCITRAL, Partial Award, September 13, 2001 (hereinafter "*CME* Partial Award"), ¶ 613, C-229; *Azurix Corp. v. Argentine Republic*, ICSID Case No. ARB/01/12, Award, July 14, 2006 (hereinafter "*Azurix* Award"), ¶ 408, C-245; *Biwater* Award ¶ 729, C-270; *Siemens A.G. v. Argentine Republic*, ICSID Case No. ARB/02/08, Award, February 6, 2007 (hereinafter "*Siemens* Award"), ¶ 303, C-232 ; *National Grid P.L.C. v. Argentine Republic*, UNCITRAL, Award, November 3, 2008 (hereinafter "*National Grid* Award"), ¶ 187, C-269; *Vivendi II* Award, ¶¶ 7.4.15-7.4.17, C-253.

> [T]he content of the standard may extend to matters other than physical security. It implies a State's guarantee of stability in a secure environment, both physical, commercial and legal. It would in the Arbitral Tribunal's view be unduly artificial to confine the notion of "full security" only to one aspect of security, particularly in light of the use of this term in a BIT, directed at the protection of commercial and financial investments.[857]

Thus, there is no basis for Kazakhstan to claim that this measure of protection is limited to physical security.

483. That the standard includes legal security and protection is particularly evident in cases like the present where the investment includes intangible assets. As the Tribunal in *Siemens v. Argentina* stated:

> As a general matter and based on the definition of investment, which includes tangible and intangible assets, the Tribunal considers that the obligation to provide full protection and security is wider than "physical" protection and security. It is difficult to understand how the physical security of an intangible asset would be achieved.[858]

Likewise, the Tribunal in *National Grid v. Argentina* found that "in the context of the protection of investments broadly defined to include intangible assets, the Tribunal finds no rationale for limiting the application of a substantive protection of the Treaty to a category of assets — physical assets — when it was not restricted in that fashion by the Contracting Parties."[859]

484. The Tribunal in *Vivendi II* noted that: "Such actions or measures need not threaten physical possession or the legally protected terms of operation of the investment."[860] Many tribunals have thus accepted that the principle extends to other forms of protection and security, including legal protection.

485. In any event, Kazakhstan's antiquated understanding of the protection and security standard would not be dispositive of this claim, even if that understanding were correct. In addition to failing to provide legal security, Kazakhstan failed to provide physical protection

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857 *Biwater* Award ¶ 729, C-270.

858 *Siemens* Award ¶ 303, C-232.

859 *National Grid* Award ¶ 187, C-269.

860 *Vivendi II* Award ¶ 7.4.15, C-253.

and security to Claimants' investments. Kazakhstan's callous arrest of Mr. Cornegruta, its attempts to arrest the other senior in-country managers of KPM and TNG, and its harassment of company staff during its investigations clearly undermined the physical security of Claimants' investments and rendered them an unsafe place to work. Additionally, Kazakhstan's outright physical seizure of KPM and TNG in July 2010 amounts to a breach of its duty to provide both physical and legal protection and security.

486. Kazakhstan next contends that if the obligation to ensure the most constant protection and security were to extend to legal protection and security of investments, it would have no content separate from other ECT obligations, in particular the obligation to provide fair and equitable treatment.[861] Kazakhstan cites no authority for that proposition,[862] and its contention ignores the findings of the tribunals discussed above which have recognized the obligation as separate from that of fair and equitable treatment and other treaty standards.

487. Whether or not the facts that give rise to violations of the most constant protection and security provision can, in some cases, also give rise to violations of other ECT provisions does not mean that an analysis of one claim "obviates" the need to consider the other. Because the ECT explicitly provides for most constant protection and security in addition to other substantive protections, the standard requires separate consideration and determination. The Tribunal should decline Kazakhstan's invitation to ignore an express standard of protection found in the ECT.

488. Third, Kazakhstan submits that the obligation to ensure the most constant protection and security merely requires a host state to "diligently implement reasonable mechanisms of protection"[863] and that Kazakhstan "provided sufficient mechanisms of protection."[864] Kazakhstan's interpretation is wrong. It effectively conflates the "most constant protection and security" standard with the obligation to provide effective means to assert claims and enforce rights under Article 10(12) of the ECT. In making this argument, Kazakhstan also conveniently overlooks the fact that it was the instigator and perpetrator of the violations.

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861 Statement of Defense ¶ 36.11.

862 Statement of Defense ¶ 36.11.

863 Statement of Defense ¶¶ 36.3; 36.6.

864 Statement of Defense ¶ 36.12.

489. Kazakhstan cites three cases to support its argument that the obligation to ensure the most constant protection and security is one of mere diligence or vigilance of the host State.[865] However, the issue arose in those three cases because the respective tribunals needed to determine whether the acts in question were attributable to the host state and whether the state could have protected claimants.[866] In the present case, Kazakhstan does not — and cannot — dispute that the misconduct complained of was perpetrated by Kazakhstan. There is no issue of state attribution in this case. As the Tribunal in *Wena v. Egypt* concluded, where the host State is itself the instigator or a participant in the violations, there is "no question" that the obligation was breached.[867] As it is Kazakhstan itself that instigated and carried out the breach of the ECT's most constant protection and security standard, it is not relevant that the standard might also import a due diligence standard in respect of the conduct of others.

490. Kazakhstan next contends that Claimants have not attempted to show that Kazakhstan has failed to provide reasonable mechanisms of protection and that the facts put forward by Claimants are "completely disconnected from Claimants' own legal understanding of the guarantee."[868] These assertions are flatly contradicted by the facts of this case.

491. The scheme orchestrated by the President of Kazakhstan, other senior Government officials, and the Financial Police was carried out by officials, judges, and law enforcement and other agencies who, in violation of their duties and contrary to Kazakh and international law, conducted a campaign of harassment and coercion against Claimants from October 2008 until July 2010.

492. As set forth in Section III.A, *supra*, the pretext for Kazakhstan's conduct was a letter from President Voronin to President Nazarbayev that provided the justification for

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865 Statement of Defense ¶¶ 36.4-36.5; *Asian Agricultural Products Ltd. (AAPL) v. Sri Lanka*, ICSID Case No. ARB/87/3, Final Award, June 27, 1990 (hereinafter "*AAPL* Award"), ¶ 77, C-255; *American Manufacturing and Trading, Inc. v. Zaire*, ICSID Case No. ARB/93/1, Award, February 21, 1997 (hereinafter "*American Manufacturing* Award"), 36 I.L.M. 1534, 1548-49, ¶ 6.05 (1997), C-256; *Noble Ventures, Inc. v. Romania*, ICSID Case No. ARB/01/11, Award, October 12, 2005 (hereinafter "*Noble Ventures* Award"), ¶ 166, R-66.

866 *AAPL* Award ¶¶ 77-86, C-255; *American Manufacturing* Award ¶¶ 6.05-6.11, C-256; *Noble Ventures* Award ¶¶ 160-162, R-66.

867 *Wena* Award ¶ 84, C-216.

868 Statement of Defense ¶¶ 36.12, 36.6.

Kazakhstan's actions. President Nazarbayev seized upon the opportunity and ordered Kazakhstan's State organs to effectively destroy Claimants' investments in Kazakhstan.

493. In terms of physical security, Kazakhstan arrested and incarcerated Mr. Cornegruta, the general manager of KPM, on trumped-up criminal charges. The court decisions that sentenced Mr. Cornegruta to four years in jail and fined KPM in excess of US$ 145 million were entirely unfounded and unlawful because the provisions of Kazakh law relied on by the Kazakh courts did not, and could not, justify the reclassification of KPM's 18-km pipeline as a main pipeline. The ridiculous calculation of KPM's allegedly enormous "profits," and the sentencing of KPM — a non-party to the criminal trial – were further travesties of justice. Kazakhstan relied on the same frivolous legal grounds to initiate criminal actions against four other general managers of KPM and TNG and threaten their arrest. Those four general managers had no choice but to flee the country. Kazakhstan also summoned, interrogated, and threatened a number of Claimants' key in-country personnel, based on the same manufactured allegations. Respondent also conducted searches and raids of KPM's and TNG's offices, all in clear violation of the most constant protection and security standard.

494. Furthermore, the Kazakh courts, the Prosecutor's Office, the Financial Police, and numerous Government officials rejected Claimants' repeated protests, requests for assistance, lawsuits, and appeals filed by Claimants, KPM, TNG, and Mr. Cornegruta.[869] From the President of Kazakhstan to the Financial Police, from the Governor of the Mangystau Region to the MEMR (and its successor, the MOG), Kazakhstan colluded to deprive Claimants of their investments.

495. Those State organs, including the courts, the central Government, and local authorities, acting in blatant violation of Kazakh law and international law, also harassed and coerced Claimants by requesting payment of debilitating taxes and custom duties that were never due, by refusing to extend the exploration period of the Contract 302 Properties, and by reversing the State's prior waiver of its pre-emptive right for the transfer of TNG to Terra Raf.

[869] *See* Statement of Claim ¶ 332.

496. All of this conduct clearly violated the ECT's most constant protection and security standard, and the Tribunal should readily conclude that Kazakhstan is liable to Claimants for breaching that standard.

D. Kazakhstan Failed to Provide Claimants' Investments with Fair and Equitable Treatment

497. In its Statement of Defense, Kazakhstan contends that it did not breach the ECT's fair and equitable treatment standard because Claimants failed to pursue all available remedies before commencing arbitration and, in any event, none of Kazakhstan's actions were unfair or inequitable. Kazakhstan's first contention is wrong as a matter of law, and its second contention is difficult to take seriously. Kazakhstan's treatment of Claimants' investments in the October 2008-July 2010 period is a paradigm case of a host state failing to afford fair and equitable treatment. As with indirect expropriation and most constant protection and security, Kazakhstan should be held liable to Claimants as from October 2008 for failing to provide fair and equitable treatment to Claimants' investments.

1. Claimants Were Not Required to Exhaust Domestic Remedies Before Commencing Arbitration

498. Kazakhstan quotes the *Helnan v. Egypt* case out of context to support its argument that Claimants' fair and equitable treatment claim "must fail" because Claimants did not pursue all available remedies.[870] But there is no exhaustion of local remedies requirement in applying the fair and equitable treatment standard. Kazakhstan is simply wrong as a matter of law. In fact, the *Helnan* Annulment Committee expressly annulled the part of the arbitral decision that had taken the view Kazakhstan wants this Tribunal to adopt. It explained:

> In numerous ICSID cases, tribunals have rendered awards in favour of the claimants as a result of administrative decisions, in which no such application to the local courts had been made. Of course, a claimant's prospects of success in pursuing a treaty claim based on the decision of an inferior official or court, which had not been challenged through an available appeal process, should be lower, since the tribunal must in any event be satisfied that the failure is one which displays insufficiency in the system, justifying international intervention. ***But that is a very different matter to imposing a requirement on the claimant to pursue local remedies***

[870] Statement of Defense ¶¶ 37.4, 37.11.

> ***before there can be said to have been a failure to provide fair and equitable treatment***.[871]

499. As the *Helnan* Annulment Committee correctly observed, whether or not a Claimant pursued domestic remedies can be, in certain instances, one factor in determining whether a Government's treatment of an investor was fair – such as when a host state afforded an opportunity to appeal an administrative decision, but the investor did not avail itself of the opportunity. But that is markedly different from requiring an investor to exhaust domestic remedies as a matter of course before it can assert a fair and equitable treatment claim. There is no such exhaustion requirement in international law or investment treaty practice.

500. Furthermore, even if there were such a requirement, it would certainly not be applied in a case such as the present where further pursuit of domestic remedies would have been futile. International law does not require the pursuit of domestic remedies (in any context) when doing so would amount to a pointless exercise.

2. Kazakhstan Treated Claimants Unfairly and Inequitably

501. Kazakhstan's assertion that its treatment of Claimants' investments was not "unfair" or "inequitable" is farcical. As the distinguished members of this Tribunal are undoubtedly aware, fair and equitable treatment has become one of the dominant standards of investment treaty law in recent years. Literally dozens of treaty tribunals have found violations of the standard in cases where the host state's mistreatment of an investment was markedly less severe that Kazakhstan's mistreatment of Claimants' investments over the period from October 2008 to July 2010. Suffice it to say that Kazakhstan's conduct falls well within the scope of a standard that has been held to include the following types of state misconduct:

- Actions that violate an investor's legitimate expectations in relation to the investment;[872]

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[871] *Helnan* Decision on Annulment ¶ 48 (emphasis added), C-556. Kazakhstan neglected to include the first and third sentence of that paragraph from the Helnan decision in its Statement of Defense. Kazakhstan's reliance on *Parkerings* is also misplaced, because that tribunal was discussing the difference between a mere breach of contract and a breach of the treaty. *Parkerings* Award ¶¶ 316 *et seq*, R-1. Here, Claimants contend that many actions by Kazakhstan amount to unfair and inequitable treatment that were not necessarily breaches of contract. For those acts that did breach the Subsoil Use Contracts - *i.e.*, the unilateral termination in July 2010 - KPM and TNG were prevented from pursuing arbitration to contest those measures because they themselves were expropriated. *See* discussion in Section VI.A, *supra*.

[872] *See*, *e.g.*, Dolzer & Schreuer, at 146 (2008), C-219; *Rumeli* Award ¶ 609, C-236; *Occidental Exploration and*

- Conduct that creates an unstable or unpredictable legal framework or business environment for the investment;[873]

- Conduct that violates due process[874] or results in a "denial of justice,"[875] including (but not limited to) improper judicial or administrative proceedings as well as governmental interference in such proceedings;[876]

- Interference with a contractual relationship;[877]

- Actions that treat an investor or an investment inconsistently,[878] ambiguously, or with a lack of transparency;[879]

Production Company v. The Republic of Ecuador, LCIA Case No. UN3467, Final Award of July 1, 2004 ¶¶ 183-185 ("*Occidental* Award"), C-233; *CME* Partial Award ¶ 611, C-229; *CMS Gas Transmission Co. v. The Argentine Republic*, ICSID Case No. ARB/01/8, Award, May 22, 2005 ¶¶ 274-76 ("*CMS* Award"), C-65; *Azurix* Award, ¶ 372, C-245; *PSEG* Award ¶ 240, C-261; *Saluka* Partial Award ¶ 301-03, C-259; *MTD* Award ¶¶ 113-15, C-258; *Eureko* Partial Award ¶ 235 C-260; *Metalclad* Award ¶ 85, C-226; *Waste Management, Inc. v. Mexico*, ICSID Case No. ARB(AF)/00/3 (NAFTA), Award, April 30, 2004 ("*Waste Management* Award"), C-234; *LG&E* Decision on Liability ¶¶ 124-25 C-262; *Enron* Award ¶¶ 259-60, 262, C-263; *Sempra v. Argentina*, ICSID Case No. ARB/02/16, Award, September 28, 2007, ("*Sempra* Award") ¶¶ 298-300, C-265; *Thunderbird v. Mexico* (UNCITRAL-NAFTA), Final Award, January 26, 2006 ¶ 147, C-266 ("*Thunderbid* Award"); *Siemens* Award ¶¶ 297-99, C-232; *ADC* Award ¶¶ 423-25, 445 C-206; *Bogdanov et al. v. Moldova*, SCC Case Award, September 22, 2005 ¶ 72 C-267; *BG Group Plc v. Argentina*, UNCITRAL, Award, December 24, 2007 ¶¶ 294-300 ("*BG* Award"), C-268; *National Grid v. Argentine Republic*, UNCITRAL, Nov. 3, 2008 ¶ 179, Award, C-269; *Siag v. Egypt*, ICSID Case No. ARB/05/15, Award, June 1, 2009 ¶ 450, C-217; *Biwater Gauff v. Tanzania*, ICSID Case No. ARB/05/22, Award, July 24, 2008 ¶ 602 (internal citations omitted) ¶ 615 ("*Biwater* Award"), C-270; *Suez and others v. Argentina*, Decision on Liability, ICSID Case No ARB/03/17, July 30, 2010 ¶ 203 ("*Suez* Decision on Liability"), C-271. *Tecmed* Award ¶ 154, C-209.

873 *See LG&E* Decision on Liability ¶¶ 127-131 ("the fair and equitable treatment standard consists of the host state's consistent and transparent behaviour, free of ambiguity that involves the obligation to grant and maintain a stable and predictable legal framework necessary to fulfill the justified expectations of the foreign investor."), C-262. Notably, the *Occidental v. Ecuador* tribunal, in finding a breach of the FET standard, emphasized that "stability of the legal and business framework is . . . an essential element of fair and equitable treatment." *Occidental* Award, ¶ 190-1, C-233; *see also Saluka* Award, ¶¶ 301-303, C-259.

874 Dolzer & Schreuer, C-219; *see also*, *Tecmed* Award, ¶¶ 153, 174, C-209 (stating that "It is understood that the fair and equitable treatment principle included in international agreements for the protection of foreign investments expresses '. . . the international law requirements of due process, economic rights, obligations of good faith and natural justice.'").

875 Harvard Research, Art. 9 (1929), reported in American Journal of International Law, April 1929, C-272. *See also*, Alvyn Freeman, "The International Responsibility of States for Denial of Justice", (Kraus Reprint Co. 1970), at 252, C-273; *Vivendi II* Award, ¶7.4.11, C-253; *Vivendi* Award, ¶ 80, C-241 (finding that the standard would be violated if Claimants were denied access to pursue remedies in court, were treated unfairly in court, or if the judgments were substantively unfair); *Waste Management* Award, ¶ 98, C-234; *Mondev International Ltd. v USA*, ICSID Case No. ARB(AF)/99/2, Award of October 11, 2002, ¶ 127 C-274; *Loewen Group, Inc., and Raymond L. Loewen v. US*, ICSID Case No. ARB(AF)/98/3, Award of June 26, 2003, ¶ 132, C-275.

876 *Petrobart* Award, C-204 (stating that "Government intervention in judicial proceedings is not in conformity with the rule of law in a democratic society").

877 *Alpha* Award, ¶¶ 420 and 422, C-207; *see also*, *Eureko* Partial Award ¶ 132, C-260; *Suez* Decision on Liability, ¶¶ 203, 231 C-271; *Rumeli* Award, ¶ 615, C-236.

- Failure to sufficiently notify an investor in advance of impending acts that will impact the investment;[880]
- Actions that are discriminatory;[881]
- Harassment or coercive conduct;[882] and
- Conduct that is in bad faith.[883]

502. In many cases in which tribunals have found a violation of the fair and equitable treatment standard, the host state in question only engaged in one or two of the foregoing forms of misconduct, and often in a fairly routine sort of way (such as by unexpectedly altering the legal or regulatory framework applicable to an investment). In this case, Kazakhstan violated the fair and equitable treatment standard in nearly every manner that has been articulated in case law to date, and its violations were severe, if not exceptional.

503. Claimants trust that the myriad ways in which Kazakhstan violated the fair and equitable treatment provision of the ECT are clear and that a brief summary of those violations will suffice.

