

ARBITRATION V (116/2010)

**IN THE ARBITRATION INSTITUTE OF THE STOCKHOLM
CHAMBER OF COMMERCE AND IN THE MATTER OF ARBITRATION
BETWEEN:**

**ANATOLIE STATI, GABRIEL STATI, ASCOM GROUP S.A., AND TERRA RAF
TRANS TRADING LTD.**

Claimants

- and -

REPUBLIC OF KAZAKHSTAN

Respondent

Rejoinder on Jurisdiction and Liability

13 August 2012

INDEX

A.	INTRODUCTION.....	1
B.	JURISDICTION	4
I.	ECT nature and purpose and international law	6
II.	No Investors.....	7
1.	The Stati Family.....	7
a)	Anatolie Stati	9
b)	Gabriel Stati	14
c)	The Statis’ Other Foreign Investments	15
2.	Ascom	18
3.	Terra Raf	22
III.	No “Investment”.....	26
1.	Article 1(6) of the ECT should be interpreted in accordance with international law and the law of the host State	27
2.	Inherent meaning of “investments”	28
a)	<i>Salini</i> characteristics are indicative but not exhaustive	30
b)	Investments are required to be made in accordance with the host law and in Good Faith.....	33
IV.	There were no investments in fact.....	36
1.	Financial contribution on and post investment	37
a)	Contribution on investment.....	38
b)	Contribution Post-investment	40

2.	Lack of Risk undertaken by some or all of the Claimants.....	42
3.	Lack of contribution to the economy of Kazakhstan and undue exploitation of the assets.....	44
4.	Claimants’ “investment” not made in accordance with Kazakh law.....	47
a)	Claimants’ failure to obtain the required consent in relation to the transfer of TNG and circumvention of the Republic’s pre-emptive right.....	49
b)	Other illegalities the Republic discovered in relation to Claimants’ “investment” in Kazakhstan.....	58
5.	Claimants have not made a <i>bona fide</i> investment.....	64
a)	Claimants’ illegal activities in Kazakhstan.....	64
b)	Other breaches of good faith.....	65
V.	Claimants did not fulfil the “cooling off” requirement.....	67
1.	The “cooling off” period is a jurisdictional requirement.....	68
2.	There was no notice of amicable settlement or an amicable settlement prior to the Request for Arbitration.....	70
3.	No offer to arbitrate.....	71
4.	Cases Claimants rely on are not relevant for interpreting the ECT.....	71
5.	The stay of the arbitral proceedings cannot be conflated with a “cooling-off” period.....	75
VI.	The arbitration clause is invalid because of an ambiguous reference to the arbitral institution.....	76
C.	FACTS.....	77
I.	The alleged “Kazakhstan Playbook”.....	77
1.	The Republic does not harass foreign investors as part of a “Playbook”.....	78
a)	Financial Police.....	78
b)	Kazakh courts.....	79

c)	Alleged aim to renegotiate contracts or purchase a substantial equity stake in companies owned by foreign investors	80
2.	The motives Claimants describe for the Republic using the “Playbook” are fictional	83
a)	Alleged motive of enhancing Timur Kulibayev’s power and wealth	83
b)	Alleged political motives	84
c)	Alleged aim to renegotiate contracts or purchase a substantial equity stake in companies owned by foreign investors	86
II.	Alleged campaign initiated by President Nazarbayev upon receipt of letter from President Voronin	86
1.	President Voronin’s letter	86
2.	The authorities’ inspections and checks/audits were normal and legal	89
a)	Introduction	89
b)	Culture of inspection	90
c)	Criminal inspections/investigation	94
d)	Inspections in June and July 2010	103
e)	Conclusion	113
3.	In 2009 and 2010, the authorities were worried about the situation and sought to find a mutually agreeable solution	113
4.	The Blagovest letter	117
5.	Alleged attempts to acquire KPM and TNG by the Republic or by influential people within the Republic	118
a)	Attempts to purchase KPM and TNG by GazImpex, KazRosGas and Starleigh	120
b)	Attempts made to purchase KPM and TNG by KazMunaiGaz Exploration Production (“ KMG EP ”) and KazMunaiGas National Company (“ KMG NC ”)	122

III.	Poor conduct by Claimants was regulated by the Republic	126
IV.	Tax, export duties and transfer pricing matters	127
1.	Claimants’ tax claims relate to Taxation Measures under the ECT.....	127
2.	Corporate back taxes.....	129
3.	Export Duties	135
4.	Transfer pricing.....	138
V.	Non-Extension of Contract No. 302.....	141
1.	An extension was never granted	141
2.	The MEMR was under no obligation to extend Contract No. 302	145
3.	The MEMR’s decision not to enter into the additional agreement to prolong Contract No. 302 was not an act of bad faith	146
4.	Claimants have not properly responded to the Republic’s arguments.....	146
VI.	Criminal prosecution of Mr. Cornegruta on behalf of KPM.....	148
1.	The theory of premeditation is based on a skewed chronology.....	148
2.	Mr Cornegruta’s illegality was established through a thorough application of process and evidence gathering	150
VII.	Pre-trial Inspections and Investigations	152
1.	The inspections were not predicated on a “reclassification” of KPM and TNG’s pipelines	152
2.	No trunk pipeline licences held by ARNM.....	154
3.	Potential criminal liability through illegal economic activity.....	156
4.	The investigations agreed with the findings of the inspections department.....	159

5.	Identification of key personnel and detention of Mr Cornegruta	161
6.	Indictment by the Investigation Department.....	164
VIII.	Trial and Prosecution of Mr Cornegruta on behalf of KPM for Illegal Entrepreneurship	165
1.	The legal tests	166
2.	Issue A: Entrepreneurship.....	170
3.	Issue B(i): Classification of Pipeline	171
a)	Law and Applicable Legislation	171
b)	Definition	174
c)	None of the characteristics that Claimants rely on demonstrate that the KPM is not trunk.....	177
4.	The Court properly relied on fact and expert evidence when considering the legal tests	182
a)	Mr Baymaganbetov’s report was independent	182
b)	Mr Baymaganbetov’s decision was technically correct.....	187
c)	The Court was entitled to rely on Mr Baymaganbetov’s report	190
d)	Inadmissible evidence was not considered	191
5.	Proper and correct classification of the KPM Pipeline as “trunk”.....	194
6.	Issue B(ii): Whether the correct licences are held	195
7.	Issue C: Recovery of illegal income	197
a)	Recovery of KPM’s illegal income.....	197
b)	Amount of recovered income.....	202
8.	No interference with trial and due process	207
9.	Appeal of the KPM Pipeline Decision and Enforcement Decision	208
a)	Court System.....	210
b)	Claimants failed to pursue the available remedies.....	211

IX.	Termination of Contracts 210 and 305 for breach and invocation of the trust management system	214
1.	Termination of Contracts 210 and 305	216
a)	Existing breaches and wrongdoing by KPM and TNG	217
b)	Applicable Law and Contractual Provisions.....	219
c)	Inspections in 2010	221
d)	Termination of Contracts 210 and 305	223
2.	Trust Management and Transfer.....	229
a)	The Call of 22 July 2010: Claimants’ failure to engage with the Republic	232
b)	Current Management of the Property	234
c)	Claimants have ignored possibilities of appeal.....	236
X.	External circumstances and Claimant’s own actions led to a deterioration of value of KPM and TNG and their abandonment by the alleged investors.....	237
1.	Claimants’ activities in Kazakhstan were given only a limited chance by the markets from the beginning	239
2.	From the beginning, KPM and TNG were overexposed to debt	240
3.	The companies’ revenues were under pressure because of falling energy prices	242
4.	The companies were in such bad shape that a bridge loan to provide additional working capital was needed.....	242
5.	In early 2009, the companies’ cash position became very tight	243
6.	The companies’ liquidity shortage was made worse by numerous factors outside of the Republic’s influence.....	245
7.	KPM and TNG were obliged to make substantial tax payments in summer 2009.....	247
8.	Claimants obtained a ruinous bridge loan with a horrendous interest rate from a group of venture capitalists	248

9.	Claimants withdrew cash from the companies even when the financial situation of the companies was took a turn for the worse.....	249
10.	Conclusion	250
XI.	Claimants’ attempts to sell the companies did not fail because of any of the allegedly illegal actions of the Republic	251
1.	Overview of attempted sales.....	251
2.	The bids during Phase I of Project Zenith do not indicate possible sales prices	252
3.	The lack of interest of potential buyers in 2009 is not to be blamed on the Republic	254
a)	Reasons why several of the original bidders did not engage in the next stage of the sales process	254
b)	Reasons why all bidders eventually dropped out in 2009.....	255
c)	Claimants’ theories regarding the failure of the sales process do not add up.....	257
4.	Letters from the bidders	262
5.	Claimants’ own inactivity and failure to cooperate prevented the sale to Cliffson from going forward.....	263
a)	The Republic did not hinder the sale to Cliffson from going forward.....	264
b)	No link between the Cliffson offer and the termination of the contracts.....	267
c)	Value of the Cliffson offer	267
XII.	Alleged Damages	268
D.	NO VIOLATION OF THE ECT OR INTERNATIONAL LAW	269
I.	Applicable law	269
1.	Importance of considering the host state’s domestic law in investment treaty arbitrations	269
2.	Decisive significance of Kazakh law in this dispute	271

3.	Irrelevance of new legal arguments for the assessment of applicable law.....	273
II.	General approach under International Law: Deference.....	276
III.	Expropriation	277
1.	Introduction.....	277
2.	Exhaustion of available remedies	278
IV.	Direct expropriation	282
1.	Direct Expropriation requires a transfer of title.....	282
2.	No direct expropriation	284
3.	The Republic’s measures were legitimate regulatory actions.....	284
V.	Indirect expropriation	286
1.	Regulatory acts do not constitute a compensable indirect expropriation	288
2.	No interference with the day-to-day management.....	289
3.	No deprivation of the ability to manage	290
4.	No deprivation of the ability to prove reserves.....	291
5.	No deprivation of the ability to dispose of the investment.....	291
VI.	Any allegation of expropriation is overridden by the Republic's right to regulate.....	293
1.	The sovereignty of the state includes the right to regulate	293
2.	Regulatory actions do not constitute compensable expropriations.....	294
3.	Scholarly opinion	299
4.	The Practice of investment arbitration.....	300

VII.	Most constant protection and security	300
1.	Scope of Article 10(1) of the ECT	301
a)	Physical protection and security	301
b)	Implementation of reasonable measures of protection and security	305
2.	The Republic’s provision of most constant protection and security of Claimants’ investments	307
VIII.	Fair and equitable treatment	309
1.	No case that the Republic acted unfairly and inequitably where available remedies were not pursued	310
2.	Claimants accept that available remedies were not pursued.....	311
3.	Fair and Equitable Standard was not breached in this case	312
IX.	Unreasonable or discriminatory measures	315
1.	The Republic’s measures were not unreasonable	315
a)	Meaning of “unreasonable”	315
b)	Prerequisites not fulfilled	320
2.	The Republic’s measures were not discriminatory	323
3.	No Impairment of investments.....	325
X.	Observance of Obligations in terms of the Umbrella Clause	328
1.	Scope of the Umbrella Clause.....	328
a)	Interpretation of the Umbrella Clause in accordance with the Vienna Convention.....	329
b)	Interpretation of the Umbrella Clause by Scholars and Tribunals.....	331
2.	Irrelevance of Subsoil Use Contracts and Contract No. 302 under the Umbrella Clause.....	335
3.	The Republic’s compliance with domestic law	339

XI.	Effective means of Asserting Claims and Enforcing Rights	342
1.	Meaning of the duty arising from Article 10(12) of the ECT.....	342
a)	Legislative obligation to provide a fair and efficient system of justice.....	342
b)	No contention nor proof of a legislative failure to provide a fair and efficient system of justice	345
2.	Claimants’ failure to exhaust remedies.....	346
3.	No violation of Article 10(12) of the ECT with regard to the criminal proceedings against Mr. Cornegruta	349
XII.	Obligation to Permit Employment of Key Personnel	352
1.	Meaning of the duty arising from Article 11(2) of the ECT.....	352
2.	No contention nor proof of any failure to permit the employment of key personnel	354
E.	ARBITRATION PROCEDURE.....	356
I.	The Republic acted properly in the arbitration procedure	356
1.	Stay of proceedings in early 2011	356
2.	Objections to jurisdiction.....	357
3.	“Sleeper“ reports	358
a)	IBA Rules on the Taking of Evidence in International Arbitration (“IBA Rules”)	358
b)	Compliance with procedural duties	360
II.	Claimants did not act properly in the arbitration procedure.....	361
F.	Requests for Relief	364

A. INTRODUCTION

- 1 Anatolie Stati is a Moldovan businessman better known for his work in the construction business than oil and gas sector. He claims to have acquired two relatively minor oil and gas companies in Kazakhstan, KPM and TNG. The mechanism of the supposed acquisition and holding of these companies is opaque, involving multiple intermediate entities outside Kazakhstan, some disclosed others not.
- 2 The rationale for this complex holding structure is unknown, but liabilities seemed to gravitate to KPM and TNG from their owners and their owner's affiliates, whilst cash flowed out to a number of affiliated companies outside Kazakhstan.
- 3 Tristan Oil, a BVI registered entity has no disclosed stake in KPM or TNG, but since the end of 2006, it has issued over half a billion dollars in debt, ostensibly for the purpose of funding KPM and TNG. Whilst KPM and TNG are apparently guarantors of this debt, it is by no means clear that they benefited from all of the funds this brought into Tristan Oil. As a BVI registered entity Tristan Oil does not benefit from the protection of the ECT.
- 4 In late 2008, when at a domestic level the Republic began to become aware of problems with KPM and TNG, it seems that KPM and TNG's precarious debt laden ownership structure was pushed to the brink by the financial crisis, resulting in yet more funds being stripped from the companies.
- 5 In late 2008 little of the above was known to the agencies of the Republic that regulated the performance of KPM and TNG. At that time their principal concern was a litany of breaches by KPM and TNG of their contractual and other legal obligations. There were also wider social consequences for the area in which the companies operated, caused by what, at the time, seemed an inexplicable decline in the companies' performance and indifference of their management.
- 6 The Republic was ultimately driven to terminate KPM and TNG's contract contracts and place their subsoil use assets into trust management to

preserve them from decay. That was not the outcome that anyone wanted, least of all the Republic, which generates much of its income from active subsoil users. However, KPM and TNG's apparent disinterest in remedying their desructive poor performance made it unavoidable.

7 Since this Arbitration was commenced, the Republic has learned rather more about KPM and TNG and Mr Stati, though perhaps not enough fully to explain the decline of KPM and TNG. However, what it has learned has re-inforced its view that fundamentally the Claimants are seeking to use international arbitration to shield them from the consequences of their wrongdoing in Kazakhstan and perhaps from matters outside Kazakhstan as well.

8 In the Republic's respectful submission, the Tribunal should not allow its power to be abused either to protect the Claimants from the Republic's legitimate reaction to KPM and TNG's illegal conduct or from the apparent wider troubles of Mr Stati's buiness empire in which the Republic plays no part.

9 In dealing with this case, the Tribunal should keep four basic points in mind:

(a) First, the Claimants' illegal and bad faith conduct already excludes any protection under the ECT and any jurisdiction of the Tribunal. A foreigner breaching the laws of a state cannot expect protection under international law. Conversely, a state making promises in the expectation of (i) lawful investor conduct, (ii) mutual cooperation and (iii) mutual profiting of both the state and the investor from the investment cannot be held to such promises when the investor acts illegally and contrary to the purposes of admission of foreign investment.

(b) Second, Claimants claims are in any event completely without merit. Claimants suggest that they fell victim to a "harassment campaign" initiated by the President of the Republic for the purpose of expropriating the Claimants' assets and that this "harassment campaign" was based on a "Kazakhstan playbook". These are mere pretty words with which Claimants try to turn the case on its head. Claimants, as foreign subsoil use contractors in Kazakhstan, were not

respecting the laws that Kazakhstan had enacted in order to safeguard its interests and ensure its subsoil use policies. The Republic's audits, inspections and investigations were the lawful reaction to Claimants' illegal conduct. This is not harassment but the legitimate measures any state in the position of the Republic would have taken.

- (c) Third, Claimants are trying to blame the Republic for the demise of their companies, when it was in fact the Claimants' own conduct, as well as external circumstances, which made the Claimants' project companies KPM and TNG fail in the end. Claimants overburdened KPM and TNG with debt. This approach backfired when the global financial crisis hit the markets in 2008, energy prices took a dive and important local customers of KPM and TNG could no longer fulfil their contracts with Claimants. Yet, in this severe situation, instead of supporting the companies, Claimants decided to strip them of cash even more. The ultimate failure of the companies can come as no surprise against this background.
- (d) Fourth, Claimants also largely overstate the importance of their alleged investment within the Republic. Claimants' activities were of a rather minor scale compared to many other exploration and production projects in the Republic. This has two consequences: For one, this further undermines Claimants' spurious allegation of a "harassment campaign" initiated by the President of the Republic. Apart from all other reasons excluding this argument, Claimants' assets were simply not valuable enough to merit such action in the first place. Moreover, this also shows that Claimants' claim for compensation is artificially inflated. In fact, Claimants claim for compensation runs into billions, a sum which no interested third party ever offered to pay for KPM and TNG.

B. JURISDICTION

- 10 Despite expanding on the flimsy 5 pages of assertions set out in the Statement of Claim, Claimants have still failed to demonstrate to the sufficient level¹ an entitlement to benefit from the ECT. Nor have they demonstrated under international law or otherwise that the Stockholm Chamber of Commerce has jurisdiction to hear the matters brought before them by Claimants.
- 11 The Republic is only prepared to offer the right to arbitrate to a certain pool of investors. The parameters of entitlement are framed by the provisions of the arbitration agreement in article 26 of the ECT, the rules of the Stockholm Chamber of Commerce, international law and the relevant rules of applicable law. The Republic has not consented to resolve any dispute with any of the Claimants under the ECT through arbitration.
- 12 The Republic's responses can be summarised as follows:
- (a) The ECT should be interpreted in accordance with international law which includes the requirement to act in good faith in accordance with the general principle of *pact sunt servanda*.
 - (b) Anatolie Stati and Gabriel Stati, who allegedly own and/or control Ascom, Terra Raf, KPM and TNG, are not true investors and none of the Claimants is entitled to benefit from the ECT for the following reasons:
 - Anatolie Stati is a political creature whose political connections, previous expertise and other international dealings strongly suggest that any investments he has made in Kazakhstan are not made as a commercial investor in energy resources with which the ECT are concerned. The same is true of Gabriel Stati who is more a playboy than a businessman.
 - The benefits of the ECT are denied to Ascom under article 17 of the ECT.

¹ Discussed in the Statement of Defence dated 21 November 2011, paras. 5.8 to 5.15.

- Gibraltar is not a party to the ECT and therefore Terra Raf cannot seek protection from the Treaty.

(c) No investments have in fact been made

- There is an inherent meaning of “investment” which has to include international law and national law. As such the inherent meaning includes (1) Salini characteristics (which are relevant if not exhaustive), and (2) compliance with the laws of the host State and good faith.
- There was no investment on the facts.
 - There is insufficient evidence of investments being made.
 - Claimants have not demonstrated that it has acted in good faith.
 - Moreover, the investments allegedly made by the KPM and TNG were in violation of Kazakh law.

(d) In any event, even if (any of) the Claimants were entitled to benefit from the ECT (and can demonstrate to the relevant standard that investments had been made), Claimants did not comply with the cooling off period and therefore no jurisdiction vests in the tribunal.

13 Lastly, Claimants have not discharged their burden of proof. Casting Claimants’ arguments in the most flattering light, the case they now present is at best ambiguous and unclear. As set out in the recent award of *ICS Inspection and Control Services Limited (United Kingdom) v. Argentine Republic*, PCA Case No. 2010-9, Award on Jurisdiction, 10 February 2012, “a State’s consent to arbitration shall not be presumed in the face of ambiguity.”² Where such consent is uncertain, no jurisdiction should be found, and the case against the Republic falls at the first hurdle. More likely, their assertions that their claims are entitled to any further consideration by the tribunal are simply unevicenced and unfounded.

14 This may explain why Claimants now devote 11 pages to their theory that the arbitration itself is part of a premeditated strategy to access Claimants’

² *ICS Inspection and Control Services Limited (United Kingdom) v. Argentine Republic*, PCA Case No. 2010-9, Award on Jurisdiction, 10 February 2012, para. 80 (**Exhibit R-214**).

assets without compensation, with its “obstructionist”³ behaviour in the arbitration, the final step in thwarting Claimants out of their assets without compensation.⁴ This argument is incorrect, unsupported, and moreover, irrelevant to the issue of jurisdiction, and can be dealt with swiftly, without troubling the Tribunal further. Of course, as is made clear by their failure to comply with the cooling-off period in the ECT discussed below⁵ it is Claimants and not the Republic who have rushed towards arbitration, foregoing protections that Claimants had available to them under Kazakh law to seek redress for the situation they complain of. The disrespectful manner in which Claimants accuse the Republic of premeditating the arbitration itself is indicative of the arrogant way in which Claimants approach the claims for entitlement in this arbitration and, more generally, their poor custody of what were always, ultimately, the Republic’s natural resources.⁶ International investment treaty arbitration is not a foregone right, but a reciprocal pact involving effort from both sides to engage the mechanisms which enable assistance from an international tribunal (as opposed to the courts of the host State where such a dispute might otherwise be heard). On any level, Claimants in this case have not demonstrated that they deserve this assistance.

I. ECT nature and purpose and international law

15 As set out in Section 4B of the Statement of Defence, the ECT’s fundamental objective is to create a level playing field for energy sector investments and reduce “*non-commercial risks associated with energy-sector investments*”.⁷ Its purpose is to “*establish a legal framework in order to promote long-term co-operation in the energy field, based on complementarities and mutual benefits, in accordance with the objectives and principles of the Charter.*”⁸

³ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 22.

⁴ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, paras. 6 to 31.

⁵ See below section B.V.

⁶ Section 4B of the Statement of Defence sets out the State’s explicit right to regulate referred to at article 18 of the ECT.

⁷ Energy Charter Treaty dated 1994, p.14 (**Exhibit C-1**) and Statement of Defence dated 21 November 2011, para. 4.10.

⁸ Energy Charter Treaty dated 1994, Article 2.

- 16 Its interpretation is a matter of international law as set out in the Vienna Convention and, in particular, in accordance with the principle of *pacta sunt servanda* or the provision that “[e]very treaty in force is binding upon the parties to it and must be performed by them in good faith.” This applies as much to those investors who benefit from the treaty, as it does to the signatories of the treaty.
- 17 As such, and as noted by Dr Christian Tietje, Professor of Law at the Law School of University Halle, Germany, “at a minimum, the principles of international law must be complied with in relation to the interpretation of a treaty”⁹. This also implies “that the ECT has to be interpreted in the context of the whole body of applicable international law rules.”¹⁰ Moreover, “a treaty operating in public international law cannot enforce a violation of public international law. This, again, underlines the importance of interpreting and applying the provisions of an international treaty in accordance with inter alia applicable general principles of international law in a broader sense”.¹¹
- 18 The remainder of the Republic’s arguments follow from this premise, which hopefully, is not contentious.

II. No Investors

1. The Stati Family

- 19 In their Reply Memorial on Jurisdiction and Liability, Claimants argue that, in their view, evidence of nationality or permanent residence is sufficient to establish that Gabriel and Anatolie Stati are entitled to benefit from the ECT as “investors”.¹² The Republic agrees that the definition of “investor” is set out in Article 1(7). If Claimants can provide evidence to discharge their burden of proof to the Tribunal, which demonstrates that Gabriel and Anatolie Stati are citizens, nationals, or permanent residents of a Contracting Party, it is not for the Republic to dispute this. Indeed, the

⁹ Expert Report of Professor Tietje dated 8 August 2012, p.6.

¹⁰ Expert Report of Professor Tietje dated 8 August 2012, p.6.

¹¹ Expert Report of Professor Tietje dated 8 August 2012, p.8.

Republic accepts that the question of nationality is for the sovereign state to determine, not the international tribunal. However, as a matter of principle, that is not the “*end of the enquiry*” as Claimants assert.¹³

20 When assessing jurisdiction, the question of nationality is one which the tribunal, in its discretion, has competence to examine from the standpoint of international law, not merely domestic law. Thus, the tribunal in the *Nationality Decrees Issued in Tunis and Morocco* case expounded the basic principle that the question of nationality is one for sovereign states to determine.¹⁴ However, it went on to explain that an exception to this rule arises when nationality is examined for the purposes of the jurisdiction of an international tribunal. In such cases, as the tribunal stated in the *Nationality Decrees Issued in Tunis and Morocco* case, the question is one for the tribunal to determine based on the facts. Thus, as Crina Baltag notes, “*when nationality becomes a question of jurisdiction, the reference to domestic law suffers two significant limitations: the principles of international law and the power of arbitrators or judges to assess nationality.*”¹⁵ This is applicable here since the question of nationality arises in considering whether Claimants satisfy the requirements of Article 26 of the ECT, dealing primarily with the consent of the parties to arbitrate.

21 Accordingly, the tribunal’s interpretation of the requirements of nationality, permanent residence and citizenship must be considered in the light of the general principles of international law referred to above.

22 Therefore, it is the Republic’s position that the question of whether individuals can take advantage of the ECT as investors must, where the circumstances demand, not only consider the words of Article 1(7) of the ECT but also consider the nature of the claimants seeking protection. Against this background, it is pertinent to consider the overall nature of

¹² Reply Memorial on Jurisdiction and Liability dated 7 May 2012, paras. 79 to 81.

¹³ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, paras. 79 to 81.

¹⁴ *Nationality Decrees Issued in Tunis and Morocco (French Zone)*, PCIJ, November 8th, 1921, para 41: “For the purpose of the present opinion, it is enough to observe that it may well happen that, in a matter which, like that of nationality, is not, in principle, regulated by international law, the right of a state to use its discretion is nevertheless restricted by obligations which it may have undertaken towards other states. In such a case, jurisdiction which, in principle, belongs solely to the state, is limited by rules of international law.” Cited in “*The Energy Charter: The Notion of Investor*,” C. Baltag, (2012), p.72 (**Exhibit R-215**).

¹⁵ “*The Energy Charter: The Notion of Investor*,” C. Baltag, (2012), p.72 (**Exhibit R-215**).

Claimants and their general conduct to ascertain whether, in its view, Claimants are investors for the purposes of the ECT. This perspective is consistent with and mirrored by the analysis required in determining whether an investment has been made in accordance with international law under the ECT.

23 At the head of the group of alleged investors currently claiming for protection under the ECT, are father and son, Anatolie and Gabriel Stati. As a matter of international law (as well as the ECT) the benefits of the ECT should not be extended to these individuals (or for that matter their group of companies).

a) Anatolie Stati

24 Anatolie Stati was no ordinary investor seeking to reduce the “*non-commercial*” risk involved in investing in the energy sector. He was and is a highly skilled political animal who is adept at converting long term assets into the short term aims of “*advancing political goals.*” As a matter of principle, he is not the ordinary type of investor who should benefit from the protections of the ECT. This conclusion is advanced given the weight of evidence against Stati as to his previous business activities abroad and the political connections he has fostered closer to home.

25 Anatolie Stati is not a well-known figure in the oil and gas industry. Professor Olcott, a leading expert on Central Asia, who has extensive knowledge of the regional oil and gas industry has noted:

“I had never previously encountered Anatol Stati in my research, this despite the fact that I have put in several years of research into Turkmenistan’s oil and gas industry... I should also add that some of the close friends that I met in those years (both Turkmen and Russian) government officials and business men who were active in or knowledgeable about the oil and gas business in Turkmenistan also had no knowledge of Stati, although they did know about the Rumanian business interests with

whom Stati had originally partnered, who were prominent figures and who appear to have broken with Stati”¹⁶

- 26 This is not surprising given that his expertise lies predominantly in the construction sector in the former USSR rather than the oil and gas industry. This was a business which was far from “clean”, as Professor Olcott notes:

*“Stati himself came out of the construction business in the USSR, and was reported to have had close ties to the Communist Party central Committee in Moscow during Soviet rule. While there are no specific reports of improprieties tied to Stati personally, **this was one of the most corrupt sectors in the soviet Union, as virtually no construction materials were available for purchase by individuals who wanted to erect dachas or make improvements to their apartments, and enterprise managers often needed to find construction “on the left” as it was termed, in order to meet their government building targets.** Many post-Soviet era fortunes were erected on this fundament. “[emphasis added]*

- 27 There is nothing to suggest that an individual, who built a major business empire out of the fall of the USSR, would not have been involved in this crooked business. It further raises questions as to how Anatolie Stati (an individual with a background in “construction”):

- (a) became involved in the oil and gas industry, which he had no direct previous experience of; and
- (b) obtained the financial clout to invest in Central Asian states, including Kazakhstan.

- 28 None of this is clear from what Claimants have divulged. What is however apparent is that Anatolie Stati has certainly played the political field in his own country very well in order to establish himself in a position of power; a matter which is intrinsically linked with entry into the business world in Kazakhstan. As Professor Olcott explains:

¹⁶ Expert Report of Professor Olcott dated 7 August 2012, para. 94.

98. *One constant theme in all of these accounts is that Stati was deeply involved in Moldova's politics, and that he was very close to a number of leading political figures, of the late Soviet era, such as Pyotr Luchinskii a leading communist party official of the late Soviet era who served as Moldova's leader at the time of the breakup of the soviet union and then was elected later on to another term as president.*

99. *During Luchinskii's tenure in office as Speaker of the Parliament , in December 1995, he signed legislation which freed Ascom-Kelme (as Ascom was then known) and Gheso from some of their tax obligations, the only business explicitly freed (various sectors of the economy also had tax obligations reduced or removed, but no other enterprises were explicitly freed.*

100. *Luchinskii was very close to many of Romania's post-Ceausescu communist government and there is speculation that Stati was able to use these contacts to get into the oil and gas field reclamation projects in Turkmenistan, a business that he used to piggy-back his way into Kazakhstan. Luchinskii himself made a trip to Kazakhstan in 1999, while he was President of Moldova, roughly at the time that Ascom was beginning to engage in the Kazakh oil and gas industry, when Luchinskii was received at the highest levels. There continue to be reports, albeit from Communist Party of Moldova sources that Luchinskii receives a regular allowance from Stati. Luchinskii has also continued to travel to Kazakhstan since leaving office, as recently as 2007, being granted meetings with Nazarbayev, with the stated goal of improving Kazakh-Moldovan relations.*

101. *The ties between Stati and a number of prominent Moldovan political figures quite likely contributed to Stati's ability to create the first building blocks of his empire. In fact, Ascom has maintained a revolving door with Moldova's government, at least when the*

Luchinskii—Gimpul—Filat—Diacov—Pasat factions have been in power.”¹⁷

- 29 Certainly this wide array of political support in Moldova raises more questions than it answers. In particular, it is difficult to understand what the motive was behind these political figures’ decision to support a regular “construction” man. One can only speculate as to what these political figures had to gain from providing such support to Anatolie Stati and his companies. However, it seems difficult to rule out the implication that these political figures assisted Anatolie Stati in obtaining the funding he needed to invest in the oil and gas industry throughout the region, including Kazakhstan.
- 30 These political figures were far from your “ordinary” politicians. As Professor Olcott comments regarding Dumitru Diacov, Gabriel Stati’s father in law:

*“Diacov is himself an interesting figure. A journalist for a variety of communist party newspapers during the Soviet period, including a sojourn in Moscow, he headed Moldova’s parliament between 1998-2001. For a time one of his daughters was married to Gabriel Stati (they are now divorced), while another was married to a Lebanese businessman (Mahmoud Hammoud) who served as honorary consul of Lebanon but nonetheless had something of an unsavory reputation, including accusations that surfaced in Moldova’s press that Hammoud was wanted by Interpol (purportedly for ties to Arab terrorist groups). **Hammoud received Moldovan citizenship, but was later stripped of it when Moldovan authorities accepted the assertions reported to have been made by Moldovan security services that he belonged to Hezbollah**” [emphasis added]¹⁸*

- 31 It is certainly not implausible to believe that this web of “political” figures (engaged with corrupt practices and terrorism), had direct interests in Anatolie Stati’s investments in Kazakhstan. Further, it would not be

¹⁷ Expert report of Professor Olcott dated 7 August 2012 2011, paras. 98 to 101.

¹⁸ Expert Report of Professor Olcott dated 7 August 2012, para. 106.

difficult to envisage that such figures were in fact behind the investment, with this “construction” man, Anatolie Stati, as their “puppet”. As Professor Olcott points out:

“109. Mihai Contiu, of the Moldova Suveran newspaper, has written that some thirty prominent Moldovan political figures and roughly the same number of politicians in Romania have some form of business relations with Stati.

As Contiu describes Stati:

*“The successful business he had so far, according to document, are owed to certain personal abilities that are his exclusive merit, but his problems concern the fact that he is a master of “swindles,” who owes his relative success to a very complex octopus that brought him in front as a group prototype. His success is based on Moldovan state leaders, important politicians, former secret service respondents in numerous states, banks, but also strange doubtful groups. **Of course he owes them and he has to offer his wallet when their political interests require it**”.*¹⁹

32 It appears that Stati pays politicians in return for political power, and business connections and opportunities. Equally, politicians pay Stati to act as a front in their business endeavours.

33 Professor Olcott’s conclusory observation is apposite:

“This means that Stati was not your typical foreign investor in Kazakhstan but someone who had strong obligations to keep a political machine functioning, which would explain why he was always seeking forms of external financing to keep his business interests in Kazakhstan functioning, rather than actually returning

¹⁹ Expert report of Professor Olcott dated 7 August 2012, para. 109.

*capital from the sale of oil and gas back into the business.*²⁰

b) Gabriel Stati

34 As for Anatolie Stati's "pampered son", Gabriel Stati, it is clear that he is more of a "playboy"²¹ than an astute businessman. As Professor Olcott notes:

*"The younger Stati is better known as a hard partier than he is as a businessman. He is an oft-written about part of Chisanau's party scene at the Flamingo (a D and B property), boasting of friendships with movie stars like Steven Seagal and even Arnold Schwarzenegger, and for his expensive cars..."*²²

35 He is certainly no stranger to more serious controversy either. He was arrested following the April 2009 elections in Moldova amid allegations that he was involved in the organization and financing of civil unrest and attempting to overthrow the Moldovan government. The Moldovan authorities went as far as extraditing Gabriel Stati from the Ukraine.²³

36 There is little to suggest that he has had any active involvement in Claimants' alleged investment in Kazakhstan, let alone a genuine interest (in a similar manner to his father). Instead, he seems to be no more than a product of his father's failed ambition to obtain further political influence in Moldova:

*"Political observers in Moldova report that Anatol Stati tried to fashion a political career for his son, who headed the political movement "The Union of Students of Moldova," much like Luchinskii had for his son Kirill who ran for parliament on the party list headed by Gabriel's father-in-law Diacov. **But these same observers imply that this effort was doomed to defeat due to Stati's***

²⁰ Expert report of Professor Olcott dated 7 August 2012, para. 114.

²¹ Expert report of Professor Olcott dated 7 August 2012, para. 123.

²² Expert report of Professor Olcott dated 7 August 2012, para. 123.

²³ Expert report of Professor Olcott dated 7 August 2012, para. 120.

reputation as a playboy, and his clash with police in the “Zimbru” stadium during a football match in 2008.²⁴
[emphasis added]

c) The Statis’ Other Foreign Investments

37 The exact circumstances giving rise to the Stati’s alleged investments in Kazakhstan is dealt with in detail below.²⁵ The nature of the Stati’s investments elsewhere raises real cause for concern about the lawfulness and propriety of his investment habits in Kazakhstan, a theme returned to later.

aa) The Statis’ Investments in Turkmenistan

38 Anatolie Stati has been investing in Turkmenistan from around 1995. The political players behind him look to have had a significant role in this. As Professor Olcott notes:

“Stati’s initial entry into Turkmenistan seems to have been facilitated by his personal contacts with Moldova’s then president Mircae Snegur. The contract was said to be for some \$40 million to cover 3600 oil derricks and wells, with Ascom subcontracting part of the work to the Romanian UPETROM, a prominent Romanian drilling equipment repair firm. The UPETROM engineers involved in the project (and two associates) was arrested in the Bucharest airport for trying to smuggle out documents to Ascom from Romania’s Institute of Oil Research.”²⁶ (emphasis added)

39 Claimants’ involvement in this “smuggling” is certainly troubling. Moreover, it begs the question as to what involvement these political figures behind Anatolie Stati’s investment had, as they appear to have assisted him in avoiding prosecution for his involvement:

²⁴ Expert report of Professor Olcott dated 7 August 2012, para. 124.

²⁵ See below section B.IV.

²⁶ Expert report of Professor Olcott dated 7 August 2012, para. 129.

“The well-respected Romanian daily Evenimentul Zilei is reported to have published a series of articles between May and October 1996 on this affair, claiming that these documents were intended to be sold by Ascom to “Uralmash” (a major Russian machine building factory in competition with Romanian firms) in Russia, and that as a result Petrom (the Romanian Oil Company) and Upetrom were asked to sever their connections with Ascom. Stati’s political ties were such that he is said to have avoided persecution.”²⁷ (emphasis added)

bb) The Stati’s dealings in Sudan

40 Stati’s involvement in Sudan has also been mired in controversy. The Republic has already set out in paragraphs 9.55 to 9.64 of the Statement of Defence that it engaged in a number of activities in Sudan that are contrary to international law. It is simply disingenuous for Claimants to assert that such investments constituted “normal, commercial investments.”²⁸

41 Contrary to Claimants’ assertions, the statements made by both President Voronin and Mr. Andreyev in relation to Anatolie Stati’s financing of illegal militant groups in Sudan and circumvention of UN sanctions are not “defamatory”.²⁹ There is nothing to suggest that both President Voronin (as a political adversary) and Mr. Andreyev (as a former employee) would not have had actual knowledge of Claimants’ businesses in Sudan, given their respective relationships with Claimants. It is also noteworthy that both statements are largely consistent. Mr. Voronin and Mr. Andreyev effectively corroborate each other’s views (notwithstanding that they would not, to the Republic’s knowledge, have discussed these matters with each other and both statements were made in completely different contexts).

42 Moreover, there is a clear suggestion from Mr. Andreyev that Claimants were using money received from their exploitation of the Republic’s subsoil resources to fund these illegal activities in the Republic.³⁰ It is

²⁷ Expert report of Professor Olcott dated 7 August 2012, para. 129.

²⁸ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 194.

²⁹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 193.

³⁰ Statement of Defence dated 21 November 2011, para. 9.57.

unlikely that this funding would have emanated from Sudan itself, given that the assets there were largely non-producing.³¹

- 43 There is very little to suggest these were “normal” investments into the oil and gas industry as Claimants suggest, let alone investments which contribute “*enormously to the well-being of the population of South Sudan*”³², a point which Claimants advance with absolutely no evidence in support. To the contrary, in discussing an education project that Stati was involved in in South Sudan, reports of shoddy workmanship of Stati’s work and the unthinking supply of unsuitable teachers, the provision of tents as student housing, all of which paid for out of the local government’s funds suggest that Stati’s involvement had very much the opposite effect.³³
- 44 In fact, Stati’s activities in Sudan have been questioned for their lack of transparency generally. It would not be difficult to believe that this is because he is attempting to downplay his involvement in what could be deemed as assisting with terrorism in Sudan.
- 45 Furthermore, as noted by Professor Olcott, another very senior employee of Ascom has testified to Claimants’ somewhat strange business cultures in Africa and clear involvement in illegal use of funding emanating from Kazakhstan:

“A window into some of Stati’s business activities in Africa was opened during the arrest of Andrei Bastovoi a former Vice President of Ascom in August and October 2011. Bastovoi was a leader of the late Soviet-era Popular Front for Moldova, and served as a member of Moldova’s first parliament. Then, like so many Moldovan politicians of that era came to work with Ascom, spending 10 years as a Vice President of Ascom.

153. Bastovoi led KMP’s operation in Kazakhstan and worked with them in Turkmenistan as well. In August 2011 he and his son were charged with misappropriating some \$185,000 of Ascom funds . Bastovoi’s defense was

³¹ Expert report of Professor Olcott dated 7 August 2012, para. 151.

³² Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 194.

³³ Expert report of Professor Olcott dated 7 August 2012, para. 147.

that he was effectively under orders to divert this funding from Sudan to another African country (the funds were reportedly found in Uganda) , for corporate purposes. He was released from house arrest for these charges in September 2011, but in October of that same year he was rearrested under charges of plotting the murder of members of the Stati family.”³⁴

46 As evidenced above, when a light is shone on Claimants’ activities the evidence raises serious concerns as to whether Stati and his group are genuinely commercial and straightforward business people entitled to attract protection from the ECT.

2. **Ascom**

47 In its Statement of Defence, The Republic has already raised the point that the benefits of the ECT are denied to Ascom by way of Article 17(1) ECT. Claimants attempts at countering this conclusion³⁵ are futile.

48 Article 17 of the ECT provides:

“Each Contracting Party reserves the right to deny the advantages of this Part to:

(1) a legal entity if citizens or nationals of a third state own or control such entity and if that entity has no substantial business activities in the Area of the Contracting Party in which it is organized.”

49 Thus, a two-fold test applies: A state can deny the benefits under the ECT if citizens or nationals of a third state own or control the investor and if the investor has no substantial business activity in the state in which it is organised. Presently, Ascom fulfils both legs of this test.

³⁴ Expert report of Professor Olcott dated 7 August 2012, para. 152-4. At para. 146, Professor Olcott also cites sources that indicate that there is also significant speculation that Stati had been involved in the small arms trade between the Democratic Republic of the Congo and South Sudan.

³⁵ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, paras. 87 et seq.

- 50 As to the first leg of the test: Ascom is controlled by citizens of a third state. That is because Ascom is a company organised under the laws of Moldova³⁶ but not controlled by citizens of Moldova. Applying the ordinary meaning of the term “third state”, it is clear that a “third state” is any state other than the state of incorporation.
- 51 Claimants implicitly contend that Anatoli Stati and Gabriel Stati are controlling Ascom.³⁷ The Republic maintains that Claimants have not proven this contention. However, if the Tribunal were to take Claimants’ contention at face value, it would have to find that Anatoli and Gabriel Stati, as citizens of Romania, are citizens of a third state for the purposes of Article 17(1) ECT.
- 52 Claimants have tried to avoid this conclusion by arguing that “third state” in Article 17(1) ECT means states other than contracting states of the ECT.³⁸ This unsupported contention is contradicted by the use of the term “third state” in other parts of the ECT, namely in Article 7(10)(a)(i) ECT. This provision, regulating the transit of energy products and materials, clearly states that “third state” can mean both contracting and non-contracting states.³⁹ Claimants’ theory is thus squarely contradicted by the ECT. As a result, Romania is to be treated as a third state and the first leg of the test is fulfilled.
- 53 Moreover, the second leg of test is also given. Ascom has no substantial business activities in Moldova. In that regard, it is of paramount importance that the burden of proof for establishing substantial business activities is with Claimants. The Republic cannot be burdened with trying to provide negative proof, i.e. with providing proof of the fact that Ascom has no substantial business activities in Moldova. Such negative proof is practically impossible to obtain since the Republic cannot check the whole Moldovan business landscape for signs of activities by Ascom. On the other hand, it is much easier for Claimants to provide proof of their alleged

³⁶ Ascom’s Certificate of Incorporation dated 19 December 2008 (**Exhibit C-31**).

³⁷ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 94.

³⁸ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 94.

³⁹ Cf. the wording of Article 7(10)(a)(i) ECT: “Transit” means (i) the carriage through the Area of a Contracting Party, or to or from port facilities in its Area for loading or unloading, of Energy Materials and Products originating in the Area of another state and destined for the Area of a third state, so long as either the other state or the third state is a Contracting Party.

business activities in Moldova, if these exist. This is also in line with previous arbitral decisions which put it to the investor to prove that the prerequisites of Article 17(1) ECT are not met.⁴⁰

54 So far, Claimants have not provided any proof. Rather, Claimants only made the unsubstantiated and unsupported contention that Ascom’s “board of directors and management (including Messrs. Stati, Lungu, and Pisica) direct and control Ascom from its headquarters in Chisinau, Moldova.”⁴¹ This is not enough to discharge the burden of proof placed on Claimants. As such, the conclusion stands that the second leg of the test of Article 17(1) ECT is also fulfilled.

55 The logical conclusion is that the Republic may deny the benefits of the ECT to Ascom. In their Reply, Claimants try to avoid this conclusion by arguing that Article 17(1) ECT only applies prospectively.⁴² This argument is incorrect. The Republic can deny the benefits of the ECT to Ascom retrospectively.

56 The Republic recognises Claimants’ contention stems from the decision of the *Plama* tribunal⁴³ and was later also adopted by the *Yukos* tribunal.⁴⁴ However, the reason given by these tribunals for their respective decisions has drawn constant and substantial criticism. The *Plama* and *Yukos* tribunals based their finding on the argument that a retrospective application would undermine an investor’s legitimate expectations regarding the existence of protection under the ECT.⁴⁵

57 However, commentators have pointed out that this argument is flawed. The tribunals in *Plama* and *Yukos* have overlooked that an investor fulfilling the requirements of Article 17(1) ECT cannot have a legitimate expectation of

⁴⁰ *Plama Consortium Limited v. Bulgaria*, ICSID Case No. ARB/03/24, Award, 27 August 2008, paras. 89, 94 (**Exhibit C-400**).

⁴¹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 95.

⁴² Reply Memorial on Jurisdiction and Liability dated 7 May 2012, paras. 90 et seq.

⁴³ *Plama Consortium Limited v. Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction, 8 February 2005, para. 162 (**Exhibit C-400**).

⁴⁴ *Yukos Universal Limited (Isle of Man) v. The Russian Federation*, PCA Case No. AA 227, Interim Award on Jurisdiction and Admissibility, 30 November 2009, para. 458 (**Exhibit C-360**).

⁴⁵ *Thorn/Doucleff*, Disregarding the Corporate Veil and Denial of Benefits Clauses: Testing Treaty Language and the Concept of “Investor”, in: *Michael Waibel, Asha Kaushal, et al.* (ed.), *The Backlash against Investment Arbitration*, 3, 25 (**Exhibit R-216**).

protection under the ECT. The mere existence of Article 17(1) ECT is a clear warning for a putative investor that protection can be denied if the prerequisites of the provision are fulfilled.⁴⁶

58 Consequentially, the tribunal in the case of *Ulysseas, Inc. v. Ecuador* stated with regard to the denial of benefits clause in the US/Ecuador BIT:

*“The Tribunal sees no valid reasons to exclude retrospective effects. In reply to Claimant’s argument that this would cause uncertainties as to the legal relations under the BIT, it may be noted that since the possibility for the host State to exercise the right in question is known to the investor from the time when it made its the investment, it may be concluded that the protection afforded by the BIT is subject during the life of the investment to the possibility of a denial of the BIT’s advantages by the host State.”*⁴⁷

59 Moreover, the interpretation of *Plama* and *Yukos* renders Article 17(1) ECT practically inapplicable. In order to be sure that a denial of benefits has the desired effect, states would have to check on every investor’s corporate structure at the time of the making of the investment and to then declare the denial immediately. This approach is blatantly impractical. It is also in clear neglect of investment practice. Foreign investors oftentimes do not even have to inform host states of their investment in the first place and investment is made “under the radar” of the host states.⁴⁸ Under such conditions, an effective application of the denial of benefits clause would

⁴⁶ *Thorn/Doucleff*, Disregarding the Corporate Veil and Denial of Benefits Clauses: Testing Treaty Language and the Concept of “Investor”, in: *Michael Waibel, Asha Kaushal*, et al. (ed.), *The Backlash against Investment Arbitration*, 3, 25 (**Exhibit R-216**).

⁴⁷ *Ulysseas Inc. v. The Republic of Ecuador*, UNCITRAL, Interim Award, para. 173 (**Exhibit R-217**).

⁴⁸ *Sinclair*, Investment Protection for “Mailbox Companies” under the 1994 Energy Charter Treaty – A note on one aspect of the Decision on Jurisdiction in *Plama Consortium Ltd. v. Republic of Bulgaria*, 2 TDM, Issue 5, p.6 (2005) (**Exhibit R-218**).

not be possible.⁴⁹ Yet, tribunals have frequently held that the effective interpretation of treaty provisions is of tantamount importance.⁵⁰

60 Accordingly, in the recent decision of *Pac Rim Cayman v. El Salvador*, the tribunal held that the denial of benefits clause of DR-CAFTA applied with retrospective effect.⁵¹

61 As a result, it is clear that Article 17(1) ECT applies also with retrospective effect. Thus, Ascom cannot rely on the protection of the ECT. For this reason alone, the Tribunal should dismiss Ascom's claim in the present proceedings.

3. Terra Raf

62 Claimants' argument that Terra Raf is entitled to protection under the ECT is untenable either on the basis that the ECT applies provisionally in Gibraltar, or alternatively, on the basis that Gibraltar is a party to the ECT via the EU's signature of the ECT.

63 The ECT does not apply to Gibraltar on a provisional basis. To the extent that the ECT ever applied to Gibraltar on a provisional basis as a result of the United Kingdom's signature of the ECT on 17 December 1994, this was terminated by the ratification of the ECT by the United Kingdom on 13 December 1996 which made no reference to or inclusion of Gibraltar.⁵²

64 The ECT provides a complete mechanism for the cessation of provisional application under Article 45 of the ECT which provides that:

"(1) Each signatory party agrees to apply this Treaty provisionally pending its entry into force for such signatory in accordance with Article 44, to the extent that

⁴⁹ *Thorn/Doucleff*, Disregarding the Corporate Veil and Denial of Benefits Clauses: Testing Treaty Language and the Concept of "Investor", in: *Michael Waibel, Asha Kaushal, et al.* (ed.), *The Backlash against Investment Arbitration*, 3, 25 (**Exhibit R-216**).

⁵⁰ Cf. *Eureko B.V. v. Republic of Poland*, Partial Award, 19 August 2005, para. 248 (**Exhibit C-260**) ("It is a cardinal rule of the interpretation of treaties that each and every operative clause of a treaty is to be interpreted as meaningful rather than meaningless.").

⁵¹ *Pac Rim Cayman LLC v. Republic of El Salvador*, ICSID Case No. ARB/09/12, Decision on the Respondent's Jurisdictional Objections dated 1 June 2012, paras. 4.83 et seq. (**Exhibit R-219**).

⁵² Statement of Defence dated 21 November 2011, paras. 8.11 to 8.55 are repeated. (**Exhibit R-48**). Statement of Defence dated 21 November 2011, para. 8.31.

such provisional application is not inconsistent with its constitution, laws or regulations...

(3)(a) Any signatory may terminate its provisional application of this Treaty by written notification to the Depositary of its intention not to become a Contracting Party to the Treaty”.⁵³ (emphasis added).

65 Article 45 provides two methods of termination of provisional application of the ECT. On the one hand, the entering into force of the ECT will automatically bring provisional application of the Treaty to an end. The Republic has referred to this as the “*de facto*” method. Claimants are wrong to say that this is not a permitted method of termination.⁵⁴ Once the ECT came into force, provisional application for Gibraltar ceased under Article 45(1).

66 The “*de facto*” method is distinct from the notice method set out in Article 45(3)(a) of the ECT. That said, the same act - i.e. the entry into force of the ECT - in these circumstances, also constituted notice of the United Kingdom’s intention that Gibraltar would not be part of the ratification of the ECT and that its provisional application would also terminate.

67 The United Kingdom’s ratification of the ECT on 13 December 1996 constituted express notice of those territories the ECT would apply to; this did not include Gibraltar. The United Kingdom’s practice since 1967 reveals that United Kingdom territories that are to be included in the ratification of a treaty, are explicitly referred to at the time of ratification.⁵⁵ By not including Gibraltar, the United Kingdom intended that the ECT would not apply to Gibraltar either provisionally or otherwise. Professor Tietje explains the United Kingdom’s practice:

“UK treaty practice provides that the territories are not included in the coverage of a given treaty unless it is specifically stated: “When expressing consent to be bound by a multilateral treaty the United Kingdom declares in writing to the depositary to which, if any, of its overseas

⁵³ Energy Charter Treaty dated 1994, Article 45 (**Exhibit C-1**).

⁵⁴ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 101.

⁵⁵ Expert Report of Professor Tietje dated 8 August 2012, p.18.

territories the treaty will extend.” It is the practice of the United Kingdom to include territories at the time of ratification or at a later date through an application of the territory’s declaration to be bound by it.”⁵⁶

68 Therefore, when the United Kingdom signed the treaty, it made a declaration as to which overseas territories it should extend to. When the United Kingdom ratified the ECT, provisional application of the treaty came to an end for itself and its territories that were included in the provisional application. The United Kingdom does not usually make separate declarations. Therefore, in ratifying the ECT, it simultaneously made a declaration that the ratification would only extend to certain territories, not including Gibraltar:

“Pursuant to Article 45, provisional application of the ECT for the UK—and by extension any territories included in provisional application—ended when the UK ratified the treaty, in the event that the UK had the authority in the first place to include such a territory. At the ratification in December 1996, the treaty protections were extended to the UK, Jersey and the Isle of Man. No mention was made of Gibraltar. Such exclusion, based on the treaty practice of the United Kingdom, was a clear declaration that Gibraltar was not included in the treaty ratification.”⁵⁷ (emphasis added).

69 Thus, it is considered that ratification of the ECT constituted express notice of the termination of Gibraltar’s provisional application under Article 45(3)(a) of the ECT. The onus is on Claimants to demonstrate that this is not the case and they have failed to do this.

70 Claimants’ alternative argument is no more persuasive. Claimants’ analysis is simplistic and relies on the assumption that the European Union (EU) is a contracting party to the ECT and therefore that Gibraltar is similarly bound to the ECT. As Professor Tietje explains, the United Kingdom has signed the ECT in its capacity as a Member State of the EU under what he

⁵⁶ Expert Report of Professor Tietje dated 8 August 2012, p.17.

⁵⁷ Expert Report of Professor Tietje dated 8 August 2012, p.18.

describes as a “mixed agreement”.⁵⁸ The significance of a “mixed agreement” is that a signatory Member State, signs up only in respect of those matters where the Member State aligns its policy with the EU. There is a strong presumption that mixed agreements are concluded in territorial areas which do not fall outside the regulatory scope of the application of EU law. Thus, quoting Professor Tietje, according to Article 5 (2) of the Treaty on European Union (**EU Treaty**):

“the Union shall act only within the limits of the competences conferred upon it by the Member States in the Treaties to attain the objectives set out therein. Competences not conferred upon the Union in the Treaties remain with the Member States”.

71 Gibraltar is a disputed territory as between the United Kingdom and Spain. As such, important parts of EU policy do not apply to Gibraltar (notwithstanding that the territorial scope of EU law applies in principle by virtue of Article 52 of the EU Treaty and Article 355 of the Treaty on the Functioning of the European Union)⁵⁹. The Common Commercial Policy does not apply to Gibraltar (its status is as a third party) and since the ECT was agreed within the framework of the Common Commercial Policy, Professor Tietje concludes that *“the territorial scope of application of the EU concerning the ECT comprehensively does not include Gibraltar.”*⁶⁰

72 Therefore, Terra Raf is not an “investor”, as defined in the ECT. Any investments - that fall within the ECT’s definition of “investment” - otherwise owned or controlled by it, have no protection under the ECT. According to Claimants’ case, Terra Raf owned 100% of TNG, its assets and the LPG Plant. Since Terra Raf is not entitled to benefit from the ECT, neither do these “investments”. Claimants say that Terra Raf is owned and controlled by the Stati’s and that therefore the investments in the Republic are protected on the basis of indirect ownership or control. These issues will be dealt with more fully in submissions relating to quantum, however, it is noteworthy that to the extent that Claimants seek to recover losses suffered by TNG, its assets and the LPG Plant, clearly no double recovery

⁵⁸ Expert Report of Professor Tietje dated 8 August 2012, p.11.

⁵⁹ Expert Report of Professor Tietje dated 8 August 2012, p.13.

⁶⁰ Expert Report of Professor Tietje dated 8 August 2012, p.15.

for the same loss should be available (if it is found that Terra Raf is an “investor” within the definition).

III. No “Investment”

73 In their Reply, Claimants argue that the words of Article 1(6) defining “investment” are sufficient to assist the Tribunal in ascertaining whether there has been an investment in this case. On this basis, they conclude that the test in *Salini* does not apply. Further, Claimants argue that in any case, the test set out in *Salini* has been satisfied. The Republic disagrees on all counts.

74 The thrust of Claimants’ argument appears to be that the Tribunal should ignore well recognised international law standards on the concept of “investment” and instead rely solely on the precise definition of the term in the ECT. Moreover, they ask the Tribunal to adopt the lowest standard of investment they can feasibly put forward, and in lowering the bar to this degree, they expect the Tribunal to readily find that investments have occurred. In so doing, they choose to ignore the fact that the term “investment” has an inherent meaning, which is apparent from the way the term is actually referred to in Article 1(6). Furthermore, they disregard numerous cases which provide for an independent interpretation of the term “investment”.

75 For the reasons set out in paragraphs below, their only reason for taking this misguided approach is to detract attention away from the questionable nature of their alleged “investment” and the mysteries which remain as to who the puppeteers are behind Anatolie Stati and his companies. Furthermore, even on Claimants’ version of the facts, they fail to satisfy international law criteria as to what constitutes an “investment”. Notwithstanding their attempts to argue otherwise, it is quite clear that Claimants have not established that they have made an investment which is entitled to the protection afforded to it under the ECT. The mainstay of Claimants’ arguments is legal and little factual information is added to assist the Tribunal to understand how Stati’s investments were made and the Republic’s response is, therefore, by necessity, similarly legal in its response.

