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 QUANTUM

May 28, 2012

KING & SPALDING

1100 Louisiana, Suite 4000
Houston, Texas 77002
U.S.A.

65-67 Avenue des Champs-Elysées
75008 Paris
France

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I. Preliminary Statement

1. As Claimants demonstrated in their Reply Memorial on Jurisdiction and Liability, Kazakhstan's harassment campaign had as its principal objective a devaluation of 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 its strategy to force Claimants to sell to KazMunaiGas at a firesale price. When that strategy failed, Kazakhstan seized the investments, deciding to take its chances in arbitration.

2. Respondent has continued that strategy in this arbitration, making a series of disingenuous arguments about the value of Claimants' investments in an effort to enlist the Tribunal in accomplishing the objective Respondent could not accomplish in negotiations with Claimants — namely, acquiring Claimants' investments for far less than their actual 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."[1] More specifically, Kazakhstan's assertions include:

- That "Claimants have failed to adequately plead loss attributable to any of the Claimants," apparently alleging that Claimants have not shown any injury to their investment equity interests;
- That Claimants have failed to demonstrate a causal link between Respondent'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' investments should instead be the date of final seizure by Respondent, July 21, 2010;

[1] Statement of Defense ¶ 46.12.

- 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;[2]

- 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;[3]

- That over-production of the Tolkyn field by Claimants in 2008 allegedly damaged the field by causing an increase in water production in 2009;[4]

- 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;[5]

- 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;[6]

- 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;[7]

- That Claimants' un-risked prospective valuation for the Contract 302 Properties improperly values Claimants' loss of opportunity to prove the full value of the Properties,[8] and that the Contract 302 Properties should instead be valued at US $68 million;[9]

- That Claimants' prospective valuation of the LPG Plant is improper because Claimants have not shown that there would have been sufficient

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2 Statement of Defense ¶¶ 49.8-49.15.

3 Statement of Defense ¶¶ 46.13-46.16; 50.5.

4 *See* Neftegazconsult Report ¶¶ 8, 11 at 17, R-173.

5 *See, e.g.,* GCA Report ¶ 26; Deloitte Report, Appendix 7 at 75-76, Appendix 8 at 80; Neftegazconsult Report, at 18-22, R-173.

6 *See* GCA Report ¶¶ 25, 46, 47.

7 *See* Statement of Defense ¶ 51.5; GCA Report ¶ 46.

8 *See* Statement of Defense ¶¶ 52.1-52.35.

9 *See* Statement of Defense ¶ 52.35; Deloitte Report ¶ 10.21.

gas supplies to operate the Plant at capacity, and profitability of the Plant was too uncertain to warrant damages;[10] and

- That Claimants' assessment of the investment value of the LPG Plant is improper, and that the LPG Plant has only salvage value.[11]

3. Claimants addressed the first three assertions by Respondent in the foregoing list in their Reply Memorial on Jurisdiction and Liability.[12] Claimants address the remaining assertions herein. Also submitted herewith are the second reports of FTI and Ryder Scott, which provide more extensive detail regarding the valuation manipulations and errors by Respondent and Respondent's experts, Deloitte TCF (Deloitte) and Gafney, Cline & Associates (GCA).

4. Respondent 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 on an enterprise value basis (*i.e.*, without considering debt).[13] To arrive at this exceedingly low value, Respondent fabricates capital costs, overstates operating costs, ignores existing reserves, fabricates artificially low gas 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.

5. To put this low valuation by Respondent in perspective, the Tribunal should contrast it with the terms of the arms-length Cliffson transaction that was pending at the time of Kazakhstan's seizure of Claimants' investments.[14] In summary overview, that pending transaction was between Claimants and Cliffson Company, a company owned by the Aussabayevs, a wealthy Kazakh family that had recently sold a majority stake in the mining company KazakhGold.[15] Claimants and Cliffson executed a comprehensive Stock Purchase Agreement on February 13, 2010.[16] The Agreement provided for a sale of all of Claimants'

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[10] *See* Statement of Defense ¶ 53.4.

[11] *See* Statement of Defense ¶¶ 53.16-53.20.

[12] *See* Claimants' Reply Memorial on Jurisdiction and Liability, Section VII.

[13] Deloitte Report ¶¶ 11.1, 11.4.

[14] A full description of the Cliffson transaction is set out at ¶¶ 388-395 and Section IV. B. 2. d. of Claimants' Reply Memorial on Jurisdiction and Liability. *See also* Second Stati Statement ¶¶ 27-28.

[15] Second Stati Statement ¶ 27.

[16] *See* Cliffson Sale Agreement, C-540.

equity interests in TNG, KPM, and Tristan to Cliffson Company for US $267 million.[17] In addition to this equity acquisition, 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.[18]

6. 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.[19] The Cliffson transaction needed only Kazakh approval for its consummation. On April 12, 2010, Claimants submitted applications for that approval, and a waiver of Kazakhstan's pre-emptive rights, to the Ministry of Oil and Gas and Ministry of Industry and Technology, respectively.[20] 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.[21] On June 1, 2010, the Ministry of Oil and Gas sent an additional request to KPM and TNG for

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[17] Cliffson Sale Agreement § 3.1, C-540. The Cliffson Agreement also included Claimants' equity interest in Casco, making the total amount of Cliffson's offer for the equity interests in all four companies 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.

[18] Cliffson Sale Agreement § 2.1, C-540 and Schedule 6; Second Lungu Statement ¶ 12; FTI's Second Report submitted herewith ¶ 3.2.

[19] *See* FTI's Second Report ¶¶ 3.1-3.13, for detailed analysis of the total value of the Cliffson transaction.

[20] 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.

[21] 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.

voluminous amounts of additional information regarding the transaction (in a 2-page, single-spaced list for each company).[22] On June 23, 2010,[23] Claimants provided everything that Kazakhstan had reasonably requested in its April 30 and June 1 letters.[24] Kazakhstan never responded,[25] and instead, less than a week later, it initiated the final inspection blitz that led to the ultimate expropriation of Claimants' assets on July 22, 2010.

7. While Claimants believe that a July 2010 valuation date is highly improper and would work a manifest injustice in this case, and that the proper valuation date to accord Claimants full compensation is October 14, 2008,[26] there can nevertheless be little dispute that the best evidence of the value of Claimants' investments as of July 21, 2010 is the actual, then-pending Cliffson transaction — an arms-length transaction to which both Claimants and Cliffson had contractually committed themselves, and a transaction that would have closed but for Kazakhstan's interference.[27] That Respondent ignores entirely the actual value placed on Claimants' investments by a contemporaneous willing buyer, and engages instead in disingenuous, value-depressing manipulations to drive the value down to US $161 to US $237

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22 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.

23 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.

24 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. The information that was provided and that remains in the possession of Claimants is attached hereto as C-671.

25 Second Lungu Statement ¶ 13.

26 *See* Claimants' Reply Memorial on Jurisdiction and Liability, Section VII. B.

27 *See* Mark Kantor, VALUATION FOR ARBITRATION: COMPENSATION STANDARDS, VALUATION METHODS, AND EXPERT EVIDENCE 17-20 (Kluwer Law International 2008), C-672. As Mr. Kantor states, "[t]he best evidence of a company's value, of course, may be the actual price received in an arm's-length transaction for the sale of an interest in that very business." *Id. See also Enron Corp. v. Argentine Republic*, ICSID Case No. ARB/01/3, Award, May 22, 2007, ¶ 388, C-263 ("LECG [claimants' valuation expert] uses DCF for establishing both the value before the measures were taken and the current value of the Claimants' participation in that business, the difference between one and the other being the estimated losses . . . . Because there are in this case specific transactions concerning the Claimants' participation in TGS, the Tribunal considers that the real value obtained in these transactions better reflects the current value of such participation. This is a value, which is certain and arises from market transactions."); *Estate of James Waldo Hendrickson v. Comm'r,* 78 T.C.M. (CCH) 332, at *43 (August 23, 1999) ("While listed market prices are the benchmark in the case of publicly traded stock, recent arms-length transactions generally are the best evidence of fair market value in the case of unlisted stock."), C-673.

million, speaks volumes about the credibility of Kazakhstan's damages-related contentions in this proceeding.

II. Respondent's Valuation Arguments

A. Respondent's Arguments Concerning Gas Pricing and Production Forecasts for the Tolkyn and Borankol Fields

1. Respondent's Arguments Concerning Gas Pricing

8. In connection with Respondent's valuation, Deloitte has made the assumption that all natural gas produced from the Tolkyn and Borankol fields would be sold on the domestic Kazakhstan market.[28] This assumption significantly depresses the value of these properties,[29] and it is facially unreasonable because not only has the domestic market never been able to fully absorb the gas volumes produced from the Tolkyn and Borankol fields, but also a significant proportion of the gas production from the fields was in fact sold on the export market.[30]

9. In its valuation, FTI has made the reasonable assumption that, as of October 14, 2008, a willing buyer of the companies would expect them to be able to sell gas on the export market (as had already been done in the past), *and* to acquire prevailing international export prices for those sales. TNG and KPM had the contractual right to export gas under the terms of their Subsoil Use Contracts,[31] and there had been a lengthy negotiation beginning in May of 2007 for a three party contract between TNG, KazMunaiGas, and KazAzot (the "Tripartite Agreement") that explicitly provided for both TNG gas exports and payment of prevailing export prices.[32] The Tripartite Agreement was being negotiated in connection with KazAzot's contemplated construction of a local fertilizer plant. Pursuant to its terms, TNG was to provide three streams of gas: (i) to local industrial users; (ii) to KazAzot, to be paid for first at near local

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28 *See* FTI's Second Report ¶ 6.5.

29 *Id.*

30 *Id. See also* Second Lungu Statement ¶¶ 2-4.

31 *See* Contract No. 210, at § 6, ¶¶ 6.1.11 (providing the contractual right "to access the transportation systems, which directly or indirectly are owned and controlled by the republic, at commercial reasonable prices and conditions"), 6.1.12 (providing the contractual right to "[e]xport its own share of hydrocarbons in any time and periodically"), C-52; Contract No. 305 § 7.1.17 (providing the contractual right "[t]o dispose of Hydrocarbons either in part or in full on the territory of the Republic of Kazakhstan or outside it), § 15.9.1 (providing that "Contractor and its founders may freely extract and export their share of the Hydrocarbons produced in accordance with the terms and conditions of this Agreement"), C-45.

32 *See* FTI's May 17, 2011 Report ¶¶ 5.21-5.34; Statement of Claim ¶¶ 57-61.

market prices and thereafter at prevailing export prices; and (iii) to KazMunaiGas, to be exported via KazTransGas and also paid for at prevailing export prices.[33] The history of the State's active pursuit of this Tripartite Agreement provided every indication that gas exports at international export prices were an imminent development in 2008.[34]

10. That TNG's future receipt of international export prices was reasonably contemplated in 2008 is also clear from several of the indicative offers that Claimants received for TNG's Tolkyn field in the initial round of Project Zenith.[35] A comparison of FTI's valuation of the Tolkyn field and the indicative offers demonstrates this. FTI has valued TNG's Tolkyn field as of October 14, 2008 at US $508.4 million, using a DCF methodology and incorporating as an important element the receipt of future gas export prices at a flat US $180 per 1000 cubic meters (a conservative estimate given the fact that export prices were set to be raised at the time to US $305 per 1000 cubic meters in January of 2009).[36] By comparison, among the initial round of indicative offers received by Claimants, the Tolkyn field as a segregated component was valued by KNOC at US $1,067 million on an enterprise value basis, by OMV Exploration & Production GmbH at US $952 million on an enterprise value basis, and by Total at US $730 million on an equity basis using DCF methodology.[37] The magnitude of these offers indicates that they certainly contemplated receipt of export prices for TNG's gas as a critical component.[38]

11. The assumption on the part of prospective buyers that export prices for TNG's gas would be available was perfectly reasonable. Not only did TNG have an explicit export right

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33 *See* FTI's May 17, 2011 Report ¶¶ 5.26, 5.30, 5.31.

34 *See* Statement of Claim ¶¶ 57-61.

35 *See* FTI's Second Report ¶ 6.10.

36 *See* FTI's May 17, 2011 Report ¶ 11.18.

37 *See* Indicative Offer for Project Zenith from Indicative Offer for Project Zenith from Total, September 26, 2008 (for total US $1 billion), C- 75; Indicative Offer for Project Zenith from OMV, September 26, 2008 (for total US $1.3 billion), C-76; Indicative Offer for Project Zenith from Korea National Oil Corporation, September 26, 2008 (for total USD 1.55 billion), C-18. *See also* FTI's May 17, 2011 Report ¶¶ 14.29, 14.31, 14.32; FTI's Second Report ¶ 6.10.