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878 *MTD Equity Sdn Bhd. v. Chile* Award ¶¶ 53-57, 80, 165, C-258 (concluding that the FET standard was breached because "two arms of the same Government" had acted inconsistently toward the same investor, and noting that the host state "has an obligation to act coherently and apply its policies consistently, independently of how diligent an investor is.").

879 *See, e.g.*, *Tecmed* Award, ¶¶ 172-174, C-209; *Saluka* Partial Award, ¶¶ 420-423, C-259 ("The Czech Government's exchange of views with Saluka/Nomura and IPB on possible solutions for IPB also lacked sufficient transparency to allow Saluka/Nomura and IPB to understand exactly what the Government's preconditions for an acceptable solution were… . The Government failed to respond in any constructive way."); *see also* UNCTAD, *Fair and Equitable Treatment*, UNCTAD Series on Issues in International Investment Agreements at 51 (United Nations 1999) (references omitted), C-276.

880 *Metalclad* Award, ¶ 91, C-226; *see also Middle East Cement* Award, ¶143, C-228 (the case involved Egypt's failure to notify the claimant of the auction of a ship it owned. The Tribunal held that although Egypt had satisfied the notice had satisfied the notice provisions under domestic law, Egypt violated the fair and equitable treatment requirement because "a matter as important as the seizure and auctioning of a ship of the Claimant should have been notified by a direct communication"); *Tecmed* Award, ¶ 162, C-209.

881 *Waste Management* Award, ¶ 98, C-234; *MTD* Award, ¶ 109, C-258; *see also Eureko* Partial Award, ¶¶ 36-41, C-260.

882 *Vivendi II* Award, ¶¶ 7.4.37 and 7.4.39, C-253; *LG&E* Decision on Liability, ¶¶ 39 and 68, C-262; *Enron* Award, ¶ 266, C-263; *Suez* Decision on Liability, C-271; *Pope & Talbot* Interim Award ¶ 181, C-244.

883 *See*, *e.g.*, *Waste Management* Award ¶ 138, C-234; *Saluka* Partial Award ¶ 407, C-259; *Tecmed* Award, ¶ 124, C-209; Dolzer & Schreuer, at 146, C-219; *Siag* Award ¶ 450, C-217 ("The general, if not cardinal, principle of customary international law that States must act in good faith is thus a useful yardstick by which to measure the Fair and Equitable standard."); *CMS* Award ¶ 280, C-65; *Vivendi II* Award ¶ 7.4.12, C-253; *LG&E* Decision on Liability ¶ 129, C-262; *Azurix* Award ¶ 372, C-245; *Enron* Award ¶ 263, C-263; *BG* Award ¶ 301, C-268; *Siemens* Award ¶¶ 293-300, C-232; and *Occidental* Award ¶ 186, C-233.

Re-Classification of Field Pipelines as Trunk Pipelines

504. Kazakhstan argues that its re-classification of KPM's and TNG's field pipelines as trunk pipelines does not amount to a breach of the fair and equitable treatment provision because "the competent officials, *i.e.*, the Financial Police and the courts" found that the pipelines were trunk pipelines under the law, and it "at all times" treated Claimants "even-handedly."[884] The facts show the exact opposite.

505. First, the Financial Police were not a "competent authority" to determine whether the pipelines in question were field or trunk pipelines, and the court abused its authority in making this determination because it simply adopted the Financial Police's conclusion, while ignoring all contrary expert evidence.[885] In any event, Kazakhstan's approach to the pipelines amounts to inconsistent treatment that also lacked transparency, which are two hallmarks of a breach of the fair and equitable treatment standard. The MEMR (now MOG) approved the pipelines for operation as field pipelines, issued licenses for the production of oil and gas that permitted their use for that purpose, and allowed Claimants to operate KPM and TNG without any complaint from 2002 until late 2008. No changes occurred to the pipelines themselves, the manner of their operation, or even the applicable legislation that would have "converted" the field pipelines into trunk pipelines during that period. Yet, after Nazarbayev's order in October 2008, Kazakhstan suddenly "discovered" that the very same pipelines were in fact "trunk" pipelines. The Financial Police conjured that sudden "discovery," and Kazakhstan's courts gave it its intended impact through proceedings that amounted to egregious denials of justice.

506. Kazakhstan now claims that "all of [KPM's and TNG's] previous licenses were simply not sufficient for the type of pipeline the Claimants [were] operating."[886] That claim is preposterous. And even if it were correct — which it is decidedly not — it would simply underscore the inconsistency and lack of transparency with which Kazakhstan treated Claimants and their investments. Indeed, even under Kazakhstan's own case, there is no transparency

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884 Statement of Defense ¶¶ 37.35 - 37.41.

885 In fact, Kazakhstan disclosed the authority and duties of the Financial Police, which do not include the authority to interpret laws or, specifically to conclude what pipelines are trunk pipelines. *See* Law of the Republic of Kazakhstan "On Financial Police" No. 336, R-113 and Law of the Republic of Kazakhstan "On Financial Police" No. 336, Article 9, R-209.

886 Statement of Defense ¶ 37.40.

regarding what pipelines are trunk pipelines. Kazakhstan contends that the most well respected of industry specialists were wrong in classifying KPM's and TNG's pipelines.[887] Apparently, its own officials that approved the design and construction of those pipelines were also wrong.[888] The classification of the pipelines was so unclear that even Kazakhstan's own judicial executor "referred to [them] in a confusing way" when he described KPM's pipeline as a "field pipeline."[889] It is simply no defense to Claimants' fair and equitable treatment claim for Kazakhstan to argue that its own laws were so confusing and unclear that multiple Kazakh officials applied them incorrectly for nearly a decade.

507. Kazakhstan is in a conundrum. Either it unlawfully and unfairly reclassified KPM's and TNG's field pipelines as trunk pipelines as a pretext for taking over Claimants' investments — as the evidence overwhelmingly demonstrates — or Kazakhstan's laws and its application of those laws were so confusing and non-transparent that they amounted to unfair and inequitable treatment. Either way, Kazakhstan violated the ECT's fair and equitable treatment standard.

Mr. Cornegruta's Conviction and the Verdict Against KPM

508. Kazakhstan's criminal proceeding amounts to a breach of the fair and equitable treatment provision because it denied justice to both Mr. Cornegruta and KPM. It is well-established that "[c]ompliance with the most basic due process requirements is necessary to avoid a denial of justice."[890] Kazakhstan failed to comply with those requirements.

509. With respect to Mr. Cornegruta, as explained above,[891] Kazakhstan violated numerous provisions of its own criminal procedure code and Mr. Cornegruta's due process rights. In addition to simply fabricating the grounds on which he was accused, Kazakhstan failed to provide Mr. Cornegruta access to the allegations and supporting evidence against him, and the court summarily rejected the evidence demonstrating his innocence.

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887 *See* Statement of Defense Section 28.

888 *See* Section III.C(1), *supra*.

889 Statement of Defense ¶ 37.36.

890 UNCTAD, *Fair and Equitable Treatment: A Sequel*, UNCTAD Series on Issues in International Investment Agreements II at 80-1 (United Nations 2012), C-571.

891 *See* Section III.C, *supra*; *see generally* Malinovsky Opinion.

510. Kazakhstan also failed to respect due process and denied justice in relation to KPM. Three acts stand out as the most egregious. First, KPM was not a party to the criminal proceeding (and could not have been under Kazakh law), but Kazakhstan nevertheless named KPM in its judgment so that the US$ 145 million judgment could be enforced against KPM.[892] Second, Kazakhstan denied KPM a right to appeal — despite KPM's attempt to do so — on the grounds that KPM was not a named party to the case.[893] Finally, Kazakhstan assessed an arbitrary and baseless penalty against KPM (which bore no relation to the alleged "crime and amounted to all of KPM's revenues for several years) precisely so that KPM would not be able to satisfy the judgment, enabling Kazakhstan to seize its assets.[894]

511. KPM repeatedly complained to the Kazakh authorities regarding the court's decision and the Government's enforcement actions,[895] but those complaints fell on deaf ears. Kazakhstan's judgment against KPM is the worst kind of denial of justice, because it was not a mere failure of due process or act of incompetence, but rather part of a deliberate scheme to seize the company's assets.

Kazakhstan's Harassment and Coercion Campaign

512. Claimants already have explained — and Kazakhstan does not dispute — that harassment and coercion of an investor breach the fair and equitable treatment provision.[896]

513. Again, Kazakhstan initiated a campaign of harassment and coercion in October 2008 that endured for 21 months, greatly interfered with Claimants' use and enjoyment of their investments, and ensured that Claimants could not market or sell their companies. In October 2008, Kazakhstan launched an assault of inspections that interfered with normal business

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892 *See* Judgment, September 18, 2009, C-117.

893 *See* Statement of Claim ¶ 120; s*ee also*, *e.g.*, Decision on Appeal, November 12, 2009, C-565; KPM's Request for Copy of Decision of Sept. 18, 2009, on January 14, 2010, C-566; KPM's Claim of Appeal, January 25, 2010, C-481; KPM's Claim to court regarding challenge of court's refusal to reinstate term of appeal, February 8, 2010, C-637; KPM's Claim of Appeal, February 25, 2010, C-640; KPM's Claim of Cassation, May 11, 2010, C-642.

894 *See* Writ of Execution, December 29, 2009, C-119.

895 *See* KPM's request for the court decision against it, January 14, 2010, C-566; KPM's complaint regarding the challenge of court decision, January 21, 2010, C-567; KPM's complaint regarding challenge of court decision and enforcement order, March 5, 2010, C-568; KPM's complaint regarding violations of enforcement procedures, April 9, 2010, C-569; KPM's complaint regarding its decision on public sale of its property, June 25, 2010, C-570.

896 Statement of Claim ¶ 345.

activities and paved the way for more egregious conduct. The campaign was carried out in bad faith, for the purpose of acquiring Claimants' investments at firesale prices.[897]

514. Kazakhstan refused to execute a previously-agreed extension of Claimants' Contract No. 302, which violated Claimants' legitimate expectation that the exploration period for that contract — which Kazakhstan had approved — would be extended. That refusal too was in bad faith, as there was no justification for it, and Kazakhstan only took that action in furtherance of its campaign of harassment and coercion. Additionally, Kazakhstan's tax measures were found to be unlawful, yet Kazakhstan embroiled KPM and TNG in litigation over them for months. Kazakhstan also refused to refund US$ 10 million that KPM and TNG paid under protest, after those taxes were found to have been improper. Finally, Kazakhstan refused to either waive or assert its pre-emptive rights to KPM and TNG, again in bad faith and without justification, thereby preventing Claimants from selling their companies.

515. All of those measures severely harassed Claimants and subjected them to extreme coercion in violation of the ECT's fair and equitable treatment standard.

Contract No. 302

516. Kazakhstan's actions with respect to Contract No. 302 were especially unfair and inequitable. Kazakhstan undertook to extend the exploration period under that contract, and then strung Claimants along for months before ultimately refusing to do so. That inconsistent conduct left Claimants in a state of limbo *vis-a-vis* Contract No. 302, because they could not perform under it without risking a claim of breach, yet Kazakhstan clearly indicated that it did not intend for the contract to expire. Furthermore, Kazakhstan clearly viewed that contract as still in force as of July 14, 2010, when it sent TNG a notice of multiple (yet baseless) allegations of violations. Upon receiving TNG's explanations of how those allegations were incorrect, Kazakhstan realized its errors, changed its position, and only then claimed that Contract No. 302 had terminated in 2009. Thus, with respect to Contract No. 302, Kazakhstan breached the fair and equitable treatment provision by, first, creating a legitimate expectation that it would extend the contract term and then breaching that undertaking, and second, changing its position with respect to the validity of that contract in an unfair, confusing, and inconsistent manner.

[897] *See* Section III.A, *supra*; s*ee also* Letter from Blagovest President to MEMR, February 7, 2010, C-23.

E. Kazakhstan Impaired Claimants' Investments Through Unreasonable and Discriminatory Measures

517. The ECT not only requires Kazakhstan to treat Claimants' investments fairly and equitably, but also prohibits Kazakhstan from impairing Claimants' investments by unreasonable or discriminatory measures.[898] Over the past several years, the Tribunals in *BG Group v. Argentina*; *Siemens v. Argentina*; *ADC v. Hungary*; *Azurix v. Argentina*; and *Saluka v. Czech Republic* have all determined that conduct of a host State violated an impairment clause, thereby breaching the relevant treaty.[899]

1. Kazakhstan's Acts and Omissions Were Unreasonable

518. Kazakhstan does not dispute that measures need only be arbitrary to violate the BIT. Rather, relying primarily on the *ELSI* case, Kazakhstan asserts that "a finding of a breach of the guarantee requires a high threshold."[900] In the *ELSI* case, the ICJ considered a claim from the United States that certain actions by Italian officials were arbitrary. In that case, the ICJ defined an arbitrary act in this way: "Arbitrariness is not so much something opposed to a rule of law, as something opposed to the rule of law . . . It is a willful disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety."[901]

519. Kazakhstan's reliance on the *ELSI* case is misguided, however, as the definition of arbitrariness in that case does not accord with the ordinary meaning of the term as required by Article 31(1) of the Vienna Convention. For this reason, among others, the *ELSI* standard for arbitrary treatment has been the target of much criticism. For instance, Professor Sean Murphy referred to this "very narrow approach to arbitrary acts" as "inconsistent with standards operating on both international and domestic levels."[902]

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898 ECT art. 10(1), C-1.

899 *BG Group Plc v. Argentine Republic*, UNCITRAL, Award, December 24, 2007 (hereinafter "*BG Group* Award"), ¶ 346, C-268; *Siemens* Award ¶ 319, C-232; *ADC Affiliate Ltd. v. Hungary*, ICSID Case No. ARB/03/16, Award, October 2, 2006 (hereinafter "*ADC* Award"), ¶ 476, C-206; *Azurix* Award ¶ 442, C-245; *Saluka* Partial Award ¶ 457-81, C-259.

900 Statement of Defense ¶ 38.5.

901 *ELSI* Judgment ¶ 128, R-81.

902 *See* Sean D. Murphy, *The ELSI Case: An Investment Dispute at the International Court of Justice*, 16 Yale J. Int'l. L. 391, 451 (1991), C-572; *see also* Francis A. Mann, *Foreign Investment in the International Court of Justice: The ELSI Case*, 86 Am. J. Int'l. L. 92, 99 (1992), C-573; Kurt J. Hamrock, *The ELSI Case: Toward an International Definition of "Arbitrary" Conduct*, 27 Tex. Int'l. L.J. 837, 846-52 (1992), C-574.

520. Moreover, none of the three cases cited by Kazakhstan that approve of the *ELSI* case have eschewed the ordinary meaning of the term or limited the notion of arbitrary treatment to Kazakhstan's narrow articulation of the standard.[903] For instance, the Tribunal in *Siemens*, while also finding the definition of arbitrary in *ELSI* "close to the ordinary meaning of the term," turned to the dictionary definition of "arbitrary" to ascertain its ordinary meaning.[904] The *Siemens* Tribunal went on to find that "certain measures taken by Argentina do not seem to be based on reason."[905] In doing so, the *Siemens* Tribunal acknowledged Argentina's legitimate interest in temporarily suspending the claimant's immigration control and personal identification subsystems and withholding the required permit required to operate those systems, but found the permanent suspension of the systems arbitrary. In other words, the *Siemens* Tribunal held Argentina's interference with the investment was arbitrary because it lacked proportionality.

521. The *LG&E* Tribunal adopted a standard for arbitrary treatment similar to that in *Siemens*. The *LG&E* Tribunal turned to the dictionary definition of the word "arbitrary" and quoted the *Lauder* Tribunal's articulation of arbitrary as "depending on individual discretion; . . . founded on prejudice or preference rather than on reason or fact."[906] The Tribunal then took into account language from the US-Argentina BIT's preamble to adopt the following general description of arbitrary measures:

> It is apparent from the Bilateral Treaty that [the Contracting States] wanted to prohibit themselves from implementing measures that affect the investments of nationals of the other Party without engaging in a rational decision-making process. Such process would include a consideration of the effect of a measure on foreign investments and a balance of the interests of the State with any burden imposed on such investments. Certainly a State that fails to base its actions on reasoned judgment, and uses abusive arguments instead, would not stimulate the flow of private capital.[907]

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[903] *Noble Ventures* Award ¶ 176, R-66 (where the Tribunal simply indicated that "reference can be made to the decision of the ICJ in the *ELSI* case."); *Siemens* Award ¶ 318, C-232; and *LG&E* Decision on Liability ¶¶ 161-63, C-262.

[904] *Siemens* Award ¶ 318, C-232.

[905] *Siemens* Award ¶ 319, C-232.

[906] *LG&E* Decision on Liability ¶ 157, C-262.

[907] *LG&E* Decision on Liability ¶ 158, C-262.

522. Thus, contrary to Kazakhstan's assertion, cases like *Siemens* and *LG&E* confirm that State measures must not merely have a rational basis related to a legitimate end, but must also be proportionate to the end sought. Moreover, these cases provide a definition of "arbitrary" based on its ordinary meaning, which is broader than the requirement of manifest impropriety proffered by the Court in *ELSI*. In further support of the ordinary meaning approach to defining "arbitrary," the Tribunal in *National Grid* found that "the plain meaning of the terms 'unreasonable' and 'arbitrary' is substantially the same in the sense of something done capriciously, without reason."[908]

523. In short, there is little support for Kazakhstan's proposition that unreasonable treatment requires a "high threshold" and is limited to the standard articulated in *ELSI*. When tribunals have relied on the ordinary meaning of "unreasonable," as required by the Vienna Convention, they have arrived at the conclusion that unreasonable treatment consists of a much wider scope of acts than those that are intentional, shocking, or improper. The definition of "unreasonable" or "arbitrary" measures employed by investment treaty tribunals[909] have been categorized in Professor Schreuer's expert opinion in *EDF v. Romania*, which was adopted by the Tribunal, as follows:

a. a measure that inflicts damage on the investor without serving any apparent legitimate purpose;

b. a measure that is not based on legal standards but on discretion, prejudice or personal preference;

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[908] *National Grid* Award ¶ 197, C-269.