1. Article 1(6) of the ECT should be interpreted in accordance with international law and the law of the host State

76 As the Republic asserted in the Statement of Defence and above, there are certain international law and national law principles that must be adhered to when considering whether an investment has been made under the ECT.⁶¹

77 In particular, since the ECT is an international law treaty, it is axiomatic that international law will apply. This is reinforced by Article 26(6) of the ECT which contains an express choice of law clause which allows “*applicable rules and principles of international law to be applied*” by the Tribunal. This is not disputed by Claimants.⁶²

78 As to its application of national law principles, as Tietje argues, “*this compliance with general principles of international law extends further into recognition of law on the national level.*”⁶³ He goes on to point out that “*providing protection for investments that contravene the laws of the host state undermines this broader compliance with international law.*”⁶⁴

79 In respect of the interpretation of the ECT, Tietje argues that these principles should not simply be disregarded as soon as the treaty has been concluded.⁶⁵ Thus, the starting point for any interpretation of the term “investment” (whether found in the ICSID Convention, the ECT or any other bilateral investment treaty) are the general principles set down in Article 31(1) the Vienna Convention. The characteristics of what an investment is identified as, in accordance with international law, has been expounded in a number of cases (involving both ICSID and other institutional and non-institutional arbitration), including the cases of *Salini* and *Phoenix*. Since such cases amount to an expression of international law, the stance taken in these cases should not now be ignored in the arbitral proceedings, regardless of whether or not they were heard under the ECT.

⁶¹ Statement of Defence dated 21 November 2011, paras. 9.4 - 9.10.

⁶² Statement of Claim dated 18 May 2011, section VII and Statement of Defence dated 21 November 2011, section V. The Republic’s position in relation to “applicable rules”, and thereby the relevance of Kazakh law to this dispute is set out at Statement of Defence dated 21 November 2011, section 10.

⁶³ Expert Report of Professor Tietje dated 8 August 2012, p.9.

⁶⁴ Expert Report of Professor Tietje dated 8 August 2012, pp.9 - 10.

⁶⁵ Expert Report of Professor Tietje dated 8 August 2012, p.7.

80 Professor Tietje refers to Roe and Happold’s ECT text in recognising that the literal words themselves are not always sufficient, noting that “*there are gaps in the definition that require reference to sources of law beyond the ECT.*”⁶⁶

81 This perspective is bolstered by the ECT itself, which, as mentioned in the Statement of Defence, includes information on the parties’ intentions as to the meaning of “investment” in its third “Understanding”⁶⁷. Roe and Happold are of the view that this strongly suggests that the parties intended there to be more to the definition of “investment” than simply the words in Article 1(6) of the ECT. Thus, “*the notion of the “management and operation of the Investment” and the ability to exercise “influence over” the “managing body” of the Investment is quite inconsistent with an Investment consisting of no more than “...any right property or interest in money or money’s worth.”*”⁶⁸

82 Taking into account international legal principles, the ECT itself, and the probable intention of the parties, “*One is thus driven to consider the broader meaning of “investment.”*”⁶⁹

2. Inherent meaning of “investments”

83 Accordingly, it is the Republic’s contention that Article 1(6) of the ECT has an inherent meaning which goes beyond its explicit wording. As noted by Roe and Happold:

“‘Investment’ may be a defined term for the purposes of the Treaty but it is surely unlikely that the draftsman intended thereby to divest the word of any sense of its more widely understood meaning. As the tribunal in Romak S.A. v. Uzbekistan said of the Switzerland-

⁶⁶ Expert Report of Professor Tietje dated 8 August 2012, p.8.

⁶⁷ Energy Charter Treaty dated 1994, p.26. (**Exhibit C-1**).

⁶⁸ Roe and Happold, *Settlement of Investment Disputes Under the Energy Charter Treaty*, 2011 p.57. (**Exhibit R-207**).

⁶⁹ Ibid.

*Uzbekistan BIT, ‘The term “investment” has a meaning in itself that cannot be ignored...’*⁷⁰

84 In determining the inherent meaning of “investment”, it should be given its ordinary meaning in light of the ECT’s other provisions, as opposed to being constricted simply by the words of Article 1(6).

*“That the meaning of ‘Investment’ ought to bear some relation to the ordinary meaning of that word is also apparent from Article 10(1)...If Investment literally meant ‘asset’ (as Article 1(6) says it does), this provision would make no sense as a matter of language.”*⁷¹

85 A number of international tribunals have supported this view. The tribunal’s support for this notion in the *Romak* case⁷² has already been highlighted above. Further, as the tribunal (constituted under UNCITRAL) noted in *Alps Finance and Trade AG v. Slovak Republic*⁷³:

*“The Tribunal is aware that the multitude of bilateral and multilateral investment treaties - although containing different definitions (either narrow or broad) of what constitutes an “investment” - explicitly or implicitly refers to an “objective” definition given by international law, as applied by other treaty-based tribunals. Tribunals must therefore be cautious to enforce the true intention of the Contracting Parties to the specific treaty forming the basis of their jurisdiction, which cannot grossly depart from the “objective” case-law definition.”*⁷⁴

86 The objective meaning of the word “investment” was also discussed in another non-ICSID case founded on the UNCITRAL Rules, *Compagnie Internationale de Maintenance (CIM) v. Ethiopia*. The case concerned non-payment by a partly Ethiopian-owned enterprise (Chemin de Fer Djibouti-

⁷⁰ Roe and Happold, *Settlement of Investment Disputes Under the Energy Charter Treaty*, 2011 p.56. (Exhibit R-207).

⁷¹ Ibid.

⁷² Ibid.

⁷³ *Alps Finance and Trade AG v. Slovak Republic*, UNCITRAL, Award, 5 March 2011. (Exhibit R-220).

⁷⁴ Ibid., para. 239. See also para. 240 (Exhibit R-220).

Ethiopian) under a contract for the delivery of equipment by CIM. In this case, the “investment” (the contract and the sums due under it) constituted a “*right to performance having an economic value*” under the relevant bilateral investment treaty. Despite this, the tribunal considered that the contract was more akin to a commercial arrangement rather than a long-term partnership and shied away from characterising a commercial debt as an “investment” since it appeared to contradict the object and purposes of the treaty.

87 Though this case has not been published in full, analysis by certain commentators highlights that despite the clear wording of the treaty, there are circumstances in which it is justified to move away from the precise wording of the bilateral investment treaty in favour of the broader meaning of the word “investment” employed in many ICSID arbitrations. Moreover, it appears that the tribunal was in favour of moving towards a uniform definition of “investment” that was not institution-specific. Thereby, indicating that it is entirely appropriate to employ a test used in an ICSID arbitration to other arbitrations, which do not have definitions of “investment” in this way.⁷⁵

88 While Claimants may be able to cite tribunals that have countered this view (for example, dicta quoted by Claimants in *White Industries v. India*),⁷⁶ this perspective resonates with the ECT and the intention of the signatories (as shown by the third Understanding).

89 As to the content of the inherent definition of “investment”, this is a matter for each tribunal to determine in accordance with the relevant principles of national and international law and against the facts of the case. This includes reference to *Salini* and also to the laws of the host State and international principles such as good faith.

a) *Salini* characteristics are indicative but not exhaustive

90 The tribunal in *Romak* chose to refer to the *Salini* test and subsequent cases endorsing the essential characteristics identified in that case consistently

⁷⁵ Hepburn and Peterson, “*Ethiopia prevailed in face of foreign investor’s attempt to use investment treaty to sue over ICC arbitral award*” in Investment Arbitration Reporter, date of access, 9 July 2012. (**Exhibit R-221**).

⁷⁶ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 116.

identify that characteristics of an investment include certain characteristics familiar due to their citation in the *Salini* case:

“The Arbitral Tribunal therefore considers that the term “investments” under the BIT has an inherent meaning (irrespective of whether the investor resorts to ICSID or UNCITRAL arbitral proceedings) entailing a contribution that extends over a certain period of time and that involves some risk. The Arbitral Tribunal is further comforted in its analysis by the reasoning adopted by other arbitral tribunals (see, supra, 198 - 204) which consistently incorporates contribution, duration and risk as hallmarks of an “investment.”⁷⁷

91 Furthermore in *Pren Nreka v Czech Republic*, another non-ICSID case, the tribunal expressly endorsed the *Salini* test and identified that “investments” will have the following characteristics:

“an extended duration and entail some form of risk, will show a certain regularity of profit and return, will not be wholly insignificant in amount, and will contribute to the host State’s economic development.”⁷⁸

92 Given this wide support for the inherent meaning which is evidenced in cases such as *Salini* and *Phoenix* and *Bayindir*, Claimants’ argument (namely that the so-called *Salini* test is not applicable) loses its persuasiveness. Taking this to its logical conclusion, Claimants’ central argument appears to be that the ECT does not incorporate basic principles of international law and, moreover, that international law does not apply to them. Any argument premised on the idea that Claimants are somehow immune to international law should, it is submitted, be strongly resisted by the Tribunal.

93 In any event, the Republic responds and disagrees with the points made by Claimants.

⁷⁷ Reply Memorial on Jurisdiction and Liability, para. 207.

⁷⁸ *Pren Nreka v Czech Republic*, unpublished decision in Investment Arbitration Reporter, vol. 11, 2009 (**Exhibit R-222**).

- 94 Firstly, Claimants argue that the *Salini* test⁷⁹ should not apply to this case as: the three cases in which such test has been applied were not ECT cases and secondly, those cases were decided by ICSID tribunals. As this is not an ICSID arbitration, but rather an SCC arbitration, the test should not apply⁸⁰.
- 95 As to the first argument, the Republic has addressed above why it submits that the test applicable in ICSID arbitrations is equally one that should and could be applicable in ECT arbitrations since each is predicated on general principles of international law which allows for a wider definition of “investment” than that set out in Article 1(6).
- 96 As to the second argument, as shown above, there are non-ICSID cases such as *CIM v Ethiopia*, *Romak* and *Nreka* in which, because the word “investment” was construed in accordance with its inherent meaning, the *Salini* test applied.
- 97 This approach is correct as a matter of international law and also on a practical level. Given that the ECT provides investors with the choice of commencing arbitration under three different institutions, including ICSID⁸¹, Claimants’ argument would effectively mean that in any given ECT arbitration, three different definitions of “investment” could apply depending on which institution the investor chooses. Not only would this render the position as to what an “investment” is under the ECT alarmingly inconsistent, it would also leave states in an inequitable position as opposed to investors, who have free reign to chose different institutional rules in order to circumvent those which are less preferential to them. In the words of the tribunal in *Romak*,⁸² in response to a suggestion by the claimant that the definition of “investment” in UNCITRAL proceedings is wider than in an ICSID Arbitration:

“The Arbitral Tribunal does not share this view, which could lead to “unreasonable” results. This view would imply that the substantive protection offered by the BIT

⁷⁹ As applied in *Salini v Morocco* (**Exhibit R-223**).

⁸⁰ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 114 et seq.

⁸¹ Energy Charter Treaty dated 1994, Article 26 (4). (**Exhibit C-1**).

⁸² *Romak S.A. v. Uzbekistan*, PCA Case No. AA280, Award, 26 November 2009. (**Exhibit R-224**).

would be narrowed or widened, as the case may be, merely by virtue of a choice between the various dispute resolution mechanisms sponsored by the Treaty. This would be both absurd and unreasonable... **There is no basis to suppose that this word had a different meaning in the context of the ICSID Convention than it bears in relation to the BIT.**”⁸³ (emphasis added).

98 The *Romak* tribunal further noted that:

“it would be unreasonable to conclude that the Contracting Parties contemplated a definition of the term “investments” which would effectively exclude recourse to the ICSID Convention and therefore render meaningless – or without effet utile – the provision granting the investor a choice between ICSID or UNCITRAL Arbitration” (emphasis added).

99 The search for a consistent meaning across investment treaties is endorsed by *CIM v Ethiopia*. It is unsurprising and insignificant that a more developed definition of “investment” has arisen in the context of ICSID arbitrations given that in investment arbitration, ICSID Awards are by far the most numerous awards in the public domain.⁸⁴ Moreover, since there is no definition in the ICSID Convention of the word “investment”, it is plain that tribunals have had to build up a definition or test of “investment” based on international legal principles.

b) Investments are required to be made in accordance with the host law and in Good Faith

100 The two additional characteristics that were relevant for the tribunal in *Phoenix*, namely, (i) that the assets should be invested in accordance with the law of the host State and (ii) that the assets are invested by the investor *bona fide*, are already well established principles under international law. As such, these principles require no further discussion. However, Claimants appear to argue that they are immune from these general principles of

⁸³ Ibid., para. 194 (Exhibit R-224).

international law and that therefore it is justified that they bypass these requirements (paras. 130 to 138 of the Reply Memorial on Jurisdiction and Liability).⁸⁵ These arguments are ill-founded and unattractive.

101 National law forms part of the international legal principles to be applied in this context and tribunals have also found that host laws are generally relevant, particularly when assessing whether an investment has been made. The tribunal in *Phoenix* held:

*“the conformity of the establishment of the investment with the national laws – is **implicit even when not expressly stated in the relevant BIT**”* (emphasis added).

102 The tribunal in *Plama* specifically held that in the context of the ECT:

*“Unlike a number of Bilateral Investment Treaties, the ECT does not contain a provision requiring conformity of the Investment with a particular law. **This does not mean, however, that the protections provided for by the ECT cover all kinds of investments, including those contrary to domestic or international law...The Arbitral Tribunal concludes that the substantive protections of the ECT cannot apply to investments that are made contrary to law**”* (emphasis added).

103 This is in line with Professor Tietje’s view that *“compliance with the laws of the host state was necessary in order to secure jurisdiction under the investment treaty.”*⁸⁶

104 As to Claimants’ assertion that there is no requirement under the ECT for investments to be made in good faith,⁸⁷ it is again a well established principle under international law. As such, it is not unusual or surprising that this was referred to as a characteristic in *Phoenix*. The Republic repeats paras. 9.36 to 9.41 of the Reply Memorial on Jurisdiction and Liability and addressed the additional points raised by Claimants herein.

⁸⁴ Ibid., para 196 (**Exhibit R-224**). The Tribunal also noted that the parties themselves had made multiple references to ICSID Arbitral Awards.

⁸⁵ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, paras. 130 to 131.

⁸⁶ Expert Report of Professor Tietje dated 8 August 2012, p.9.

⁸⁷ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, paras. 134 et seq.

105 Claimants refer to the rejection of this principle in *Saba Fakes v Turkey*. As stated in paras. 9.45 to 9.47 of the Reply Memorial on Limitation and Liability, the behaviour of the parties by reference to the principle of good faith has actually been considered and accepted in numerous ECT cases including *Plama*⁸⁸ and *Cemnetownia “Nowa Huta” S.A. v Republic of Turkey*⁸⁹. The principle is clearly one that is well recognised as being relevant to the ECT.

106 Furthermore, the circumstances of when the principle of good faith is relevant should not be limited to those instances when an “investment” amounts to fraud, as suggested by Claimants.⁹⁰ As stated in para. 9.42 of the Statement of Defence, the principle does not have a clear-cut definition and should be assessed on a case-by-case basis. In *Plama*, the tribunal held:

*“The principle of good faith encompasses, inter alia, the obligation for the investor to provide the host State with relevant and material information concerning the investor and the investment. This obligation is particularly important when the information is necessary for obtaining the State’s approval of the investment”*⁹¹ (emphasis added).

107 Further, the tribunal in *Inceysa Vallisoletana S.L. v. Republic of El Salvador*⁹² held:

“Concerning the scope and content of the principle of good faith, it is necessary to take into account the following comments: ‘The Latin expression bona fide is used in the original or translated into various languages, in Spanish “buena fe,” to indicate the spirit of loyalty, respect for the law and fidelity, in other words, absence

⁸⁸ Statement of Defence dated 21 November 2011, paras. 9.46 to 9.47.

⁸⁹ *Cemnetownia “Nowa Huta” S.A. v Republic of Turkey* ICSID Case No. ARB(AF)/06/2, Award 17 September 2009, paras. 153 to 155. (Exhibit R-225).

⁹⁰ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 133.

⁹¹ *Plama Consortium Limited v Republic of Bulgaria*, Decision on Jurisdiction, ICSID Case No. ARB/03/24, 8 February 2005, para. 144. (Exhibit R-32.1).

⁹² *Inceysa Vallisoletana S.L. v. Republic of El Salvador*, ICSID Case No. ARB/03/26, Award, 2 August 2006. (Exhibit R-226).

of dissimulation or fraud in relations between two or several parties in a legal act’”⁹³ (emphasis added).

108 The Republic has already set out the key factors which are relevant as to whether an investor’s behaviour can be considered to be in good faith in paras 9.43 to 9.44 of the Statement of Defence and based on this and the analysis above, it is certainly not as restrictive as Claimants suggest.

IV. There were no investments in fact

109 When the facts are applied to the legal principles expounded by the Republic above, it becomes evident that Claimants have not satisfied the relevant hurdles for establishing that investments have been made.

110 As discussed, the Republic’s view is that the inherent meaning of “investment” is applicable in this case. However, even on Claimants’ own case, they do not, as they assert ⁹⁴ fulfil the narrower *Salini* test. Other than a cursory few paragraphs addressing the issue of financial contributions, they make no attempt to satisfy the other aspects of the *Salini* test, such as whether the investments were of a sufficient duration, what risk was posed to Stati or the other Claimants, and whether the Statis and the other Claimants’ activity in the host State contributed to its development. In the absence of information on these matters from Claimants, the Republic is forced to analyse Claimants’ activities using the information it has gathered. This does not cast Claimants in a positive light and indicates perhaps why Claimants have not been forthcoming on this matter.

111 The Statis’ holdings are opaque; as might be expected, although their holdings are listed on a website, such holdings are not publicly traded. As such, Professor Olcott notes that in reviewing the Statis’ involvement in the Republic, a certain amount of conjecture goes into establishing the true nature of the investments made by the Statis and their companies.⁹⁵

112 That said, the following is evident based on Professor Olcott’s report and the evidence she cites therein, and from the questions already raised in the

⁹³ Ibid., para. 230 (**Exhibit R-I**).

⁹⁴ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, paras. 121 et seq.

⁹⁵ Expert report of Professor Olcott dated 7 August 2012, para. 118.

Statement of Defence and this Rejoinder Memorial on Jurisdiction and Liability:

- (a) Claimants are not ordinary commercial investors;
- (b) There was little or no contribution into the companies by some / all of the Claimants;
- (c) There was no risk undertaken by any of the Claimants;
- (d) The real investor was not Claimants. It may have been Tristan Oil (in the first instance), which, it is noticed, fails to qualify as an “investment” under the ECT on the basis of its BVI nationality;
- (e) As set out in detail above, the primary reason for investment appears to be political and not necessarily economic;
- (f) The investments were not made in accordance with host State laws; and
- (g) Claimants have not shown the investments were made in good faith.

113 For the reasons explained above, all of these factors should be taken into account in the analysis.

1. Financial contribution on and post investment

114 Section B.II.1 of the Rejoinder Memorial on Jurisdiction and Liability explained the nature of Stati’s investments abroad and the political nature of his actions. On the back of their politically “supported” investment in Turkmenistan described above at Section B.II.1, involvement in “smuggling” and avoidance of criminal charges (with the assistance of his political allies), the Statis used three vehicles to carry out their “investment”⁹⁶ in Kazakhstan, namely, Ascom, Terra Raf and Gheso.⁹⁷

115 The Republic raised a number of concerns regarding Claimants’ investment at the time of the alleged acquisition of KPM and TNG and subsequently. This was set out in para. 14.1 to 14.16 of the Statement of Defence. The

⁹⁶ For the reasons set out in paras. herein, this investment was in any event illegal.

⁹⁷ Interestingly, none of these vehicles are listed on the “Stati Holding” website, setting out their interests. Professor Olcott’s report dated 8 August 2012, para. 125.

concerns raised there have not been entirely soothed by the limited further information provided by Claimants in the Reply Memorial on Jurisdiction and Liability since the information provided by Claimants on this topic is unclear at best.

a) Contribution on investment

116 Notwithstanding the information now produced by Claimants purporting to evidence the amount of money paid into KPM and TNG at the time of acquisition briefly stated in two paragraphs, the amounts that were invested appear to be relatively small. Even if Claimants' case is to be believed, Claimants initially invested in the businesses by way of:

- (h) Purchasing shares in KPM;
- (i) Purchasing shares in TNG; and
- (j) Investing in working programs.

117 As to the purchase price for the initial 62% shareholding by Ascom in KPM, Claimants now produce evidence that certain monies were paid to a company called Telwin under a brokerage agreement. This document raises more questions than it answers and the following points are noteworthy:

- (a) Under the brokerage agreement, Telwin is obliged to find the owner of rights in the exploration of the Borankol field and to assist in the acquisition of these rights for Ascom. However, it appears that Telwin held 85% of the shares in Aksai. Hence, Telwin was granted USD1.5 million in consideration of locating the owner of the rights even though it must have known that its subsidiary Aksai owned these rights and as Telwin controlled Aksai, it could also have arranged for the transfer of the rights;
- (b) In any case, the purchase price for the shareholding appears to have been USD15 million, so Claimants' evidence falls significantly short in establishing that Ascom (or any of the other Claimants) gave full value for those shares.

(c) As to the remaining 38% of shares in KPM, it is acknowledged that Claimants have provided evidence of USD9 million having been provided by Ascom and Terra Raf.⁹⁸

118 It is also acknowledged that in relation to the TNG shares, Claimants have produced evidence of certain payments being made by Ascom (the SWIFT states “Ascom-Petroleum Company Gibraltar) to Kaihar TOO in the amounts of USD421,000 and USD1,137,000 at the time of the acquisition itself.⁹⁹ However, it is notable that this investment was made by Ascom and not Terra Raf. Further, it seems that the formal shares themselves were only bought for USD189,185.¹⁰⁰ This discrepancy has not been explained by Claimants.

119 Professor Olcott’s review of the “investments” also reveals that Claimants’ description of the amounts spent is unclear and potentially inaccurate. What does seem clear is that Anatolie Stati took the least amount of risk possible, acquired KPM and TNG with little or no down payment and without having to invest much of his own capital. Her analysis reveals that:

“The subsoil contracts appear to have been purchased through staged payments, buying a controlling majority stake initially and then using the earnings from the project to purchase the rest. Moreover, one of the original deposit holders Aksai, from whom they bought Borankol (KPM) in tranches of 62 percent, and 38 percent reported in December 2011 that they were still owed \$1.5 million of payment due in December 2001. TNG was bought in tranches of 75 percent and 25 percent. There is some confusion over how much was actually paid for this subsoil contract. For example, the total value of the formal transfer of shares was only \$189,185.”¹⁰¹

120 It is by no means clear that the investments were substantial as Claimants assert.

⁹⁸ **Exhibit C-379.**

⁹⁹ **Exhibit C-383.**

¹⁰⁰ Transaction Report dated 16 January 2009 (**Exhibit R-39**).

¹⁰¹ Expert Report of Professor Olcott dated 7 August 2012, para. 159.

b) Contribution Post-investment

121 Claimants attempt to distract the Tribunal from the seemingly small amounts on acquisition by asserting that over time they have contributed USD473m in KPM and USD640m in TNG and USD208.5m in the LPG Plant.

122 As to the amounts paid for the working programs, the Republic notes that Claimants' evidence here is incomplete. Claimants have provided evidence of only seven of the 33 transfers cited and as such it is unclear whether the USD14,166,558 they say was provided was in fact provided. It is not clear how Claimants say that the remainder was invested. In any case, this deals with KPM only.

123 As to investment into the LPG Plant there seems to be a discrepancy between Claimants' figure of USD208.5m quote in the Reply Memorial on Jurisdiction and Liability and the USD245m figure quoted previously.¹⁰² In any event, neither of these figures tally easily with the reports in 2010 that the initial project costs for the LPG Plant were USD176.5m and that the estimated spend was upwards of (but presumably in the region of) USD156.2m in 2010 (as evidenced in Claimants' own exhibit).¹⁰³ Further, though invited to do so¹⁰⁴, Claimants have not clarified or evidenced that the amount of USD43m was invested in the Contract 302 Properties. Lastly, no more clarity is forthcoming to explain Claimants' assertions that they own the operating plant, when in fact, it appears that Ascom contributed only as much as USD20m (the other USD 20m coming from Vitol as evidenced by the Joint Operating Agreement).¹⁰⁵

124 In general, as for developing these assets, it seems that there was little financial contribution which actually came from Claimants themselves. In fact, the way in which these assets were financed does little to dispel the notion that it was Tristan Oil and not KPM and TNG who was getting value

¹⁰² Statement of Claim dated 18 May 2011, para. 64.

¹⁰³ Exhibit C-187.

¹⁰⁴ Statement of Defence dated 21 November 2011, para. 14.18.

¹⁰⁵ FTI Report, Exhibit 44 referred to in the Statement of Claim dated 18 May 2011, para. 14.15.

of these assets. This is consistent with the fact that it was Tristan Oil who was putting the money in.¹⁰⁶ This topic is addressed in further detail below.

125 Against this backdrop, Claimants now claim that they are entitled to damages amounting to some USD3bn (which the Republic strongly denies both in principle and in measure) in respect of the following assets (together with further damages and interest):

- (a) KPM's Borankol field: USD198m;
- (b) TNG's Tolkyng field: USD561m;
- (c) LPG Plant: USD344m; and
- (d) Contract 302 Properties: USD1.766m.

126 There is, therefore, a great disparity between the investment purportedly made by the investors and the amounts claimed by Claimants.

127 This very low purchase price is concerning in itself.¹⁰⁷ However, when placed in context and compared with the amount claimed in this arbitration, such low prices raise doubts as to whether there was a true economic contribution arrangement in making the investment by Claimants.

¹⁰⁶ Statement of Defence dated 21 November 2011, paras. 14.8 and 14.9. From looking at the 2009 financial accounts for Tristan Oil, the bulk of KPM's financing is from Tristan Oil who it owed US\$50m to at the end of 2008 and US\$14,572,985 at the end of 2009 (Exhibit 68 of the 1st FTI Report, p.F-113). This suggests that the real substantial investor in the company was Tristan Oil and not Ascom. From looking at the 2009 accounts for Tristan Oil, the majority of its financing was from Tristan Oil which TNG owed US\$275m to at the end of 2008 and US\$208,758,685 to at the end of 2009 (1st FTI Report, Exhibit 68, p.F-158). Indeed it is difficult to see what investment if any has been made in TNG by Terra Raf. The financial statement of TNG for 2009 does not show any subsequent investment by Terra Raf in TNG (1st FTI Report, Exhibit 68, p.F-173). In fact it appears that Terra Raf is nothing more than a shell company existing only to hold shares in TNG without participating itself in the investment.

¹⁰⁷ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 121, Claimants assert that there is no requirement that an investment be "substantial". The Republic does not dispute that there are cases that adopt this approach. However, there are, equally, cases that require a certain threshold should be met. See *Andres Rigo Sureda*, Investment Treaty Arbitration: Judging Under Uncertainty, 2012, p.63 citing *Malaysian Historical Salvors, SDN, BHD, v Malaysia*, ICSID Case No. ARB/05/10, Award, 17 May 2007, para. 143 (**Exhibit R-227**).

2. Lack of Risk undertaken by some or all of the Claimants

128 As set out by the tribunal in *Toto* (an ICSID case),¹⁰⁸ the underlying concept of an economic investment includes the notion that financial risk be undertaken by the investor: “*it implies an economical operation initiated and conducted by an entrepreneur using its own financial means and at its own financial risk, with the objective of making a profit within a given period of time. It has been argued that “investment” should include some duration, e.g., a minimum duration of two years, although a shorter duration also may be conceivable, or that the investment should serve the public interest.*”

129 The Republic has explained in detail its concerns that financial gain may not have been the primary motivator for Stati and the other Claimants in investing in Kazakhstan and that, in any event, this is mixed up with political and not purely business related goals.¹⁰⁹ What is more concerning, is that it is apparent that little risk was undertaken by any of the Claimants currently party to the arbitration and that any profit that was being made was not being directed back to Claimants.

130 As set out in the Statement of Defence, Claimants were funded by Tristan Oil in their activities. The Republic repeats paragraphs 14.9 to 14.12 of the Statement of Claim. Professor Olcott’s analysis of the group of companies provides an insight into the way in which the group of companies was structured:

“163. The financing for the development of these assets was done initially through an 11 percent credit facility provided to TNG KazKommertsBank, which was repaid through the Eurobonds raised by Tristan Oil (with 10.5 percent interest), in which the \$13.4 million early repayment penalty was paid for by TNG. Tristan in turn lent money (including interest free) to Terra Raf Trans Trading which then lent money to TNG and K.PM at 15 percent (2006). Ascom also lent the two firms money at 15 percent and 16.5 percent (2007).

¹⁰⁸ *Toto Costruzioni Generali S.p.A. v. Republic of Lebanon*, ICSID Case No. ARB/07/12, Decision on Jurisdiction, 11 September 2009, para. 84 (**Exhibit R-228**).

¹⁰⁹ See above section B.II.1.

164. As the annual reports of Tristan Oil make clear, the financing of the development of the oil and gas assets was structured in a way to maximize the income to Tristan Oil and various Stati subsidiaries that provided all the goods and services to the oil and gas fields as well as sold the oil and gas produced, and to minimize the income of the TNG and KMP, and so the tax to which the Kazakh government was entitled.”¹¹⁰

131 Claimants do not challenge the factual assertion made by the Republic that “the majority of the financing of KPM and TNG came from Tristan Oil.”¹¹¹ Instead, they argue that there is no “origin of capital” required in the ECT. Whether this is actually the case is not admitted by the Republic since this point is irrelevant to the issue raised by the Republic. Unlike other cases relating to origin of capital, the Republic’s argument does not raise these issues in order to demonstrate that the capital was truly “foreign” capital. Rather, the Republic raises this argument to demonstrate the following:

- (a) Firstly, Claimants are not the “real investor” in this transaction. In truth, the Republic is not in a position to know who the “real investor” is. However, Tristan Oil’s involvement suggests that at the very least, it is Tristan Oil (rather than any of the Claimants) who are primarily funding and, ultimately, taking the risk for, these investments;
- (b) Secondly, this suggests very strongly that none of the Claimants were the major risk takers in this transaction. This devalues Claimants’ arguments that they made “investments” in accordance with the inherent meaning of the word (or even in accordance with the *Salini* test).

132 The Republic refers and relies upon Section C.X. of this Rejoinder and Memorial on Jurisdiction and Liability which sets out fully the way in which Claimants invested in the Republic.

¹¹⁰ Expert Report of Professor Olcott dated 7 August 2012, paras. 163 to 164.

¹¹¹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 25.

3. Lack of contribution to the economy of Kazakhstan and undue exploitation of the assets

- 133 The inherent meaning of “investments” dictates that the host state benefits from the “investment” being made by the investor. The dicta in *Toto* referred to above goes even further to suggest that in addition to having an economic basis, the “investment” should in effect serve the public interest. This approach accords with the reciprocal nature of the ECT. In this case, Claimants operated the fields in order to maximize income for Stati (and those behind him) whilst also evading taxes and damaging the fields through overproduction leading to water flooding. In operating their investments in this manner it is difficult to see how Anatolie Stati or the other Claimants operated in any way which contributed to Kazakhstan’s economy.
- 134 The following chronology gives an alternative historical perspective on the nature of the Claimants’ investments highlighting how little of the money generated from the investments flowed back into Kazakhstan.
- 135 As described above, the entire structure was aimed at taking any money that was created by the investments offshore.¹¹² In particular, Professor Olcott observes that: “*Some of these companies, like General Affinity Ltd. seem to have been created for the sole purpose of the transfer of profits out of TNG and KPM. General Affinities effectively only had assets (and liabilities) for 2008 and 2009, and unlike TNG and KPM the Stati family made sure that there were no liabilities in General Affinities when the price of energy dropped and the two oil and gas fields were turning into distressed investments.*”¹¹³
- 136 In 2008, Claimants appear to have used offshore havens for diverting profit away from KPM and TNG, the two assets that were incorporated in Kazakhstan, and as such were liable to pay taxes in Kazakhstan.
- 137 In particular, money was pouring out of KPM and TNG and into Montvale Invest (another Stati-owned offshore company based in the British Virgin Islands):

¹¹² Expert Report of Professor Olcott dated 7 August 2012, para. 165.

¹¹³ Expert Report of Professor Olcott dated 7 August 2012, para. 165.

“...when [Stati] got caught in dropping oil and gas prices, and had over-financed Tristan Oil, and had set his priorities on maximizing the profit of subsidiaries at the expense of KPM and TNG, continued to draw off money to maximize the financial viability of these assets at the expense of KPM and TNG, as detailed by the complainant, and as found in Tristan Oil’s annual reports, KPM’s oil was traded by Montvale Invest (a BVI registered corporation) with Vitol SA which advanced financing to Montvale, in increasing sums, eventually reaching \$80 million (for the year ending in June 2009).”¹¹⁴

- 138 Certainly, it does not appear that Claimants were concerned about the positively contributing to the development of the Republic. For example, echoing the approach taken by Stati in relation to training in Sudan where Ascom imported inappropriate teachers, it seems that Ascom was also intent on importing foreign labour into the Republic rather than using local resources. Claimants’ group *modus operandi* appears to be less about technology transfer for the Republic and more about generateing and offshoring profit.¹¹⁵
- 139 In any case, during the period that the investments were running under Claimants’ alleged stewardship, KPM and TNG paid little of the taxes that were due to the Republic. The issue of Claimant’s failure to pay taxes due is dealt with below.¹¹⁶ This is a quintessential example of failing to provide benefit to the host state.
- 140 At the same time Claimants ramped up production in the Tolkyng gas field.¹¹⁷ The aim of which appears to have been maximizing profit; it does not seem to have been the best strategy for maintaining the long term usefulness of the asset.

¹¹⁴ Expert Report of Professor Olcott dated 7 August 2012 2012, para. 166.

¹¹⁵ Rejoinder Memorial on Jurisdiction and Liability dated 13 August 2011, section B.II.1(c) and Expert Report of Professor Olcott dated 7 August 2012, para. 147. Letter from the Ministry of Labour dated 11 November 2001 (**Exhibit R-229**).

¹¹⁶ Rejoinder Memorial on Jurisdiction and Liability dated 13 August 2011, section C.IV.

¹¹⁷ GCA Expert Report dated 8 August 2012, para. 20: “Production was ramped up to over 6 MMscm at the end of 2007”.

- 141 After near enough “finishing” with them, Claimants then sought to sell this investment for an inflated price, in the farcical “Project Zenith” process. For the reasons set out further below Section C.XI of this Rejoinder Memorial on Jurisdiction and Liability, this whole purported sale was a complete sham.¹¹⁸ After swindling the Republic, Claimants then sought to dupe a buyer into taking on its “investment”. None of those potential purchasers were interested once they discovered the assets actual worth.
- 142 In 2009, when the global economic crisis was strengthening its grip, meaning that KPM and TNG’s major “customers” (in fact, Stati owned companies) could not pay intra-group loans, and Claimants were facing unpaid tax bills in the Republic, it is evident from the accounts of Tristan Oil¹¹⁹ that TNG and KPM were facing future financial difficulties. Claimants, in this case, Ascom, responded by stripping TNG and KPM of its assets:¹²⁰

“KPM issued a \$52.6 million dividend, something that was prohibited by the terms of its secured loans, as the disclaimer from the auditors noted:

“As disclosed in Note 25, at 31 December 2009 and subsequent to this date Kazpolmunay LLP declared dividends (Note 24) which were prohibited under the terms of the Senior Secured Notes Indenture Agreement among the Companies and Wells Fargo Bank, N.A (the “Trustee”). As a result of this covenant breach, the Trustee or noteholders holding at least 25% of the aggregate principal amount of the notes outstanding, may declare all of the Notes to be due and payable immediately. This condition indicates a material uncertainty which may cast significant doubt about the companies’ ability to continue as a going concern.”

¹¹⁸ Expert Report of Professor Olcott dated 7 August 2012, para. 8 August 2012.

¹¹⁹ Notably, KPM and TNG’s accounting was done with Tristan Oil and not, for example, Ascom or Terra Raf.

¹²⁰ Expert Report of Professor Olcott dated 7 August 2012, paras. 167 - 169.

143 During this time, it was also deemed appropriate to pay out a large bonus to Anatolie Stati in 2009 (only slightly smaller than had been paid out to him the previous year):

*“172. The audit also revealed that in the midst of all of Tristan Oil’s financial difficulties for the year ending December 31, 2009 Anatolie Stati received a bonus of \$3,863,000, down from \$4,435,000 in 2008.”*¹²¹

144 Of course, it may be Claimants’ contention that what it chooses to do with its profits is entirely their own business. With the exception of behaviour that is in violation of Kazakh law (for example, the non-payment of taxes), the Republic does not seek to comment on the way that Claimants run their affairs. Rather, these observations are made simply to demonstrate that there has been little, if any, contribution back to the host state resulting from Claimants’ investments. If Anatolie Stati’s reputation in South Sudan is to be believed, it is not unreasonable to view his “investments” in the Republic through a similar lens. This strengthens the indication that Claimants’ “investments” should not qualify for protection under the ECT.

145 The Republic refers and relies upon Section C.X of this Rejoinder and Memorial on Jurisdiction and Liability which sets out fully the way in which Claimants invested in the Republic.

4. Claimants’ “investment” not made in accordance with Kazakh law

146 The Republic has explained in detail why investments must be made in accordance with national laws under the ECT and international laws.¹²² Thomas Waelde has considered which sort of activities would not qualify under the ECT as an “investment”:

“an invalid right or title, not issued by the competent authority, but issued under material breach of mandatory procedures or issues in contravention of the peremptory law, does not constitute “investment”. A contractual right to explore and develop oil and gas issued by an

¹²¹ Expert Report of Professor Olcott, dated 7 August 2012, para. 172.

¹²² See section B.III.2.b) above.

incompetent local entity, or issued without complying with mandatory tender procedures, or issued with material breach of such procedures suggesting illicit practices and, certainly, if issued under the influence of proven corruption, would not constitute “investment”.”¹²³

147 The breaches committed by Claimants when investing in the Republic fall squarely within this definition. This has already been quite plainly set out in section 13 of the Statement of Defence. Such breaches were not minor illegalities based on “*hyper-technical, minute formalities of Kazakh corporate law*”¹²⁴ as Claimants suggest, but breaches of essential aspects of the law. Claimants’ mis-description is characteristic of its disrespectful attitude to the Kazakh legal regime. They clearly believe it is appropriate to act outside the law and disobey the governing authorities within States that have provided them with the opportunity to invest in their country and exploit their resources. It is therefore telling that in the Reply Memorial on Jurisdiction and Liability, Claimants effectively admit that they did breach Kazakh law¹²⁵. This admission is enough to demonstrate that Claimants have not acted lawfully and to cast significant doubt as to Claimants’ entitlement to protection under the ECT.

148 In any “normal” case, there might be indications that there were one or two illegalities that cause the validity of the investment to falter. In this case, there are several to choose from. Claimants seek to wriggle away from their own unlawful conduct by criticizing the Republic’s actions rather than taking responsibility for their own conduct. In any case, the Republic never repeatedly approved Claimants’ “investment” nor did it disregard their breaches of Kazakh law as they suggest.¹²⁶ Instead:

¹²³ Thomas W. Wälde, *The Energy Charter Treaty: An East-West Gateway for Investment & Trade*, pg. 273 (**Exhibit R-230**).

¹²⁴ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 134.

¹²⁵ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, section II. D. 2.

¹²⁶ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, paras. 135-136. Claimants’ reference to the *Saluka* case (*Saluka Investments BV (The Netherlands) v The Czech Republic*, UNCITRAL, Partial Award, 17 March 2006, para. 218 (**Exhibit C-259**)) should in any event be distinguished on the facts from this case, as in *Saluka*, the illegalities arose in relation to failings not by the Claimant in those proceedings but the bank from which it bought the shares from, Nomura. Here, as is clear in section 13 of the Statement of Defence dated 21 November 2011 and in this part of the Rejoinder Memorial on Jurisdiction and Liability, the failings include those made by Claimants, specifically Ascom and Terra Raf, themselves in acquiring KPM and TNG.

- (a) In relation to those illegalities that the Republic did become aware of (Claimants' failure to obtain consent for transfers involving TNG and a waiver of the Republic's pre-emptive right in order to transfer TNG from Gheso to Terra Raf) the Republic legitimately challenged TNG and Terra Raf on their violation of Kazakh law. For the reasons set out below, Claimants now completely misconstrue the facts on this matter to deceive the Tribunal; and
- (b) As to the other violations, the Republic only became aware of them following the commencement of these arbitration proceedings¹²⁷. Claimants acknowledge this themselves in paragraph 141 of the Reply Memorial on Jurisdiction and Liability by noting that the Republic "*never relied upon any of its current allegations of "illegality" in order to terminate the Subsoil Use Contracts*". This is because the Republic was not aware of them. It would therefore have been impossible for the Republic to challenge them and/or bring any claims against them at the time - Claimants carefully concealed their illegal behaviour.

149 The Tribunal should therefore not be persuaded by Claimants' attempts to deny they breached Kazakh law when making their investment, whether or not the violations were contested before these proceedings were commenced. For the reasons set out below, each and all of the violations committed were serious breaches of Kazakh law (both individually and together), thereby extinguishing any right Claimants had to be afforded protection under the ECT.

a) Claimants' failure to obtain the required consent in relation to the transfer of TNG and circumvention of the Republic's pre-emptive right

150 As a matter of fact, Claimants did not obtain prior consent to any of the transfers they were involved in with TNG, from either the Licensing Authority or Competent Authority. Claimants now try to:

- (a) Deny that it ever needed this consent from either of those authorities as a matter of law; and

(b) Argue that, in any event, it did obtain such consent.¹²⁸

151 The first argument is legally incorrect. As to the second, Claimants cannot rely on the consent it obtained almost four years after the last transfer in TNG (from Gheso to Terra Raf) took place which was legitimately revoked as a result of Claimants providing false and misleading information. Therefore, there can be no doubt that Terra Raf’s “investment” in TNG was not in accordance with Kazakh law.

aa) Legal requirement to obtain consent from the Licensing and Competent Authorities

152 As already explained in the Statement of Defence, Article 53 of the 1995 Law on Oil clearly states that consent is required from both the Licensing Authority and Competent Authority when there is a transfer of shares in a company with subsoil use rights:

“Article 53 - Transfer of Rights and Obligations

1. Contractor can transfer to a physical person or legal entity or international organization all or part of its rights and obligations under the [subsoil use] agreement, including by means of alienation of a majority stake of shares, only upon written consent of a Licensing and Competent Authorities...”¹²⁹ (emphasis added)

153 Claimants’ justification for arguing that consent was not required is that the 1995 Law on Oil did not apply “*as a result of Kazakh laws governing the hierarchy of statutory acts*”¹³⁰. They argue that the 1996 Subsoil Law (as amended) would have instead been applicable, and under that law no such consent was required. This argument is quite simply wrong.

154 First, these are two distinct laws which apply in their own right to all persons affected by them. Claimants have provided no evidence to

¹²⁷ Claimants provide no evidence in support of its assertion that “*Kazakhstan repeatedly inspected and approved the corporate structures of KPM and TNG over many years*” (Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 135).

¹²⁸ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, section D. 2. c.

¹²⁹ Article 53 of Decree No. 2350 of the President of the Republic of Kazakhstan having the force of Law on Oil of June 28, 1995 (**Exhibit C-411.1**).

¹³⁰ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 162.

demonstrate that this is not the case and obviously entities in the Republic were required to comply with both of them. As Claimants readily admit with respect to the 1995 Law on Oil, the “*statute technically existed when the share transfers in question occurred*”.¹³¹ If a law exists and is in force, obviously it should be complied with.

155 Second, when the 1995 Law on Oil was amended on 11 August 1999, the requirement for obtaining consent under Article 53(1) was not removed. If the Republic wished to amend or remove this provision it would have done so. It did not, so the law remained in force, subsequently only being amended in December 2004.¹³²

156 Third, pursuant to both Article 4(1) of the 1996 Subsoil Law and Article 2 of the 1995 Law on Oil, the 1995 Law on Oil actually took precedence over the 1996 Subsoil Law in the event of any inconsistency. As Professor Ilyasova explains (in relation to supposed contradictory terms in each law regarding whether consent is required):

“Pursuant to Paragraph 1 of the Article 4 of the Decree on Subsurface as of 1996, the peculiar features of Subsurface Operations in terms of certain types of Mineral Wealth and Man-Made Mineral Formations shall be determined by the legislative acts on such types of Mineral Wealth and Man-Made Mineral Formations.

Article 2 of the Oil Decree stipulated the following:

*1. This Decree shall regulate the relationships emerging in the event of **Petroleum Operations** performed within the territory under the jurisdiction of the Republic of Kazakhstan, including Sea and Inland Water.*

*2. **This Decree shall apply in conjunction with the Presidential Decree of the Republic of Kazakhstan “On***

¹³¹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 162.

¹³² Decree No. 2350 of the President of the Republic of Kazakhstan having the force of Law on Oil of June 28, 1995 (**Exhibit C-411.3**) and Law of the Republic of Kazakhstan “On Making Amendments and Additions to Certain Legislative Acts of the Republic of Kazakhstan on Matters of Subsoil Use and Conduct of Oil Operations in the Republic of Kazakhstan of December 1, 2004, No. 2-III. (**Exhibit C-414**). As Ilyasova notes, the law was again amended on 18 October 2005 (Professor Ilyasova Expert Report dated 12 August 2012, para. 6).

Subsurface and Subsurface Use” as of January 27, 1996 effective as law and other legislative acts of the Republic of Kazakhstan.

3. In the event of any discrepancy between the present Decree and any other legislative acts of the Republic of Kazakhstan in terms of regulating the Petroleum Operations provisions of the present Decree shall apply.”¹³³ *(emphasis added)*

157 In the circumstances, Article 53 of the 1995 Law on Oil did apply. Claimants are simply now seeking to mislead the Tribunal by referring to the 1996 Subsoil Law and arguing that it somehow takes precedence over the applicable 1995 Law on Oil.

bb) Transfers involving TNG

158 Claimants failed to obtain consent from the licensing authority and competent authority in relation to any of the eight transfers which involved its companies at the time of those transfers.¹³⁴

159 Remarkably, instead of acknowledging this derogation, Claimants chose instead to base the legitimacy of Terra Raf’s shareholding in TNG on the one consent they obtained some four years after the very last share transfer in TNG (from Gheso to Terra Raf), allegedly took place.¹³⁵

160 However, Claimants cannot rely on this one authorization to “heal” its failures to obtain consent for the three preceding transfers in TNG its companies were supposedly involved in. Each of these transfers would have been invalid pursuant to Article 14 of the 1996 Subsoil Law¹³⁶. The Tribunal should therefore not be misled by Claimants on this issue.

161 Furthermore, Terra Raf only actually requested consent after being prompted to apply for it by the Republic.¹³⁷ It never had any intention of

¹³³ Professor Ilyassova Expert Report dated 12 August 2012, para. 6.

¹³⁴ Statement of Defence dated 21 November 2011, para. 13.28(b).

¹³⁵ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 167.

¹³⁶ Professor Ilyassova Expert Report dated 12 August 2012, para. 7.

¹³⁷ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 167, Letter from MEMR to TNG on 13 February 2007 (**Exhibit C-132**).

seeking to obtain consent otherwise. Furthermore, as explained below, when applying for consent to the transfer Claimants failed to provide pertinent information on the date Terra Raf was registered as a shareholder in TNG. In addition, by law that consent should never have been granted without a waiver of the Republic's pre-emptive right¹³⁸. This therefore cannot be deemed as consent by the appropriate body as Claimants allege.¹³⁹

162 Claimants persist in arguing that consent was not required in relation to the transfer of TNG from Gheso to Terra Raf as they were affiliated companies.¹⁴⁰ However, they have provided no evidence to support that the companies were affiliates.¹⁴¹ Interestingly, any alleged affiliation between Gheso and Terra Raf did not prevent TNG from belatedly requesting consent to the transfer - quite probably because they were not affiliate companies.

163 It is also noteworthy that at the time, Claimants also made no mention of this supposed "hierarchy" of Kazakh law which meant that the 1995 Law on Oil did not apply. It clearly did and always has believed that it needed consent to transfer TNG. It simply decided not to obtain that consent.

cc) The Republic's discovery of the date when Terra Raf was registered as a shareholder in TNG

164 When the MEMR wrote to TNG requesting that it applies for consent to the transfer of TNG from Gheso to Terra Raf (pursuant to Article 53 of 1995 Law on Oil) it also pointed out that under Article 71 of the 1995 Law on Oil (as amended in December 2004),¹⁴² the Republic has a pre-emptive right to purchase shares in a company that holds rights to use the State's subsoil. This law applied not only in relation to newly concluded subsoil

¹³⁸ See section B.IV.4.a) below.

¹³⁹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 168.

¹⁴⁰ Second Witness Statement of Grigore Pisica dated 6 May 2012, paragraph 28.

¹⁴¹ Notwithstanding the Republic position in Statement of Defence dated 21 November 2011, para. 13.47.

¹⁴² Letter from MEMR to TNG on 13 February 2007 (**Exhibit C-132**).

agreements but also to those concluded prior to the 2004 Amendments Law.¹⁴³

165 In their response to the MEMR's letter, Claimants denied that the State's pre-emptive right needed to be waived on the grounds that the transfer of 100% of the shares in TNG occurred in 2003.¹⁴⁴ Therefore, they asserted that Article 71 of the 1996 Law on Oil did not apply.

166 The MEMR, in good faith, believed what Claimants had told them was correct. As a result, it accepted that the Republic's pre-emptive right was not applicable.¹⁴⁵ (Claimants still refer to two internal government documents¹⁴⁶ as evidence that the Republic had "granted its permission" to the transfer. It is telling that Claimants have failed to address how it obtained possession of these documents, let alone their authenticity. The Republic can only assume that it obtained these documents through improper means, which is characteristic of its behaviour throughout the period of its alleged "investment" in Kazakhstan.)

167 However, it later came to the Republic's attention that Terra Raf was registered as a shareholder in TNG in 2005¹⁴⁷. This was pertinent information about the company which should have been provided to the MEMR at the time it belatedly applied for consent. The MEMR therefore decided to look into the transfer as:

- (a) It was not clear how Terra Raf could have been registered as a shareholder in TNG in 2005 given that no consent had been granted to the transfer nor had there been a waiver of the Republic's pre-emptive right; and

¹⁴³ This is not disputed by the Republic's own expert (Maggs Expert Report, dated 5 May 2012, para. 63).

¹⁴⁴ Letter from TNG to MEMR, 19 February 2007, (**Exhibit C-424**).

¹⁴⁵ Witness Statement of Mr. Ongarbayev, para. 5.5.

¹⁴⁶ Excerpt from the Minutes no. 4 of the meeting of the appraisal commission concerning the analysis of the requests filed by the subsoil users with regard to the alteration of the conditions stipulated in Licenses and Contracts dated February 20, 2007 (**Exhibit C-134**) and letter from the General Prosecutor's Office to Mr E Ramazam dated 21 February 2007 (**Exhibit C-133**).

¹⁴⁷ Witness Statement of Mr. Ongarbayev, para. 5.6.

(b) It was clear that TNG had provided misleading information by not disclosing this fact.¹⁴⁸

168 As Professor Ilyasova notes, under Kazakh law, prior to 2004 a share transfer is only concluded when consent to the transfer is obtained from the licensing and competent authorities¹⁴⁹. Any share transfer before taking these steps would have been invalid. Claimants deceptively registered Terra Raf as a shareholder in TNG without obtaining these consents.

169 Furthermore, when obtaining consent to the transfer in 2007, Claimants should have applied for a waiver of the Republic's pre-emptive right. As Professor Ilyasova explains, the Republic's pre-emptive right would have applied in respect of any transfer which had not been completed after Article 71 of the 1996 Petroleum Law was amended in December 2004¹⁵⁰. However, Claimants misleadingly informed the MEMR that it did not require a waiver.

170 Therefore, when the MEMR recognised that it had been misled by Claimants in 2008, it rightfully revoked its authorisation to the transfer of TNG from Gheso to Terra Raf. The MEMR was obliged to do so, as a waiver of the Republic's pre-emptive right would have been necessary for a lawful transfer of ownership from Gheso to Terra Raf. The MEMR cannot approve transfers that were obtained in breach of Kazakh law and where it has been given false information, it is entitled to revoke any authorisation given pursuant to Article 14 of the 1996 Subsoil Law and further, pursuant to Article 15(2), the transfer "*shall be deemed invalid from the moment of execution thereof*"¹⁵¹. As Mr. Ongarbayev explains:

"Following our investigation into this issue, we determined that TNG should have obtained a waiver of the Republic's pre-emptive right when it applied for consent to the transfer, given that at that point in time, the Republic's pre-emptive right was applicable. Claimants incorrectly informed us that the Republic's pre-emptive

¹⁴⁸ Witness Statement of Mr. Ongarbayev, para. 5.5 et seqq.

¹⁴⁹ Professor Ilyasova Expert Report dated 12 August 2012, para. 8(b).

¹⁵⁰ Professor Ilyasova Expert Report dated 12 August 2012, para. 8(a).

¹⁵¹ Professor Ilyasova Expert Report dated 12 August 2012 para. 7. As Ilyasova notes, judicial proceedings were not required to declare the transaction invalid.

right did not apply. We therefore informed TNG by a letter of 18 December 2008 (Exhibit C-140) that it must comply with the procedure outlined in Article 71 of the Law on Subsoil and Subsoil Use and apply for an approval of the transfer of shares.”¹⁵²

171 Clearly, the revocation of the Republic’s consent had nothing to do with an alleged harassment campaign as Claimants suggest.¹⁵³ Nor was any “press release” an official press release of the MEMR.¹⁵⁴ Claimants provide no evidence to support this outrageous assertion and it is noteworthy that at the time, when corresponding with the MEMR, they did not claim that the MEMR was in any way responsible for the irregularities in the transfer of TNG being “*spread in mass media*”.¹⁵⁵

172 Furthermore, it is now ironic that Claimants blame the Republic for casting “*a cloud on Claimants’ title to TNG*”¹⁵⁶ by querying the transfer. Any uncertainty was caused by Claimants themselves - they deceived the MEMR and when the MEMR discovered this, it rightly revoked its consent to the transfer.

173 It is also noteworthy that Claimants have produced a document dated 15 September 2004, which expressly refers to Ascom being the owner of TNG as at that date.¹⁵⁷ Claimants provide no explanation of how this could be the case, given that by this point, Terra Raf had supposedly acquired TNG from Gheso. On Claimants’ case, the last time Ascom owned TNG was in 2002¹⁵⁸. Clearly, there were some irregularities in many of the transfers involving TNG, and it would not be difficult to believe that the various Share Purchase Agreements Claimants have produced are not entirely genuine.

¹⁵² Witness Statement of Mr. Ongarbayev, para. 5.7.

¹⁵³ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, paras. 189 and 228.

¹⁵⁴ Witness Statement of Mr. Ongarbayev, para. 5.9.

¹⁵⁵ Letter from Tolkyneftegaz to Secretary Batalov A.B. dated 24 February 2009 (**Exhibit C-619**).

¹⁵⁶ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 190.

¹⁵⁷ Explanatory memoire regarding the purchase of a share-quota of OAO “Tolkyneftegaz” (TNG) dated 15 September 2004 (**Exhibit C-514**).

¹⁵⁸ Statement of Claim dated 18 May 2011, para. 50.

174 The Republic sought to resolve the issues caused by Claimants amicably with TNG (rather than commence unnecessary domestic legal proceedings as Claimants suggest it should have done).¹⁵⁹ However, there is no basis for Claimants to assert that KPM and TNG were not given the opportunity to dispute the charges, as they clearly were through the various correspondence exchanged and meetings held.¹⁶⁰ Throughout this time TNG did not act reasonably and admit it needed to request a waiver of the Republic's pre-emptive right. Instead, it continuously denied this fact, thus never resolving the Republic's concerns.¹⁶¹

175 It is therefore quite evident that the problems arising out of the transfer of TNG from Gheso to Terra Raf were caused by Claimants themselves since they clearly:

- (a) Failed to seek consent to the transfer at the time (or any of the eight transfers that involved their entities);
- (b) After belatedly seeking consent, submitted incorrect information thereby circumventing the requirement to obtain a waiver to the State's pre-emptive right; and
- (c) Once the Republic discovered the various irregularities highlighted above and rightly revoked its consent to the transfer, they persisted with denying their violation of Kazakh law rather than accepting the position and remedying it.

176 It is difficult to not draw the conclusion that Claimants acted in this manner in order to avoid having to obtain a waiver of the Republic's pre-emptive right. This is now further supported by the fact that Claimants have produced a letter they wrote to KazRozGas showing that they were clearly worried about the Republic exercising its pre-emptive right and buying TNG if it attempted to sell a stake in the company¹⁶².

177 Acting in this manner is a clear breach of Kazakh law. At the time it caused serious questions to be raised as to whom title in TNG should vest with. Overall, given that the Republic did not consent to the transfer, Terra Raf

¹⁵⁹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 230.

¹⁶⁰ Statement of Defence dated 21 November 2011, paragraphs 13.43 to 13.47.

¹⁶¹ Letter from Tolkyneftegaz to Secretary Batalov A.B. dated 18 March 2009 (**Exhibit C-41**).

¹⁶² Letter from Terra Raf to Mr Boranbaev, undated (**Exhibit C-520**).

cannot be regarded as having legally invested in TNG and this entity should not be afforded protection under the ECT.

dd) Planned transfer of shares in TNG and KPM to Tristan Oil

178 Claimants further argue that the waivers to the Republic's pre-emptive right, that it allegedly obtained in 2007 allowing it to transfer TNG and KPM to Tristan Oil somehow have relevance to its failure to obtain consent and a waiver of the state's pre-emptive right, in relation to the transfer of TNG from Gheso to Terra Raf.¹⁶³ As the Republic has already stated in the Statement of Defence, these waivers are completely irrelevant as they concern an entirely different transfer.¹⁶⁴ Claimants have said nothing in response to suggest otherwise.

179 This argument is another attempt by Claimants to deceive the Tribunal by distorting the facts. The Tribunal should not be persuaded to follow an intrinsically logically flawed argument.

180 In any event, it is quite clear that the Republic would never have waived its pre-emptive right for the proposed transfer to Tristan Oil had it known that Claimants should have requested a waiver at the time of the Gheso to Terra Raf transfer.

b) Other illegalities the Republic discovered in relation to Claimants' "investment" in Kazakhstan

181 The Republic has now discovered various other violations of Kazakh law in relation to Claimants' "investment" in Kazakhstan. Each of these constituted a serious breach of Kazakh law, concealed from the Republic, which therefore meant it was unable to act upon them at the time. These illegalities are set out in section 13 of the Statement of Defence, and in summary consist of the following:

- (a) Violations of Kazakh law in relation to the issuing of shares in KPM;
- (b) KPM was transformed from a "non-commercial" entity into a commercial entity in breach of Kazakh law;

¹⁶³ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 187.