38 FTI's Second Report ¶ 6.10. Interestingly, KazMunaiGaz also made an indicative offer for the Tolkyn field, supported by an asset valuation performed by RBS. R-41.1. Notwithstanding the orders of this Tribunal that it do so, Kazakhstan has refused to produce that asset valuation, and Claimants are entitled to an adverse inference that KazMunaiGaz also valued the Tolkyn field based upon export pricing. *See* Tribunal's Decision dated 3 February 2012 (admitting Claimants' Request for Production No. 12); April 17, 2012, Letter to Respondent's counsel (re-requesting the attachments referenced in the "October 21 2011 letter from KazMunaiGas, R-41.1" that the Tribunal ordered to be produced, which include the RBS asset valuation), C-698.

under its Subsoil Use Contract and the Tripartite Agreement in the final stages of negotiation, but also the Central Asia Center (CAC) pipeline, a direct export route, is proximate to the Tolkyn field, and Kazakhstan was at the time forecasting both an expansion of total gas production from 33.7 Bcm in 2008 to 61.5 Bcm by 2015, with a concomitant export volume expansion from 6.2 Bcm in 2008 to 12.9 Bcm in 2015.[39] Furthermore, in March of 2008, Gazprom and the heads of the national oil and gas companies from Turkmenistan, Kazakhstan and Uzbekistan announced that beginning in January 2009, gas would be priced at European-level prices, minus the costs of transportation and storage back to the relevant delivery point in Central Asia.[40] The intention was to move to a pricing formula that was linked to the price for Russian exports to Europe, which would limit the need for annual price negotiations.[41] KazMunaiGas itself announced expectations in 2008 that its own price could increase by 60-70% from January 2009 to up to US $306/mcm.[42]

12. Respondent does not address Claimants' explicit contractual right to export gas under its Subsoil Use Contract, the self-evident inclusion of export pricing assumptions in the initial round of Project Zenith offers, the proximity of the Center-Asia-Center pipeline, or the State's own projections as of 2008 regarding increases in gas production, exports, and export prices. Respondent instead focuses on alleged evidentiary deficiencies in the Tripartite Agreement, arguing selectively (i) that a May 7, 2007, Memorandum of Understanding relating to the Tripartite Agreement "only makes vague reference to a formula" for export gas pricing,[43] (ii) that a May 16, 2008, document containing meeting minutes relating to the Tripartite Agreement "only states that the parties 'should' sign the Tripartite Agreement,"[44] (iii) that the

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[39] *See* Shamil Midkhatovich Yenikeyeff, *Kazakhstan's Gas: Export Markets and Export Routes* 74 (Oxford Institute for Energy Studies 2008), C-674. Indeed, Kazakhstan became a net exporter of gas in 2009, with exports exceeding imports by 134 Bcf. *See* EIA, Country Analysis Briefs: Kazakhstan Energy Data, Statistics, and Analysis - Oil, Gas, Electricity, Coal (November 2010), C-675.

[40] *See* Tim Gould et. al, *Perspectives on Caspian Oil and Gas Development* 11-12 (IEA Working Paper Series, Directorate of Global Energy Dialogue/2008/1, December 2008), C-676.

[41] *Id.* at 12. *See also*, FTI's May 17, 2011 Report, ¶ 4.48.

[42] *See* Maria Golovnina, *Kazakhstan sees 70 pct gas price rise from 2009*, REUTERS, March 18, 2008, *available at* http://uk.reuters.com/article/2008/03/18/kazakhstan-gas-idUKL1840067520080318 (last visited May 24, 2012), C-677.

[43] Statement of Defense ¶ 15.7 (b) (ii).

[44] Statement of Defense ¶ 15.7 (b) (iii).

final Tripartite Agreement "was never signed merely negotiated,"[45] and (iv) that KazAzot did not execute the final Tripartite Agreement because it ultimately decided in (August of 2009) that construction of the fertilizer plant was not economically feasible.[46]

13. These arguments by Respondent are disingenuous at best. First, the early Memorandum and Minutes reflecting the intention of the parties to enter into the Tripartite Agreement were indeed lacking in some detail. They were memorials of ongoing negotiations after all. The May 7, 2007 Memorandum did state, however, that the parties intended to enter into a long-term agreement with the company to supply natural gas starting from 2010 until 2012 in the volume of 1.1 billion cubic meters per year at the price agreed by the parties," and "…starting from 2013, the gas would be bought at the price equal to export price for Kazakhstan's gas."[47]

14. This May 7 Memorandum was followed by an April 28, 2008 agreement executed by the Director of the State Department of Development of Gas Industries, and representatives from TNG, KazAzot, and KazTransGaz, stating the parties desired to "accelerate the process of achieving the main goals of the [May 7, 2007] Memorandum," and providing that TNG would be paid for its gas exports at the European market price for gas, minus the transportation deductions of Gazprom and KazTransGaz, and minus the mark-ups of Gazprom and KazTransGaz.[48] Thereafter, a preliminary agreement signed by representatives of all three parties set out in careful detail the two explicit export pricing methodologies for deliveries of gas to KazAzot and to KazMunaiGas.[49] Respondent conveniently ignores both of these documents.

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[45] Statement of Defense ¶¶ 15.7 (b) (iv)-(v), 49.9.

[46] Statement of Defense ¶ 15.7 (c).

[47] In addition, the May 7, 2007 Memorandum expressly stated that the Agreement was intended "to resol[ve] the issue of export of gas for the Supplier [TNG] on the basis of reciprocity, regarding the issue of the export of gas of the supplier, produced by them in the period from the middle of 2007 and to the end of the effective period of the contract." It further provided that the MEMR promises "[t]o coordinate the activities of the parties for achieving the set goals, and to monitor the parties in their implementing of their responsibilities relating to the Memorandum, and to facilitate the Supplier [TNG] in exercising their rights in terms of the transportation and export of gas as related to their contractual obligations," and "to coordinate the actions of the requisite government agencies, and also the gas transportation entities of the Republic of Kazakhstan in the resolution of the question of the export gas, and including OAO Gazprom," C-300.

[48] Agreement for the Implementation of the Memorandum of Understanding of May 7, 2007 dated April 28, 2008, C-301.

[49] *See* FTI's May 17, 2011 Report ¶¶ 5.30, 5.31.

15. As for Respondent's argument that the Tripartite Agreement was "never signed merely negotiated," and that KazAzot ultimately decided against construction of the fertilizer plant in August of 2009, these facts are irrelevant for two reasons.

16. First, Kazazot's late November 2008 decision not to sign the Agreement was for the stated purpose of re-auditing the economics of its fertilizer plant.[50] This decision was accompanied by KazAzot's indication that it would sign the Agreement within six months subject to the new audit being performed,[51] and it was followed by a confirmation in August of 2009 from the Governor of the Mangystau Region, KazAzot, and Mitsubishi (the construction contractor) that the plant would go forward.[52] Thus, through August of 2009, the Agreement remained a viable prospect and confirmatory reason for a belief that TNG would be able to export gas at international prices. What is vitally important to the proper valuation of Claimants' assets here are the reasonable expectations of TNG and its prospective buyers as of October 14, 2008. At that time, it was reasonable to assume that the Agreement would be executed shortly and would lock in future international export prices for Tolkyn field gas.

17. Second, why KazAzot did not sign the Agreement in November of 2008, and why KazAzot decided not to proceed with the fertilizer plant in August of 2009, is ultimately irrelevant to the reasonable expectations of a prospective purchaser that gas exports at international prices would be available to TNG. Even accepting Respondent's contentions that Respondent had nothing to do with KazAzot's decisions,[53] the fact remains that KazMunaiGas participated in every step of the negotiation process, and KazMunaiGas *did* execute the November 17, 2008 Agreement. Thorough negotiation and execution of the Tripartite Agreement by the State's captive oil and gas company was a clear indication that gas exports and export prices could reasonably be presumed to be available to a prospective purchaser upon re-entry into negotiations with KazMunaiGas, irrespective of the existence of an appurtenant fertilizer plant contract. It was, after all, KazMunaiGas through KazTransGas, not KazAzot, that

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50 First Lungu Statement ¶ 22.

51 *Id.*

52 *See* Memorandum of Understanding Between KazAzot, Severodonetki Orghim, and Mitsubishi Heavy Industries Ltd., August 26, 2009, C-678.

53 Claimants continue to believe that, in furtherance of its harassment campaign, the State itself intervened to prevent KazAzot's November execution of the Tripartite Agreement and ultimately quash the Agreement in August of 2009.

was to take delivery of TNG's export gas and pay the specified export prices under the Tripartite Agreement. The export provisions in the Agreement were a separate component, providing for their own discrete gas stream from TNG for export, and providing their own pricing formula for the payment of international export prices. The fact that KazAzot might not need the portion of the gas allocated to it in the Tri-Partite agreement means only that *more* of TNG's gas could be exported, not less. Respondent cannot now claim that an Agreement it effectively executed itself for TNG gas exports and export pricing is no evidence of the right, expectation, and ability to export gas at such pricing.[54]

18. Respondent also argues that FTI's conservative assumption of a flat, future export price of US $180 per 1000 cubic meters is unreasonable because it was based on the KazRosGas export delivery price, and "[i]n 2008, KazRosGas LLP sold only Karachaganak gas" at US $180 per 1000 cubic meters.[55] Respondent suggests that other gas prices "were regulated by the State and were significantly lower than export prices due to the lack of any direct entry to international markets . . . ," citing as an example an undocumented arrangement by which a supposed company named GasTradeInternational LLP exported gas produced by Tengizchevronoil LLP at US $70 per 1000 cubic meters.[56] Respondent concludes that "even if it can be demonstrated that a viable international market existed (which is denied) it would be more correct to have used" Respondent's undocumented US $70 export price than FTI's documented US $180 export price.[57]

19. This argument is both brazen and revealing. What Respondent is actually describing appears to be an export gas racket pursuant to which a State-controlled middle man pays a domestic producer of gas a reduced price (*e.g.*, US $70), flips the gas at the border for the international export price (*e.g.*, US $180), and retains the difference between the two prices. Respondent attempts to put a gloss on this racket by suggesting that the export prices received by

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[54] Again, Kazakhstan has refused to produce the RBS valuation performed for KazMunaiGas, which would undoubtedly indicate the underlying pricing assumptions, and Claimants' seek an adverse inference that the RBS valuation would reflect the use of export prices

[55] Statement of Defense ¶ 49.13(a).

[56] Statement of Defense ¶ 49.13(b). Respondent did not provide any documentation at all of this alleged contract between GasTradeInternational and Tengizchevornoil, and Claimants' can locate no company anywhere named "GasTradeInternational LLP." Indeed, this entire argument by Respondent is evidence-free and hence should be rejected.

[57] Statement of Defense ¶ 49.15.

domestic producers "were regulated by the State and were significantly lower than [international] export prices due to the lack of any direct entry to international markets." Respondent does not, however, cite *any* "regulation" supporting this contention, and Claimants invite Respondent to provide a regulatory basis for this State sponsored profit-skimming enterprise. And Respondent's reference to a "lack of any direct entry to international markets" is simply a euphemistic way of saying that a State-controlled middle man must be paid an illegitimate cut if a domestic producer wants to export gas. There exists, after all, an otherwise "direct entry to international markets" in the form of the Center-Asia-Center pipeline running adjacent to the TNG and KPM oil and gas fields, which TNG and KPM had a legal right to access at commercially reasonable rates under their Subsoil Use Contracts.

20. Claimants were well aware of this racket, having been subjected to it in the past. During the period 2005-2008, the buyers of gas production from KPM and TNG have included both domestic-users and buyers that exported KPM's and TNG's gas. Domestic buyers have included local companies such as Aktaugazservice and MAEK.[58] The buyers who exported TNG's and KPM's gas were primarily KazRosGaz,[59] Gas IMPEX SA,[60] and Kemikal.[61] Each of these companies was controlled by Mr. Kulibayev, the son-in-law of President Nazarbayev and the chairman of KazMunaiGas.[62] Under these contracts, the majority of TNG's gas production was in fact exported, and TNG received in the range of US $20 to approximately US $26 under the contracts with Gaz Impex and KazRosGas, and US $44 to US $53 before VAT under the Kemikal contract.[63] Claimants were, however, not at all satisfied with these artificially reduced

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58 FTI's May 17, 2011 Report, ¶ 5.19, Table 3; Second Lungu Statement ¶¶ 2-3.

59 *See* Sale Purchase Agreement Between TNG and KazRosGaz, May 24, 2003 and addenda thereto, C-679.

60 KPM sold its production to Gas IMPEX SA between 2005 and 2006, and sold its gas production thereafter to TNG. *Id.*

61 *See* Kemikal Contract, C-680. Claimants negotiated the Kemikal contract with the Kulibayev group that controlled Gas Impex and KazRosGas, and not directly with Kemikal. Consequently, it was Claimants' understanding that Kemikal was itself under the control of Mr. Kulibayev. It addition, it was Claimants' understanding that gas sold to Kemikal was in whole or significant part sold into the export market. *See* Second Lungu Statement ¶ 4.

62 Second Lungu Statement ¶¶ 2, 4; Second Stati Statement ¶¶ 1-2, 13, 41-42.

63 Second Lungu Statement ¶¶ 2, 4.

prices for KPM and TNG's gas exports, and consistently sought through negotiations to acquire reasonable export prices.[64]

21. Respondent was also well aware that there existed no regulatory reason for such dramatically reduced export prices. Hence, KazMunaiGas, through long and arduous negotiations with TNG, explicitly agreed in the Tripartite Agreement to pay a legitimate export price tied to the prevailing price at the Kazakh border, coupled with what TNG viewed as a reasonable, if still high, 20% fee to KazMunaiGas. This effectively set as a benchmark the reasonable expectations of prospective purchasers regarding the negotiated prices that could be obtained for gas exports. The State cannot now invoke, under the false guise of "regulation," alternative and extortionate export prices allegedly existing under contracts that it has not produced involving purchasers that cannot be identified.

2. Respondent's Argument Concerning Future Production Forecasts for the Tolkyn Field

22. Respondent has based its valuation of the Tolkyn field as of July 21, 2010 on GCA's projections for future production.[65] Setting aside the impropriety of its chosen valuation date, Respondent's future production calculations are themselves grossly inaccurate. GCA states in its Report:

> GCA has reviewed all of the available data from the field, and has developed independent most-likely production and cost (CAPEX and OPEX) forecasts for the field. (Appendix II) These forecasts are based on use of the existing wells only with minor work-overs and recompletions.[66]

23. It is readily apparent from GCA's forecasts, and from its statement that those forecasts are based solely on existing wells with only minor work-overs and recompletions, that the data GCA actually reviewed was remarkably incomplete. GCA clearly did not include in its forecasts any of the significant "behind-pipe" reserves in the Tolkyn field.[67] This information

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64 Second Lungu Statement ¶ 3.