[909] *See*, *e.g.*, *Al-Bahloul* Partial Award ¶ 248 (endorsing the definition of the *Plama* Award ¶ 184, C-400, and defining unreasonable or arbitrary measures as "those which are not founded in reason or fact but on caprice, prejudice or personal preference."), R-181; *National Grid* Award ¶ 197, C-269; *Saluka* Partial Award ¶ 460 (defining the standard of "reasonableness" as State conduct which "bears a reasonable relationship to some rational policy"), C-259; *Rumeli Telekom A.S. v. Kazakhstan*, ICSID Case No. ARB/05/16, Award, July 29, 2008 (hereinafter "*Rumeli* Award"), ¶ 679 (endorsing the *Saluka* standard), C-236; *AES Summit Generation Ltd. v. Hungary*, ICSID Case No. ARB/07/22, Award, September 23, 2010 (hereinafter "*AES Summit* Award"), ¶¶ 10.3.7-10.3.9 ("There are two elements that require to be analyzed to determine whether a state's act was unreasonable: the existence of a rational policy; and the reasonableness of the act of the state in relation to the policy. A rational policy is taken by a state following a logical (good sense) explanation and with the aim of addressing a public interest matter. Nevertheless, a rational policy is not enough to justify all the measures taken by a state in its name. A challenged measure must also be reasonable. That is, there needs to be an appropriate correlation between the state's public policy objective and the measure adopted to achieve it. This has to do with the nature of the measure and the way it is implemented."), C-575.

c. a measure taken for reasons that are different from those put forward by the decision maker;

d. a measure taken in willful disregard of due process and proper procedure.[910]

524. In the present case, this discussion is almost certainly academic. Kazakhstan's conduct was so egregiously arbitrary that it falls well within the *ELSI* standard, even if that standard were applicable — which it is not. In the words of the *ELSI* Court, Kazakhstan's treatment of Claimants was "not so much something opposed to a rule of law, as something opposed to the rule of law." Kazakhstan "willfully disregarded due process of law" and its actions "shock, or at least surprise, a sense of judicial propriety." Kazakhstan's shockingly arbitrary conduct in this case includes:

- Kazakhstan's "reclassification" of KPM's and TNG's pipelines as "main" pipelines, despite there being no "main" pipeline as acknowledged by numerous State authorities and agencies;[911]
- Kazakhstan's arrest, conviction, and incarceration of Mr. Cornegruta, which did not serve any legitimate purpose, were not based on legal standards, and were carried out in willful disregard of due process and proper procedure;[912]
- Kazakhstan's criminal verdict against the non-party KPM, freezing of KPM's assets, and barring of KPM from lodging an appeal against its conviction, which inflicted considerable damage on Claimants without serving any legitimate purpose and violated applicable legal standards, due process and proper procedure;[913]
- Kazakhstan's retroactive reversal of its approval of the transfer of TNG to Terra Raf and waiver of its pre-emptive rights, which did not serve any legitimate purpose, had no legal basis, and violated due process;[914]

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910 *EDF (Services) Ltd. v. Romania*, ICSID Case No. ARB/05/13, Award, October 8, 2009 (hereinafter "*EDF* Award"), ¶ 303, C-576.

911 *See* Statement of Claim Sections IV.B.1 and IV.B.3 and Reply Memorial Section III.C.1 above.

912 *See* Statement of Claim Section IV.B.4 and Reply Memorial Section III.C.2 above. Kazakhstan cannot seriously contend that general principles of international law and its Constitution do not form part of the contractual and legal framework under which a foreign investor invests in Kazakhstan.

913 *See* Statement of Claim Section IV.B.5 and Reply Memorial Section III.C.3 above.

914 *See* Statement of Claim Section IV.C and Reply Memorial Section III.B.1 above.

- Kazakhstan's refusal to extend TNG's exploration period in the Contract 302 Properties, notwithstanding its express approval of the extension;[915]

- Kazakhstan's imposition of the Crude Oil Export Tax on KPM, which violated exemption and legal stabilization clauses in the Subsoil Use Contract and inflicted damage on Claimants without serving any legitimate purpose;[916] and

- Kazakhstan's wrongful and unilateral repudiation of KPM's and TNG's Subsoil Use Contracts without any justifiable basis and without providing the companies any opportunity to cure the alleged deficiencies.[917]

2. Kazakhstan Discriminated Against Claimants

525. In its Statement of Defense, Kazakhstan agrees with Claimants' and the *Saluka* Tribunal's definition of discrimination that "State conduct is discriminatory, if (i) similar cases are (ii) treated differently (iii) and without reasonable justification."[918] But that is where the agreement ends. Kazakhstan contends that Claimants have failed to discharge their burden of proof regarding the similarity of cases and the differential treatment their investments suffered at the hands of Kazakhstan.[919] That is incorrect.

526. In *BG Group v. Argentina*, relied on by Kazakhstan,[920] the Tribunal found that the similarity of cases had not been sufficiently established as "there [was] no discussion on the record as to why BG was 'in like circumstances' to companies operating [in another industry sector]."[921] In the present case, Claimants' evidence demonstrates that Kazakhstan only reclassified KPM's and TNG's gathering systems as "main" pipelines, despite the fact that neighboring companies — including KazakTurkMunai — and companies throughout

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915 *See* Statement of Claim Section IV.D and Reply Memorial Section III.B.3 above.

916 *See* Statement of Claim Section IV.E and Reply Memorial Section III.B.2 above.

917 *See* Statement of Claim Section V.B and Reply Memorial Section III.D.1 above.

918 *Saluka* Partial Award ¶ 313, C-259. *See* Statement of Defense ¶ 38.18. Claimants fail to understand how their description of the standard of discrimination as requiring "a differential treatment applied to people who are in similar situations" without a "rational justification for any differential treatment of a foreign investor" is "unclear," or different from the definition in the *Saluka* case. *See* Statement of Defense ¶ 38.18.

919 Statement of Defense ¶ 38.19.

920 Statement of Defense ¶ 38.19.

921 *BG Group* Award ¶ 357, C-268.

Kazakhstan own and operate similar pipelines as part of their in-field gathering system.[922] If Kazakhstan's contention that a contractor's pipeline extending outside the Contract Area is a "main" pipeline were correct, hundreds of oil and gas companies in Kazakhstan would operate "main" pipelines, but only Claimants' companies have faced that charge. As the *Nykomb* Tribunal — the other case relied on by Kazakhstan[923] — held "all of the information available to the Tribunal suggests that the ... companies are comparable, and subject to the same laws and regulations."[924] Yet, KPM's and TNG's gathering systems alone were reclassified. That is clearly discriminatory.

527. In *Feldman v. Mexico* and *Nykomb*, the Tribunals held that once *prima facie* evidence of *de facto* discrimination had been presented by the claimant, the burden of proof shifted to the respondent to rebut the presumption of discrimination.[925] Kazakhstan has not rebutted the presumption; indeed, Kazakhstan fails to convincingly deny that its measures resulted in differential treatment injuring Claimants.

528. Kazakhstan's singling out of KPM and TNG for the "main" pipeline charge and convictions that followed was clearly discriminatory. Professor Kenneth Vandevelde explained that "[d]iscrimination may refer to denials of national treatment, MFN treatment, or arbitrary action *directed at particular investors or investment[s]*."[926] As Messrs. DiMascio and Pauwelyn stated in their recent article on non-discrimination, national and most-favored treatment provisions are inserted in BITs to "protect individual foreign investors from *targeted attacks by their host governments*."[927] Kazakhstan does not deny — nor could it — that it singled out KPM

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[922] Statement of Claim ¶ 87; First Romanosov Statement ¶ 32; Reply Memorial Section III.C.1.b. *See* Statement of Defense ¶¶ 21.10, 23.19(e)-(h). Letter from KazakhTurkMunai to the MOG, October 19, 2011, R-135.1.

[923] Statement of Defense ¶ 38.20.

[924] *Nykomb* Award ¶ 4.3.2(a), C-281.

[925] *Feldman v. Mexico,* ICSID Case No. ARB(AF)/99/1, Award, December 16, 2002 (hereinafter "*Feldman* Award"), ¶ 183, C-283; *Nykomb* Award ¶ 4.3.2(a), C-281.

[926] Kenneth J. Vandevelde, UNITED STATES INVESTMENT TREATIES: POLICY AND PRACTICE 77 (Kluwer Law and Taxation 1992) (emphasis added), C-280. Pursuant to Article 10(7) of the ECT, "Each Contracting Party shall accord to Investments in its Area of Investors of other Contracting Parties, and their related activities including management, maintenance, use, enjoyment or disposal, treatment no less favourable than that which it accords to Investments of its own Investors or of the Investors of any other Contracting Party or any third state and their related activities including management, maintenance, use, enjoyment or disposal, whichever is the most favourable." ECT art. 10(7), C-1.

[927] Nicholas DiMascio & Joost Pauwelyn, *Nondiscrimination in Trade and Investment Treaties: Worlds Apart or Two Sides of the Same Coin?*, 102 Am. J. Int'l. L. 48, 81 (2008) (emphasis added), C-577.

and TNG for its extraordinary campaign of harassment and coercion between October 2008 and July 2010, much of which was predicated on its "main pipeline" allegation. Kazakhstan has provided no credible, rational justification for its conduct, and its discriminatory treatment of Claimants' investments is clear.

3. Kazakhstan's Conduct Impaired Claimants' Investments

529. In its Statement of Defense, Kazakhstan disputes that its conduct "impaired" Claimants' management, maintenance, use, enjoyment, or disposal of their investments.[928] This allegation is belied by the facts. The term "impair" is commonly defined as "[t]o make worse, less valuable, or weaker; to lessen injuriously; to damage, injure."[929] Tribunals have defined "impairment" in precisely that manner. For instance, the *Saluka* Tribunal stated:

> "Impairment" means, according to its ordinary meaning (Article 31 of the Vienna Convention on the Law of Treaties), any negative impact or effect caused by "measures" taken by the [host State].
>
> The term "measures" covers any action or omission of the [host State].[930]

530. There cannot be any serious dispute that Kazakhstan's arbitrary and discriminatory measures "impaired" Claimants' management, maintenance, use, enjoyment, and disposal of their investments. On the heels of Nazarbayev's October 14, 2008 order, the Kazakh authorities initiated a concerted and comprehensive series of audits and inspections in October and November 2008 by the MEMR, the Tax Committee, the Customs Committee, the National Bank of Kazakhstan, the Geology Committee, the Ecology Committee, and the Ministry of Emergency Situations. Those intrusive audits and inspections obviously had a "negative impact" on Claimants' management, use, and enjoyment of their investments.

531. Further, on December 18, 2008, the MEMR informed TNG that it was repudiating Kazakhstan's unequivocal approval of the 2003 transfer of TNG to Terra Raf, thereby revoking its previous waiver of its pre-emptive right. On the same day, Kazakhstan issued a press release that notified potential buyers that the State would assert a pre-emptive right over TNG, and accused Claimants of having "forged" documents in order to allegedly defraud Kazakhstan. The

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928 Statement of Defense ¶¶ 38.25-38.30.

929 OXFORD ENGLISH DICTIONARY (online ed. March 2012), C-578.

930 *Saluka* Partial Award ¶¶ 458-59, C-259.

damaging effect of that press release clearly impaired Claimants' ability to dispose of their investments.

532. The plethora of audits and inspections led by the Kazakh Financial Police — which on their own impaired Claimants' management and enjoyment of their investments — resulted in the improper assessment of US$ 62 million of alleged corporate back taxes in February 2009, the imposition of illegal export duties against KPM in December 2008, and an intrusive 13-month audit of KPM and TNG with respect to transfer pricing starting in November 2008. Again, Kazakhstan cannot deny that the financial burden of those measures impaired Claimants' management, use, and enjoyment of their investments.

533. Kazakhstan's refusal to execute the previously-agreed extension to TNG's exploration period for the Contract 302 Properties prohibited Claimants from performing further exploration and establishing the full market value of the Contract 302 Properties. It is clear that Kazakhstan impaired Claimant's management, use, and enjoyment of its rights under Contract No. 302.

534. Kazakhstan's reclassification of the KPM and TNG gathering systems as "main" pipelines, which resulted in criminal proceedings against four then-existing and former general managers of KPM and TNG and a sham trial, conviction, and incarceration of Mr. Cornegruta, clearly impaired Claimants' ability to manage their investments. Top personnel left the country and the conviction itself was used to ultimately take over the companies. Similarly, Kazakhstan froze KPM's assets in an effort to execute the US$ 145 million judgment against KPM, thereby directly impairing Claimants' management, use, and enjoyment of KPM.

535. Kazakhstan's violations of the ECT's impairment clause are beyond serious dispute.

F. Kazakhstan Violated the Umbrella Clause

536. Kazakhstan's arguments pertaining to its violation of the last sentence of ECT Article 10(1) — the "umbrella clause" — are misguided.[931] Kazakhstan contends that the umbrella clause only extends to contractual obligations.[932] Kazakhstan then argues that

[931] Statement of Defense ¶¶ 39.1-39.13.

[932] Statement of Defense ¶¶ 39.2-39.8.

Claimants cannot bring claims for breach of their Subsoil Use Contracts under the umbrella clause because they contain exclusive arbitration clauses.[933] Finally, Kazakhstan alleges that the "Republic acted at all times in accordance with its domestic law and with the Subsoil Use Contracts."[934] Those arguments are incorrect, and in any event, do not relieve Kazakhstan from liability under the ECT.

537. First, Kazakhstan contends that the wording of the umbrella clause in the six authentic languages of the ECT limits the scope of that provision to "obligations stemming from contracts."[935] Kazakhstan relies on the use of the verb "contract" in the French and Spanish versions to make that claim. Kazakhstan's purely linguistic argument is unpersuasive. Both versions of the ECT clearly indicate that each Contracting Party shall observe ***any*** obligation that ***it*** has undertaken (or "contracted") towards an Investor or the Investments of an Investor of another Contracting Party. Likewise, the four other authentic versions of the ECT refer to the obligations "assumed with regard to" the investor or investment.[936] The plain language of the umbrella clause does not differentiate between contractual obligations as opposed to legislative or regulatory undertakings.

538. Kazakhstan relies primarily on two cases[937] to support its restrictive reading of the ECT umbrella clause, but neither case stands for the contention that only contractual obligations fall within the purview of the clause. To the contrary, in *Al-Bahloul v. Tajikistan*, the tribunal held that the ECT umbrella clause "is broadly stated, referring as it does to 'any obligation' and, as such, by the ordinary meaning of the words, includes both statutory and contractual obligations."[938] Likewise, the *CMS ad hoc* committee held:

> In speaking of "any obligations it may have entered into with regard to investments," it seems clear that Article II(2)(c) is concerned with consensual obligations arising independently of the

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933 Statement of Defense ¶¶ 39.9-39.12.

934 Statement of Defense ¶ 39.1. In this respect, Claimants agree with Kazakhstan's statement that: "Claimants at all times complied with domestic law, with the Subsoil Use Contracts and with Contract No. 302." *See* Statement of Defense ¶ 39.13.

935 Statement of Defense ¶ 39.3.

936 Statement of Defense ¶ 39.4.

937 *Al-Bahloul* Partial Award, R-181; *CMS Gas Transmission Co. v. Argentine Republic*, ICSID Case No. ARB/01/8, Annulment Decision, September 25, 2007 (hereinafter "*CMS* Annulment Decision"), R-182.

938 *Al-Bahloul* Partial Award ¶ 257, R-181.

> BIT itself (*i.e.* ***under the law of the host State or possibly under international law***). Further they must be specific obligations concerning the investment. They do not cover general requirements imposed by the law of the host State.[939]

539. The clear terms of the umbrella clause show that it protects "any" obligation entered into "with an Investor or an Investment of an Investor." The ECT defines "Investment" broadly to include "every kind of asset" including "any right conferred by law or contract or by virtue of any licenses and permits."[940] It follows that the Subsoil Use Contracts and other legal and contractual rights are included in the ECT's definition of "Investment." Kazakhstan indisputably undertook a number of contractual, legislative, and regulatory obligations with regard to Claimants and their investments, which are protected under the umbrella clause.[941]

540. Second, Kazakhstan argues that the arbitration provisions in the Subsoil Use Contracts bar claims relating to those contracts under an umbrella clause. Once again, Kazakhstan is conflating contract claims with treaty claims. Claimants are not arguing that Kazakhstan breached KPM's and TNG's contracts under Kazakh domestic law (although that may well be the case); rather, Claimants assert that Kazakhstan breached its obligation to observe all obligations undertaken with respect to their investments, and that includes its contractual obligations. As the *SGS v. Paraguay* Tribunal explained, umbrella clause claims stemming from a contract are not identical to breach-of-contract claims.[942] The ECT provides jurisdiction over "disputes … relating to an Investment," which includes contractual claims that may arise under the umbrella clause, whereas contractual forum-selection provisions, such as

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939 *CMS* Annulment Decision ¶ 95(a), R-182.

940 ECT art. 1(6), C-1.

941 A number of investment treaty tribunals have held that not only contractual obligations, but also obligations undertaken through law or regulation, falls within the scope of an umbrella clause. *See*, *e.g.*, *SGS Société Générale de Surveillance S.A. v. Philippines*, ICSID Case No. ARB/02/6, Decision on Objections to Jurisdiction, January 29, 2004 (hereinafter "*SGS v. Philippines* Decision on Jurisdiction"), ¶¶ 127-28, C-282; *LG&E* Decision on Liability ¶¶ 170, 175, C-262; *Eureko B. V. v. Poland*, Ad Hoc, Partial Award, August 19, 2005 (hereinafter "*Eureko* Partial Award"), ¶ 246, C-260; *Enron Corp. v. Argentine Republic*, ICSID Case No. ARB/01/3, Award, May 22, 2007 (hereinafter "*Enron* Award"), ¶ 274, C-263.

942 *See*, *e.g.*, *SGS Société Générale de Surveillance S.A. v. Paraguay*, ICSID Case No. ARB/07/29, Award, February 10, 2012 (hereinafter "*SGS v. Paraguay* Award"), ¶ 173 ("Claimant's [umbrella clause] claims are not co-extensive with claims under the Contract, and they are not necessarily disposed of by the four corners of the Contract. . . . Accordingly, it would sweep too broadly to say that all umbrella clause claims—and, in particular, all of the umbrella clause claims before us—can be disposed of on contractual grounds by the contractual forum."), C-579.

those in the Subsoil Use Contracts, naturally would cover only contractual claims (and those claims belong to KPM and TNG, rather than to Claimants).

541. Kazakhstan cites two cases[943] to support its submission that Claimants cannot bring claims for breach of their Subsoil Use Contracts because they contain exclusive arbitration provisions.[944] However, contrary to the present case, the claimants in both of those cases were the parties to the respective contracts at issue, and therefore bound by the terms of the arbitration provisions in their contracts. The tribunals in those cases found, unsurprisingly, that a party to a contract must abide by the contract's terms, to which that party agreed when it entered into the contract. The same principle does not apply here, because Claimants are not parties to the contracts at issue.

542. Moreover, those two cases were essentially one-issue disputes involving the amount of payment due under a contract.[945] Neither case involved the types of government measures involved here in which Kazakhstan blatantly disregarded its legal and contractual obligations in order to effectively destroy Claimants' investments.[946] Thus, the Tribunals in the *SGS v. Philippines* and the *BIVAC v. Paraguay* cases were not called upon to determine whether myriad breaches, such as those alleged here, would constitute international treaty violations.[947]

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943 Statement of Defense ¶¶ 39.10-39.11; *SGS v. Philippines* Decision on Jurisdiction, C-282; *Bureau Veritas, Inspection, Valuation, Assessment, and Control BIVAC, B.V. v. Paraguay*, ICSID Case No. ARB/07/9, Decision of the Tribunal on Objections to Jurisdiction, May 29, 2009 (hereinafter "*Bureau Veritas* Decision on Jurisdiction"), R-184.