¹⁶⁴ Statement of Defence dated 21 November 2011, para. 13.47(f).

- (c) The transfer of KPM's shares to Ascom was illegal due to the failure to obtain consent from the Licensing and Competent Authorities;
- (d) The reorganisation of KPM and TNG into LLPs was illegal; and
- (e) KPM and TNG failed to amend their licenses when amending their contracts.

182 Claimants have not denied that these violations occurred as a matter of fact¹⁶⁵. Instead they primarily seek to deny that their investments were illegal by employing Kazakh law arguments on alleged actions the Republic should have taken. Each of these arguments seek to detract the Tribunal's attention away from the fact that Claimants' original "investment" was not made in accordance with Kazakh law. In any event, for the reasons set out below, their interpretation of Kazakh law is misguided and their arguments fundamentally flawed.

aa) KPM's share issue was not valid

183 Claimants actually admit that KPM failed to submit the relevant documents required for state registration, which meant that it did not have a national identification number.¹⁶⁶ As their General Counsel, Grigore Pisica, readily admits, they knew about this but instead of accepting that there had been serious breaches of Kazakh law, regarded them as merely "technical".¹⁶⁷ This was an unacceptable manner for an investor in the Republic to behave.

184 Claimants also now state that the Republic needed to commence proceedings in respect of KPM's failure to submit the required registration documentation under Article 16 of Law No. 77-1 on Securities Market (**SM Law**)¹⁶⁸. Although this would be the case if it wanted to apply for the company to be reorganised or liquidated under Article 16(1), it does not follow that the Republic was required to pursue the issue in court to challenge the validity of the registration in the first place.

¹⁶⁵ Save for illegalities surrounding the transfer of KPM's shares, which in any event their reasoning for is flawed.

¹⁶⁶ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 142.

¹⁶⁷ Second Witness Statement of Grigore Pisica dated 6 May 2012, para. 5.

¹⁶⁸ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 143.

185 Pursuant to Article 15 of the SM Law the documents needed to be submitted as part of the share issue in itself.¹⁶⁹ If those documents are not submitted, the share issue cannot be registered pursuant to Article 17(1). The consequence of this is quite clear under Article 17(2), which provides:

*“The issuances of securities not listed in the State register of securities shall be deemed invalid.”*¹⁷⁰ (emphasis added)

186 Based on this, the initial share issue in KPM was invalid and given that Claimants purchased the company, they cannot be regarded as investing in the company in accordance with the host state law, as required under international legal principles.

187 Claimants further argue that under general Kazakh law, a court would have needed to annul the share issue as under Article 157 of the Civil Code of Kazakhstan (**Civil Code**) all transactions are valid until voided by the courts. They further argue that there is no concept *void ab initio* under Kazakh law¹⁷¹.

188 However, it is clear that as a matter of Kazakh law the concept of *void ab initio* exists and is expressly referred to in certain legislation including the 1996 Subsoil Law.¹⁷² Claimants have also failed to adequately demonstrate that the Civil Code would be applicable here. In any event, as Professor Ilyasova explains “*in the legal literature the question whether the Civil Code of the Republic of Kazakhstan provides for invalid transactions which are null and void without the court judgment or not, is unclear.*”¹⁷³ Any arguments Claimants raise on the matter being time-barred are similarly not applicable, and in any event rely on some alleged belief that the Republic knew it did not have the required documentation to register KPM, when it did not.

¹⁶⁹ Article 15 of the SM Law (**Exhibit R-231**).

¹⁷⁰ Law of the Republic of Kazakhstan on the Securities Market, March 5, 1997 (**Exhibit R-7**).

¹⁷¹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 144.

¹⁷² Professor Ilyasova Expert Report dated 12 August 2012, para. 7.

¹⁷³ Professor Ilyasova Expert Report dated 12 August 2012, para. 7.

bb) KPM was illegally transformed into a commercial company

189 The Republic has evidenced its position that KPM was registered as a non-commercial company. In their response, Claimants argue that the “supposed re-registration” of KPM as a commercial company was merely the correction of the Republic’s own clerical error¹⁷⁴ and that Claimants were never even aware of it.¹⁷⁵ However, they provide no evidence of:

(a) this alleged “clerical error”; or

(b) the fact that they were not aware of the re-organisation.

190 In any event, Claimants cannot hide behind their supposed ignorance of the fact that the company was registered as a non-commercial company. The facts speak for themselves. The company was re-registered as a commercial company on 13 December 1999.¹⁷⁶ This is evidenced by the State Registration Card¹⁷⁷.

191 Claimants have provided no evidence to dispute this fact. Instead they rely on KPM’s constitutional documents, which are not definitive on this issue and provide various examples of the Republic’s supposed recognition of KPM as a commercial entity, notwithstanding that it has failed to demonstrate that the authorities mentioned were even competent for assessing the matter.

192 As such, their arguments are simply not compelling. Claimants willingly invested in KPM as a *non-commercial entity* knowing it was carrying out *commercial activities* in breach of Kazakh law.

cc) The transfer of KPM’s shares to Ascom was illegal due to the failure to obtain consent from the Licensing and Competent Authorities

193 The Republic has already set out above that pursuant to the 1995 Law on Oil, consent was required from the Licensing and Competent Authorities in

¹⁷⁴ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 150.

¹⁷⁵ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 155.

¹⁷⁶ Record Card of Legal Entity State Registration as of December 13, 1999, dated 14 October 2011 (**Exhibit R-13**).

¹⁷⁷ Record Card of Legal Entity State Registration as of December 13, 1999 dated 14 October 2011 (**Exhibit R-12**).

relation to any transfer of shares in companies with rights to exploit its subsoil. This would include KPM.

194 To date, Claimants have still not shown that they obtained consent in relation to Ascom's purchase of KPM. Instead, they refer to a letter from the Agency of Investments and quote two paragraphs which allegedly evidence that it submitted a request for consent. However, the third paragraph of this document quite clearly shows that the process for obtaining consent had only just begun and further action needed to be taken:

*"...At the same time, after the change of founding members, you need to address to the Competent Authority to make corresponding modifications in the licence."*¹⁷⁸

195 Given that this was the case, it cannot be said that Ascom obtained consent to the transfer. It therefore acted in breach of Kazakh law in making its investment in KPM.

dd) Reorganisation of KPM and TNG into LLPs was illegal

196 As a result of the above violations of Kazakh law, Ascom and Terra Raf were not legal shareholders in KPM and TNG. Thus, for the reasons already explained in the Statement of Defence¹⁷⁹, the attempted reorganisation of those companies into LLPs was ineffective and in itself was a further breach of Kazakh law.

197 Claimants now argue that there is no "domino theory" in Kazakh law, which means that the invalidity of a previous transaction invalidates later transactions. Instead all transactions need to be voided by the court.¹⁸⁰

198 However, as mentioned above and supported by Professor Ilyasova¹⁸¹ this is not the case as in certain circumstances transactions are *void ab initio*. On this basis alone, Claimants have failed to adequately set out their argument and their point regarding there being no "domino theory" under Kazakh law is flawed.

¹⁷⁸ Letter from B Elemanov, undated (**Exhibit C-47**).

¹⁷⁹ Statement of Defence dated 21 November 2011, paras. 13.24-26 and 13.30-33.

¹⁸⁰ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 170.

199 As to the alleged three year limitation period which now supposedly bars the Republic’s claim, the Republic has already explained above that the majority of the illegalities came to light only after the commencement of this arbitration, by which point any scope for bringing a claim would have been useless (since Claimants had abandoned KPM and TNG). Claimants cannot now employ the statute of limitations to argue that it did not breach Kazakh law as a matter of fact.

ee) Failure to amend the licences in accordance with the amendments to the contracts

200 Finally, Claimants argue that they did not need to amend their licenses when amending their Subsoil Use Contracts as “*amendments to subsoil use licenses were effectively replaced by amendments to subsoil use agreements after the 1999 Amendments Law.*”¹⁸² Therefore they deemed it sufficient to amend their Subsoil Use Contracts only.

201 Their interpretation of Kazakh law here is wrong. As Professor Ilyasova notes, pursuant to Article 2(3) of the 1999 Amendments Law No. 467-1, it is clear that:

*“all licenses to subsurface use issued before the effective date of the Law shall remain in full force and effect until expiration thereof, **including terms of extension**, in accordance with the laws of the Republic of Kazakhstan, effective as of the issue date of such licenses.”*¹⁸³
(emphasis added)

202 In terms of the applicable law here, the 1995 Law on Oil took priority over the 1996 Subsoil Law in the event of a discrepancy for the reasons set out in section B.IV.4.a) above. As Professor Ilyasova explains, when taking into account Articles 26 and 29 of this law and the overall practice in the Republic, it is clear that extensions to licenses were needed as well as extensions to the Subsoil Use Contracts.¹⁸⁴

¹⁸¹ Professor Ilyasova Expert Report dated 12 August 2012, para. 7.

¹⁸² Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 177.

¹⁸³ Professor Ilyasova Expert Report dated 12 August 2012, para. 5(a).

¹⁸⁴ Professor Ilyasova Expert Report dated 12 August 2012, para. 5(a).

203 Professor Ilyasova provides various examples of companies extending their licenses in this manner including OJSC “Tenizmunaigaz”, OJSC “Uzenmunaigaz” and OJSC “Donskoy Ore Mining and Processing Plant (GOK)”. Furthermore, she also highlights various resolutions passed showing that amendments to licenses are required in addition to amendments to contracts.¹⁸⁵

204 Claimants’ mis-description of Kazakh law on this matter is another attempt to hide their legal violations. Claimants should have amended their Subsoil Use Licenses but did not. Their argument now is quite simply misleading.

5. Claimants have not made a *bona fide* investment

205 In the Statement of Defence, the Republic has already set out the reasons why Claimants have failed to demonstrate that their investment was made in good faith.¹⁸⁶ In so doing, it has highlighted various indications that demonstrate that their “investment” was not made *bona fide*.¹⁸⁷ These are serious issues and not an attempt by the Republic to “lob” unsupported accusations at Claimants as they suggest.¹⁸⁸

206 It is noteworthy that Claimants have failed to adequately address any of these issues in their Reply Memorial on Jurisdiction and Liability. Instead they choose to deny the allegations without any substantial evidence in support primarily by using endless rhetoric about the allegations being “frivolous”. They are not. Furthermore, for the reasons set out below, the Tribunal should have no hesitation in concluding that Claimants’ “investments” were not made in good faith.

a) Claimants’ illegal activities in Kazakhstan

207 As has already been set out in paras. 9.51 to 9.54 to the Statement of Defence Claimants have breached fundamental aspects Kazakh law in numerous ways throughout their investment in the Republic, including:

¹⁸⁵ Professor Ilyasova Expert Report dated 12 August 2012, para. 5(a).

¹⁸⁶ Claimants mischaracterise this as an allegation of “bad faith”. The Republic’s case is that Claimants failed to act in good faith, however it invites the Tribunal to conclude that the seriousness of the Claimant’s actions is actually indicative of bad faith.

¹⁸⁷ Statement of Defence dated 21 November 2011, paras. 9.48 to 9.87.

- (a) Unlawfully investing in the Republic and illegally engaging in activity involving the Republic’s subsoil resources;¹⁸⁹
- (b) Illegally operating a trunk pipeline without a licence in order to exploit the subsoil area KPM and TNG operated in;¹⁹⁰
- (c) Failing to pay legally imposed taxes as well as penalties it incurred;¹⁹¹ and
- (d) Repeated violation of the Contracts resulting in their valid termination.¹⁹²

208 Claimants do not deny any of the above in relation to the Republic’s contention that the “investments” were not made in good faith. The Republic has demonstrated in this pleading and the Statement of Defence that each of the breaches identified were committed.

209 For the reasons set out in paragraph 9.51 of the Statement of Defence and Section C.III. above, the ECT does not apply to investments carried out in violation of the law. This is a clear case of an “investment” not being made in good faith and contrary to the law of the host state. On these grounds alone Claimants’ “investment” should not be afforded protection under the ECT.

b) Other breaches of good faith

210 As set out in section B.II.1, Claimants’ standards in investment fall below what might be expected of a normal commercial investor. In relation to Anatolie Stati:

- (a) He has a history of engaging in corrupt and illegal activities in various countries outside of Kazakhstan. This ranges from his earlier links to the construction industry in the Soviet Union and smuggling documents when investing in Turkmenistan up to his financing of

¹⁸⁸ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 191.

¹⁸⁹ As set out in section B.III. above.

¹⁹⁰ As set out in section C.IX. below.

¹⁹¹ As set out in section C.IV. below.

¹⁹² As set out in section C.IX. below.

illegal militant grounds in Sudan and circumvention of UN sanctions and his involvement with terrorists in Libya¹⁹³;

- (b) There are clear indications that there are political players behind his investments in various countries including the Republic. Anatolie Stati appears to be no more than a front for a group of investors and very much acts as their “puppet”. Certainly he uses his political ties to avoid prosecution for the various criminal offences he has been linked to¹⁹⁴; and
- (c) Anatolie Stati has been using profits received from his investments to keep political machines in Moldova functioning and to fund and advance his own political goals.¹⁹⁵

211 As to Gabriel Stati, it is clear that he is not a normal commercial investor given:

- (a) His involvement in organising and financing civil unrest in Moldova and attempts to overthrow the Moldovan government;¹⁹⁶ and
- (b) His “playboy” lifestyle and lack of active involvement in Claimants’ alleged investment.¹⁹⁷

212 Based on the above, it is difficult to see how both Anatolie Stati’s and Gabriel Stati’s investment in the Republic could have been made in good faith given their engagement in criminal and terrorist activities, the fact that they have concealed who is behind their investment, and the fact that they have been using their investment in the Republic to fund and advance their political goals in Moldova.

213 In addition, there are clear indications that Claimants have in fact corrupted Kazakh officials. Claimants were able to present documents in this arbitration which should normally never have been in their possession. One such example is the presidential instruction attached to the letter sent by the

¹⁹³ See section B.II.1.a) above.

¹⁹⁴ See section B.II.1.a) above.

¹⁹⁵ See section B.II.1.a) above.

¹⁹⁶ See section B.II.1.b) above.

¹⁹⁷ See section B.II.1.b) above.

head of the Blagovest fund to MEMR.¹⁹⁸ This instruction was an internal government instruction which was not supposed to be seen by or disclosed to the public. Yet, as Mr. Zakharov explained, this document was given to him by Mr. Andreyev, the director of KPM at the time.¹⁹⁹ This makes it very likely that KPM obtained this document by bribing or otherwise corrupting Kazakh officials.

- 214 This is by far not the only internal government document in Claimants' possession: Other examples include President Nazarbayev's investigation instruction of October 2008,²⁰⁰ MEMR's letter to the Ministry of Industry and Trade from September 2009²⁰¹ and Governor Kuserbayev's letters to Prime Minister Massimov of August 2009 and February 2010.²⁰² The fact that Claimants were able to obtain confidential internal government documents in fact points to serious corruption on behalf of Claimants.
- 215 There can be no doubt that Claimants have failed to demonstrate that they have made investments in the Republic either on the *Salini* test, or otherwise under international law or national law. Claimants continue to provide the tribunal with little, if any, assistance as to whether the criteria has been met. Instead of adequately demonstrating their entitlement under Article 1(6), they persist with their broad brush approach of asserting that their “*investments clearly fall within the definition of ‘Investment’ in the ECT*”, listing their holdings as “*included*” and then stating, as a whole, which subcategories under Article 1(6) they would fall under.²⁰³

V. Claimants did not fulfil the “cooling off” requirement

- 216 Even if Claimants demonstrate entitlement under Article 1(6) and Article 1(7) of the ECT, Claimants failed to fulfil the required “cooling off” period

¹⁹⁸ Attachment to the Letter from Blagovest President to MEMR, dated 7 February 2010 (**Exhibit C-23**).

¹⁹⁹ Witness Statement of Yuri Zakharov dated 28 October 2011, Question 9.

²⁰⁰ President Voronin's letter with President Nazarbayev's note, (**Exhibit C-8**).

²⁰¹ Letter from MEMR to the Ministry of Industry and Trade of the Republic of Kazakhstan dated 28 September 2009 (**Exhibit C-294**).

²⁰² Letter from the Akim of Mangystau Oblast to the Prime Minister, K.K. Masimov, C-293; Letter from the Akim of Mangystau Oblast to the Prime Minister, K.K. Masimov, dated 24 February 2010 (**Exhibit C-665**).

²⁰³ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, paras. 119 to 120.

prior to initiating arbitral proceedings under the auspices of the Stockholm Chamber of Commerce.

217 This alone is fatal to Claimants' case since the Claimant's right to resolve a dispute under the ECT never arose. The Republic repeats the statements made in the Statement of Defence,²⁰⁴ none of which are called into question by any of the new argument raised by Claimants.

1. The “cooling off” period is a jurisdictional requirement

218 In accordance with Article 31(1) of the Vienna Convention,²⁰⁵ the words of the ECT should be given their ordinary and natural meaning and should be interpreted in the light of the ECT's object and purpose.

219 Article 26(1) provides that disputes “*shall, if possible, be settled amicably.*” The types of dispute that are to be settled amicably in compliance with Article 26(1) include alleged breaches of the obligations owed by a State under Part III of the ECT. Article 26(2) states that one of the dispute resolution mechanisms thereunder can be invoked if disputes arising under Part III “*can not be settled...within a period of three months from the date on which either party to the dispute requested amicable settlement, the Investor party to the dispute may choose to submit it for resolution...*”.

220 Therefore, the primary goal of the dispute resolution mechanism is settlement (disputes “*shall...be settled amicably*”). The word “*shall*” is not permissive, but mandatory and obligatory. This is clarified by the caveat (“*shall, if possible*”), which assumes that settlement may not always be forthcoming. In this case, where one party has requested amicable settlement and this has not been settled within three months of such notification, the Investor may submit the dispute for resolution in accordance with the terms of the remainder of the article. As to the nature of those settlement discussions, it is settled under international legal principles that they must be conducted in good faith.

²⁰⁴ Statement of Defence dated 21 November 2011, section 7.

²⁰⁵ Energy Charter Treaty dated 1994, Article 31 (1) (**Exhibit C-203**).

221 The importance of amicable settlement is clear not only from the words of the ECT but also from its purpose, which requires cooperation in the energy sector. As the tribunal noted in *Amtco v Ukraine*:

*“The purpose of the Energy Charter Treaty includes the promotion of long-term cooperation in the energy field, based on complementarities and mutual benefits, in accordance with the objectives and principles of the Charter. This purpose is facilitated by the amicable settlement of disputes...[Article 26(2)] is an important element of the dispute resolution process and is a manifestation of the cooperation in the energy sector that is at the heart of the ECT.”*²⁰⁶

222 Therefore, under Article 26(2) of the ECT notice of the relevant dispute must be given together with the positive obligation on the parties to attempt to settle within three months of that notice before the right to invoke one of the dispute resolution options (set out in Article 26(2)(a) to (c)) even arises.

223 In this sense, then the ECT differs from other investment treaties which may simply require the parties to seek a resolution through negotiation, without requiring the submission of a specific notice (and simply requiring a certain amount of time to have elapsed since the dispute arose).²⁰⁷ Given this, the phrase “*waiting period*” used by Claimants is a misnomer since in fact, Article 26(2) requires the parties to take active steps to settle the dispute. This is not a case where the parties are required to “sit it out” or wait until the time has passed before pursuing more formal dispute resolution.

²⁰⁶ Limited Liability Company *Amtco v. Ukraine*, Arbitration No. 080/2005, Final Award, 26 March 2008, para. 50. (**Exhibit C-334**).

²⁰⁷ Therefore, the ECT requirements differ from those in, e.g. the BIT between Argentina and United States, Article VII(3) which states: “*Provided that the national or company concerned has not submitted the dispute for resolution under paragraph 2 (a) or (b) and that six months have elapsed from the date on which the dispute arose, the national or company concerned may choose to consent in writing to the submission of the dispute for settlement by binding arbitration..*” (**Exhibit R-232**).

2. There was no notice of amicable settlement or an amicable settlement prior to the Request for Arbitration

224 Though the facts need not be considered in a case where the meaning of the words is clear, this interpretation is also correct when considering the specifics of the current case. Prior to the Request for Arbitration, which was submitted on 26 July 2010, the Republic had no notice (express or otherwise) of the imminent arbitration proceedings to be launched against it, nor of the dispute (as set out in Article 26(1) of the ECT) to be referred to arbitration. Indeed, how could they when it was on 22 July 2010, not five days beforehand that the contracts, allegedly owned by Claimants, terminated? It is such contracts, and their termination, that largely form the basis of the current dispute. It is inconsistent with the aims of the ECT for a respondent State to be ambushed by proceedings of a serious and complex nature. This is what the precise wording of the ECT is designed to avoid.

225 As discussed above, the “cooling-off” period runs from the date of the notification by the parties. In this case, there was no notification prior to the Request for Arbitration. In any event, even if the “waiting period” runs from the date on which Kazakhstan “*became aware of the dispute*”, as Claimants contend (at paragraph 67 of the Reply), this was not before the Request for Arbitration. Therefore, it is incorrect to say, as Claimants do, that the “waiting period” had been complied with by the time the Request for Arbitration was filed.

226 In this context, it is disingenuous to suggest, as Claimants do, that either the letter dated 18 March 2009 or the letter dated 7 May 2009 fulfilled the requirements of Article 26(2) of the ECT.²⁰⁸ Firstly, they both predate the majority of the events, which Claimants complain give rise to the alleged breaches of the ECT. Secondly, the ECT was not even mentioned in either letter. Thirdly, even if, which is denied, it could be established that these letters did constitute effective notice and it could be shown that the letters referred to any of the disputes currently before the tribunal, the letters are from TNG and Ascom respectively. These could only ever constitute effective notice in respect of those Claimants’ claims and certainly not in respect of KPM, Gabriel Stati or Anatolie Stati (who is allegedly an

²⁰⁸ Statement of Claim dated 18 May 2011, paras. 38 and 39 and the Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 68.

Investor under the ECT and Claimant in his own right). There is no suggestion (nor could there feasibly be on the facts) that any notice was given to the Republic of the dispute at any time prior to 26 July 2010, when the Request for Arbitration was submitted.

3. No offer to arbitrate

227 The wording of Article 26(2) of the ECT is clear. The dispute resolution provisions of Article 26(2) of the ECT may only be invoked if and when notification of the dispute has been given by one party to the other and the parties have attempted to settle. Where no notification for amicable settlement has been given and, moreover, no attempts to settle have been made prior to Claimants' attempts to invoke the dispute resolution mechanisms in 26(2)(c); the Republic's offer to arbitrate never arose.²⁰⁹

228 Claimants' focus on the need for procedural economy neglects these important considerations.²¹⁰ Moreover, it is somewhat distasteful for Claimants to rely on the needs of procedural economy in circumstances where they could quite easily have complied with the provisions of the ECT. This issue is not one of the Republic's making.

4. Cases Claimants rely on are not relevant for interpreting the ECT

229 Claimants cite the decisions of other tribunals to support their contentions that the "cooling-off" period is procedural and not jurisdictional in nature. However, since there is no doctrine of precedent in international investment treaty arbitration, each case must be dealt with separately in accordance with the particular treaty and particular facts in question. In any event, the treaties in the cases cited by the tribunal bear little resemblance to Article 26(2) of the ECT. For example, in *Lauder*, the Bilateral Investment Treaty (**BIT**) provides that:

²⁰⁹ *Adnan Amkhan*, Consent To Submit Investment Disputes To Arbitration Under Article 26 Of The Energy Charter Treaty, Investment Disputes To Arbitration [2007] Int.A.L.R. 65, 71: "The absence of an attempt to settle the dispute amicably within the prescribed period can be interpreted as the non-existence of the offer by a contracting party to arbitrate." (**Exhibit R-233**).

²¹⁰ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 56.

“(2) In the event of an investment dispute between a Party and a national or company of the other Party, the parties to the dispute shall initially seek to resolve the dispute by consultation and negotiation, which may include the use of non-binding, third party procedures. Subject to paragraph 3 of this Article, if the dispute cannot be resolved through consultation and negotiation, the dispute shall be submitted for settlement in accordance with previously agreed, applicable dispute-settlement procedures;

3. (a) At any time after six months from the date on which the dispute arose, the national or company concerned may choose to consent in writing to the submission of the dispute for settlement by conciliation or binding arbitration to the International Centre for the Settlement of Investment Disputes (“Centre”)... ”²¹¹

230 In this case, the obligation on the parties is to “*seek to resolve the dispute*” (somewhat less onerous wording than that of the ECT). No notice period is required, simply the passing of time. Also, it is noted on the facts that, a notice letter was sent prior to the Request for Arbitration (albeit only shortly before).

231 In *Wena*, the BIT between Egypt and the UK provided that “*if any such dispute should arise and agreement cannot be reached within three months between the parties to this dispute through pursuit of local remedies*” then the investor was permitted to submit its dispute to ICSID.²¹² Neither a notice nor amicable settlement is required by this clause. In any case, the jurisdictional objection in that case (which the Republic strongly maintains in this case) was abandoned and not argued out by the Republic and it is therefore not analogous to this case.

²¹¹ Treaty with the Czech and Slovak Federal Republic Concerning The Reciprocal Encouragement and Protection of Investment, 1992, Article VI. (**Exhibit R-234**).

²¹² Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Arab Republic of Egypt for the Promotion and Protection of Investments London, 11 June 1975, Article 8(1). (**Exhibit R-235**).

232 Again, in the *Western NIS* case, which featured the BIT between United States and the Ukraine, did not explicitly provide for notice (contrary to Claimants’ assertions that it did so provide):²¹³

“In the event of an investment dispute, the parties to the dispute should initially seek a resolution through consultation and negotiation. If the dispute cannot be settled amicably, the national or company concerned may choose to submit the dispute for resolution... in accordance with the terms of paragraph 3.

*3. (a) Provided that the national or company concerned has not submitted the dispute for resolution under paragraph 2 (a) or (b) and that six months have elapsed from the date on which the dispute arose, the national or company concerned may choose to consent in writing to the submission of the dispute for settlement by binding arbitration... ”*²¹⁴

233 In this case, the tribunal found that notice was not a jurisdictional requirement. This was presumably on the basis that there was no explicit requirement for notice as a prerequisite to dispute resolution under the BIT itself. It is submitted that its decision did not rest on the fact that notice was unimportant since the tribunal stated: “[p]roper notice is an important element of the State's consent to arbitration, as it allows the State, acting through its competent organs, to examine and possibly resolve the dispute by negotiations.”²¹⁵ In any event, the tribunal in *Burlington* considered similar wording and came to a different conclusion. Again there was no notice explicitly required under the terms of the BIT between Ecuador and the United States of America²¹⁶, however, the tribunal interpreted the BIT

²¹³ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 64.

²¹⁴ Treaty Between The United States Of America And Ukraine Concerning The Encouragement And Reciprocal Protection Of Investment, 1994, Article VI, 2 and 3. (**Exhibit R-236**).

²¹⁵ *Western NIS Enterprise Fund v. Ukraine* ICSID Case No. ARB/04/2, Order, 16 March 2006, para. 5. (**Exhibit C-352**).

²¹⁶ The Treaty between the United States of America and the Republic of Ecuador concerning the Encouragement and Reciprocal Protection of Investment, 1993, Article VI(2) requires that “the parties to the dispute should initially seek a resolution through consultation and negotiation.” Article VI(3) requires that that “six months have elapsed from the data on which the dispute arose” before a claim can be submitted to ICSID. (**Exhibit R-237**).

thus: “as long as no allegation of Treaty breach is made, no dispute will have arisen giving access to arbitration under Article VI. This requirement makes sense as it gives the state an opportunity to remedy a possible Treaty breach and thereby avoid arbitration proceedings under the BIT, which would not be possible without knowledge of an allegation of a Treaty breach.”²¹⁷ In that case, the “waiting period” had not been triggered because no allegations had been made of a breach of the BIT prior to the Request for Arbitration being submitted and therefore, the jurisdictional requirements of the BIT had not been fulfilled.

234 None of these cases concern breaches of the ECT and therefore they are not wholly relevant to the interpretation of Article 26(2) of the ECT. Unlike the definition of “investment” under Article 1(6) of the ECT, this is not an instance where general principles of international law demand a wider meaning; the words are specific and sufficient.

235 That said, if comparisons with other investment treaties are instructive to the tribunal, it is worth noting that the provisions of Article 26(2) of the ECT are not dissimilar to those in the BIT between Belgium and Burundi which provides that written notification of the dispute is required and the parties are required to attempt to settle the dispute amicably or through diplomatic channels before the dispute may be submitted to ICSID.²¹⁸ Notably, in the case which considered this BIT, Schreuer notes that jurisdiction was *not* established in respect of those disputes where the “cooling-off” period had not been satisfied.²¹⁹ Certainly, Article 26(2) of the ECT has more in common with this BIT than it does with the investment treaty cases relied upon by Claimants.

236 There is no doctrine of precedent in investment treaty arbitration. Even if decisions relating to previous cases have a definitive bearing on the tribunal’s decisions in this case, there a number of cases (including *Burlington* and *Murphy*) in which the tribunal characterised the

²¹⁷ **Exhibit R-187**, paragraph 335.

²¹⁸ Convention between the Belgo-Luxembourg Economic Union and the Republic of Burundi concerning the reciprocal promotion and protection of investments dated 13 April 1989, Article 8(2) and 8(3). (**Exhibit R-238**).

²¹⁹ C. Schreuer, *Travelling the BIT Route: Of Waiting Periods, Umbrella Clauses and Forks in the Road*, *The Journal of World Investment and Trade*, Vol 5, No. 2, April 2004, page 237. (**Exhibit R-239**).

requirement to negotiate as compulsory and / or jurisdictional in nature.²²⁰ In any case, the relevance of those cases identified by Claimants has not been made out. Therefore, it is not correct to say, as Claimants do (at paragraph 65 of the Reply) that the Republic has disregarded a “*well-established line of case law*” in favour of minority decisions.

5. The stay of the arbitral proceedings cannot be conflated with a “cooling-off” period

237 The timing of any settlement discussions between the parties is key to establishing whether or not the “cooling-off” period is satisfied. In this case, the settlement discussions occurred after the Request for Arbitration was submitted and therefore cannot be considered to fulfil the requirement for the “cooling-off” period.

238 Claimants missed the “cooling off” period and no notice was given to trigger access to the dispute resolution mechanism in Article 26(2). Such failures cannot be cured retrospectively. The investor has all the time in the world to bring the claim. The waiting period is also supposed to allow the State to properly react and to properly prepare its defence. If the waiting period is ignored, there is an imbalance. This imbalance cannot be remedied by staying the proceedings at a later point in time. The defence needs to be strong from the start. If it is not, it might be too late.

239 The Republic has been willing to settle this dispute. In fact, as Claimants assert in the Reply Memorial on Jurisdiction and Liability²²¹, it was the Republic who suggested settlement. This is not denied. The settlement period proposed by the Republic was always without prejudice to the jurisdictional issues that this defect could later cause.²²² At no time was this

²²⁰ For example, *Enron Creditors Recovery Corporation (formerly Enron Corporation) and Ponderosa Assets, L.P. v. Argentine Republic*, ICSID Case No. ARB/01/3, Decision on Jurisdiction, 14 January 2004, para. 88 and *Salini Costruttori S.P.A. and Italstrade S.P.A. v. Kingdom of Morocco*, ICSID Case No. ARB/00/4, Decision on Jurisdiction, 16 July 2001, paras. 15 and 16. (**Exhibit R-240**) and (**Exhibit R-223**).

²²¹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 74.

²²² Letter from Miriam Harwood to Professor Karl-Heinz Böckstiegel dated 18 January 2011, p.3 (**Exhibit C-350**): “*We offer this as a practical solution that best serves the interests of the parties notwithstanding the fact that this jurisdictional defect could result in dismissal after full briefing and hearing on the merits.*”

settlement window proposed as a waiver of the jurisdictional arguments on which the Republic continues to rely.

240 Police were in any way inappropriate or contrary to their powers.²²³

VI. The arbitration clause is invalid because of an ambiguous reference to the arbitral institution

241 As already set out in the Republic's Statement of Defence,²²⁴ the Republic is not bound to arbitration under the ECT. That is because the offer contained in Article 26(4) ECT is ambiguous and thus pathological.

242 The text in the Russian language refers to the Arbitration Institute of the International Chamber of Commerce, whereas the texts in other authentic languages (English, Spanish, Italian, German and French) refer to the Arbitration Institute of the Stockholm Chamber of Commerce, with both the text in the Russian language and the texts in the languages being equally authentic.²²⁵ This means that the offer contains indications for two different arbitration courts. The ambiguity of the offer stems from the irremovable discrepancy between the Russian and other authentic texts of Article 26 of the ECT.

243 The acceptance by the Investor of an ambiguous offer cannot result in the conclusion of a valid arbitration agreement. Hence, the alleged arbitration agreement between the Republic of Kazakhstan and Claimants concerning dispute examination in the Arbitration Institute of the Stockholm Chamber of Commerce does not exist. In this regard, the Republic maintains its arguments made with the Statement of Defence.

²²³ Statement of Defence, paragraph 26.5.

²²⁴ See Respondent's Statement of Defence, paras. 6.1 et seqq.

²²⁵ Cf. Article 50 ECT (**Exhibit C-1**).

C. FACTS

I. The alleged “Kazakhstan Playbook”

244 Claimants’ account of the “Kazakhstan Playbook” is nothing more than a fairytale. There is no “Kazakhstan Playbook” and certainly no campaign to expropriate Claimants’ investments by using these so-called “Playbook” tactics. For the reasons already set out in some detail in Part 3 of the Statement of Defence, and in this section C, Claimants’ Reply Memorial on Jurisdiction and Liability provides no evidence of a planned nor a concerted harassment of Claimants’ business by the Republic or any person or entity associated with the Republic. Instead, the Republic legitimately investigated Claimants, uncovering substantial legal and contractual violations, ultimately leading to a rightful and lawful termination of the Contracts. Any conspiracy theory which Claimants concoct cannot circumvent these facts.

245 Claimants’ “Playbook” theory is completely unsubstantiated and wholly dependant on defamatory opinions of the Republic’s oil and gas industry. Claimants fail to provide any factual evidence to support the existence or operation of a “Playbook”. Notwithstanding this, Claimants still draw the most inconceivable conclusions to fabricate their conspiracy. The expert report they largely rely on from Scott Horton does not assist them in this regard. Notwithstanding this, Claimants still deem it appropriate to make ludicrous comments about the Republic, including describing its political system as an “*advanced kleptocracy or a 21st-century dictatorship*”²²⁶. These statements are not only irrelevant and inappropriate but also fundamentally incorrect.

246 The “Playbook” theory itself hinges on a misguided belief that the Republic harasses foreign investors by “*inspections, outrageous tax assessments, criminal prosecutions, fines, etc*”²²⁷ using the Financial Police and the

²²⁶ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 371.

²²⁷ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 365.

Kazakh courts and through coercing the investors to renegotiate their contracts, to “*make all these problems go away*”.²²⁸ Claimants state that the motives for the Republic’s “conduct” are to enhance President Nazarbaev’s “*personal wealth and power of himself and his allies*”²²⁹ including Timur Kulibayev and to “*weaken political opponents of President Nazarbayev by eliminating their sources of income*”²³⁰. For the reasons set out below, each of these alleged tactics of harassment employed and motives for doing so are completely unfounded. Furthermore, the farcical manner in which Claimants seek to associate this theory with the very legitimate action taken by the Republic against them is completely misleading. Although Claimants’ various legal and contractual violations will be addressed in other parts of this Rejoinder Memorial on Jurisdiction and Liability, the Tribunal should not, in any event, be persuaded that this “Kazakhstan Playbook” that Claimants have concocted exists.

1. The Republic does not harass foreign investors as part of a “Playbook”

a) Financial Police

247 As part of this supposed “Playbook” harassment of foreign investors, Claimants argue that the Financial Police “*often play a prominent role*” given their “*wide-ranging powers*”²³¹. This completely mischaracterises the purpose and role of the Financial Police. The Financial Police are not only entitled but also obliged by law to investigate and prosecute financial crimes. This would evidently include carrying out investigations of subsoil users that have potentially committed such offences, particularly when they receive information that indicates that an offence may have been committed, as is the case in relation to Claimants²³². The Financial Police certainly do not set out to “harass” foreign investors. The procedure which the Financial Police went through when investigating Claimants is set out in section C.II.2. and from this it is quite clear that there was nothing untoward in their investigations and inspections. The Financial Police held

²²⁸ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 370.

²²⁹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 372.

²³⁰ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 373.

²³¹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 367.

²³² Second Witness Statement of Mr. Turganbayev, paras. 2.3 to 2.4.

a genuine and legitimate belief that Claimants had committed serious offences.

248 Claimants further argue that the Financial Police are somehow directly controlled by President Nazarbayev and act as his “instrument” to coordinate multi-agency investigations and to ensure that more independent agencies reach the conclusions he desires.²³³ This is quite simply ludicrous. It is very telling that Claimants provide no evidence in support. This is because President Nazarbayev does not directly control the Financial Police in the manner Claimants describe. To the contrary, over the past few years the Financial Police has become an accountable agency, headed up by professional security officials, independent from the executive²³⁴.

249 In any event, for the reasons set out in section C.II.2., President Nazarbayev certainly did not control the Financial Police’s investigation of KPM and TNG nor did he use the financial police to coordinate the investigation. It is absurd to believe that he would even be interested in what was effectively a very minor investment.²³⁵

b) Kazakh courts

250 Claimants further argue that the Kazakh courts form part of this harassment given that they are “dominated” by the executive. This is quite simply wrong. The executive certainly does not ensure a pre-determined outcome in the courts and Claimants provide absolutely no evidence to that effect.

251 It is baffling that Claimants believe they can credibly conclude from their argument that the “rule of law” in Kazakhstan is allegedly weak, that the judiciary is somehow controlled by the executive and therefore plays a role in their fairytale “Playbook”. It is also not at all clear what Claimants are trying to achieve by referring to an un-sourced quote on the hypothetical impact of criminal allegations and prosecutions of investors²³⁶. It certainly has no relevance to the Republic or to this case at all.

²³³ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, paras. 365 and 367.

²³⁴ Professor Olcott Expert Report dated 7 August 2012, para. 24.

²³⁵ Professor Olcott Expert Report dated 7 August 2012, para. 177.

²³⁶ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 369.

252 The Tribunal should note that major steps have been taken in recent years to reform the judiciary. This has not been sufficiently noted by western observers of the Republic²³⁷. Allegations that the judiciary is not independent are generally based on accounts which are far more complex than those that have allegedly suffered injustices portray. As Olcott explains:

*“the Kazakh judicial system is only partially reformed, and it is certainly possible to point out instances in which there have been seeming injustices. **In virtually all of these cases though, the story behind the seeming injustice is more complex than the “victim” portrays. I have done research and have written about all of the various allegedly political trials or instances of exile listed in Scott Horton’s report, including that of Akezhan Kazhegeldin, Mukhtar Ablyazov, and Mukhtar Zhakishhev, and would be happy to answer questions about them, however I see no parallels between the experiences and background of the men and those of the Stati family.**”*²³⁸ (emphasis added)

253 Furthermore, the Kazakhstan constitution expressly refers to the independence of the judiciary and the separation of powers between the executive, legislature and judiciary.

254 Claimants provide absolutely no evidence that the executive was controlling or influencing the courts as part of this alleged harassment of KPM and TNG. Further, it is clear from sections C.IV. and C.VIII. that such an inference cannot be drawn.

c) Alleged aim to renegotiate contracts or purchase a substantial equity stake in companies owned by foreign investors

255 Claimants argue that on the backdrop of this “harassment” of foreign investors the next tactic the Republic employs as part of its concocted “Playbook” is to make it clear that *“the renegotiation of a contract or the*

²³⁷ Professor Olcott Expert Report dated 7 August 2012, para. 34.

²³⁸ Professor Olcott Expert Report dated 7 August 2012, para. 59.

sale of a substantial equity stake to KMG (or another Kazakhstan-owned entity) will make these problems go away.”²³⁹

256 The relevance of this to Claimants’ conspiracy theory is at best confusing. Claimants themselves assert that the Republic was seeking to renegotiate subsoil contracts and/or acquire equity interests in the mid-2000s, as it believed that the subsoil use contracts granted in the 1990s were too generous²⁴⁰. Even if this was the case, there is nothing untoward with the Republic legitimately re-negotiating subsoil use contracts and/or national companies acquiring interests in companies that had rights to exploit its subsoil. It certainly cannot be seen as part of some “Playbook” conspiracy against foreign investors.

257 Claimants provide four examples of when this “tactic” has been employed on companies since the mid-2000s²⁴¹. However, with each of these, they fail to establish that the alleged charges and sanctions imposed were illegal or even incorrect. Furthermore, they provide no evidence that there was a conspiracy against these investors nor do they prove that the so-called “Playbook” was being used against them.

258 In any case, the examples are not comparable at all. Instead, it is quite clear that the companies involved had very serious problems of their own and had violated the terms of their contracts and Kazakh law, which meant that contractual renegotiation and/or other state assistance was necessary. As explained by Olcott:

“The three major giant oil and gas projects, Tengizchevroil, Karachaganak and Kashagan have all had their share of problems over the past twenty years, some the result of the technical difficulties of developing these fields, some the result of difficulties within the consortia (this is particularly true of Kashagan) and some the result of changing expectations of the Kazakh government itself [...].

²³⁹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 370.

²⁴⁰ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 364.

²⁴¹ Tengizchevroil, Agip KCO, Karachaganak Petroleum Operating BV and Caratube International Oil Company.

Kashagan was originally supposed to enter production in 2008, then 2010, now 2013, and the substantial delays on this project opened the door for the Kazakh government to press for renegotiation of the terms of this project [...].

The differences of opinion between the government of Kazakhstan and the consortium that was developing Karachaganak were substantially more complicated than presented in the complainants case. The development of the third stage of that project meant substantially deferred income for the Republic which would enjoy substantial royalties from the continuation of stage two. The ability of the Republic to acquire a share in the project made the delay of earnings more acceptable.”²⁴²

259 Except for the *Caratube* case (which was in any event dismissed)²⁴³, none of the examples Claimants have provided have led to international law proceedings. As Olcott notes, this case is quite different:

“The case of Caratube International Oil Company has already gone through one arbitration (in which Scott Horton served as an expert for the complainant and I was an expert for the Republic) and is very dissimilar from Kashagan and Karachaganak. It is a very small deposit, in which there had been very little investment, whose sub-soil license was held by relatives of Rakhat Aliyev, and as it is a potential case for further arbitration it would be inappropriate to comment further.”²⁴⁴

260 It is clear from section C.II.5. below that there was nothing untoward about the bids for TNG and/or KPM made by companies supposedly associated with the Republic or Timur Kulibayev. Certainly the bids did not conform with the “Playbook” tactics which Claimants raise here in a flimsy manner at best.

²⁴² Professor Olcott Expert Report dated 7 August 2012, paras. 203 to 205.

²⁴³ IAR article, Vol. 5, No. 11 dated 14 June 2012 (**Exhibit R-241**).

²⁴⁴ Professor Olcott Expert Report dated 7 August 2012, para. 206.

2. The motives Claimants describe for the Republic using the “Playbook” are fictional

a) Alleged motive of enhancing Timur Kulibayev’s power and wealth

261 Claimants argue that one of the motives for using the so-called Playbook is to enhance President Nazarbayev and his allies’ wealth. In particular, they describe the President’s son-in-law Timur Kulibayev as a “*clear beneficiary of this scheme*”²⁴⁵.

262 The relevance of this to the so-called “Playbook” is again confusing. Claimants provide no evidence that Playbook tactics have been used to either directly or indirectly benefit Mr. Kulibayev through a sale or transfer of assets or shareholdings in companies owned by foreign investors to him or to companies he owns. Without this evidence, it is difficult to see how they can credibly argue that this is a motivation for any alleged harassment.

263 In any event, Mr. Kulibayev is far from this omnipotent figure in the Kazakh regime as Claimants describe. He was recently even dismissed from his position at Samruk-Kazyna.²⁴⁶ Furthermore, his role as a manager and state servant of companies such as KazMunaiGas NC (which is not privately owned but state owned) is quite different to his very separate business interests. As Professor Olcott explains:

*“There is plenty of oil held in non-government hands (including some in Kulibayev’s) but growth of KMG is not a history of Kulibayev’s personal enrichment, but of the development of what is intended to be a world class national oil company. KMG seeks to be an international player, which means that it is required to observe transparency in its practices.”*²⁴⁷

264 Claimants certainly provide no evidence that the Republic was trying to coerce them into selling their investments to entities owned or controlled by Mr. Kulibayev. This is dealt with in section C.II.5. below, which makes

²⁴⁵ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 372.

²⁴⁶ Professor Olcott Expert Report dated 7 August 2012, para. 30.

²⁴⁷ Professor Olcott Expert Report dated 7 August 2012, para. 208.

clear that the allegations are another unsupported aspect of Claimants' concocted conspiracy.

b) Alleged political motives

265 Claimants' assertion that there were political motives for using "Playbook" tactics against Claimants is even more bewildering.

266 First, Claimants again fail to provide any evidence to support their bold assertion that "*Kazakhstan frequently uses this harassment playbook to weaken political opponents of President Nazarbayev by eliminating their sources of income.*"²⁴⁸ Without this, it is difficult to see how they can argue that this is a motivation for using the "Playbook" with any credibility.

267 Second, by Claimants' own admission Anatolie Stati is not a political opponent of President Nazarbayev. He has no interest in Kazakh politics and any attempt to twist the political dynamic to make it applicable to him is at best fanciful. As Professor Olcott comments:

*"Scott Horton spent a great deal of time describing the relationship between government and opposition in Kazakhstan, a topic that I have written on extensively in other places, I find it hard to see the relevance of this discussion to the current case. Anatoli and Gabriel Stati are not from Kazakhstan nor did either Stati have any direct political ties to any serious Kazakh political figures---either pro or anti-government."*²⁴⁹

268 Third, the fact that President Voronin saw Anatolie Stati as a political adversary is wholly irrelevant and certainly does not lead to any conclusion that President Nazarbaev had political reasons for allegedly using "Playbook" tactics against Anatolie Stati. The content of the letter from President Voronin which allegedly triggered the investigations of KPM and TNG is considered further in section C.II.1. below. As Olcott notes, it is clear that the letter did not present the Republic with an "irresistible

²⁴⁸ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 373.

²⁴⁹ Professor Olcott Expert Report dated 7 August 2012, para. 61.

target”, as Claimants assert,²⁵⁰ to use the “Playbook” against Anatolie Stati’s investments:

“Neither this letter, nor the rather vague comments made by Voronin about some earlier query by Nazarbayev (dealt with more explicitly below) suggest that Nazarbayev was looking for a pretext to investigate Stati and his investments (Horton paragraph 171).

*The etiquette of dealings between CIS leaders, and formal communist officials is such that, **the kind of letter that Voronin sent would have required some sort of follow-up, and this is what Nazarbayev did; he asked the appropriate officials to investigate. That is all he did.** His note was just a formulaic bureaucratic instruction to “look into this” and ascertain if the investor involved posed a risk to Kazakhstan. **There is nothing in the note that gives any evidence of any sort of “plot” by the Kazakhs to terminate their subsoil license.**”²⁵¹ (emphasis added)*

269 Upon investigating Claimants’ “investment” the Republic discovered serious violations of Kazakh law committed by KPM and TNG. Clearly, the “Kazakhstan Playbook” has only been concocted by Claimants to divert the Tribunal’s attention from this. The fact that the Statis were engaging in such activity is unsurprising given the manner in which they went about investing in the oil and gas sector in other countries.²⁵² As Olcott explains:

“Certainly, as the history of the Stati businesses as developed in Moldova, Turkmenistan and South Sudan suggests, the Stati family was not used to playing on a level playing field. They were close confidants of the leaders of three of Moldova’s political parties (all derived from the leadership of the Communist Party of the Moldovan S.S.R.). Although bad terms with the Communist Party of Moldova (the fourth party based on

²⁵⁰ Reply Memorial on Jurisdiction and Liability dated 7 May 2012 para. 373.

²⁵¹ Professor Olcott Expert Report dated 7 August 2012, paras. 176-177.

²⁵² See sections B.III. and B.IV. above.

*the old CP MSSR), the Stasis were generally presumed to be benefactors of the other three, and they made use of these connections to create a safety net under their operations in other countries. **Voronin’s letter inevitably triggered a series of investigations that eliminated their special privilege. But the loss of special privilege is not evidence of discrimination.***”²⁵³ (emphasis added)

c) Alleged aim to renegotiate contracts or purchase a substantial equity stake in companies owned by foreign investors

270 Claimants argue that on the backdrop of this “harassment” of foreign investors “*Kazakhstan invariably makes it clear that the renegotiation of a contract of the sale of a substantial equity stake to KMG (or another Kazakhstan-owned entity) will make these problems go away.*”²⁵⁴

271 The relevance of this to Claimants’ theory is at best confusing. Claimants themselves assert that the Republic was seeking to renegotiate subsoil contracts and/or acquire equity interests in the mid-2000s, as it believed that the subsoil use contracts granted in the 1990s were too generous²⁵⁵. Even if this was the case, there is nothing untoward with the Republic taking these actions and it certainly cannot be seen as part of some “Playbook” conspiracy against foreign investors.

II. Alleged campaign initiated by President Nazarbayev upon receipt of letter from President Voronin

1. President Voronin’s letter

272 Claimants’ suggest that the note with which President Nazarbayev forwarded the Moldovan President Voronin’s letter for further

²⁵³ Professor Olcott Expert Report dated 7 August 2012, para. 212.

²⁵⁴ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 370.

²⁵⁵ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 364.

investigation²⁵⁶ is proof of a campaign against Claimants.²⁵⁷ Their argument fails for several reasons.

273 First of all, a simple reading of the note shows that it is a pro-forma document with which a complaint by another head of state is forwarded to the competent authorities. As Professor Olcott explains:

*“The etiquette of dealings between CIS leaders, and formal communist officials is such that, the kind of letter that Voronin sent would have required some sort of follow-up, and this is what Nazarbayev did; he asked the appropriate officials to investigate.”*²⁵⁸

274 Second, had this not been a request from another CIS head of state, there is hardly any chance that President Nazarbayev would have paid attention to Claimant’s activities, given their small size. In recent years, President Nazarbayev has withdrawn more and more from dealing with investors and in any event, the management of assets or the assignment of rights to assets has always been the work of the appropriate ministries.²⁵⁹

275 Third, for anyone familiar with the political alliances in post-soviet countries, it seems implausible that President Nazarbayev would take the side of President Voronin rather than the side of Anatoli Stati. As Professor Olcott explains:

“If President Nazarbayev were to have any bias in this case it would likely have been with Stati rather than with Voronin. Stati was close to Luchinskii [a close ally of Stati], who Nazarbayev certainly knew and must have known quite well as Luchinskii was First Secretary of the Communist Party of Moldova from 1989-1991, corresponding to Nazarbayev’s appointment as First Secretary of the Communist Party of Kazakhstan. By contrast Voronin was simply head of the Ministry of

²⁵⁶ President Voronin’s letter with President Nazarbayev’s note (**Exhibit C-8**).

²⁵⁷ Reply on Jurisdiction and Liability dated 7 May 2012, paras. 210 et seqq.

²⁵⁸ Expert Report of Professor Olcott, para. 177.

²⁵⁹ Expert Report of Professor Olcott, paras. 177 et seq.

Internal Affairs in Moldova at the time, and certainly not Nazarbayev's pre-independence equal."²⁶⁰

276 In order to let President Nazarbayev's note seem improper, Claimants allege that "*Voronin's allegations had nothing to do with Kazakhstan, and would not have amounted to criminal behavior even if true.*"²⁶¹ Apparently, Claimants have not read Voronin's letter closely. It very clearly states:

*"Concealing his profits from the previous activity conducted in Romania and Turkmenistan in offshore international areas, he is now presenting himself as a foreign investor in Kazakhstan."*²⁶²

277 With this statement, President Voronin accused Mr. Stati of concealing profits from the states where these profits were being made. Clearly, this had to be important to the authorities since even under a narrow reading this meant that potentially, taxes were being withheld from the Republic. Against this background, it would have been careless not to inspect.

278 Further, Claimants allege that the Republic "*did not investigate the actual allegations contained in Voronin's letter.*"²⁶³ With regard to the concealment of profits, this is obviously not true: As Claimants admit, the authorities indeed inspected whether tax payments had been made properly.²⁶⁴ Thus, this allegation by President Voronin was clearly taken up by the authorities. In any event, given the grave charges made by President Voronin, there was no reason to limit the scope of inspections to one specific area. Allegations of concealment of profits as well as allegations of an engagement in war-torn areas certainly merited a thorough checking of KPM's and TNG's activities.

279 Also, with one inspection giving rise to a suspicion of breach of the law, further investigation is of course justified. The financial police was of

²⁶⁰ Expert Report of Professor Olcott, para. 180. For an explanation of the Stati–Luchinskii connection, see *ibid.*, paras. 101 et seqq.

²⁶¹ Reply on Jurisdiction and Liability dated 7 May 2012, para. 211.

²⁶² President Voronin's letter with President Nazarbayev's note (**Exhibit C-8**).

²⁶³ Claimants' Reply on Jurisdiction and Liability, para. 213.

²⁶⁴ Cf. Claimants' Reply on Jurisdiction and Liability, para. 213.

course free to rely on other aspects proven by the inspections to open the criminal investigations.²⁶⁵

2. The authorities' inspections and checks/audits were normal and legal

a) Introduction

280 A central plank of Claimants assertion that there was a coordinated campaign to harass KPM and TNG are their allegation regarding audits and inspections. Claimants litter their pleadings with references to such events under emotive headings such as "*The State's Final Inspection Blitz*".²⁶⁶ (SoC Part V A 1). The various inspections are presented as a continuous presence with a single purpose originating with the Resolution of President Nazarbaev in October 2008 and building to a crescendo just prior to the termination of KPM and TNG's contracts in July 2010.

281 In reality, the position was quite different. In this section the Republic seeks to address the overall impression which Claimants seek to create with their allegations concerning audits and inspections, whilst dealing with a number of specific allegations raised about the conduct of particular audits and inspections.

282 On closer scrutiny it is apparent that, rather than a constant barrage of seemingly random inspections, there were two actually principal phases of inspections of KPM and TNG. Each phase was initiated for unconnected reasons by different organisations and for different purposes. In each case the outcome was also different. In fact, the only things that the two phases had in common was that they were lawful, they concerned KPM and TNG and they revealed breaches by those companies of various legal obligations.

283 The first phase of inspections took place in October to November 2008 and responded to the concerns of President Nazarbayev concerning KPM and TNG that were highlighted in the letter of President Voronin of Moldova. Those inspections were instigated by the Financial Police and were intended to establish whether there was any truth in President Voronin's allegations. The principal result of the first phase of inspections was the

²⁶⁵ Second witness statement Turganbayev and Rakhimov.

criminal prosecution of Mr Cornegruta for illegal entrepreneurial activity which was concluded in September 2009. The first phase of inspections also resulted in a number of assessments of taxes and duties by the Tax Committee and Customs Committee.

284 The second phase of inspections took place in June and July 2010 and responded to complaints by residents of Mangystau Region that KPM and TNG were not fulfilling their obligations to employees and to comply with legislation and their subsoil use contracts. Those inspections were instigated by the General Prosecutor's Office and were intended to establish whether there was any truth in the complaints. The second phase of inspections discovered a string of infringements by KPM and TNG of their contractual and other legal obligations. Certain of those infringements ultimately lead the MEMR to terminate KPM and TNG's subsoil use contracts, prior to transferring the companies' subsoil assets into trust management.

285 Whilst it is correct that there were other inspections taking place in the period between November 2008 and July 2010, they were principally a continuation of the processes set in motion by the inspections of October and November 2008, in particular the criminal investigation which involved inspections on 30 December 2008 and May 2009. Those further inspections shared the justification and objective of the initial inspections in October and November 2008 and are not, as Claimants suggest, further examples of random harassment by the Republic.

b) Culture of inspection

286 It is important to understand that subsoil users will always be subject to a relatively high level of scrutiny. It is simply a feature of that business. As Mr Kravchenko, the Deputy General Prosecutor of the Republic, notes in his witness statement:

“9.1 The area of subsoil use being the basis of the economic security of the Republic of Kazakhstan is under constant supervision of the state regulatory authorities. From this point of view, a subsoil user is aware about the

*importance of the mineral resources for the state and he understands that his activity will be scrutinized by the state.*²⁶⁷

287 In other words, the Republic regulates the activity of sub-soil users closely due to the significance of sub-soil resources to the Republic's economic security and it makes no secret of the fact.

288 As the Republic pointed out at length in the Statement of Defence, the high level of scrutiny is advertised in KPM's and TNG's contracts and licences including:

- (a) the obligation to disclose information to competent authorities;
- (b) the obligation to maintain records;
- (c) the right of competent authorities to undertake inspections and
- (d) the right of competent authorities to visit KPM and TNG's premises for inspections.²⁶⁸

289 As set out in the Statement of Defence, those contractual rights are re-enforced by legislative rights of inspection and audit contained in law including:

- (a) the "Code of Administrative Violations of the Republic of Kazakhstan" 2001;
- (b) the "Law on Subsoil" 1996 and 2010;
- (c) the "Rules of monitoring and enforcement of the conditions of subsoil use contracts" 2007;
- (d) the "Code on taxes and other mandatory payments to the budget" 2001; and
- (e) the Law on "National Bank of the Republic of Kazakhstan".²⁶⁹

290 However, those rights are required to be exercised within a legal framework so that the rights of individuals and companies are not

²⁶⁷ Second Witness Statement of Andrey Kravchenko para 9.1.

²⁶⁸ Statement of Defence dated 21 November 2011, paras. 20.10 to 20.14.