65 Statement of Defense ¶ 50.11; GCA Report ¶ 25; Deloitte Report ¶ 7.3.

66 GCA Report ¶ 25.

67 *See* Second Ryder Scott Report p. 4. Behind-pipe reserves are those reserves that are expected to be recovered from additional zones other than those already in production that can be exploited in existing wells, which will require additional completion work or future recompletion prior to the start of production. Ryder Scott's Second Report at p. 4, fn. 1.

was provided in full in the data accompanying Ryder Scott's first report. GCA's exclusion of the behind-pipe reserves from its forecasts without explanation effectively GCA's analysis of the Tolkyn field fatally flawed.

24. The behind-pipe reserves in the Tolkyn field are substantial. They amount to proven and probable (2P) reserves of 1,869 MBO (thousands of barrels) and 43.7 BCF (billions of cubic feet) of gas as of October 14, 2008. These estimates include 973.3 MBO and 8.2 BCF of recoverable hydrocarbons in the Jurassic VII and VIII, as well as the Triassic. As noted above, Ryder Scott provided 3 DVD's of data with its first report, and Disk 2 includes maps, log data, log analyses, volumetric analyses, reserve allocations and numerous other components of information associated with these reserve estimates. GCA provides no explanation as to why it failed to include these reserves in its forecasts.

25. Regarding its Tolkyn field analysis, GCA also states in its Report:

> GCA has developed independent production forecasts for the Tolkyn Field using Decline Curve Analysis (DCA). This is an industry standard technique for the generation of forecasts and assumes that past production history can be used to forecast the future production from the field. The method requires all the available data to be reviewed and analysed and considered in the generation of the forecast. [68]

However, it is clear that GCA did not, in fact, consider all of the available data in its application of the rather simplistic decline curve analysis.[69] As noted above, GCA did not include any of the substantial 2P behind-pipe reserves in its analysis, and it is also clear that GCA failed to recognize that the Assilian Sand formation in the Tolkyn field has been and was still being produced as of July of 2010, since GCA's analysis is restricted to existing production from the Artinsikan formation.[70] Furthermore, there is no indication that GCA incorporated the much more thorough and accurate Material Balance and Volumetric analyses into its study, and no explanation as to why it chose to exclude these industry standard analyses.[71] One explanation may be that to conduct these particular analyses would require review and incorporation of

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[68] *See* GCA Report ¶ 27.

[69] Regarding the use of "decline curve analysis," *see* Ryder Scott's Second Report pp. 5-6.

[70] Ryder Scott's Second Report p. 3.

[71] *See* Ryder Scott's Second Report pp. 5-6.

geological mapping, pressure data, log analyses, and numerous other forms of data that GCA apparently chose not to review. The failure of GCA to include the relevant reserve and production data in its analysis, and its choice of analytic methodology, not only affects the credibility of its own report, but also renders the analysis of Respondent's economic expert unreliable as well, since Deloitte relied upon the GCA estimates to reach its valuation conclusions.[72]

3. Respondent's Argument Concerning Future Production Forecasts for the Borankol Field

26. Respondent and Deloitte have similarly based their valuation of the Borankol field as of July 21, 2010 on GCA's projections for future production.[73] Again, setting aside the impropriety of its chosen valuation date, GCA's future production calculations for the Borankol field are also inaccurate. GCA states in its Report:

> The RS Borankol production profile, Exhibit 5, shows significant, unexplained production increases in 2015 and 2016. It is not apparent to GCA the reason for this increase, but it may reflect additional wells not included in the FDP or well work-over or recompletions of reservoir intervals.
>
> GCA has developed production and cost forecasts for the field assuming a limited work programme reflecting no major increased investment above that envisaged in the field development plan.[74]

27. What Respondent and GCA call "unexplained production increases in 2015 and 2016" are in fact forecasted production increases by Ryder Scott for 2014, 2015, 2016 and 2017. These are fully explained in the data accompanying Ryder Scott's first report. The Ryder Scott production forecasts for Borankol were produced on Disk 1, at "1-Borankol," on the data disks that accompanied Ryder Scott's report. As shown there, the future operations for the Borankol field included 58 well recompletions and 4 development wells to be drilled, two of which have three future recompletions scheduled. Each of these was supported by complete geologic analysis, geologic interpretations, log analysis, volumetric analysis, and the development schedule.

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[72] *See* Deloitte Report § 7.

[73] Statement of Defense ¶ 51.5; GCA Report ¶¶ 46, 47; Deloitte Report ¶¶ 76.1-6.8.

[74] GCA Report ¶¶ 46, 47.

28. These production increases represent full exploitation of the remaining reserves in the Borankol field, exploitation that any reasonable operator would be expected to pursue, and reserves that any reasonable prospective purchaser would be expected to value. Indeed, Ryder Scott's estimate of remaining crude oil and condensate in the Borankol field as of October 14, 2008 was 18.8 million barrels.[75] This is 344% of GCA's estimate of 5.45 million barrels of remaining crude oil and condensate as of July 21, 2010.[76] To put this in perspective, cumulative production between October of 2008 and July of 2010 in the Borankol field was approximately 2.3 million barrels of oil and condensate, which means that GCA's forecasted future production ignores 11.05 million barrels of recoverable crude oil and condensate.[77] GCA does this by simply assuming "a limited work program" for the Borankol field. GCA does not, however, provide any explanation of why a limited work program should be assumed, or why otherwise recoverable reserves should be left in the ground. Simply ignoring without explanation a vast quantity of recoverable crude oil and condensate is not, to say the least, a credible method of calculating the fair market value of an oil and gas field, and calls into serious question the overall credibility of the reports submitted by GCA and Deloitte

B. Respondent's Arguments Concerning Water Production in the Tolkyn Field Wells

29. Respondent's arguments concerning water production in the Tolkyn field wells are confused, contradictory, and largely just wrong. Respondent first contends that an existing problem with excessive water-cut in the Tolkyn field was partly responsible for Claimants' initial decision to sell the properties in the summer of 2008, claiming that the "Tolkyn field . . . slumped significantly in early 2008 as water production in the gas wells spiked as a result of the Claimants ramping up of gas production in 2007."[78] Respondent bases this contention on GCA's conclusions that:

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[75] Ryder Scott's Second Report p. 8.

[76] GCA Report, Appendix III, Table AII.2; Ryder Scott's Second Report pp. 8-9.

[77] Ryder Scott's Second Report p. 9.

[78] Statement of Defense ¶¶ 16.1-16.2, 53.16 (d). Respondent also appears to suggest that significant water-cut in the Tolkyn field was a reason why a majority of the prospective purchasers contacted in the initial phase of Project Zenith did not make an indicative offer, stating that "the assets were unattractive to potential purchasers for reasons unconnected to the Republic's actions," including "no geological upside." Statement of Defense ¶ 16.7. Claimants address at length the general fallacy of Respondent's arguments concerning the allegedly few responses received in the initial phase of Project Zenith, and Claimants' decision not to proceed to the binding

> At the Tolkyn Field, initial gas/condensate production commenced in 2003 with only small volumes of produced water being recorded. Gas production was significantly increased in 2007 to meet the production plan approved in the Field Development Plan. This increase in gas and condensate production was followed by a rapid increase in the volume of water produced, which ultimately resulted in a dramatic reduction in the volume of gas and condensate being produced. This increase in 2007 in gas production was achieved by increasing individual well rates and not by drilling additional wells. This rapid increase in individual well rates may have accelerated water production.[79]
>
> The trend of increasing water production was clearly evident at the time of the 2008 RS report, yet this was not mentioned in the report and the risk to future gas production levels was not discussed as might have been expected.[80]

30. Respondent also contends that the problem with water-cut in the Tolkyn field in early 2008 was so significant that Respondent and GCA "are surprised that the Claimants' experts appeared to have ignored the issue completely in their reports."[81] Both the contention that water-cut was a significant problem in early 2008, and the contention that Ryder Scott ignored water-cut in its first report, are incorrect.

31. As Ryder Scott points out, the trends of associated products for gas wells, such as condensate and water production, are best viewed as ratios related to the primary products. Doing so provides needed perspective. The average water/gas ratio (WGR) for the first 10 months of 2008 in the Tolkyn field for all wells producing in the Artinskian formation was 9.8 BW/MMcf (Barrels of water per Million cubic feet of gas).[82] While this was an increase over historical norms of approximately 2.12 BW/MMcf, it did *not* reflect a dramatic or problematic

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bid phase in the fall of 2008, at Section IV. B. 2. of their Reply Memorial on Jurisdiction and Liability. Suffice it to say here that, because Respondent is wrong in its assertions about Tolkyn field water-cut in 2008, no prospective purchaser was likely concerned about it.

[79] GCA Report ¶ 32. Remarkably, in its Statement of Defense, Respondent edits this passage from its own expert's report to omit the inconvenient reference to production increases being made "to meet the production plan approved in the Field Development Plan." Statement of Defense ¶ 46.15. Since nowhere in its Statement of Defense does Respondent even reference the process by which Development Plans and Working Programs are established and approved by the State itself (discussed *infra*), one can only conclude that this is yet another example of Respondent's deliberate attempts to mislead.

[80] GCA Report ¶ 38.

[81] Statement of Defense ¶ 16.2; GCA Report ¶ 31.

[82] Ryder Scott's Second Report p. 7.

increase in water production.[83] Indeed, as of October 14, 2008, only three Artinskian wells in the Tolkyn field were making appreciable water (the T-3, T-7, and T-101).[84] As Ryder Scott states in its Second Report, "[e]xcluding the three wells experiencing appreciable water production, the average WGR for the remaining Artinskian wells for 2008 was only 3.6. It is noteworthy that the three water producers, the T-3, T-7, and T-101, are in close proximity to one another and low on structure in their fault block, suggesting a reasonable conclusion at the time that water production was a localized formation problem, and not a field wide problem."[85]

32. Ryder Scott provided in connection with its first report three DVD's of data supporting its analysis. This extensive data included Ryder Scott's projections of WGR in BW/MMcf for every Artinskian producing well in the Tolkyn field.[86] Although a great deal of this data was re-produced to Claimants in Respondent's belated April 2, 2011 document production (thus confirming beyond doubt that Respondent received this data), Respondent clearly ignored this data, and it is apparent that GCA did as well. Ryder Scott has provided a graph in its Second Report, in the traditional semi-log rate versus time format,[87] reflecting its water and WGR projections.[88] The graph shows gradually increasing water production in 2008 corresponding to the increased gas production, and it shows Ryder Scott's projected increases in water production after 2008 and into 2010.

33. Respondent also argues that Claimants' over-production in the Tolkyn field in 2007 and 2008 damaged the field by causing an increase in water production in 2009 and 2010.[89] Respondent makes this argument both in furtherance of its claim that reasons beyond State conduct caused a progressive decrease in the value of Claimants' investments between October of 2008 and the State's final seizure of the investments on July 21, 2010, and as the basis for asserting that Claimants' recovery should be reduced because of Claimants' intentional injury to

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83 Ryder Scott's Second Report p. 7.

84 Ryder Scott's Second Report p. 7.

85 Ryder Scott's Second Report p. 7.

86 Ryder Scott's Second Report pp. 7-8.

87 In support of its contention that there existed a dramatic increase in water production in 2008, GCA provided a graph in non-standard and very misleading format. GCA Report, Figure 2, at p. 6.

88 *See* Ryder Scott's Second Report, Figure1, p. 8.

89 Statement of Defense ¶¶ 54.2- 54.3.

production from the Tolkyn field.[90] The ostensible bases for the argument are the conclusions contained in the report by Neftegazconsult, a report that Respondent does not identify as an expert report, and is merely attached as Exhibit R-173 to Respondent's Statement of Defense. In its report, Neftegazconsult states that:

> The incompliance of the subsoil user [TNG] with the requirements to development of the gas-condensate reservoir in 2006–2008 led to a loss of active gas reserves, growth of operating expenditures for gas treatment, and reduction of the field efficiency (reduction of recoverable reserves and revenues);[91] and
>
> Due to the violation of the gas-condensate reservoir development process by the subsoil user, the current development project must be revised completely with due attention to the obtained data.[92]

34. To appreciate the absurdity of these contentions, one must understand the process by which the oil and gas Development Plans and Working Programs that TNG and KPM operated under were authored and approved by the State, and the history of Tolkyn field production in 2007 and 2008.

35. The Development Plans for TNG's Tolkyn field and KPM's Borankol field were the product of Kazakh research institutes associated with the Kazakh MEMR.[93] The Tolkyn Development Plan was the product of JSC KazNIPImunaygaz.[94] The Borankol Development Plan was the product of NIPI NefteGas.[95] These Development Plans are the overall design documents for mineral extraction from the Tolkyn and Borankol fields.[96] The first step in creation of the Development Plan is for the operating company and holder of a Subsoil Use Contract, here TNG and KPM, to provide raw data (in the form of seismic results, well logs, test

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90 Statement of Defense ¶ 54.3.

91 Neftegazconsult Report, November 14, 2011, ¶ 8 at 17, R-173.

92 Neftegazconsult Report, November 14, 2011, ¶ 11 at 17, R-173.

93 Second Cojin Statement ¶ 4.

94 *See* "Project on development of Artinskian gas condensate reservoir and on experimental-industrial production of the Middle Jurassic deposits of Tolkyn oil field," JSC KazNIPImunaygaz (the "2008 Tolkyn Development Plan"), C-681; Second Cojin Statement ¶ 4.

95 *See* "Flow Chart of Borankol Field Development," NIPI NefteGas (the "Borankol Development Plan"), C-682; Second Cojin Statement ¶ 4.