944 Statement of Defense ¶¶ 39.9-39.12.

945 *SGS v. Philippines* Decision on Jurisdiction ¶¶ 15-17, C-282; *Bureau Veritas* Decision on Jurisdiction ¶¶ 7-12, R-184.

946 *See*, *e.g.*, *Compañía de Aguas del Aconquija, S.A. and Vivendi Universal v. Argentine Republic*, ICSID Case No. ARB/97/3, Award, November 21, 2000 (hereinafter "*Vivendi I* Award"), ¶ 53 (a forum selection clause in a contract "does not divest this Tribunal of jurisdiction to hear this case because that provision did not and could not constitute a waiver by [claimant] of its rights under [the dispute resolution clause] of the BIT to file the pending claims against the Argentine Republic."), C-241. The *Ad Hoc* Committee confirmed that: "A state cannot rely on an exclusive jurisdiction clause in a contract to avoid characterisation of its conduct as internationally wrongful under a treaty." *See Vivendi I* Decision on Annulment ¶ 103, C-549.

947 In any event, the interpretation of the umbrella clause advocated by these two Tribunals was heavily criticized. *See*, *e.g.*, Emmanuel Gaillard, *Investment Treaty Arbitration and Jurisdiction Over Contract Claims – The SGS Cases Considered*, *in* INTERNATIONAL INVESTMENT LAW AND ARBITRATION: LEADING CASES FROM THE ICSID, NAFTA, BILATERAL INVESTMENT TREATIES AND CUSTOMARY INTERNATIONAL LAW 325, 334 (Todd Weiler ed., Cameron May 2005) ("[T]o the extent this solution recognises, 'in principle,' an investor's right to choose an international arbitral tribunal for the settlement of its investment disputes and, in the same breath, requires that the selected tribunal stay the proceedings on the basis of an exclusive forum selection clause contained in the investment contract, it results in the BIT tribunal having jurisdiction over an empty shell and depriving the BIT dispute resolution process of any meaning."), C-580.

Furthermore, in the *SGS v. Paraguay* case, a case with "extensive factual commonalities"[948] with the *BIVAC* case, the Tribunal held that "a forum selection clause should not be permitted to override the jurisdiction to hear Treaty claims of a tribunal constituted under that Treaty."[949]

543. Kazakhstan's focus on the issue of application of a contractual forum selection clause is also misguided because unlike the BITs at issue in the *SGS v. Philippines*[950] and *BIVAC*[951] cases, the ECT gives foreign investors the choice to submit their claims *either* before a previously-agreed forum *or* to international arbitration under the aegis of ICSID, UNCITRAL, or the SCC.[952] It is for the party instituting proceedings to select the forum that it deems most suitable.[953] Indeed, Article 26 of the ECT expressly provides this option:[954]

> [T]he Investor party to the dispute may chose to submit it for resolution:
>
> (a) to the courts or administrative tribunals of the Contracting Party party to the dispute;
>
> (b) in accordance with any applicable, previously agreed dispute settlement procedure; or
>
> (c) [to international arbitration] in accordance with the following paragraphs of this Article.

As explained by Professor Amkhan, "the Investor's choice to submit the dispute to international arbitration is not constrained by the existence of a dispute settlement mechanism contained in the

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948 *SGS v. Paraguay* Award ¶ 172, C-581.

949 *SGS v. Paraguay* Award ¶¶ 180-84, C-581.

950 *SGS v. Philippines* Decision on Jurisdiction ¶ 34, C-282.

951 *Bureau Veritas* Decision on Jurisdiction ¶ 21, R-184.

952 ECT art. 26, C-1.

953 *SGS v. Paraguay* Award ¶ 107, C-581; *Bayindir* Decision on Jurisdiction ¶ 167 ("when the investor has a right under both the contract and the treaty, it has a self-standing right to pursue the remedy accorded by the treaty."), R-208.

954 *See* Amkhan Opinion ¶ 112 ("It is clear that it is the aggrieved Investor(s) who alone "may choose to submit" the dispute to one of the three dispute settlement mechanisms listed in Article 26(2)"). *See also* Professor Crivellaro recognized this principle in his dissenting declaration in the *SGS v. Philippines* case: "It is my understanding that the most significant advantage which, in practice, is granted by a BIT to foreign investors is, precisely, the right to select, amongst the alternative forums made available by the BIT, the forum that the investor deems the most suitable to him." *See SGS v. Philippines* Decision on Jurisdiction, Declaration by Professor Crivellaro ¶¶ 5, 3, C-582.

contract."[955] The Claimants had a choice under the ECT, and they chose to pursue international arbitration under the SCC Rules. That is the end of the matter.

544. Furthermore, Article 26(3)(c) of the ECT grants Contracting Parties the right to exclude international arbitration for violation of the umbrella clause, but Kazakhstan has not done so.[956] Only four countries do not allow foreign investors to submit a dispute concerning the last sentence of Article 10(1) to international arbitration.[957] Kazakhstan could have — but elected not to — opt out.

545. The case law and the terms of the ECT therefore support Claimants' view that a cause of action under the ECT is not subject to exclusive jurisdiction clauses pursuant to the underlying contracts, regardless of whether the Treaty claims relate to a greater or lesser extent to contractual issues. In sum, regardless of whether Claimants' claims raise questions relating to the Subsoil Use Contracts, Claimants are asserting a cause of action under the ECT. The jurisdiction of the Tribunal over those claims is not affected by the forum-selection clause of the Subsoil Use Contracts.

546. Throughout their Statement of Claim and this Reply Memorial, Claimants have listed a number of instances in which Kazakhstan undertook contractual, as well as legal and regulatory obligations with respect to Claimants and Claimants' investments, each of which it breached. The most striking examples are summarized below:

- Kazakhstan "reclassified" KPM's and TNG's pipelines as "main" pipelines, in violation of the approvals by its state authorities and agencies for the design, construction, and operation of the "reclassified" pipelines as in-field pipelines pursuant to Kazakhstan's Law on Oil and relevant regulations;[958]

- Kazakhstan arrested, convicted, and incarcerated Mr. Cornegruta, in violation of general principles of due process and Articles 12 and 16 of the

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955 Amkhan Opinion ¶¶ 121-22.

956 ECT art. 26(3)(c), C-1. *See also* ECT Annex ID, C-1 and Amkhan Opinion ¶¶ 114-115; 119-120.

957 ECT Annex IA, C-1. Hungary is the only Contracting Party listed in Annex IA. *See* Amkhan Opinion ¶¶ 116-117.

958 *See* Statement of Claim, Sections IV.B.1 and IV.B.3 and Reply Memorial, Section III.C(1) above.

Kazakh Constitution recognizing each person's human rights and freedoms;[959]

- Kazakhstan issued a criminal verdict against the non-party KPM, froze KPM's assets, and barred KPM from lodging an appeal against its conviction , in violation of general principles of due process and of Article 77(3) of the Kazakh Constitution;[960]

- Kazakhstan approved the transfer of TNG to Terra Raf and waived its pre-emptive rights, and then later rescinded its express approval and waiver;[961]

- Kazakhstan refused to extend TNG's exploration period in the Contract 302 Properties although it had expressly approved the extension;[962]

- Kazakhstan imposed the Crude Oil Export Tax on KPM, in violation of exemption and legal stabilization clauses in the Subsoil Use Contract;[963]

- Kazakhstan imposed amortization rates at higher than contractually-agreed rates, in violation of clear amortization and legal stabilization provisions in the Subsoil Use Contracts;[964]

- Kazakhstan wrongfully and unilaterally repudiated KPM's and TNG's Subsoil Use Contracts, in violation of the contract terms;[965] and

- Kazakhstan illegally seized Claimants' investments, in violation of general principles of law and Articles 6 and 26 of the Kazakh Constitution protecting private property.[966]

547. Each of those measures constitutes a distinct violation of the ECT's umbrella clause.

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[959] *See* Statement of Claim, Section IV.B.4 and Reply Memorial, Section III.C(2), *supra*. Kazakhstan cannot seriously contend that general principles of international law and its Constitution do not form part of the contractual and legal framework under which a foreign investor invests in Kazakhstan.

[960] *See* Statement of Claim, Section IV.B.5 and Reply Memorial, Section III.C(3), *supra*.

[961] *See* Statement of Claim, Section IV.C and Reply Memorial, Section III.B, *supra*.

[962] *See* Statement of Claim, Section IV.D and Reply Memorial, Section III.B(3), *supra*.

[963] *See* Statement of Claim, Section IV.E and Reply Memorial, Section III.B(2), *supra*.

[964] *See* Statement of Claim, Section IV.D and Reply Memorial, Section III.B(2), *supra*. The change of amortization rates from those set in the Subsoil Use Contracts does not constitute a "Taxation Measure" under the ECT.

[965] *See* Statement of Claim, Section V.B and Reply Memorial, Section III.D, *supra*.

[966] *See* Statement of Claim, Section V.C and Reply Memorial, Section III.D, *supra*.

G. Kazakhstan Failed to Afford Claimants Effective Means of Asserting Their Claims and Enforcing Their Rights

548. Article 10(12) of the ECT expressly requires Kazakhstan to "ensure that its domestic law provide effective means for the assertion of claims and the enforcement of rights with respect to Investments, investment agreements, and investment authorizations."[967] The Tribunal in the *Chevron v. Ecuador* case stated that "a failure of domestic courts to enforce rights 'effectively' will constitute a violation" of the guarantee to provide effective means to assert claims and enforce rights.[968] Kazakhstan wrongly contends that Claimants cannot invoke Article 10(12) of the ECT because they "largely" did not turn "to the courts or the contractually agreed arbitral tribunals."[969] That is mistaken.

549. First, as explained in the umbrella clause section above, a foreign investor faced with a plethora of wrongful measures by a host State has the right to choose the forum with the more comprehensive jurisdiction. Kazakhstan's repudiation of the Subsoil Use Contracts and seizure of Claimants' investments was the proverbial straw that broke the camel's back. Therefore, in the present dispute, international arbitration under the ECT is the appropriate choice since it covers both disputes relating to investments *and* contractual claims. Moreover, the forum selection clauses in the Subsoil Use Contracts refer to the Arbitration Institute of the Stockholm Chamber of Commerce.[970]

550. Second, Kazakhstan cannot seriously allege that Claimants have not made a *bona fide* attempt to resolve their dispute before the Kazakh courts. Indeed, as acknowledged by Kazakhstan in its Statement of Defense, "KPM and TNG made numerous references to the Kazakh courts."[971] Therefore, Claimants made a "reasonable" — if not exhaustive — "effort . . . to obtain correction"[972] before the Kazakh courts. With respect to Kazakhstan's seemingly contradictory claim that "insofar as [Claimants] did turn to the courts, they did not pursue all

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967 ECT art. 10(12), C-1.

968 *Chevron Corp. (USA) v. Ecuador*, UNCITRAL, PCA Case No. 34877, Partial Award, March 30, 2010 (hereinafter "*Chevron* Partial Award"), ¶ 244, C-285.

969 Statement of Defense ¶¶ 40.2-40.7.

970 Contract No. 305, art. 28.2, C-45; Contract No. 210 and 302, arts. 23.2, C-52 and C-53. *See* Statement of Defense ¶¶ 33.21.

971 Statement of Defense ¶ 40.5.

972 *Generation Ukraine* Award ¶ 20.30, R-2.

available appeals,"[973] Claimants were either denied the possibility to appeal by the relevant courts or precluded from pursuing their pending lawsuits before the local courts by Kazakhstan's repudiation of the Subsoil Use Contracts and seizure of their investments. Therefore, Claimants have "adequately utilized the means made available to them to assert claims and enforce rights . . . in a manner that attracts the protection" of Article 10(12) of the ECT.[974]

551. Finally, Kazakhstan's assertion that "it was legally correct and not to KPM's disadvantage that it was not a party to the [criminal] proceedings"[975] is breathtaking. Claimants do not deny that "a measure of deference" is to be "afforded to the domestic justice system."[976] However, Kazakhstan has far exceeded whatever "measure of deference" may exist under international law, as evidenced, *inter alia*, by its attempts to justify the findings of its courts *ex post facto* in the present arbitration.[977] In any event, the Tribunal need not review the criminal case against Mr. Cornegruta and KPM *de novo* to decide that the Kazakh court decisions were far from "perfectly legal"[978] or not even remotely "fair and impartial." No fair and impartial judge would have convicted KPM, which was not a party to the criminal proceeding and could not have been, since criminal charges may not be brought against a legal entity under Kazakh law. Likewise, no impartial court would have convicted KPM and Mr. Cornegruta when there was no "main" pipeline, as acknowledged repeatedly by the Kazakh State authorities. Additionally, a fair judge would have considered all the evidence before it and not disregarded multiple expert reports from Claimants. An impartial court would not have based its decision on a conclusory opinion drafted in a couple of days by an unqualified employee of the Ministry of Justice. A fair judge would also have given KPM a right to present its case and would not have prevented KPM from appealing the decision.

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973 Statement of Defense ¶ 40.4.

974 *Chevron* Partial Award ¶¶ 268-69, C-285.

975 Statement of Defense ¶ 40.5.

976 *Chevron* Partial Award ¶ 247, C-285.

977 *See* Reply Memorial, Section III.C, *supra*. This is also evidenced by Kazakhstan's attempts to shield its so-called "taxation measures" and the ensuing court decisions from review by the present Arbitral Tribunal.

978 Statement of Defense ¶ 40.5.

552. Kazakhstan clearly violated Article 10(12) of the ECT, a standard specifically designed to protect foreign investors from gross travesties of justice such as those suffered by Claimants in the present case.

H. Kazakhstan Violated Its Obligation to Permit Claimants to Employ Key Personnel of Their Choice

553. Kazakhstan also violated Article 11(2) of the ECT, which states:

> A Contracting Party shall permit Investors of another Contracting Party which have Investments in its Area, and Investments of such Investors, to employ any key person of the Investor's or the Investment's choice regardless of nationality and citizenship provided that such key person has been permitted to enter, stay and work in the Area of the former Contracting Party and that the employment concerned conforms to the terms, conditions and time limits of the permission granted to such key person.

554. Article 31 of the Vienna Convention on the Law of Treaties provides the general rule of treaty interpretation under customary international law. Article 31 provides in relevant part:

> A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose.[979]

555. According to the ordinary meaning of Article 11(2) of the ECT, Claimants were entitled to employ any key in-country personnel they wished. However, Kazakhstan arrested and incarcerated Mr. Cornegruta, the general manager of KPM, on trumped-up criminal charges. Moreover, Kazakhstan relied on the same spurious legal grounds to initiate criminal actions against four other general managers of Claimants and threaten their arrest. Those four general managers had no choice but to flee the country. Kazakhstan also summoned, interrogated, and threatened a number of Claimants' key in-country personnel, based on the same manufactured allegations, so that Claimants had no choice but to recall all their key personnel from Kazakhstan. Therefore, Kazakhstan violated its obligation to permit Claimants to employ key personnel of their choice under Article 11(2) of the ECT.

[979] Vienna Convention art. 31(1), C-203.

VII. KAZAKHSTAN'S MEASURES CAUSED DAMAGE TO CLAIMANTS AND THEIR INVESTMENTS

556. A principal objective of the State's harassment campaign was to devalue Claimants' investments in an effort to acquire them for far less than their fair market value. Kazakhstan saddled KPM and TNG with unfounded liabilities, interfered with the companies' cash flows, and obstructed the sale of the companies all as part of a coordinated strategy to force Claimants to sell the companies to KazMunaiGaz at a firesale price. When that strategy failed — because Claimants defiantly refused to buckle under to Kazakhstan's pressure — Kazakhstan simply seized the investments, deciding to take its chances in arbitration.

557. In its Statement of Defense, Kazakhstan makes a series of disingenuous arguments about the value of Claimants' investments in an effort to enlist the Tribunal in accomplishing the objective it could not accomplish in negotiations with Claimants — namely, acquiring Claimants' investments for far less than their worth. In summary, Kazakhstan argues that the value of Claimants' investments as of October 14, 2008 (the valuation date used by Claimants) was significantly less than Claimants calculate; that Claimants' investments were of *de minimis* value by the time of their final seizure in July 2010; and that, between October 2008 and July 2010, "there are other possible causes of a reduction in the value of the Claimants' investments that cannot possibly be attributable to the Republic and may even be attributable to the Claimants."[980] More specifically, Kazakhstan's assertions include:

- That "Claimants have failed to adequately plead loss attributable to any of the Claimants,"[981] apparently alleging that Claimants have not shown any injury to their investment equity interests;
- That Claimants have failed to demonstrate a causal link between the State's actions and injury to their investments;
- That the October 14, 2008, valuation date used by Claimants should be rejected, and that the date for assessing the fair market value of Claimants'

[980] Statement of Defense ¶ 46.12.

[981] Statement of Defense ¶ 46.3. Respondents' introductory arguments in Sections 44 and 45 of its Statement of Defense hardly merit a response. Section 44 merely asserts that Claimants are entitled to no compensation because they have not established jurisdiction or a violation of the ECT. That is incorrect. Section 45 of the Statement of Defense agrees with Claimants that fair market value is the correct standard for valuing an investment, and raises immaterial quibbles about the definition of fair market value.

investments should instead be the date of final seizure by the State, July 21, 2010;

- That the future export gas pricing calculations made by Claimants in connection with the valuation of TNG are incorrect and a proper valuation should assume only domestic gas sales at domestic gas prices;

- That water production in TNG's Tolkyn gas field began increasing significantly in 2007, undermining the future productivity of the Tolkyn field and making Claimants' forward looking estimates of gas production as of the October 14, 2008 valuation date incorrect;

- That over-production of the Tolkyn field by Claimants in 2008 allegedly damaged the field by causing an increase in water production in 2009;

- That, as a consequence of increased water production in the Tolkyn field, extensive capital investment is now required to increase gas production, which in turn reduces the profitability and value of the field;

- That a proper forecast for future production from the Tolkyn and Borankol fields should be based only on existing wells with minor workovers and recompletions, and on a limited work program, thereby significantly reducing the future production forecast;

- That certain unnecessary and overestimated capital expenditures and costs must be added to the operations of the seized investments which dramatically reduce the value of KPM and TNG;

- That Claimants' have included in their estimates of future production from KPM's Borankol field an unexplained production increase for 2015 and 2016, and that this production increase should be excluded in reaching a valuation for KPM;

- That Claimants have used an improper method for estimating future oil and condensate prices in their calculation of the value of KPM;

- That Claimants' un-risked prospective valuation for the Contract 302 Properties improperly values Claimants' loss of opportunity to prove the full value the Properties, and that the Contract 302 Properties should instead be valued at US$ 68 million;

- That Claimants' prospective valuation of the LPG Plant is improper because Claimants have not shown that there would have been sufficient gas supplies to operate the Plant at capacity; and

- That Claimants' assessment of the investment value of the LPG Plant is improper, and that the LPG Plant has only salvage value.