²⁶⁹ Statement of Defence dated 21 November 2011, paras. 20.15 to 20.22.

infringed. That framework is supervised by the General Prosecutor's office as Mr Kravchenko described:

“3.1 The General Prosecutor's Office (GPO) exercises the highest supervision over implementation of laws and regulations in Kazakhstan. It oversees the legality of operational investigations, inquiry and preliminary investigation, administrative and enforcement proceedings. It takes measures to identify and eliminate any violations of laws and regulations. It represents the state's interests in the court and conducts prosecutions.

3.2 The Department for Supervision over the legality in the socio-economic sphere (hereinafter - Department) of the GPO is responsible for compliance with law in the social-economic sphere and exercises in this field the highest supervision over the compliance with the laws in the activities of all public bodies, including ministries and departments. Where the GPO finds non-compliance with the laws of the Department, it submits proposals and other acts of prosecutorial response.

3.3 In its practices, the Prosecutor's Office relies upon article 83 of the Constitution of the Republic of Kazakhstan from August 30, 1995 having direct effect, the Act of the Republic of Kazakhstan "On Prosecution Service" dated December 21, 1995, as well as internal decrees of the Prosecutor General of the Republic of Kazakhstan detailing the Prosecutor's activities, including the Decree of the Prosecutor General of the Republic of Kazakhstan No. 60 “Concerning the Organisation of the Prosecution Supervision of the Application of Laws, Observance of Rights and Freedoms of Citizens in the Social and Economic Spheres” dated November 21, 2002 (which was in force until October 01, 2010. On October 01, 2010, the Decree of the Prosecutor General of the Republic of Kazakhstan No. 60 “Concerning the Organisation of the Prosecution Supervision of the Application of Laws, Observance of Rights and Freedoms

of Citizens in the Social and Economic Spheres” was issued).

3.4 The GPO also exercises the highest supervision over the legality of the activities of organizations, corporations and legal entities, including the activities of commercial organizations, as well as non-governmental organizations and associations.

3.5 In addition, the GPO protects the rights and freedoms of citizens, as well as the rights of businessmen in Kazakhstan.”²⁷⁰

291 As the Republic has previously demonstrated²⁷¹, KPM and TNG were not subjected to any greater degree of scrutiny that other subsoil users and as Mr Kravchenko notes:

9.2 The General Persecutor’s office maintains records of inspections carried out by the state authorities of the Republic of Kazakhstan.

9.3 The analyses of statistical data on inspections rebuts the arguments of the Claimants, that the inspections conducted by state authorities in respect of KPM and TNG were unprecedented. For example, on the basis of official information on inspections of subsoil users in Mangistau region for the period from 2001 to 2010: KPM was inspected 88 times, TNG - 100 times, "Karazhanbasmunai" - 246 times, "Mangistaumunaigaz" - 298 times, "Uzenmunaygaz" - 390 times, "Emir Oil" - 76 times.

9.4 In 2008 alone the inspections were conducted in respect of: KPM - 6 times, TNG - 11 times, "Karazhanbasmunai" - 13 times, "Mangistaumunaigaz" - 24 times, "Uzenmunaygaz" - 77 times, "Emir Oil" - 9 times.

²⁷⁰ Second Witness Statement of Andrey Kravchenko, paras. 3.1 to 3.5.

²⁷¹ Statement of Defence dated 21 November 2011, paras. 20.23 to 20.33.

9.5 "Uzenmunaygaz" belongs to the national (state) company; however, it was inspected more frequently than the TNG and the KPM.

9.6 Despite the transfer of assets of the Claimants to the state company in trust, the trustee - the branch of JSC "Marine Oil Company" KazMunayTeniz" was subject to inspections by the public authorities 3 times by August 2011.

9.7 Summarizing the above said, no inspection in respect of Claimants' companies did go beyond the average inspections for the region.²⁷²

c) Criminal inspections/investigation

292 Of course some of the inspections of KPM and TNG were not within the framework of routine inspections carried out as part of the normal supervision of the activities of subsoil exploitation. The inspections in October and November 2008 and those forming part of the ensuing criminal investigation were additional to the normal inspection regime that a subsoil user can expect, but were nevertheless justified and lawful.

293 Those inspections were motivated by the need to investigate allegations of potential criminal behaviour. Once such an allegation has been brought to the attention of the Financial Police, as Mr Turganbaev notes:

"The Financial Police is legally required under Article 24 of the Law on Financial Police to undertake complete and objective inspections following receipt of information that a criminal offence may have been committed. This necessitates a wide range of inspections. If such inspections are not fully or properly carried out, the GPO can discipline the relevant Financial Police Officers, if there were later found to be any irregularity in the inspections. As such, the inspections ordered in this instance were completely standard in the circumstances.

²⁷²

Second Witness Statement of Andrey Kravchenko, paras. 9.1 to 9.7.

In my experience inspections of a similar breadth and frequency have been undertaken in relation to other companies.”²⁷³

294 The results of those inspections were then reviewed by a separate department of the Financial Police before any decision was taken as to whether there was sufficient information to take matters further. As Mr Rakhimov, an inspector with the Financial Police, states that review concluded that there was sufficient evidence that a criminal offence had been committed

“3.1 After I had thoroughly and objectively examined the materials of pre-investigation inspections received from a Senior Inspector Turganbaev, I concluded that there were reasonable grounds to believe that KPM was operating a main pipeline without a licence which was a crime pursuant to Article 190 of the CPC of the RoK (the exercise of entrepreneurial activity without a licence). Therefore, on 15 December 2008, I opened a criminal investigation against KPM and issued a relevant Resolution.

3.2 My decision to open a criminal investigation against KPM was based on the following findings.

3.3 According to the Law of the Republic of Kazakhstan "On Licensing" the operation of a main pipeline needs to be licensed. From the materials of pre-investigation inspections, I learnt that on 13 June 2008, KPM applied to the Agency of the RoK for Regulation of Natural Monopolies (ARNM) for re-issuance of a license for the right to perform operations in the field of mining, petrochemical, chemical, oil- and gas- refining business, operation of gas-, oil- and oil products storages. In its application, KPM listed a number of activities for which it required a licence including the operation of main

²⁷³

Second Witness Statement of Danyar Turganbayev, para. 7.2.

pipelines (C-115). This indicated to me that KPM believed it was operating a main pipeline.

3.4 In its reply dated 14 July 2008 to the aforementioned application, the ARNM informed KPM that in order for it to acquire the license for operation of a main pipeline, KPM must submit the documents according to the Rules for licensing (C-480).

3.5 Also amongst the pre-investigation inspection materials was a letter dated 4 December 2008 from the Ministry of Energy and Mineral Resources (MEMR) to the Financial Police in which the MEMR confirmed that it had not issued a licenses to KPM or TNG for the operation of main pipelines (C-422).

3.6 I examined the pipeline project documentation, and found out that KPM had been operating the pipeline at least since 2005. However, the company applied for a license only in 2008. My suspicions grew when I discovered that KPM tried to disguise its application for a license for operation of a main pipeline in the application for a re-issuance of the license.

3.7 In addition, there was an expert report on the pipeline operated by TNG in the materials of the pre-investigation inspections. According to this report, TNG's pipeline was a main pipeline. The technical characteristics and functions of this pipeline were similar to the characteristics and functions of the pipeline operated by KPM.

3.8 Amongst the materials of the pre-investigation inspections was report No.2262 from a Chief Expert of the Regional Scientific and Production Forensic Laboratory of Astana dated On 28 November 2008, according to which the income derived by KPM from the operation of the main pipeline without a license amounted to 41 166 014 544 Tenge (C-452).

3.9 After considering all aforementioned findings, I decided that there were reasonable grounds to believe that KPM committed the crime under Article 190 of the CPC of the RoK and that I had to carry out an objective investigation.”²⁷⁴

295 It is clear therefore that the inspections of October and November 2008 identified evidence of criminal offences. Furthermore, this assessment was made independently of the individuals that had undertaken the inspections as Mr Turganbayev confirms:

“6.1 The inspections revealed a potential breach of criminal law. In this instance all files involved in the inspection were passed over to Mr Rakhimov for the purpose of deciding whether there was sufficient evidence to open a criminal investigation. I was not involved in the process of assessing whether the contents of the various inspection files justified the opening of a criminal investigation.”²⁷⁵

296 Furthermore, that review concluded that certain findings of the inspections should not be pursued in the criminal investigation²⁷⁶, which is clear evidence for the fact that the Financial Police took a reasonable proportionate approach to investigating KPM and were not simply out to get the company by any means as Claimants suggest.

297 In relation to the development of the investigation of the a criminal offence relating to the unlicensed operation of a main pipeline, Mr Rakhimov comments further:

“4.3 Pursuant to Article 117 of the CPC of the RoK, the following circumstances, together with other mandatory circumstances, shall be subject to proof:

²⁷⁴ Second Witness Statement of Arman Rakhimov, paras. 3.1 to 3.9.

²⁷⁵ Second Witness Statement of Daniyar Turganbayev, para. 6.1.

²⁷⁶ Resolution of the Financial Police not to open an investigation dated 18 May 2009 (**Exhibit-242**).

(a) The event and the elements of a crime under criminal law (time, place, method and other circumstances of commission of a crime);

(b) who committed an act prohibited by the criminal law;

(c) nature and amount of harm caused by the crime,

4.4 Therefore, the following circumstances were subject of proof in this criminal investigation:

(a) a classification of the pipelines,

(b) profits received from the operation of the pipelines without a licence,

(c) a subject of the crime, i.e. a person who committed the alleged crime.”²⁷⁷

298 It is clear therefore that the continuation into 2009 of the initial inspection from October and November 2009 was a structured attempt to gather the evidence necessary to develop the case, rather than an unguided capricious exercise of power. As Mr Rakhimov describes, it included the following steps which align with the objectives set out above:

4.5 On 25 December 2008, we interviewed Mr. Cornegruta (General Manager of KPM) and on 4 February 2009 we interviewed Mr Cojin (General Manager of TNG). At that time they were interviewed as witnesses rather than suspects or Defendants because we had not reached a conclusion as to who should be a defendant yet. Written records of both interviews were prepared.

...

4.7 I recall the first visit to Borankol, Tolkyn fields and Opornaya st. which took place in December 2008. This involved an inspection of the pipelines themselves. The purpose of the inspection was to specify the process of

²⁷⁷

Second Witness Statement of Arnam Rakhimov, paras. 4.3 and 4.4.

production, refining and further transportation of hydrocarbon material. Another purpose was to make sure that the pipelines match the documents describing their construction, placement and other physical features. After this the pipelines were arrested by the Financial Police, with the approval of prosecutor, in order to be secured as evidence.

...

4.9 The purpose of the searches in KPM's and TNG's offices on 06 May 2009 and 07 May 2009 was to find data related to these companies and their finances. This can be seen from the record of materials seized during the course of the inspection of 06.05.2009 and 07.05.2009 (C-114) which relate principally to employment records, the whereabouts of certain senior employees and the financial affairs of the companies.

...

5.1 In addition to the factual evidence obtained during the course of the inspections and investigation of KPM and TNG, it was also necessary to obtain expert evidence to support the charges against KPM and TNG. Expert opinion was required to support the claim that the pipelines were trunk pipelines and also to support the calculation of illegal profits earned as a result of their operation.”²⁷⁸

299 Claimants allege that these legitimate efforts to gather evidence for the case were some form of vindictive harassment carried out simply for the purpose of making life difficult for KPM and its employees. It is clear from the above that the purpose of the Financial Police's work was really diligent pursuit of evidence for a criminal prosecution i.e. their job. However it is also clear that Claimants misrepresent the character of these investigations as sinister and threatening. As Mr Rakhimov explains that is far from the truth.

²⁷⁸

Second Witness Statement of Arman Rahimov, paras 4.5, 4.7, 4.9 and 5.1.

300 In relation to the visit to KPM's premises at the end of December 2008 he says:

*"4.8 I recall that representatives of KPM and TNG willingly assisted us with our inspection despite the fact that the inspection took place in deep snow and poor weather. We explained our duties, and they understood that our actions were required by the law and the nature of an investigation, and they were very helpful in providing descriptions of various physical and technical features of the pipelines. The employees were cooperative and I do not recall any complaints being made in the course of this inspection."*²⁷⁹

301 In relation to the search of KPM and TNG's premises on 6 and 7 May 2009, which Claimants portray as a militaristic act of oppression he says:

"4.9 The purpose of the searches in KPM's and TNG's offices on 06 May 2009 and 07 May 2009 was to find data related to these companies and their finances. This can be seen from the record of materials seized during the course of the inspection of 06.05.2009 and 07.05.2009 (C-114) which relate principally to employment records, the whereabouts of certain senior employees and the financial affairs of the companies.

4.10 I attended these searches. I have seen the first witness statement of Mr Veaceslav Stejar in which he describes the course of those searches. I do not agree with his description because members of our investigative group acted properly.

4.11 I visited the offices with five or six other members of the Financial Police. I recall that the number of KPM's and TNG's security services members was greater than the number of the Financial Police officers. Moreover, I and my officers were not armed while KPM's and TNG's security personnel were armed. It is correct that I was not

²⁷⁹

Second Witness Statement of Arman Rakhimov, para. 4.8.

wearing uniform but several other members of my team did.

4.12 I am surprised that Mr. Stejar now claims that the search was carried out in a bullying and intimidating manner. To the contrary, the search was conducted in a proper manner. I recall that Mr. Stejar and employees of KPM and TNG co-operated with us. We appreciated their co-operation and likewise tried, to the extent possible, not to create inconveniences and difficulties.

4.13 By this time everybody knew that Mr Cornegruta had been arrested and I wanted to make sure that nobody panicked because of the search. Therefore at the beginning of the search, I asked all the employees of KPM and TNG to gather in the main board room. I respectfully asked everyone to remain calm, showed my identification and explained what the purpose of the search was. I recall that Mr. Stejar agreed that our proposal to inform the employees and calm them down was reasonable. And later on, to the extent possible, we tried not to disrupt the companies' operation.

4.14 For example, during the search, in order to avoid misunderstandings while seizing certain documents, we asked employees to stay directly at their working places. Then I identified those employees who lived locally and who had families and children waiting for them at home so that we could search their offices first and let them go home.

4.15 It is correct that while waiting for their offices to be searched, employees had to wait outside their offices with the doors closed and an officer of the Financial Police was placed in each corridor. However, all employees were provided with chairs so they were not forced to stand. This is a standard procedure the purpose of which is to ensure that documents are not destroyed or concealed. This procedure is generally accepted and it is

not intended to cause suffering, discomfort or harm to anybody.

4.16 I did not say anything about the use of "special forces" nor did I call for "additional forces". Also, I am not aware that anyone else called for the support of special services. In fact, I could have arrived with armed officers and seized all documents and computers in the office. However, I chose to take a less aggressive approach because I did not want to create inconveniences or disrupt the companies activities.

4.17 One of the KPM and TNG security guards made an attempt to videotape the search and I stopped him from doing so. Then I explained to the head of the security service that this was not acceptable as the Financial Police are the only people entitled to record the search, which we did. However, I neither threatened nor intimidated the head of the security service or the employees of KPM and TNG and I certainly did not threaten to make employees face the wall if it happened again.

4.18 Mr. Stejar was asked to sign the record of the search and he did so willingly. We neither intimidated nor threatened him to make him sign the document.

4.19 The search of Mr. Cornegruta's apartment described by Mr. Stejar is also quite different from the style in which the Financial Police undertakes such searches. Mr. Stejar tries to depict our officers in a negative light. Even though I did not attend the search of the apartment and the search was conducted by other investigators under my instruction, I am confident to say that while conducting this search our officers behaved properly.

4.20 Our officers tried to cause as little disturbance as possible. According to the Financial Police officer who participated in the search, it was limited to the safe in the

*apartment which was opened by Mr. Stejar himself. However, as Mr Stejar confirms, we took nothing from it.*²⁸⁰

302 It is clear from Mr Rakhimov's measured account of this search that far from seeking to harass KPM and TNG and to intimidate their employs, the Financial Police went out of their way to avoid these possibilities.

303 From the above it will be apparent that Claimants colourful allegations of harassment and threats by a militaristic police force are a wild exaggeration.

304 However, stepping back from this detail, it is also clear that from a structural point of view Claimants' allegation that the inspections and criminal investigation were undertaken as part of a coordinated campaign to harass KPM and TNG are quite wrong. Rather, from detailed accounts of Mr Turganbaev and Mr Rakhimov it is apparent that the inspections of October and November 2008 and the resulting criminal investigation in 2009 were

- (a) part of a clearly structured and regulated process applicable to all such inspections and investigations and not specific to KPM or TNG;
- (b) conducted pursuant to clear rights and obligations of the Financial Police in relation to the investigation of allegations of criminal conduct;
- (c) motivated by the obligation on the Financial Police to investigate such allegations and not by any desire to harass KPM or TNG; and
- (d) not connected in any way with the subsequent inspections of KPM and TNG in June and July 2010.

d) Inspections in June and July 2010

305 Unlike the inspections in October 2008 and the first half of 2009 that were initiated by the Financial Police as a result of allegations of criminal behaviour, the inspections in June and July 2010 were initiated by the General Prosecutor's office in relation to complaints that KPM and TNG

²⁸⁰ Second Witness Statement of Arman Rakhimov, paras. 4.9 to 4.20.

had infringed the rights of their employees as well as breaching a number of contractual and legislative obligations. Contrary to Claimants' case their timing had nothing to do with the introduction at around that time of the new subsoil legislation. This is explained by Mr Kravchenko the Deputy General Prosecutor of the Republic as follows:

“7.1 On June 28, 2010 the GPO of the Republic of Kazakhstan received a complaint from Mr. Sadyrbaev, Mr. Makashev, Mr. Esenov, and Mr. Sagindikov about violations in the activities of KPM and TNG, related to non-payment of salaries, mass dismissal of employees, failure to comply with environmental legislation and legislation on subsoil use and requesting the GPO to take measures to prevent the loss of deposits and to establish a stable social environment. According to the petition, the individuals who submitted it were residents of the Beyneu District of Mangystau Province, where the Tolkyn and Borankol oil deposits as well as the KPM & TNG oil exploitation infrastructure were situated.

7.2 The residents have appropriately addressed the Prosecutor General's Office, as the questions raised by the applicants could be resolved by the Prosecutor General's Office, considering these questions' wide scope. Namely, residents reported of mass employee dismissals, failures to comply with the requirements towards deposits' exploitation, and the necessity to stabilise the situation on KPM & TNG.

7.3 With that, the obligation to conduct a comprehensive inspection follows from the requirements placed on subjects reviewing the petitions to provide an objective, comprehensive review of the physical persons' petitions as instructed by article 9 of the Law of the Republic of Kazakhstan "Concerning the Procedure for Handling Petitions of Physical Persons and Legal Entities" dated January 12, 2007.

7.4 At that difficult time civil society exerted strong pressure on state institutions, requiring the restoration of violated labor rights of workers, whose requests went to all existing authorities. Due to the economic crises of that period, the GPO has been heavily exercised prosecutorial supervision in social vulnerable areas.

7.5 Every company, which had delays in payment of salaries, was perceived, and still is being perceived as a signal to the GPO, requiring the immediate restoration of the violated labor rights of workers. In early 2010, the total due on salaries throughout the Republic amounted to 4.6 bil. tenge. Presently, our collaborative efforts managed to reduce the due amount to 1.6 bil. tenge. Examples of other complaints and inspections similar to those concerning KPM and TNG include ,in December 2008 in Almaty Province, violations of the labour, pension, and migration legislation were discovered at AO "Transstroykost" including a 2-month delay in the payment of salaries and mandatory pension contributions. ”²⁸¹

306 In response to the complaints it received, the General Prosecutor’s office instructed a number of agencies to undertake inspections of KPM and TNG. However, Claimants exaggerate the number of agencies involved by referring to individual sub-departments within agencies as if they were separate agencies in themselves. Mr Kravchenko explains these steps as follows:

“7.6 Taking into account:

(a) available information on the facts of the delay in payment of salaries to workers of TNG and KPM in February to March 2010;

(b) the previous record of complaints against KPM and TNG, including involvement in breaches of environmental regulations in 2004 to 2008 relating to storage by the

²⁸¹

2nd Witness Statement of Andrey Kravchenko. paras. 7.1 to 7.5.

subsoil users of drilling waste and a separate failure to pay salaries in February 2010; and

(c) the need for prompt resolution of complaints from Mr. Sadyrbaev, Mr. Makashev, Mr. Esenov, and Mr. Sagindikov,

the GPO took a decision to initiate and conduct full-scope inspections of KPM and TNG. This inspection was primarily aimed at protecting workers' rights.

7.7 The GPO therefore decided to organize the inspections of KPM and TNG in 2 forms:

(a) by a ruling by prosecutors to conduct the inspection; and

(b) By assignment of the inspection to the appropriate regulatory authorities, namely Ministry of Internal affairs, Ministry of Emergency Situations, MOG, Ministry of labor and social protection of population, Ministry of Environmental Protection, Ministry of Industry and New Technologies.

...

7.9 The inspections were appointed to be conducted by state bodies in consideration of the matters raised in the petition regarding non-payment of salaries, non-compliance with the legislation on environment and legislation on subsoil and subsoil use, and also in consideration of the request to take measures to prevent the loss of the deposit and stabilize the social situation.”²⁸²

307 Whilst Claimants complain at the number of agencies involved in the inspections, each was instructed because it had particular expertise relating to the subject matter of the complaint made against KPM and TNG²⁸³

²⁸² 2nd Witness Statement of Andrey Kravchanko, paras. 7.6, 7.7 and 7.9.

²⁸³ 2nd Witness Statement of Andrey Kravchenko, paras. 7.9 to 7.25.

308 Inspections undertaken by a number of agencies simultaneously is known as a complex or comprehensive audit. As Mr Kravchenko explains, the simultaneous inspection of all issues raised is intended to be less intrusive than a steady “drip, drip” of inspections:

“5.10 When the inspection of the activities of private entrepreneur relates to complex issues of compliance with laws and regulations of the Republic then such an inspection is considered as a full-scope/ comprehensive inspection.

5.11 When the inspection of the activities of private entrepreneur relates to discrete issues of compliance with laws and regulations of the Republic, then such an inspection is regarded as a thematic inspection.

5.12 Where many issues need to be investigated, a full-scope inspection is preferable to repeated thematic inspections, as the latter can stretch over long periods of time, distracting the entrepreneurs from their main work.

5.13 The use of full-scope inspections in the case of KPM and TNG reduced the overall number and duration of inspections in respect of these subsoil users and so reduce the interference with their work as far as possible.”²⁸⁴

309 These inspections were carried out at the request of the General Prosecutor’s Office and revealed a number of infringements by KPM and TNG that were recorded in the inspection reports of the investigating state agencies described by Mr Kravchenko as follows:

7.11 In the course of its inspection the Ministry of Environment Protection has discovered violations concerning unauthorised emissions, discharge of sewage water that is significantly polluting the environment, non-fulfillment of ecologists' earlier directives toward eliminating violations, non-performing of environmental monitoring activities, absence of record on waste, etc.

²⁸⁴

2nd Witness Statement of Andrey Kravchenko paras. 5.10 to 5.13.

...

7.13 The Ministry of Oil and Gas has discovered violations concerning failure to meet the target rates on drilling, non-fulfillment of exploratory works, failure to keep a record for flared gas metering, and non-fulfillment of obligations regarding accommodation and training of kazakh employees. The obligations regarding payment toward the decommissioning costs fund and reimbursement of past costs were not fulfilled either. The Ministry of Oil and Gas has sent notices to KPM and TNG to eliminate violations of the terms of the contract.

...

7.18 The Ministry of Industry and New Technologies (The Committee of Geology and Resource Exploitation, the Department of the Committee for Technical Regulation and Metrology) has discovered violations concerning non-compliance with project design, non-performing interference testing, oil influx profile investigations, determining inundation sources and intervals and of use of uncalibrated measurement tools.

...

7.21 The Ministry of Labor and Social Protection has discovered violations concerning personnel not receiving safety training, absence of orientation, delays in salaries in June 2010, compensation payments, employees being called back to work from vacation without consent. The Ministry of Labor has issued directives toward elimination of the discovered violations.

...

7.23 The Ministry of Emergency Situations has discovered violations regarding industrial and fire safety. These violations included non-completion of evaluation of industrial safety requirements by the company's

employees, absence of signal devices to control gas accumulation in the boiler plant facilities, non-fulfillment of earlier directives toward eliminating violations, non-completion of fire depot construction, absence of automated fire alarms, lack of individual protection gear, facilities, equipment, and other resources, as well as reserves for civil defence activities...

...

7.25 The Sanitary and Epidemiological Inspection authorities discovered violations concerning absence of medicaments in the KPM compressor department workshop. The Sanitary and Epidemiological Inspection authorities have composed a protocol regarding K. Shakabaev, the Head of the Compressor Department, and imposed a fine in the amount of 7,000 tenge”²⁸⁵

310 As Mr Kravchenko describes, those inspections were initiated lawfully and no contemporaneous complaint was received in relation to their conduct:

“7.27 Carrying out the above described actions we acted in accordance with Article 83 of the Constitution of the Republic of Kazakhstan, as well as Articles 5, 7, 20 Republic of Kazakhstan Law "On Prosecutor's Office" of 21 December 1995.

7.28 Because of the range of complaints made against KPM and TNG it was necessary to involve professionals with specialized knowledge of relevant areas of activity. This is related to the prosecutor's duty to provide objective, comprehensive examination of appeals of individuals as provided in Article 9 of the Law of the Republic of Kazakhstan "On the order of consideration of the requests from natural persons and legal persons" of 12 January 2007.

7.29 According to the current practice, the General Prosecutor's Office gets involved in the supervision over the legality of inspectoral measures taken by regulatory authorities, in case of

²⁸⁵

2nd Witness Statement of Andrey Kravchenko, paras 7.11, 7.13, 7.18, 7.21, 7.23 and 7.25.

appeal of the actions of the latter. However, no complaints about the actions of regulatory authorities with regard to the undertaken inspections have been received by the prosecuting authorities.

7.30 I would like to note that the inspections carried out in respect of KPM and TNG were of normal nature, since such work relates to the daily supervisory activities of prosecutors in ensuring the rule of law, as it is usually being done with respect to other subsoil users.”²⁸⁶

311 Claimants complain that the results of the inspections were not recorded in an Act of Inspection in time and, as such, they suggest that the results of the audit could not form the basis for the enforcement action which followed and in particular the termination of KPM and TNG’s contracts. However, as Mr Kravchenko explains the requirement to which Claimants refer does not apply to the GPO. Further, Acts of Inspection were in fact prepared and sent to the companies by the inspection authorities involved, such that KPN and TNG could have taken any action based on those documents. Additionally, Claimants complaint has never been raised with the General Prosecutor’s Office:

“8.4 The role of the prosecutor in this comprehensive inspection was limited to ensuring examination of all arguments of the applicants' complaints, by orienting regulatory authorities with respect to the raised questions and by compiling the information on the results of the inspections.

8.5 According to the Law of the Republic of Kazakhstan "On private entrepreneurship" of 31 January 2006 (as in force at the time of inspection of KPM and TNG), prosecution bodies did not belong (and currently do not belong either) to the state control and supervision authorities. Therefore, a requirement to draft an inspection report (para. 14 Article 38 of the Law of the Republic of Kazakhstan "On private entrepreneurship" of 31 January 2006) does not apply to prosecutors.

²⁸⁶

2nd Witness Statement of Andrey Kravchenko, paras 7.27 to 7.30.

8.6 *However, the actions and acts of the prosecution officer may be appealed to a senior officer or to the court, but KPM & TNG did not raise any challenge the inspections of the Prosecution Office authorities and governing bodies.*

8.7 *Considering the fact that the inspection in this case was organized with inspection tasks being assigned to authorised institutions, and that the prosecution officer conducted an inspection independently, the notes and acts on the results of the inspections were composed by each authorised institution independently.*²⁸⁷

312 In relation to Claimants complaint that Acts of Inspection were received too late for KPM and TNG to avoid termination of their contracts, it is notable that:

- (a) The issue of operating a main pipeline without a license, referred to in the MEMR's letters of 14 July 2010²⁸⁸, had been know to the companies since at least 18 September 2009 when Mr Cornegruta was convicted of the offence of illegal entrepreneurial activity²⁸⁹. Therefore ample time had been available to respond to the allegation;
- (b) The issue of non payment of taxes, also referred to in the MEMR's letters, had been known about since at least 8 and 9 September 2009 when the Astana City Court ruled against their challenge to the Tax Committee's assessment of corporate back taxes;²⁹⁰
- (c) Claimants admit that they received the MEMR's Act of Acceptance several days prior to the 19 July 2010 deadline set by the MEMR to reply to its notices of breach²⁹¹ and sufficiently in advance for Mr Calancea to conclude that "*Kazakhstan's allegations were essentially*

²⁸⁷ 2nd Witness Statement of Andrew Kravchenko, paras. 8.4 to 8.7.

²⁸⁸ Letters of the MEMR to KPM and TNG dated 14 July 2010 (**Exhibit C-2**).

²⁸⁹ Decision of the Aktau City Court dated 18 September 2009 (**Exhibit C-117**).

²⁹⁰ Statement of Claim dated 18 May 2011 para. 159 footnote 311.

²⁹¹ Reply Memorial on Liability and Jurisdiction dated 7 May 2012, para. 346.

groundless”²⁹² and for KPM and TNG to each provide 5 to 6 page responses to the MEMR’s notices.²⁹³

313 Further it is undeniable that infringements were found as a result of the inspections. These are recorded in the individual inspection reports that were provided to the General Prosecutor’s Office and to KPM and TNG.

314 Given the nature of the infringements found, any requirement to take remedial action was determined by the inspecting authorities, being the competent authorities in each of the areas of regulatory activity covered by the inspection.

315 It was therefore entirely proper that the MEMR was left to address the various breached of KPM and TNG’s subsoil use contracts that were revealed in this round of inspections.

316 Claimants make a number of specific allegations regarding MEMR’s termination of KPM and TNG’s subsoil use contracts on the basis of the results of the June and July 2010 inspections. Those allegations are addressed at Section C.IX. of this Rejoinder.

317 However, from a structural point of view, it is quite clear that the Claimant’s allegation that the inspections were a “*Final Inspection Blitz*” or in any way the culmination of a campaign of harassment by the Republic are unfounded.

318 The June/July 2010 inspections were prompted by complaints of infringements of employees’ rights by KPM and TNG that were first raised at the end of June 2010 and result from the obligation of the General Prosecutor’s Office to safeguard such rights. It is clear that they have nothing to do with any alleged campaign of harassment and are quite unconnected with

- (a) the complaint of President Voronin;
- (b) the Resolution of President Nazarbaev;
- (c) the inspections by the Financial Police in October and November 2008; and

²⁹² Witness statement of Mr Calancea para 5.

²⁹³ Letters from KPM and TNG to MEMR dated 19 July 2010 (**Exhibits C-24, C-25, C-26**).

(d) the criminal investigation and prosecution of Mr Cornegruta of 2009.

e) Conclusion

319 It should be entirely clear from the above that Claimants' attempt to weave a conspiracy theory from accounts of individual and unrelated inspections fails when proper scrutiny is applied.

320 KPM and TNG were subject to a number of inspections in the period from 2008 to 2010. However they were instigated by different organisations at different times and for different legitimate reasons. It is clear that there was no conspiracy involved.

3. In 2009 and 2010, the authorities were worried about the situation and sought to find a mutually agreeable solution

321 Several letters presented by Claimants prove that contrary to what Claimants seem to allege, the authorities were genuinely worried about the situation and attempted to find a mutually agreeable solution to the problems. Against this background, the notion of a campaign against Claimants is baseless.

322 As will be set out in more detail below,²⁹⁴ the so-called Tristan bonds, the financial crisis, drops in the energy prices and a substantial and uncontested tax debt had brought KPM and TNG in a precarious situation in mid-2009. Yet, KPM and TNG were important in the economic framework of the Mangystau region. The companies employed a considerable number of people.²⁹⁵ In addition, TNG was one of the major suppliers of gas for the local electricity plant. Hence, a failure by TNG to deliver could have materially affected the Mangystau economy.²⁹⁶ For this simple reason, high ranking politicians were worried about the situation of the companies since the summer of 2009. Hence, they tried to ensure that the companies would not simply fall into bankruptcy by developing plans for a government involvement. Obviously, there is nothing sinister about this and comparable

²⁹⁴ See below section C.X.

²⁹⁵ Witness Statement of Mr. Suleimenov, para. 2.29.

²⁹⁶ Ibid.

things have happened in many countries in the aftermath of the 2008 financial crisis.

323 To begin with, Mangystau Governor Kuserbayev²⁹⁷ was interested in finding a mutually agreeable solution to the problems that arose.

324 As is evidenced by a letter he sent to Prime Minister Massimov on 24 February 2010, Governor Kuserbayev tried to broker a compromise in the conflict by submitting a proposal made by Anatoli Stati to the Prime Minister.

325 According to Mr. Stati's proposal, Claimants were to finish the construction of the LPG plant if claims against KPM and TNG were to be dropped.²⁹⁸ After having explained Mr. Stati's proposal, the letter ended with the words: *"In connection therewith, deeply respected Karim Kajimkanovich, we shall kindly ask You to facilitate the adoption of a final decision on this matter."* Clearly, if Mr. Kuserbayev were only interested in somehow expropriating Claimants, he would not have submitted Mr. Stati's proposal.

326 The same can be concluded with regard to the letter the Governor sent to the Prime Minister in August of 2009.²⁹⁹ In this letter, the Governor expressly stated that he had "raised a question about making a decision regarding the state's buyout of assets of subsoil users". Governor Kuserbayev was hence not aiming at an expropriation but instead at a regular purchase of the companies because of the problems that were surrounding them. As the Republic's expert Professor Olcott explains:

"It was a letter from a governor of a province that was increasingly beset by labor problems, problems over which he had little capacity to resolve personally. His letter [...] asks for something to be done to remedy the

²⁹⁷ His official title is "Akim of the Mangystau Oblast".

²⁹⁸ Letter from the Akim of Mangystau Oblast to the Prime Minister, K.K. Masimov, dated 24 February 2010 (**Exhibit C-665**).

²⁹⁹ Letter from the Akim of Mangystau Oblast to the Prime Minister, K.K. Masimov (**Exhibit C-293**).

problem, and his advice is that the State purchases these assets.”³⁰⁰

327 MEMR was also not trying to take over Claimants’ assets for free. This is confirmed by the letter from MEMR to the Ministry of Industry and Trade dated 28 September 2009.³⁰¹ In this letter, MEMR rejected any notion of a “gratuitous transfer of assets” of the companies.³⁰² Instead, the letter said:

“In the nearest time, the Ministry together with KMG is planning to initiate negotiations with the owners of “Tolkynneftegas” LLP and “Kazpolmunai” LLP regarding further acquisition of their assets.

*In connection with the aforesaid, the ministry recommends the akim of Mangystau Oblast together with “NWF Samruk-Kazyna” JSC and KMG to examine the issue about acquisition of assets of “Tolkynneftegas” LLP.”*³⁰³

328 In fact, this is precisely what happened in the following. As Mr. Suleimenov explains, KMG NC started negotiations with Claimants for the sale of KPM and TNG. Again, this was not for the interest of personal gain of individuals or of KMG NC as a whole but instead because of the potential for social tension in the Mangystau region. As Mr. Suleimenov from KMG EP explains:

“I was told by the responsible people at KMG NC that because of social tension in the Mangystau region and because of the importance of gas supply to the local station and possible disruptions in the heating season, KMG NC was interested in the transaction in this so-called “white knight” role.”³⁰⁴

³⁰⁰ Expert Report of Professor Olcott, para. 187.

³⁰¹ Letter from MEMR to the Ministry of Industry and Trade of the Republic of Kazakhstan dated 28 September 2009 (**Exhibit C-294**).

³⁰² See also Respondent’s Statement of Defence dated 21 November 2011, para. 19.26.

³⁰³ Letter from MEMR to the Ministry of Industry and Trade of the Republic of Kazakhstan dated 28 September 2009 (**Exhibit C-294**).

³⁰⁴ Witness Statement of Mr. Suleimenov, para. 2.30.

- 329 Strangely, Claimants still try to twist the contents of MEMR’s letter to the Ministry of Industry and Trade so as to suggest that it hinted at some kind of state intent to simply take over the assets.³⁰⁵ Claimants’ arguments to that end do not withstand scrutiny.
- 330 Firstly, it is not correct that the letter shows that the Republic wanted to take control of the companies “*all along*”.³⁰⁶ As is set out at the beginning, the letter was a reaction to a letter from Mangystau Governor Kusherbayev³⁰⁷ who, as explained above, was addressing the central government with regard to the problems of the companies at the time. Hence, MEMR’s letter only proves that in summer and autumn of 2009, MEMR was aware of the companies’ problems and was considering ways to find a solution.
- 331 Secondly, nothing else follows from the Cliffson offer. Claimants spuriously insinuate that at the time of the letter, the state would have known that Claimants would not accept its allegedly too low offer because of the much higher Cliffson offer.³⁰⁸ Supposedly, the argument is that this excludes any serious intention to purchase the companies. Yet, MEMR’s letter was written in September 2009. The Cliffson offer, on the other hand, was made only in February of 2010.³⁰⁹ Obviously, there is no way the Cliffson offer could have been taken into account in September 2009.
- 332 Further, with regard to the highest level of government, President Nazarbayev’s instruction of 19 November 2009 also reflects that the President was genuinely worried about the status of the companies and tried to find a solution to the crisis. Far from pursuing any sinister plans, he asked the responsible authorities “*to revisit these issues in view of anti-crisis measures of the Government*”.³¹⁰ This was purely helpful to KPM and TNG.³¹¹ Hence, contrary to what Claimants suggest, President

³⁰⁵ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, paras. 225 et seq.

³⁰⁶ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 225.

³⁰⁷ Letter from MEMR to the Ministry of Industry and Trade of the Republic of Kazakhstan dated 28 September 2009 (**Exhibit C-294**).

³⁰⁸ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 226.

³⁰⁹ Cliffson Sale Agreement dated 13 February 2010 (**Exhibit C-540**). See also Reply on Jurisdiction and Liability dated 7 May 2012, para. 418.

³¹⁰ Attachment to the Letter from Blagovest President to MEMR, dated 7 February 2010 (**Exhibit C-23**).

³¹¹ See also Expert Report of Professor Olcott, para. 187.

Nazarbayev’s instruction does not show that he wanted “*to strip the companies of their assets, while maintaining the assets operational.*”³¹² A simple reading of the instruction confirms that President Nazarbayev not even hinted at anything of that sort.³¹³

4. The Blagovest letter

333 In their Reply memorial, Claimants repeat their extraordinary argument that the so-called Blagovest letter³¹⁴ was proof of a campaign initiated by the Republic in order to gain control over KPM and TNG.³¹⁵ It is worth looking at Claimants’ arguments in detail because they are a perfect example of Claimants’ flawed way of reasoning and their tendency to bend the facts so as to make them fit to their theories.

334 According to Claimants, the fact that Yuri Zakharov, the president of the so-called Blagovest fund, in February 2010, suggested a number of measures to resolve the solution surrounding KPM and TNG (among those also the establishing of control over KPM and TNG), logically entails that since 2008, Kazakhstan had engaged in a campaign to take over these companies.³¹⁶ In doing so, Claimants apparently insinuate that the Blagovest fund is a public entity closely connected to Kazakhstan because it is a so-called “public fund”.

335 However, nothing could be further from the truth. So-called public funds are not state-controlled but private entities.³¹⁷ They are called “public” or “social” funds simply because they serve some specific public interest.³¹⁸ Obviously, it is absurd to consider as proof of an alleged state intent to take over KPM and TNG the fact that the president of such a private entity, without being addressed first by the authorities, writes on his own initiative to the Minister of Energy and Mineral Resources and makes all kinds of

³¹² Statement of Claim dated 18 May 2011, para. 182.

³¹³ Letter from Blagovest President to MEMR, dated 7 February 2010 (**Exhibit C-23**).

³¹⁴ Letter from Blagovest President to MEMR, dated 7 February 2010 (**Exhibit C-23**).

³¹⁵ See Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 224; Statement of Claim, paras. 15, 181 et seq.

³¹⁶ Statement of Claim dated 18 May 2011, para. 181.

³¹⁷ Statement of Defence dated 21 November 2011, para. 18.16, referring to the relevant provisions of Kazakh law.

³¹⁸ Ibid.

wild suggestions. There is simply no connection between Mr. Zakharov and the Republic and the opinions and statements of Mr. Zakharov cannot be attributed to the Republic.³¹⁹

336 Interestingly, however, there is a link between Mr. Zakharov and Claimants. Blagovest is a Cossack charitable fund.³²⁰ The Stati family has been involved in the reconstruction of Russian Orthodox churches for which Claimant Gabriel Stati has even received an order from the church. As Professor Olcott concludes, this may have been what led Mr. Zakharov to try and mediate the dispute.³²¹ This is also in line with what Mr. Zakharov stated himself, namely that he had been approached by Mr. Andreyev, then general director of KPM.³²²

337 Spuriously, Claimants try to link Mr. Zakharov to the Republic by arguing that with his February 2010 letter, he responded to an instruction by President Nazarbayev from 19 November 2009.³²³ Claimants omit to mention that neither Blagovest nor Mr. Zakharov were addressees of the instruction. As Professor Olcott explains, the fact that the instruction is attached to the letter “creates the erroneous impression that Mr. Zakharov had intimate knowledge of these proceedings.”³²⁴ And as Mr. Zakharov himself stated, the letter as well as the attachments were prepared by Mr. Andreyev.³²⁵

5. Alleged attempts to acquire KPM and TNG by the Republic or by influential people within the Republic

338 In their Reply Memorial on Jurisdiction and Liability, Claimants make various assertions arising out of alleged attempts to purchase KPM and TNG by companies associated with Timur Kulibayev³²⁶. In particular, they assert that:

³¹⁹ See already Statement of Defence dated 21 November, paras. 18.19, 19.26.

³²⁰ Expert Report of Professor Olcott, para. 183.

³²¹ Expert Report of Professor Olcott, para. 185.

³²² Witness Statement of Yuri Zakharov, para. 7.

³²³ Statement of Claim dated 18 May 2011, para. 181.

³²⁴ Expert Report of Professor Olcott, para. 186.

³²⁵ Witness Statement of Yuri Zakharov, para. 9.

³²⁶ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, section IV B.

- (a) Each of these companies are owned or controlled by Mr. Kulibayev;
- (b) Such companies made “lowball” offers for KPM and TNG;
- (c) After failing with their offers, the Republic attempted to coerce a sale of KPM and TNG to some of these companies by “harassing” them; and
- (d) On the back of these actions the Republic took over Claimants’ “investment”, for the benefit of Timur Kulibayev, without paying for them or giving any compensation³²⁷.

339 These arguments and assertions are quite simply delusional:

- (a) Claimants provide no evidence that Mr. Kulibayev owns or controls any of those companies;
- (b) The inferences they have drawn from the supposed low value of offers made are at best fanciful;
- (c) There is absolutely nothing to suggest that the Republic was in any way seeking to force a transfer of KPM and TNG to Timur Kulibayev, companies he is associated with or any other influential people within the Republic, nor is there anything to suggest the Republic had any interest in doing this; and
- (d) There is also absolutely no evidence to suggest that Mr. Kulibayev was somehow influencing the decision-making of the Republic.

340 For the reasons set out below, it is quite clear that Claimants’ arguments are no more than another attempt by them to frame what was a rightful termination of the Contracts and transfer of the contractual territories into trust management as some sort of fictional conspiracy against them. The Tribunal should not be deceived by this.

³²⁷

Reply Memorial on Jurisdiction and Liability dated 7 May 2012, paras. 373 and 417.

- a) Attempts to purchase KPM and TNG by GazImpex, KazRosGas and Starleigh
- 341 Claimants argue that two companies controlled by Mr. Timur Kulibayev, GazImpex³²⁸ and KazRosGas,³²⁹ tried to buy TNG in 2004 and 2007³³⁰ respectively and a further company, Starleigh³³¹ attempted to purchase both KPM and TNG in 2009. However, Claimants fail to prove that Mr. Kulibayev owned or controlled any of the companies in question. Claimants’ arguments are based on rumour and hearsay.
- 342 In any event, even if Claimants can prove that Mr. Kulibayev did control these companies, the inferences they draw from the bids are implausible and reliant on numerous unsupported assumptions. This is clear when considering each of the offers in turn.
- 343 The offer made by GazImpex for TNG in 2004 is irrelevant to this arbitration. It is clear from the facts Claimants set out themselves³³² that both GazImpex and Ascom (who was not even the owner of TNG at the time) entered into good faith negotiations for the sale of a 35% share in TNG. These negotiations broke down when GazImpex made an offer, based on a detailed analysis of the information it had,³³³ which was deemed too low by Ascom. From this, Claimants jump to the conclusion that “*this was Mr. Kulibayev’s first attempt to acquire Claimants’ investments at a bargain price*”. It was clearly not - GazImpex quite simply did not value the company as highly as Claimants did.
- 344 Even if this had been an attempt by GazImpex to buy TNG at a “bargain price”:
- (a) There is absolutely no evidence linking GazImpex’s bid to the Republic; and

³²⁸ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 375.

³²⁹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 376.

³³⁰ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, paras. 374 et seq.

³³¹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 416.

³³² Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 375 and Explanatory memoir regarding the purchase of a share-quota of OAO “Tolkynneftegaz” (TNG) dated 15 September 2004 (**Exhibit C-514**).

³³³ Explanatory memoir regarding the purchase of a share-quota of OAO “Tolkynneftegaz” (TNG) dated 15 September 2004 (**Exhibit C-514**).

- (b) The bid is completely irrelevant to any allegation that the Republic was trying to “coerce” Claimants to sell TNG to a company associated with Mr. Kulibayev. There is nothing coercive about one company bidding for another.

345 The offer by KazRosGas is similarly irrelevant. Again, from the facts Claimants have provided themselves³³⁴, KazRosGas expressed an interest in purchasing a shareholding in TNG. KazRosGas corresponded with Terra Raf on the potential share purchase in 2007, however there were no official proposals and negotiations. Once again this has absolutely no link to:

- (a) The Republic; and
- (b) Any allegations that the Republic was trying to “coerce” Claimants to sell to companies associated with Mr. Kulibayev. There is nothing coercive about a company expressing an interest in buying another company.

346 As to the Starleigh offer, Claimants somehow conclude that Mr. Kulibayev is linked to this company as:

- (a) Its offer for KPM and TNG was for the same amount as the offer made by KazMunaiGas National Company (five months before Starleigh’s offer)³³⁵; and
- (b) There is a letter which allegedly shows that Starleigh is a joint venture between Lakshmi Mittal and Merix International Ventures Ltd. Claimants state that it is “widely understood” that Mr. Kulibayev owns Merix International Ventures Ltd. However, they provide absolutely no evidence in support of this.

347 Clearly this is not evidence of Mr. Kulibayev owning or controlling Starleigh. Even if Mr. Kulibayev was involved in Starleigh, Claimants provide absolutely no evidence to support their remarks that Starleigh is:

- (a) Somehow linked to the Kazakh government³³⁶; and

³³⁴ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 376.

³³⁵ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 387.

³³⁶ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 414.

(b) Was involved (together with the Republic) in orchestrating a conspiracy against Claimants that would have enabled it to eventually obtain control of KPM and TNG without “*any payment through expropriation*”³³⁷.

348 Claimants provide no evidence as they have none. In any event, their argument makes no logical sense. If Starleigh genuinely believed it could somehow obtain KPM and TNG for no money at all³³⁸, it surely would not have made the very substantial bid it did at the time, which included dealing with the debt Claimants had amassed, which amounted to more than US\$500m.

349 Starleigh clearly made an independent assessment of what it believed the value of KPM and TNG was and based on this, made a bid for those companies. There was no attempt to “take advantage” of Claimants³³⁹. All of the problems which allegedly led to a decline in Claimants’ “investment” were effectively caused by themselves³⁴⁰.

b) Attempts made to purchase KPM and TNG by KazMunaiGaz Exploration Production (“**KMG EP**”) and KazMunaiGas National Company (“**KMG NC**”)

350 Claimants refer to bids made by KMG EP and KMG NC to support their fairytale “Playbook” theory that the Republic orchestrated “*a concerted attempt to coerce Claimants to sell their successful investments to KazMunaiGaz (or some other company owned by Timur Kulibayev) at a firesale price*”³⁴¹. However, their theory is flawed on a number of grounds.

351 First, Claimants refer to two very separate entities, KMG EP and KMG NC, simply as “KazMunaiGas”. This is misleading. They are two very separate entities and were involved in bids for KPM and TNG in completely different ways and at different stages:

³³⁷ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 416.

³³⁸ Notwithstanding that Starleigh had no connection to the Republic, its supposed harassment campaign and the “Playbook” conspiracy Claimants have concocted.

³³⁹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 417.

³⁴⁰ See section C.X. below.

³⁴¹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 373.

- (a) KMG EP is not a state entity. It is a separate legal entity with shareholdings in the company split between various investors.³⁴² KMG EP's shares are listed on both the London Stock Exchange and the Kazakhstan Stock Exchange and Global Depository Receipts (GDP). The company is therefore required to adhere to the stringent rules of those stock exchanges along with the various corporate governance requirements.³⁴³ Furthermore, it would evidently need to take into account the interests of all its shareholders, not simply those of KMG NC. KMG EP operates as a business and therefore its prime concern when carrying out investment activity is the commercial benefits of a deal;³⁴⁴
- (b) In contrast, KMG NC is a state entity. As such, its interests are very different to that of KMG EP. It considers the various social and economic implications of an acquisition and the potential impact and benefits of the deal to the Republic as a whole.³⁴⁵

352 Second, other than a passing reference to Timur Kulibayev being “Chairman”³⁴⁶, Claimants also provide no evidence that he had any interests in either of the above entities. He certainly does not own either of them as Claimants deceptively assert.³⁴⁷ Mr. Kulibayev was the Chairman of KMG NC but not of KMG EP. He therefore had no “control” over KMG EP and Claimants provide no evidence of his involvement in their bid.

353 Claimants also provide no evidence that Mr. Kulibayev was involved in KMG NC's bid. A managerial function in this entity is certainly not evidence that he orchestrated any attempt to purchase KPM and TNG. Nor is it evidence that he was directing or somehow influencing the Republic to coerce Claimants into selling KPM and TNG to KMG NC.

³⁴² This does include KMG NC, but also includes the Chinese fund CIC (which has an 11% holding) and various other public shareholders.

³⁴³ Witness Statement of Suleimenov dated 12 August 2012, para. 2.1.

³⁴⁴ Witness Statement of Suleimenov dated 12 August 2012, para. 2.30.

³⁴⁵ Witness Statement of Suleimenov dated 12 August 2012, para. 2.30.

³⁴⁶ Again, without specifying which entity he is or was chairman of and when he held that position.

³⁴⁷ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 373.

- 354 In any event, a sale of KPM and TNG to KMG NC would hardly lead to an enhancement of Mr. Kulibayev's wealth as Claimants allege³⁴⁸. KMG NC is a state owned company. It is not owned by Mr. Kulibayev. He would therefore have no personal financial interest in an acquisition of KPM and TNG.
- 355 Third, it is clear from the facts that neither KMG EP nor KMG NC were part of any alleged attempt by the Republic to force Claimants to sell KPM and TNG to entities allegedly owned or controlled by Timur Kulibayev.
- 356 KMG EP only actually bid for the companies after being invited to do so by Claimants themselves³⁴⁹. It is therefore astonishing for Claimants to consider KMG EP's involvement as being part of some concerted attempt to force Claimants to sell KPM and TNG to them for as low a value as possible. Claimants clearly wanted KMG EP to bid for KPM and TNG.
- 357 Prior to this, KPM and TNG were not even on the list of potential targets KMG EP was considering acquiring. KMG EP always tries to identify potential companies which may be worth investing in, in order to maximise its profits and benefit its shareholders.³⁵⁰ KMG EP made a very substantial bid of \$754m for the companies. The value of the bid was based on, *inter alia*, the very limited information it had been provided by Claimants.³⁵¹ Furthermore, the bid was well within the range of offers for KPM and TNG. It could by no means have been considered as "lowball". In any event, there is absolutely nothing untoward with one company submitting an indicative offer for another after being invited to do so.
- 358 Similarly, Claimants invited KMG EP to participate in the so-called second phase of Project Zenith³⁵², again undermining their argument that the Republic was "coercing" it to sell to KMG EP. As set out in Section C.XI. below, the value of the offer it made in June 2009 was based on the information it had following, *inter alia*, an analysis of the data room and the current market conditions. There is no plausible way for Claimants to

³⁴⁸ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 372.

³⁴⁹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 377.

³⁵⁰ Witness Statement of Suleimenov dated 12 August 2012, para. 2.3.

³⁵¹ See section C.X. below.

³⁵² Witness Statement of Suleimenov dated 12 August 2012, para. 2.12.

equate the value of KMG EP's bid with its "Playbook" theory³⁵³. Certainly the bid was not a form of harassment.

359 KMG EP withdrew from "Project Zenith" in July 2009 as it decided it was, inter alia, not commercially sensible to buy the assets.³⁵⁴ From this point onwards there can be no argument that KMG EP was trying to acquire Claimants.

360 As to KMG NC, the entity only expressed an interest in purchasing TNG and KPM in November 2009. As Suleimenov explains, KMG NC effectively took an interest in the assets in order to play a "white knight" role in resolving the issues Claimants had caused to its assets:

*"I was told by the responsible people at KMG NC that because of social tension in the Mangystau region and because of the importance of gas supply to the local station and possible disruptions in the heating season, KMG NC was interested in the transaction in this so-called "white knight" role. One of the important differences between KMG EP and KMG NC is that the national company has an interest in socio-economic factors given the fact that it is a State-owned entity whereas KMG EP is really only interested in the commercial aspects of the potential deal."*³⁵⁵

361 There is nothing to suggest that KMG NC was working with the Republic or in any way trying to coerce Claimants to sell KPM and TNG or take advantage of any alleged weaknesses in the businesses (which for the avoidance of doubt, was clearly caused by Claimants themselves)³⁵⁶. To the contrary, KMG NC was trying to find a solution in the best interests of the Republic, in light of the problems highlighted by Mr. Suleimenov above, which had all been caused by Claimants. Claimants again provide no evidence to support their conspiracy. It is quite clear therefore that the Republic did not try to force Claimants into selling KPM and TNG to KMG NC or any other companies supposedly associated with Mr. Kulibayev.

³⁵³ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 383.

³⁵⁴ Witness Statement of Suleimenov dated 12 August 2012, para. 2.28.

³⁵⁵ Witness Statement of Suleimenov dated 12 August 2012, para. 2.30.

³⁵⁶ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 414.

III. Poor conduct by Claimants was regulated by the Republic

362 The actions that the Claimants complain of that span from 2008 to 2010 comprise broadly of the following thematic events: (1) the inspection and audit of KPM and TNG's tax payments, (2) the non-extension of the 302 Contract, (3) investigations in relation to and the ultimate prosecution of Mr Cornegruta on behalf of KPM, (4) the termination of contracts 305 and 210.

363 Claimants' incredulous suggestion that these were all generated from a single letter has been addressed thoroughly above. The Republic has equally rebutted Claimants' notions that the investigation of Claimants' activities was in any way premeditated to generate the specific outcome of expropriation of KPM and TNG's assets, and moreover that this was part of the systematic harassment of foreign investors in the Republic.³⁵⁷

364 Having displaced these unsustainable arguments that the Republic acted in a way which was, procedurally inoffensive, it is plain to see that the acts that Claimants' light upon demonstrate a far more troubling reality: during the course of these 2 years, it became plain to the Republic that Claimants were simply not dealing with their investments in a lawful manner. This was to the detriment of the Republic, but ultimately also to themselves. More specifically, it was revealed that:

- (a) Claimants had failed and / or underpaid in relation to a number of taxes;³⁵⁸
- (b) Contract 302 had in fact expired despite Claimants' continued operation of the contract as if it were ongoing,³⁵⁹
- (c) The operation of one of their main pipeline was conducted without a licence and in flagrant disregard to its duty to be licensed for such activities;³⁶⁰ and

³⁵⁷ See Sections C.I and C.II.

³⁵⁸ See Section C.IV

³⁵⁹ See Section C.V

³⁶⁰ See Sections C.VI to C.VIII.

(d) Claimants breached the terms of their agreement with the Republic to deal with the Republic's natural resources in a way that sought to create a balanced outcome for both the investor and the state.³⁶¹

365 The Republic has explained in detail why poor behaviour of a subsoil investor does not trigger the benefits of the ECT.³⁶² These actions, together with the external factors and other deliberate acts of Claimants demonstrate that the Republic was not responsible for the negative consequences Claimants complain of. In so far as the Republic regulated the poor behaviour of the Claimants, it cannot be held to be in breach of the ECT. Deference should be applied to the State's conduct.³⁶³

IV. Tax, export duties and transfer pricing matters

1. Claimants' tax claims relate to Taxation Measures under the ECT

366 In relation to paragraphs 231 and 232 of the Reply Memorial on Jurisdiction and Liability it notable that Claimants effectively admit that Corporate Taxes, Export Duties and Transfer Price Taxes are Taxation Measures within the meaning of Article 21(7) of the ECT.

367 The Republic maintains its position, set out in paragraphs 30.19 to 30.36 of the Statement of Defence, that the Tribunal does not need to concern itself with the question of whether Taxation Measures amount to expropriation or are discriminatory. That is because the issue has been decided by the Competent Tax Authority in accordance with the provisions of Article 21(7).

368 Without prejudice to that position and without waiving any right to dispute the Arbitral Tribunal's jurisdiction in relation to Claimants' tax related claims, for completeness the Republic will nevertheless address the detail of Claimants' arguments in the Reply Memorial on Jurisdiction and Liability. In summary:

³⁶¹ See Sections C.I and C.IX.

³⁶² See Sections B.III.b).

³⁶³ See Section D.II.