96 Second Cojin Statement ¶ 3.

well results, etc.) to the responsible Kazakh research institute.[97] Reserve engineers commissioned and controlled by Kazakhstan then produce State reserve estimates for the field,[98] and the State research institute, in conjunction with the reserve engineers and input from the respective operating companies, creates and issues the final, State-approved Development Plan that sets annual production, drilling, and capital outlay expectations for the field.[99]

36. The Working Programs are yearly plans developed jointly by personnel from the respective companies and State personnel, including a Kazakh team of geologists.[100] Their purpose is to establish the specifications for extraction, drilling, and capital outlays to implement the Development Plans.[101] They are the product of several joint meetings between the company and State personnel, with the State making proposals that must be included in the Programs and the Kazakh geologists making recommendations regarding, *inter alia*, production rates, geophysics, and locations of wells.[102] The annual Working Programs for the following year are ordinarily submitted in November for approval by the territorial representative of the Kazakh Ministry of Resources and Power (the MRP), with the approval results from the MRP generally being received in December.[103]

37. KPM and TNG submitted quarterly reports to the Kazakh Department of Statistics concerning the companies' progress toward fulfillment of the annual Working Programs (the "LKU Reports"),[104] and Kazakh mineral and geology agency personnel, in conjunction with

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97 *Id.*

98 *Id.* For a list of the State reserve reports prepared for the Tolkyn field, see the State "Certificate on the results of planned check of performance of the Republic of Kazakhstan about the mineral resources and subsoil usage, license-contract obligations of the limited liability partnership Tolkynneftegaz," (the "2008 Tolkyn Certificate") ¶ 2.2, C-683. For a list of the State reserve reports prepared in connection with the Borankol field, see the State "Report on the results of the extraordinary verification of the fulfillment of the contractual obligations and the observance of the provisions of the Kazakhstan legislation on subsoil and its exploitation by TOO Kazpolmunay," 2010, ¶ II, C-684.

99 Second Cojin Statement ¶ 3.

100 Second Cojin Statement ¶ 5; Working Program for 2009 Tolkyn Field, C-591; Working Program for 2010 Tolkyn Field, C-592; Working Program for 2009 Borankol Field, C-593; Working Program for 2010 Borankol Field, C-594.

101 Second Cojin Statement ¶ 5.

102 *Id.*

103 *Id.*

104 *See* sample quarterly LKU Reports for 2009 and 2010 for TNG, C-685; sample quarterly LKU Reports for 2009 and 2010 for KPM, C-686; Second Cojin Statement ¶ 6.

input from company personnel, issued and approved periodic Reports, Certificates, Acts, and Minutes on the results of agency inspections and on company compliance with Subsoil Use Contract requirements, Development Plans, and approved Working Programs.[105]

38. For the Tolkyn field, there was a pre-existing Development Plan for pilot development of the field that was confirmed by the Kazakh Central Commission on Development in December of 2006, and extended by the Commission as the operational Development Plan through January 1, 2008.[106] This pilot Development Plan was therefore the operative plan for the Tolkyn field in 2007.[107] The expected 2007 gas production from the field pursuant to the pilot Development Plan was 1984 million cubic meters (mcm),[108] TNG's actual 2007 gas production from the field was 1257.2 mcm, 726 mcm less than expected under the Plan.[109] The reason why TNG did not produce the expected amount of gas was because it did not have in place an additional gas sales contract to cover the seasonal downturn in domestic demand during the summer months.[110] As stated in the State's 2008 Tolkyn Certificate on TNG's compliance with its Contract, Development Plans, and approved Working Programs, the

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[105] Second Cojin Statement ¶ 6. *See, e.g.,* Certificate by MEMR on results of Planned Check Performance of the Legislation of the Republic of Kazakhstan about Mineral Resources and Subsoil usage, License-contract Obligations of the Limited Liability Partnership "Tolkynneftegaz", the field of Tolkkyn, July 12, 2008, C-683; "Minutes on the results of the extraordinary verification of the fulfillment of the contractual and licensing obligations as well as of the compliance with the provisions of the legislation in the Republic of Kazakhstan by TOO Tolkynneftegaz, January 25-February 5, 2010, C-599; Reports on the Results of an Unscheduled Inspection with Respect to Fulfillment of the Contractual Obligations and Compliance with Requirements of the Legislation of the Republic of Kazakhstan in Subsoil and Subsoil Use by Tolkynneftegas of the Ministry of Energy and Mineral Resources for KPM and TNG, February 5 and 6, C-385 and C-386; Act on Results of Unscheduled Inspection for Observance of Contractual terms and Compliance with the Requirements of the Legislation of the Republic of Kazakhstan on Subsoil and Subsoil Use by the Partnership "Tolkynneftgas", June 30, 2010, C-687; Acts on Results of Unscheduled Inspection of TNG from the Geology and Subsoil Use Committee, July 16, 2010, C-315; Act on Results of the Inspection regarding Compliance with Environmental Legislation of the Republic of Kazakhstan, July 3, 2010, C-688; Act on Results of Unscheduled Inspection of the State of Efficient and Complex Subsoil Use and Compliance with the Legislation of the Republic of Kazakhstan "On Subsoil and Subsoil Use" by "Kazpolmunai" LLP, C-689; Report on the Results of a Special-Purpose Inspection of "Kazpolmunai", LLP, May 25, 2007, C-690; Report by MEMR on Results of Planned Verification of Performance of the Legislation of the Republic of Kazakhstan about Mineral Resources and Subsoil Usage, License-Contract Obligations of the Limited Liability Partnership "Kazpolmunay", field of Borankol, July 12, 2008, C-691; Act on Unscheduled Inspection of KPM by the Geology Committee, July 16, 2010, C-651; Report on the Results of the Unscheduled Inspection of the legislation of the Republic of Kazakhstan about Oil, Subsoil and Subsoil Use, and Contract Obligations of KPM, November 11, 2008, C-86.

[106] *See* Second Cojin Statement ¶ 7; 2008 Tolkyn Certificate ¶ 5.1, C-683.

[107] *Id.*

[108] *See* 2008 Tolkyn Certificate ¶ 11.3, C-683.

[109] *Id.*

[110] Second Cojin Statement ¶ 8.

"[d]iscrepancies of actual volume of extraction with scheduled in 2007 is linked to absence of a commodity market . . . ."[111]

39. During 2007, a new Development Plan was established for the Tolkyn field by the State research institute, KazNIPImunaygaz, to be effective on January 1, 2008.[112] The expected 2008 gas production under this new 2008 Development Plan was 2500 mcm, an increase of 516 mcm over the expected 2007 gas production of 1984 mcm under the prior pilot Development Plan, and twice TNG's actual 2007 production of 1257.2 mcm.[113] Although the 2008 Development Plan called for this marked production increase, it provided for an insignificant increase in well stock.[114]

40. On November 15, 2007, TNG executed a contract with Kemikal for the provision of 1,895 mcm of gas.[115] This contract, coupled with TNG's doubling of its gas processing capacity in the fall of 2007, permitted TNG to increase its production, both resolving the production shortfall in 2007 resulting from lack of a contract to cover the summer downturn in domestic demand, and positioning TNG to meet the 2008 Development Plan production expectation of 2500 mcm. Nevertheless, TNG's actual production for 2008 was 2352.2 mcm, 147 mcm less than expected under the 2008 Development Plan.[116]

41. As noted by Ryder Scott, the 2008 production increase in the Tolkyn field (to an amount less than the production expectations in the Development Plan) did result in an increase in water production.[117] But this increase, while marginally larger than historical water production, was not "dramatic" in 2008, and a notable increase in WGR (water gas ratio) did not become apparent until 2009.[118] This water-cut issue was addressed in 2009 by a revision to the

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111 *See* 2008 Tolkyn Certificate ¶ 11.3, C-683.

112 *See* 2008 Tolkyn Certificate ¶ 5, C-683; 2008 Tolkyn Development Plan, C-681.

113 *See* 2008 Tolkyn Development Plan, C-681; Acts on Results of Inspection of Tolkynneftegas LLP, July 16, 2010, at "Commissions Conclusions" ¶ 1, C-315; Second Cojin Statement ¶ 9.

114 *Id.*

115 *See* Kemikal Contract, C-680; Second Lungu Statement ¶¶ 4-5.

116 *See* "Act on Results of Unscheduled Inspection for Observance of Contractual Terms and Compliance with the Requirements of the Legislation of the Republic of Kazakhstan on Subsoil and Subsoil Use by the Partnership Tolkynneftegas," July 15, 2010, § 6, C-650.

117 Ryder Scott's Second Report p. 7.

118 Ryder Scott's Second Report p. 7.

Development Plan, reducing the expected production under the Development Plan from 2500 mcm to 1800 mcm.[119]

42. Because the Kemikal contract was cancelled at the end of 2008 due to Kemikal's persistent non-payment,[120] TNG was left in 2009 without a contract to cover the summer domestic demand downturn.[121] Due to this lack of a market, TNG's actual production for 2009 was only 1317.1 mcm, or 482.9 mcm less than the adjusted reduction to 1800 mcm in the modified Development Plan.[122]

43. The 2009 water production issue and accompanying production adjustment in the Development Plan was discussed in the February 5, 2010 Report on the MEMR's verification of TNG's subsoil use compliance:

> In 2009, within the ordinary report on the author inspection for the implementation of the exploitation project, amendments have been operated concerning the natural gas and condensate gas extraction volumes from the Atinskian condensate gas deposit of the Republic of Kazakhstan (Protocol of ȚKR No. 59/October 1st, 2009). The takeover rate was reduced from 2.5 billion m^3/year to 1.8 billion m^3/year. Cause: complications generated by the sustained rate of gas capture from the deposit (flooding and others). The named reduction of the extraction volumes applied for the period 2009–2010, until the elaboration of a new design document.[123]

44. It was also discussed in two State inspection reports that were issued just before the State's final seizure of Claimants' investments. As stated by the Kazakh Geology and Subsoil Use Committee in its July 16, 2010 report on the results of its unscheduled inspection of TNG:

> **The development project, approved in 2007, provides for gas production, since 2008, in the volume of 2500 mln.m3, which**

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[119] *See* "Minutes on the results of the extraordinary verification of the fulfillment of the contractual and licensing obligations, as well as of the compliance with the provisions of the legislation in the Republic of Kazakhstan, in the field and subsoil and the exploitation hereof by TOO Tolkynneftegaz," 2010 (the "2010 Tolkyn Minutes"), at § 5, C-599.

[120] Second Lungu Statement ¶ 6.

[121] *Id.* at ¶ 8.

[122] Second Lungu Statement ¶ 8; 2010 Tolkyn Minutes, at § 5, C-599.

[123] 2010 Tolkyn Minutes, at § 5, C-599.

> **twice exceeds the production volume of 2007, with insignificant increase of well stock (15 against 14).** This led to increase of the content of water in gas, 133 g/m3 as compared to 9-10 g/m3. Established rate of gas extraction from accumulation leads to loss of approved gas and condensate reserves and requires to be reviewed in favour of gas production decrease.[124]

And as observed by the Kazakh Ministry of Oil and Gas in its July 15, 2010 report on the results of *its* unscheduled inspection:

> **In the approved development project of 2007 water cut was not expected**. Within the 1st year of development in 2008 gas extraction in the volume of 2500 mln.$m^3$was expected which was 2 times more than the volume extracted in 2007 with the slight change in well stock—15 wells as compared to 14 wells in 2007. This resulted in coning of reservoir edge waters and water cut. The content of water in products within 2003-2007 pilot production made up about 9-10 g/m^3. And it was regarded that the water present in products was condensed. This circumstance indicates that the chosen operation mode is wrong, as a result of which it is considered to review the conditions of development taking newly revealed circumstances into account.[125]

45. It is readily apparent that, contrary to the assertions of Respondent and Neftegazconsult, there was no "incompliance" on the part of TNG "with the requirements to development of the gas-condensate reservoir in 2006–2008," and no "violation of the gas-condensate reservoir development process" by TNG. Indeed, TNG was in full compliance with the State-authored Development Plan and the State-approved Work Programs for implementation of the Development Plan. The State itself in all three of its reports in 2010 duly notes that water production was unexpected "in the approved development project of 2007." It was compliance with, not violation of, the State-authored Development Plan that led to the marginal increase in water production in 2008. Upon recognition of the water cut issue, the State itself reviewed its

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[124] *See* "Act on results of unscheduled inspection of the state of efficient and complex subsoil use and compliance with the legislation of the Republic of Kazakhstan 'On subsoil and subsoil use' by Tolkynneftegas LLP," July 16, 2010, at Commission's Conclusions, C-315.

[125] *See* "Act on Results of Unscheduled Inspection for Observance of Contractual Terms and Compliance with the Requirements of the Legislation of the Republic of Kazakhstan on Subsoil and Subsoil Use by the Partnership Tolkynneftegas," July 15, 2010, § 6, C-650.

Development Plans and mandated a reduction in gas production volumes for the 2009 Development Plan, a reduction that was sufficient in and of itself to address the issue.[126]

46. It is also readily apparent that Respondent is here simply trying to concoct another ostensible reason to justify its seizure of Claimants' investments, a reason that none of its own mineral and geological agencies ever raised prior to seizure, and that the State did not even obliquely reference in its notices issued immediately prior to seizure listing the alleged grounds for seizure.[127] Indeed, Respondent never took issue with any of the field drilling or extraction operations of either KPM or TNG at any time, and throughout the history of Claimants' ownership, the State repeatedly approved of all of TNG's and KPM's drilling and extraction operations in its verifications and reports on compliance.[128]

C. Respondent's Arguments Concerning CAPEX and Costs

47. FTI has dealt in detail with the errors in the CAPEX, OPEX, depreciation, liquidation, and calculations of inflation and exchange rates contained in the Deloitte and GCA expert reports submitted by Respondent. Here, Claimants will highlight only one of the examples of Respondent's efforts to devalue Claimants' investments by summarily adding unnecessary capital costs.