558. The first three assertions by Kazakhstan in the foregoing list will be addressed in this submission. The remaining assertions, among others, will be addressed in Claimants' Reply on Quantum. Each of the assertions individually is erroneous, and in combination they ignore the effect of Kazakhstan's deliberate, coordinated efforts beginning in October 2008 to drive down the value of Claimants' investments.

559. There is more than a little irony in Kazakhstan's damages arguments. Kazakhstan repeatedly asserts as a justification for seizure of Claimants' investments their "strategic importance" to the State, and the State's Geology and Subsoil Use Committee stated just five days before final seizure that the LPG Plant, "in case of its complete fulfillment, would be of great regional and industrial importance for development of the region."[982] These are the same assets that Kazakhstan now argues have "little value"[983] and, in the case of the LPG Plant, amount to scrap.

560. Kazakhstan purportedly arrives at a range for the total market value of Claimants' investments, as of its chosen July 21, 2010 valuation date, of US$ 161 to US$ 237 million.[984] To arrive at this exceedingly low value, Kazakhstan fabricates capital costs, overstates operating costs, ignores existing reserves, fabricates artificially low gas, oil, and condensate prices, attributes no value at all to five of the six resource areas at issue in the Contract 302 Properties, relegates the LPG Plant to scrap value, and ignores entirely any attributes of the investments that would be of uniquely enhanced value to the State itself.

561. To put this low valuation by Kazakhstan in perspective, it should be contrasted with the terms of the Cliffson offer, an offer that remained outstanding at the time of Kazakhstan's July 21, 2010 seizure of Claimants' investments, and an offer that was made by a purchasing group with political connections in Kazakhstan that was fully aware of (and benefited from) Claimants' precarious situation.[985] The Cliffson offer was for more than US$ 920 million, a rather staggering US$ 693 million more than the State now claims the investments are worth.[986]

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982 Acts on Results of Inspection of Tolkynneftegas LLP, July 16, 2010, at "Commissions Conclusions" ¶ 4, C-315.

983 Statement of Defense ¶ 31.158 (b).

984 Deloitte Report ¶¶ 11.1, 11.4.

985 A full description of the Cliffson offer is set out at Section IV. B(2)(d) of this Reply. *See also* Second Stati Statement ¶¶ 27-28.

986 *See* Cliffson Sale Agreement, § 2.1 and Schedule 6, C-540; Second Stati Statement ¶ 27.

The Cliffson offer speaks volumes about the credibility of Kazakhstan's damages related contentions in this proceeding.

562. What the State has been doing with Claimants' investments since the time of their seizure is unclear. Kazakhstan has produced little documentation or evidence concerning the current state of production and development in the Tolkyn and Borankol fields, the current state of exploration and development in the Contract 302 Properties, or the current or intended development and use of the LPG Plant. Kazakhstan only states in conclusory fashion that "There has . . . been no investment in the territories since they have been held in trust management and production levels have continued the trend of decline (from 2008 onwards) since KPM and TNG abandoned the property."[987] This statement by Kazakhstan appears to be an outright falsehood, since the documents that Kazakhstan has produced (and that Claimants have been able to review to date) show that Kazakhstan is training specialists for operation of the LPG Plant, a rather clear indication that Kazakhstan is going to complete the Plant and put it into operation,[988] and that Kazakhstan has conducted at least one, if not more, recompletions in the Tolkyn field. Furthermore, summary dismissal of the value of Claimants' investments by Kazakhstan begs the question of why such insignificant assets were seized at all.

A. Claimants Have Proven Loss

563. Kazakhstan begins by stating in Section 46 of its Statement of Defense that "Claimants have failed to adequately plead loss attributable to any of the Claimants." Although this argument is close to indecipherable, Kazakhstan makes two discernible assertions here.

564. The first assertion is that Claimants only describe the effect of Kazakhstan's actions on the four categories of assets set out in Claimants' compensation claim, rather than the effect on each Claimant's investment, and that Claimants have failed "to establish which alleged investors own or control which alleged investments."[989]

565. To the extent that Kazakhstan is arguing here that Claimants must segregate their compensation claim into discrete categories of injury for each individual Claimant, Kazakhstan

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987 Statement of Defense ¶ 36.14 (f).

988 *See* "Application of the need for trained workforce; Projects included in the map of industrialization for 2012-2014," identifying the Borankolsky gas processing plant, Mangystau, Beineu district, Borankol, C-583.

989 Statement of Defense ¶¶ 46.3-46.5.

cites to no authority requiring such a segregation, and there is none. Claimants have pled and proved their respective interests in the seized assets at issue in this case. As made clear in Section III A. of Claimants' Statement of Claim, and in Section II D. of this Reply, Anatolie Stati and Gabriel Stati own 100% of Moldova-based Ascom and Gibraltar-based Terra Raf, and Ascom and Terra Raf were in turn 100% owners of KPM and TNG and the assets of those entities, including the LPG Plant. Indeed, the State itself explicitly acknowledged the ownership interest of Ascom in KPM.[990] Similarly, before its arbitrary reversal of its position on December 18, 2008, the State acknowledged the legitimacy and effect of the share transfer from Gheso to Terra Raf vesting Terra Raf with 100% ownership of TNG.[991] And regarding the LPG Plant, the State expressly acknowledged shortly before its seizure that the Plant was "an independent investment project" of TNG.[992] Moreover, Kazakhstan implicitly acknowledges in its Statement of Defense that Claimants were owners of the LPG Plant when it makes the curious statements that the LPG Plant (although indisputably seized) was not "transferred to KazMunaiGaz on trust management and therefore it still remains the property of TNG," and "Claimants . . . have shown no interest in protecting the LPG Plant . . . ."[993]

566. Kazakhstan has also acknowledged that the ECT protects directly and indirectly owned or controlled investments, stating that "[t]he Claimants are required to demonstrate that the alleged investment is either owned or controlled (either directly or indirectly) by an investor

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990 *See* Letter from the Agency of the Republic of Kazakhstan on Investments No. 3-3016, November 18, 1999, C-47; Letter from KPM to the Agency of the Republic of Kazakhstan on Investments dated December 23, 1999, C-49; Letter from Agency of the Republic of Kazakhstan on Investments to KPM dated December 30, 1999, C-48. *See also* Register of KPM's Shareholders No. 1395, December 15, 2004, C-50; Articles of Association of Limited Liability Partnership "Kazpolmunay", April 20, 2005, C-36.

991 *See* Letter from the General Prosecutor's Office to the MEMR, February 21, 2007, C-133; Excerpt from the Minutes of Meeting of the Appraisal Commission, February 20, 2007 (allowing the transfer of the shares of TNG from Gheso to Terra Raf), C-134; . *See also* Sale and Purchase Agreements, May 17, 2000, between Ascom, Kainar-Ltd. LLP, Dobro PKF LLP, and Anavi LLP, C-54 (pursuant to which Ascom acquired 75% or TNG and the TNG Subsoil Use Contracts; Sale and Purchase Agreement between Ascom and Gheso JSC, registered by TNG's registrar, March 13, 2002, C-55 (pursuant to which Ascom transferred its 75% interest in TNG to its subsidiary, Gheso S.A.); Sale and Purchase Agreements between Gheso JSC and Kainar-Ltd. LLP, Dobro PKF LLP, Nd Anavi LLP, C-56, 57, and 58 (pursuant to which Gheso acquired the remaining 25% interest in TNG); Register of TNG's Shareholders, May 7, 2002, C-59 (acknowledging Gheso's 100% ownership of TNG); Sale and Purchase Agreement between Gheso and Terra Raf, May 12, 2003, C-60 (pursuant to which Gheso transferred its 100% ownership of TNG Terra Raf).

992 Acts on Results of Inspection of Tolkynneftegas LLP, July 16, 2010, at "Commissions Conclusions," C-315.

993 Statement of Defense ¶¶ 31.152, 31.165.

under the ECT".[994] Claimants here jointly owned and controlled, directly and indirectly, all of the assets of KPM and TNG that were unlawfully expropriated by the State. The distribution of any recovery amongst the respective Claimants and their creditors is of no relevance to the Tribunal's ascertainment of the total compensation due for that injury as a result of Kazakhstan's Treaty breaches.

567. The second assertion by Kazakhstan, found in Paragraph 46.6 of its Statement of Defense, is that "[n]o mention at all is made as to the effect (if any) on the equity interests in KPM and TNG assets that the Claimants asserted were investments at paragraph 34 of the Statement of Claim."[995]

568. If by this cryptic statement Kazakhstan is contending that the State's actions had no effect on the free alienability and consequent diminution in value of Claimants' equity interests, the statement is pure nonsense. It is patently evident that the State concocted its criminal case for alleged operation of a trunk pipeline without a license as a vehicle by which it could seize KPM and TNG assets, including Claimants' KPM and TNG equity interests, thereby encumbering them and preventing their alienation.

569. The evidence shows that the State was, from the very outset of its campaign, intent upon using this criminal-law vehicle despite the obvious impediment presented by the lack of any KPM or TNG trunk pipeline. As made clear in Claimants' Statement of Claim and the discussion above,[996] the Kazakh Financial Police had to coerce the relevant Kazakh regulatory agencies into making a finding that what were self-evidently not trunk pipelines were in fact trunk pipelines. After coercing this preposterous finding and launching its criminal case, the Financial Police then issued resolutions for the arrest of Claimants' equity interests in KPM and TNG on April 30, 2009 (five days after the arrest of Mr. Cornegruta),[997] and delivered a

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[994] Statement of Defense ¶ 9.18. That the ECT protects directly and indirectly owned or controlled investments is plain from the text of Article 1(6) of the ECT, which defines "investment" as "[e]very kind of asset directly or indirectly owned or controlled by an Investor." It is therefore sufficient for the Claimant investor to either "own *or* control" the investment (emphasis added), be it directly or indirectly, for the investment to qualify for protection under the ECT.

[995] Statement of Defense ¶ 46.6.

[996] *See* Statement of Claim at Section IV.B., and Section V.C., *supra*.

[997] *See* April 30, 2009 orders for arrest of KPM's and TNG's equity interests, Subsoil Use Contracts, the KPM and TNG in-field pipelines that had been reclassified as main pipelines, and the companies' vehicles, referred in Section III.C.(3), *supra*.

notification that it had seized Claimants' equity interests in KPM and TNG effective May 13, 2009.[998] The notice of seizure effective May 13, 2009 stated that "100% share ownership in the statutory capital" of KPM and TNG had been "sequestered," and "[i]t is prohibited to dispose, i.e. carry out any actions related to alienation or transfer of the aforementioned property to third parties."[999] There could be no more direct effect on Claimants' equity interests in KPM and TNG than this outright ban on their alienability.[1000]

570. Alternatively, to the extent that Kazakhstan's cryptic statement in Paragraph 46.6 of its Statement of Defense is suggesting that Claimants have improperly failed to provide a discrete valuation of their equity interests in their compensation claim, this suggestion is equally in error. In the present case, the total value of the assets that Kazakhstan seized (summarized in Paragraph 465 of the Statement of Claim) is the amount of the effect on Claimants' equity investment because Kazakhstan seized all of the assets of KPM and TNG but did not assume or extinguish any of their accompanying liabilities. In so doing, Kazakhstan deprived Claimants of their ability to receive their equity value in KPM and TNG free and clear of all debts. Consequently, a proper measure of compensation in this case must calculate Claimants' investment based on the total value of the assets that Kazakhstan seized without deducting the value of the debt (for which Claimants remain liable).

571. The notes that were issued by Tristan Oil Ltd., which provided a portion of the capital for construction and operation of the KPM and TNG oil and gas assets, illustrate why this is so. Tristan issued notes with a face value of US$ 531.1 million, which matured on January 1,

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998 *See* Notification of arrest of KPM and TNG assets, May 15, 2009, C-485.

999 *Id.*

1000 Regarding the State's freezing of Claimants' equity interests in KPM and TNG, Respondent states at Paragraph 26.26(c) of its Statement of Defense that:

> It is not admitted that on 15 May 2009 the Financial Police notified KPM and TNG that it had seized KPM's and TNG's equity interests on 13 May 2009 and the Claimants are put to proof that such notification was given or that such seizure took place as asserted in paragraph 121 of the Statement of Claim. That said, if the allegation is that KPM and TNG were prevented from selling or transferring their interests *"during the proceedings against Mr Cornegruta"*, such a move would seem entirely appropriate in the circumstances. As the Claimants admit, the assets *"could otherwise be used in normal business operations"* and if the Financial Police moved to gain interim measures of security over KPM and TNG pending the resolution of a bona fide underlying dispute, this would not be surprising.

This disingenuous combination of denial and admission glosses over both the underlying impropriety of the State's criminal action in the first instance, and the clearly intended effect of the State's fabricated criminal action on the free alienability of Claimants' assets.

2012. While Tristan is the nominal principal obligor on those notes, Tristan is a special purpose entity that was created solely for the purpose of raising capital through the note issuance to fund KPM and TNG. It has no operating assets with which to repay the notes. The expectation of all parties involved, including the Tristan noteholders, was that KPM and TNG oil and gas operations would provide the funds to repay the principal and interest on the Tristan notes. Consequently, KPM and TNG guaranteed repayment of all obligations under the Tristan notes.[1001]

572. Moreover, Ascom and Terra Raf secured those guarantees through a pledge of 100% of their share interests in KPM and TNG. Those share pledges provide:

> On the occurrence of an Event of Default, (a) the Collateral may be realised in whole or in part by the Pledgeholder in a compulsory extra-judicial procedure in accordance with Kazakhstan Law or otherwise as may be permitted by Kazakhstan Law or any other applicable law, and (b) the Pledgeholder is entitled to receive and apply any and all dividend and other payment or distributions of any kind relating to the Participatory Interest as if the Pledgeholder were the holder of the Participatory Interest in and towards discharge of the Secured Obligations until such time as the Secured Obligations are fully discharged without prejudice to its rights under the Documents and without any obligation to exercise such rights prior to enforcement of or action under this Agreement, and (c) exercise the voting rights attached to the Participatory Interest.

Accordingly, the Tristan noteholders may seek to enforce their claims on the Tristan Notes against any award in this proceeding.

573. Similarly, KPM and TNG guaranteed other debts incurred by affiliates in transactions that financed the operations of KPM and TNG. Specifically:

- TNG guaranteed indebtedness of Montvale Invest, Ltd. to Vitol, S.A., pursuant to a Crude Oil Marketing Services Agreement ("COMSA") between TNG, Montvale, and Vitol. Under that COMSA, TNG assigned its right to export crude oil and condensate to Montvale, which in turn sold oil and condensate to Vitol. The COMSA allowed Montvale to demand substantial prepayments from Vitol. Montvale in turned provided those funds to TNG, which TNG applied toward a portion of the costs to construct the LPG Plant;

[1001] *See* Tristan note indenture § 11.01, C-584.

- KPM guaranteed similar indebtedness of Montvale to Vitol with respect to crude oil that KPM sold to Vitol through Montvale; and

- In June of 2009, TNG and KPM guaranteed a US$ 60 million loan facility obtained by Laren Holdings, Inc. Laren loaned US$ 30 million of those funds to Montvale to pay tax obligations on behalf of KPM and TNG. Laren used the remaining US$ 30 million to purchase Tristan Notes, which Laren assigned to the lenders of the loan facility. Tristan used the proceeds of that Note sale to pay accrued interest on the outstanding Tristan Notes.

574. In short, Claimants financed the operations of KPM and TNG in part with debt incurred outside of those two companies, but which those companies nevertheless guaranteed. For this reason, any sale of Claimants' equity interests in, or the assets of, KPM and TNG would require arrangements to satisfy the debts held outside of (but guaranteed by) those companies.[1002] There are basically two ways that could be accomplished.

575. First, the buyer could purchase the companies on a debt-free and cash-free basis (*i.e.*, based on "enterprise value"), with Claimants paying off the debts out of the proceeds of the sale. This is the model reflected in most of the indicative offers that Claimants obtained in Project Zenith.[1003] For instance, if Claimants had consummated a sale to KNOC on the terms set out in its indicative offer, then: (1) the final transaction documents would have arranged for the satisfaction of all debts held or guaranteed by KPM and TNG out of the purchase price; (2) KNOC would have received the shares of KPM and TNG free and clear of all debts; and (3) Claimants would have received US$ 1.55 billion less the amount used to pay off the aforementioned debts, free and clear of all debts.

[1002] This is in fact required by the financing agreements. *See* Tristan Indenture § 11.05(a) (requiring that the proceeds of any sale of the assets of KPM and TNG be applied to satisfy the obligations under the Tristan Notes before the guarantees of TNG and KPM will be released), C-584; Ascom and Terra Raf Pledge Agreements, § 4.2(j)(ii) (prohibiting Ascom and Terra Raf from selling, transferring, or otherwise disposing of their share interests in KPM and TNG except with the consent of the Tristan Note holders), C-585.

[1003] The process letter issued by RenCap for the first round of Project Zenith instructed the participants to state the amount of cash "which you are prepared to pay on a debt (including intergroup balances) and cash free basis….", C-303. Four of the indicative offers expressly stated that they were presented on a debt-free and cash-free basis (*i.e.*, "enterprise value"). *See* C-18 (KNOC indicative offer); C-19 (KazMunaiGaz indicative offer); C-73 (Safmar indicative offer); C-76 (OMV indicative offer). Two of the indicative offers were silent, and thus it is assumed that they were presented on a debt-free and cash-free basis as stated in the process letter. *See* C-71 (Meridien indicative offer); C-72 (CNPC indicative offer). *See generally* May 17, 2011 FTI Report, Table 36.

576. Second, the buyer could purchase the companies based on the value of the Claimants' equity interests (*i.e.*, on an "equity value" basis), with the buyer assuming or paying off the debts. This is the model reflected in the Cliffson, Starleigh, and KazMunaiGaz (June 2009) offers.[1004] Thus, for instance, if Claimants had been able to consummate the sale to Cliffson then: (1) Cliffson would have assumed or paid off all debts held or guaranteed by KPM and TNG out of its pocket; and (2) Claimants would have received US$ 277 million free and clear of all debts.

577. As explained in the Statement of Claim, "'absent limiting terms in the relevant treaty, it is generally accepted today that, regardless of the type of investment, and regardless of the nature of the illegitimate measure, the level of damages awarded in international arbitration is supposed to be sufficient to compensate the affected party fully and to eliminate the consequences of the state's action.'"[1005] Kazakhstan does not dispute these principles, and there are no limiting terms in the ECT.

578. Kazakhstan's violations of the ECT have deprived Claimants of their ability to realize the equity value of their investments free and clear of all debts. Kazakhstan seized the assets of KPM and TNG, but has not assumed or performed those companies' guarantee obligations. Thus, to make Claimants whole, an award must either: (1) be calculated based on the equity value of Claimants' investments, *and* require Kazakhstan to satisfy all the debts guaranteed by KPM and TNG; or (2) be calculated based on the enterprise value of Claimants' investments, with Claimants remaining responsible for the debts guaranteed by KPM and TNG.