(a) In relation to corporate back taxes

- Claimants mischaracterise the nature of the dispute. They allege that the Tax Committee ignored the tax stability provisions of KPM and TNG's contracts. In reality KPM, TNG and the Tax Committee applied the tax laws and regulations, but differ as their application, in particular in relation to the classification of expenses for taxation purposes.
- The main reason for additional taxes being assessed against KPM and TNG was that those companies unlawfully classified costs for geological exploration and prospecting works so that they could claim greater deductions from taxable income than they were entitled to under the tax stabilisation provisions of their subsoil use contracts.
- The companies had been shown to be guilty of the same offence in an audit covering an earlier period.
- The Tax Committee's assessment was clearly correct, considering was supported by the Supreme Court of Kazakhstan.
- Even if (which is strongly denied) the Tax Committee's assessment was incorrect, neither KPM nor TNG paid the taxes and therefore suffered no detriment as a result.
- Accordingly, these taxes cannot form the basis of any claim under the ECT.

(b) In relation to export duties:

- The 2008 duties were assessed to be lawful by the Aktau Economic Court. Even if the duties were unlawful there is no evidence that TNG paid any duties.
- KPM paid only \$700,000 in duties in 2008, a fraction of the \$10m that Claimants say it paid.
- The 2009 duties were withdrawn before either KPM or TNG made any payment. They caused no material prejudice to either company or Claimants

- With the exception of KPM's payment of duties on its 2008 exports, KPM and TNG resolved their complaints using the domestic legal forums. Therefore those complaints cannot be raised in this forum.
- In relation to KPM's payment of duties in 2008 . this cannot be the basis of any claims under the ECT, as \$700,000 is not a sufficiently material sum to a company like KPM to provide a foundation for such claims and nor for that matter is the \$10m for which Claimants contend.

(c) In relation to the transfer pricing audit:

- Claimants wholly misrepresent the character of the audit. KPM and TNG were subject to inspections for only 30 business days (as stipulated by law) not 13 months as Claimants suggest.
- There is no evidence presented by Claimants that the conduct of the transfer price audit had any material effect on KPM and TNG. In fact, the available evidence suggests that KPM and TNG were able to function normally and that Claimants had no difficulty in managing or controlling them in the period of the audit.
- The taxes imposed at the conclusion of the audit were not financially material to KPM or TNG.
- Finally, neither KPM nor TNG paid those taxes.
- Accordingly neither the audit nor the resulting charges can form the basis of any claim under the ECT.

2. Corporate back taxes

369 It is not clear whether Claimants' complaint in relation to audits and inspections encompasses the audit by the Tax Committee in November 2008, such is the effect of Claimants' "scatter gun" approach to complaining about audits and inspections. However, as is apparent from the statement of Nurlan Rahimgaliev, who was in charge of the audit, there can

be no complaint about the conduct of that audit. As Mr Rahimgaliev relates, the audit:

- (a) was conducted legitimately in response to a request from the Financial Police;³⁶⁴
- (b) lasted only 30 working days, as proscribed by law;³⁶⁵ and
- (c) involved no more than 5 members of the Tax Committee at any one time.³⁶⁶

370 Turning to the resulting tax assessment, Mr Rahimgaliev explains that, contrary to Claimants assertion, the Tax Committee did apply the tax stability provisions of KPM and TNG's contracts. When the Tax Committee considered KPM and TNG's records and tax reporting they did so against exactly the same laws and rules and KPM and TNG themselves.³⁶⁷

371 In fact, as Mr Rahimgaliev relates, the difference between the position of the Tax Committee and that of KPM and TNG relates to the extent and manner of KPM and TNG's deductions of drilling expenses from their taxable income in the period 1 January 2005 to 31 December 2007.

“6.5 In the course of the audits of KPM and TNG we discovered that the companies had incorrectly used Article 20 of the 1999 Tax Law to deduct drilling expenses that did not relate to either the acquisition of fixed assets or to “own construction”. We determined that the expenses in question related to geological expenses works and should have been deducted in accordance with Article 23 of the 1999 Tax Law and clauses 2.3.1 and 2.3.2 of the supplements to KPM and TNG's contracts. Under clause 6.2.5 of Appendix II of the above supplements to KPM and TNG's contracts, geological exploration expenses include, amongst other things:

³⁶⁴ Witness statement of Rahimgaliev paras. 2.3 and 5.1

³⁶⁵ Witness statement of Rahimgaliev paras. 5.3 and 5.4

³⁶⁶ Witness statement of Rahimgaliev para.5.2

³⁶⁷ Witness statement of Rahimgaliev paras 4.1 to 4.4

‘...drilling works, re-entry with the view to conduct Exploration of earlier plugged and abandoned wells and any other works relative to geological prospecting operations.’

6.6 In considering the nature of the expenses in question, we used the annual work programmes of KPM and TNG for 2005 to 2007 which provide the costs of exploration, exploration costs, the cost of setting up and identify the types of work to be undertaken, including geological and prospecting works. We also referred to reports LKU-2 “Report on the implementation of licencing/contractual conditions of subsoil users” that were periodically submitted to the MEMR by KPM and TNG. These contain data on the volume of work performed including drilling, testing, recovery testing of wells and other exploration works.

6.7 As a result of KPM and TNG’s misclassification of expenses and incorrect use of Article 20 instead of Article 23, the companies had overstated the deductions available when calculating the taxable income and consequently understated the amount of corporate income tax due in each of the years covered by the audit.

6.8 The expenses in question related to exploration and so should have been be capitalized in accordance with the agreed clause 4.4.7.12 procedure for calculating depreciation. In each subsequent new year after the reporting period the amount of costs capitalized in accordance with Art. 23 of the 1999 Tax law of the tax increases by the costs incurred in the tax year. In turn, the capitalization of costs to be reduced by the amount of depreciation incurred in the previous fiscal year. Amortization deductions under this group are made at rates of depreciation, determined at the discretion of the

Contractor, but not higher than the maximum rate of depreciation of 25 percent.” ³⁶⁸

372 In summary, KPM and TNG contended that its drilling expenses should be classified such that 100% of their value should be deducted from their taxable income in the relevant periods under Article 20 of the Decree of the President of the Republic of Kazakhstan “On Taxes and Other Mandatory Payments into Budget” 1995, which came into force on 1 January 1999 (the 1999 Tax Law). However, as Mr Rahimgaliev relates, in fact those expenses do not fall within the classes of expenses eligible for deduction under Article 20 of the 1999 Tax Law. Instead, they fall under Article 23 of the 1999 Tax Law, which still permits deductions from taxable income, but in a more restricted fashion.

373 As a result, KPM and TNG had underreported their taxable income for the period 1 January 2005 to 31 December 2007 and paid too little tax. The Tax Committee therefore determined that additional taxes should be paid. Further, because those taxes were in effect being paid late, penalty charges applied.

“6.11 As a result KPM and TNG’s taxable income for the years covered by the audit was higher than the companies had presented. These additional taxes and penalties are summarised below:

<i>KPM</i>	<i>TNG</i>
<i>Corporate Income Tax 2,255,019,100 Tge</i>	<i>Corporate Income Tax 4,007,519,000 Tge</i>
<i>Penalty 1,002, 105,500 Tge</i>	<i>Penalty 1,898,215,500 Tge</i>
	<i>Reduction in loss 1,558,600,300 Tge”</i> ³⁶⁹

374 Claimants state that KPM and TNG’s contract required the Tax Committee to apply Article 20 of the 1999 Tax Law to the deduction of expenses from taxable income³⁷⁰. However, as is apparent from the account of Mr

³⁶⁸ Witness statement of Rahimgaliev paras. 6,5 to 6.8

³⁶⁹ Witness statement of Rahimgaliev para 6.11

³⁷⁰ Statement of Case dated 18 May 2011 para 159

Rahimgaliev³⁷¹, that is incorrect. KPM and TNG’s contract allow for deduction of expenses under both Article 20 and Article 23 of the 1999 Tax Law, depending on the nature of the expenses in question.

375 Having chosen glibly to mischaracterise the nature of the dispute, Claimants offer no evidence or explanation as to why the Tax Committee was wrong to determine that the drilling expenses in question should be deducted under Article 23 rather than Article 20 of the 1999 Tax Law. However, in truth there is no need for the Tribunal to be detained by the detail of Kazakh tax law, since the Tax Committee’s assessment survived a comprehensive challenge in the Kazakh Courts before ultimately being approved by the Supreme Court of Kazakhstan³⁷².

376 Claimants suggest that they were prevented from fully appealing the Tax Committee’s assessment by:

- (a) The alleged commencement of bankruptcy proceedings against KPM³⁷³;
- (b) the assertion that “[Kazakhstan] took over KPM and TNG (in July 2010)”³⁷⁴.

377 In relation to the alleged commencement of bankruptcy proceedings, it is notable that the Claimant only say that they “*perceived*” that a bankruptcy notice had been served KPM³⁷⁵. As Claimants well know, at that stage KPM was merely informed that it was being monitored for bankruptcy³⁷⁶ (C-157). As Mr Rahimgaliev confirms, whilst the Ministry of Finance did subsequently commence bankruptcy proceedings against KPM those proceedings were unsuccessful³⁷⁷. As such, this did not prevent KPM from pursuing any appeal of the tax assessment.

378 As to Claimants’ allegation that the Republic “*took over*” KPM and TNG, that is inaccurate both in terms of the events complained of and the

³⁷¹ Witness statement of Rahimgaliev para 6.5

³⁷² Witness statement of Rahimgaliev paras 8.4 to 8.7

³⁷³ Statement of Case dated 18 May para 160

³⁷⁴ Reply Memorial on jurisdiction and Liability dated 7 May 2012 para 233

³⁷⁵ Statement of Claim dated 18 May 2011 para 160

³⁷⁶ Statement of Claim dated 18 May 2011 para 160 and C-157, Notice from the Ministry of Finance to KPM

³⁷⁷ Witness statement of Rahimgaliev para 9,1

allegation that those events would prevent any appeal from proceeding. The Republic did not take over KPM in July 2010, rather the subsoil assets of KPM were transferred to into trust management³⁷⁸. KPM continued to exist as a legal entity and could have pursued any appeal against the Tax Committee's assessment notwithstanding that transfer of assets.

379 Further, as is clear from the existence of the judgment of the Supreme Court of the Republic of Kazakhstan³⁷⁹, the appeal did continue and ultimately the Tax Committee's assessment was upheld.

380 Finally and perhaps most significantly, Claimants clearly accept that neither KPM nor TNG paid the taxes and penalties demanded in the assessment as they raise no challenge to the Republic's statement to that effect³⁸⁰.

381 As to the prejudice that Claimants say was caused to their investment by the Tax Committee's assessment, they make only a bare, if melodramatic assertion that the assessment "*devastated the companies' financial situation*"³⁸¹. In circumstances where no details are provided of any assessment against TNG and where neither KPM nor TNG paid the taxes assessed, it is difficult in the extreme to see how any such prejudice could really have been suffered even if (which is strongly denied) the Tax Committee's assessment was incorrect.

382 Claimants also complain that the Tax Committee's assessment deterred potential buyers from acquiring the companies. Again, however, Claimants offer no evidence to support this statement. Acquiring oil and gas companies is a complex and risky undertaking and a multitude of factors might persuade a bidder not to proceed. The evidence of Hervé Chagnoux of Total, one of the participants in Project Zenith, clearly suggests that KPM and TNG's tax affairs had nothing to do with the Claimant's inability to sell the companies.

"2.6 KPM's and TNG's troubles with the Kazakh authorities did not play a role in our decision not to make

³⁷⁸ Statement of Defence dated 21 November 2011 para 31.150

³⁷⁹ Witness statement of Rahimgaliev para 8.6

³⁸⁰ Statement of Defence dated 21 November 2011 para 30.53

³⁸¹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para 233

*a firm offer. In the management presentation made to TOTAL in February 2009, one slide was providing some information on this matter. However this was no longer significant for us the basic facts regarding reserves and potential production were a sufficient “killing factor” not to investigate in depth the nature and impact of these claims”.*³⁸²

383 In conclusion therefore it is clear that

- (a) the Tax Committee’s audit of KPM and TNG was lawful and did not interfere with the operation of either company;
- (b) the Tax Committee’s assessment of corporate back taxes was legitimate;
- (c) that neither KPM nor TNG suffered any detriment as a result of the assessment; and
- (d) accordingly these taxes cannot form the basis of any claim under the ECT.

3. Export Duties

384 As regards paragraph 234 of the Reply Memorial on Jurisdiction and Liability, it is denied that the crude oil export duties were illegal and the Claimant produce no evidence to that effect.

385 As with its account of these issues in the Statement of Case, Claimants confuse two distinct assessments of crude oil export duties. The first related to KPM’s liability to pay crude oil export duty in 2008. The second concerns KPM and TNG’s liability to pay crude oil export duty from January 2009 onward.

386 In relation to KPM’s obligation to pay crude oil export duty in 2008 there is no dispute that ultimately it was decided that KPM was not liable for such payments from October 2008 onward, when the working group established by Order of the Prime Minister of the Republic of Kazakhstan

³⁸² Witness statement of Mr. Chagnoux, para 2.6

№ 203 dated 29 July 2008 to consider the application of export customs duty to all subsoil users, determined that KPM and TNG should not be liable to pay the duty on crude oil exports³⁸³.

387 There is however a dispute over the amount of crude oil export duty that KPM paid in 2008 prior to that decision. Though it should be noted that Claimants do not allege that TNG was unlawfully required to pay any export duties in 2008.

388 KPM paid 926,425,000 Tge, equivalent to \$700,000 at an average exchange rate of \$1 to 120Tge³⁸⁴, because the terms of its subsoil use contract did not exempt it from payment of customs duties on crude oil exports.³⁸⁵ A point which Claimants admit was subsequently confirmed by the Kazakh courts³⁸⁶

389 In the Statement of Claim, Claimants' position was that KPM paid \$10m and that none of that sum was refunded³⁸⁷. Now Claimants say KPM paid \$12.77m, \$2.6m of which was refunded³⁸⁸. Neither position is correct.

390 In the Reply Memorial on Liability and Jurisdiction, Claimants' principal complaint in relation to the amount of export duties paid by KPM is that the Republic provided no evidence to support its position. That is ironic considering that, whilst Claimants bear the burden of proof in relation to the events on which they rely, they originally advanced their claim without a shred of evidence. It is doubly ironic then that the best evidence Claimants can now produce are a handful of unsigned "Payment Orders" from KPM³⁸⁹. Further, despite increasing their estimate of the sums paid by KPM, that 'evidence' accounts for only \$5m of these alleged payments.

391 Claimants also have the burden of proof of demonstrating that the acts complained of caused the breaches of the ECT of which they complain. Even if (which is denied) the Republic wrongfully received and retained \$5m from KPM in unlawful crude oil export duties, there is absolutely no

383 Witness statement of Balzhan Zhanbekova para 3.8

384 Witness statement of Balzhan Zhanbekova para 3.9

385 Witness statement of Balzhan Zhanbekova paras 3.4 and 3.5

386 Reply Memorial on Liability and Jurisdiction dated 7 May 2012 para 243 fn. 371

387 Statement of Claim dated 18 May 2011 paras. 164 and 165

388 Reply Memorial on Liability and Jurisdiction dated 7 May 2012 para 235

389 C-460 Letter from Central Bank of Kazakhstan

evidence that such payments could cause or even materially contribute to the expropriation of KPM or any other breach of the ECT. In that regard it should be recalled that in the Statement of Claim Claimants allege that KPM held assets worth \$193m in 2008³⁹⁰ (SoC 465).

392 In relation to the 2009 crude oil export duties, Claimants' story has changed. Following the decision of the Interdistrict Economic Court of Mangystau Region to dismiss Claimants challenge to these duties Claimants originally said that "*subsequent appeals of this decision against KPM were also dismissed*"³⁹¹. That assertion was supported by the evidence of Mr Condorachi who stated "*All our appeals were dismissed, including by (sic) the Supreme Court on August 5, 2010.*"³⁹².

393 Now Claimants contradict their previous submissions and Mr Condorachi's evidence and say (inaccurately) "*KPM refused to pay the unlawful tax and fought the measures in local court, despite considerable pressure from the Financial Police...The court did not issues a ruling before Kazakhstan seized KPM and TNG in late July 2010.*"³⁹³.

394 In fact Mr Condorachi was correct, as Balzhan Zhanbekova confirms³⁹⁴. As such the Customs Committee's assessment of crude oil export duties in 2009 was completely vindicated in the Kazakh courts.

395 Furthermore, KPM and TNG were not "seized". Rather their subsoil assets were transferred in such a manner that would not have prevented the companies from continuing to pursue appeals against assessments by the Customs Committee.

396 In any event, on 31 March 2010 the Central Customs Committee cancelled the notifications issued by the Regional Customs Committee in which export duties on KPM's January 2009 exports had been demanded³⁹⁵. That effectively cancelled the charges and brought the affair to an end.

³⁹⁰ Statement of Claim dated 18 May 2011 para. 465

³⁹¹ Statement of Claim dated 18 May 2011 para. 169

³⁹² First Witness Statement of Condorachi para. 37

³⁹³ Reply Memorial on Liability and Jurisdiction dated 7 May 2012 para. 276

³⁹⁴ Witness statement of Balzhan Zhanbekova paras 4.3 and 4.4

³⁹⁵ Statement of Claim dated 18 May 2011 para. 170 and Statement of Defence dated 21 November 2011 para. 30.56(e)

Furthermore, neither KPM nor TNG had paid duties as a result of those notices.

397 As with the Tax Committee's assessment of corporate back taxes, it is difficult to see how KPM and TNG (and by extension Claimants) suffered any material prejudice as a result of the Customs Committee's assessments of export duties in 2008 and 2009.

398 There is no evidence that TNG paid any duties. Even if (which is denied) KPM paid \$5m, that is not a sufficiently material amount for a company such as KPM to found a claim for expropriation under the ECT, neither is the \$10m for which Claimants contend, let alone the \$700,000 which KPM actually paid.

399 The 2009 duties were withdrawn before either KPM or TNG made any payment. They caused no material prejudice to either company or Claimants and cannot be the basis of any claim under the ECT.

4. Transfer pricing

400 In common with many resource rich nations, the Republic seeks to control abuses of its taxation system by parties who seek to avoid paying domestic taxes by channeling funds through affiliated offshore companies, based in tax havens, whilst leaving only liabilities in the domestic operating companies. Amongst the Republic's defences to such practices is its regulation of transfer pricing.

401 As noted in the Statement of Defence³⁹⁶ Claimants rely on the audit of transfer pricing in relation to alleged harassment only. Or, as they put it "*treat Claimants unfairly and to interfere with and usurp Claimants' control of their investments*"³⁹⁷.

402 As noted in the SoD, the audits by the Tax Committee resulted in demands for payment of further taxes and penalties for late payment as follows:

(a) to KPM \$2,607,070.00³⁹⁸; and

³⁹⁶ Statement of Defence dated 21 November 2011 para.30.60

³⁹⁷ Reply Memorial on Liability and Jurisdiction dated 7 May 2012 para. 238

³⁹⁸ C-137 Notice from the Ministry of Finance to KPM

(b) to TNG \$2,203,694.00³⁹⁹.

403 Whilst neither sum is small, in the context of companies that Claimants say held assets worth \$193m (in the case of KPM) and \$2.7bn⁴⁰⁰ it is difficult to credit the suggestion that, even if those charges were incorrect they would “*interfere with and usurp Claimants’ control of their investments*” .

404 Further, as Mr Rahimgaliev confirms, neither KPM nor TNG paid the taxes.⁴⁰¹

405 Claimants make the ridiculous assertion that by the chronology of events set out in paragraph 30.65 of the Statement of Defence, the Republic “*essentially admits that it directly expropriated KPM and TNG before the legal claims related to the transfer pricing dispute could be appealed through the Kazakh courts*”. The chronology shows nothing of the sort and the allegation is denied.

406 Turning to Claimants’ allegations regarding the audit giving rise to the above charges, they focus heavily on the duration of the audit and the evidence of Mr Condorachi to the effect that the audit involved looking at all of KPM and TNG’s sales records.

407 Mr Condorachi’s assertion that the audit lasted 13 months is hugely misleading. Whilst it is correct that 13 months elapsed between the Tax Committee’s first attendance at KPM and TNG’s offices and the issue of its findings from the audit, the maximum permissible period of such audits is 30 business days. In fact, as Mr Rahimgaliev explains⁴⁰², the audit commenced on 12 November 2008 and was suspended on 12 December 2008. It was then recommenced and concluded on 29 December 2009. In total therefore, the audit lasted less than 30 working days. Furthermore representatives of the Tax Committee were not present at KPM and TNG’s while the audit was suspended. In short, KPM and TNG suffered no harassment and were treated no differently to any other company that is subject to such audits.

³⁹⁹ C-138 Notice from the Ministry of Finance to TNG

⁴⁰⁰ Statement of Claim dated 18 May 2011 para. 465

⁴⁰¹ Witness statement of Rahimgaliev para 10.7

⁴⁰² Witness statement of Rahimgaliev paras 10.5 and 10.6

408 In light of the fact that Claimants hugely exaggerated the duration of the audit, it is perhaps less surprising that no particulars are provided as to how the audit acted to “*interfere with and usurp Claimants’ control of their investments*”.

409 Indeed, the evidence suggests the audit had no such effect. In the period between the start of the audit (November 2008) and the date of the Tax Committee’s notice demanding payments (December 2009) KPM, TNG and Claimants were very active. In addition to conducting numerous court actions against various government bodies of the Republic, the 2009 consolidated financial statements for Tristan Oil⁴⁰³ and Claimants’ own case show that KPM and TNG/ Claimants took at least the following significant steps in relation to the management/control of their investment:

- (a) sold almost \$175m of gas, crude oil and condensate⁴⁰⁴;
- (b) conducted the second round of Project Zenith⁴⁰⁵;
- (c) agreed to sell KPM and TNG to Cliffson Company S.A.⁴⁰⁶;
- (d) negotiated a major new gas supply and purchase agreement with MAEK SPA and two major new gas supply and purchase agreements with AktauGasService SPA⁴⁰⁷; and
- (e) undertook exploratory drilling and declared geological a discovery of oil in the Tabyl Block⁴⁰⁸.

410 In conclusion therefore

- (a) Claimants hugely exaggerate the duration of the audit, which in reality took less than 30 business days, as with any such audit of any other company;
- (b) no evidence is presented by Claimants that the conduct of the transfer price audit had any material effect on KPM and TNG;

⁴⁰³ Exhibit 68 to the report of 1st FTI dated 17 May 2011

⁴⁰⁴ Exhibit 68 to the report of 1st FTI dated 17 May 2011 page 2

⁴⁰⁵ Statement of Claim dated 18 May 2011 paras. 185 to 190

⁴⁰⁶ Exhibit 68 to the report of 1st FTI dated 17 May 2011 page 3

⁴⁰⁷ Exhibit 68 to the report of 1st FTI dated 17 May 2011 page 5

⁴⁰⁸ Exhibit 68 to the report of 1st FTI dated 17 May 2011 page 6

- (c) the available evidence suggests that KPM and TNG were able to function normally and that Claimants had no difficulty in managing or controlling them in the period of the audit;
- (d) the additional taxes imposed at the conclusion of the audit were legitimate and in any event were not financially material to the KPM or TNG;
- (e) neither KPM nor TNG paid those taxes
- (f) accordingly neither the audit nor the resulting charges can form the basis of any claim under the ECT.

V. Non-Extension of Contract No. 302

411 TNG's Contract No. 302 expired on 30 March 2009. The Republic neither granted an extension of the contract nor was it under any obligation to do so.

1. An extension was never granted

412 Claimants are wrong to argue that the Republic substantially interfered with Claimants' investments by refusing to officially extend the exploration period under Contract No. 302, despite its clear commitment to Claimants that it would do so.⁴⁰⁹ In fact, the Republic never committed, promised or even granted the extension of the exploration period under Contract No. 302.

413 The principal flaw in Claimants' line of argumentation is their assertion that the MEMR "granted" the extension of the exploration period for a period of 2 years.⁴¹⁰ Claimants' misperception rests on a misunderstanding of the procedure for the extension of exploration contracts as well as on an erroneous translation of the MEMR's letter of 9 April 2009⁴¹¹.

⁴⁰⁹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, paras. 240 et seqq.

⁴¹⁰ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 242.

⁴¹¹ Letter from the MEMR to TNG dated 9 April 2009, Exhibit C-27.

414 In the process of the extension of contracts for subsoil use, several steps need to be observed. First, the subsoil user is required to apply for an extension of the contract in writing and within the prescribed period and to identify the reasons for the application.⁴¹² An expert commission of the competent authority (MEMR or MOG depending on when the application was filed) will then consider this request and issue a recommendation for the competent authority on whether the process for the extension of the contract should be initiated. Based on the non-binding recommendation of the expert commission, the competent authority informs the applicant about the decision of the expert commission. Thereafter, the subsoil user submits a draft addendum to the contract. After this notice, a working group consisting of representatives from all interested ministries such as the Ministry of Finance or the Ministry of Economics considers the draft addendum to the contract. Eventually, amendments are proposed to the subsoil user. In the following, the extension of the contract may or may not be agreed between the authority and the subsoil user, depending on whether the amendments by the working group are acceptable to the subsoil user or the subsoil user makes acceptable alternative proposals and these proposals are agreed by the working group. The extension of the contract of subsoil use only becomes effective upon its registration with the competent authority after the signature of both parties.⁴¹³

415 By simply not mentioning this process, Claimants try to create the wrong impression that there had already been an agreement to extend the contract. In fact, however, the extension process had not yet been gone through, and any reliance on an extension by Claimants was completely misplaced.

416 TNG made an application to extend Contract No. 302 on 14 October 2008.⁴¹⁴ Subsequently, the expert commission recommended initiating the process of extension. On the basis of this recommendation, the MEMR decided to initiate the process of extension and informed TNG about the expert commission's decision by letter of 9 April 2009.⁴¹⁵

⁴¹² See for an example Application from TNG to the MEMR dated 14 October 2008, Exhibit C-67.

⁴¹³ For a comprehensive overview of all steps see Witness Statement of Mr. Ongarbayev, para. 7.2.

⁴¹⁴ Application from TNG to the MEMR dated 14 October 2008, Exhibit C-67.

⁴¹⁵ Letter from the MEMR to TNG dated 9 April 2009, Exhibit C-27.

417 Claimants mistake this letter to be the permission to extend the contract. In fact, it is only the document which informs Claimants' about the expert commission's decision to initiate the process of extension. At the same time the decision of the expert commission is of recommendatory nature only, and it is not a decision of the competent authority and thus does not bind the competent authority to take its decision in accordance with the decision of the expert commission. The competent authority has the right to take it into account or to disregard it at its own discretion.⁴¹⁶ Contrary to Claimants' assertions, the MEMR's letter is not the final step in the extension of subsoil use contracts. Its true meaning is that the MEMR will consider entering into an additional agreement with the subsoil user to extend the contract.⁴¹⁷

418 The contractual nature of the subsoil use contract and the contractual procedure for making amendments to the contract, including the extension, follows directly from the legislation of the Republic of Kazakhstan on Subsoil. Changes in terms of subsoil use contract, including the extension of its action, are carried out on a contractual basis by making changes and additions. The proposal of the expert committee on the subsoil and the decision of the competent authority for an extension of the contract are internal procedures in forming the will of one party (the state represented by competent authority) and is preceded by negotiations between the parties on the conditions of contract renewal, provided that the subsoil user is entitled to such extension. The extension shall be considered valid from the date of entry into force of the treaty concluded by the parties on amendments and addenda to the contract. If the parties fail to reach agreement on the conditions of the renewal of the contract, the contract is not considered to be prolonged.⁴¹⁸

419 Claimants' translation of the MEMR's letter of 9 April 2009 is misleading. Given the context described above, the first sentence of the letter cannot be translated in the way which Claimants suggest:

“Following the analysis of your requests no. 721T of 03/24/2009 and no. 680T of 03/18/2009, the Minister of

⁴¹⁶ See Expert Report of Professor Kulyash Ilyassova dated 12 August 2012, pp. 24 et seqq.

⁴¹⁷ See also Witness Statement of Mr. Ongarbayev, para. 7.2.

⁴¹⁸ See Expert Report of Professor Kulyash Ilyassova dated 12 August 2012, p. 25 et seq.

energy and mineral resources of the Republic of Kazakhstan, decided the following: The extension of the exploration period is granted for a period of 2 years, until 03/30/2011.”⁴¹⁹ (emphasis added)

420 Rather, this sentence has to be interpreted to mean:

“The Ministry of Energy and Mineral Resources of the Republic of Kazakhstan has reviewed your requests No. 721T dated 24.03.09 and No. 680T dated 18.03.09 and has resolved to: Permit extension of the exploration period by 2 years until 30.03.2011.”⁴²⁰

421 It is admitted that the Russian wording generally allows for both translations. Bearing the process for the extension in mind, however, there can only be one correct translation.

422 Claimants also misinterpret the last sentence of the MEMR’s letter of 9 April 2009. Claimants choose a very liberal interpretation by translating the last sentence to mean:

“The appropriate modifications will be introduced in the Contract no. 302 of 07/31/ 2008 by July 2, 2009.”⁴²¹ (emphasis added)

423 Instead the sentence needs to be translated in the following way:

“Contract No. 302 dated 31.07.1998 to be amended accordingly by 02 July 2009 (Minutes No. 7 dated 02.04.2009).”⁴²² (emphasis added)

424 Both sentences make it obvious that a prolongation was never granted. The MEMR only agreed that the process of prolongation should be initiated. The true translation of the last sentence highlights that the actual prolongation still needs to be undertaken and is not a mere formality. However, by the specified date the parties had not reached the agreement

⁴¹⁹ Letter from the MEMR to TNG dated 9 April 2009, C-27.

⁴²⁰ Letter from the MEMR to TNG dated 9 April 2009, R-163.1.

⁴²¹ Letter from the MEMR to TNG dated 9 April 2009, Exhibit C-27.

⁴²² Letter from the MEMR to TNG dated 9 April 2009, Exhibit R-163.1.

on the conditions of the renewal of the contract and the contract thus expired.

425 In any event, the Tribunal should also take note of the fact that Claimants' version of events contradicts their own allegations. Claimants assert that the Republic started a campaign of indirect expropriation and illegal harassment on 14 October 2008.⁴²³ They do however fail to explain why, as they claim, the Republic would then grant an extension of contract No. 302.

2. The MEMR was under no obligation to extend Contract No. 302

426 It is noteworthy that Claimants still have not been able to explain why the MEMR should have been under an obligation to extend Contract No. 302. In fact they even concede that the MEMR was under no such obligation by stating:

“The mere fact that Kazakhstan was not obliged to agree to extend the exploration period does not justify its bad faith refusal to execute the contract extension after it had agreed to extend the exploration period”⁴²⁴

427 In any event, there is no general obligation of the state to extend a subsoil use contract. Even after the recommendation of the expert committee and the initiation of the process of an extension by the Ministry, no obligation to enter into the necessary additional prolongation agreement existed.

428 In this specific case, as already demonstrated in the Statement of Defence⁴²⁵ and as explained in more detail below⁴²⁶, the Republic could not even have legally extended the term of the contract because Claimants did not apply for a renewal of the underlying licence No. 243-D.

⁴²³ Statement of Claim dated 18 May 2011, para. 11.

⁴²⁴ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 242 (emphasis in the original).

⁴²⁵ Statement of Defence dated 21 November 2011, paras. 14.32 and 31.73 et seqq.

⁴²⁶ See Rejoinder Memorial on Jurisdiction and Liability dated 13 August 2012.

3. The MEMR’s decision not to enter into the additional agreement to prolong Contract No. 302 was not an act of bad faith

429 Claimants’ allegation of a “bad faith refusal” to execute the contract extension is bound to fail for the reason alone that the MEMR never agreed to extend the contract but only to initiate the process for a potential extension.

430 Claimants’ assertion that “Kazakhstan strung Claimants along for months with promises that execution would be forthcoming”⁴²⁷ is also meritless. This is yet another example of Claimants’ utterly unsubstantiated allegations brought forward in admittedly picturesque language. The only proof that Claimants provide is a letter from the MEMR in which the Ministry invites members of KPM and TNG to a Working Group meeting to discuss agreements and terms of additional projects, as well as conduct of negotiations with subsoil users.⁴²⁸

431 The letter does not in any way express a promise by the MEMR to enter into the additional agreement for the prolongation of Contract No. 302. Claimants have therefore failed to prove that the Ministry promised to extend the contract.

4. Claimants have not properly responded to the Republic’s arguments

432 Not only is Claimants’ description of the extension process ill perceived. Claimants also either simply ignore the Republic’s arguments made in the Statement of Defence⁴²⁹ or address them in the most cursory manner. This only allows the conclusion that Claimants are not able to explain the issues raised by the Republic.

433 In particular, the Republic has explained in detail that no extension of Contract No. 302 was possible without an extension of the underlying license No. 243-D.⁴³⁰ Claimants decided to address this vital question in a footnote.⁴³¹ They insist on not having been under an obligation to apply for

⁴²⁷ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 244.

⁴²⁸ Letter from the MEMR to KPM and TNG dated 14 January 2010, Exhibit C-461.

⁴²⁹ See Statement of Defence dated 21 November 2011, paras. 14.25 et seqq., 31.66 et seqq.

⁴³⁰ Statement of Defence dated 21 November 2011, paras. 14.32 and 31.73 et seqq.

⁴³¹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, footnote 388.

an extension of licence No. 243-D by arguing that Decree No. 1017 which creates this obligation was repealed as of January 21, 2000.⁴³²

434 However, as the Republic demonstrated in its Statement of Defence⁴³³ the transition provision of the 1999 law provided that this abolition did not apply in relation to licences/contracts signed prior to that date. Claimants cannot overcome this express provision in the Law of the Republic of Kazakhstan dated August 11, 1999 No. 467-1⁴³⁴ by simply ignoring it.

435 Changes in terms of subsoil use contracts concluded during the term of the license-contract system need to be based on the agreement of the parties and shall conform to the requirements of this License. An extension of the subsoil use contract without the renewal of the license was not permissible.⁴³⁵

436 Since TNG did not apply for a renewal license No. 243-D in conjunction with the application for the extension, the competent authority had no right to extend the term of the Contract No. 302.

437 Also, the Republic has drawn Claimants' attention to the facts that Claimants could have challenged the alleged bad faith conduct of the MEMR in the Kazakh courts.⁴³⁶ However, again Claimants have refrained from explaining why TNG did not make use of these rights. It may be reiterated that TNG did not take any such measures as prescribed in the contract and the Civil Code of the Republic. Instead, Claimants only initiated arbitration in July 2010, i.e. more than one year after the Republic had allegedly granted the extension of Contract No. 302.

438 It is once more apparent that as in the case with contracts No. 210 and No. 305, Claimants are not interested in preserving their subsoil use contracts but rather used the lawful termination of the contract No. 302 due to expiry as an excuse to initiate arbitration, despite the protections of their rights under the legislation of Kazakhstan.

432 Ibid.

433 Statement of Defence dated 21 November 2011, para. 13.49.

434 Law of the Republic of Kazakhstan "On introduction of amendments and additions to some legislative acts of the Republic of Kazakhstan concerning subsoil use and performance of oil operations in the Republic of Kazakhstan" No. 467-1, Article 2, Exhibit R-21.

435 Expert Report of Professor Kulyash Ilyassova dated 12 August 2012, pp. 34 et seqq.

436 Statement of Defence dated 21 November 2011, paras. 14.33 and 31.82 et seqq.

439 In accordance with paragraph 9 of Article 72 of the Law “On Subsoil and Subsoil Use” 2010 the termination of the contract does not relieve the subsoil user from the obligations to return to the State the contract area and eliminate the consequences of the mining operations in accordance with the legislation of the Republic of Kazakhstan. Hence, in the notification of 22 July 2010⁴³⁷, TNG was informed that it is under the duty to provide the competent authority with the following items within one month: Contract No. 302 (the original) with all attachments and amendments, a brief report on the activities of the company to fulfill the contract conditions, a certificate of financial expenses actually incurred from the date of the Contract to carry out mining operations, the act of returning the geological information and the act of returning the contract area. However, TNG did not fulfill these duties. This is yet another example of Claimants’ disregard of Kazakh law.

440 The fact that TNG has not fulfilled the order means that the order is still in effect and as such could be cancelled by the state.⁴³⁸ Consequently, TNG could still request an extension of contract if only it were willing to meet all the requirements of the law.

VI. Criminal prosecution of Mr. Cornegruta on behalf of KPM

1. The theory of premeditation is based on a skewed chronology

441 Claimants elaborate upon their theory that the criminal prosecution of Mr Cornegruta constituted a string of premeditated and coordinated actions by the Republic’s various ministries and judicial authorities which culminated in the unlawful indirect and, subsequently, direct expropriation of Claimants’ assets.⁴³⁹

442 In short they assert that this commenced with the Financial Police’s “fabrication” of the criminal charges through the “reclassification” of pipelines, leading to a “sham trial” conducted by the Aktau court, in which

⁴³⁷ Notification of MOG to TNG of 22 July 2010, Exhibit C-5.

⁴³⁸ Expert Report of Professor Kulyash Ilyassova dated 12 August 2012, p. 34.

⁴³⁹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, section III.C, paras. 246 to 337.

the Republic (through the Financial Police) allegedly interfered. This was followed by the application of an inordinate fine, which was the necessary hook required to enable the Republic to carry out the alleged seizure of Claimants' assets. These were "critical steps"⁴⁴⁰ in the Republic's premeditated plan to orchestrate a situation in which it could take over KPM's and TNG's assets. This notion of a preconceived plan lies at the heart of Claimants' allegation that the issues relating to the pipeline constituted indirect expropriation for which the Republic is responsible.

443 To make good their exaggerated allegations, Claimants require the Tribunal to accept not only that the Republic's various ministries could and did act in concert to engineer the demise of Claimants' assets in Kazakhstan, but moreover that the Republic's institutions, and in particular, the Financial Police and the Aktau court are, and were in this particular case, capable of flagrant denials of justice. As is shown throughout this Rejoinder there is insufficient evidence to make out these serious allegations.

444 Moreover it is simply not true. To be successful, Claimants' arguments rely on demonstrating that the inspections and investigations were improperly conceived or without legal basis, that the Aktau court both reached the wrong decision on the classification of pipelines and that it carried out its trial in an improper way, breaching Kazakh as well as international laws of due process. The Republic demonstrated at length in the Statement of Defence⁴⁴¹ that Claimants' allegations are unfounded and this is a position that the Republic maintains. In relation to the inspection, investigation and trial of Mr Cornegruta and enforcement measures against KPM, the authorities involved all thoroughly, properly and even-handedly applied Kazakh law.

445 Claimants' hyperbolic language, deliberately confused narrative and unsupported allegations do not change this. Nor do they change the outcome of the Kazakh courts' decisions.

⁴⁴⁰ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 245.

⁴⁴¹ Statement of Defence dated 21 November 2011, sections 19 to 29.

2. Mr Cornegruta's illegality was established through a thorough application of process and evidence gathering

446 The events that Claimants assert amounted to breaches of the ECT occurred are set out here and considered in more detail below.⁴⁴²

- (a) In compliance with its obligations to do so and in accordance with its rights to audit and inspect⁴⁴³ under Kazakh law, the Financial Police's inspections department inspected KPM and TNG in October 2008 pursuant to a valid order from the President and the discovery that Claimants were operating main pipelines without a licence.⁴⁴⁴
- (b) The Financial Police sought further information from the various authorities regarding suspicions raised by the inspection that KPM and TNG were operating pipelines without the correct licences. This took the form of a request of the competent authority for the licensing of trunk pipelines, ARNM, as to whether or not KPM held a licence for a trunk pipeline and the engagement of an expert in the field of pipeline.
- (c) Once satisfied that there might be grounds for concern that a criminal offence had been committed, the inspection team passed on the material to the investigation team in late 2008.
- (d) The investigation team considered all the evidence carefully and procured their own reports from the relevant authorities to establish whether, in their view there were grounds for a criminal prosecution.
- (e) The Financial Police detained Mr Cornegruta in April 2009 on the suspicion that he was personally liable for the criminal offence committed and on the reasonable evidence that he was likely to leave the country, evading questioning and possible prosecution.
- (f) The Financial Police's investigation team prepared the charge using the information provided by the Financial Police's inspection team, presenting the indictment dated 15 June 2009⁴⁴⁵ to the prosecution

⁴⁴² Rejoinder Memorial on Jurisdiction and Liability dated 13 August 2012, section C.VI - V.III.

⁴⁴³ On the Republic's entitlement to conduct audits and inspections, see Statement of Defence dated 21 November 2011, section 20.

⁴⁴⁴ Statement of Defence dated 21 November 2011, para. 20.

⁴⁴⁵ Exhibit C-454.

department of the Ministry of Justice. Submitted over 6 months after the initial inspections, this gave ample time for the proper consideration of the alleged and crime and also included time for Mr Cornegruta to review the file against him.

- (g) The Aktau court carried out the trial and conviction of Mr Cornegruta (on behalf of KPM in his capacity as General Manager of KPM) in accordance with due process and Kazakh law and, after rendering a guilty verdict on 18 September 2009,⁴⁴⁶ applied the relevant charges against Mr Cornegruta and ordered the recovery of monies from KPM.
- (h) This verdict was fully considered and confirmed on 12 November 2009 by the Mangystau Regional Court following Mr Cornegruta's appeal against the Republic.⁴⁴⁷
- (i) As a result of non-payment by KPM of the illegal accrued income, the Aktau court and the Judicial Executors diligently applied enforcement procedures against KPM resulting in, ultimately, the seizure of a number of KPM assets.
- (j) Appeals that KPM brought were brought in respect of enforcement proceedings rather than the pipeline classification itself and were brought outside the time limits and were therefore ultimately unsuccessful.

447 There was nothing manufactured or fabricated about the charges that were brought against KPM's representative, Mr Cornegruta, either in terms of procedure or in substance.

448 Indeed, it is Claimants' who invert the true sequence of events, reverse-engineering the facts to suit their case. As the chronology above and the submissions in below show, charges against Mr Cornegruta on behalf of KPM were brought only once the case in respect of illegal entrepreneurship had fully been made out and not before. Claimants' allegations that this was premeditated does not ring true against the facts.

⁴⁴⁶ Exhibit C-117.

⁴⁴⁷ Exhibit C-565.

VII. Pre-trial Inspections and Investigations

1. The inspections were not predicated on a “reclassification” of KPM and TNG’s pipelines

449 Throughout the Statement of Claim and the Reply Memorial on Jurisdiction and Liability⁴⁴⁸ Claimants assert that the Financial Police “fabricated” the criminal charges (and then, later, it is implied, sought to justify such fabricated charges retrospectively).

450 Central to this is the allegation that the Financial Police’s “finding” that KPM and TNG operated a trunk pipeline post-dated their “accusations” to that effect.⁴⁴⁹ This is incorrect.

451 The KPM Pipeline was always a trunk pipeline; there has never been any suggestion by the Republic that the pipeline somehow changed its nature. Rather, the KPM Pipeline was always a trunk pipeline and it was never operated with the correct licence. The process of inspection in 2008 uncovered illegal activity that had been ongoing since 2002, when construction on the KPM Pipeline was completed. It is the owner of the trunk pipelines who must ensure that its activities are covered by all the relevant licences required and its attempts to wilfully neglect or, worse, conceal their unlawful behaviour again suggest the poor nature of Claimants now seeking assistance from the Tribunal.

452 The inspections (also referred to as “pre-investigation checks”) and investigation of the criminal operation of a pipeline which led to the prosecution of Mr Cornegruta were led primarily by the Agency for Economic and Corruption Crimes (described herein as the Financial Police), the competent authority in relation to such issues. The Financial Police’s processes are divided between inspection and investigation, as set out in detail above.⁴⁵⁰ Mr Turganbaev, a Senior Inspector of the Inspection Department and Mr Rakhimov, Chief Investigator for Particularly Important Cases in the Investigative Department of the Financial Police, both describe in detail the process that was undertaken by the Financial

⁴⁴⁸ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para.249.

⁴⁴⁹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 249.

⁴⁵⁰ Rejoinder Memorial on Jurisdiction and Liability, section C.II.2(c).

Police from inspection of KPM and TNG's assets in late 2008 to the prosecution of Mr Cornegruta on behalf of KPM in mid-2009.⁴⁵¹

453 The inspection of the KPM and TNG territories which gave rise to suspicions of illegal activity was instigated as a response to the letter from President Voronin dated 6 October 2008.⁴⁵² A central figure in the inspections phase was Mr Turganbaev.

454 The Financial Police is empowered to order specialist bodies to undertake inspections with or without the presence of the Financial Police Accordingly the Financial Police requested that the Geological Committee inspect KPM and TNG site to ascertain whether they were complying with their contractual obligations.

455 This inspection took place on 11 November 2008 which.⁴⁵³ As the reports show, this particular meeting was attended by the Financial Police.⁴⁵⁴ Claimants repeatedly suggest that there was something unusual or improper about this. Mr Turganbaev says:

“Claimants say that it was illegal / improper / unusual for the Financial Police to attend this inspection (Reply, paragraph 217, Cojin witness statement, paragraph 4-5, Pisica, paragraph 13). There is simply no basis for complaint here. The Financial Police is entitled to be involved and physically present at inspections or, alternatively, to engage experts from a competent authority to undertake the inspections instead. In the present case, as far as I recall, in any event, Financial Police Officers were involved in only one inspection, being the inspection of the pipeline at the Borankol field

⁴⁵¹ Second Witness Statement of Turganbaev dated 9 August 2012, and Witness Statement of Rakhimov dated 12 August 2012.

⁴⁵² Exhibit C-8. Witness Statement of Mr Turganbaev dated 12 August 2012, section 3.

⁴⁵³ Witness Statement of Mr Turganbaev, para 4.1: “According to Article 9 of the Law on the Financial Police of 4 July 2002, the Financial Police is entitled to carry out inspections itself but also to instruct specialist bodies to undertake inspections with or without the presence of the Financial Police.”

⁴⁵⁴ Statement of Defence dated 21 November 2011, paras. 26.8 to 26.10. Exhibits Exhibit C-86 and Exhibit C-87.

by the Geological Committee of the MOG on 11 November 2008.”⁴⁵⁵

456 More insultingly they assert that the Financial Police pressurized the Geological Committee to insert certain conclusions in the reports that KPM and TNG did not hold licences that allowed them to carry out operations of trunk pipelines. The Financial Police are not in a position to influence the outcome of the inspections. Mr Turganbaev states:

*“If the Financial Police does attend an inspection it is not permissible for the Financial Police to give an instruction to the competent authority to include anything in their report. Of course, the Financial Police are not entitled to influence the outcome of inspections and nor do they discuss and therefore influence the content of a report with the inspecting body.”*⁴⁵⁶

457 Of course, the Financial Police were not (nor did they ever suggest that they were) the competent authority in relation to the classification of pipelines so it would be inappropriate for them to comment, or require the inclusion of any determinative statements relating to the operation and / or licensing of trunk pipelines in a report.

458 The Financial Police did not consider themselves the competent authority. This is plain from the Financial Police’s next action, which was to check the Geology Committee’s statement. It needed the assistance of other departments to establish whether or not there had been an actionable offence.

2. No trunk pipeline licences held by ARNM

459 The Financial Police verified which licences were held by the companies with the Agency for the Regulation of Natural Monopolies (ARNM). Mr Turganbaev explains further:

“Upon completion of the inspection by of the Geology Committee, members of the Financial Police in Mangistau

⁴⁵⁵ Second Witness Statement of Mr Turganbaev, dated 9 August 2012, para. 4.4.

⁴⁵⁶ Second Witness Statement of Mr Turganbaev, dated 9 August 2012, para. 4.6.

*region, who participated in the inspection of the field, checked the licenses issued to KPM and TNG. It was established that KPM and TNG had relevant state licences to operate the production facilities and mechanisms. As part of that process, on 12 November 2008, I sent a request to the Agency for Regulation of Natural Monopolies to confirm what licences they had issued to KPM and TNG for the operation of pipelines.”*⁴⁵⁷

460 As Claimants acknowledge,⁴⁵⁸ ARNM is the competent authority for licensing main pipelines.

461 ARNM is the regulator and controller of activities of natural monopolies and regulated markets. The specific function of licensing of trunk pipelines operation (gas pipelines, oil pipelines and oil product pipelines) were transferred to the ARNM in compliance with Decree of the President of the Republic of Kazakhstan No.346 dated June 19, 2007 “*On Further Improvement of the State Management System of the Republic of Kazakhstan*”.⁴⁵⁹ Since this time, the ARNM became the licensor in respect of trunk pipelines.

462 As to whether the ARNM is, as Claimants allege “*the exclusive regulator of trunk pipelines*”, the ARNM’s role is to regulate licence holders, not to police whether or not the trunk pipeline owner has complied with its duties to procure a licence for its activities.⁴⁶⁰

463 As discussed further below, licensing of such activities is required in order to provide for national security, law enforcement, environmental protection, and safeguarding of the property, life and health of citizen and the requirement to be licensed for pipeline activity (discussed further below)⁴⁶¹ is taken seriously by the Republic.

⁴⁵⁷ Second Witness Statement of Mr Turganbaev, dated 12 August 2012, para. 5.1

⁴⁵⁸ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para 275.

⁴⁵⁹ Exhibit R-128.

⁴⁶⁰ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para 267. Claimants infer from the fact that KPM and TNG’s pipelines were “never regulated” by ARNM, that there was no trunk pipeline. This is incorrect. Rather, it is more appropriate to infer from this fact simply that Claimants never held a trunk pipeline licence. See futher section C.VIII.4.

⁴⁶¹ Rejoinder Memorial on Jurisdiction and Liability dated 13 August 2012, section C.VIII.4.

464 Accordingly, on 14 November 2008 the Financial Police asked the ARNM whether KPM and TNG held a licence for a trunk pipeline.⁴⁶²

465 In setting out its request, the Financial Police explained that the Financial Police was carrying out an inspection further to the Republic's instructions concerning the alleged illegal actions of Stati. The inspection involved Stati's companies, KPM, TNG and another company called "Kok Mai" (tax payer registration number 600900114918). The Financial Police requested that the ARNM "*please furnish us, by 12th November 2008, information on the possession by the above-mentioned legal entities of the existing state licenses for carrying out activities in the oil and gas sector, and the possession of the license for exploitation of the oil and gas trunk pipelines and the oil processing and pumping centre.*"⁴⁶³

466 The ARNM replied swiftly and confirmed that no such licences were held by KPM or TNG.⁴⁶⁴ This confirmed the findings of the Geological Committee that certain licences were lacking. From this it was likely that Kazakh law had been breached. As to whether the pipeline was in fact a trunk pipeline, the inspections department also engaged specialists from the Ministry of Justice to consider whether or not KPM and TNG were operating main pipelines and added this information to the file submitted to the investigations department.⁴⁶⁵

3. Potential criminal liability through illegal economic activity

467 As discussed further below, any failure to licence a trunk pipeline is contrary to the trunk pipeline owner's obligation to licence.⁴⁶⁶ According to the law on illegal entrepreneurship, when a large amount of profit accrues from illegal unlicensed operations, criminal (as apposed to civil) liability for economic activity is triggered under Chapter 7 of the Criminal Code of the Republic.⁴⁶⁷

⁴⁶² Statement of Defence dated 21 November 2011, para. 26.10.

⁴⁶³ C-441.

⁴⁶⁴ C-88 and Statement of Defence dated 21 November para. 26.10(b)

⁴⁶⁵ Second Witness Statement of Mr Turganbaev, dated 9 August 2012, para. 5.2.

⁴⁶⁶ Expert Report of Professor Didenko, section IV and Rejoinder Memorial on Jurisdiction and Liability, section C.VIII.4.

⁴⁶⁷ Exhibit R-58.. Expert Report of Professor Didenko dated 9 August 2012, section IV.

468 As a result, the criminal offence of illegal entrepreneurship is one which punishes individuals and corporate entities from accruing large profits and causing significant loss from illegal activity. For holding a party criminally liable under Article 190 of the Criminal Code, it is necessary to establish that the relevant illegal actions indicated in the disposition have caused a large loss to individuals, to entities or to the state, or it involved deriving income on a large scale or the production, storage and sale of goods subject to excise in significant amounts.

469 As the Republic explains below, the criminal consequences of unlicensed behaviour is only triggered where there is large profit.⁴⁶⁸ Therefore as part of establishing whether was a suspicion of the commission of this crime, as part of the information gathering process, the Financial Police also contacted the Tax Committee on 17 November 2008 to ascertain what profits had been accumulated by KPM and TNG illegally.⁴⁶⁹

470 Based on the information given by the ARNM, the Tax Committee asked to calculate the amount of profits that KPM and TNG had accrued in order to ascertain if a criminal offence had been committed.

471 As explained above, this was an integral part of the inspection procedure:
*2.4 Once all necessary inspections have been performed, the inspection department of the Financial Police is obliged to pass on all materials to the investigation department of the Financial Police. Based on the collected material, an investigator of the investigation department of the Financial Police decides whether there is sufficient evidence that a crime may have been committed to justify opening a criminal investigation.*⁴⁷⁰ It is wrong for Claimants to suggest that this was a demand.⁴⁷¹

472 Once satisfied that all the material has been gathered, the Financial Police's inspection department is required to pass the information to the Financial Police's investigations department. In this case, there was a potential breach of criminal law and Mr Turganbaev remembers that in his view all the material was relevant:

⁴⁶⁸ Expert Report of Professor Didenko dated 9 August 2012, section IV. Second Witness Statement of Mr Turganbaev, dated 9 August 2012, para. 5.4.

⁴⁶⁹ Exhibit C-89.

⁴⁷⁰ Second Witness Statement of Mr Turganbaev dated 9 August 2012, para 2.4.

⁴⁷¹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 249.

*“The inspections revealed a potential breach of criminal law. In this instance all files involved in the inspection were passed over to Mr Rakhimov for the purpose of deciding whether there was sufficient evidence to open a criminal investigation. I was not involved in the process of assessing whether the contents of the various inspection files justified the opening of a criminal investigation.”*⁴⁷²

473 Mr Turganbaev reported back to the Prime Minister’s office to explain how the inspections had progressed on 10 December 2008. In his letter, as Claimants note, Mr Turganbaev did mention that *“it is ascertained that “Kazpolmunay” LLP and “Tolkyneftegas” LLP are operating trunk oil and gas pipelines”*.⁴⁷³ However, the letter, as Claimants acknowledge,⁴⁷⁴ goes on to explain the considerations upon which the Financial Police’s statement is based and the fact that further enquiries needed to be made because since, the Financial Police are not the competent authority in relation to the classification of pipelines, *“it is impossible to make a lawful procedural decision in respect of this case”*. The letter goes on to explain that requests were being made of the licensing agencies to establish whether they could provide a view on whether the pipelines were trunk or not, taking into account the *“functions actually performed”* by those pipelines.⁴⁷⁵

474 So even at this stage, it is clear that the Financial Police, though it had procured information on the amount of profits gained by KPM and TNG and had information about the licences held by the companies, and had also made enquiries of the Ministry of Justice, had not yet reached a definition conclusion as to whether the KPM or TNG pipelines were trunk or not. It is absurd to suggest that the “classification of pipelines” was premeditated when, even at this stage, two months after the inspection of TNG and KPM’s fields, no final conclusion had yet been drawn.

⁴⁷² Second Witness Statement of Mr Turganbaev dated 9 February 2012, para. 6.1.

⁴⁷³ C-448.

⁴⁷⁴ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 220.

⁴⁷⁵ C-448.

4. The investigations agreed with the findings of the inspections department

475 The Financial Police's investigations team that took over the issue of the suspected illegal activity was led by Mr Rakhimov. His task was to consider the evidence and provide the information to the prosecutor if he considered that there was enough evidence that a violation had been caused. He opened a case in relation to the illegal operation of a pipeline without a licence on 15 December 2008.⁴⁷⁶

476 The Financial Police conducted their own investigations into the issues which including procuring the relevant documents to investigate whether or not as crime had been committed. These documents would typically come from government authorities or the companies themselves.

477 Accordingly, the Financial Police carried out a number of searches in December 2008 which also involved interviewing employees of KPM and TNG. This included carrying out an investigation at KPM and TNG's offices in December 2008. As Mr Rakhimov notes, this was authorised by Article 36, 230, 231 and 232 of the Criminal Procedure Code.⁴⁷⁷

478 In terms of the information that needed to be gathered, the required information is governed by Article 117 of the Criminal Procedure Code.⁴⁷⁸
Thus:

“Pursuant to Article 117 of the Criminal Procedure Code of the Republic of Kazakhstan, the following circumstances, together with other mandatory circumstances, shall be subject to proof:

(a) The event and the features provided for by the criminal law of composition of crimes (time, place, method and other circumstances of commission of a crime);

(b) who committed an act prohibited by the criminal law;

⁴⁷⁶ Witness Statement of Rakhimov dated 12 August 2012 para. 2.2.

⁴⁷⁷ Second Witness Statement of Rakhimov dated 12 August 2012, para 4.1.

⁴⁷⁸ Second Witness Statement of Rakhimov, dated 12 August 2012, para. 4.3

(c) *nature and amount of harm caused by the crime,*

4.4 *Therefore, the following circumstances were subject of proof in this criminal investigation: Certain information was particularly important for the preparation of the case:*

(a) *evidence relevant to the classification of the pipelines,*

(b) *profits received from the operation of the pipelines without a licence, including the pipelines themselves.*

(c) *a subject of the crime, i.e. a person who committed the alleged crime.*⁴⁷⁹

479 Therefore, the relevant information was collated as set out below.

480 The Financial Police interviewed Mr. Cornegruta (General Manager of KPM) on 25 December 2008 and Mr Cojin (General Manager of TNG) on 4 February 2009: *“At that time they were interviewed as witnesses rather than suspects or Defendants because at that stage we had not reached any conclusion as to which individual would be the appropriate defendant to any criminal proceedings.”*⁴⁸⁰

481 On 30 December 2008, the Financial Police inspected the pipelines. As Mr Rakhimov recalls: *“The purpose of the inspection was to specify the process of production, refining and further transportation of hydrocarbon material. Another purpose was to make sure that the pipelines match the documents describing their construction, placement and other physical features.”*⁴⁸¹

482 In order to decide whether the pipelines were main pipelines, the investigations department engaged specialists from the Ministry of Justice, who had expertise in this area. According to the Criminal Procedure Code and the Law “On Financial Police”, in order to carry out an inspection, the Financial Police has a right to appoint a judicial construction and technical examination and it was done in this case. This report was provided in

⁴⁷⁹ Second Witness Statement of Rakhimov, dated 12 August 2012, para. 4.3 to 4.4.