48. It is clear from the reports of both GCA and Deloitte that Respondent's goal is to increase projected CAPEX and costs by any method possible in order to drive down its estimate of the value of the fields. One such method chosen is GCA's contention that a US $41 million cost must be included in the calculation of the Tolkyn field's value for "needed" future compression to be added to the field operations. GCA states:

> Due to the declining reservoir pressure, compression will be needed in the field from 2012. This is required to boost the flowing wellhead pressure to a level adequate for processing and

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126 *See* Ryder Scott's Second Report p. 5.

127 *See* 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; Notice of infringement of obligations under the Subsoil Use Contract No. 302, from MOG to TNG, July 14, 2010, C-7.

128 *See* verifications and reports listed in fn. 105, *supra.*

> onward transport of the gas. GCA has included costs for this in the production and cost profiles in Appendix II.[129]

49. It is not clear what the point of this contemplated compression would be. GCA's contention is that compression will be needed "to boost the flowing wellhead pressure" due to "declining reservoir pressure." But, as pointed out by Ryder Scott, if GCA is contending that compression is needed to alleviate water production in the Tolkyn field, there exists no evidence in industry experience to support this. In water producing wells, the primary detriment to production rates is the loading caused by the water, and reduced delivery pressure will only temporarily alleviate this problem.[130] Furthermore, as of Respondent's chosen valuation date, with the exception of a few high water-producing wells, the vast majority of the remaining Artinskian producing wells were flowing at or above 2000 psig FTP (flowing tube pressure).[131] This is considerably above the pipeline delivery pressure of approximately 540 to 680 psig, and above the designed inlet pressure for the Borankol LPG Plant of 870 psig.[132] A review of the historical production, flowing tube pressures, and performance trends suggests that very little, if any, compression will be required prior to expiration of the Tolkyn Subsoil Use Contract, and if any is eventually needed, it would be considerably later than 2011.[133] Indeed, as Ryder Scott points out in its Second Report, the reduced delivery volumes in the revised 2009 Development Plan, coupled with increased production from specific well re-completions, should suffice alone to mitigate water production.[134]

50. Deloitte states that it has applied GCA's capital expenditure forecasts in its DCF models. Deloitte, however, takes GCA's unnecessary US $41 million capital expenditure for compression in 2011 and *increases* it to US $51.472 million.[135] FTI has not been able to discern any reason for Deloitte's US $10.5 million increase.[136] It appears that GCA and Deloitte simply tack US $41 to US $51.472 million on to Tolkyn's 2011 costs (an enormous sum that represents

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[129] *See* GCA Report ¶ 26.

[130] Ryder Scott's Second Report pp. 4-5.

[131] Ryder Scott's Second Report p. 5.

[132] *Id.*

[133] *Id.*

[134] *Id.*

[135] *See* Deloitte Report, Appendix 8 at p. 80.

[136] *See* FTI's Second Report ¶ 6.24.

more than 80% of the total future capital expenditures that GCA estimates for the field[137]) in order to exaggerate CAPEX and drive down value. Moreover, both GCA and Deloitte add this unnecessary cost at the earliest time possible in their calculation of the Tolkyn field's capital needs. Because discounting lessens the effect of both revenues and expenditures the further forward in time they occur, the earlier a cash expense is projected to occur, the greater the negative impact that expense has on the overall value. In short, by putting this significant, if unnecessary, expenditure in 2011, GCA and Deloitte have maximized its impact and created the greatest possible reduction in overall value.[138]

51. In addition to the unnecessary compression recommended by GCA, Respondent has also submitted in its Neftegazconsult report a recommendation that an extensive testing, workover, new drilling, and directional sidetrack drilling program be commenced in December of 2011 in the Tolkyn field to allegedly address the water issue.[139] Neftegazconsult does not provide any estimates of the costs or CAPEX for this undoubtedly costly program of testing and drilling. Neither does Deloitte. Indeed, Deloitte's report does not reference (or even acknowledge) the Neftegazconsult report in any way. And in a further indication that GCA's alleged compression requirement is itself both unnecessary and a purely fabricated expenditure, Neftegazconsult does not mention GCA's alleged compression requirement anywhere in *its* report.

52. Neither the compression program put forward by GCA, nor the testing, workover, and drilling program put forward by Neftegazconsult, would do anything more to address the water cut issue in the Tolkyn field than the simple reduction in production that the State already incorporated into the 2009 Development Plan.[140] And Respondent's inclusion of these two different, and enormously expensive, programs to allegedly address the water cut issue in the Tolkyn field, both intended to commence in 2011, begs a question: — It is now 2012; were either of these programs undertaken in 2011, or were they deemed unnecessary? Claimants have not been able to locate in the documents produced by Kazakhstan any indication that either program has been commenced, and if they have not, it is certainly logical to assume that

[137] FTI's Second Report ¶ 6.48.

[138] FTI's Second Report ¶ 6.49.

[139] *See* Neftegazconsult Report, November 14, 2011, at 18-22, R-173.

[140] *See* Ryder Scott's Second Report p. 5.

Respondent simply invented them in order to impose the maximum possible negative impact on a discounted cash flow analysis and thereby suppress the value of the Tolkyn field.

D. Respondent's Arguments Concerning Valuation of the Contract 302 Properties

53. Respondent acknowledges that Claimants have provided a prospective valuation of the Contract 302 Properties in connection with their lost opportunity claim,[141] a claim that is based upon the State's deprivation of both Claimants' opportunity to fully prove the Contract 302 Properties' reserves, and, by ultimate expropriation, to realize any value for the properties at all.[142] However, by selective quotation and, frankly, gross misrepresentation, Respondent then deliberately miscasts Claimants' Contract 302 Property claim as one for lost profits. Respondent states in paragraph 52.5 of its Statement of Defense:

> However, ultimately it is clear from SoC 421 that, whatever gloss the Claimants attempt to put on their claim in respect of the Contract 302 Properties, they are essentially making a claim for *"profits the Claimants could have earned if allowed to process the potential gas volumes from the Contract 302 Properties"*. There is no apparent attempt to discount forecast future profits as would be required for a claim for lost opportunity.[143]

54. FTI conducted precisely the DCF calculation that Respondent here claims "there was no apparent attempt" to conduct. As FTI made clear in its first report, "[i]n our application of the DCF valuation method, we have prepared a separate DCF analyses for the independent values of Borankol field, Tolkyn field, LPG Plant and Contract 302 Properties."[144] Indeed, Respondent itself later acknowledges that FTI conducted the very DCF calculation it claims is missing when it describes "the total CAPEX in the FTI cash flow" for the Contract 302

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[141] Statement of Defense ¶ 52.4.

[142] Statement of Claim ¶ 422.

[143] Statement of Defense ¶ 52.5. The full sentence from which Respondent carves out this selective quotation reads: "The damages calculation for the Contract 302 Properties, and the enhanced market value of the LPG plant based on profits that Claimants could have earned if allowed to process the potential gas volumes from the Contract 302 Properties, presents a greater valuation challenge." Statement of Claim ¶ 421. Calculation of future costs and profits is, of course, a standard increment in any DCF analysis.

[144] FTI's May 17, 2011 Report ¶ 14.4. FTI's DCF analysis for the Contract 302 Properties is contained in Section 15 of their first report, and a description of FTI's valuation methodology is contained in ¶¶ 439-446 of the Statement of Claim.

Properties, and contrasts that CAPEX with the cash flow analysis performed by GCA.[145] Respondent's objective in making this transparent misrepresentation is to simply change by summary declaration the legal standards applicable to a proper damages award for the loss of the Contract 302 Properties. As Respondent puts it: "Accordingly the Claimants entitlement to the sums claimed should be judged by reference to the requirements for making a claim for lost profits and in particular the requirements as to certainty . . . ."[146]

55. The claim that is being made for the Contract 302 Properties is, however, obviously not a lost profits claim. It is a claim for the loss of the opportunity to prove the complete value of the Contract 302 Properties — Properties that the State now holds by seizure, and Properties that Claimants spent approximately US $43 million exploring.[147] Because Claimants' exploratory work was truncated by the State, certainty as to the value of the Contract 302 Properties cannot rise to the level achievable with developed properties like the Tolkyn and Borankol fields. That the Contract 302 Properties have value is, however, indisputable. Even with the concerted manipulations that Respondent has repeatedly employed to suppress the overall value of Claimants' investments, Respondent itself puts a value of US $68 million on the singular Munaibai Main oil resource area contained in the Contract 302 Properties,[148] a value four times greater than the farcical US $17 million that Respondent puts on the entirety of the developed Borankol field.[149]

56. In addition to misrepresenting the very nature of Claimants' Contract 302 Properties claim, Respondent misleadingly portrays the actual state of the exploratory work that had already been performed on the Properties by the time of State seizure. Respondent states that "much of the claimed 'potential' of the Contract 302 Properties remains unexplored."[150] If by unexplored, Respondent means that test wells were not drilled on all of the resource areas covered by the Contract 302 Properties, that is true. However, by the time of seizure, Claimants had already successfully test drilled the Tabyl and Munaibai resource areas, conducted seismic

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145 Statement of Defense ¶ 52.26 (m).

146 Statement of Defense ¶ 52.5.

147 *See* FTI's May 17, 2011 Report ¶ 6.21.

148 Statement of Defense ¶ 52.35; Deloitte Report ¶ 10.21.

149 Statement of Defense ¶ 51.7.

150 Statement of Defense ¶ 52.3.

work in the Tabyl West, Munaibay North, Bahyt, and Interoil Carboniferous Reef resource areas, and commenced a test well in the Bahyt resource area that has log data to approximately 3950 meters.[151] Furthermore, the Tabyl West and Munaibai North resource areas are immediately proximate to the already successfully drilled Tabyl Main and Munaibai Main resource areas, which, as explained in the geology report (Exhibit 4) accompanying Ryder Scott's First Report, significantly increases their geological chance of success. In short, the totality of the data available for estimating quantities of hydrocarbons in the Contract 302 Properties is significant.

57. Respondent goes on to state that, "[n]evertheless the Claimants seek to attribute some value to all areas of the Contract 302 Properties, whether or not explored, which they admit 'presents a greater valuation challenge.'" Claimants do indeed seek to attribute some value to all areas of the Contract 302 Properties, and do indeed admit that this presents a greater valuation challenge than valuation of, for example, the developed Tolkyn and Borankol fields. But the benefit of the doubt concerning the outcome of that valuation must accrue to the Claimants as victims, and not to Kazakhstan as the wrongdoer. Kazakhstan was well aware of both the extent of the exploratory work that had already been conducted on the properties and the available information indicating the properties' potential, and it is readily apparent that the very potential of these properties was among the motivating factors for the State's harassment campaign against Claimants and ultimate seizure of Claimants' investments. Kazakhstan now holds what it minimally concedes are Properties with a value of US $68 million, and in addition, holds Properties with the potential for spectacularly unjust enrichment. Kazakhstan has full possession of all of the contingent resources in the Tabyl and Munaibai areas that Claimants expended the effort and money to establish, and the prospective resources for which Claimants had already conducted seismic work and geological evaluation, including the costly process of commencing a test well in the Bahyt area. Respondent should not be permitted to sit on these Contract 302 Properties without paying for them until the Tribunal renders an award that minimizes their value, and then prove by development the actual value of the bargain that it illegally acquired.

58. The appropriate framework for analyzing Claimants' Contract 302 Properties claim is not the lost-profits certainty standard that Respondent seeks to apply, but the standard enunciated in *Sapphire International Petroleum, Ltd. v. National Iranian Oil Company*:

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[151] *See* File: 2.2.3.12.2.1 Well 1 Bahyt dates.las, in the data accompanying the Ryder Scott May 15, 2011 Report.

> Since the question concerns the concession of an area which has not yet been prospected and where therefore the presence of oil-bearing beds in commercially workable quantities was and still is today uncertain, the existence of damage is not without doubt. No one today can affirm that the operation would have been profitable, and no one can deny it. But if the existence of damage is uncertain, it is nevertheless clear that the plaintiff had an opportunity to discover oil, an opportunity which both parties regarded as very favourable. **Does the loss of this opportunity give the right to compensation? It is not necessary to prove the exact damage suffered in order to award damages. On the contrary, when such proof is impossible, particularly as a result of the behaviour of the author of the damage, it is enough for the judge to be able to admit with sufficient probability the existence and extent of the damage**.[152]

As in the present case, the *Sapphire International* Tribunal noted that the claimant there had submitted expert geological analysis of the oil and gas prospect at issue that made "it possible to affirm that there is a very strong chance, but not a certainty, that deposits of commercially workable oil exist in the concession area." Unlike the relatively extensive exploration and consequent geological information present here, however, the claimant in *Sapphire* had performed no drilling and no seismic work, and the only bases for assessing the prospect at issue was summarized by the claimants' expert as follows: "[T]he geology of the undersoil should be deduced from the geology of the surface of the concession, from a geophysical survey of the terrain and from the generally known structure of the Middle East." With *Sapphire* as a precedential guide, there is most certainly sufficient evidence in the present case "for the judge to be able to admit with sufficient probability the existence and extent of the damage."

59. Even within the realm of the lost-profits certainty standard that Respondent seeks to apply here, there exists the modifying principal that, "[o]nce causation has been established, and it has been proven that the *in bonis* party has indeed suffered a loss, less certainty is required in proof of the actual amount of damages; for this latter determination Claimant only needs to provide a basis upon which the Tribunal can, with reasonable confidence, estimate the extent of the loss."[153] This standard is based on the "general legal principle [that], when a respondent has

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[152] *Sapphire Int'l Petrol. Ltd. v. Nat'l. Iranian Oil Co.*, Award, March 15, 1963, 35 I.L.R. 136, 187-88 (emphasis added), C-308.