579. The first alternative is not practicable in this instance because there is no effective means for the Tribunal to ensure that Kazakhstan assumes or satisfies the debt obligations to the satisfaction of third parties such that Claimants have no further liability for those debts. Accordingly, the proper measure of damages in this case should be based on the enterprise value of Claimants' investments in KPM and TNG.

[1004] This also is the model reflected in two of the indicative offers in the first round of Project Zenith. *See* C-74 (TPC indicative offer) and C-75 (Total indicative offer). To compare those offers to the other indicative offers on an enterprise value basis, it thus is appropriate to add the value of debt the buyers were offering to assume. *See* May 17, 2011 FTI Report, Table 36 and n. 229.

[1005] Statement of Claim ¶¶ 389-402 (quoting *Vivendi II* ¶ 8.2.7), C-253.

B. Claimants Have Proven that the State's Actions Caused Injury and Have Demonstrated that the Proper Valuation Date is October 14, 2008

580. Kazakhstan argues in separate sections of its Statement of Defense that (i) "Claimants make no attempt to establish a causal link between the losses claimed and any of the alleged events of indirect expropriation or the alleged breaches of Article 10 of the ECT,"[1006] and (ii) that the Tribunal should adopt July 21, 2010, the date of the State's final seizure of Claimants' assets, as the date for measuring the fair market value of those assets.[1007] These two issues are inextricably intertwined. It is the causal link between Claimants' injury and the State's unlawful conduct in pursuit of its harassment campaign — a campaign which was intentionally launched by the State on October 14, 2008, and continued unabated until the State's outright seizure of Claimants' assets on July 21, 2010 — that provides the very reason for setting the valuation date at the commencement of that campaign.

581. It should be noted preliminarily that Kazakhstan accepts the valuation methodology used by Claimants for the Tolkyn and Borankol properties as of October 14, 2008,[1008] but (i) contests the gas pricing and oil pricing assumptions made by FTI,[1009] (ii) contests certain capital expenditure (CAPEX), operating expenditure (OPEX), and depreciation calculations made by FTI,[1010] (iii) posits that Tolkyn production began to decline in the 2007 to

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[1006] Statement of Defense ¶ 46.7.

[1007] Statement of Defense ¶¶ 47.1-47.13. In effect, Respondent seeks to have the Tribunal apply a valuation date that would be the most conservative conceivable date available for a *lawful* expropriation that meets the conditions of Article 13 of the ECT. Article 13 provides that any expropriation that complies with Article 13(1)'s other requirements (*i.e.*, the taking is for a public purpose, in accordance with due process of law, and is non-discriminatory), shall be "accompanied by the payment of prompt, adequate and effective compensation," which compensation shall further consist of the following:

> Such compensation shall amount to the fair market value of the Investment expropriated at the time immediately before the Expropriation or impending Expropriation became known in such a way as to affect the value of the Investment (hereinafter referred to as the "Valuation Date").

ECT art. 13(1), C-1. By selecting the actual date of State seizure as its valuation date, Respondent is effectively contending that, despite the duration and effect of the State's harassment campaign against Claimants, the State's actions had no effect whatsoever on the value and alienability of Claimants' assets prior to actual seizure, and indeed, that the State's intention to expropriate was not known prior to the actual date of seizure. Given the litany of State unlawful conduct that preceded the July 2010 seizure, and the overwhelming evidence that seizure was in fact the goal of the State when it commenced its expropriative campaign in October of 2008, Respondent's extreme position regarding the proper valuation date is untenable.

[1008] Statement of Defense ¶¶ 50.2 (a); 51.1.

[1009] Statement of Defense ¶¶ 49.1-49.15.

[1010] Statement of Defense ¶¶ 49.16-49.19; 51.4.

2008 period as a consequence of then-significant watering issues with the Tolkyn gas wells,[1011] and (iv) complains about "significant unexplained production increases in 2015 and 2016" in the Borankol field production projections.[1012] Kazakhstan's contentions regarding these individual issues are incorrect, and will be addressed in the Reply Reports of FTI and Ryder Scott. These elements of methodological application aside, however, Kazakhstan's principal argument against the fair market value assigned by Claimants to the Borankol and Tolkyn properties is that the valuation date of October 14, 2008 is itself improper.[1013]

582. Just as Kazakhstan accepts the valuation methodology adopted by Claimants, Kazakhstan accepts that the international law principles cited by Claimants would render the October 14, 2008 valuation date appropriate if the facts support the date.[1014] By mischaracterization of Claimants' contentions and selective recitation of the facts, however, Kazakhstan contends that no injury to Claimants can be traced to October 14, 2008, and, to the extent the State's actions did cause injury, that injury did not manifest itself until some time thereafter.[1015] In short, Kazakhstan's argument is designed to push the valuation date to, or as close as possible to, the State's final July 21, 2010 seizure date in order to reap the benefit of the devaluation and inalienability of Claimants' properties caused by the State's misconduct. This, however, is precisely the unjust result that international law seeks to avoid.

583. Kazakhstan's mischaracterization of Claimants' contentions is as much omission as commission. It is telling, for example, that Kazakhstan does not reference at all Claimants' efforts to sell their assets or the effect of the State's actions on the alienability of those assets in either its argument concerning the causal link between the State's actions and Claimants' injuries,[1016] or its argument concerning the proper valuation date.[1017] Turning a blind eye to

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[1011] Statement of Defense ¶¶ 46.13-46.16; 50.5.

[1012] Statement of Defense ¶ 51.5.

[1013] Statement of Defense ¶¶ 50.2; 51.6-51.7.

[1014] "As to the unlawful actions in breach of the ECT (including unlawful expropriation), it is accepted that the measure of damages will be established by general principles of international law." Statement of Defense ¶ 45.4.

[1015] "[I]t is clear there can have been no effect on the value of Claimants investments as of October 2008 or for some considerable time thereafter . . . ." Statement of Defense ¶ 47.7.

[1016] Statement of Defense ¶¶ 46.7-46.18.

[1017] Statement of Defense ¶¶ 47.1-47.13.

Claimants' well documented (and thoroughly argued) efforts to sell, and the effect of the State's actions on those efforts, is consistent with Kazakhstan's utter dismissal of this fact in its treatment of Claimants' claims for indirect expropriation,[1018] for violation of the fair and equitable standard, for violation of the most constant protection and security standard, and for violation of the ECT's impairment and umbrella clauses.

584. It is clear from its discussion of damages in its Statement of Defense that Kazakhstan wants to pigeonhole Claimants' case into a classic claim of creeping expropriation under which alleged ownership-interfering actions by the State eventually "ripen" along a continuum into a taking.[1019] Misclassifying Claimants' case in this way provides Kazakhstan with an avenue to argue (unpersuasively) that no single action by the State during the course of its harassment campaign amounted to a State seizure — other than, of course, the State's ultimate seizure of Claimants' assets on July 21, 2010, which Kazakhstan then claims must be the valuation date if damages are to be awarded. Coupled with this argument is Kazakhstan's repeated and rote assertion that its harassment campaign was merely an appropriate exercise of State regulatory power,[1020] and that it was neither an intentional expropriative campaign nor executed in furtherance of a conspiracy to expropriate. Thus, under this argument, any diminution in the value or profitability of the assets to Claimants between October of 2008 and July of 2010 was not the fault of the State.

585. By this argument, Kazakhstan is effectively contending that Claimants must itemize the loss caused by each discrete act in Kazakhstan's harassment campaign. Kazakhstan goes so far as to argue that "the Arbitral Tribunal is apparently asked to believe that the audit by the Tax Committee in November 2009 alone caused a $2.8bn reduction in the value of the

[1018] Statement of Defense ¶¶ 35.1-35.23.

[1019] Creeping expropriation is only one type of indirect expropriation, and it is not what Claimants allege occurred here. *See* Section VI.B, *supra*. *See, e.g.,* R. Doak Bishop, *International Arbitration of Petroleum Disputes: The Development of a Lex Pertrolea*, 23 Y.B. Comm. Arb. 1133, 1161 (1998) ("A nationalization can be *de jure* or ***de facto***. Creeping expropriation **is a variation** of a *de facto* nationalization in which the expropriation occurs over a period of time by a series of gradual actions and measures rather than by a single act taken at a definite time. For example, new taxes affecting the economic returns of a project or increasing regulations undermining the control of a venture may ripen into an effective expropriation over time.") (emphasis added), C-586; *Tecmed v. Mexico* Award ¶ 114 ("a difference should be made between creeping expropriation and *de facto* expropriation"), C-587.

[1020] *See*, *e.g.*, Statement of Defense ¶¶ 34.10, 34.11, 34.13, 35.15, 35.17, 35.23.

Claimants' investments."[1021] This plainly mischaracterizes Claimants' contentions regarding the manner in which Kazakhstan caused injury to Claimants' investments. Claimants do not contend that each particular event in Kazakhstan's harassment campaign caused the *entirety* of Claimants' losses. Rather, the combined effect of Kazakhstan's conduct caused Claimants to lose control over their investments, deprived them of the rights of autonomous stewardship and free alienability associated with ownership, and violated Claimants' rights to have their investments treated fairly and equitably and in accordance with the other substantive standards of protection in the ECT.

586. Claims of indirect expropriation and for violation of a Treaty's provisions on protection and security, fair and equitable treatment, and impairment are fact-sensitive by nature. The unique facts of each case must be examined to determine the effect of a State's conduct, the nature of the injury inflicted, and the appropriate valuation date that will fully compensate a Claimant for a State's adjudicated unlawful conduct. There is no mechanical formula for determining whether one or more State acts amount to an indirect expropriation or other violation of a treaty.[1022]

587. The factual crux of Claimants' case here is that the State's harassment campaign, initiated on the order of President Nazarbayev on October 14, 2008, was designed to (i) prevent Claimants from selling their properties to a third party, (ii) make normal daily operations an effective impossibility, and (iii) create an extremely risky investment environment to stop Claimants from continuing to make capital outlays for development of their investments. The very purpose of these efforts was to devalue and impair Claimants' investments, thus either forcing Claimants to sell their investments to Kazakhstan at a substantial discount or, by

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[1021] Statement of Defense ¶ 46.9.

[1022] *See, e.g.*, Jan Paulsson & Zachary Douglas, *Indirect Expropriation in Investment Treaty Arbitrations*, *in* ARBITRATING FOREIGN INVESTMENT DISPUTES: PROCEDURAL AND SUBSTANTIVE LEGAL ASPECTS 145-46 (Norbert Horn & Stefan M. Kröll eds., Kluwer Law International 2004) ("[S]tate measures that can potentially impact upon an investor's rights in its investment are too varied to fit into a neat formula."), C-588. As further stated by the Tribunal in *Sempra*, "[i]t follows that it would be wrong to believe that fair and equitable treatment is a kind of peripheral requirement. To the contrary, it ensures that even where there is no clear justification for making a finding of expropriation, as in the present case, there is still a standard which serves the purpose of justice and can of itself redress damage that is unlawful and that would otherwise pass unattended. Whether this result is achieved by the application of one or several standards is a determination to be made in the light of the facts of each dispute. What counts is that in the end the stability of the law and the observance of legal obligations are assured, thereby safeguarding the very object and purpose of the protection sought by the treaty." *Sempra Energy Int'l. v. Argentine Republic*, ICSID Case No. ARB/02/16, Award, September 28, 2007 (hereinafter "*Sempra* Award"), ¶ 300, C-235.

regulatory and criminal harassment, creating an excuse to eventually seize Claimants' investments outright without any compensation. The State's harassment campaign was clearly expropriatory; equally, it violated the ECT's other standards of protection, including the Treaty's most constant protection and security, fair and equitable treatment, and impairment provisions.

588. Regarding Kazakhstan's efforts to prevent the sale of Claimants' investments, the free alienability of assets has long been established under international law as a crucial benefit of ownership with which Kazakhstan may not unlawfully interfere.[1023] Here, Kazakhstan's active and intentional interference with Claimants' efforts to sell their properties after the issuance of Nazarbayev's order on October 14, 2008 is not the only consideration. Nazarbayev's issuance of his order and the resulting harassment campaign necessarily cost Claimants their last opportunity to sell their properties without interference in 2008 during the first round of Project Zenith.[1024] Claimants' decision in the fall of 2008 not to proceed to the binding bid phase of the initial Project Zenith sale process would *not* have been made had they known that Kazakhstan was on the cusp of commencing a harassment campaign that would frustrate all efforts to sell the properties.[1025] Once Claimants realized the threat that Kazakhstan was posing to a sale of their properties, they re-initiated the Project Zenith sale process in the spring of 2009, even in the teeth

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[1023] For example, the 1967 OECD Draft Convention on the Protection of Foreign Property makes clear in the notes to Article 3 that the concept of "taking" applies to misuse of otherwise lawful regulation to deprive an owner of the benefits of ownership, including free alienability:

> 4(a) " . . . By using the phrase 'to deprive . . . directly or indirectly . . . ' in the text of the Article it is, however, intended to bring within its compass any measures taken with the intent of wrongfully depriving the national concerned of the substance of his rights and resulting in such loss (**e.g. prohibiting the national to sell his property or forcing him to do so at a fraction of the fair market price**)."
>
> 4(b) " . . . Thus in particular, Article 3 is meant to cover 'creeping nationalisation' recently practiced by certain States. Under it, measures otherwise lawful are applied in such a way as to deprive ultimately the alien of the enjoyment or value of his property, without any specific act being identifiable as outright deprivation. As instances may be quoted excessive or arbitrary taxation; prohibition of dividend distribution coupled with compulsory loans; imposition of administrators; prohibition or dismissal of staff; refusal of access to raw materials or of essential export or import licences."

OECD Draft Convention on the Protection of Foreign Property, October 12, 1967, 7 I.L.M. 117, 125-26 (1968) (emphasis added), C-589.

[1024] Second Stati Statement ¶ 18.

[1025] Second Stati Statement ¶ 18.

of a declining market,[1026] but by then the opportunity to rapidly see the sale process through was inexorably lost.

589. In a separate section of its Statement of Defense,[1027] Kazakhstan dismisses as irrelevant the offers received by Claimants in the initial Project Zenith sale process that commenced in the summer of 2008 because (i) Claimants' independently initiated that process prior to the issuance of President Nazarbayev's October 14, 2008 order, and hence "Claimants' motivations for sale cannot have had anything to do with the alleged expropriations,"[1028] and (ii) "the offers . . . do not demonstrate accurately the value of the assets at the time" because they were indicative, non-binding, and subject to further due diligence.[1029] Kazakhstan goes on in that section to argue that Claimants' subsequent re-initiation of Project Zenith in the spring of 2009 failed to procure a binding bid because the properties "were not worth very much (if they were worth anything at all),"[1030] and that the State's conduct after President Nazarbayev's October 14, 2008 order simply had no impact on potential buyers.[1031]

590. Having summarily dismissed the importance of the Project Zenith sale process and the impact of its own harassment campaign on the alienability of Claimants' assets, Kazakhstan then dismisses the significance of President Nazarbayev's October 2008 order, stating simply:

> In relation to President Nazarbayev's Order of 14 October 2008, it is denied that the Order could have affected the value of KPM or TNG or their assets in any manner. Indeed it is not apparent that either company was even aware of the Order until some time later.[1032]

[1026] Second Stati Statement ¶¶ 18-19.

[1027] Statement of Defense ¶¶ 16.1-16.11.

[1028] Statement of Defense ¶ 16.1.

[1029] Statement of Defense ¶ 16.8.

[1030] Statement of Defense ¶ 16.10(f). This statement by Respondent must be juxtaposed against Respondent's repeated assertion that Claimants' assets had to be seized because they are "strategic assets" of the State, and the State could not afford to permit these "strategic assets" to be harmed by Claimants ongoing ownership and operation. *See* Statement of Defense ¶¶ 19.26 (d), 31.52, 31.59 (c), 31.129.

[1031] Statement of Defense ¶ 16.10(e).

[1032] Statement of Defense ¶ 47.8.

591. Claimants' lack of knowledge about Nazarbayev's order until some time later, however, is precisely the point. Had Claimants known that the order was coming, and had they known about the impact that the impending harassment campaign would have on their ability to sell the properties, they would have proceeded with sale negotiations with due haste in the fall of 2008.[1033] The State may nevertheless have acted in some manner to prevent any such sale before October 14, 2008 (a reasonable presumption given the alarming rapidity with which the State ramped up its harassment campaign after that date), but such a presumption only serves to emphasize the appropriateness of October 14, 2008 as the valuation date.

592. As it is, Kazakhstan's actions in response to the October 14, 2008 order had a close to immediate effect on Claimants' ability to sell. Not only did the Financial Police initiate a concerted and comprehensive series of audits and inspections in October and November of 2008 by the MEMR, the Tax Committee, the Customs Committee, the National Bank of Kazakhstan, the Geology Committee, the Ecology Committee, and the Ministry of Emergency Situations,[1034] but also on December 18, 2008, the MEMR informed TNG that it was cancelling the State's unequivocal February 20, 2007 approval of the 2003 transfer of 100% of the TNG shares from Gheso to Terra Raf, effectively re-asserting a pre-emptive right to ownership of TNG.[1035] *On the same day* that it notified TNG of its re-assertion of a pre-emptive right, the State issued a press release that unequivocally notified the world of potential buyers that the State was asserting a pre-emptive right to TNG, and falsely accusing Mr. Stati of fraud and forgery in acquisition of the State's February 20, 2007 share-transfer approval.[1036] This press release was followed by a Dow Jones Newswire article on January 14, 2009 reporting that Fitch Ratings had placed Tristan's long term default rating and senior unsecured rating of 'B+' on Rating Watch Negative, and providing a direct link between the State's improper conduct at issue here and the downgrade:

[1033] Second Stati Statement ¶ 18.

[1034] *See* Order from the Financial Police to the MEMR, October 20, 2008, C-9; Order from the Financial Police to the Tax Committee, October 24, 2008, C-10; Order from the Financial Police to the Customs Committee, October 18, 2008, C-11; Order from the National Bank of Kazakhstan, November 2008, C-15; Order from the Financial Police to the Geology Committee, October 28, 2008, C-12; Order from the Financial Police to the Ecology Committee, October 28, 2008, C-13; Letter from the Ministry of Emergency Situation to the Financial Police, October 31, 2008, C-14.

[1035] *See* Notice from the MEMR to TNG, December 18, 2008, C-140.

[1036] *See* Press release circulated on Interfax from the MEMR, December 18, 2008, C-141.