⁴⁸⁰ Second Witness Statement of Rakhimov, dated 12 August 2012, para. 4.5.

February 2009 by Mr Baymaganbetov who was employed by the Department of Forensic and Construction Expert Examination at the Regional Scientific-production forensic laboratory of the Centre Astana forensic Ministry of Justice, Astana in the Republic. This is discussed in detail below.⁴⁸²

483 On 6 and 7 May 2009, the Financial Police procured human resources and financial records from KPM and TNG.⁴⁸³

484 In order to ascertain whether the illegal entrepreneurship crime was triggered, the Financial Police asked the Regional Scientific and Production Laboratory of Forensic Expert Examination of Astana City, to calculate the amount of profit that had been earned by KPM. The report was provided by Mr Askarov on 18 May 2009.⁴⁸⁴ This report concentrated on KPM and considered the income that would be generated on the basis of a number of calculations, the largest amount calculated being 65 479 414 197 tenge for the amounts received from the operation of the pipeline for the whole period since construction in 2002 to 2008.⁴⁸⁵ For the period between 2007 and 2008 only, the expert calculate the lower level of profit of 21 673 919 031 tenge accrued. The fact that the expert was asked to conduct a number of different calculations, demonstrates that there was no fixed notion at this stage of the amount of that should be recovered by the Republic, if it were found that Mr Cornegruta was guilty of illegal entrepreneurship.

5. Identification of key personnel and detention of Mr Cornegruta

485 Up until April 2009, Mr Rakhimov's investigation was concerned with establishing whether or not the facts gave rise to the conclusion that a crime had been committed. In April, he turned to the questions of who was responsible for such crimes. Mr Rakhimov describes the process such:

As was stated above, initially criminal cases were not instituted against specific persons but regarding the fact

481 Second Witness Statement of Rakhimov, dated 12 August 2012, para. 4.7.

482 Rejoinder Memorial on Jurisdiction and Liability dated 13 August 2012, section C.VIII.4.

483 Second Witness Statement of Rakhimov, dated 12 August 2012, para. 4.9.

484 C-184

485 C-184.

of the exercise of illegal entrepreneurial activity by KPM and TNG. At the first stage of investigation we did not consider it reasonable to make quick findings and identify particular persons as suspects or defendants. For this exact reason, at the first stage of investigation Mr. Cornegruta and Cojin were interviewed as witnesses.

7.2 In the course of the investigation, analysis of the results of conducted investigative and operational procedures, a circle of persons being subject to be engaged as defendants was established, namely those persons who were responsible for license-free activity related to operation of trunk pipelines by KPM and TNG (i.e. Messr. Cornegruta, Spasov, Salagor and Cojin).

7.3 Operative officers of the investigative operational group informed me that the members of the management of KPM and TNG took immediate measures to leave the Republic of Kazakhstan. I left for Aktau immediately but upon arrival I learned that Messr. Cojin, Spasov and Salagor had already left the Republic of Kazakhstan, and that Mr. Cornegruta was issued a Schengen visa, and was absent from the place of residence registered with the migration police agency. Later on it was found out that, in violation of established rules, he permanently lived out of the place prescribed by the migration laws.”⁴⁸⁶

486 Mr. Rakhimov identified Mr Stejar, Mr Cojin, Mr Spasov and Mr Salagor (the senior managers of TNG and KPM) as the likely relevant responsible individuals. Following attendance at their offices, it became clear that the majority of these senior members had left Kazakhstan. Mr Cornegruta also proved uncooperative.⁴⁸⁷ Mr Rakhimov explains his concerns that Mr Cornegruta would also evade prosecution by leaving the country:

“7.5 Taking into account the real danger that Cornegruta might abscond during the investigation or trial, or

⁴⁸⁶ Second Witness Statement of Mr Rakhimov dated 12 August 2012, paras. 7.1 to 7.3.

⁴⁸⁷ C-454. Mr Rakhimov describes how during the course of the pre-trial investigation, Mr Cornegruta refused to give evidence.

encumber the investigation, I made the decision to arrest him. I was concerned that Mr. Cornegruta might also leave Kazakhstan. Therefore, according to Articles 132-134 of the Criminal Procedure Code of the Republic of Kazakhstan, I resolved to arrest Mr Cornegruta.”⁴⁸⁸

487 On 20 April 2009, in accordance with Articles 132 - 134 of the Criminal Procedure Code, Mr Rakhimov took the decision to detain Mr Cornegruta and opened criminal proceedings against him referring to Article 190(2)(b) of the Criminal Code of the Republic.⁴⁸⁹ The decision to detain Mr Cornegruta was confirmed on appeal on 1 May 2009.⁴⁹⁰

488 After having examined the all the evidence

“On 19 May 2009, after all investigative actions had been performed and the evidence sufficient to issue an indictment had been collected, I announced the completion of the investigation initiated the period during which the defendant Mr. Cornegruta and his lawyer could study the files of the criminal case.

At this stage the defendant Mr. Cornegruta and his lawyer, pursuant to Article 275 of the CPC of the RoK, were presented with the criminal case files and were allowed to take notes of any details and also to copy documents, and they were were given all the time necessary to familiarize themselves with the case files.

Mr Cornegruta completed this process on 15 June 2009.”⁴⁹¹

489 This was required under Article 275 of the Criminal Procedure Code of the Republic⁴⁹² and functions to allow the prospective defendant an

⁴⁸⁸ Second Witness Statement of Mr Rakhimov dated 12 August 2012, para. 7.5.

⁴⁸⁹ Resolution on Institution of Criminal Proceedings and Commencement of Proceedings dated 20 April 2009 and Second Witness Statement of Mr Rakhimov, dated 12 August 2012, para. 7.5 (**Exhibit R-243**).

⁴⁹⁰ Second Witness Statement of Mr Kravchenko dated 12 August 2012, para. 13.16.

⁴⁹¹ Second Witness Statement of Mr Rakhimov dated 12 August 2012, paras. 6.1 to 6.3.

⁴⁹² Second Witness Statement of Mr Rakhimov dated 12 August 2012, para. 6.2.

opportunity to understand and comment upon the case being brought against him.

6. Indictment by the Investigation Department

490 Only once Mr Cornegruta had an opportunity to reveal the case against him was completed the indictment against Mr Cornegruta was drawn up. Mr Rakhimov filed this on 15 June 2009 in accordance with Articles 278 -279 of the Criminal Procedure Code.⁴⁹³ This indictment was carefully drafted by Mr Rakhimov.⁴⁹⁴ It evidences the results of all the inspections and interviews carried out by the Financial Police and attached all the relevant information for the review of the General Prosecutor's Office and serves as a good record of the due process undertaken in the pre-trial investigation stage.

491 The criminal activity that had been identified was that of operating a trunk pipeline without a licence. Other possible crimes or breach regarding which Mr Rakhimov also had evidence of as a result of the investigations, were not found to be well-founded and Mr Rakhimov issued an order explaining that such cases were not to be pursued.⁴⁹⁵

492 At this stage the whole file, together with the indictment was transmitted to the First Deputy of the Western Regional Prosecutor's office for examination (a division of the General Prosecutor's Office).⁴⁹⁶

493 It is patent from the analysis above that no formal indictment was brought against Mr Cornegruta until it had been established that KPM had no licence to operate a trunk pipeline and that KPM did operate a trunk pipeline in the opinion of a competent expert and until the prospective defendant himself had an opportunity to comment on the evidence being collated. Claimants' characterisation of Financial Police's inspections team's correspondence with the ARMN (to establish what licences were held by KPM and TNG) and the Tax Committee (to prepare indicative

⁴⁹³ Second Witness Statement of Mr Rakhimov dated 12 August 2012, para. 2.7.

⁴⁹⁴ Second Witness Statement of Mr Rakhimov dated 12 August 2012, 6.1.

⁴⁹⁵ Resolution of the Financial Police not to open an investigation dated 18 May 2009 (**Exhibit R-242**).

⁴⁹⁶ Exhibit C-454.

figures on illegal profit) and the investigation team's subsequent procurement of material for use in the trial, is incorrect.

494 Claimants' conspiracy is based on nothing more than gratuitous, incomplete and incorrect readings of the evidence. There is no rewriting of history by the Republic. In its Reply Memorial on Jurisdiction and Liability, Claimants have failed to present further evidence to support its contention that the actions of the Financial Police were in any way inappropriate or contrary to their powers.⁴⁹⁷

VIII. Trial and Prosecution of Mr Cornegruta on behalf of KPM for Illegal Entrepreneurship

495 Following the Financial Police's investigation and charge of Mr Cornegruta on behalf of KPM, the prosecution lodged the case against Mr Cornegruta on the basis that Mr Cornegruta was, in the prosecutor's opinion based on the facts and evidence reviewed, liable for illegal entrepreneurial activity under Article 190 of the Criminal Code of the Republic.

496 The Republic maintains its position that there are no grounds for the Tribunal to reopen the decision of the Aktau court in a case concerned with alleged breaches of the obligations at international law.⁴⁹⁸ This is the case even where a decision is wrong as to the law, let alone a case, such as this where the decision taken by the Court taken by was valid, correct and confirmed on appeal.

497 In any event, it is the Republic's case that there was nothing incorrect or improper about the decision of the Aktau court to prosecute Mr Cornegruta for illegal entrepreneurship. The Republic maintains the position set out in the Statement of Defence.⁴⁹⁹ Judge Ryskaileva exercised her discretion based on a thorough review of the admissible facts and evidence and concluded that Mr Cornegruta was culpable of illegal entrepreneurship on the basis of KPM's illegal operation of a trunk pipeline without a licence.

⁴⁹⁷ Statement of Defence dated 21 November 2011, para. 26.5.

⁴⁹⁸ Statement of Defence dated 21 November 2011, para. 23.2.

⁴⁹⁹ Statement of Defence dated 21 November 2011, paras. 27.24 to 27.60.

This resulted in criminal prosecution and imprisonment of Mr Cornegruta and a fine being imposed on KPM.

1. The legal tests

498 The Aktau court was asked to rule on whether Mr Cornegruta on behalf of KPM was guilty, pursuant to Article 190(2)(b) of Criminal Code of Republic. The Republic has outlined the nature of this criminal offence above.⁵⁰⁰ In order to consider this question properly, Judge Ryskalieva was required to render legal determinations on four key issues including:

- (a) Whether or not Mr Cornegruta was an entrepreneur.
- (b) Whether there is activity considered to be illegal. On the facts of this case, the illegal activity complained of constituted KPM's operation a pipeline without the correct licensing. This involved findings as to:
 - (i) whether or not the pipeline was a trunk pipeline; and
 - (ii) if so, whether this activity was, in fact, appropriately licensed.
- (c) If a crime had been committed (and illegal profit of a sufficient level procured), from whom and in what amount the income of the criminal activity could be recovered.

499 Therefore, Judge Ryskalieva's task was a legal one which involved applying the facts and the applicable expert evidence to the applicable legislative tests set out in general form below.

500 Pursuant to Article 190 of Criminal Code the crime of illegal entrepreneurial activity is defined as follows:

Article 190. Illegal Entrepreneurship

1. The exercise of illegal entrepreneurial activity without registration or without a special permit (license), in cases in which such a permit (license) is obligatory, or in violation of terms of licensing, as well as engagement in prohibited types of entrepreneurial activity, if these acts

⁵⁰⁰ Rejoinder Memorial on Jurisdiction and Liability dated 13 August 2012, section C.VII.3.

caused a considerable damage to a citizen, organisation, or the state, or if these acts are combined with the receipt of profit in a large amount, or production, storage or marketing of excisable goods in material quantities, -

shall be punished by a fine in an amount from three hundred up to five hundred monthly assessment indices, or in an amount of wages or other income of a given convict for a period from three to five months, or by engagement in public works for a period from one hundred eighty up to two hundred forty hours, or by detention under arrest for a period up to six months, or by imprisonment for a period up to two years with a fine in an amount up to fifty monthly assessment indices, or in an amount of wages or other income of a given convict for a period up to one month, or without it.

2. The same acts:

a) committed by an organised group;

b) accompanied by extraction of profit in an especially large amount;

c) committed by a person who was earlier convicted for illegal entrepreneurship or illegal banking activity, -

shall be punished by a fine in an amount from seven hundred up to one thousand monthly assessment indices, or in amount of wages or other income of a given convict for a period from seven months up to one year, or by imprisonment for a period up to five years with forfeiture of property, or without it.

Note. 1. In Articles 190 and 191 of the present Code, profit in a large amount shall be understood to mean income an amount of which exceeds five hundred monthly assessment indices, and profit in an especially large amount shall be understood to mean income an amount of

which exceeds two thousand monthly assessment indices.”⁵⁰¹

501 As to Issue A, under Article 10 of the Civil Code of the Republic “entrepreneurship” is defined as:

*“initiative activity of citizens and legal persons, independently of the type of ownership, aimed at net profit gaining through satisfaction of demand on goods (works, services) based in the right of private ownership (private entrepreneurship) or on the right of economic management or operating management of state-owned enterprise (state entrepreneurship). Entrepreneurial activity is exercised on behalf, for risk and under the property responsibility of an entrepreneur.”*⁵⁰²

502 As to Issue B(i), whether a pipeline is trunk or otherwise is a process of classification to be carried out in accordance with the law, and in particular with the Law on Oil section 14(1), 28 June 1995 which contains a definition of a “trunk” pipeline.

503 As to Issue B(ii), in accordance with the Law “On Licensing” 1995⁵⁰³ a licence from the MEMR was required to operate trunk oil or gas pipelines. In 2007 that licensing regime was altered by the Law “On Licensing” 2007. Holders of existing pipeline licences (for both trunk and other pipelines) were required to renew their licences with the ARNM under Article 12 of the Law “On Licensing” 2007.⁵⁰⁴

504 As to Issue C, a “large loss” triggers the criminal nature of this unlawful entrepreneurship as set out above.⁵⁰⁵ Further, according to Article 19 of the Regulatory Resolution of the Supreme Court of the Republic of Kazakhstan of 18 June 2004, companies convicted of illegal entrepreneurial activity are

501 Exhibit R-58.

502 Exhibit R-8.

503 Exhibit R-24.

504 Exhibit R-24.

505 Rejoinder Memorial on Jurisdiction and Liability dated 13 August 2012, section C.VIII.1.

liable for forfeit all (and the aggrieved party is entitled to cover) monies gained during the period of such activities.⁵⁰⁶

505 In relation to the classification of pipelines at Issue B(i), Claimants make much of the innocuous comment by the Republic in its Statement of Defence that “*the question of whether the pipelines operated by KPM and TNG are field or trunk pipelines is a matter of the correct application of the relevant Kazakh legislative instruments*”⁵⁰⁷ and concludes (inaccurately) that the Republic’s case is that this is a purely legal issue. In fact, the Republic’s position is that pipeline classification is a matter of legal *interpretation*.⁵⁰⁸ The same is true of the process to be followed to make a finding in relation to each of the key matters in issue.

506 No sensible legal interpretation would be possible if the facts were entirely ignored. It is disingenuous of Claimants to suggest this is the Republic’s argument. The “correct application” of the legal instruments (which, as the Republic has explained above, constitutes, primarily the application of the Law on Oil) necessarily means applying the key relevant factual and expert evidence to determine the question.

507 Presumably it is not seriously contested by Claimants that the question before the court is one of legal interpretation since the greater part of the following paragraphs of the Reply Memorial on Jurisdiction and Liability appears itself to rely on quoting and interpreting various legislative authority against the relevant facts.⁵⁰⁹

508 Crucially, the Judge was required to act in accordance with Article 25 of the Criminal Procedure Code which requires that the judge evaluate the evidence based on his or her inner convictions and beliefs, remembering always that no evidence shall have any pre-determined force. Mr Kravchenko describes this as follows:

“10.2 According to Art. 25 of the CPC (assessment of proofs on the internal belief), the judge can estimate the proof on the basis of his/her internal belief based on

⁵⁰⁶ Exhibit R-144.

⁵⁰⁷ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 254 and Statement of Defence, para. 23.6.

⁵⁰⁸ Statement of Defence dated 21 November 2012, para. 23.10.

⁵⁰⁹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 253 onwards.

aggregate of the considered proofs being guided by the law and conscience.”⁵¹⁰

509 other words, the Judge was entitled and required to exercise her discretion in the determination of the issues brought before her.

2. Issue A: Entrepreneurship

510 Mr Cornegruta was the General Manager of KPM and, as such the most senior executive of that company. Given Mr Cornegruta’s position within KPM it was trite that he would in theory carry responsibility under law for any criminal activity of KPM. During the investigation, the Financial Police identified the correct person to take responsibility on behalf of KPM by searching for an analysing the human resources records of KPM.

511 The Judge determined that the scope of the relevant law meant that an individual is capable of entrepreneurial activity in both their own right and on behalf of a company:

*“From the Civil Code of Regulations of the Republic of Kazakhstan it can be observed that entrepreneurial activity takes place by means of establishment of a legal entity, as well as without establishing a legal entity, i.e. entrepreneurial activity is carried out by individuals either in their own interest or in the interest of a legal person.”*⁵¹¹

512 She then reviewed the Charter of KPM to ascertain the precise role of the General Director and the relevant facts to conclude that “[i]t follows from the described above that the defendant exercised management of Kazpolmunay LLP’s operations, including its entrepreneurial activity, i.e. the activity aimed at gaining profit by meeting the demand for goods, work and services.”⁵¹²

⁵¹⁰ Second Witness Statement of Mr Kravchenko dated 12 August 2012, para. 10.2.

⁵¹¹ Exhibit C-117, p.10.

⁵¹² Exhibit C-117, p.10.

3. Issue B(i): Classification of Pipeline

513 Claimants allege that in relation to the classification of trunk pipelines, new arguments have been introduced by the Republic in an attempt to retroactively improve its arguments. This is not the case. The arguments presented in the Statement of Defence responded to Claimants' undisciplined analysis of the "correct" method of classification of pipelines. It is the Republic's primary case that such an analysis is not strictly necessary where the Kazakh court has already ruled on the issue in a perfectly appropriate manner. In any event, to the extent that any arguments are new, these are not inconsistent with the outcome or the rationale of the decision in the Aktau court which was confirmed by the Mangystau Court on appeal. The judge took the correct decision procedurally and substantively.

514 This section therefore, addresses the legal question that the court needed to determine in order to classify the pipeline as trunk or otherwise. In doing so, the Republic addresses the arguments put forward by Claimants in the Rejoinder Memorial on Jurisdiction and Liability and in the Expert Report of Mr Suleymenov. In response to the addition of Mr Suleymenov's opinion on these issues, the Republic repeats and relies fully on the expert opinion of Professor Didenko. The following section highlights the key points raised by his report. Further, the Republic addresses the questions raised by Claimants regarding Mr Bagmaganbetov's expert below.⁵¹³ As set out there, the decision taken by Mr Baymaganbetov that the pipeline was trunk was entirely correct.⁵¹⁴

a) Law and Applicable Legislation

515 According to Article 1(14) of the Law "On oil" dated June 28, 1995 (in edition, which was in force at the time of the contract) a trunk pipeline is an engineering facility consisting of linear part and connected with it ground objects, utility lines, telecontrol and communications, designated for transportation of oil from places of production (processing) to places of

⁵¹³ Rejoinder Memorial on Jurisdiction and Liability, section C.VIII.4.

⁵¹⁴ The Republic relies on the Expert Report of Mr Latifov dated 22 July 2012 in this respect.

transfer to other kind of transport, processing and consumption. Trunk pipelines do not include a gathering pipeline.⁵¹⁵

516 As set out above,⁵¹⁶ in order to classify a trunk pipeline, other legislation can be useful and be applied by the judge to the law in question. It should be noted that for the purposes of determining the correct classification of a pipeline under the Law on Oil, any of these regulations are meaningless and irrelevant on their own since they pertain to the design features or requirements of a pipeline rather than specifically applying to the issue of classification of pipeline under the Law on Oil. However, they are often more specific documents (frequently specific to design and construction) which can assist in filling any lacunas in the Law on Oil where necessary. Among these are certain regulations and laws such as:

- (a) The Law “On Subsoil Assets and Their Use” in relation to the definition of Contract Area.⁵¹⁷
- (b) The definition of “Oil and Gas Pipelines” in the Law on Oil 1995.

The more general definition for the “Trunk Pipeline” is the definition of the "Oil and Gas Pipelines", which means any pipelines designated for oil transportation, including trunk lines, collecting pipelines, and also equipment and mechanisms for cleaning, separation and liquefaction of substances, transported through a system of pipelines or its separate parts, the system of control and isolation, system of electrochemical protection and other equipment intended for servicing these pipelines (article 1 of the Law “On Oil”).

- (c) Certain regulations including:

⁵¹⁵ Exhibit R-23. Further it is worth noting that in the text of the Law of the Republic of Kazakhstan “*On Oil*” on 01.12.2004, Trunk Pipeline means an engineering facility consisting of a linear part and accompanying surface level objects, communications, remote controls and communications, which is intended for transportation of oil from the place of production (refining) to the place of transfer to a different type of transport, processing or use. A pipeline that is operated as a collector shall not be regarded as a trunk pipeline (Article 1(10) of the Law).

⁵¹⁶ Rejoinder Memorial on Jurisdiction and Liability dated 13 August 2012, section C.VIII,1.

⁵¹⁷ Expert Report of Professor Didenko dated 9 August 2012, p.8. Professor Didenko explains that the Law on Oil 1995 and the Law On Subsoil Assets and Their Use work together and therefore the Law On Subsoil Assets and Their Use is no less applicable than the Law on Oil.

- (i) SNiP RK 1.04-03, 2002 "Acceptance of the completed major repairs of residential and public buildings and objects of public purpose ",⁵¹⁸
- (ii) SNiP 2.05.06-85 * Pipelines and SNiP III-42-80 * Pipelines and, now SNIP RK 3.05-01-2010 • (in exchange for SNIP 2.05.06-85* and SNIP III-42-80*). In accordance with clause 3.31 of SNIP RK 3.05-01-2010⁵¹⁹, a trunk pipeline is the indivisible integrated operational-technological complex consisting of underground, underwater, overground, and over land pipelines and other objects ensuring safe transportation of prepared in accordance with requirements of technical regulations production from receiving points to delivery points to consumers transfer to other pipelines and other types of transport and (or) storage.
- (d) More information is also provided by the construction standards and Regulations of the Republic of Kazakhstan (CSR) 3.05.-01-2010, and the content of the Trunk Pipeline was also mentioned in the prior CSR 2.05.06-85.
- (e) With respect to design and construction of in-field pipelines the following are relevant:
 - (i) VSN 005-88 "Construction of in-field steel pipelines. Technology and organization".⁵²⁰
 - (ii) VSN 51-3-85 "Design of in-field steel pipelines";⁵²¹
- (f) With respect to diameter size of trunk pipelines also GOST 20295-85 "Steel welded pipes for trunk oil and gas pipeline. Technical specifications" is relevant:

517 In relation to the design and construction of the KPM Pipeline in particular the following documents are relevant:

⁵¹⁸ Witness Statement of Mr Baymaganbetov dated 10 August 2012, para 3.3.

⁵¹⁹ Exhibit R-327.

⁵²⁰ Expert Report of Mr Latifov, dated 22 July 2012, Exhibit 14.

⁵²¹ Expert Report of Mr Latifov, dated 22 July 2012, Exhibit 2.

- (a) RD 39-015-02 “Rules of Technical Operation of Reservoirs of Trunk Pipelines” with respect to operation of reservoirs used for collection and storage of oil in tank farms of oil pumping stations of Trunk oil pipelines;⁵²²
- (b) VNTP 3-85 “Norms of technological design of facilities for collection, transportation, preparation of oil, gas and water od oil fields”.⁵²³

518 Lastly, key to any analysis of whether the KPM Pipeline is trunk or not, the Work project “”TSB in Borankol” TSB (**Work Project**) provides the following information at clause 1.1:

- (a) head pump station with intermediate storage tank farm with capacity for oil – 4000m3 and for condensate – 6000m3;
- (b) export pipeline from TSB to trunk pipeline “Uzen-Atyrau-Samara”;
- (c) railway loading rack with 12 loading posts into railway tanks;
- (d) system of engineering support for work of designated objects in accordance with technical safety and efficiency of technological processes; power supply control and automation, water supply and sewage, fire extinguisher and etc.⁵²⁴

b) Definition

519 Thus, a trunk pipeline is an engineering structure intended for transportation of commercial (prepared in accordance with the requirements of technical regulations) oil from the points of intake (from Contractor’s pipeline) to the places of:

- (a) transshipment to a different means of transport;
- (b) processing;
- (c) consumption;

⁵²² Exhibit R-131.

⁵²³ Expert Report of Mr Latifov, dated 22 July 2012, Exhibit 6.

⁵²⁴ Expert Report of Professor Didenko dated 12 August 2009, section I, para. 7, p.14; see also Clause 1.1 Work Project “Consumer raw base in Barankol” (**Exhibit R-244**).

(d) storage.

520 A number of key points should be borne mind when considering the classification of the pipeline. Firstly, as Professor Didenko explains, a pipeline is classified in relation to its how it operates :

“Therefore, under the Law of the RK, pipeline classification is based on its operational regime and divides pipelines as follows:

- pipelines operating to transport the refined oil,

- pipelines operating in the mode of the oil accumulation and transfer to the oil preparation and transshipment installation (that is operating as a receiving manifold (industrial pipeline)).”⁵²⁵

521 As such while there are a number of different names for various types of pipelines (e.g main pipeline, field pipeline, contractor pipeline, gathering manifold (or industrial) pipeline), there is a key overarching distinction between two main types of pipelines: trunk oil pipelines on the one hand and field pipelines on the other.

522 Moreover, by definition, because “trunk” pipeline starts only where a “Contractor’s Pipeline” finishes, a “trunk” pipeline is not a “contractor’s” pipeline. Identifying the end of a contractor’s pipeline is therefore of central importance.⁵²⁶ The term “contractor’s pipeline” does not have a specific meaning but it can be inferred from the Law on Oil in the following ways:

(a) Pursuant to the definition of the Law “On Oil,” contractor is a legal or physical entity which has executed a contract with the competent authority to perform certain oil operations.

(b) Pursuant to Article 4.1 of the Law on Oil, contractor carries out exploration and extraction within the contract territory according to the license and terms of the contract.

⁵²⁵ Expert Report of Professor Didenko, dated 9 August 2012, section I, para 4, p.9.

⁵²⁶ Expert Report of Professor Didenko, dated 9 August 2012, throughout and in particular, para.7, p.10, paras. 8 where Didenko explains that a contractor’s pipeline is not, by definition a trunk pipeline.

523 Thus, the contractor’s pipeline means a pipeline used for the extraction of oil within the contract territory, or the “Contract Area” as defined in the pipeline owner’s contractual documents.⁵²⁷ Accordingly, as Professor Didenko explains, if a pipeline leaves the Contract Area any pipeline goes beyond the Contract Area is and “designated for other transport mode” is a trunk pipeline, it is a trunk pipeline, even if all other factors (including design characteristics) remain the same.⁵²⁸ Once this is understood, most of Claimants’ arguments lose their significance.

524 For example, Claimants take issue with the inclusion of the “storage” in the definition of trunk pipeline. This is not a pivotal issue here. Where a pipeline, running into a storage facility, lies outside the Contract Area as it does in this case, then, it becomes a trunk pipeline, whether or not it is attached to a storage facility. This is the case here: a length of the KPM Pipeline sits outside the Contract Area and flows into the storage facility. Of course, where a storage facility to which a pipeline connects sits within the Contract Area, this does not render it a trunk pipeline. The issue of “storage” is not determinative of whether or not it is a pipeline.⁵²⁹

525 In any case, storage clearly falls within the definition of “trunk pipeline” for the following reasons:

- (a) The contract provides for a wide definition of “oil operations” which includes storage.⁵³⁰
- (b) The Work Project refers to storage as being part of the integrated complex of the TSB at Oporiaya station, the end point of the KPM currently under scrutiny.
- (c) Article 1 on the Law on Oil in effect at the applicable time provides that oil storage is an integral part of business activity in the oil and

⁵²⁷ Expert Report of Professor Didenko, dated 9 August 2012, section I, para 9, p.15.

⁵²⁸ Expert Report of Professor Didenko, dated 9 August 2012, section I, para 9, p.15.

⁵²⁹ Expert Report of Professor Didenko dated 9 August 2012, section I, para 7, p.12.

⁵³⁰ Clause 1.20 of Contract 305 states that Oil Operations means: “*all works related to exploration, production, realization and related with them by integrated technological process **storage of oil** and its shipment by pipeline transport or other means*”. Exhibit C-45

gas industry since having reserve stocks of oil ensure quantitative and qualitative integrity of the product over time.⁵³¹

526 As result, the TSB at Opornaya station is a single complex, which includes facilities for storage. As such, as a matter of fact, the KPM Pipeline is a trunk pipeline that runs to a point of storage.

c) None of the characteristics that Claimants rely on demonstrate that the KPM is not trunk

527 In the Statement of Claim, Claimants' case relied heavily on observations as to the size and length of Claimants' pipelines. This argument has failed to withstand scrutiny by the Republic and was deemed as untenable by Claimants' own expert witness.⁵³² As explained above, the Republic's position is that characteristics can be indicative of whether or not a pipeline is trunk or otherwise, but this classification will always be subordinate to the legal interpretation of a trunk pipeline as set out directly above.

528 In any event, none of the four characteristics relied upon by Claimants in the Reply Memorial on Jurisdiction and Liability, and discussed below change the conclusion that the KPM Pipeline is a trunk pipeline.⁵³³

aa) The KPM Pipeline is not a gathering pipeline

529 Claimants argue that the Republic omitted Sentence 2 of Article 1(14): "Pipelines operating in the gathering main mode shall not be referred to as main pipelines"⁵³⁴. The KPM Pipeline is not a gathering main mode pipeline. Firstly, as Professor Didenko's explains, a gathering pipeline (or "receiving manifold") cannot extend outside the Contract Area. Therefore it

⁵³¹ Expert Report of Professor Didenko supports this position at section I, para. 7, p.10. Mr Latifov also endorses this view, Expert Report of Mr Latifov dated 22 July 2012, para. 5.1.

⁵³² Professor Suleymenov acknowledges that "*any conclusion that a pipeline is a trunk pipeline based only on certain technical parameters (wall thickness, diameter etc) finds no support in Kazakh law.*" (Suleymenov, para 55) and Statement of Defence, paras. 23.18 to 23.21. In this respect, Claimants appear to now accept that the question of whether or not the KPM pipeline is a main pipeline or not is a question of Kazakh law.

⁵³³ They key issues raised are addressed here and the remainder are dealt with in Professor Didenko's Expert Report on which the Republic relies.

⁵³⁴ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 263.

is plain that the KPM Pipeline, which did extend outside the contract territory was not a gathering pipeline.

*“As for the pipelines operating as receiving manifolds, within the meaning of law, they cannot go beyond the borders of the contract territory.”*⁵³⁵

530 Further, where a pipeline is used for pumping oil to third parties as is described below, it cannot be a gathering pipeline. In Mr Latifov’s experience, a gathering pipeline would never carry oil to third parties because this would compromise its quality.⁵³⁶

bb) The KPM Pipeline transports oil to a place of transshipment into other means of consumption of oil

531 Claimants assert that since the KPM Pipeline links into the CRMB, which is a place for the storage of oil, TNG and KPM do not, as a matter of fact, transfer oil and gas to *“places of transshipment into other means of transport or consumption”*⁵³⁷ as specified by the Law on Oil and therefore TNG and KPM cannot be operating main pipelines. This is incorrect.

532 Against this, two things are noteworthy. Firstly, the pipeline transported oil to a transshipment point. This is the CRMB base. As Professor Didenko explains:

“For the pipeline from the CPPM [preparations and pumping shop] to TSB [commodities raw material resource base], the key criteria for its inclusion to the trunk pipelines is either the direct delivery of the product via such pipeline to the third parties, or to the facility for preparation to the subsequent transfer. TSB is exactly that transshipment point for pumping the oil to the KazTransOil pipeline Delivery to such facility could be considered as “delivery by the pipeline operating as a receiving

⁵³⁵ Expert Report of Professor Didenko, Seciton I, para. 7, p.10.

⁵³⁶ Expert Report of Latifov dated 22 July 2012, para. 5.1.

⁵³⁷ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 257.

manifold (industrial pipeline),” only if the facility were located on the contract territory.”⁵³⁸(emphasis added)

533 From there, KPM transported oil for consumption. KPM had a number of transportation contracts for the sale of commercial oil. These contracts include the following clause: “4.5. *The ownership for Good as well as all the risk including accidental loss or damage shall be passed from the Seller to the Buyer at the moment of Good transfer to the shipper (Kaztransoil JSC).*”⁵³⁹ This demonstrates that the goods passed from KPM to the buyer under the contract at the point at which the oil was taken over by the buyer at the KTO pipeline. This is another indication that the KPM Pipeline is a trunk pipeline.⁵⁴⁰ Mr Latifov also considers that the use of the KPM Pipeline for commercial oil was envisaged by the Working Project and is one of the distinguishing features of a trunk pipeline.⁵⁴¹

cc) The KPM Pipeline shares oil with other contractors

534 The Republic contends that field pipelines serve the purpose of pumping solely the contractor’s oil or gas. Since KPM also transported TNG’s oil, this is another indication that the KPM Pipeline is indeed a trunk pipeline.⁵⁴²

535 Claimants argue that there are often arrangements between different contractors to share facilities and field transportation.⁵⁴³ However, in order to make good this argument, Claimants must demonstrate that the other contractors **who do** share each other’s pipelines do not hold trunk pipeline licence. They fail to do this.

536 More importantly, there is no basis in law for conflating the activities of these two companies, which have clearly been set up as two separate legal entities with different purposes. Most obviously, TNG operates for the

⁵³⁸ Expert Report of Professor Didenko dated 9 August 2012, section II, para 2, p.27.

⁵³⁹ Exhibit R-131.

⁵⁴⁰ Further, in accordance with Article 188(1) of Civil Code of the Republic the right of ownership includes aspects of right to own, use and dispose. Consumption, i.e. the extraction of useful natural properties of goods has exactly the same meaning. Therefore in this legislation, the word “consumption of oil” can also properly be taken to mean “transfer of ownership” of oil.

⁵⁴¹ Expert Report of Mr Latifov dated 22 July 2012, para. 4.3, p.8.

⁵⁴² Statement of Defence, para. 23.13.

production of gas, whereas KPM's function relates to the production of oil. If it were the intention that the activities of separate legal entities should be considered as a together, this is something that should be explicitly set out in the law. The Law on Oil makes no such provision.⁵⁴⁴

537 In any event, again, this argument flawed as a matter of logic. According to Professor Didenko a contractor pipeline is understood as pipeline, used in the process of oil production within the contract territory. Therefore a field is designated for pumping of such contractor's oil only. As such a field pipeline cannot be used for transportation of oil to third-party organizations.⁵⁴⁵

dd) Irrelevant considerations

538 Claimants continue to raise irrelevant issues that have nothing to do with the classification of the KPM Pipeline.

(A) Irrelevance of the 1km pipeline

539 Claimants argue that the 1km pipeline that followed on from the 17.9km pipeline that was determined as a trunk pipeline by the Aktau court was not a trunk pipeline. Moreover they say that the Republic was required to introduce this argument in the Statement of Defence because it renders the Republic's argument (that the pipeline is a trunk pipeline) more feasible. They are wrong on both counts.

540 Firstly, the small 1km piece of pipeline is a trunk pipeline. The fact that it is so short is of no significance.⁵⁴⁶

⁵⁴³ Rejoinder Memorial on Jurisdiction and Liability dated 13 August 2012, para. 281.

⁵⁴⁴ Expert Report of Professor Didenko dated 9 August 2012, section II, para 7. p.31.

⁵⁴⁵ This follows from the fact that a field pipeline is used primarily on the basis of a license which is issued for mining operations within (and not outside) a specific contract territory. Logically this excludes the idea of sharing or transportation a third party's oil.

⁵⁴⁶ Claimants and their expert refer to a technical standard (Standard 1316-2004) established by administrative order according to which main pipelines must exceed 50km in length and 219mm in diameter which is significantly more than the 1km length of pipe referred to by KPM. As has been set out above, technical regulations can never be determinative on the issue of classification of pipelines. In any case, the Regulation to which they refer came into in force in 2005, several years after the construction of the KPM Pipeline and this 1km pipeline were constructed earlier and as such, this Standard is irrelevant. Since they are not

541 Secondly, for the reasons set out above regarding the significance of Contract Area to the definition of a trunk pipeline, since the 1km pipeline outside the Contract Area, it is, quite evidently, a trunk pipeline. Though it might be unusual to have such a short trunk pipeline, under the definition of “trunk pipeline” in the Law on Oil 1995, it is perfectly plausible. As the Republic has previously asserted, physical characteristics are not determinative of whether or not the pipeline is trunk or otherwise.⁵⁴⁷

542 Thirdly, and more importantly, it is incorrect that the 1km pipeline was reclassified in the Statement of Defence and that this was the first time that the 1km pipeline was mentioned. In particular:

(a) there was no “reclassification” in the Statement of Defence. As the Republic has noted above, if a pipeline is a trunk pipeline then it remains a trunk pipeline, regardless of when that fact is discovered.

(b) the 1km pipeline was simply considered as part of the process of assessing whether the 17.9km KPM Pipeline was a trunk pipeline. It is hardly surprising that when considering whether the pipeline was trunk or not, the entire complex was taken into account.

543 Thus the Work Project referred to above shows that the CRMB at Oponaya station is one integrated whole that includes the 1km section leading up to the KTO pipeline. In classifying the pipeline it is not surprising that this was taken into consideration. Therefore, Mr Baymaganbetov referred to this 1km pipeline in writing his report and the Aktau court, in referring to Mr Baymaganbetov’s decision also referred to this 1km pipeline.⁵⁴⁸ Neither the Aktau court nor the Republic in the Statement of Defence “reclassified” this 1km section of pipeline. They simply referred to it in their deliberations as to the status of the KPM Pipeline.

(B) Prior approval by State authorities irrelevant

544 Claimants contend again that the approvals by various state authorities of the pipeline (at the point of completion, for example) demonstrate that the

considered to be statutory law, they do not have a binding effect in any case. Expert Report of Professor Didenko, Section II, para 10. p.18.

⁵⁴⁷ Rejoinder Memorial on Jurisdiction and Liability, section VII.

⁵⁴⁸ Exhibit, C-110, p.2, and Exhibit C-117, p.2.

pipeline could have been classified earlier, and was not, indicating that it is not a trunk pipeline.⁵⁴⁹ Those state authorities on which Claimants rely on were not competent or interested in the classification of the pipelines at the time. As is explained above, the ARNM is competent to licences trunk pipelines only. It neither polices who owns trunk pipelines nor does it classify whether or not a pipeline was trunk or otherwise.

545 As for the continued comparison between KPM and the KazTurkMunai pipelines, they Claimants have not proved any like features between the two. Further, they have not established that the KazTurkMunai is licensed as a trunk pipeline, therefore the comparison leads nowhere.⁵⁵⁰

4. The Court properly relied on fact and expert evidence when considering the legal tests

546 The Judge included a number of pieces of evidence in her legal analysis and conclusion that the KPM Pipeline was a trunk pipeline. In their Reply, Claimants continue to take issue with the evidence which the Judge chose to rely on, as well as the evidence chose not to rely on, including the evidence which was excluded from the trial. All these factors, Claimants say, led to both the wrong decision being taken in respect of the classification of pipelines and the decision being taken in the wrong manner procedurally. It is Claimants who are wrong. All steps taken in relation to the evidence were procedurally and substantively correct.

a) Mr Baymaganbetov's report was independent

547 The Judge relied on the expert evidence of Mr Baymaganbetov, who at the time worked at the Department of Forensic and Construction Expert Examination at the Regional Scientific and Production Laboratory of Forensic Expert Examination of Astana City.⁵⁵¹

548 The scope of the report was *“to perform forensic-construction and technical expert examination within the criminal case under*

⁵⁴⁹ Statement of Claim, para. 83 and following, Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 270 and following.

⁵⁵⁰ Statement of Defence dated 21 November 2011, para. 21.f(g) is repeated.

⁵⁵¹ Exhibit C-109.

investigation.”⁵⁵² The report was procured by the Financial Police’s inspection department and then submitted to the court to provide evidence and technical assistance to the trial judge.

549 Claimants raise a number of issues with Mr Baymaganbetov’s report. They argue that the report was not independent,⁵⁵³ that it was not correct and, it seems, that the Judge erred somehow in relying on this evidence (to the exclusion of other evidence) to make her finding against Mr Cornegruta.

*As to the independence of the report, it is important to understand how the report came about. As mentioned above, the Financial Police’s investigations team resolved to procure expert advice by way on an Order dated 9 February 2009. This letter provided that for the purposes of the criminal investigation (1) the Ministry of Justice (Regional Scientific and Production Laboratory of Forensic Examination) are authorised to consider whether the KPM pipeline “Oil Treatment Plant - Commodities and Raw Material Base, Opornaya station” is a trunk pipeline, (2) documents are to be given to the experts, and (3) that the experts be informed of their duties to the court in providing evidence.*⁵⁵⁴

550 Claimants assert that this Order demonstrates:

- (a) that the Financial Police had already made up its mind prior to appointing the expert that it considered that KPM operated a main pipeline without a pipeline, and
- (b) that the expert was instructed under threat of criminal prosecution. Presumably the implication is that, therefore, the expert was pressurised to make an assessment in line with the Financial Police’s misplaced and predetermined conclusion.

⁵⁵² Exhibit C-109.

⁵⁵³ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 308.

⁵⁵⁴ C-109. It is noted that the original translation of Exhibit C-109 provided with the Statement of Claim uses more intimidating language. In the initial version, the expert is to be “warned” rather than “informed” of its duties.

551 The Republic has already carefully addressed the suggestion that the Financial Police acted in a premeditated manner. The evidence does not support Claimants' contention. Rather, it demonstrates how little Claimants understand the allegations they are making.

552 Firstly, the Order they refer to was not an instruction to the expert. It is an internal Financial Police document that discusses and authorises the action to be taken by the Financial Police, namely, it describes the documents to be given to the expert and also notes that, when instructed, that the expert must be informed of its duties to the court. This is standard in any letter of instruction to an expert and should no be of any surprise.

553 Secondly, this Order was forwarded to the expert under cover of a letter and was received by the expert on the same date, 9 February 2009.⁵⁵⁵ It was not an unusual letter. The covering letter explained that the Financial Police were under time pressure and required a determination of the expert issue explained further in the Order attached to the covering letter. As Mr Baymaganbetov says, these resolutions were received frequently by the department in respect of investigations of companies:

“Current legislation of the RoK set out unified procedure for preparation, appointment of expertise, evaluation of its results in the framework of criminal and preliminary investigations, criminal and civil proceedings and cases regarding administrative wrongdoings. Decree [i.e. resolution] of the authority initiating of criminal procedure about the initiation of forensic expertise, made pursuant to Chapter 32 CPC, Law “On forensic expertise” and Regulation on forensics’ expertise in the Centre of forensic expertise is binding for. Everyday CFCE received over 30 decrees on initiation of expertise.”⁵⁵⁶

554 The next day, Mr Baymaganbetov met Mr Turganbaev (who had previously been in charge of running the inspection and also procuring a preliminary report on the classification of pipelines). Mr Baymaganbetov recalls

⁵⁵⁵ Witness Statement of Mr Baymaganbetov dated 9 August 2012, para. 3.1; Letter from the Financial Police to the Forensic Expert Centre dated 9 February 2009 (**Exhibit R-245**).

⁵⁵⁶ Witness Statement of Mr Baymaganbetov dated 10 August 2012, para. 3.2.

meeting him on 10 February 2009, after which an act of inspection was drawn up setting out what documents had been given to Mr Baymaganbetov.⁵⁵⁷

“On 10 February 2009, I together with Financial Police inspector, Mr. Turganbaev concluded an act of acceptance of substantial evidences, so that the following materials were presented and accepted for the review:

the Decree for initiation of Forensics Construction Inspection dated February 9, 2009, in 2 sheets;

Work Project on the construction of "Commodities and Raw Materials Base in Borankol";

SNiP 2.05.06-85, SNiP III-42-80*; and*

*a copy of the act of the working committee on the completed "Oil Pipeline of the Borankol Deposit toward to the Commodities and Raw Materials Base at Oporny Station" object's readiness for operation dated April 2002..”*⁵⁵⁸

555 Mr Baymaganbetov came to his decision quickly. This was not due to improper pressure from the Financial Police but because the matter at hand was not unduly complex and he had time to devote to the issue, which fitted with the Financial Police’s totally proper need for a prompt opinion:

“This expertise I finished within the 3 days (between 11 and 13 February 2009).

4.2 This examination does not require sophisticated research according to the question posed was necessary to carry out comparison of the pipeline is operated with the working documents and regulations, and to determine the identity and number of facilities affected by the study presented is not great: therefore complex types of

⁵⁵⁷ Report of inspection 10 February 2009 (**Exhibit R-246**).

⁵⁵⁸ Witness Statement of Mr Baymaganbetov, dated 10 August 2012, para. 5.3.

*research did not apply and it took me three days to complete.*⁵⁵⁹

556 Thirdly, the “threat” of criminal prosecution which Claimants state demonstrates a lack of independence, is a stipulated requirement of the Criminal Procedure Code. In fact its function is to ensure independence.

“Under Article 83(6) CPC for any deliberately false statements the expert held criminal liability established by the Article 352 of the Criminal Code.

*Article 83(7) CPC Expert, who is an employee of forensic authorities, is presumed to have acquainted with his rights and obligations and warned about his criminal liabilities for the deliberate false reports”*⁵⁶⁰

557 Far from having the effect of forcing the expert to make a finding in its favour of any convictions the Financial Police’s might have as to the outcome of this case, the purpose and effect of the statement is to remind the expert of the serious implications of making any false statements in the report and thereby ensures independence of the expert’s analysis and thereby the integrity of the function of appointing expert witnesses.

558 Fourthly, as Mr Kravchenko explains, any expert presented to the court by the prosecution needs to fulfil the requirements of Article 243 of the CPC:

*“Furthermore, the specialists and experts are brought into the case only on the basis of the decision and reasoned decree of the person conducting the criminal proceedings, and inspection tasks may only be appointed to specific persons as stated in art. 243 of the Criminal Procedure Code (forensics employees, licenced forensic workers, one-time other persons in accordance with the provisions of the law), which the people that made the conclusion are not.”*⁵⁶¹

⁵⁵⁹ Witness Statement of Mr Baymaganbetov, dated 10 August 2012, para. 4.1 and 4.2.

⁵⁶⁰ Witness Statement of Mr Baymaganbetov, dated 10 August 2012, para. 8.3.

⁵⁶¹ Second Witness Statement of Kravchenko, dated 8 August 2012, para 11.12 and Criminal Code of the Republic (**Exhibit R-247**).

559 The Centre of Forensic Examination in which Mr Baymaganbetov worked was one of the authorised experts on this list. In fact, given that the Centre operates from within the Ministry of Justice, it could not be surprising if it was the most frequently used body for the provision of forensic examination. Mr Baymaganbetov’s testimony was independent and trustworthy.

560 Claimants have failed to demonstrate that the expert appointed by the Republic lacked independence. In fact, Claimants raised independence challenges during the trial itself and these were rejected by the Republic.⁵⁶² Claimants appear to place great store by the fact the challenge was rejected. This is strange since it cannot be right that simply because a decision goes against Claimants that it was an incorrect decision. In Mr Baymaganbetov’s experience, this type of challenge is not an unusual defence strategy:

“ 9.3 During the trial the defence team challenged the admissibility of my opinion, but this is an entirely normal part of any criminal prosecution since the defence team always tries to challenge and did not agree with the experts report.”⁵⁶³

b) Mr Baymaganbetov’s decision was technically correct

561 Mr Baymaganbetov came to the conclusion that the pipeline was a trunk pipeline:

“Based on the results of the research, I issued Expert Opinion № 0324 on 13 February 2009. Pursuant to the conclusions KPM pipeline is a trunk pipeline I came to such conclusion by researching of the working project for construction of “Raw base Borankol”, comparing factual data of pipeline with law technical standards in the field of architecture and construction, (SNIps), specialized literature on pipeline, actual law provisions.”⁵⁶⁴

⁵⁶² This is discussed in detail section C.VIII.4.

⁵⁶³ Witness Statement of Mr Baymaganbetov dated 10 August 2012, para.2.3.

⁵⁶⁴ Witness Statement of Mr Baymaganbetov dated 10 August 2012, para. 6.1.

562 As to whether the expert came to the right decision, it is noted that Mr Baymaganbetov was well qualified to give this opinion:

“5.2 I have a higher education as engineer constructor, a qualification of forensic expert and registered in state register of forensic experts (in 2009), permissions for forensic-construction type of research, and pursuant to legislation, I possess special science knowledge in specified area of forensic examination in particular case in the construction field.”⁵⁶⁵

563 Mr Baymaganbetov was asked to consider whether the 17.9km pipeline that ran from the Centre for Treatment and Pumping of Borankol Field Oil (CTPO) to Commodities and Raw Material Base of Opornaya Station (CRMB) was trunk or not. The documents he reviewed were provided to him by the Financial Police and were all that he required to classify the pipeline. He did not need to see the pipeline itself and there was nothing improper in not having investigated the pipeline physically:

“6.4 In order to resolve the question at hand, it was required to determine the classification of pipeline. It was possible to do this with the use of presented documents - objects of research and law regulations were sufficient to determine classification of used pipeline documentary without the need to visit the facility. I consider that visit and exploration should be appropriate in case the questions of quality and price were raised. In order to determine classification of pipeline it is sufficient to use all the documents which were presented.”⁵⁶⁶

564 In coming to his decision, Mr Baymaganbetov relied on the technical specifications provided to him by the Financial Police. Also he made reference to the legal definitions set out in the Law on Oil definitions of trunk and oil pipelines and considered the layout factual layout of the site (as provided for in the Working Program). In his view, the characteristics of the KPM Pipeline were consistent with those of a trunk pipeline as applied to the law.

⁵⁶⁵

Witness Statement of Mr Baymaganbetov dated 10 August 2012, para. 5.2.

565 Mr Baymaganbetov stands by the determination he gave in 2009: *“At the present time I have the same view that this pipeline in its assignment, content and classification is a trunk pipeline.”*⁵⁶⁷

566 Mr Latifov, deputy director of the department of operations at JSC KazTransOil comes to the same view. Again Mr Latifov’s perspective is that of an engineer and industry man given his experience, covering 21 years in the oil pipeline sector. Mr Latifov demonstrates through a careful analysis that the KPM Pipeline shares the characteristics of a trunk pipeline as analysed against the major relevant norms: Construction Norms and Rules 2.05.06-85 and Departmental Construction Norms 51-3-85 "Design of steel upstream pipelines together with the Law on Oil."⁵⁶⁸ Mr Latifov identifies a significant number of characteristics that the KPM Pipeline has that accord with those required under the regulations that he examined. For example as to the diameter of the pipeline the two engineers are in agreement:

In accordance with clause 2.2 of the Construction Norms and Rules 2.05.06-85, the trunk pipelines, depending on the nominal diameter of the pipeline, are divided into four classes, in millimetres:*

I - with diameter of more than 1,000 to 1,200 inclusively;

II - the same here, with diameter of 500 to 1,000 inclusively;

III - the same here, with diameter of more than 300 and up to 500 inclusively;

IV - 300 and less.

*The pipeline "From the Center for preparation and pumping of oil at Borankol field to the commodities storage base at Opornaya station" is classified as trunk pipeline class IV based on its diameter.*⁵⁶⁹

⁵⁶⁶ Witness Statement of Mr Baymaganbetov dated 10 August 2012, para. 6.4.

⁵⁶⁷ Witness Statement of Mr Baymaganbetov dated 10 August 2012, para. 6.6.

⁵⁶⁸ Expert Report of Mr Latifov dated 22 July 2012, para. 4.3.

⁵⁶⁹ Expert Report of Mr Latifov dated 22 July 2012, para. 4.10.

567 Importantly, Mr Latifov also notes that the distinction between a trunk pipeline and a field or a production is also important relates primarily to whether or not the pipeline is within or outside the Contract Area:

*“Therefore, upstream pipelines are the pipelines that run between oil field facilities (well - installations for oil preparation), i.e. directly within the boundaries of the contract area. As seen from the schematic presentation by academician M.K.Suleimanov, this oil pipeline reaches out to beyond the limits of the contract area, and this fact serves as proof that this pipeline cannot be referred to as an upstream or a gathering collector pipeline.”*⁵⁷⁰

568 In the Statement of Case, Claimants suggested that the Republic “armed” itself with one expert whose conclusion flied in the face of the carefully considered opinions of five other experts. This is far from the reality. Mr Latifov agrees with Mr Baymaganbetov (and, for that matter, Professor Dikenko) on all the key defining characteristics of a main pipeline. His election as an expert came supported by all the credentials of independence that the Ministry of Justice can offer. In these circumstances, it is difficult to see how Claimants can seriously suggest that the choice of Mr Baymaganbetov and his decision in favour of the Republic was somehow indicative of foul play.

c) The Court was entitled to rely on Mr Baymaganbetov’s report

569 Finally, Claimants suggest that it is inappropriate to base her decision on the expert’s report.⁵⁷¹ This is incorrect. The Judge was perfectly entitled to rely on this expert report, so as to inform her view on whether the pipeline was trunk or not. Furthermore, the Judge adequately cross-examined the expert in the normal way.⁵⁷² Following such scrutiny, the Judge found that the conclusions set out in the expert report “*are reasonable and lawful, and consistent with other evidence in the case.*”⁵⁷³ Given this, it was entirely

⁵⁷⁰ Expert Report Mr Latifov dated 22 July 2012, para. 4.7.

⁵⁷¹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 309 and the Statement of Claim dated 18 May 2011, para. 104 are two such examples.

⁵⁷² Witness Statement of Mr Baymaganbetov dated 10 August 2012, para. 9.1.

⁵⁷³ Exhibit C- 117, p.6.

proper for her to include this expert report in her analysis and ultimate determination on this issue.

d) Inadmissible evidence was not considered

570 Claimants argue that the court did not consider any of the evidence that proved Mr. Cornegruta's innocence.⁵⁷⁴ This is simply not the case. The court considered the evidence that was admissible in the case in accordance with Kazakh procedural rules.

571 The key materials for consideration are the 5 opinions that Claimants, unprompted, procured from various government ministries and companies to support their view, so they thought, that the KPM Pipeline was not trunk. As mentioned above, as per the Criminal Procedure Code, experts in criminal cases must come from the authorised experts listed in the code.

572 It is not clear that any of the entities from whom Claimants procured the opinions fall within the categories set out in the list. Such lists are designed to increase the transparency and the independence of the expert process. One conclusion that the Tribunal might infer from this (especially given the silence on this issue) is that none of those opinions were independent.

573 Even if these opinions had been admitted, they would not have assisted the court in making its decision. Claimants have failed to address the key points raised by the Republic in the Statement of Defence⁵⁷⁵ at paragraphs of the Statement of Defence which highlight the substantive weaknesses of the opinions. To reiterate:

(a) Four of the five opinions obtained by KPM in connection with the issue of whether KPM's pipeline was a trunk pipeline are wholly irrelevant because they were produced by consultants that were not qualified to express an opinion on the issue, since they were neither lawyers nor were they technical experts appointed by the Ministry of Justice to give expert advice on this issue, as Mr Baganmaybetov was. This required under Article 243 of the Criminal Procedure Code of the

⁵⁷⁴ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para, 292.

⁵⁷⁵ Statement of Defence dated 21 November 2011, paras 21.5 (f) and (g), 26.12, 28.1 to 28.21

Republic.⁵⁷⁶ Moreover, legal entities are not qualified to interpret the norms set out in the Law on Oil.⁵⁷⁷

- (b) Mr Suleymenov, though a legal expert and therefore potentially more attuned to the issues at hand, did not, in the “opinion” provided in 2009, give any answer to the critical question of what constitutes a “contractor’s pipeline”. Further since the purpose of the expert was to assist the Judge with technical aspects, the provision of his legal opinion to the Judge (also competent in this field) is not necessarily relevant and is certainly not determinative.⁵⁷⁸
- (c) Claimants have not explained why and how they instructed the experts and therefore, have not established that these experts are independent or what the scope of the experts’ instructions were at the time.

574 Instead of seeking to address these important points, Claimants expend a number of paragraphs⁵⁷⁹ repeating (in some cases nearly word for word) paragraphs 91 and 98 to 102 of the Statement of Claim. The new points Claimants do raise do not add to the debate and can be dealt with in swift measure.

575 Firstly, at paragraph 284 of the Reply, Claimants introduce evidence that NIPneftegaz and KazNIPImunaygas are, they assert, the only holders of licences issued by the Republic for the design and engineering of oil and gas pipelines (including trunk oil and gas pipelines). The Republic neither admits nor denies this fact. However, as set out above, the Republic’s view is that the design of the pipelines is not in itself conclusive of whether or not a pipelines is trunk or otherwise.

576 Secondly, at paragraph 290 of the Reply, Claimants refer to an audit in January and February 2010 conducted by the MEMR and concluded that KPM and TNG were in compliance with Kazakh law with respect to the “classified pipelines”. The exhibits show nothing of the sort. The first quote

⁵⁷⁶ Second Witness Statement of Mr Kravchenko dated 12 August 2012, para. 10.1.

⁵⁷⁷ Second Witness Statement of Mr Kravchenko dated 12 August 2012, para. 10.6.

⁵⁷⁸ Statement of Defence, dated 21 November, para. 28.21.

⁵⁷⁹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, paras. 284 to 201.

in paragraph 290 of the Reply Memorial of the Jurisdiction and Liability refers to the KPM report at C-385, which states as follows:

*“7. The crude oil treatment and pumping facility (Russian abbreviation - TPPN) of Borankol and the raw materials base (Russian abbreviation - TSB) belong to the single technological process of the crude oil extraction system in accordance with Contract No. 305 dated March 30, 1999 and License series MG No. 309-D dated May 23, 1997.”*⁵⁸⁰

577 The Republic does not necessarily disagree with this statement but this does not amount to a finding that KPM and TNG were in compliance with Kazakh law.