[153] *Lemire v Ukraine*, ICSID Case No. ARB/06/18, Award, March 28, 2011, ¶ 246, C-61.

committed a legal wrong causing loss to a claimant (as found by a tribunal), the respondent is not entitled to invoke the burden of proof as to the amount of compensation for such loss to the extent that it would compound the respondent's wrongs and unfairly defeat the claimant's claim for compensation."[154] Thus, as Professor Gotanda duly notes in his survey of recent case law and arbitral awards dealing with the requisite certainty required in lost profits calculations, many jurisdictions no longer require complete certainty when assessing lost profits damages, and uncertainty alone does not (and should not) bar recovery.[155]

60. Indeed, even Respondent effectively concedes in the end that the complete certainty standard it seeks to impose is not the proper standard to be applied, stating:

> As to the Claimants' reliance on Professor Gotanda's analysis . . . to assert that in proving these lost profits, it is not necessary to prove such losses with "complete certainty" and that uncertainty alone should not be a barrier to recovery . . . , it is noted by the Republic that there exists an important distinction between situations where the quantum of loss is uncertain and where the existence of loss is uncertain . . . .[156]

Of course, Respondent has already made clear by assigning its minimal US $68 million value to the Contract 302 Properties that the existence of loss is certain in the present case, and that it is only the quantum of loss that remains to be determined.

61. Regarding the appropriate quantum, FTI has made adjustments to its original prospective valuation of the Contract 302 Properties to account for updated information regarding gas revenues, cost of goods sold, administrative expenses, transportation, and depreciation.[157] With the adjustments, FTI has provided an un-risked, middle range, 2C and Best Estimate prospective valuation for the Contingent and Prospective resource areas in the Contract 302 Properties of US $1.58 billion.[158] Given the egregiousness of the State's conduct in this case, and the potentially enormous windfall to Kazakhstan that the Contract 302 Properties

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[154] *Gemplus & Talsud SA v United Mexican States*, ICSID Cases Nos. ARB(AF)/04/3 & ARB(AF)/04/4, Award, June 16, 2010, ¶ 13-92, C-309.

[155] John Y. Gotanda, *Recovering Lost Profits in International Disputes*, 36 Geo. J. Int'l. L. 61, 71-72, 77-78 (2004), C-62.

[156] Statement of Defense ¶ 46.26.

[157] *See* FTI's Second Report ¶¶ 2.47-2.53.

[158] FTI's Second Report ¶ 2.53.

represent, Claimants feel strongly that an appropriate damage award would be the total sum of US $1.58 billion, and urge the Tribunal to make such an award.

62. Respondent's *de minimis* US $68 million value for the Contract 302 Properties is certainly an inappropriate damage sum. As noted above, Respondent attributes the entirety of this US $68 million value to just the oil production from only one of the six resource areas that comprise the Contract 302 Properties, the Munaibai Main. In reliance on GCA's conclusion that the Tabyl Main and the Tabyl West resource areas are, effectively, too small to bother with (an unknown industry standard, as Ryder Scott points out),[159] Deloitte does not even conduct a valuation of these two areas.[160] And Deloitte assigns a zero value to the Munaibai Main gas resources, and to the Munaibai North, Bahyt, and Interoil Reef resource areas. By assigning a zero value to all of the Contract 302 resources areas other than Munaibai Main oil (and indeed, by contending that Tabyl Main and Tabyl West are just too small to bother with), Respondent is effectively contending that none of these resource areas will, in the future, be subject to any further exploration or development, and that Kazakhstan will not re-offer to any oil and gas company the full Contract 302 Properties that it illegally seized from Claimants. Any such contention is, however, belied by the fact that Kazakhstan promptly entertained bids from interested oil and gas companies, including Naftohaz Ukrainy, for the Borankol, Tolkyn *and Contract 302 Properties* shortly after it seized them.[161]

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[159] Ryder Scott's Second Report pp. 12-13.

[160] The Tabyl Main is a contingent resource area that has been test drilled with the Tabyl-2 and Tabyl-3 wells. *See* Ryder Scott's May 15, 2011 report at p. 7. The Tabyl West, on which seismic has been conducted, is a prospective resource area approximately 2 kilometers to the west of the Tabyl-2 well. *Id.* at p. 8. The discrete un-risked, middle range, 2-C estimate of value for the Tabyl Main is US $32.6 million. *See* FTI's Second Report ¶ 2.53, fn. 46. The discrete un-risked, middle range, Best Estimate of value for the Tabyl West is US $5.4 million. *Id.*

[161] *See* "Naftohaz Ukrainy Considering Possibility Of Buying Three Oil And Gas Deposits In Kazakhstan," *available at* http://www.finchannel.com/Main_News/Ukraine/75768_Naftohaz_Ukrainy_Considering_Possibility_Of_Buying_Three_Oil_And_Gas_Deposits_In_Kazakhstan_/ (last visited May 23, 2012) ("The Naftohaz Ukrainy national joint-stock company is considering the possibility of acquiring the Tolkyn and Borankol oil and gas deposits and the Tabyl oil and gas block (Mangistauskaya region of Kazakhstan). . . . The tender documentation states that the winning bidder should estimate the known reserves at these deposits based on the prices of crude oil and natural gas, the ownership rights, and taxes, as well as determine Naftohaz Ukrainy's operating and capital expenditures in case of acquisition of the deposits. In addition, the winner is required to gather, analyze, systematize, and audit the geologic/geophysical and geologic/industrial materials at the Tolkyn and Borankol oil and gas deposits and the Tabyl oil and gas block as of January 1, 2020, as well as to determine the expected net revenues and the expected discounted net revenues from every category of estimated reserves

63. Even if it were to be accepted that potential oil production from the Munaibai Main is the only thing of value in the Contract 302 Properties (which Claimants vigorously dispute), Deloitte's calculation of US $68 million is itself far too low a valuation. Deloitte made this calculation by applying Economic Chance of Success (ECOS), Geologic Chance of Success (GCOS), and Risked Capital values supplied by GCA. As noted by FTI, the risk factors that could be applied in any such calculation vary widely depending upon the engineering and fiscal wherewithal of any given prospective purchaser,[162] making prediction of which risk factors to apply and how to apply them a highly uncertain endeavor. GCA itself has not provided any explanation or underlying calculations for how it derived the ECOS factors it supplied to Deloitte,[163] and, while Deloitte states that all of the ECOS, GCOS and Risked Capital values used in its report were provided by GCA,[164] it appears that Deloitte applies, without any explanation, a higher Risked Capital amount than that presented by GCA.[165] Nevertheless, using the *same* ECOS, GCOS, and Risked Capital factors that GCA provided to Deloitte, FTI made its own calculation of the value of Munaibai Main oil, calculating that value to be US $153 million.[166] Based on the egregiousness of the State's conduct here, the potentially enormous windfall that Kazakhstan has positioned itself to receive, and the inherent uncertainty surrounding application of appropriate risk factors, Claimants believe that the appropriate damage sum for the totality of the Contract 302 Properties, including the Munaibai Main oil resources, is the unrisked, middle range, 2C and Best Estimate calculation made by FTI.

64. Finally, Respondent complains at considerable length about Claimants' valuation of the Interoil Reef resource area. This is not surprising since the Interoil Reef indisputably

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at the abovementioned deposits and block."), C-692. The collective group of Contract 302 resource areas are often referred to as the "Tabyl block."

[162] As FTI stated in its May 17, 2011 report: "In evaluating properties with contingent and prospective resources, investors often make adjustments to the potential value of a project based on their assessment of various categories of risk related to these properties. The categories of risk include geological and geophysical risks, engineering risks, and commercial risks. The assessment of these factors, particularly relating to engineering and commercial risks, can vary widely depending on the investor, with the assessment of the engineering and commercial risk factors being dependent on the engineering and fiscal wherewithal of a prospective investor." FTI's May 17, 2011 Report, n.242.

[163] FTI's Second Report ¶ 8.12

[164] Deloitte Report pp. 25, 26.

[165] FTI's Second Report ¶ 8.8 and Table 27.

[166] For comparison, the discrete un-risked, middle range, 2C estimate of value for the Munaibai Main oil is US $227 million. *See* FTI's Second Report at ¶ 2.53, fn. 46.

holds the highest total potential among the Contract 302 resource areas.[167] Claimants acknowledge that, coupled with this exceedingly high potential, the Interoil Reef necessarily carries higher risk, but Claimants believe that it was this particular discovery that the State was most acutely interested in acquiring when it launched its harassment campaign. Claimants believe that, given its exceedingly high potential, and the State's apparently acute interest in gaining cost-free control over it by any nefarious means possible, the Interoil Reef must be accorded considerable value in any damage award, and should properly be valued at its full un-risked, middle range, Best Estimate value.[168]

E. Respondent's Arguments Concerning Valuation of the LPG Plant

65. Respondent argues that Claimants are not entitled to recover the sums that they actually invested in the LPG Plant, and that Claimants are only entitled to recover a salvage value of the Plant of between US $24 to US $32 million.[169] To support this conclusion, Deloitte makes the assumption that the LPG Plant would not generate income sufficient to recover future capital expenditures because of low utilization, and then uses this assumption to conclude that the only value of the Plant is in the sale of its component parts.

66. As a preliminary matter, Deloitte's assumption of salvage value is intrinsically an inappropriate premise. As of the appropriate October 14, 2008 valuation date, Claimants fully intended to finish construction of the LPG plant and put it into operation, and in connection with all of Claimants' efforts to sell the LPG Plant both before and after October 14, 2008, Claimants offered the Plant, and prospective purchasers bid on the Plant, not as scrap but as prospectively operational. This fact is clearly reflected in the indicative offers made by interested buyers in 2008, which valued the LPG Plant at US $150 million on average. Indeed, the offer made for the LPG Plant by KazMunaiGas at that time was US $199 million. While Claimants did not accept these offers because at the time they deemed them too low and did not feel that they would lead to a sale,[170] the Tribunal should note that State-owned KazMunaiGas itself offered almost US

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[167] The Interoil Reef resource area, on which seismic has been conducted, has a middle range Best Estimate potential for 1,048.6 Bcf of gas, and 53,374 Mbbl of oil and condensate. *See* Ryder Scott's May 15, 2011 Report at Exhibit No. 12.

[168] The Interoil Reef resource has a discrete un-risked, middle range, Best Estimate value of US $1,070.4 million. *See* FTI's Second Report at ¶ 2.53, fn. 46.

[169] Deloitte Report p. 24.

[170] Second Stati Statement ¶¶ 4-5; First Lungu Statement ¶ 34.

$200 million for the Plant, more than six times the highest value assigned to the LPG Plant by Deloitte of US $32 million. Little more is needed to demonstrate that Deloitte's salvage value assumptions and calculations are worthless.

67. Furthermore, current publicly available information indicates that Kazakhstan is in fact gearing up to finally open the LPG Plant in 2012. In a document entitled "List of Investment projects of the Mangistauskoi Region, which are being supervised in 2011," there is a specific reference to the LPG Plant under "Regional Projects".[171] The project is identified as having a cost of US $315 million (47 billion Tenge), and it is expected to start up in the first half of 2012 with a capacity of 7 mcm of gas per day.[172] It is clear that, with an identified cost of US $315 million, Kazakhstan has been in the process of spending additional capital to complete the LPG Plant since its seizure, and that consequently Kazakhstan does not view the Plant as scrap. Furthermore, Kazakhstan is training specialists for operation of the LPG Plant, a clear indication that Kazakhstan is going to complete the Plant and put it into operation.[173] The Tribunal should not take seriously any argument that salvage value is an appropriate award for a seized LPG Plant that Kazakhstan is on the verge of putting into operation at full capacity.

68. In addition to these glaring absurdities in Respondent's salvage value argument, Deloitte has made a number of apparently unsupported assumptions that serve to significantly decrease the value assigned to the LPG plant. Deloitte's salvage value calculation for the LPG Plant begins with a conceded "book value" of the Plant as of December 31, 2009 of US $244 million.[174] From this book value, Deloitte then makes summary "adjustments" that reduce the value to its final range of US $24 to US $32 million. These "adjustments" include:

- the addition of non-capitalized construction costs in the amount of US $28 million;[175]

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171 *See* Second FTI Report ¶ 7.7 and FTI fn.'s 138, 139.

172 *Id.* The LPG plant is also listed on a "Kazakhstan Embassy in Israel" website under the caption "List of Large Investment Projects in Kazakhstan through 2021," with the same project cost of 47 billion Tenge. *See* FTI's Second Report ¶ 7.7 and FTI fn. 140.

173 *See* "Application based on the need to train human resources on the projects, included in the industrialization map for 2012-2014," identifying the Borankolsky gas processing plant, Mangystau, Beineu district, Borankol, C-583.

174 *See* Deloitte Report ¶ 9.17; FTI's Second Report ¶ 7.12.

175 *See* Deloitte Report at ¶ 9.19; FTI's Second Report ¶ 7.13.