> The RWN reflects Fitch's concern of a potential negative impact relating to the latest actions of the Kazakh authorities on Tristan's financial standing and business prospects. The Ministry of Energy and Mineral Resources of Kazakhstan (MEMR) cancelled a previously issued waiver of the state's pre-emptive rights in respect to one of the two operating companies of Tristan - Tolkynneftegaz LLP (TNG) (accounting for about 69% of the group's 9M08 revenue and 77% of operating profit) - which may result in a revocation of TNG's subsoil use contract. Furthermore, the other operating company of the group - Kazpolmunay LLP (KPM) - is subject to a criminal investigation.
>
> Fitch believes that a negative resolution of either of the authorities' actions will have a significant negative impact on Tristan's operational and financial profile, and is thus likely to result in a multi-notch rating downgrade. Although TNG is the larger of the two operating companies, Fitch believes that the group does not have sufficient financial cushion to service its debt (two eurobond issues totalling USD420m due in 2012) and cover capex needs in case of a detachment of either of the companies.[1037]

593. The chilling effect on any sale negotiations of the State's immediate press release on December 18, 2008, and the Dow Jones Newswire article on January 14, 2009, cannot be minimized. Neither can the rather obvious State purpose of immediately releasing to the press unfounded allegations of forgery and fraud (which it never acted upon in any legal proceeding that would have required it to prove its assertions). To any neutral observer, it was readily apparent by no later than December 18, 2008, that unfettered acquisition of Claimants' assets would be a virtual impossibility.

594. Tellingly, in its argument that the October 14, 2008, valuation date should be rejected, Kazakhstan makes no mention of either its abrupt, December 18, 2008, reversal of its February 20, 2007, share-transfer approval, or its remarkably heavy-handed December 18, 2008 press release. These highly effective State dampers on the free alienability of Claimants' assets were, apparently, too early in the chronology of the State's harassment campaign, and too close to the October 14, 2008 valuation date, to warrant mention by Kazakhstan. Instead, in its effort to push the valuation date forward to July 21, 2010, Kazakhstan globally describes selected

[1037] *See Fitch Places Tristan Oil Ltd. on Rating Watch Negative*, DOW JONES INTERNATIONAL NEWS, January 14, 2009, C-590.

aspects of its harassment campaign and summarily states that these could not have individually had any impact on the operations or value of Claimants' assets.

595. For example, Kazakhstan contends that the plethora of audits and inspections by the Financial Police, and the State's imposition of unwarranted tax levies, had no effect on the operations or value of KPM and TNG.[1038] That contention is sheer nonsense. The inspections and audits were Kazakhstan's enormously time-consuming and threatening pretext for its invention of alleged company infractions. Kazakhstan used the audits and inspections, and the alleged results from them, to impose $62 million in fabricated corporate taxes, to impose illegal export duties, to tie the companies up in a protracted examination of every sales invoice in connection with a fishing expedition for transfer pricing infractions, to fabricate its frivolous criminal case, and to ultimately:

- impose a $145 million criminal fine;
- freeze Claimants' equity interests in KPM and TNG to prevent their alienation during the course of the criminal proceedings (a freeze that notably remains in place to this day despite the presumed non-existence of any remaining criminal proceedings against KPM and TNG);
- render collection orders against all of KPM's Kazakh bank accounts and seize the accounts and the cash within them;
- seize KPM's vehicles and place them in an impound yard;
- seize land administered by KPM in Beyneu district;
- seize KPM's oil pipeline from its processing and pumping unit to its Opornaya raw material resources base;
- seize KPM's accumulator oil tanks;
- prohibit KPM's transfer of oil from the oil accumulator tanks to the Uzen-Atyrau-Samara main oil pipeline operated by KazMunaiGaz' subsidiary KazTransOil; and
- prohibit contracting for the import and export of goods and property.

596. This State inspection and audit assault clearly interfered with the day-to-day operations of KPM and TNG, not only through the equity, cash, and equipment seizures and

[1038] Statement of Defense ¶¶ 47.9, 47.10.

production transfer prohibitions, but also in the consumption of employee time. As described by the former General Manager of TNG and Deputy General Manager of KPM, Mr. Alexandru Cojin:

> Generally speaking . . . I have witnessed KPM and TNG transformed from working, fully operative and functional oil and gas production companies to two bodies that exist to answer requests from various Government officials and write reports. This process began around November 2008 and continued for nearly two years.
>
> The requests that came were voluminous and clearly intended to harass us . . . . In November and December 2008, the Financial Police attended numerous inspections of KPM and TNG and repeatedly called and questioned company employees . . . .[1039]

597. Furthermore, through the vehicle of these audits and inspections, the companies were indisputably devalued by the more than $200 million in trumped up tax assessments and criminal fines; by the impact these monetary liabilities had on the market value Claimants could realize for their assets; by the cloud on the transferability of Claimants' equity interests; and by the chilling effect such State impositions of arbitrary and debilitating monetary liabilities undoubtedly had on prospective purchasers.

598. Remarkably, Kazakhstan also contends that "the arrest of Mr. Cornegruta and the trial of KPM" did not effect the operations or value of KPM or TNG "in any way."[1040] Kazakhstan specifically contends that:

- "[T]he mere prosecution and trial of a company does not affect its value;"[1041]
- The actual criminal judgments had little effect because they were not delivered until September and November of 2009;[1042] and
- "[T]he imprisonment of Mr. Cornegruta" did not affect "the value of either KPM or TNG or any of their assets in any manner" because (i) "Mr. Cornegruta is not an asset and there were other senior managers available

[1039] Cojin Statement ¶¶ 6-8.

[1040] Statement of Defense ¶¶ 47.11, 47.12.

[1041] Statement of Defense ¶ 47.11(c).

[1042] *Id.*

> to continue the operation of KPM," and (ii) "Mr. Cornegruta was not detained until 25 April 2009."[1043]

599. The absurdity and startling callousness of these contentions is matched only by the absurdity and callousness of the criminal case concocted by the State against Mr. Cornegruta. Not only did the criminal proceedings against Mr. Cornegruta and KPM lead directly to the equity, contract, equipment, and cash seizures summarized above, but also they had the clearly intended effect of striking fear into the management of KPM and TNG and ultimately driving them abroad.[1044] It is well worth repeating here Mr. Pisica's description of the State's May 6, 2009 raid of Claimants' offices shortly after Mr. Cornegruta's detention:

> In another twist, on May 6, 2009, the Financial Police raided KPM's and TNG's offices searching for other General Directors of KPM, Messrs. Salagor and Spasov, and the General Director of TNG, Mr. Cojin, as well as for information on their whereabouts. The three in-country managers had been charged of the same offense as Mr. Cornegruta. The twelve-hour search started at 4:20 p.m. on May 6 and ended at 4:15 a.m. on May 7. During the entire time, the employees of KPM and TNG had to stand in the corridor in front of their closed offices waiting for the Financial Police to search the premises.[1045]

600. Kazakhstan's rather bizarre argument that Claimants "abandoned" their investments only serves to prove the point that the State's actions intentionally rendered normal daily operations effectively impossible. Kazakhstan states:

> As highlighted previously, the Claimants had abandoned their investments and left the Republic to deal with the turmoil created. This can be seen as:
>
> (a) **By July 2010 all of the senior and middle management had left the Republic on their own accord. Rather than face the responsibilities and address the Kazakh courts in relation to charges of a serious and criminal nature, they chose to be criminal fugitives of the Republic.**
>
> (b) There was a risk that as a result of this abandonment, without any management, the fields would have been poorly operated or stopped operating at all which could have led to a technological

[1043] Statement of Defense ¶ 47.12.

[1044] First Romanosov Statement ¶ 37.

[1045] First Pisica Statement ¶ 44.

> catastrophe and environmental damage on both a regional and national level.
>
> (c) On a practical level, the subsoil area needed to be transferred into trust management to ensure that the fields continued operation. KPM's and TNG's employees were also offered the opportunity to join KMG to avoid the risk of considerable redundancies and social tension in the region.[1046]

601. That Kazakhstan can feign indignation at the normal reaction of managers being hunted for the purpose of incarceration on false criminal charges speaks volumes about the credibility of its many protestations that it was merely pursuing normal and innocent regulatory monitoring. It was clearly the intention of the State to drive Claimants' managers abroad, and to create the very excuse for seizure that is now manifested in Kazakhstan's "abandonment" argument.

602. Not only were Claimants' normal daily operations progressively undermined by the State's campaign, but Claimants' ongoing investment strategy was also affected in an unsurprising way. Claimants withheld planned expenditures for drilling and field upgrades because the risk associated with such further expenditures was simply too great to warrant them.[1047] This was not "abandonment" of the investments by Claimants — it was a reasonable decision not to risk additional capital in light of the State's increasingly obvious efforts to devalue the investments, prevent their alienation, and very probably seize them. The progressive course of the harassment campaign led Claimants to this inexorable conclusion.[1048] In addition to the State threatening the very ownership of TNG by its prompt, December 18, 2008 reversal of its position on pre-emptive rights, during the course of its expropriative campaign the State had,

- On April 30, 2009, issued resolutions for the arrest of KPM's and TNG's equity interests, Subsoil Use Contracts, the KPM and TNG in-field pipelines that had been reclassified as main pipelines, and the companies' vehicles;[1049]

[1046] Statement of Defense ¶ 31.146.

[1047] Second Stati Statement ¶¶ 35-45.

[1048] *Id*.

[1049] *See* April 30, 2009 orders for arrest of KPM's and TNG's equity interests, Subsoil Use Contracts, the KPM and TNG in-field pipelines that had been reclassified as main pipelines, and the companies' vehicles, referred in Section III.C(3), *supra*.

- On May 13, 2009, "sequestered" these assets, forbidding their alienability during the duration of the State's criminal action;[1050]

- On June 17, 2009, issued a press release from the Financial Police announcing publicly that the investigative phase of the State's criminal action had ended and that the four former and current in-country managers of KPM and TNG would be prosecuted for having realized an "illegal profit" of 147 billion tenge (approximately US$ 980 million as of June 2009);[1051]

- On December 29, 2009, issued a writ of execution against KPM for payment of US$ 145 million as a fine in connection with the contrived criminal conviction of Mr. Cornegruta;[1052]

- On January 10, 2010, issued a court order seizing KPM's bank accounts, including two settlement accounts with Kazkommertsbank in Bostandykskyi District; forty-one settlement accounts with Kazkommertsbank in Aktau City; and nine settlement accounts with Halyk Bank of Kazakhstan in Aktau City, and further issuing instructions to the subject banks to inform the judicial executor whenever it received any funds from KPM;[1053]

- On January 30, 2010, issued instructions to the Chief of the Aktau Territorial Department to execute enforcement procedures including (i) a visit to the Borankol Village to confirm whether KPM was operating, and if so, to make an inventory of and attach its property; (ii) to demand all documentation from KPM; and (iii) to make note of and inventory any motor vehicles discovered that were previously attached;[1054] and

- On February 19, 2010, issued yet another writ of execution formally attaching the 2,186 assets listed in the State's January 26, 2010 inventory of KPM's assets — a list that included everything from the companies' oil and gas wells to their tea, coffee, and sugar — and specifically warning

[1050] *See* Notification of arrest of KPM and TNG assets, May 15, 2009, C-485.

[1051] *See* Press release of the Financial Police, June 17, 2009 entitled "Case investigation regarding the leadership of 'Kazpolmunay' and 'Tolkynneftegaz' accused of illegal conduct of business activities has been finalized in the Mangystau Region," C-118.

[1052] *See* Writ of Execution Issued by the Aktau City Court of December 29, 2009, C-119; *see also* Decision of Aktau City Court, September 18, 2009, C-117; *see also* Cojin Statement ¶¶ 18, 21.

[1053] *See* Order from Chief of Aktau Territorial Department, January 10, 2010, C-121.

[1054] *See* Instruction from Deputy Administrator of Mangystau Oblast Courts to Chief of Aktau Territorial Department, January 25, 2010, C-124.

> KPM's General Manager, Mr. Stejar, that he could face criminal responsibility for embezzlement or alienation of that property.[1055]

603. This ongoing threat to ownership and control over their *existing* capital investments made further capital investment by Claimants untenable.[1056] It was abundantly clear that any additional development of the Borankol and Tolkyn fields would be an invitation to additional penal State actions and seizures.[1057] Hence, Working Programs that were established for the Tolkyn and Borankol fields for the years 2009 and 2010 went unfulfilled by Claimants, who viewed the considerable capital expenditures associated with them as too risky to pursue.[1058] These Working Programs were approved by the State and designed to enhance the productivity of the fields. The enhanced productivity would have come through the drilling of:

- one exploration well and four production wells in the Borankol field in 2009;
- five production wells in the Borankol field in 2010;
- one exploration well in the Tolkyn field in 2009; and
- two exploration wells in the Tolkyn field in 2010.

As Mr. Stati explains:

> Ascom's engineers told me that these wells would have provided substantially enhanced production, and I discussed at length with my engineers and finance staff the costs and benefits of drilling these wells. I decided that to proceed with them did not make business sense because they, or their enhanced production, were likely to become just additional assets for Kazakhstan to attach, levy against, or seize.[1059]

604. Furthermore, the business risk created by the State's conduct made further capital investment in completion of the LPG Plant as nonsensical as further investment in development

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[1055] *See* Order from Chief of Aktau Territorial Department, February 19, 2010, C-125.

[1056] Second Stati Statement ¶¶ 35-45.

[1057] *Id.*

[1058] *See* Working Program for Tolkyn Field for 2009, C-591; Working Program for Tolkyn Field for 2010, C-592; Working Program for Borankol Field for 2009, C-593; Working Program for Borankol Field for 2010, C-594; Second Stati Statement ¶¶ 44-45.

[1059] Second Stati Statement ¶ 45.

of the operating oil and gas fields.[1060] Consequently, in May of 2009, Claimants ceased their capital outlays for construction of the LPG Plant, having already invested more than US$ 245 million in its construction.[1061] The State itself explicitly acknowledged that its own actions had caused the cessation of construction on the LPG Plant in its 2010 verification of the fulfilment of TNG's 2009 contractual and licensing obligations. In the discussion of the capital outlays and construction status of the Plant, the verification states:

> Taking into consideration the sequestration of the subsoil exploitation agreements and the participation quota to the registered share capital, the funding of the construction works was stopped, and the construction entered into conservation. The commissioning at UPG was delayed until further notice.[1062]

Given the State's ultimate and celebratory seizure of Claimants' investments in July 2010,[1063] Claimants' decision not to sink additional money into drilling and the LPG Plant was, in hindsight, indisputably wise.

605. The totality of the State's actions here constitute precisely the type of State conduct that is universally recognized as expropriative. In *Sempra v. Argentina*, the Tribunal provided a synopsis of State measures considered to be tantamount to expropriation:

> The Respondent has invoked, among other authorities, the list of measures considered in the *Pope & Talbot* case as being tantamount to expropriation. These are, in the Tribunal's view, representative of the legal standard required to make a determination on alleged indirect expropriation. **Substantial deprivation results under this list from depriving the investor of control over the investment, managing the day-to-day operations of the company, arresting and detaining company officials or employees, supervising the work of officials, interfering in administration, impeding the distribution of dividends, interfering in the appointment of officials or**

[1060] Second Stati Statement ¶ 40. *See* also, Letter from Terra Raf to the Akim of Mangystau Region, February 23, 2010, C-664; Letter from the Akim of the Mangystau Region to the Prime Minister of Kazakhstan, February 24, 2010, C-365; and Letter from Ascom to the Akim of the Mangystau Region, February 25, 2010, C-366.

[1061] May 17 FTI Report ¶ 6.23.

[1062] January 25-February 5, 2010 "Minutes on the results of the extraordinary verification of the fulfillment of the contractual and licensing obligations . . . by TOO Tolkynneftegaz," at § 11 ("Information concerning the Gas Processing Plant"), C-599.

[1063] *See* First Romanosov Statement ¶¶ 38-39; *"Tolkynneftegaz" was denied the right to build Borankol Gas Processing Plant*, July 21, 2010, *available at* www.zakon.kz (last visited May 6, 2012), C-187.

> **managers, or depriving the company of its property or control in whole or in part. The list of measures could be expanded significantly in the light of the findings of many other tribunals, but would still have to meet the standard of having as a result a substantial deprivation of rights.** [1064]

606. Any expansion of this list would have to contain deprivation of the right to free alienability of an investor's properties, a fundamental prerogative of ownership. With this added to the list, each of these indirectly expropriative measures are present in the case at hand — and most are present to a significantly greater degree than in the typical indirect expropriation case. Considering the cumulative impact of the numerous measures taken by the State in pursuit of expropriation here, any exercise in parsing the individual events to determine their relative severity and impact would be an absurd exercise.[1065] Kazakhstan's suggestion that the Tribunal do so should be rejected.

607. Selection of the appropriate valuation date is critical for purposes of assessing damages that will fully compensate a claimant for a State's unlawful conduct. Here, the totality of Kazakhstan's unlawful conduct constituted not only direct and indirect expropriation, but also, as discussed above, violation of the fair and equitable treatment standard, the most constant protection and security standard, the ECT'S impairment and umbrella clauses, and the ECT's provisions on key personnel and affording effective means of asserting claims.[1066] The principle

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[1064] *Sempra* Award ¶ 284, C-265 (citing *Pope & Talbot Inc. v. Government of Canada*, Interim Award, June 26, 2000, ¶ 100, C-244); Campbell McLachlan, L. Shore & M. Weiniger, INTERNATIONAL INVESTMENT ARBITRATION SUBSTANTIVE PRINCIPLES 298-309 (Oxford University Press 2007) (emphasis added) (footnotes omitted), C-595. In his concurring opinion in *Starrett v. Iran*, Judge Holtzman provided an analogous list of expropriative measures: "I turn now to consider the particular kinds of measures which constitute expropriation. International case law and commentary are rich with examples of the circumstances which deprive an owner of the use, control or benefit of its property. These circumstances include: (i) measures which force the owner to flee the country and thus deprive it of the effective management and control of its property; (ii) measures which deny the owner access to its funds and profits; (iii) coercion and intimidation forcing the owner to sell at unfairly low prices; (iv) interference with the owner's access to needed facilities and supplies; and (v) appointment of conservators or administrators to manage the property in the enforced absence of the owner." *Starrett Housing Corp. v. Iran*, Iran-US Claims Tribunal Case No. 24, Interlocutory Award No. 32-24-1, December 19, 1983, 23 I.LM. 1090, 1124 (1984), C-224.

[1065] The absurdity of the event-parsing exercise in general has been noted by one commentator: "[W]here a slow accretion of interferences with the investor's management or control of the foreign enterprise results in the inability of the project to continue, determining the date on which 'an action' created that result is an absurd exercise." Vance R. Koven, *Expropriation and the 'Jurisprudence' of OPIC*, 22(2) Harv. J. Int'l L. 269, 277 (1981), C-596. Of course, in the case at hand, there was anything but a "slow accretion of interferences." As noted, the State here ramped up its harassment campaign with alarming rapidity.