578 The second quote is missing the following words after “*in full compliance*”: “*with, and certain of them (UKPG, oil- and gas pipelines) in excess of, those required for the current volumes of extraction.*”⁵⁸¹ This conclusion relates to the levels of production rather than classification of pipelines. Accordingly, neither of the reports of the audit expressly mention the classification of the pipelines in the way that Claimants suggest and the Republic is invited to draw the relevant inference from this silence.

579 Thirdly, Claimants seeks prejudicial advantage from highlighting that in its approach to Claimants’ opinions, the Republic appears to dismiss the evidence of its own officials and other well respected industry specialists.⁵⁸² This is a misunderstanding of the Republic’s position. The Republic does not seek to discredit its own officials or other respected companies. Rather, it merely notes that their evidence was not suitable for the case in hand for the reasons set out above (i.e. they were neither admissible nor relevant). While it is true that some of Claimants’ evidence was declared inadmissible, it is hardly the case that no evidence was referred to in the course of the trial.⁵⁸³

⁵⁸⁰ Exhibit C-385.

⁵⁸¹ Exhibit C-386.

⁵⁸² Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 506.

⁵⁸³ Exhibit C-117.

5. Proper and correct classification of the KPM Pipeline as “trunk”

580 Judge Ryskalieva determined that the KPM Pipeline is trunk. Her decision was correct both substance and form.

581 Ultimately, the decision on the classification of pipelines is one for the Judge to take in her discretion, taking into account the perspectives of the relevant experts. Claimants recognise this. In seeking to justify their strange assertion that the Financial Police is not the competent authority to classify pipelines (which is not denied by the Republic), they assert that “*Kazakhstan eventually found its “competent authority” in the form of the Aktau Court...*”.⁵⁸⁴ Once made, the finding has at least circumstantial weight for any other cases considered on similar issues.⁵⁸⁵

582 In this case, the court's decision was based partly on the technical expert's report and partly on her discretion. It is in the Judge's gift to determine the issue using her own legal analysis and interpretation.

583 Mr Baymaganbetov also agrees with this approach and explains that the issues dealt with by the expert report and the legal decision taken by the Judge are separate and distinct:

*“Rights and obligations of the forensic expert stated in legislation Article 83 CPC RoK, Articles 11 and 12 of the Law “On forensic expertise”, according to the Normative Decree of the Supreme Court of the RoK No. 16 dated November 26, 2004, based on the abovementioned legal authorities expert should give a statements on the questions related with the investigation and by this report expert has no rights to resolve legal questions, on non competence base.”*⁵⁸⁶

584 Mr Baymaganbetov goes on to explain that the decision as to the classification of a pipeline under the Law on Oil is, ultimately the preserve of the Court: “*Pursuant to my rights and obligations I do not resolve law*

⁵⁸⁴ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 222.

⁵⁸⁵ Expert Report of Professor Didenko. There is no doctrine of formal precedent in Kazakhstan. However, any judge faced with a similar issue is entitled to consider this case and take it into account in reaching a decision.

⁵⁸⁶ Witness Statement of Mr Baymaganbetov, 10 August 2012, para. 5.2.

*related issues which are not under my competency. I state that the main document, which covered construction of pipelines are SNiPs, in our case SNiP “Trunk pipelines”. I consider that the classification of the pipelines should be determined by specialists who pose special knowledge in the architecture and construction field. Judge of Aktay decided based on my report and her interpretation of the Law “On Oil” 1(14) that the pipeline was trunk. **However the provision of evaluation of the courts decision is beyond the responsibility [of the expert].**”⁵⁸⁷ (emphasis added)*

585 Significantly, Mr Suleymenov’s expert does not, in either of his opinions seek to challenge the decision of the court, although it is acknowledged that his opinion is contrary to the conclusion of the court on this issue. This is hardly surprising since there is always the possibility of conflicting conclusions and competing arguments when an issue which is the subject of legal interpretation is considered by lawyers. This does not render Mr Suleymenov’s opinion of superior weight to that of the Judge in either the Aktau court proceedings or these arbitral proceedings.

586 Further, while it can be seen that Mr Suleymenov disagreed with Judge Ryskaliyeva’s decision, it is significant that when Judge Ryskaliyeva’s decision was carefully scrutinised and reconsidered by a panel of three judges, Mr Kim, Mr Bisembaev and Mr Nuryshev, on 12 November 2009 in the Mangystau District Court they all agreed with her. Indeed, the appeal court effectively retraced and reconsidered the Judge decision step by step merely providing another new view on the issues. By contrast, Mr Suleymenov’s conclusion has been generated afresh. This suggests that the appeal courts’ endorsement of the decision at first instance is more persuasive than that of Claimants’ expert.

6. Issue B(ii): Whether the correct licences are held

587 Claimants acknowledge and admit that neither KPM nor TNG held licences from either the MEMR or the ARNM for the operation of a trunk

⁵⁸⁷ Witness Statement of Mr Baymaganbetov., 10 August 2012, para. 5.3. Mr Sulymenov, Claimants’ own legal expert also asserts that this a matter of law: “[a]ny conclusion that a pipeline is a trunk pipeline based only on certain technical parameters (wall thickness, diameter, etc.) finds no support in Kazakh law.” Expert Report of Mr Suleymenov, para.55.

pipeline.⁵⁸⁸ The judge heard from Mr Ismagulov of the MEMR to ascertain that “[KPM] never applied for a license for the type of activity of operation of oil pipelines, and therefore such license has never been issue to it.”⁵⁸⁹ The Judge also heard from Mr Abdakarimov from the ARNM with respect to the fact the procedure for applying for a main pipeline and the fact that KPM had not applied properly for such a licence. The judge concluded that no trunk pipeline was ever applied for and therefore no one was ever granted noting simply that “the defence does not deny that operation of a trunk pipeline is a type of activity subject to licensing” and “besides, there was no trunk pipelines in its books.”⁵⁹⁰ Little further by way of analysis was needed here.

588 That said, Claimants make much of the role of the ARNM, basing their assertions on incorrect statements as to the role of the ARNM. Claimants assert because the ARNM “exclusively” pipelines, and because the ARNM “never regulated any of KPM and TNG’s pipelines”, it follows that KPM and TNG did not own any pipelines. Further, they allege that ARNM had the “greatest interest in determining whether those pipeline were main”. Claimants understanding of the operation of the ARNM is entirely misplaced.

589 Mr Akhemetov explains the function and purpose of the ARNM very clearly:

“The Agency of the Republic of Kazakhstan on regulation of natural monopolies functions as the regulator and controller of activities of natural monopolies and regulated markets.

Functions of licensing of the trunk pipelines operation (gas pipelines, oil pipelines and oil product pipelines) were transferred to the ARNM in compliance with Decree of the President of the Republic of Kazakhstan No.346 dated June 19, 2007 “On Further Improvement of the State Management System of the Republic of Kazakhstan”

⁵⁸⁸ Statement of Claim dated 18 May 2011, para. 80.

⁵⁸⁹ C-117, p.4.

⁵⁹⁰ C-116, p.3.

(R-128). Since this time, the ARNM became the Licensor in respect of trunk pipelines.”⁵⁹¹

590 Its function is not to police owners of trunk pipelines to procure licenses. The duty is clearly on the owners of the trunk pipeline or the provider of services to the trunk pipeline owner to procure a licence for its activities:

“In accordance with Article 9(1)(11) of the Law “On Licensing” 1995 (R-24), carrying out of the certain types of activity or certain actions (operations) subject to licensing is permitted only with a licence. According to Article 12 of the Law of the Republic of Kazakhstan “On Licensing” 2007, it is necessary to obtain a relevant license for the operation of the trunk gas pipelines, oil pipelines and oil product pipelines.”

591 This is not to say that licensing is taken lightly as the potential for criminal liability demonstrates. As Mr Akhmetov explains: *“Licensing of such activities is required in order to provide for national security, law enforcement, environmental protection, and safeguarding of the property, life and health of citizen.”*⁵⁹²

7. Issue C: Recovery of illegal income

a) Recovery of KPM’s illegal income

592 In addition to the sentence against Mr. Cornegruta, the court also decided that the proceeds of the crime of illegal entrepreneurial activity accrued by KPM were to be recovered by the state.⁵⁹³ Claimants and their expert Professor Malinovsky throw together a whole number of wild allegations as to why this recovery supposedly breached Kazakh law as well as, *inter alia*, KPM’s rights to trial and to present their case.⁵⁹⁴

⁵⁹¹ Expert Report of Mr Akhmetov dated 10 August 2012, para.2.1 to 2.5.

⁵⁹² Expert Report of Mr Akhmetov dated 10 August 2012, para.2.1 to 2.5

⁵⁹³ Judgement of the Aktau City Court dated 18 September 2009, C-117.

⁵⁹⁴ Claimants’ Reply on Jurisdiction and Liability, paras. 319 et seqq., Expert Opinion of Professor Malinovsky, p.17-19.

593 None of these arguments are convincing. As the Republic’s Expert, Professor Kogamov, notes, all court decisions in the criminal proceedings and in particular, the recovery of approx. US\$ 145 million of illegal income from KPM was in accordance with procedural and substantive Kazakh criminal law.⁵⁹⁵ None of KPM’s procedural rights were violated.

aa) The recovery of income from crime

594 Kazakh law provides for the recovery of proceeds from criminal activity. As the Aktau City Court stated in its judgment:

*“Under section 19 of the Regulatory Case of the Republic of Kazakhstan Supreme Court of June 18, 2004 no. 2 “On some questions concerning the qualification of crimes in economic activity”, income from crime in economic activity, under Chapter 7 of the Criminal Code, will be confiscated from the defendant and will be considered state income as a result of unjustified enrichment, acquired via crime.”*⁵⁹⁶

595 Based on this Regulatory Case of the Supreme Court,⁵⁹⁷ which is binding upon the courts in Kazakhstan, it can be ensured that no one may remain *unjustly enriched* from income obtained by way of criminal activity.⁵⁹⁸ In other words, one could say that the Regulatory Case foresees that no one may profit from his own crime, similar to the principle of *nemo auditur propriam turpitudinem allegans*. This principle dates back to Roman law and is today a universally accepted principle recognised in all civilised nations and thus a general principle of international law.⁵⁹⁹

⁵⁹⁵ Expert Report of Professor Kogamov, p. 5 et seq.

⁵⁹⁶ Judgement of the Aktau City Court dated 18 September 2009 (**Exhibit C-117**).

⁵⁹⁷ Regulatory Case of the Supreme Court of the Republic of Kazakhstan of 18 June 2004, No. 2 “On some issues of qualification of crimes in the sphere of economic activity”, section 19, R-144.

⁵⁹⁸ Expert Report of Professor Kogamov, p. 6 et seq.

⁵⁹⁹ *Inceysa Vallisoletana S.L. v. Republic of El Salvador*, Award of 2 August 2006, ICSID Case No. ARB/03/26, paras. 240-242 (**Exhibit R-226**).

- bb) The recovery of illegal income from a company
- 596 Naturally, this principle must also apply in case of crimes committed by a natural person in their capacity as director of a company. If the proceeds of the natural person's crime go to the company, it is the company that is unjustly enriched and the unjustly gained proceeds can be reclaimed from the company.⁶⁰⁰
- 597 Yet, Claimants want the Tribunal to believe that in such a situation, under Kazakh law, the hands of the authorities are tied and that the authorities must sit idly by while the proceeds from the crime remain with the company. Such an obviously unjust result can of course not be correct. Rather, as Professor Kogamov notes, it is not relevant where the illegal income is being accumulated. In all cases, the income shall be treated as income of the state. It can be recovered, for the simple reason that it was accrued by means of a crime.⁶⁰¹
- 598 In practice, courts frequently order the recovery of proceeds obtained by criminal means from the company for which the convicted natural person acted.
- 599 For example, in Case No. 1-122, Judgement of 22 September 2010,⁶⁰² several individuals were convicted both for illegal entrepreneurial activity (Article 190 of the Kazakh Criminal Code) and tax evasion (Article 222 Kazakh Criminal Code). Recovery orders were not directed against these individuals but against the property and money of several LLPs in which the individuals were managers.
- 600 Likewise, in Cases No. 1-829, Judgement of 25 June 2010,⁶⁰³ No. 1-771, Judgement of 9 July 2010,⁶⁰⁴ and No. 1-947, Judgement of 24 August 2010,⁶⁰⁵ the courts convicted directors of LLPs for tax evasion while ordering a recovery of the retained money from the LLPs themselves.

⁶⁰⁰ Expert Report of Professor Kogamov, p. 7.

⁶⁰¹ Expert Report of Professor Kogamov, p. 7.

⁶⁰² Case No. 1-122, Judgement of 22 September 2010 (**Exhibit R-248**).

⁶⁰³ Case No. 1-829, Judgement of 25 June 2010 (**Exhibit R-249**).

⁶⁰⁴ Case No. 1-771, Judgement of 9 July 2010 (**Exhibit R-250**).

⁶⁰⁵ Case No. 1-947, Judgement of 24 August 2010 (**Exhibit R-251**).

601 Against this backdrop of cases, it cannot be contested that Kazakh law foresees the recovery of income of companies obtained by criminal activity of their managers.⁶⁰⁶

602 Claimants try to contest this clear fact by arguing that the purpose of a recovery is to punish the individuals who themselves profited from illegal activity.⁶⁰⁷ According to Claimants logic, this entails that illegal income cannot be recovered from a company. From which source Claimants get this interpretation remains unclear. Claimants refer to their own expert, Professor Malinovsky,⁶⁰⁸ however, Professor Malinovsky never stated that recovery serves the purpose of punishment. For this reason alone, Claimants unsupported suggestion cannot be accepted. In any event, as explained by Professor Kogamov, the actual purpose of a recovery order is counter-acting an unjust enrichment.⁶⁰⁹

cc) The Aktau City Court followed the proper procedure in ordering the recovery of the illegal income

603 Claimants complain that KPM was not a party to the criminal proceedings against Mr. Cornegruta. Based on this, they allege that KPM's procedural rights, such as their right to a fair trial, were not guaranteed by the Republic.⁶¹⁰ Again, Claimants arguments have to be rejected.

604 First of all, it has to be noted that the Kazakh Code of Criminal Procedure *in general* foresees a proceeding for the recovery of illegal income, the so-called "civil claim in the criminal process".⁶¹¹ This "civil claim" for the recovery of the illegal income is presented in the same proceeding as the criminal case and is judged based on the same evidence.⁶¹² It is a special proceeding by way of which the decision on the recovery is made together

⁶⁰⁶ This also excludes Claimants' apparent suggestion that recovery of illegal income from a company somehow breached the principle of *nulla poena sine lege*, cf. Claimants' Reply on Jurisdiction and Liability, para. 321; Expert Opinion of Professor Malinovsky, p. 5-6.

⁶⁰⁷ Claimants' Reply on Jurisdiction and Liability, para. 327.

⁶⁰⁸ See Claimants' Reply on Jurisdiction and Liability, footnote 563.

⁶⁰⁹ Expert Report of Professor Kogamov, p. 6 et seq.

⁶¹⁰ Claimants' Reply on Jurisdiction and Liability, para. 322; Expert Opinion of Professor Malinovsky, p.19.

⁶¹¹ Chapter 20 of the Kazakh Code of Criminal Procedure, see also Expert Report of Professor Kogamov, p. 8.

⁶¹² Expert Report of Professor Kogamov, p. 8.

with the decision on the criminal charge. Through such proceeding, KPM could have been made a “party” to the case in question – though KPM would not have been charged with a crime since there is no criminal liability of companies under Kazakh law.⁶¹³

605 Importantly, however, it is not necessary to always conduct such proceeding. As Professor Kogamov explains,

*“when deciding on the matters related to the verdict, the court has the right to decide on compensation of damages caused to the state also in cases when there is no civil claim brought under the criminal proceedings, but the circumstances related to the infliction of damages have been fully studied in the court hearing“.*⁶¹⁴

606 In such a case, there is no need for further discussion or for further participation since all matters have already been fully addressed as part of the criminal trial. Hence, there is also no need to make the company a “party” to the proceeding. This is precisely what happened in the cases cited above.⁶¹⁵ In none of these cases had a civil proceeding been initiated. Nonetheless, the courts ordered the recovery of the illegal income.

607 Importantly, this also applies to the case of KPM. During the trial of Mr. Cornegruta, all issues relevant to the recovery had been discussed. As explained above, in particular the amount of the illegal income was determined because this was necessary to decide whether or not there was a crime in the first place.⁶¹⁶

608 Even looking past the technical details of Kazakh criminal procedural law, there can be no question that none of KPM’s procedural rights, be they stemming from Kazakh law, the Kazakh constitution or international law, were infringed.

609 Of course, the Republic agrees that in general, a company needs to be involved in a case potentially affecting its rights. However, in cases such as the ones described above, and also in the case of KPM, this is actually the

⁶¹³ Expert Report of Professor Kogamov, p. 10 et seq.

⁶¹⁴ Expert Report of Professor Kogamov, p. 8, with further references.

⁶¹⁵ See above section C.VIII.7.a).

⁶¹⁶ See above section C.VIII.1.

case. With regard to KPM, this is evidenced by the fact that during the trial, KPM was represented by Mr. Cornegruta as its manager. Any defence that needed to be brought against the recovery could have been brought by Mr. Cornegruta and his lawyers. Anything KPM needed to “know” about the proceedings, it “knew” through its manager. Moreover, it is obvious from Mr. Condorachi’s written testimony that all other decision makers within KPM were always informed about what was going on during the investigation of Mr. Cornegruta and at his trial.⁶¹⁷

610 Notably, Claimants have not even tried to show how it would have helped KPM if KPM had participated directly in the proceedings. The evidence before as well as the legal considerations of the court would still have been the same. Claimants have not made any allusion to additional facts KPM would have presented or additional proof KPM would have offered. Under these circumstances, it stands to reason that the court would have come to the same conclusion in any event.

611 Under these circumstances, Claimants’ complaints about an alleged violation of KPM’s right to a fair trial, right to present its case and to a defence or other procedural rights is entirely misplaced. In addition, as will be set out in more detail below, even if these rights had not been fully complied with in the trial before the Aktau City Court, KPM was in any event entitled to appeal the recovery decision and could have presented its case and its defence on appeal. Yet, KPM failed to properly do so.⁶¹⁸

b) Amount of recovered income

612 Claimants imply that the charge of illegal entrepreneurship is not a serious one and that economic crimes such as these do not (internationally and under Kazakh law) normally carry penitentiary consequences or large “fines” (as they refer to the recovery order) such as the one in question. Indeed, Claimants go further than this to assert that the operation of a main pipeline without a licence is a “minor regulatory violation”.⁶¹⁹

⁶¹⁷ First Witness Statement of Mr. Condorachi, paras. 14 et seqq.

⁶¹⁸ See below section C.VIII.9.

⁶¹⁹ Claimants’ Reply on Jurisdiction and Liability, paras. 294, 336.

- 613 Of course, this is typical of Claimants’ attempts to downplay the significance of their own breaches while exaggerating and misrepresenting the conduct of the Republic throughout these proceedings. Yet, as Mr Kravchenko says, subsoil use is the basis of the economic security of the Republic and therefore, any reasonable investor must expect that his activity will be scrutinized by the state.⁶²⁰
- 614 Ultimately, Claimants’ suggestions are beside the point. The mechanism for the recovery of illegal income is quite simple. The amount to be recovered is directly linked to the profit made as a result of the criminal activity, so as to ensure that no unjust enrichment remains with the company.⁶²¹ So, if it is the case that the recovered amount was “astronomical”,⁶²² this is only an indication of the “astronomical” income derived from the illegality of the defendant rather than the impropriety of the Republic.
- 615 In its Judgement of 18 September 2009, the Aktau City Court determined that an amount of KZT 21,675,854,578 (approx. US\$ 145 million) was to be recovered from KPM.⁶²³ This amount of money corresponded to KPM’s illegal profits from operating a main pipeline between March 2007 and May 2008. The sum was taken from a report prepared by an expert committee.⁶²⁴
- 616 Claimants raise several issues with regard to calculation of the amount to be recovered, all of which miss the point.
- aa) No limitation to the profits made by Mr. Cornegruta personally
- 617 Claimants contend that the recovery should have been limited to the profits made by Mr. Cornegruta.⁶²⁵ However, as set out above,⁶²⁶ the institute of recovery ensures that an unjust enrichment from criminal activity is corrected. In the case of a company being unjustly enriched through the

⁶²⁰ Second Witness Statement of Mr Kravchenko, para. 9.1.

⁶²¹ See above section C.VIII.7.a).

⁶²² Claimants’ Reply on Jurisdiction and Liability, para. 247.

⁶²³ Judgement of the Aktau City Court dated 18 September 2009, C-117.

⁶²⁴ Expert Report No. 1537 of the Center for Forensic Examination of the Ministry of Justice dated 18 May 2009 (**Exhibit C-184**).

⁶²⁵ Claimants’ Reply on Jurisdiction and Liability, para. 327.

⁶²⁶ See above C.VIII.7.a).

criminal acts of its manager, it is the company that must be stripped from the proceeds of the crimes. Claimants' contention should thus not be accepted by the Tribunal.

bb) No fictitious calculation of profits

618 Further, Claimants suggest that the recovered sum should have been reduced by KPM's revenues stemming from legal activity.⁶²⁷ Based on this and their own calculations, Claimants conclude that no more than "around US\$ 60,000" could have been recovered. Again, their objection cannot convince.

619 In principle, it is correct that income stemming from legal activity has to be disregarded in calculating the sum to be recovered. As was stated in the Regulatory Case No. 2 of the Kazakh Supreme Court, "revenue received from parts of the operations that are legal must be excluded from the calculation of illegal profits."⁶²⁸ This is in line with the purpose of the recovery which is limited to the elimination of unjust enrichment.⁶²⁹

620 Claimants try to use this Regulatory Case in their favour by suggesting that the profit from the *sale* of oil which was transported through the main pipeline should be excluded. In their view, only the fictitious costs of "what a licensed main-pipeline operator would charge to transport oil 17.9 kilometers"⁶³⁰ could be deemed illegal profit. However, Claimants completely fail to name any basis in law for applying fictitious costs of transport and they do not name any case in which such fictitious calculation was applied. Even more damaging, their own expert, Professor Malinovsky, nowhere in his statement addresses this concept of a fictitious calculation.⁶³¹

⁶²⁷ Claimants' Reply on Jurisdiction and Liability, paras. 328 et seqq.

⁶²⁸ Regulatory Case of the Supreme Court of the Republic of Kazakhstan of 18 June 2004, No. 2 "On some issues of qualification of crimes in the sphere of economic activity", section 9, quoted in Expert Opinion of Professor Malinovsky, p.10.

⁶²⁹ See above section C.VIII.7.a).

⁶³⁰ Claimants' Reply on Jurisdiction and Liability, para. 329.

⁶³¹ Professor Malinovsky does allude to the principle that "revenue received from parts of the operations that are legal must be excluded from the calculation of illegal profits" established in Regulatory Case No. 2. However, he never concludes that Claimants' concept of a fictitious profit calculation applies.

621 Quite clearly, the Kazakh Supreme Court’s Regulatory Case No. 2 does not support Claimants’ contention: It does not mention the need for a fictitious calculation, but rather states, in no uncertain terms:

*“Income derived from crime in the sphere of economic activity envisaged in Chapter 7 of the Criminal Code shall be recovered from a guilty person and referred to the revenue of the state as a result of unjust enrichment, acquired by criminal means.”*⁶³²

622 In the present case, “[i]ncome derived from crime” is any income resulting from the operation of KPM’s main pipeline without a license. Naturally, this includes all income resulting from the sale of oil that was transported through the pipeline. That is because the transport of the oil through the main pipeline was *conditio sine qua non* (necessary requirement) for KPM to make profits from the sale of the oil. KPM could simply not have made this profit without the unlicensed pipeline. It is thus not correct to deduct allegedly legal profits from the recovered amount based on some fictitious calculation.

623 Quite outrageously, Claimants’ propose that “Kazakhstan is fully aware of the gross miscalculation that it made.”⁶³³ They contend that the opinion of the expert committee on which the court relied when fixing the recovered amount differentiated between “transport and further sale of oil and condensate” and “services provided to third parties for transport of oil and condensate through the oil pipeline”.⁶³⁴ Yet, Claimants completely fail to mention why this would be relevant. The fact that this opinion referred to different categories of income is merely proof of thorough calculation by the experts. Had the experts muddled together all categories of income, Claimants would probably have complained that the basis of calculations is unclear.

⁶³² Regulatory Case of the Supreme Court of the Republic of Kazakhstan of 18 June 2004, No. 2 “On some issues of qualification of crimes in the sphere of economic activity”, section 19 (**Exhibit R-144**).

⁶³³ Claimants’ Reply on Jurisdiction and Liability, para. 330.

⁶³⁴ Claimants’ Reply on Jurisdiction and Liability, para. 331. Likewise, Claimants rely on the fact that the same differentiation was made in the Tax Committee’s initial calculation in November 2008, Claimants’ Reply on Jurisdiction and Liability, para. 330.

- cc) No possibility for the court to deduct expenses and taxes
- 624 Claimants further argue that the recovered amount should have been limited to revenue, i.e. that expenses and taxes should have been deducted from the total profit.⁶³⁵ This argument has several flaws:
- 625 First of all, prior to the Supreme Court’s Regulatory Case of 21 April 2011,⁶³⁶ no practice of deducting taxes and expenses was established under Kazakh law. Only with this ruling, it was clarified that taxes and expenses have to be deducted. Prior to this, the Supreme Court’s Regulatory Case of 18 June 2004⁶³⁷ applied, which did not foresee the deducting of expenses. Claimants could thus not expect that taxes and expenses would be deducted.
- 626 Moreover, and in any event, a court can only make such deduction if expenses and taxes are documented, i.e. if the company in question provides proof of having paid expenses and taxes.⁶³⁸ Presently, the record shows that Mr. Cornegruta, through which KPM acted in this proceeding,⁶³⁹ did not do so. The court was aware of the issue of deduction, yet, due to lack of proof, it could not deduct anything. As was stated explicitly in the judgement,
- “According to the materials from the record, the income of ‘Kazpolmunay LLP’ obtained because of their unlicensed activity is 21,675,854,578 Tenge [KZT], no information being present about the paid taxes, so the shown revenue must be directed for the state.”⁶⁴⁰*
- 627 Importantly, Claimants could have submitted proof also on appeal but failed to do so.⁶⁴¹

⁶³⁵ Claimants’ Reply on Jurisdiction and Liability, para. 333.

⁶³⁶ Kazakh Supreme Court Regulatory Case of 21 April 2011 (**Exhibit-252**).

⁶³⁷ Kazakh Supreme Court Regulatory Case of 18 June 2004, para. 9 (**Exhibit Malinovsky-2**).

⁶³⁸ Expert Report of Professor Kogamov, p. 15.

⁶³⁹ See above C.VIII.7.a).

⁶⁴⁰ Judgement of the Aktau City Court dated 18 September 2009, C-117 (p.13, para. 1 of the English translation).

⁶⁴¹ Expert Report of Professor Kogamov, p. 15.

8. No interference with trial and due process

628 Claimants argue that the “executive branch” must have interfered with the trial because allegedly, no independent court could have come to that conclusion.⁶⁴² This is not a sustainable observation in that the basis of their allegations is both incorrect and not adequately evidenced. Claimants have engaged in little more than a picture-painting exercise to attempt to bolster their otherwise unconvincing argument that the Financial Police were in cahoots with Judge Ryskalevia. They do not sufficiently explain who from the “executive branch” interfered, when and with what effect. In fact, their allegations amount to little more than extension of their grumbles in relation to process which have been addressed above.

629 Firstly, they rely on the severity of the conviction against Mr Cornegruta and the allegedly “undisputed” fact that the prosecution was the result of the letter of President Voronin (“top down” investigation) and general remarks on the Republic’s political culture.⁶⁴³ Claimants argue that a top down approach in the investigation that is evidence here is indicative of a “dirigiste” process that, in itself, calls into doubt the fairness or the basis of the charges and the fairness of the proceedings.⁶⁴⁴

630 Indeed, it is true to say that the initial inspection was connected with the President’s instructions, however, it is not true to say that the instruction led to the conviction of Mr Cornegruta. It is true to say that the authorities were involved in the inspection, the investigation, the trial and the events leading up to it but it not true that a true conclusion is that the authorities interfered in this process. Once the proper chronology of events is understood, it is evident that the process, even if initiated by the President’s instruction has been, if anything, from the bottom up, starting with the inspection of KPM and TNG’s pipelines and ending in the prosecution of criminal charges following due process, this submission loses its potency.

631 Secondly, Claimants again take issue with the expert opinions in Mr. Cornegruta’s favour that were deemed inadmissible by the Aktau judge. This allegedly happened only with the final judgement, so that Mr.

⁶⁴² Reply Memorial on Jurisdiction and Liability dated 8 August 2012, para 293.

⁶⁴³ Reply Memorial on Jurisdiction and Liability dated 8 August 2012, para. 294 and 298.

⁶⁴⁴ Reply Memorial on Jurisdiction and Liability dated 8 August 2012, paras. 297, 298.

Cornegruta could not even object against the inadmissibility decision.⁶⁴⁵ The reasons why these opinions were validly found to be inadmissible (by both the Financial Police and, separately, by the Judge in Aktau) have been addressed above.

632 Further, Claimants allege that they did not know that their opinions had been rendered suggested inadmissible by the investigations department. Mr Rakhimov issued an application against the inclusion of this evidence on 18 May 2009 and, according to Mr Kravchenko, the court was justified in deeming these opinions inadmissible.⁶⁴⁶ Mr Kravchenko also notes there were no objections to Mr Rakhimov's decree in relation to this evidence at the time, and as such there was nothing unlawful about his decree.⁶⁴⁷

633 Claimants again return to the issue of the independence of Mr Baymaganbetov's expert report and the "confession" letter. The Republic response on these points have been addressed in the Statement of Defence fully and there is no need to repeat this issue here.

634 There is little to commend Claimants' fabrications that the authorities inferred with the trial process.

9. Appeal of the KPM Pipeline Decision and Enforcement Decision

635 Claimants make little more than a cursory reference to the unsuccessful appeal of the Aktau court's decision to the Mangystau Regional Court in the Statement of Case.⁶⁴⁸ Moreover, in the Reply Claimants leave unexplained why, if they were unhappy with either their treatment in the Kazakh courts, or the finding of the court, they did not appeal the trunk pipeline decisions to the highest court in Kazakhstan, the Supreme Court. The Republic has an appeals system within the Republic which Claimants' could have availed themselves of.

636 Claimants argue that KPM attempted to appeal the court judgment against them but that "*Kazakhstan did not permit it to do so.*"⁶⁴⁹ Claimants cite a

⁶⁴⁵ Reply Memorial on Jurisdiction and Liability dated 8 August 2012, paras. 299 and 300.

⁶⁴⁶ Second Witness Statement of Mr Kravchenko dated 12 August 2012, para. 11.13 and 11.14.

⁶⁴⁷ Second Witness Statement of Mr Kravchenko dated 12 August 2012, para. 11.22.

⁶⁴⁸ Statement of Case dated 18 May 2011, para. 120.

⁶⁴⁹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 322.

number of exhibits in support of this proposition but do not expand as to how these demonstrate their assertion that Kazakhstan blocked Claimants' access to appeal. Further Claimants suggest that KPM's complaints simply fell on "deaf ears" which suggests that the Kazakh court system was unresponsive to KPM's complaints which is simply not the case.⁶⁵⁰ In reality, KPM missed its deadline to appeal. Mr Kravchenko explains:

"14.3 KPM did not appeal against the sentence of 18 September 2009 within the time allowed. According to materials of criminal case, KPM represented by Kondoraki A.I. applied in Aktaumunicipal court for an extension of the deadline to appeal the Aktau municipal court of Magnistay region decision of 18 September 2009, in part of 21 675 854 578 fee.

14.4 The Aktau municipal court of Magnistayu region by its decision of 29 January 2010 dismissed the appeal on 29 January 2010 and stated in its reasoning the absence of legitimate excuse (valid reason) and therefore absence of grounds for extension of the deadline."⁶⁵¹

637 Pursuant to the requirements of Article 400 of Criminal Procedure Code, where an appeal has been missed for a valid reason, individuals who possess a right to appeal may apply for an extension of the limitation period.⁶⁵² Courts decision to dismiss deadline period may be appealed in appropriate region court or other court equivalent to this, which has authority to extend missed deadline and hear an appeal.⁶⁵³ It was the court's view that KPM had notice of the decision against it since its senior management were present when at the hearing:

"The trial of the Director of KPM S. Cornegruta involved the participation of Deputy Director Nurlibekov G. as a witness and also several employees of KPM acting as witnesses and attending all the hearings. The Aktauysk Municipal Court of Magnistay region therefore concluded

⁶⁵⁰ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 505.

⁶⁵¹ Second Witness Statement of Kravchenko dated 8 August 2012, paras 14.3 and 14.4.

⁶⁵² Second Witness Statement of Kravchenko dated 8 August 2012, paras 14.3.

⁶⁵³ Second Witness Statement of Kravchenko dated 8 August 2012, paras 14.3.

that KPM was fully aware of this court decision and deadline for appeal.”⁶⁵⁴

638 Mr Cornegruta did appeal the initial court decision against him and was unsuccessful in overturning the decision of the Aktau Court. However, as set out in the Statement of Defence, Claimants failed to appeal the pipeline (and other decisions) to the highest court, the Supreme Court and that for this reason this, Claimants are not entitled to claim that expropriation has occurred.⁶⁵⁵ This is not for want of a sophisticated appeal system that Claimants were entitled to avail themselves of.

a) Court System

639 Unlike the precedential style of justice in the U.S. and United Kingdom, judges in Kazakhstan's courts are not bound by previous decisions, but only their interpretation of the Constitution and law. The Kazakhstan court system consists of three levels⁶⁵⁶: (1) the Supreme Court; (2) local Oblast Courts and those with equal status; and (3) local District and City Courts. The Supreme Court is the highest court in the Republic and acts as a court of appeal and a court of original jurisdiction. The Supreme Court supervises lower courts and issues clarifications on issues of judicial practice. There are also specialized courts, for instance, specialized economic courts, specialized criminal courts and specialized administrative courts, which fall under Local District Courts of Kazakhstan.

640 Appellate complaints and protests are considered as follows:

- (a) by an Oblast Court or a court equated to it — on Decisions passed by local District and City Courts and courts equated to them;
- (b) by the Supreme Court of the Republic of Kazakhstan — on decisions passed by Oblast Courts and courts equated to them, with regard to first instance courts local District and City Courts Decisions as well. An Oblast Court has two instances of appeal: (i) Appeal Court Panel; and (ii) Cassation Court Panel.

⁶⁵⁴ Second Witness Statement of Kravchenko dated 8 August 2012, paras 14.5.

⁶⁵⁵ Statement of Defence dated 21 November 2011 , paras 33.6 - 16.

⁶⁵⁶ Clauses 1 and 2 of Article 3 of Law on Court System and Status of Judges in the Republic of Kazakhstan dated December 25, 2000 (**the “Law on Court System”**). [Exhibit R-253]

aa) Appeal Court Panel

641 The Decisions of the local District and City Court can be appealed with the Appeal Court Panel within 15 (fifteen) calendar days from the date of handing the copy of the Decision. Appeals and protests must be filed with the court which passed the Decision. The judge of the Appeal Court Panel renders its resolution (the “Resolution”) upon considering the appeal. Unless appealed with Cassation Court Panel the Resolution comes into force within 15 (fifteen) calendar days from the date of its handing the copy of the Resolution.

bb) Cassation Court Panel

642 The Cassation Court Panel considers appeals against the Resolution of the Appeal Court Panel by three judges. The judges render their determination (the “Determination”) upon considering the appeal. The Determination comes into force from the moment of its rendering. The Determination can be challenged at the Supreme Court, within one year from the date the Determination has come into force.

cc) Supreme Court

643 The Decisions, Resolutions, Determinations which have entered into legal force may be challenged in the Supreme Court by the parties and other persons who participated in the case and have the right to submit appellate complaints. The appellate complaint can be submitted within one year.

b) Claimants failed to pursue the available remedies

644 Claimants’ own evidence highlights circumstances in which this system has been used, when Claimants have employed it, in Claimants’ favour. Claimants refer to a suite of documents which comprise a series of “appeals” and complaints that were made against the Decision and the Enforcement Decision.⁶⁵⁷ These documents demonstrate that:

- (a) Mr Cornegruta did not appeal the decision to the Supreme Court as he could have done;

⁶⁵⁷ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 322.

- (b) KPM was out of time to file an appeal against the decision in respect of illegal entrepreneurship. and
- (c) KPM did not pursue the appeals against the Enforcement decisions to the highest court as they could have done.

aa) The Aktau court decision

645 On September 18, 2009 the Aktau city court of the Mangistau Oblast (the **Aktau City Court**) rendered the judgement against Sergei Cornegruta (the **KPM Pipeline Court Decision**), a citizen of the Republic of Moldova, a former General Director of KPM. According to the Court Decision S.Cornegruta was recognized guilty under Article 190.2 (b) of the Criminal Code of Kazakhstan. Mr Cornegruta was convicted for deprivation of freedom for 4 (four) years in the penal colony of general regime and his property was seized. In accordance with the Court Decision KPM is liable to pay the illegal revenue in the amount of 21,675,854,578.00 Tenge (approximately, USD145,475,534.08) (the “Revenue”) to the Kazakhstan state budget.

646 The Court Decision came into force on appeal on 12 November 2009 following an unsuccessful appeal by Mr Cornegruta.

647 Claimants allege that they did not receive the copy of the Court Decision. Rather, KPM missed the established time for appeal of the Court Decision. On January 25, 2010 KPM filed a request with the Aktau City Court to reinstate the missed time for the appeal. However, on January 29, 2010 the Aktau City Court dismissed the application to reinstate the missed time for the appeal (the **Decree of January 29, 2010**).

bb) Enforcement Orders

648 In respect of the various enforcement orders issued against KPM and KPM’s appeals, the following sequence of events are instructive:

- (a) On December 29, 2009 the Aktau City Court issued the enforcement order (the **“Enforcement Order”**).⁶⁵⁸ On January 5, 2010 the head of the Aktau Division of the Enforcement Officers of the Mangistau

⁶⁵⁸ Exhibit C-119.

Oblast (the “**Enforcement Officer**”) issued the Decree on Initiating of the Enforcement Proceedings against KPM on recovery of the Revenue (the “**Decree of January 5, 2010**”).⁶⁵⁹

- (b) The Enforcement Order does not contain the following information: (i) the bank details of the creditor under the Court Decision; (ii) the full information about the debtor; and (iii) other information required by the Kazakhstan Procedural Code.⁶⁶⁰
- (c) The Enforcement Officer was obliged to return to the court the Enforcement Order that contravenes statutory requirements.⁶⁶¹
- (d) Given the fact that the Enforcement Order was disputed by KPM, the Enforcement Officer was obliged to suspend the enforcement proceedings.⁶⁶²

649 This demonstrates that where there is a good reason to challenge the Republic’s actions, the Republic will respond. In summary:

- (a) The relevant Claimants appealed all Decrees on the Execution and the Decree of January 5, 2010 at the Appeal Court Panel of Mangistau Oblast Court.
- (b) The relevant Claimants also appealed all the above Decrees of the Appeal Court Panel at the Cassation Court Panel of Mangistau Oblast Court. However, Claimants did not use all instances of appeal available to them under the Civil Procedural Code.

650 However, the relevant Claimants are entitled to challenge the Court Decision and the Execution at the Supreme Court of Kazakhstan by submitting the relevant appellate complaint,⁶⁶³ which, to date, has not been effected.

⁶⁵⁹ Exhibit C-501.

⁶⁶⁰ Clause 4 of Article 236 of the Civil Procedural Code (**Exhibit R-254**).

⁶⁶¹ Clause 1 of Article 11 of the Law on Enforcement Proceedings and Status of Enforcement Officers dated June 30, 1998 (the “**Law on Enforcement**”) (**Exhibit R-255**).

⁶⁶² Sub clause 4 of Article 15 of the Law on Enforcement (**Exhibit R-255**).

⁶⁶³ Clause 1 of Article 385 of the Civil Procedural Code (**Exhibit R-254**).

IX. Termination of Contracts 210 and 305 for breach and invocation of the trust management system

651 In the Statement of Claim, Claimants allege that the Republic seized their assets in acts of pre-meditated illegal expropriation, intentionally not compensating Claimants for the alleged deprivation of their assets.⁶⁶⁴ The Republic's response in the Statement of Defence demonstrates that the termination of Contract 210 and 305 was not an expropriation of Claimants' investments and was justified both under the Contracts themselves and under the law, and that Claimants' assets were dealt with in accordance with the particular trust arrangement envisaged by the Subsoil Law 2010.⁶⁶⁵ In particular, the Republic asserts that:

- (a) Claimants: (i) were in continuing and serious breach of the Contracts⁶⁶⁶ (despite advance and timely actual notice of the breaches), (ii) demonstrated an unwillingness to cooperate with the Republic to cure the breaches (partly acknowledging that there were breaches), and (iii) had for all intents and purposes, abandoned their assets. Therefore notices were served on KPM and TNG terminating the Contracts for breach and invoking the relevant provisions of the Subsoil Law 2010.⁶⁶⁷
- (b) Accordingly, Claimants' assets were taken into a specific trust arrangement. Under such an arrangement, although title in Claimants' assets did not transfer to the Republic (since the arrangement was merely temporary), Claimants stopped reaping financial benefits (as one would expect where a subsoil user is both absent and in breach of its contractual obligations).⁶⁶⁸
- (c) The current trust management of the assets involves holding money in escrow until a new subsoil user is brought in to manage the assets.

⁶⁶⁴ Statement of Claim dated 18 May 2011, section V.

⁶⁶⁵ Statement of Defence dated 21 November 2011, section 31

⁶⁶⁶ Statement of Defence dated 21 November 2011, paras. 31.90 - 31.94

⁶⁶⁷ Statement of Defence dated 21 November 2011, paras. 31.90 - 31.143

⁶⁶⁸ Statement of Defence dated 21 November 2011, paras. 31.144 - 31.161 and in particular para. 31.150.

However, unsurprisingly, a willing subsoil user has not yet been found as a result of the ongoing arbitration over the assets.⁶⁶⁹

- (d) Claimants could have resolved this issue amicably by invoking one of the mechanisms in the Contracts or, indeed, by complying with the voluntary mechanism in the Subsoil Law 2010 at Article 72(10) for the handing over of assets to the trust and appealing the decision in accordance with Article 73 of the Subsoil Law 2010.⁶⁷⁰
- (e) The opportunity to resolve this issue in accordance with the Contracts themselves and/or the Subsoil Law 2010 was sidestepped by Claimants who filed substantive proceedings against the Republic in an international forum only five days after the terminations.⁶⁷¹

652 Claimants leave a number of these key points unanswered in the Reply Memorial on Jurisdiction and Liability. Most significantly, they do not adequately deal with the allegations of breach made against them, nor have they provided anything other than unjustified and unreasonable procedural reasons as to why the Republic might have been incorrect in the application of its own laws.

653 Moreover, Claimants studiously evade providing an explanation for their own conduct which triggered the need to invoke the various mechanisms of Kazakh law employed by the Republic. Claimants' contradictory stance of one on the one hand stating that the Republic cannot hide behind the requirement of its own laws⁶⁷² and on the other hand, examining and criticizing the Republic's compliance with its laws, should not, as Claimants appear to believe, justify avoiding close scrutiny of Claimants' conduct and performance of their contractual obligations.

654 Lastly, Claimants have failed to credibly explain why remedies were not pursued against the Republic fully (or at all) under the law or the Contracts. Instead, the Republic's observation regarding the swift submission of the Request for Arbitration some five days after the terminations that allegedly left Claimants in "shock"⁶⁷³, stands unconvincingly addressed. As set out in

⁶⁶⁹ Statement of Defence dated 21 November 2011, paras. 31.162 - 31.166.

⁶⁷⁰ Statement of Defence dated 21 November 2011, paras. 31.154 - 160

⁶⁷¹ Statement of Defence dated 21 November 2011, paras. 31.167 - 31.178

⁶⁷² Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 338

⁶⁷³ Statement of Claim dated 18 May 2011, para. 223.

the Statement of Defence⁶⁷⁴ and below in section D.III.2., this is fatal to any claim for expropriation.⁶⁷⁵

655 In various parts of the Statement of Claim and the Reply Memorial on Jurisdiction and Liability, Claimants depict themselves as being targeted by the Republic, which they say ultimately led to the termination of the Contracts. This is incorrect on the facts. Furthermore, the Tribunal should consider the context of the termination, which is significant in understanding why Claimants' theory is quite simply wrong:

“In 2010 the Kazakh Ministry of Oil and Gas terminated roughly 10 percent of all subsoil use contracts; 28 subsoil use contracts were terminated due to breach of terms of these contracts. This is a very substantial number, more than one tenth of all contracts, meaning that ASCOM’s was far from the only company to meet Kazakhstan’s increasingly more exacting standards. On January 1, 2011 there remained 206 subsoil contracts (of which 16 were Production Sharing Agreements, 52 for production, 68 exploration and production and 70 solely for production).”⁶⁷⁶

1. Termination of Contracts 210 and 305

656 Claimants' overall approach in section D1 of the Reply Memorial on Jurisdiction and Liability is to magnify their complaints regarding the “manner” in which Contracts 210 and 305 were terminated. They fail to address in any detail the actual contractual violations that the Republic identified at the time those contracts were terminated⁶⁷⁷. In taking this approach, it is they who are trying to hide behind the alleged violation of procedural aspects of Kazakh law on termination to evade the consequences of the substantive contractual breaches their companies committed. This is (at least) ironic given Claimants' view that Kazakh law

⁶⁷⁴ Statement of Defence dated 21 November 2011, paras 33.6 to 33.26

⁶⁷⁵ Statement of Defence dated 21 November 2011, paras 33.7 to 33.26

⁶⁷⁶ Professor Olcott Expert Report dated 7 August 2012, para. 198

⁶⁷⁷ Elaborated on in the Statement of Defence dated 21 November 2011, paras. 31.90 to para. 31.104

has no place in this arbitration.⁶⁷⁸ The breaches committed were serious and left the Republic with no alternative but to terminate Contracts 210 and 305.

a) Existing breaches and wrongdoing by KPM and TNG

657 By July 2010, both KPM and TNG had substantially breached Contracts 210 and 305 on the following grounds:⁶⁷⁹

(a) KPM's General Director had been found guilty of illegal entrepreneurship as a result of operating a main pipeline without a licence⁶⁸⁰;

(b) Neither KPM nor TNG had been complying with tax legislation⁶⁸¹; and

(c) TNG and KPM were in breach of the Minimum Work Programs.

658 It is clear from sections C.VIII. and C.IV. of the Rejoinder Memorial on Jurisdiction and Liability that the Republic had legitimately established that the breaches existed. Further, the factual and legal basis of the Republic's findings were verified and checked by the Republic's courts. Claimants were therefore aware of these breaches for a considerable period of time and had the opportunity to raise objections and/or appeal through the relevant judicial routes.

659 In relation to Minimum Working Programs, Claimants were undoubtedly also aware of this breach for some time.⁶⁸² They do not deny that this was the case in the Reply Memorial on Jurisdiction and Liability.

660 In addition, based on the various audits and inspections carried out by the MEMR and the MOG⁶⁸³, KPM and TNG had violated their contracts in numerous ways between 2001 to 2010. This included systematically failing

⁶⁷⁸ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 426

⁶⁷⁹ Statement of Defence dated 21 November 2011, paras. 31.90 to 31.94

⁶⁸⁰ See further section C.VIII above

⁶⁸¹ See further section C.IV. above

⁶⁸² Statement of Defence dated 21 November 2011, para. 31.93

⁶⁸³ Information about Audits of TNG and KPM by the Competent Body, undated (**Exhibit R-33**)

to train Kazakh specialists during this period,⁶⁸⁴ a repeated failure to comply with its minimum work programme⁶⁸⁵ and most seriously the operation of a main pipeline without a licence.

661 The Republic, in good faith, allowed KPM and TNG to continue their operations notwithstanding that the above breaches had been committed some time before the Contracts were terminated. Under both the 1996 Subsoil Law and the Subsoil Law 2010, the Republic is not obliged to terminate contracts in the event of a breach but has a right to. The Republic undertook further investigations of the companies and gave them the opportunity to engage with it in order to resolve the situation. The Republic always endeavours to give its subsoil users this opportunity, as termination of subsoil use contracts is very much a last resort. In particular, termination leads to a number of complications with respect to the underlying assets, which the Republic has no real interest or financial benefit in holding⁶⁸⁶, and can only be transferred once a new subsoil user can be found. However, given the systematic nature of the breaches committed by Claimants over a lengthy period of time, the Republic deemed it appropriate to send notices for breach to Claimants and after receiving wholly inadequate responses, exercise its right to terminate Contracts 210 and 305 in July 2010.

662 It is completely disingenuous for Claimants to now claim that they did not have the opportunity to object to these breaches and/or cure them. In relying on these arguments, they have failed to adequately address the substance of the breaches in both the Statement of Claim and Reply Memorial on Jurisdiction and Liability. The only conclusion which can be drawn is that Claimants did breach the Contracts. Claimants are now trying to avoid addressing these breaches by relying on a misleading interpretation of the procedural aspects of Kazakh law on termination of subsoil use contracts.

⁶⁸⁴ As identified in inspections on April 2003, March 2006, May 2007, July 2008 and February 2010

⁶⁸⁵ From as early as April 2001

⁶⁸⁶ Witness Statement of Minister Mynbayev, para. 6.2.

b) Applicable Law and Contractual Provisions

663 The Republic passed Subsoil Law 2010 on 24 June 2010. The Republic strenuously denies any implication by Claimants that the timing of when this law passed had anything to do with its subsequent termination of the Contracts⁶⁸⁷. There are specific procedures and laws in the Republic which set out how a law should be passed. In particular, a draft law, after it has been developed, needs to be discussed with the relevant government bodies and organizations, be subject to technical assessments (anti-corruptive, legal, linguistic, ecological, financial, etc.) and be considered by both chambers of the Parliament in accordance with a law making schedule.⁶⁸⁸ The Republic spent almost two years preparing the new law as set out in the drafting history for Subsoil Law 2010⁶⁸⁹. This included the following stages:

- (a) On 31 October 2008, the Government passed the Decree 993 which introduced the Bill in the Majilis (the lower house) of the Parliament;
- (b) On 15 December 2008, the Bill was received by the Majilis of the Parliament;
- (c) On 30 April 2010, the Committee of Majilis on Ecology and Nature issued its resolution;
- (d) The Senate then provided its comments on the Bill; and
- (e) The Law was then signed on 24 June 2010. The Law on Oil (28 June 1995) and Law on Subsoil Use (27 January 1996) then expired upon entry into force of this Law⁶⁹⁰.

664 It is utterly implausible and factually incorrect for Claimants to claim that the Republic impulsively changed a law which applied to all subsoil users in the country simply with the aim of terminating the Contracts with KPM and TNG and motivated by “convenience”. As the Minister of Oil and Gas, Mr. Mynbayev comments it is “impossible” to forecast the date when a law

⁶⁸⁷ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 341

⁶⁸⁸ See Law of RK "On normative legal acts" on March 24, 1998 № 213-I (**Exhibit C-412**).

⁶⁸⁹ Resolution on the draft of the Law of the Republic of Kazakhstan “On Mineral Resources and Subsoil Use” dated 31 October 2008 (**Exhibit R-256**).

⁶⁹⁰ Article 130 of Law on Subsoil and Subsoil Use 2010 (**Exhibit R-257**).

will be passed.⁶⁹¹ It is quite clear from the drafting history that this was not the case.

665 In any event, Claimants have failed to demonstrate that the Republic would not have had grounds to terminate the Contracts under the previous subsoil use law.⁶⁹² Claimants were in breach of the Contracts and the only reason the Republic did not rely on the previous subsoil law was because it was not the applicable law at the time of termination, and prior to then, it had chosen to try and work with KPM and TNG to remedy the situation. Evidently, any willingness to cooperate on the part of those companies was simply not forthcoming.

666 Claimants now assert that the Republic is in breach of other Kazakh law⁶⁹³. Article 129(4) of the Subsoil Law 2010 preserves the terms of the licences and contracts and therefore, Claimants argue that the procedures therein should be followed or adhered to for the purposes of termination; by ignoring these provisions, they argue that the Republic is in breach of its own laws.

667 The Republic does not deny that the licences and contracts remain in place. However, Claimants' assertions in paragraph 351 of the Reply Memorial on Jurisdiction and Liability are illogical. Just because Contracts 210 and 305 remained in force after the law was passed, it does not mean that these same Contracts could not be terminated in accordance with the new Subsoil Law 2010 (as opposed to the terms of the Contracts themselves). The Contracts would of course be subject to the new Subsoil Law 2010 and the Republic is entitled to avail itself of whichever legal remedies it chooses to effect the termination. That said, it is not admitted that the Contracts were terminated under the law alone and not also under the terms of the Contracts. In any case, even if, which is denied, the Republic terminated the Contracts incorrectly as a matter of procedure under the Contracts, Claimants are put to proof that this had any detrimental and/or significant effect on Claimants since, in actual fact, Claimants received notice of their breaches under the Subsoil Law 2010.

⁶⁹¹ Witness Statement of Minister Mynbayev, para. 7.3.

⁶⁹² Article 45-2(2)(1) of Law on Subsoil and Subsoil Use No. 2828, January 27, 1996 as amended on 13 February 2009 (**Exhibit C-508**). It is noteworthy that Claimants omit to mention 5 of the grounds for terminating under this law.

⁶⁹³ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 351

668 Claimants also now rely on arguments relating to the Law on Private Business of 17 July 2009, in relation to the practice for carrying out inspections in Kazakhstan, which were first raised in a flimsy manner in TNG's and KPM's responses to the notices of breach.⁶⁹⁴ However, Claimants have not sufficiently addressed the relevance of the Republic's questions as to how this law (and the procedures required under it) relates to the operation of the Subsoil Law 2010. It remains the case that the Subsoil Law 2010 applies to this question and that this law was operated properly. The Defendant repeats paragraph 31.122 of the Statement of Defence.

669 In any event, Claimants did follow the correct procedures when terminating the Contracts the Contracts. The Republic has already set out in some detail the procedure for controlling and monitoring subsoil users in paragraph 31.102 of the Statement of Defence. The Subsoil Law 2010 does not in any way refer to these procedures and termination under Article 72 is not bound by this. The breaches set out in the notices were based on the Republic's continuous monitoring and control of KPM and TNG.

c) Inspections in 2010

670 The Republic carried out inspections in the early parts of 2010 for a number of reasons. First and foremost it was entitled to carry out the inspection in January 2010 to ensure compliance with subsoil use legislation. It certainly did not do so in order to find violations enabling it to terminate the contracts as Claimants suggest.⁶⁹⁵ This argument is without foundation and it is noteworthy that Claimants produce no evidence in support of it.

671 Furthermore, the question at hand is not whether it would have been possible in theory to terminate the Contracts in January 2010; the Republic did not seek to terminate Contracts 205 and 310 in January 2010 so this assertion is irrelevant.

672 If Claimants employ this observation to support their misguided contentions that the Republic changed the law at this point to enable it to

⁶⁹⁴ Letter from T Mardari and A Stati to Mr K Safinov dated 19 July 2010 (**Exhibit C-24**) and letter from E Calancea and A Stati to Mr K Safinov dated 19 July 2010 (**Exhibit C-25**).

terminate Contracts 310 and 205⁶⁹⁶, it is the Republic's case that in any event it had the right (though, in fact, chose not to) to terminate Contracts 310 and 205 under the terms of the Contracts themselves.

673 In any event, the Tribunal should be aware that in early 2010 it was clear that there had been repeated violations of labour law by KPM and TNG relating to, inter alia, delays in payments for employees which had serious social implications.⁶⁹⁷

674 Evidently this was a serious issue in its own right which only added to the Republic's concerns as to how Claimants were running KPM and TNG.

675 As already stated in the Statement of Defence,⁶⁹⁸ the Republic legitimately notified KPM and TNG of audits it would carry out on 29 June 2010. The Republic did of course have the right to conduct the inspections. The subsoil is the property of the State and it is important for the State to ensure that such users are complying with all laws and regulations including environmental, epidemiological, security, tax and labour laws.⁶⁹⁹

676 The inspection was instigated by the General Prosecution Office of the Republic for a number of reasons including the following:

- (a) KPM and TNG had been the subject of allegations of various breaches of Kazakh law (including environmental law and subsoil use legislation) which prompted the Republic to investigate their compliance with their contractual obligations⁷⁰⁰;
- (b) The GPO received complaints from individuals in relation to the loss of deposits⁷⁰¹ leading to poor levels of production at the companies;
- (c) The GPO also had grounds for believing that employees were not being paid their salaries by KPM and TNG and there were reports of

⁶⁹⁵ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 340

⁶⁹⁶ Which, for the reasons set out in paras. [refer to earlier paras. in section dealing with this], is completely untrue.

⁶⁹⁷ Kravchenko Witness Statement dated 12 August 2012, paras. 3.1 to 3.6

⁶⁹⁸ Statement of Defence dated 21 November 2011, para. 31.97.

⁶⁹⁹ Kravchenko Witness Statement dated 12 August 2012, para. 3.6.

⁷⁰⁰ Witness Statement of Mr. Ongarbayev, para. 2.5 and Kravchenko Witness Statement dated 12 August 2012, para. 7.1

⁷⁰¹ Kravchenko Witness Statement dated 12 August 2012, para. 7.1

mass employee dismissals.⁷⁰² This was a particular concern to the GPO given the economic situation at the time which meant that the GPO was tasked with ensuring social stability in socially vulnerable areas and was required to take greater interest in enforcing labour rights in order to main proper social order⁷⁰³; and

- (d) It was becoming more and more evident that the companies were stagnating and the likelihood was that the situation would only get worse. With a combination of each of the problems identified above⁷⁰⁴ and the absence of top management over the companies, all of whom had left Kazakhstan, the companies needed to be inspected to monitor them and try to resolve the problems.⁷⁰⁵

677 Claimants have again misleadingly stated that “more than a dozen government agencies” arrived at KPM’s and TNG’s offices to conduct the inspection⁷⁰⁶ when actually, from Claimants’ own documents, it appears that only five ministries requested further inspections. Furthermore, the teams carrying out inspections from each ministry were small and of normal nature⁷⁰⁷ and would have led to minimal interference to their operations. Following these inspections, various contractual breaches by KPM and TNG were notified to Claimants by the Republic on 14 July 2010.

d) Termination of Contracts 210 and 305

678 As set out above, the Republic terminated Contract 210 and 305 on the basis of a number of serious ongoing breaches by Claimants.