- an "adjustment" allegedly due to the remoteness of the LPG Plant, the specialized nature of the Plant, and the difficulty that would be associated with reselling the property in its current condition, with a summary conclusion that only resale of the equipment and steelworks would be feasible, amounting to 30-40% of the total asset value;[176]

- another inexplicable (and seemingly redundant) "adjustment" discounting the total value because the assets are now being sold only at salvage value;[177] and

- subtraction of "Dismantling" costs.[178]

69. From the review of Deloitte's documents that FTI has been able to conduct to date, there is no supporting documentation for these "adjustments," and they appear to be just another blunt method of slashing the value of Claimants' Investments.[179]

70. FTI has also made a DCF calculation of the prospective value of the LPG Plant if the Plant utilized volumes of gas from the Tolkyn, Borankol and Contract 302 Properties. Although FTI previously assumed the availability of limited quantities of third-party gas to load the Plant, Respondent criticized that assumption on the grounds that the quality of such gas and terms of such arrangements are too uncertain to predict. While Claimants and FTI disagree with that criticism, to be more conservative, FTI has now restricted its prospective DCF valuation to assume that only gas supplies from the Tolkyn, Borankol and Contract 302 Properties are processed in the LPG Plant.[180]

71. This is a reasonable and conservative assumption. When Claimants commenced the LPG Plant project, it was their firm conviction that the Tolkyn field alone would produce

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176 *See* Deloitte Report ¶¶ 9.18-9.19; FTI's Second Report ¶ 7.13.

177 *See* Deloitte Report ¶ 9.20; FTI's Second Report ¶ 7.13.

178 *See* Deloitte Report ¶ 9.21; FTI's Second Report ¶ 7.13.

179 FTI has made an adjustment to the total investment value that they believe Claimants' should, at a minimum, recover for the LPG Plant based on the approximately US $37 million in additional expenditures through May, 2009, which would not have been incurred by Claimants had they been able to sell the Plant in October of 2008. With the addition of these expenditures, Claimants recoverable investment value for the LPG Plant is US $245 million. FTI's Second Report ¶¶ 2.39-2.40.

180 FTI's Second Report ¶ 2.41.

sufficient gas to operate the LPG Plant at its optimal level of 7 million cubic meters per day for several years into the future.[181] Additionally, with TNG's plans to begin producing gas from the Contract 302 Properties, Claimants felt that sufficient gas supplies to operate the LPG Plant at optimal capacity would exist even as gas production from Tolkyn began to decline.[182] Regarding alternative sources of gas from third-parties, TNG did not extensively model the economics of third-party sources because TNG always expected and intended to use the LPG Plant's capacity to process its own gas supplies.[183] The LPG Plant did, however, have the capability to process gas supplied by third-party sources, and Kazakhstan in fact pressured TNG to build the LPG Plant precisely because it offered the ability to process gas on behalf of other producers.[184] There are numerous oil and gas fields in the vicinity of the LPG Plant that produce natural gas, including "associated gas" (*i.e.*, gas produced by wells that primarily produce oil), and the CAC main pipeline that is proximate to the Tolkyn field was an additional potential source.[185]

72. Respondent's principal objection to FTI's prospective DCF valuation of the LPG Plant is that there would not be enough gas from Claimants' properties or from third parties to render the Plant profitable.[186] Regarding third-party gas in particular, GCA concluded that the gas in the CAC pipeline proximate to the Tolkyn field is insufficiently rich to supply a significant third-party source for the Plant.[187] However, Ryder Scott was not able to locate in the GCA documents any support for this summary contention.[188] Respondent's contention that there was, in combination, insufficient gas from Claimants' properties and third parties to run the Plant profitably is highly suspect. As noted above, Kazakhstan has publicly announced its further capital investment for completion of the Plant, and it's expected Plant start-up in the first half of 2012, and in connection therewith has advertised the Plant's processing capacity of 7 mcm of gas

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[181] Broscaru Statement, ¶ 17.

[182] *Id.*

[183] Broscaru Statement ¶ 21.

[184] Broscaru Statement ¶ 18.

[185] Broscaru Statement ¶ 20.

[186] Deloitte Report § 9; Statement of Defense ¶ 53.4, 53.16.

[187] GCA Report, ¶ 67.

[188] Ryder Scott's Second Report p. 12.

per day. In combination with its announcement that it is training specialists for operation of the LPG Plant, Kazakhstan is clearly intending to put the Plant into operation at full capacity in immediate future.

73. Kazakhstan obviously views the LPG Plant as a valuable and "strategic" asset, and it fully intends to operate the Plant at capacity into the future utilizing gas from the Tolkyn and Borankol fields, from development of the Contract 302 Properties, and from third party sources over which it can exercise considerable (and coercive) control.[189] The prospective DCF valuation of US $408.3 million provided by FTI is a reasonable estimation of this unique value of the LPG Plant to Kazakhstan. Claimants are entitled to recover that sum from Kazakhstan, as it represents the full value that the State has actually received as a result of its illegal seizure of the Plant.

III. FTI's Adjusted Valuation

74. In order to be as accurate as possible in its valuations, FTI has made certain necessary adjustments to its DCF and damages calculations to account for additional information it has obtained since the time of its May 17, 2011 report.[190] The individual adjustments have had both negative and positive effects on the asset valuations, and FTI has adjusted its total valuations of the Tolkyn and Borankol fields, the Contract 302 Properties, and the LPG Plant accordingly.

75. FTI's adjustments to its calculation of the value of the Borankol field include updates and adjustments to distribution costs, its mix of fixed versus variable costs in its forecast of cost of goods sold, recompletion CAPEX, its estimate for liquidation expenses, and depreciation. FTI has also adjusted its application of excess profits tax (EPT) to properly calculate EPT on income after corporate income taxes.[191] With these appropriate adjustments,

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[189] Relying on the same arguments and authorities concerning certainty that it set forth regarding the Contract 302 Properties, Respondent contends that Claimants' DCF calculation of the prospective value of the LPG Plant is also an unrecoverable claim for lost profits, arguing that Claimants' Plant loading assumptions are allegedly too uncertain to warrant recovery on the claim. Statement of Defense ¶ 53.3. The contention is as groundless here as it is regarding the Contract 302 Properties. FTI conducted a DCF calculation based upon reasonable assumptions regarding Plant loading, and with its illegal seizure of the Plant, Kazakhstan is now in the position of meeting, and indeed exceeding, precisely those Plant loading assumptions.

[190] *See* FTI's Second Report ¶¶ 2.1-2.3.

[191] FTI's Second Report ¶¶ 2.4-2.23.

FTI has calculated the value of the Borankol field as of October 14, 2008 at US $231.5 million.[192]

76. FTI's adjustments to its calculation of the value of the Tolkyn field also include concomitant updates and adjustments to distribution costs, cost of goods sold, recompletion CAPEX, liquidation expenses, and depreciation.[193] With these appropriate adjustments, FTI has calculated the value of the Tolkyn field as of October 14, 2008 at US $508.4 million.[194]

77. FTI's adjustments to its DCF calculation of the prospective value of the LPG Plant include, adjustments to the gas supply source for the Plant, adjustments to gas shrinkage and material expense, and updating of the corporate income tax rate to align with the 2009 Kazakh Tax Code.[195] With these appropriate adjustments, FTI's DCF calculation of the prospective value of the LPG Plant is US $408.3 million.[196]

78. FTI's adjustments to its DCF calculation of the prospective value of the Contract 302 Properties include updates and adjustments to the crude oil and condensate sales mix and liquids prices, transportation expenses effecting its liquids pricing assumptions, and infrastructure CAPEX.[197] With these appropriate adjustments, FTI's DCF calculation of the prospective value of the LPG Plant is US $ 1.58 billion.[198]

79. With these adjustments by FTI, Claimants' updated compensation claim for damages to their investments in Kazakhstan consists of the following elements:

Fair Market Value of Borankol Field:	**US $231.5 Million**
Fair Market Value of Tolkyn Field:	**US $508.4 Million**
Prospective Value of the Contract 302 Properties:	**US $1.58 Billion**

[192] FTI's Second Report ¶ 2.55, Table 5.

[193] FTI's Second Report ¶¶ 2.24-2.38.

[194] FTI's Second Report ¶ 2.55, Table 5.

[195] FTI's Second Report ¶¶ 2.41-2.46.

[196] FTI's Second Report ¶ 2.55, Table 5.

[197] FTI's Second Report ¶¶ 2.47-2.53.

[198] FTI's Second Report ¶ 2.55, Table 5.

Prospective Value of LPG Plant: **US $408.3 Million**.[199]

IV. Claimants Are Entitled to Compound Interest at an Appropriate Rate

80. Claimants further request that the Tribunal award pre-award and post-award interest, compounded annually, to the value of each of the separate elements of Claimants' damages claim from October 14, 2008 to the date that Respondent pays the Award in full. The rate that the Tribunal selects should accord with the general principle of "full reparation" for the injuries inflicted by Kazakhstan, and should be appropriate to compensate Claimants for the full period of time that they have been deprived of the value of their investments. As noted by the *LG&E v. Argentina* Tribunal:

> [I]nterest is part of the "full" reparation to which the Claimants are entitled to assure that they are made whole. In fact, interest recognizes the fact that, between the date of the illegal act and the date of actual payment, the injured party cannot use or invest the amounts of money due.[200]

81. This "full reparation" purpose was reflected in the decision of the Tribunal in *Funnekotter v. Zimbabwe.*[201] The Tribunal there looked beyond general market rates to determine an appropriate rate under the circumstances, noting that it selected a 10% interest rate based on an evaluation of Zimbabwe's conditions and a determination that the rate should be based on the lost value of claimants' investment had they had the monetary equivalent of the expropriated property.[202]

82. Here, Kazakhstan engaged in a lengthy and extraordinary series of illegal and injurious acts, and ultimately expropriated Claimants' investments without providing compensation. Kazakhstan's failure to compensate Claimants has effectively forced Claimants

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[199] In the event the Tribunal chooses not to award the prospective value of the LPG Plant, Claimants request an award of the investment value of the LPG Plant, as adjusted by FTI to account for the approximately US $37 million in additional expenditures by Claimants through May, 2009, in the sum of US $245 million. FTI's Second Report ¶¶ 2.39-2.40, and ¶ 2.55, Table 5.

[200] *LG&E Energy Corp. v. Argentine Republic*, ICSID Case No. ARB/02/1, Award, July 25, 2007, ¶ 55, C-314.

[201] *Funnekotter v. Zimbabwe*, ICSID Case No.ARB/05/6, Award, Apr. 22, 2009, ¶ 144, C-218.

[202] *Id.* ("[C]ompensation was not paid promptly at the time of dispossession, and the Claimants were therefore not able to make any investment outside of Zimbabwe. Thus, the Tribunal must use a rate of interest taking into account the situation in that country. A 10% rate seems in this respect reasonable.").

to loan to Kazakhstan the amount of the compensation that Kazakhstan should have paid to Claimants. Accordingly, applying a rate akin to Kazakhstan's sovereign debt or borrowing rate on the compensation owed to Claimants would, at a minimum, reflect the commercial reality of the situation into which Kazakhstan involuntarily and illegally forced Claimants.

83. The Tribunal must make Claimants whole by providing full compensation for the damages they have suffered as a result of Kazakhstan's illegal conduct. It is a universal principle of law that a wrongdoer should not benefit from his wrong—*commodum ex inuria sua nemu habere debet*. As stated by Judge Brower in *Amoco*: "[N]o system of law sensibly can be understood as intended to reward unlawful conduct."[203] Further, this is consistent with the opinion of Professors Reisman and Sloane that "BITs and comparable multilateral investment treaties should, as a matter of both the intent of their drafters and the policies that animate them, be construed to deter, not reward, unlawful expropriation of all kinds."[204]

84. That there must be a difference between lawful and unlawful expropriations is intuitive and generally accepted.[205] It would be illogical and counterintuitive to fail to distinguish between lawful and unlawful takings, or to assess the same financial consequences for the two.[206] As Professor Marboe explains, "[a]s a matter of principle, a differentiation appears to be necessary because the financial consequences of lawful and unlawful behavior

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[203] *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, ¶ 18 n.22 (1988) (Concurring Opinion of J. Brower), C-247.

[204] Michael W. Reisman & Robert D. Sloane, *Indirect Expropriation and Its Valuation in the BIT Generation*, 74 Brit. Y.B. Int'l. L. 115, 148 (2004), C- 230.

[205] *Case Concerning the Factory at Chorzów (Ger. v. Pol.)*, Judgment, Sept. 13, 1928, 1928 (hereinafter "*Chrozów* Judgment"), 1928 P.C.I.J. (ser. A), No. 17, ¶ 124 (Sept. 13) ("Such a consequence [of equating lawful with unlawful expropriation] would not only be unjust, but also and above all incompatible with the aim of Article 6 …–that is to say, the prohibition, in principle, of the liquidation of the property… –since it would be tantamount to rendering lawful liquidation and unlawful dispossession indistinguishable in so far as their financial results are concerned."), C-165; *Sedco, Inc. v. National Iranian Oil Co. & Iran,* Iran-U.S. Claims Tribunal Case No. 129, Interlocutory Award No. 59-129-3 and Separate Opinion of Judge Brower, March 27, 1986, 25 I.L.M. 629, at 17, n.35 (1986) ("[T]he injured party would receive nothing additional for the enhance wrong done it and the offending State would experience no disincentive to repetition of unlawful conduct."), C-289.

[206] Derek W. Bowett, *State Contracts with Aliens: Contemporary Developments on Compensation for Termination or Breach*, 59 Brit. Y.B. Int'l. L. 49, 61 (1988), C-693. *See also* Ignaz Seidl-Hohenveldern, *L'évaluation des dommages dans les arbitrages transnationaux*, 33 Annuaire Français de Droit International 7, 12 (1987), C-694; Irmgard Marboe, CALCULATION OF COMPENSATION AND DAMAGES IN INTERNATIONAL INVESTMENT LAW 68 (Oxford University Press 2009), C-297.

would otherwise be the same. This would clearly be against the interest of legal justice and the general preventive function of law."[207]

85. Furthermore, in this case, Claimants not only suffered from a campaign of illegal indirect expropriation as from October 2008. Kazakhstan's conduct as from that date also violated the ECT's most constant protection and security, fair and equitable treatment, and impairment standards, among others, and was therefore illegal in myriad respects. Put simply, Kazakhstan's treatment of Claimants' investments from October 2008 onward was indisputably illegal. Therefore, the Tribunal must award full compensation, including compound interest, to Claimants from October 2008 until Kazakhstan's full and final payment of the Tribunal's Award in order to compensate Claimants for the damages they have suffered and will continue to suffer until that payment is made.