[1066] *See supra* Section VI.

of "full" compensation for a State's unlawful conduct is widely accepted in both expropriation and non-expropriation cases. Thus, in a recent non-expropriation case, the Tribunal in *LG&E v. Argentina* stated that it "agrees with the Claimants that the appropriate standard for reparation under international law is 'full' reparation as set out by the Permanent Court of International Justice in the *Factory at Chorzów* case and codified in Article 31 of the International Law Commission Draft Articles on Responsibility of States for Internationally Wrongful Acts."[1067]

608. The authorities make clear that, under international law, Claimants are entitled to be fully compensated irrespective of the ECT breach or breaches the Tribunal may find: "International law requires that damages be sufficient to fully compensate a foreign investor for the harms caused by a host government, regardless of whether they are the result of expropriation or some other breach of law."[1068] As stated in *MTD v. Chile*:

> [T]he BIT provides for the standard of compensation applicable to expropriation, "prompt, adequate and effective" (Article 4(c)). It does not provide what this standard should be in the case of compensation for breaches of the BIT on other grounds. The Claimants have proposed the classic standard enounced by the Permanent Court of Justice in the *Factory at Chorzów*: compensation should "wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that had not been committed."[1069]

609. Here, Kazakhstan must "re-establish the situation which existed" before Kazakhstan's wrongful acts, that is, before the *commencement* of the State's unlawful conduct. In other words, Kazakhstan must pay a sum that, in the words of *Chorzów Factory*, would "wipe out all the consequences of the illegal act and reestablish the situation which would, in all probability, have existed if that act had not been committed." The act that triggered

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[1067] *LG&E Energy Corp. v. Argentina*, ICSID Case No. ARB/02/1, Award, July 25, 2007 (hereinafter "*LG&E* Award"), ¶ 31, C-314.

[1068] Henry Weisburg & Christopher Ryan, *Means to be made whole: Damages in the context of international investment arbitration*, *in* EVALUATION OF DAMAGES IN INTERNATIONAL ARBITRATION 165, 172 (Yves Derains & Richard H. Kreindler eds., ICC Services 2006), C-305.

[1069] *MTD Equity Sdn. Bhd. v. Chile*, ICSID Case No. ARB/01/7, Award, May 25, 2004 (hereinafter "*MTD* Award"), ¶ 238 (footnote omitted), C-258. *See also Vivendi II* Award ¶ 8.2.7 ("Based on these principles, and absent limiting terms in the relevant treaty, it is generally accepted today that, regardless of the type of investment, and regardless of the nature of the illegitimate measure, the level of damages awarded in international investment arbitration is supposed to be sufficient to compensate the affected party fully and to eliminate the consequences of the state's action."), C-253.

Kazakhstan's harassment campaign, and the act that constituted the *commencement* of that campaign, was President Nazarbayev's issuance of his October 14, 2008 order. That order was in and of itself a violation of the ECT's fair and equitable treatment standard, most constant protection and security, and impairment provisions. The order targeted only Claimants, and it was not issued to investigate any allegedly known or pre-existing regulatory or legal violations. It was issued as a blanket permit for the Financial Police to conduct a broad fishing expedition, and it was clearly viewed by the Financial Police as an instruction to invent regulatory and legal violations where none in fact existed. Thus, the appropriate remedy is the re-establishment of the circumstances that existed before issuance of the October 14, 2008 order and the immediately ensuing harassment campaign.

610. This principal of full compensation, with its corollary mandate for re-establishment of the situation that existed before a State's wrongful conduct, is equally at play in the adjudication of indirect expropriation cases. Where a state's conduct has involved two or more instances of identifiable expropriative measures, the selection of an early measure, even if less severe or direct than a later measure, will assure both equity and full compensation for the State's unlawful conduct. This principle was at play in *Sedco v. Iran*. In *Sedco*, Iran conceded that expropriation occurred on August 2, 1980 when an oil-industry nationalization law was applied by order to Sediran, a joint stock oil company in which Sedco held its interests. However, on November 22, 1979, well before the actual order applying the nationalization law to Sediran, Iran had appointed temporary managers to run the day-to-day operations of Sediran. This appointment was viewed by the Tribunal as the appropriate date for fixing both liability and valuation. The Tribunal reasoned:

> When, as in the instant case, the seizure of control by appointment of "temporary" managers clearly ripens into an outright taking of title, the date of appointment presumptively should be regarded as the date of taking. The choice of the date of taking is not without significance because the value of the shareholders' expropriated interest may change dramatically during the surrounding time. **Selection of the earlier date of the appointment of government managers as the time of taking is equitably most appropriate given that the Government of Iran and not Sedco became the chief architect of Sediran's fortunes at that point. . . . It is legally the most appropriate date because valuation must discount the effect of expropriatorty acts. . . . The Tribunal thus concludes that Claimant was deprived of its shareholder**

interest in SEDIRAN by the Government of Iran on 22 November 1979.[1070]

611. The notion of full compensation also played a role in the Tribunal's findings in *Amoco International Finance Corp. v Iran*. There, the Tribunal found the date of expropriation (effectively the liability date) to be December 24 1980, when Iran notified Amoco that its joint venture agreement in Khemco was null and void. The Tribunal nevertheless awarded Amoco compensation based on the value of its interest as of July 31, 1979, the effective date of Iran's appointment of temporary managers, who had promptly taken actions contrary to those recommended by Amoco. As stated by the Tribunal:

> It therefore remains only to be seen whether the fact that Iran caused NPC, NIOC and the managing director of Khemco to act in July 1979 contrary to the position taken by the board of directors of Khemco, thus practically depriving Amoco of its rights in the management of Khemco, should be considered to have some bearing on the Claimant's right to compensation. The Tribunal decides that this fact will be duly taken into account by determining that the date to be considered for the valuation of such compensation will be the date at which measures definitively took effect, rather than the date of the final decision of nationalization. Accordingly, the date of valuation of Amoco's expropriated interest in Khemco will be 31 July 1979.[1071]

612. It is important to note that in both *Sedco* and *Amoco International Finance*, the Tribunals explicitly used as the valuation date the date upon which the claimants lost control over the future management direction of their investments. Loss of control in those cases coincided with the appointment of "temporary" state managers who supplanted the decision making authority of the claimants. However, as made clear by the Tribunal in *Tippetts, Abbett, McStratton v. TAMS-AFFA*,[1072] it was not the appointment by the government of an Iranian manager *per se* that was the decisive indicia of loss of control, but the degree of interference by the temporary manager with the owners' property rights or "fundamental rights of ownership":

[1070] *Sedco Inc. v. National Iranian Oil Co*, Iran U.S. Claims Tribunal Case No. 129, Interlocutory Award No. 55-129-3, October 28, 1985, 9 Iran-U.S. Cl. Trib. Rep. 248, at 19-20 (emphasis added), C-597.

[1071] *Amoco Int'l. Fin. Corp. v. Iran*, Iran U.S. Claims Tribunal Case No. 56, Partial Award No. 310-56-3, July 14, 1987, 27 I.L.M. 1314, 1358 (1988), C-247.

[1072] *Tippetts* Award, C-225.

> While assumption of control over property by a government does not automatically and immediately justify a conclusion that the property has been taken by the government . . . such a conclusion is warranted whenever events demonstrate that the owner was deprived of fundamental rights of ownership and it appears that this deprivation is not merely ephemeral.[1073]

613. In the case at hand, while there were no temporary managers appointed, the State's campaign clearly deprived Claimants of both their ability to freely alienate their investments and their ability to freely manage their capital expenditures for improvement of their investments. These were the direct effects of the State's very goal in the conduct of its campaign — preventing a sale to third parties while creating a regulatory and criminal trap to excuse an ultimate and complete seizure if Claimants could not be extorted to "sell" to Kazakhstan at a firesale price. And in assessing the proper valuation date, the Tribunal should be mindful of this evident State intent. While Respondent has protested that it had no such intent, and that it did not engage in a concerted scheme to achieve any expropriatory goals, such protestations should be given little, if any, weight. As noted by one commentator:

> [An] intent to expropriate would be difficult to prove. A government's protestation that it never meant to expropriate cannot be decisive. As Professor Dolzer wrote: ' . . . the mere post-event statement of a government that a taking was not intended cannot, in itself, carry in the weight in the relevant analysis.'[1074]

614. In the ordinary case, an intent to expropriate may indeed be difficult to prove. Here, however, the proof is effectively decisive. Where such proof is abundant, the State's intent to expropriate should be given significant weight in assessing the proper valuation date. As noted by Professors Reisman and Sloan:

> The absence of an expropriatory decree, but the presence of an expropriatory consequence, defines a generic indirect expropriation. But also common to most past indirect expropriations was an expropriatory intent at some level of the governmental apparatus of the host state. In consequential expropriations, states do not form an express intent to expropriate;

[1073] *Id.* at 5, C-225.

[1074] Christoph H. Schreuer, *The Concept of Expropriation under the ECT and other Investment Protection Treaties, in* INVESTMENT PROTECTION AND THE ENERGY CHARTER TREATY 27 (Clarisse Ribeiro ed., JurisNet, LLC 2006) (*quoting* R. Dolzer, *Indirect Expropriation: New Developments?*, 11 N.Y.U. Envt'l. L.J. 90 (2002), C-598), C-212

> indeed, they may not have such an intent at all. **Even though a state's responsibility to pay compensation for expropriation does not, in any event, 'depend on proof that the expropriation was intentional', the manifestation of that intent at some level of the state's government generally furnishes a tribunal with a useful demarcation. It enables a decision-maker not only to confirm that an expropriation has taken place, but to set, based on relatively objective evidence, the moment of valuation — typically, a point in time before the host state's conduct occasioned the depreciation in the value of the foreign investment.**[1075]

615. Where, as in the present case, there is a campaign of unlawful, interfering measures by the State, with the commencement of that campaign being an unfair and inequitable order that implements a deliberate strategy of expropriation through conduct that indisputably violates multiple standards of treaty protection, and the conclusion of that campaign being direct expropriation, equity and full compensation fairly demand that the intentional commencement date of that campaign be chosen as the valuation date. Equity and full compensation are not served by choosing the date of final seizure for valuation, or by granting Kazakhstan a grace period between the date of its order to commence its expropriative campaign and some arguable date thereafter when that campaign ostensibly had its first measurable effects.

616. The Tribunal should accordingly adopt October 14, 2008 as the proper valuation date, and assess the fair market value of Claimants' investments as of that date based upon the information then available to a willing buyer.

C. Kazakhstan's Measures Caused Moral Damage to Claimants

617. Kazakhstan concedes that "moral damages are permissible," and correctly states that they may be awarded "in exceptional cases, provided that:

- the State's actions imply physical threat, illegal detention or other analogous situations in which the ill-treatment contravenes the norms according to which civilized nations are expected to act;
- the State's actions cause a deterioration of health, stress, anxiety, other mental suffering such as humiliation, shame and degradation, or loss of reputation, credit and social position; and

[1075] W. Michael Reisman & Robert D. Sloane, *Indirect Expropriation and Its Valuation in the BIT Generation*, 74 Brit. Y.B. Int'l. L. 115, 130 (2004), C-230.

– both cause and effect are grave or substantial."[1076]

In a series of summary contentions, however, Kazakhstan dismisses the applicability of these general principles to its own misconduct here.

618. Kazakhstan seeks first to narrow these general principles to the specific factual circumstances presented in the *Desert Line v. Yemen* decision, effectively arguing that precedent demands conduct identical to that at issue in *Desert Line* to warrant an award of moral damages.[1077] Thus, Kazakhstan contends that, unlike *Desert Line*, here there was "no seizure of assets by armed forces," there was "no removal of the Claimants equipment by armed forces," and there was "no physical threat or attack on the Claimants, its employees, or its investment."[1078] Setting aside the relatively inconsequential distinction between armed forces and weapons-wielding police, and the fact that physical threats and attacks come in innumerable variations, the very notion that a moral damages award requires a precise repeat of the events at issue in *Desert Line* is sheer nonsense.

619. The purpose of the general principles enunciated above is to provide a framework within which a Tribunal can assess the morality of a State's given conduct. Here, Kazakhstan's conduct fits hand-in-glove with this general framework. There was Kazakhstan's actual, not implied, illegal imprisonment of Mr. Cornegruta on trumped up criminal charges, and there was also Kazakhstan's actual, not implied, threat that the fate of Mr. Cornegruta would be the fate of all of Claimants' general managers were they to remain in the country. And it cannot seriously be contended that actual and threatened imprisonment in a Kazakh jail would cause anything other than "a deterioration of health, stress, anxiety, [and] other mental suffering." Indeed, Kazakhstan's blunt and corrupt use of its police power was deliberately designed to inflict precisely those effects in order to drive Claimants' management personnel from the country and interfere with Claimants' operation and development of their investments. Both cause and effect here were grave and substantial, and the ill-treatment of Mr. Cornegruta and his colleagues clearly contravenes the norms according to which civilized nations are expected to act.

[1076] Statement of Defense ¶ 55.2(b) (quoting *Lemire* Award ¶ 333, C-61).

[1077] Statement of Defense ¶ 55.2(c). *See Desert Line Projects LLC v. Yemen,* ICSID Case No. ARB/05/17, Award, February 6, 2008 (hereinafter "*Desert Line* Award"), C-136.

[1078] Statement of Defense 55.2 (c) (i), (iii), (iv).

620. Furthermore, the facts of the present case are easily analogous to those in *Desert Line.* In *Desert Line*, Claimant alleged that its personnel had been imprisoned for four days, harassed by the Yemini military, and threatened and assaulted with artillery by tribal militants.[1079] Desert Line claimed that it was entitled to moral damages because: (i) Desert Line's executives suffered stress and anxiety from being intimidated, harassed, threatened, and detained; and (ii) Desert Line's business credit, reputation, and prestige had been tarnished.[1080]

621. Here, Mr. Cornegruta was, in Kazakhstan's own words, "sentenced to four (4) years of deprivation of liberty with forfeiture of property and service of sentence in the penal colony of general regime."[1081] Mr. Cornegruta's sentence and time in this wrongful detention considerably exceeded the four days at issue in *Desert Line*. This was coupled with Kazakhstan's intimidating threats of similar imprisonment for TNG's management, which Kazakhstan itself admits was the cause of their flight from the country.[1082] There is little, if any, distinction between the stress and anxiety of Desert Line's executives at the hands of Yemeni intimidation, harassment, threats and detention, and the stress and anxiety suffered by Claimants' personnel at the hands of Kazakh intimidation, harassment, threats and detention. And as in *Desert Line*, Claimants' business credit, reputation, and prestige was directly affected not only by the false criminal proceedings and accusations, but also by Kazakhstan's publication of unfounded claims of fraud against Mr. Stati in connection with the State's arbitrary reversal of its prior pre-emptive rights decision.[1083] The Tribunal in *Desert Line* rightly found that the physical duress exerted on Desert Line's executives was malicious, and held that the government of Yemen was liable "for the injury suffered by the Claimant, whether it be bodily, moral or material in nature."[1084] The same finding is warranted here.

622. Having summarily, and wrongly, dismissed Claimants' moral damages claim as insufficiently identical to *Desert Line*, Respondent then simply waves away as inconsequential

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[1079] *Desert Line* Award ¶¶ 33-34, 166, C-136.

[1080] *Id.* ¶ 286.

[1081] R-169, at 2.

[1082] As Respondent phrases it, "TNG's management had escaped full investigation of similar charges by fleeing the country and evading arrest." Statement of Defense ¶ 31.91.

[1083] *See* Second Lungu Statement ¶¶ 7, 10; Second Stati Statement ¶ 16.

[1084] *Desert Line* Award ¶ 290, C-136.

the impact of the State's criminal investigations and proceedings on Claimants' personnel. Kazakhstan again insists that the "arrest and detention of Mr. Cornegruta was completely in accordance with Kazakh law," and states that Claimants' have not established "that there was any stress or anxiety which resulted from the alleged actions of the Republic including to Mr. Cornegruta's family." Kazakhstan's contention that its actions were "completely in accordance with Kazakh law" is a matter for the Tribunal to adjudicate, and Kazakhstan's apparent belief that actual and threatened imprisonment is no more deleterious to individual and family mental health than any other work related stress speaks volumes about its distance from civilized norms.

623. Kazakhstan concludes its summary dismissal of the impact of its own conduct with the following non-sequitur:

> In fact, in relation to Mr. Cornegruta he has actually escaped from jail. This was discovered and proceedings were instituted against the Chief of the Prison, which casts considerable doubt on how the Claimants can bring any sort of claim for moral damages in this regard.[1085]

Mr. Cornegruta's exit from the country when the opportunity presented itself is not at all surprising for a man falsely imprisoned, and precisely how this "escape," and Kazakhstan's subsequent punishment of Mr. Cornegruta's jailor, exonerates Kazakhstan is not explained. However, to the extent that Kazakhstan is claiming here that Mr. Cornegruta's "escape" was itself immoral, and that this allegedly immoral "escape" by a desperate man offsets the immorality of his false imprisonment in the first instance, such a contention would serve only to demonstrate an almost incomprehensible amorality.

624. Finally, Kazakhstan curiously contends that Claimants "obviously overestimate the sum of moral damages which could be awarded for imprisonment for the term of 4 years (especially, taking into account the fact that the person disappeared from jail)."[1086] Kazakhstan does identify what an appropriate sum would be for such a wrongful imprisonment, and of course, neither do Claimants. The appropriate sum for Kazakhstan's malevolent conduct is, properly, left to the discretion of the Tribunal.

[1085] Statement of Defense ¶ 55.2 (d), 55.3 (c).

[1086] Statement of Defense ¶ 55.3(a).

D. Kazakhstan Should Bear the Costs of This Proceeding

625. Claimants also request that the Tribunal award them all costs and expenses associated with this arbitration, including attorneys' fees and expenses, as well as fees and expenses of the Tribunal and the SCC, pursuant to Article 44 of the SCC Arbitration Rules. Not only has Kazakhstan breached its obligations to Claimants under the ECT in a multitude of serious ways; Kazakhstan has also breached its obligation to participate in these proceedings in good faith, unnecessarily driving up Claimants' costs through its obstructionist tactics. The actions of Kazakhstan during this proceeding and in the underlying dispute are inexcusable, and the Tribunal should award Claimants all costs and fees associated with presenting its case. Claimants will submit their full request for costs at the close of this proceeding.

VIII. REQUEST FOR RELIEF

626. Based on the foregoing and Claimants' Statement of Claim, and subject to Claimants' Reply on Quantum, Claimants respectfully reiterate their request for the following relief:

- a declaration that Kazakhstan has violated the ECT and international law with respect to Claimants' investments;
- compensation to Claimants for all damages they have suffered, as set forth in Claimants' Statement of Claim and as further developed and quantified in the course of this proceeding;
- all costs of this proceeding, including Claimants' attorneys' fees and expenses as well as fees and expenses of the Tribunal and the SCC;
- pre-award compound interest from October 14, 2008 to the date of the Award;
- an award of compound interest until the date of Kazakhstan's final satisfaction of the Award; and
- any other relief the Tribunal may deem just and proper.

Dated: May 7, 2012

Respectfully submitted,

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