86. Kazakhstan must pay a sum that would, in the words of the *Chorzów Factory* case, "wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed."[208] Here, Claimants believe that should translate into consideration of a range of interest rates between Kazakhstan's borrowing rate, at a minimum,[209] and the cost of debt for commercial loans for investments in the Kazakh market during the relevant time period. One such example of a commercial loan for energy investments in the Kazakh market during the relevant period was the Tristan Notes, which bore an interest rate of 10.5%.[210]

87. Setting a rate of interest between the Kazakh sovereign debt rate and 10.5% would be in line with the approaches of other tribunals. For example, in the *Funnekotter* case,

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[207] Irmgard Marboe, CALCULATION OF COMPENSATION AND DAMAGES IN INTERNATIONAL INVESTMENT LAW 68 (Oxford University Press 2009), C-297.

[208] *Chorzów* Judgment ¶ 125, C-125.

[209] Article 13(1) of the ECT provides that in cases of lawful expropriation (not the case here), the government must pay "interest at a commercial rate established on a market basis from the date of Expropriation to the date of payment." ECT art. 13(1), C-1. Thus, had Kazakhstan lawfully expropriated Claimants' investment and delayed providing compensation, it effectively would have forced Claimants to make a loan to it for which it was obligated to pay a commercial rate based on Kazakhstan's cost of borrowing in the international market.

[210] The Tristan Notes interest rate of 10.5% is in line with the National Bank of Kazakhstan official interest rate as of the October 2008 valuation date. That rate has fluctuated between 10.5% and 6.5% as of the date of this submission. *See* http://www.tradingeconomics.com/kazakhstan/interest-rate (last visited May 28, 2012).

the Tribunal used 10%, and in two other relatively recent awards rates of 9% and 6% were used.[211]

88. Respondent has not objected to an award of either pre-award or post-award interest, and has indeed demonstrated its general acquiescence to an interest award by suggesting as an appropriate rate the 6% enunciated in the *S.S. Wimbledon* and *M/V Saiga* decisions.[212] Neither has Respondent offered any objection to use of the Kazakhstan sovereign debt rate as a minimum standard.

89. Respondent has, however, objected to compound interest, pointing to a handful of outlying authorities for the position that simple interest is the purported norm.[213] Respondent cannot dispute, however, the overwhelming trend in recent years to award compound interest, for the reason succinctly given by the *Vivendi II* Tribunal: "[C]ompound interest should be available as a matter of course if economic reality requires such an award to place the claimant in the position it would have been in had it never been injured."[214] Because "compound interest is the norm" in all financing and commercial transactions, awarding simple interest results in the unjustifiable situation in which "a party receiving simple interest is in essence making interest-free loans to the party paying the simple interest."[215] As the Tribunal in *Siemens* stated:

> As regards compounding of interest, the question is not, as argued by Argentina, whether Siemens had paid compound interest on borrowed funds during the relevant period but whether, had compensation been paid following the expropriation, Siemens would have earned interest on interest paid on the amount of

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[211] *Wena Hotels Ltd. v. Egypt,* ICSID Case No. ARB/98/4, Award, December 8, 2000 (hereinafter "*Wena* Award"), 41 I.L.M. 896, 919, ¶ 128, n. 289 (2002) (applying a rate of 9%), C-216; *Impregilo S.p.A. v. Argentine Republic*, ICSID Case No. ARB/07/17, Award, June 21, 2011, ¶ 383 (applying a rate of 6%), C-695

[212] *Case of the S.S. "Wimbledon"*, Judgment, August 17, 1923, 1923 P.C.I.J. 15, 32 (ser. A) No. 1 (Aug. 17) (awarding 6% post-interest from the date of the award to the date of compliance with the award) C-696; *M/V "Saiga" (No. 2) (St. Vincent v. Guinea)*, ITLOS Case No. 2, Judgment, July 1, 1999, ¶ 173 (awarding varying rates consisting of 6% on the award for compensation, 8% on the award for loss of profit, and 3% on the award for pain, suffering, disability, and psychological damage), C-699.

[213] Statement of Defense ¶¶ 56.2-56.4.

[214] *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"), ¶ 9.2.6, C-253.

[215] Jeffrey M. Colón & Michael S. Knoll, *Prejudgment Interest in International Arbitration*, 4(6) Transnat'l. Disp. Mgmt. 9–10 (Nov. 2007) ("Because the goal of prejudgment interest is to place parties in the same position that they would have been had the award been made immediately after the cause of action arose, awarding simple interest fails to fully compensate claimants. All awards of prejudgment interest should therefore be computed using compound interest."), C-697.

> compensation. It is in this sense that tribunals have ruled that compound interest is a closer measure of the actual value lost by an investor.[216]

Professor Marboe's book on damages in investment arbitration expressly acknowledges that "[n]umerous investment tribunals have awarded compound interest in recent years, in particular since the year 2000."[217] She adds:

> In view of the necessary economic perspective, the increasing acceptance of compound interest appears appropriate as in economic practice interest both on loans and investments is usually compounded.[218]

90. Simply put, Kazakhstan cannot deny that the overwhelming majority of recent BIT case law favors compound interest.[219] Consistent with this law and the compelling economic rationale for its application, this Tribunal should award Claimants compound interest as a result of Kazakhstan's breaches of the ECT.

V. Claimants' Are Entitled to Recovery of the Interest on the Tristan Notes

91. Respondent contends that Claimants' are not entitled to recover the interest and penalties accruing under the Tristan Notes.[220] Respondent's sole objection is that Tristan is not a party to this arbitration, and Claimants have not proven that Tristan is related to Claimants.[221] This objection is specious. Respondent is well aware of Tristan's integral relationship to Claimants, TNG, and KPM. Indeed, Respondent has explicitly and repeatedly described

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216 *Siemens A.G. v. Argentine Republic*, ICSID Case No. ARB/02/08, Award, February 6, 2007, ¶ 399, C-232.

217 Irmgard Marboe, CALCULATION OF COMPENSATION AND DAMAGES IN INTERNATIONAL INVESTMENT LAW 391 (Oxford University Press 2009), C-297.

218 *Id.*

219 *See, e.g., Wena* Award ¶ 129 ("[T]his Tribunal also has determined that compound interest will best 'restore the claimant to a reasonable approximation of the position in which it would have been if the wrongful act had not taken place.' . . . This Tribunal believes that an award of compound (as opposed to simple) interest is generally appropriate in most modern, commercial arbitrations." (footnote omitted)) C-216; *Azurix Corp. v. Argentine Republic,* ICSID Case No. ARB/01/12, Award, July 14, 2006, ¶ 440 ("The Tribunal considers that compound interest reflects the reality of financial transactions, and best approximates the value lost by an investor."), C-245; *Vivendi II* ¶ 9.2.6 ("[A] number of international tribunals have recently expressed the view that compound interest should be available as a matter of course if economic reality requires such an award to place the claimant in the position it would have been in had it never been injured."), C-253.

220 Statement of Defense ¶¶ 57.1-57.3.

221 *Id.*

precisely the relationship between Tristan, Claimants, TNG, and KPM in its Statement of Defense.[222] The relationship between Claimants and Tristan was also detailed by Mr. Lungu:

> Tristan is wholly owned by Anatolie Stati, and is organized under the laws of the British Virgin Islands. Tristan was incorporated in 2006 as a special purpose vehicle solely for the purpose of issuing Notes jointly and severally guaranteed on a senior secured basis by KPM and TNG. Proceeds from the Notes were used to repay KPM and TNG existing debt, and for KPM and TNG working capital, general corporate purposes, and capital expenditures. . . . Anatolie and Gabriel Stati are the ultimate, 100% beneficial owners of Ascom, Terra Raf, and Tristan, and, through these ownership interests, they were the 100% beneficial owners of the Kazakh companies KPM and TNG. [223]

92. As described in Claimants' Reply Memorial on Jurisdiction and Liability,[224] the expectation of all parties to the Tristan note issuances, including the Tristan note holders, was that KPM and TNG oil and gas operations would provide the funds to repay the principal and interest on the Tristan notes. Consequently, any disposition of Claimants' interests in, or the assets of, KPM and TNG requires arrangements to satisfy the Tristan note principal and interest held outside of (but guaranteed by) TNG and KPM.[225]

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[222] *See, e.g.,* Statement of Defense at ¶ 9.59 ("Based on information available to the Republic82, the Claimants began the "Bonds" project in 2006. Tristan Oil, a company under the control of the Claimants issued three tranches of bonds with a maturity of 1 January 2012 for a total amount of 531 million USD"); ¶ 9.61 ("According to available information, Tristan Oil issued bonds guaranteed by KPM and TNG"); ¶ 9.70 ("In 2008 the Claimants were planning to place at the London Stock Exchange the shares of the company 'Tristan Oil' which was under its control, which needed to be secured with the assets of TNG (by way of transfer of a 100% shareholding in the charter capital of TNG to the company 'Tristan Oil'")); ¶ 13.38 ("In 2008 the Claimants were planning to place at the London Stock Exchange the shares of the company 'Tristan Oil' which was under its control which had to be secured with the assets of 'Tolkynneftegaz' LLP (by way of transfer of a 100% shareholding in the charter capital of 'Tolkynneftegaz' LLP to the company 'Tristan Oil'"); ¶¶ 14.8-14.9 (describing the KPM and TNG financing through Tristan Oil). *See also* Letter from the Kazakh Anti-Monopoly Agency, June 16, 2008 (approving the purchase of 100% of TNG and KPM by Tristan Oil in connection with the proposed IPO), C-458.

[223] Lungu Statement ¶¶ 6, 7. *See also* Lungu Statement at ¶ 15; Second Stati Statement ¶ 43; Tristan Note Indenture, executed by Anatolie Stati as President, CEO, and Chairman of Tristan, and containing KPM and TNG note guarantees at § 11.01, C-584.

[224] Claimants' Reply Memorial on Jurisdiction and Liability, at § VII. A.

[225] *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.

93. Kazakhstan has 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 incorporate a total sum that will satisfy all the debts guaranteed by KPM and TNG, which includes the Tristan note principal, interest, and penalties. As explained in the Claimants' 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.'"[226]

VI. Claimants Are Entitled to Moral Damages

94. In its Statement of Defense, Kazakhstan correctly concedes that "moral damages are permissible" in an investment treaty arbitration and admits 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
- both cause and effect are grave or substantial."[227]

95. By any measure, this case is "exceptional" and meets the standard that Kazakhstan has enunciated. As Claimants described in their Statement of Claim and Reply Memorial on Jurisdiction and Liability, Kazakhstan's treatment of Claimants and their investments – including its heavy-handed prosecution and jailing of KPM's in-country manager, Mr. Cornegruta, on trumped-up charges – was exceptional and included physical threat, illegal detention, stress, anxiety, and the other elements that Kazakhstan concedes warrant an award of moral damages.

96. There are only a modest number of investment treaty cases on record in which a state's mistreatment of an investor was so severe, intentional, and multi-faceted as Kazakhstan's

[226] Statement of Claim ¶¶ 389-402 (quoting *Vivendi II* ¶ 8.2.7, C-253), C-253.

[227] Statement of Defense ¶ 55.2(b) (quoting *Lemire* Award ¶ 333, C-61).

treatment of Claimants in this dispute. There are even fewer cases on record in which that treatment was admittedly ordered by the Respondent's Head of State and carried out by dozens of state organs and instrumentalities over a period of years. Claimants have demonstrated that the mistreatment they suffered, while exceptional by investment treaty standards, was part of a "playbook" that Kazakhstan's rulers have employed in similar contexts.[228] Claimants have also shown that awards of moral damages are becoming increasingly accepted in investment treaty practice, as demonstrated by the recent award in *Desert Line v. Yemen*.[229]

97. If there were ever an investment treaty case in which an award of moral damages were appropriate, this is it. While ultimately a matter of discretion and judgment for the Tribunal, Claimants respectfully submit that the Tribunal should award, as moral damages, a sum equivalent to at least 10% of the total compensatory damages awarded to Claimants.

VII. Claimants' Are Entitled to a Full Award of Costs

98. Claimants also request that the Tribunal award them all costs and expenses associated with this arbitration, including attorneys' fees and expenses, experts' fees and expenses, and fees and expenses of the Tribunal and the SCC, pursuant to Article 44 of the SCC Arbitration Rules. As stated in Claimants' Reply Memorial on Jurisdiction and Liability, not only has Kazakhstan breached its obligations to Claimants under the ECT in a multitude of serious ways, but also Kazakhstan has breached its obligation to participate in these proceedings in good faith, unnecessarily and intentionally 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.

VII. Request For Relief

99. Based on the foregoing, Claimants' Reply Memorial on Jurisdiction and Liability, and Claimants' Statement of Claim, Claimants respectfully reiterate their request for the following relief:

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[228] Claimants' Statement of Claim ¶¶ 453-464; Claimants' Reply Memorial on Jurisdiction and Liability ¶¶ 617-624.

[229] *Id.*

- 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, including moral damages, as set forth herein and in Claimants' previous submissions and as may be 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 experts, 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 full and final satisfaction of the Award; and

- any other relief the Tribunal may deem just and proper.

Dated: May 28, 2012

Respectfully submitted,

KING & SPALDING

Reginald R. Smith
James E. Toher
Kevin D. Mohr
1100 Louisiana, Suite 4000
Houston, Texas 77002
U.S.A.

Kenneth R. Fleuriet
Héloïse Hervé
Amy Roebuck Frey
65-67 Avenue des Champs-Elysées
75008 Paris
France