679 In their Reply Memorial on Jurisdiction and Liability, Claimants make no attempts to address the contractual breaches by KPM and TNG identified in the notices the Republic sent to them on 14 July 2010. These were breaches

⁷⁰² Kravchenko Witness Statement dated 12 August 2012, paras. 7.1 and 7.2

⁷⁰³ Kravchenko Witness Statement dated 12 August 2012, paras. 7.1 to 7.4

⁷⁰⁴ Kravchenko Witness Statement dated 12 August 2012, para. 7.6

⁷⁰⁵ Kravchenko Witness Statement dated 12 August 2012, para. 7.7

⁷⁰⁶ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 345

⁷⁰⁷ Witness Statement of Mr. Ongarbaev, para. 2.1 and Kravchenko Witness Statement dated 12 August 2012, paras. 9.1 to 9.7

that caused the Republic considerable concern.⁷⁰⁸ Furthermore, given that many of these breaches related to violations of Kazakh law committed some time ago, which had also already been considered by the Kazakh courts, they gave the Republic further reasons for taking action without delay. Instead of addressing these issues in these proceedings, Claimants now resort only to complaints about the manner in which they were notified of the breaches which supposedly prevented them from having the opportunity to raise objections or appeal the results.

680 At the time when the Contracts were terminated, Claimants did in fact dispute the breaches in responses submitted on 19 July 2010. However, for the reasons set out in paragraphs 31.120 to 31.126 of the Statement of Defence, their responses were wholly inadequate. In particular, the Republic has demonstrated that both TNG and KPM, in part recognised the existence of violations, provided only clarifications of their outstanding obligations and refused to address the breaches committed. Claimants' response was in breach of Article 72(3) of Subsoil Law 2010 as a result of their failure to eliminate the breaches within the timeframe the Republic specified.

681 It is noteworthy that both TNG and KPM accepted that they had failed to comply with certain obligations which required the payment of various costs, failures to contribute to the liquidation funds and failure to pay taxes and other obligatory payments⁷⁰⁹. Their response to this was that they could not perform these obligations due to "force majeure". However, any force majeure due to execution orders on its account only came about as a result of the fine that was legitimately imposed on these companies as a result of their operation of a main pipeline without a license and failure to comply with the court order by repaying the fine. This is not an event of force majeure as KPM's and TNG's own failures and violations cannot be regarded as matters outside of their control. Furthermore, this is also a clear acknowledgment that the breach had been committed. There were certainly 2 or more breaches entitling the Republic to terminate the contracts.

⁷⁰⁸ See Statement of Defence dated 21 November 2011, paras. 31.104 to 31.106. See also Kravchenko Witness Statement dated 12 August 2012, paras. 7.9 to 7.30 elaborating on the severity of the breaches identified by each state entity involved.

⁷⁰⁹ Paragraphs 31.122 (b) to (d), Statement of Defence dated 21 November 2011

682 It is telling that Claimants have failed to address these inadequacies in their Reply Memorial on Jurisdiction and Liability. Furthermore, Claimants provide no evidence that the breaches were not substantial. As Professor Olcott notes:

“The complainant depicted the reasons for their being found in breach of contract as largely insignificant (save for the fine for operating a main pipeline operation without a license, which they dispute). In point of fact the government of Kazakhstan accords great importance to meeting the obligations of the provisions on local content that were included in the amended 1995 Subsoil Law, in a new law from December 2009, and in the 2010 subsoil law, which provided the formal basis upon which the two subsoil contracts were terminated.”⁷¹⁰

683 Notably, at paragraph 350 of the Reply Memorial on Jurisdiction and Liability, rather than respond to the Republic’s points on the breaches they committed, Claimants rely on the Law of Private Business to raise procedural allegations against Claimants. These procedural allegations are unfounded as Acts of Inspection were served on KPM and TNG.

684 Furthermore, pursuant to Article 72(3) of Subsoil Law 2010, it is clear that the unilateral termination of the Subsoil Use Contracts is not in any way connected to mandatory inspections of TNG and KPM. The Article does not provide that a contractual violation must be based on the results of inspections. Accordingly, Claimants allegations on this issue (including that the Notices of Breach of 14 July 2010 were invalid due to the Ministry of Oil and Gas as competent authority not having the results of these inspections) are unfounded.

685 The Tribunal should note that the contractual breaches identified by the Republic were based on the continuous monitoring and control of KPM and TNG and not simply as a result of the final inspection in July 2010. Furthermore, at the time of termination, the Ministry of Oil and Gas was already aware of the breaches committed as a result of its monitoring and control of those companies. The fact that Acts of Inspection were not

⁷¹⁰ Professor Olcott Expert Report dated 7 August 2012, para. 196

served on Claimants by 14 July 2010 has no relevance to whether the Republic was entitled to serve a notice of breach. The breaches committed by Claimants were long-standing in nature and Claimants cannot deny this.

686 In addition, if, in the opinion of Claimants, they believed the inspections were not made in compliance with the law, the fact is that KPM and TNG had the right to appeal the appointment of an act and the act of checking the results of inspections and actions (inaction) of officials of state bodies in accordance with the laws of the Republic of Kazakhstan. Claimants were well aware that they had this right. However, Claimants now choose to mislead the Tribunal by arguing that under the Law On Private Business, the Republic would allow KPM and TNG to appeal the audit findings before notices of breach under the Subsoil Law 2010 are sent. This is simply not the case as explained above. Furthermore, Claimants did not appeal the results of the inspection, again showing that by this point, they had no interest in their investment in Kazakhstan. They simply used the Republic's lawful termination of the Contracts as an excuse to commence these arbitration proceedings, despite the various protections and rights of appeal they could have been afforded in the Republic itself.

687 It is clear that even now Claimants are still:

- (a) Avoiding the allegations made against them rather than addressing the breaches; and
- (b) Challenging the legality of the Republic's actions on implausible procedural rather than substantive grounds.

688 Claimants' reaction at the time to the violations the Republic identified made it clear that they were unwilling to accept that they had breached Contracts 210 and 305 and were not willing to make any attempts to eliminate such breaches. The Republic was forced into a position whereby it was required to legally terminate Contracts 210 and 305 in accordance with the Subsoil Law 2010.⁷¹¹

689 Claimants' case is that, procedurally, the Republic allegedly has not demonstrated that termination of the Contracts was in accordance Kazakh

⁷¹¹ See Statement of Defence dated 21 November 2011, paras. 31.127 to 31.143

law⁷¹². However, this approach is wrong and places undue emphasis on the process of terminating the Contracts (which was in any event in accordance with the law) whilst totally ignoring the substantive nature of the breaches.

690 Claimants also again query the reasonableness of the five day timeframe given to cure the violations set out in the notices⁷¹³ In the Statement of Defence the Republic has already explained why that timeframe was in fact sufficient. Claimants' have ignored the Republic's legal arguments and instead chosen to make further unsubstantiated assertions on the alleged short time timeframe they were given to respond to the breaches. In the circumstances, their contention that they were only given five days to cure the breaches is misleading.

691 Firstly, Claimants were well aware of many of the breaches set out in the notices and particularly those referred to in sections C.IV. and C.VIII. above. Claimants themselves admit that such violations have been raised before⁷¹⁴ and have gone as far as objecting to and – to some extent – appealing these violations to the Kazkah courts. Furthermore, in relation to all other breaches, Claimants actively partook in the July 2010 audit and were regularly notified by the state entities involved of their findings, including if a contractual breach was identified. As this was all being done at the time of the audit,⁷¹⁵ the formal results should have come as so no surprise to them⁷¹⁶. In addition, as some of these breaches concerned monetary obligations and the requirement to provide information, five days would certainly have been a reasonable period to comply and would in any event have been in accordance with Kazakh legal principles⁷¹⁷. Claimants made no attempt to seek an extension to this deadline on the basis that it was too short. It is therefore specious for Claimants to state that they had only five days to cure the violations.

⁷¹² Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 348

⁷¹³ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 350

⁷¹⁴ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 347

⁷¹⁵ Ongarbaev Witness Statement dated 8 August 2012, para. 2.6.

⁷¹⁶ Claimants would have been verbally informed of the Ministry of Labour's findings (concluding that they were in breach of various labour laws) before the audit was concluded and report prepared on 3 July 2010 (**Exhibit R-258**). This was well before any notices of breach were sent.

⁷¹⁷ Professor Ilyassova Expert Report dated 12 August 2012, para 2(a)

692 Secondly, the breaches were serious and the Republic was entitled to act quickly in the circumstances. As to paragraph 349 of the Reply Memorial on Jurisdiction and Liability, Claimants' assertion that any social tensions that occurred were caused by the Republic's alleged "harassment" is simply false. The Republic had received complaints about KPM and TNG and the audits only served to prove that:

- (a) Production activities at KPM and TNG had virtually stopped;
- (b) There was little chance of employee salaries being paid; and
- (c) Given that the senior management at KPM were absent⁷¹⁸, it was clear that KPM and TNG had no intention of performing their contractual obligations at any point in the foreseeable future. Furthermore, it was also apparent that Claimants, as owners of those companies, were not prepared to make further investments.

693 The Republic was therefore forced to take action without delay. As Minister Mynbayev notes, it simply had no right not to take action⁷¹⁹. Claimants cannot now hide behind their own violations of Kazakh law and subsequent abandonment of their assets, which legitimately led to action being taken by the Kazakh authorities to justify its failure to cure the contractual breaches.

694 Thirdly, the oil and gas fields had regional strategic importance⁷²⁰ and the impact of a stop in production could have led to serious social unrest within the Mangystau region⁷²¹. Coupled with the social unrest, the problems associated with KPM and TNG became a serious issue and the Republic had no option but to take prompt and decisive action.⁷²²

695 Fourthly, Claimants have still failed to address whether it suffered any prejudice by any alleged lack of notice that might have occurred (which is is in any event denied).⁷²³

⁷¹⁸ Kravchenko Witness Statement dated 12 August 2012, para. 7.23

⁷¹⁹ Witness Statement of Minister Mynbayev, para 5.4.

⁷²⁰ Albeit, that on a national scale, production was relatively small.

⁷²¹ Suleimenov Witness Statement dated 12 August 2012, para. [2.9]

⁷²² Witness Statement of Minister Mynbayev, paras. 5.3 et seq.

⁷²³ Statement of Defence dated 21 November 2011, para. 31.134

696 In summary, Claimants have failed to address the substantive nature of their breaches at the time of termination. These breaches were serious and entitled the Republic to terminate Contracts 210 and 305. In contending the manner in which the Republic terminated the Contracts Claimants are attempting to divert attention from these key issues. In any event, for the reasons set out above, the Republic did terminate the Contracts in accordance with Kazakh law.

2. Trust Management and Transfer

697 Given Claimants' actions, it was necessary to terminate the Contracts and invoke the mechanisms of the Subsoil Law 2010.

698 By the time the Contracts were terminated, the majority of TNG and KPM's senior and middle management had left the country and had, in effect, abandoned their investments.⁷²⁴ The transfer of assets to KMG NC in order to continue production was therefore completely necessary. The Republic could not simply leave the fields unmanned and employees of KPM and TNG jobless. It was clear that KPM and TNG had no interest in remedying the situation and was content with continuing to neglect the territories. The Republic's actions were entirely appropriate. As explained above, and in some detail in the Statement of Defence, this was the consequence of a lawful termination under the Subsoil Law 2010. Further, Article 72(10) of the Subsoil Law 2010⁷²⁵ specifically caters for a situation where a subsoil user is absent or evades transferring its property to the national company. In this case, the competent authority is to act as the former subsoil user's attorney in order to effect the transfer.

699 The competent authority therefore had no alternative but to act as Claimants' attorney and transfer KPM's and TNG's property. Of course, as previously explained, such "transfer" was not as one might know it under other laws since this transfer did not involve a transfer of title.⁷²⁶

⁷²⁴ As highlighted in the Statement of Defence dated 21 November 2011, para. 31.146

⁷²⁵ Law of Subsoil and Subsoil Use Law of the Republic of Kazakhstan dated 24 June 2010 (**Exhibit R-257**).

⁷²⁶ Statement of Defence dated 21 November 2011, para. 31.150(b)

700 In the Reply Memorial on Jurisdiction and Liability, Claimants mischaracterise the actions taken by the Republic upon termination of Contracts 210 and 305. The transfer of the contractual territory into trust management was the lawful consequence of KPM's and TNG's misconduct under the Contracts. Claimants had various avenues of recourse under both Kazakh law and those contracts but it is telling that they did not pursue these avenues and instead abandoned their investment and prematurely commenced arbitration proceedings against the Republic. Even now, they fail to explain why they did not pursue such avenues. However, as Professor Olcott notes, it is hardly surprising that Claimants took this course:

“Once the Stati family turned TNG and KPM into debt ridden enterprises, any interested buyer would have to pay off the debts as part of the purchase package, and only pay the subsoil license holders the value of the asset that remained. So this made an international arbitration claim the only chance for the Stati's to come away from the KPM and TNG with a substantial profit, as from 2009 on (well before the Cornegruta decision) Ascom already lacked the capital to successfully continue operating the two existing oil and gas companies, not to mention successfully exploit the Tabyl block or complete the Gas Processing Plant.”⁷²⁷

701 As explained in the Statement of Defence⁷²⁸ and above, once Contracts 210 and 305 were terminated, pursuant to Article 72(10) of Subsoil Law 2010, the relevant contractual territory needed to be transferred to KMG NC to hold into its trust management. As part of this, the legislation provides that the former subsoil user's property, structures and equipment necessary for ensuring continuity of the process flow are to be transferred into **temporary possession** of KMG NC until a new subsoil user is found⁷²⁹.

⁷²⁷ Professor Olcott Expert Report dated 7 August 2012, para. 174

⁷²⁸ Statement of Defence dated 21 November 2011, paras. 31.148 to 31.150

⁷²⁹ Law of Subsoil and Subsoil Use Law of the Republic of Kazakhstan dated 24 June 2010 (**Exhibit R-257**)

The MOG ordered a transfer into temporary possession on this very basis.⁷³⁰

702 The terms of each trust management agreement between KMG NC and the Republic (signed on 21 July 2010), which govern the trust management system, made clear that the transfer was for preservation purposes:

*“Purpose of the Trust management activity is **preservation of the Object of trust management**, its maintenance in the state suitable for its further use according to the designated purpose, its use in accordance with the Plan of Trust management activity, carrying out of environment protection measures, as well as other measures provided for by the legislation”⁷³¹*
(emphasis added).

703 The transfer of the territories needed to take place swiftly in order to maintain the fields. As stated by Mr. Ongarbaev:

“A gas or oil field is not simply like a car in the sense that one cannot just turn it off and turn it back on again. Any period of ramping up or ramping down production (i.e. the production of hydrocarbons) may lead to deterioration of the underlying asset. In addition, serious technological problems began to occur in the TNG’s oil field Tolkyn. These problems related to intensive extraction of hydrocarbons at the initial stage, as a result, after a short period of extraction, the majority of wells had unregulated inflow of underground water, which, eventually, leads to intensive flooding of the field. There was simply no scope to leave the fields unmanned for a lengthy period of time. It was therefore entirely appropriate to effect the transfer into trust management as soon as possible.”⁷³²

⁷³⁰ Order by A. Magauov dated 21 July 2010 (**Exhibit R-259**).

⁷³¹ Contract of trust management of a subsoil area No.2, clause 2.2 (**Exhibit R-194**). See also Contract of trust management of a subsoil area No.1 clause 2.2 (**Exhibit R-197**)

⁷³² Witness Statement of Mr. Ongarbayev, para. 4.2.

704 It is clear therefore that this was a temporary transfer of KPM’s and TNG’s property, as required to continue the production flow and preserve and maintain the territories, and not a permanent one (which Claimants assert in paragraph 354 of the Reply Memorial on Jurisdiction and Liability). The temporary transfer was in no way an expropriation of Claimants’ assets.

a) The Call of 22 July 2010: Claimants’ failure to engage with the Republic

705 The call in on 22 July 2010 between a representative of the MOG, a representative of KMG NC and Mr Calancea dealt with the management of the assets going forward. The proposed agreements sent by the Republic to Claimants following the call were entirely reasonable in the circumstances.

706 The terms of the contracts proposed to KPM and TNG in order to transfer the territories to KMG NC to hold in trust management mirrored the terms of the main trust agreements signed the day before, and provided that the transfer was temporary until a new subsoil user was found, in order to continue the production process:

*“1. The Partnership shall transfer into **temporary possession and use** and KMG shall accept the facilities and equipment securing **continuity of production process and industrial safety** (hereinafter – the Property).*

*6. Upon conclusion of the contract with a **new subsoil user the property shall be transferred to it** on conditions provided for by the legislation in force.*

*9. The Contract of temporary possession and use of the Property, along with general grounds for termination of obligations, shall **be terminated in connection with conclusion of a contract for subsoil use with a new subsoil user in accordance with the Law of the RK “On Subsoil and Subsoil Use”**⁷³³ (emphasis added).*

707 KPM and TNG refused to sign the aforementioned proposed agreements, thus evading their obligations under the Subsoil Law 2010. Furthermore,

⁷³³ Contract of temporary possession and use of property proposed to KPM dated 21 July 2010 (Exhibit R-200.1). See also Contract proposed to TNG dated 21 July 2010 (Exhibit R-200.2)

they also breached general legal principles requiring legal entities to act in good faith, reasonably and justly when effectuating their rights and complying with the requirements contained in legislation and moral principles.⁷³⁴

708 In response to paragraph 11 of Mr. Calancea’s Witness Statement, the Republic would never have been in a position to compensate Claimants for the transfer, as through holding the assets required to continue production in trust management, it never actually owned the companies. This is clear from the provisions of Subsoil Law 2010⁷³⁵. Furthermore the terms of each of the Trust Management Agreements between the Republic and KMG NC clearly stated that:

“Transfer of the Object of trust management shall not entail transfer of title thereto to the trust manager”⁷³⁶
(emphasis added).

709 As stated above and based on the transfer agreements proposed to KPM and TNG⁷³⁷, Claimants knew that KMG NC only had temporary possession of the property. Clause 6.1 of each trust management agreement also provided that those agreements would terminate as soon as a contract with a new subsoil user is concluded and the assets are transferred to him.⁷³⁸

710 It is therefore misleading for Claimants to complain about not being compensated by the Republic as neither it nor KMG NC ever had ownership title of any of their assets. The Republic has produced evidence which shows that this is both factually and legally the case⁷³⁹ and Claimants cannot dispute this (as they have done) without adducing any factual evidence to the contrary. Furthermore, as per Article 61(2) of the

⁷³⁴ Article 2 8.4 of Civil Code of the Republic of Kazakhstan (**Exhibit C-403**)

⁷³⁵ See the Statement of Defence dated 21 November 2011, para. 31.148 and above

⁷³⁶ Contract of trust management of a subsoil area No.2 dated 21 July 2010, clause 3.a (**Exhibit R-194**). See also Contract of trust management of a subsoil area No.1 dated 21 July 2010, clause 3.2 (**Exhibit R-197**)

⁷³⁷ Contract of temporary possession and use of property proposed to KPM dated 21 July 2010 (**Exhibits R-200.1**) and Contract proposed to TNG dated 21 July 2010 (**Exhibit R-200.2**)

⁷³⁸ Contract of trust management of a subsoil area No.2 dated 21 July 2010 (**Exhibits R-194**) and Contract of trust management of a subsoil area No.1 dated 21 July 2010 (**Exhibit R-197**)

⁷³⁹ Letter from Vice-Minister A Shokpytov dated 19 September 2011, para. 31.162 (**Exhibit R-160**) and letter from A Aitkulov to K Safirov dated 23 September 2011 (**Exhibit R-161**)

Subsoil Law 2010⁷⁴⁰, any term providing for such compensation would only be in the contract entered into with the new subsoil user:

“If a contract is concluded with respect to a subsoil area which contract was terminated a contract with a new subsoil user must contain obligations to compensate the previous subsoil user and a trust manager for costs, including the cost of property transferred under Paragraph 10 of Article 72 of this Law as well as the obligation to pay a free to the trust manager” (emphasis added).

711 Claimants misunderstand the purpose behind the legislation when commenting on the fact that the draft agreements did not provide for KMG NC taking on the debts and liabilities of KPM and TNG.⁷⁴¹ KMG NC’s role was clearly as trust manager and therefore it had no business in taking on the debts and liabilities, which remained with KPM and TNG. It was therefore only legally able to hold the contractual territories in trust management and take temporary possession of the related property, structures and equipment needed to ensure continuity of the process flow and industrial safety.

b) Current Management of the Property

712 As a result of Claimants’ refusal to cooperate, the transfer of the assets was finalized on 28 July 2010 in Claimants’ absence.

713 In response to paragraph 356 of the Reply Memorial on Jurisdiction and Liability, the Republic does not dispute that the employees of KPM and TNG joined KMG NC on their own volition and in accordance with Article 72(10) of Subsoil Law 2010, the relevant property referred to above was transferred into their temporary possession. The manner in which the trust management of the assets has been operated since termination has already been set out in some detail in the Statement of Defence⁷⁴². It is quite clear from the Reply Memorial on Jurisdiction and Liability that Claimants have

⁷⁴⁰ Law of Subsoil and Subsoil Use Law of the Republic of Kazakhstan dated 24 June 2010 (**Exhibit R-257**)

⁷⁴¹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 355.

⁷⁴² See the Statement of Defence dated 21 November 2011, paras. 31.162 to 31.166

produced no evidence which suggests that they have not been operating in this manner.

714 As to the operation of the LPG Plant, since Claimants abandoned the plant, KazMunaiTeniz (which subsequently assumed the trust management responsibilities of KMG NC) has been forced to employ guards to protect the Plant and re-employ minimal staff to avoid social tension⁷⁴³. Claimants have given no explanation as to why the application at Exhibit C-583 in any way indicates that KazMunaiGas is making plans for the future of the LPG Plant.

715 In response to paragraph 358 of the Reply Memorial on Jurisdiction and Liability, it is implausible for Claimants to suggest that the Republic could have transferred the contractual territories and related property to a new subsoil user at any time. They commenced these arbitration proceedings within five days from when the Contracts were terminated. It is unrealistic to believe that any potential subsoil user would be willing to invest in the territories whilst they are subject to such significant proceedings. Claimants have created considerable uncertainties over subsoil rights in the territories and in respect of title to related property and have, as a result, delayed any prospect of them receiving compensation from a new user.

716 Since the temporary transfer, the assets are only being operated at a level to ensure that they do not deteriorate. They are not operating at a full commercial rate, as they are simply only in KMT's temporary possession, and proceeds are being paid into an escrow account as already detailed in paragraph 31.164 of the Statement of Defence. This is not in anyway a profitable situation for the Republic as:

- (a) It is not possible to tax any income earned from the assets because of the trust management system; and
- (b) Any proceeds are simply being used to maintain the assets.

717 There is in fact a real risk that KMT will incur losses from them.⁷⁴⁴ Notwithstanding this, the Republic does need to ensure the assets do not

⁷⁴³ Statement of Defence dated 21 November 2011, para. 31.165

⁷⁴⁴ See Witness Statement of Minister Mynbayev, para. 6.2.

deteriorate. Furthermore, it needs to ensure the continued employment of citizens of the Republic.⁷⁴⁵

c) Claimants have ignored possibilities of appeal

718 As to paragraph 357 of the Reply Memorial on Jurisdiction and Liability, it is quite clear that Claimants had options under Kazakh law which could have enabled them to have their former rights to the contractual territory reinstated or be compensated for them. For example:

(a) Claimants could have applied to the competent authority for a renewal of Contracts 210 and 305 under Article 73 of the Subsoil Law 2010 if they genuinely believed that the termination of Contracts 210 and 305 was based on incorrect information or the breach was out of its control.⁷⁴⁶ Claimants made no attempts to follow this process and engage and cooperate with the Republic to resolve the issues they had caused; or

(b) If Claimants were unwilling to work together with the Republic through the appeal process, they would have eventually been compensated following the transfer of the property to a new subsoil user in accordance with Article 61(2) of the Subsoil Law 2010 (see paragraphs 31.148 and 31.50(j) of the Statement of Defence).

719 If Claimants disagreed with the termination of the Contracts and considered that the Republic was in breach of the Contracts, KPM and TNG also had the option of commencing commercial arbitration proceedings or where appropriate contesting the decision to terminate with the Kazakh juridical bodies.⁷⁴⁷

720 Notwithstanding these avenues of recourse available to KPM and TNG, the companies made no attempts to pursue them. Instead, Claimants somehow concluded that their assets had been expropriated and within just five days of termination, they hastily commenced these proceedings under the ECT.

⁷⁴⁵ See Witness Statement of Minister Mynbayev, para. 6.1.

⁷⁴⁶ See the Statement of Defence dated 21 November 2011, paras. 31.149 and 31.50(e) which provide further detail on how the appeal system operated. See also Professor Ilyassova Expert Report, pg. 12 - 14.

⁷⁴⁷ Statement of Defence dated 21 November 2011, paras 31.169 and 31.170

It is clear that Claimants had no intention whatsoever of at least first exhausting the local remedies available to them.

721 The Republic's actions were lawful. In response to paragraphs 359 and 360 of the Reply Memorial on Jurisdiction and Liability, there is and never was any reason why the Republic should compensate Claimants for a legal termination of the Contracts. As has already been stated above, KPM and TNG had the opportunity to appeal the termination but chose not to. They also had the opportunity to pursue various local remedies but they completely ignored these. Kazakh law also provides them with the opportunity to be compensated by a new subsoil user but they have prevented this from happening. It is quite clear therefore that they are now only looking to swindle the Republic for the highest value they can possibly extract for their failing investment. Their intention became clear from when they started to abandon their "investment" and crystallised once they so speedily commenced these proceedings.

X. External circumstances and Claimant's own actions led to a deterioration of value of KPM and TNG and their abandonment by the alleged investors

722 Claimants try to paint a picture in which it was the Republic's actions that caused Claimants' activities in Kazakhstan to fail. The Republic strongly refutes these allegations: As shown extensively above, the Republic cannot be reproached for any of its actions simply because the Republic acted lawfully and appropriately throughout the life of Claimants' alleged investment.

723 Moreover, as will be shown in the following, it was not even the Republic's actions that caused Claimants' activities to fail. Rather, looking at the development of KPM's and TNG's financial situation and setting them in relation to

- (a) Claimants' own actions;
- (b) external events; and
- (c) the Republic's allegedly illegal actions

it becomes clear that only the former two were relevant in the demise of the companies.⁷⁴⁸ As will be set out in more detail below, there is a clear correlation in time between the companies' financial troubles and certain external events as well as Claimant's own actions.

- 724 In particular, the demise of the companies was caused by
- (a) the Tristan bond structure and the fact that Claimants withdrew excessively the returns from the companies;
 - (b) a sharp drop in oil and gas prices in 2008 and 2009;
 - (c) a sharp drop in local demand in 2009;
 - (d) the company's customers' conduct and the company's own business decisions;
 - (e) the general undercapitalization of the companies and the constant withdrawal of cash from the companies;
 - (f) the companies' failure to pay taxes on time as required by law; and
 - (g) the consequential taking out of the so-called Laren loan which was extremely risky and required the payment of very high interest rates .

725 All of these elements led to a severe underfunding of KPM and TNG and subsequently, to the companies no longer complying with their obligations under the Subsoil Use Contracts and Kazakh law. The eventual termination of the contracts was the logical consequence.

726 The Republic's allegedly illegal actions, on the other hand, did not play a role in the demise of the companies. Admittedly, as will be set out below, certain of the Republic's tax assessments had an effect on KPM's and TNG's cash situation. These specific tax assessments were however perfectly legal and Claimants have in fact never alleged otherwise.⁷⁴⁹

⁷⁴⁸ See also Expert Report of Professor Olcott, para. 162: *"Looking through the documents presented by the complainant, and supporting material that is in the public domain, what one sees instead is evidence of an increasingly financially troubled investment, in which the principals seem to have put in very little funding of their own and in which the project seemed designed to maximize income for the principals that could not be taxed by the Kazakh government or for the government of Moldova"*.

⁷⁴⁹ See below C.X.7.

1. Claimants’ activities in Kazakhstan were given only a limited chance by the markets from the beginning

727 As a starting point, it needs to be made clear that Claimants’ activities in Kazakhstan were given little chance by the markets from the beginning. This is most clearly shown by the highly speculative Tristan bond structure.

728 Tristan Oil Ltd. (“Tristan”) is an affiliate of KPM and TNG, 100 % owned by Anatoli Stati.⁷⁵⁰ It was created as a special purpose vehicle with the purpose of issuing notes.⁷⁵¹ In December 2006 and June 2007, Tristan issued bonds in the amount of \$420 million with 1 January 2012 as the maturity date. The proceeds of this note issuance were – for most part – provided to KPM and TNG by way of loans.⁷⁵²

729 Importantly, the bonds had a coupon rate of 10.5 %.⁷⁵³ In other words, Tristan had to pay 10.5 % of the overall issued \$420 million, i.e. \$44.1 million, each year. This, as such, is already quite a high coupon rate.

730 The coupon payment obligation was to be met by the profits Claimants expected to make from the operation of KPM and TNG.⁷⁵⁴ As will be set out in more detail below,⁷⁵⁵ Tristan lent parts of the money raised by way of the bond issuance to KPM and TNG. The companies were supposed to repay the loans from the profits they made from the production of oil and gas.

731 The speculative character of Claimants’ activities is documented by the ratings issued for the Tristan bonds. In 2007 and 2008, Moody’s rated the Tristan Bonds at “B2”.⁷⁵⁶ According to Moody’s “Global Long Term

⁷⁵⁰ First Witness Statement of Mr. Lungu, para. 6.

⁷⁵¹ Ibid.

⁷⁵² For the details of the Tristan bond structure, see Expert Report by Oxana Klepikova on the Tristan Bond Issuance (**Exhibit R-37**).

⁷⁵³ Expert Report by Oxana Klepikova on the Tristan Bond Issuance (**Exhibit R-37**).

⁷⁵⁴ Claimants themselves state that KPM and TNG were facing a liquidity crisis because coupon payments had to be made, cf. Reply on Jurisdiction and Liability dated 7 May 2012, para. 383; 2nd Witness Statement of Mr. Stati, para. 43; 2nd Witness Statement of Mr. Lungu, para. 9. See also below C.X.10.

⁷⁵⁵ See below C.X.2.

⁷⁵⁶ Cf. Tristan Oil Ltd. Annual Report FY 2007; p. 4 (**Exhibit 66 to the 1st FTI Report**); Tristan Oil Ltd. Annual Report FY 2008, p. 13 (**Exhibit 67 to the 1st FTI Report**).

Rating Scale”, “Obligations rated B are considered speculative and are subject to high credit risk.”⁷⁵⁷

- 732 During the same time frame, Fitch placed the Tristan Bonds at an unsecured rating of “B+”.⁷⁵⁸ Under Fitch’s denotations of credit risks, “B+” belongs to the so-called “speculative grade”, denoting risky securities (in contrast to the so called “investment grade”). Moreover, in the “speculative grade”, “B+” is not even the most stable category.⁷⁵⁹
- 733 Importantly, Claimants cannot blame the quite high coupon rate and the low ratings on the Republic. The Tristan bonds were issued in December 2006 and June 2007, long before, according to Claimants’ allegations, the Republic ever had any negative influence on the companies.⁷⁶⁰ This can only mean that in 2006 and 2007, the markets already considered Claimants’ activities in Kazakhstan as speculative. The low ratings in 2007 and 2008 confirm this interpretation. Thus, it cannot have come as a surprise when disillusion followed speculation and KPM’s and TNG’s business broke down.

2. From the beginning, KPM and TNG were overexposed to debt

- 734 Repayment obligations under the Tristan bond structure were a continuous burden on KPM’s and TNG’s financial situation. As set out above, the Tristan bonds had been issued with a high coupon rate and coupon payments were to be made from the returns of KPM and TNG.⁷⁶¹ Over the five year period, Tristan had to pay each year a coupon rate of 10.5 % on the overall bond issuance of \$420 million.⁷⁶² In other words, for five years, Tristan was obliged to pay the bond holders each year \$44.1 million of

⁷⁵⁷ Moody’s Rating Symbols and Definitions, June 2012 (**Exhibit R-260**)

⁷⁵⁸ Cf. Tristan Oil Ltd. Annual Report FY 2007; pp. 4-5 (**Exhibit 66 to the 1st FTI Report**); Tristan Oil Ltd. Annual Report FY 2008, p. 13 (**Exhibit 67 to the 1st FTI Report**).

⁷⁵⁹ Cf. Ratings explanations on the Fitch website (**Exhibit R-261**).

⁷⁶⁰ According to Claimants, the alleged “harassment campaign” started with President Nazarbayev’s letter of 14 October 2008, cf. Reply on Jurisdiction and Liability dated 7 May 2012, para. 210.

⁷⁶¹ See above C.X.1.

⁷⁶² Expert Report by Oxana Klepikova on the Tristan Bond Issuance (**Exhibit R-37**).

interest, in total \$220.5 million.⁷⁶³ Overall, interest payments were thus to amount to 51 % of the whole bond issuance.

735 This translated into yearly interest rates of 15-16 % which KPM and TNG had to pay. These interest rates were due under loans from Ascom and Terra Raf by which the money raised from the bond issuance was handed down to KPM and TNG (though only part of the money raised was actually handed down).⁷⁶⁴ It stands to reason that such a continuous and heavy financial burden had a negative impact on KPM's and TNG's operations.

736 At the same time, other parts of the Tristan structure were overexposed to debt as well, leaving little room for a drop in income by either KPM and TNG. For example, the produced oil was presold by the affiliated company Montvale, which also contributed to the financing of the Tristan structure.⁷⁶⁵ Debt exposure under this pre-sale agreement eventually reached \$80 million in 2009.⁷⁶⁶

737 As a whole, the Tristan structure was directed at maximizing the income of Tristan Oil and various other offshore Stati subsidiaries while minimizing the income of KPM and TNG.⁷⁶⁷ This was presumably intended to minimize the amount of income taxable by the Kazakh authorities, yet it backfired when the KPM's and TNG's income took a turn for the worse.⁷⁶⁸ To make matters worse, as will be set out below, Claimants even started to withdraw cash from the companies outright just when the situation of the companies started to deteriorate.⁷⁶⁹

⁷⁶³ It needs to be noted that the first instalment of coupon payments did not amount to \$44.1 million but instead to \$31.5 million since the first bond issuance in December 2006 only amounted to \$300 million. Further bonds in the amount of \$120 million were issued in June 2007.

⁷⁶⁴ Expert Report of Professor Olcott, para. 163.

⁷⁶⁵ Expert Report of Professor Olcott, para. 165.

⁷⁶⁶ Expert Report of Professor Olcott, para. 166. See also Witness Statement of Mr. Suleimenov, para. 2.23.

⁷⁶⁷ Expert Report of Professor Olcott, para. 164.

⁷⁶⁸ See below C.X.5.

⁷⁶⁹ See below C.X.9.

3. The companies' revenues were under pressure because of falling energy prices

738 Claimants admit that KPM's and TNG's revenues had been under pressure since the fall of 2008 because of falling energy prices.⁷⁷⁰ They further admit that oil and gas prices were "severely depressed" by December 2008 and January 2009⁷⁷¹ and that they were further falling sharply in spring and summer 2009, "putting significant pressure on the companies' revenues".⁷⁷²

739 Further, Claimants admit that local demand dropped in the spring of 2009, leaving TNG with a shortage of demand.⁷⁷³ Accordingly, not only did the companies sell their production at lower prices, they also sold much less of it.

740 In fact, the decline was rather dramatic. As can be seen from Tristan Oil's Annual Report for the Financial Year 2009,

*"[s]ales decreased to \$174.8 million for the year ended December 31, 2009 from \$504.6 million for the year ended December 31, 2008, a decrease of 65.4%".*⁷⁷⁴

741 Clearly, the Republic had nothing to do either with the global drop of energy prices in 2008 and 2009 or with the drop in local demand and not even Claimants can argue otherwise.

4. The companies were in such bad shape that a bridge loan to provide additional working capital was needed

742 Claimants admit that at least as early as November 2008, Claimants had been looking for a bridge loan to provide additional working capital.⁷⁷⁵

⁷⁷⁰ Reply on Jurisdiction and Liability dated 7 May 2012, para. 381. See also 2nd Witness Statement of Mr. Stati, para. 6: "[B]etween July of 2008 [...] and October 1, 2008 [...] oil and gas prices had dropped fairly significantly."

⁷⁷¹ 2nd Witness Statement of Mr. Stati, para. 18.

⁷⁷² 2nd Witness Statement of Mr. Lungu, para. 7. On the drop in energy prices, see also Expert Report of Professor Olcott, para. 173.

⁷⁷³ Reply on Jurisdiction and Liability dated 7 May 2012, para. 382; 2nd Witness Statement of Mr. Lungu, para. 8; 2nd Witness Statement of Mr. Stati, para. 41.

⁷⁷⁴ Tristan Oil Ltd. Annual Report FY 2009, p. 9 (**Exhibit 68 to the 1st FTI Report**) (emphasis provided).

⁷⁷⁵ Reply on Jurisdiction and Liability dated 7 May 2012, para. 381; 2nd Witness Statement of Mr. Lungu, para. 7. At both instances, it is stated that Credit Suisse sent to Claimants a term

This is a clear sign that already in November 2008, the companies were facing serious liquidity shortages.

743 However, even Claimants have so far not argued that the Republic's alleged "harassment campaign" started any earlier than 14 October 2008 with President Nazarbayev's letter. More importantly, the authorities did not impose any payment obligations on the companies in October and November 2008. All that happened were a number of inspections, audits and a court decision which was in fact favourable to KPM.⁷⁷⁶ Claimants cannot seriously argue that these state actions caused the companies to be stripped of cash to an extent that would have required a bridge loan to be taken out to provide additional working capital.

744 Apparently, it was already clear to Claimants in November 2008 that the obligations under the Tristan bonds together with the drop in energy prices were too much for KPM and TNG to bear. At this point, it must have dawned on Claimants that they had overextended themselves by placing the huge and very expensive bond issuance and not taking into account the possibility of falling energy prices.

5. In early 2009, the companies' cash position became very tight

745 Claimants admit that in "early 2009", KPM's and TNG's cash position became very tight.⁷⁷⁷ In fact, in the first quarter of 2009,⁷⁷⁸ Tristan's auditors were not able to provide assurance for the financial statements of KPM and TNG because the companies' ability to continue as a going concern was in doubt.

746 Again, there is no basis to blame the Republic for this development. Neither in December 2008 nor in January 2009 did the Republic impose any payment obligations on KPM or TNG. What happened were mostly inspections and audits as well as the initiation of criminal proceedings.

sheet for a \$150-175 million facility on 5 December 2008. It stands to reason that Claimants have started looking for this loan before that date, i.e. in November 2008.

⁷⁷⁶ On 19 November 2008, KPM won in the court of first instance regarding the imposition of the Crude Oil Export Tax, cf. Decision of the Board of Appeal of the Mangystau Regional Court dated 23 December 2008 (**Exhibit C-161**).

⁷⁷⁷ Reply on Jurisdiction and Liability dated 7 May 2012, para. 382.

⁷⁷⁸ Tristan Oil Ltd., Interim Report For the Three Months Ended March 31, 2009, F-2 et seq., F-71 et seq., F-111 et seq. (**Exhibit R-262**).

Clearly, these rather simple measures executed over a short time span cannot have caused KPM's and TNG's cash position to have become "very tight".

747 Admittedly, Claimants point to one specific event during this time frame, namely to the INTERFAX-KAZAKHSTAN news agency piece about the reversal of the pre-emptive rights waiver dated 18 December 2008.⁷⁷⁹ Allegedly, this news item caused Credit Suisse to step back from providing the urgently required bridge loan.⁷⁸⁰ However, Claimants miss three important points in this regard: first, that the "reversal" of the pre-emptive rights waiver was perfectly legal; second, that they have not provided sufficient proof that it was this news agency piece that caused Credit Suisse to step back from providing the bridge loan; and third, that the news agency piece is not attributable to the Republic.

748 As to the legality of the "reversal", the Republic refers to its submissions made above.⁷⁸¹ Naturally, Claimants cannot reproach the Republic alleged adverse effects from a news item which reports on perfectly legal steps taken by the Republic with regard to TNG.

749 Further, Claimants have not proven that there was any causal link between the news agency piece and Credit Suisse' decision not to provide a bridge loan. No formal letter or e-mail explaining Credit Suisse' decision has been presented to the Tribunal. Instead, the Tribunal is required to believe the unsupported statements made by Mr. Lungu.⁷⁸² This is particularly surprising given that negotiations were to a large extent held via e-mail, as is apparent from Credit Suisse' e-mail of 5 December 2008.⁷⁸³ Hence, there should be some document proving Claimants' allegations. Even if this was not the case, Claimants could have at least provided witness testimony from Credit Suisse.

750 Lastly, the INTERFAX-KAZAKHSTAN piece is not even attributable to the Republic. In order to show otherwise, Claimants would need to prove

⁷⁷⁹ INTERFAX-KAZAKHSTAN news agency piece dated 18 December 2008 (**Exhibit C-141**).

⁷⁸⁰ Cf. Reply on Jurisdiction and Liability dated 7 May 2012, para. 381; 2nd Witness Statement of Mr. Lungu, para. 7.

⁷⁸¹ Cf. section B.IV.4.a).

⁷⁸² 2nd Witness Statement of Mr. Lungu, para. 7.

⁷⁸³ Credit Suisse e-mail dated 5 December 2008, (**Exhibit C-521**).

that information was given by officials to the news agency as part of an exercise of governmental authority.⁷⁸⁴ However, Claimants have clearly not provided such proof. In fact, as is confirmed both by INTERFAX and by the MOG's press office, the MOG did not issue a press release on this matter.⁷⁸⁵ Rather, the information published by INTERFAX came from an unofficial source.⁷⁸⁶

6. The companies' liquidity shortage was made worse by numerous factors outside of the Republic's influence

751 Claimants admit that KPM's and TNG's liquidity shortage was exacerbated by the companies' own customers and by the companies' own decision making. In particular, Claimants state that in the fall of 2008, the company Kemikal failed to post bank guarantees that were part of its required payment term under its contract with TNG.⁷⁸⁷ Claimants also explain that for this reason, TNG decided not to prolong the contract with Kemikal, "*TNG's largest non-local customer*", at the end of 2008.⁷⁸⁸ Clearly, the loss of the largest non-local customer must have had serious effects on TNG's income.

752 As mentioned above, Claimants admit that local demand dropped in the spring of 2009, leaving TNG with a shortage of demand.⁷⁸⁹ Claimants also admit that they failed to secure a contract with KazRosGas which would have counter-acted the effects of this shortage, namely a contract under which KazRosGas would have purchased TNG's excess gas for export.⁷⁹⁰

⁷⁸⁴ Cf. Article 7 ILC Draft Articles on State Responsibility (**Exhibit R-263**) which reads: „The conduct of an organ of a State or of a person or entity empowered to exercise elements of the governmental authority shall be considered an act of the State under international law if the organ, person or entity acts in that capacity, even if it exceeds its authority or contravenes instructions.”

⁷⁸⁵ Letter from INTERFAX to the MOG dated 21 June 2012 (**Exhibit R-264**) and Letter from the Secretary's Office dated 21 June 2012 (**Exhibit R-265**).

⁷⁸⁶

⁷⁸⁷ Reply on Jurisdiction and Liability dated 7 May 2012, para. 382; 2nd Witness Statement of Mr. Lungu, para. 6.

⁷⁸⁸ 2nd Witness Statement of Mr. Lungu, para. 6; 2nd Witness Statement of Mr. Stati, para. 41.

⁷⁸⁹ See above C.X.6.

⁷⁹⁰ Reply on Jurisdiction and Liability dated 7 May 2012, para. 382; 2nd Witness Statement of Mr. Stati, para. 42.

753 It stands to reason that all of this had huge effects on TNG's profitability. As the Claimant Anatoli Stati himself states:

*"A decline in local demand in the spring of 2009, and the lack of a replacement contract for the volumes Kemikal had been taking, forced TNG to curtail production substantially (by as much as 50 %). This, combined with the sharp decline in oil and gas prices in late 2008 and early 2009, resulted in TNG receiving significantly less money for significantly reduced deliveries."*⁷⁹¹

754 Curiously, Claimants try to pin these negative, but yet wholly unrelated developments on the Republic. This attempt must clearly fail:

755 With regard to Kemikal, Claimants try to argue that Kemikal is a company controlled by Mr. Kulibayev.⁷⁹² However, Claimants do not provide any proof of this contention, other than Mr. Stati's and Mr. Lungu's unsupported allegations.⁷⁹³

756 More importantly, even if Mr. Kulibayev controlled Kemikal, this would not trigger any responsibility of the Republic. As Professor Olcott observes, Claimants' complaint about Mr. Kulibayev's alleged involvement in this case "*confuses Kulibayev the manager and state servant with Kulibayev the business magnate; and the two roles are distinct.*"⁷⁹⁴ Any action Mr. Kulibayev may have taken as a manager of a private company would clearly not be influenced by his position as manager of state-owned companies. For this reason alone, Claimants' theory of a conspiracy against them, somehow lead by Mr. Kulibayev, does not add up.

757 In addition, from an international law perspective, Kemikal is in any event a mere commercial entity. All that Kemikal did was engage in a contract for the purchase of gas from TNG. Naturally, Kemikal cannot be qualified as an organ of the Republic for the purposes of Article 4, it cannot be deemed to exercise governmental authority in the meaning of Article 5 and it cannot be held to have been acting on the instructions of, or under the

⁷⁹¹ 2nd Witness Statement of Mr. Stati, para. 41.

⁷⁹² As to the role, or rather, the lack of a role of Mr. Kulibayev in this case, see above C.I.2.

⁷⁹³ 2nd Witness Statement of Mr. Lungu, para. 4; 2nd Witness Statement of Mr. Stati, para. 41.

⁷⁹⁴ Expert Report of Professor Olcott, para. 208.

direction or control of the State in the meaning of Article 8 of the ILC Draft Articles.⁷⁹⁵ Hence, Kemikal's actions are not attributable to the Republic.

758 The same goes for KazRosGas. KazRosGas is a joint venture under equal participation of Gazprom and KazMunaiGas. Again, Claimants unproven allegation that Mr. Kulibayev controls KazRosGas⁷⁹⁶ is not sufficient to pin KazRosGas' conduct on the Republic. Even if Mr. Kulibayev controlled KazRosGas, this would not mean that the Republic is responsible for KazRosGas' actions. Moreover, like Kemikal, KazRosGas was acting on a purely commercial footing and was not exercising governmental authority, nor was have Claimants proven in any way that KazRosGas was acting under the authority or control of the Republic. Its alleged decision not to conclude a contract with TNG certainly does not trigger international responsibility of the Republic.

7. KPM and TNG were obliged to make substantial tax payments in summer 2009

759 As Claimants admit, the liquidity crisis of KPM and TNG first peaked in June 2009. At that point, two things came together. For one, Tristan Oil had to make coupon payments on the bonds, which required payments by the companies to Tristan Oil. At the same time, the companies had to make substantial tax payments.⁷⁹⁷ In order to meet both of these obligations, Claimants ultimately had to implement the downright ruinous Laren loan structure.⁷⁹⁸

760 Interestingly, in their written submissions, Claimants have not specified which tax payments became due at this time. This seems like a very

⁷⁹⁵ As was explained by the Tribunal in the *Paushok* case, "the liability of the State [under Article 5 of the ILC Draft Articles] is engaged only if [entities] act *jure imperii* and not *jure gestionis*," cf. *Sergei Paushok, CJSC Golden East Company and CJSC Vostokneftegaz Company v. The Government of Mongolia*, UNCITRAL, Award, 28 April 2011, para. 580 (**Exhibit R-266**). For a discussion of the application of Article 8 ILC Draft Articles in the investment context see *White Industries Australia Limited v. The Republic of India*, UNCITRAL, Final Award, 30 November 2011, paras. 8.1.1 et seq. (**Exhibit R-267**).

⁷⁹⁶ 2nd Witness Statement of Mr. Stati, para. 42.

⁷⁹⁷ Reply on Jurisdiction and Liability dated 7 May 2012, para. 383; 2nd Witness Statement of Mr. Stati, para. 43; 2nd Witness Statement of Mr. Lungu, para. 9.

⁷⁹⁸ For more details see below C.X.8.

convenient omission, given that these were tax payments *that not even Claimants have argued to have been illegal!*

761 The tax payments in question related to the so-called excess profits tax for the year ended December 31, 2008 and amounted to \$11.2 million for KPM and \$20.8 million for TNG.⁷⁹⁹ As is explained in Tristan Oil's Annual Report for the Financial Year 2009:

*“According to the Kazakhstan legislation, the excess profits tax was due April 15, 2009, but neither KPM nor TNG were able to meet the deadline because of cash constraints due to reduced sales. As a result, KPM and TNG’s bank accounts in Kazakhstan were seized by the Tax Committee of the Republic of Kazakhstan Ministry of Finance (the ‘TCMF’). On June 19, 2009, KPM and TNG paid the excess profits tax and any penalty associated with it in full and their bank accounts were subsequently released.”*⁸⁰⁰

762 Importantly, the imposition of these tax payments was perfectly legal and Claimants have never argued otherwise.⁸⁰¹ Thus, the Republic is not to be reproached for the cash constraints associated with this tax obligation.

763 As will be set out in the following, the most important consequence of the cash constraints was the taking out of the Laren loan facility which Claimants themselves have described as terrible.

8. Claimants obtained a ruinous bridge loan with a horrendous interest rate from a group of venture capitalists

764 Taking a step back and looking at the string of events so far, it becomes clear that numerous circumstances outside of the Republic's influence had brought KPM and TNG into very severe financial troubles. In early summer 2009, Claimants needed to urgently raise money both for coupon

⁷⁹⁹ Tristan Oil Ltd. Annual Report FY 2009; p. 4 (**Exhibit 68 to the 1st FTI Report**).

⁸⁰⁰ Tristan Oil Ltd. Annual Report FY 2009; p. 4 (**Exhibit 68 to the 1st FTI Report**).

⁸⁰¹ Taxes and customs Claimants allege to have been assessed improperly are corporate back taxes, export duties and transfer pricing taxes, cf. Reply on Jurisdiction and Liability dated 7 May 2012, paras. 231 et seqq.

payments and for KPM's and TNG's tax payments. The only conditions under which Claimants could obtain this money, however, were downright ruinous.

765 Under the so-called Laren loan facility, Tristan Oil had to issue new bonds with a nominal value of \$111.11 million to Laren Holdings Ltd ("Laren"). That meant further coupon payments of \$11.7 million each half year. At the same time, Laren lent \$30 million to Tristan Oil so that Tristan Oil could make the coupon payments coming due in July 2009. Further \$30 million were lent to Montvale, the trading company of KPM and TNG, which further lent the money on to KPM and TNG so that they could meet their tax obligations.⁸⁰² Laren itself is a BVI based special purpose vehicle also affiliated to Claimants. It obtained the funds necessary for the transaction by taking out a loan of \$60 million from a group of lenders, described by Claimants as "venture capitalists",⁸⁰³ at 35 % interest for a period of six months.⁸⁰⁴ Anatoli Stati himself describes these terms as "terrible".⁸⁰⁵

766 Importantly, the Laren loan only had a term of six months, meaning that within six months, Laren had to repay \$69.4 million.⁸⁰⁶

9. Claimants withdrew cash from the companies even when the financial situation of the companies was took a turn for the worse

767 As the Republic's expert Martha Olcott explains, when KPM and TNG came under acute pressure because of the circumstances described above, Claimants' counterintuitive response was to strip the cash assets from the companies.⁸⁰⁷ That only added to the companies' troubles.

768 First of all, the management of KPM and TNG decided to extend the payment terms for, Stadoil Ltd and General Affinity Ltd, two related parties described in the 2009 annual report of Tristan as the companies' largest customers. The amount in question at the end of 2009 was nearly

⁸⁰² For more details see Expert Report of Oxana Klepikova on the Tristan Bond Issuance (**Exhibit R-37**).

⁸⁰³ Reply on Jurisdiction and Liability dated 7 May 2012, para. 384.

⁸⁰⁴ Tristan Oil Press Release dated 19 June 2009 (**Exhibit R-268**).

⁸⁰⁵ 2nd Witness Statement of Mr. Stati, para. 43.

⁸⁰⁶ Tristan Oil Ltd. Annual Report FY 2009; p.17 (**Exhibit 68 to the 1st FTI Report**).

⁸⁰⁷ Expert Report of Professor Olcott, paras. 167 et seq.

\$150 million.⁸⁰⁸ Instead of ensuring that this amount of money would go straight to troubled KPM and TNG, Claimants forewent the immediate repayment.

769 In addition, as can be seen from Tristan’s Annual Report for 2009, KPM declared a dividend in the amount of \$52.6 million, including withholding tax at 15%, at the end of 2009.⁸⁰⁹

770 Somewhat less important financially but nonetheless tellingly,

*“[d]uring year ended December 31, 2009 Tristan paid a bonus amounting to USD 3,863,000 to its President, Anatol Stati, who is the ultimate owner of the Companies”.*⁸¹⁰

771 There are several reasons as to why Claimants could have decided to strip their companies of cash. One of them could be that Anatoli Stati had to realize in 2008 that his plan to provide to Moldova the gas produced by his companies would not work out⁸¹¹ and that he therefore tried to get as much money out of them as possible. Another might be that “Stati family needed the money that had been borrowed to finance TNG and KPM to keep afloat the families other and presumably core businesses.”⁸¹²

10. Conclusion

772 A number of external events lead to a rapid demise of KPM and TNG. In light of these circumstances, Claimants effectively abandoned the companies in 2009 and 2010, stripping them of as much cash as possible in the process. As to Claimants’ motives, the Republic can only speculate. It seems likely though that Claimants wanted to cut further losses while blaming the Republic for earlier losses already incurred. In any event, the Republic cannot be blamed for the ultimate failing of KPM and TNG.

⁸⁰⁸ Tristan Oil Ltd. Annual Report FY 2009; F-2 (**Exhibit 68 to the 1st FTI Report**). See also Expert Report of Professor Olcott, para. 168.

⁸⁰⁹ Tristan Oil Ltd. Annual Report FY 2009; p. 4 (**Exhibit 68 to the 1st FTI Report**). See also Expert Report of Professor Olcott, para. 170.

⁸¹⁰ Tristan Oil Ltd. Annual Report FY 2009; F-51 (**Exhibit 68 to the 1st FTI Report**). See also Expert Report of Professor Olcott, para. 172.

⁸¹¹ Expert Report of Professor Olcott, paras. 156 et seq.

⁸¹² Expert Report of Professor Olcott, para. 174.

Moreover, in the event the Tribunal should consider this necessary, the facts set out above defeat Claimants' exaggerated valuation approach.⁸¹³

XI. Claimants' attempts to sell the companies did not fail because of any of the allegedly illegal actions of the Republic

773 Claimants contend that the Republic's actions interfered with Claimants' attempts to sell KPM and TNG. According to Claimants, the alleged harassment campaign deterred potential buyers from going through with their bids even though they had initially been interested.⁸¹⁴ In so arguing, Claimants ignore many important facts and apply an oversimplified reasoning. On closer inspection, their arguments cannot be substantiated. In fact, the allegedly illegal actions of the Republic did not play a role in Claimants' failure to sell the companies.

774 As will be set out in the following, Claimants:

- (a) overstate the interest of potential buyers;
- (b) fail to mention important circumstances that led the potential buyers to not bid for KPM and TNG; and
- (c) fail to mention their own inactivity and failure to cooperate which prevented the sale to Cliffson from going forward.

1. Overview of attempted sales

775 Claimants initiated their first attempt to sell KPM and TNG (without the Contract 302 Properties, the so-called Tabyt block) under the name "Project Zenith" in Summer 2008. The sales project was organised for Claimants by the Russian bank Renaissance Capital. In Phase I of the project, 129 potential buyers were contacted from which eight responded.⁸¹⁵ These potential buyers were provided with a limited amount

⁸¹³ Further considerations regarding valuation will be made with the Republic's Rejoinder on Quantum due on 21 November 2012.

⁸¹⁴ Statement of Claim dated 18 May 2011, paras. 69 et seqq. and 184 et seqq.; Reply on Jurisdiction and Liability dated 7 May 2012, paras. 388 et seqq. and 396 et seqq.

⁸¹⁵ Statement of Defence dated 21 November 2011, para. 16.9.

of information and submitted indicative offers for the purchase of KPM and TNG at the end of September 2008. In Phase II, the potential buyers were supposed to be given access to the data room and it was envisaged that the serious bidding on a binding basis would commence. However, Claimants were not happy with the indicative offers made in Phase I and initially did not proceed to Phase II.⁸¹⁶

776 At the beginning of 2009, Claimants nonetheless decided to reopen sales attempts, this time including the Contract 302 Properties (“**Tabyl Block**”). Renaissance Capital contacted seven of the bidders of Phase I and two of them (Turkish Petroleum and TOTAL) decided to participate in the further bidding process.⁸¹⁷ Additionally, the company PSA Energy Holding SPC also joined in.⁸¹⁸ KMG EP entered the bidding process only in February 2009⁸¹⁹ after Claimants had initially not included KMG EP for this new sales attempt.⁸²⁰ The data room was opened to the bidders in mid-February 2009 and at least in some cases, management presentations were held.⁸²¹

777 Ultimately, all bidders left the bidding process without making a firm offer for KPM and TNG.⁸²²

2. The bids during Phase I of Project Zenith do not indicate possible sales prices

778 Claimants argue that the offers made in the so-called Phase I of Project Zenith in September 2008 provide a “*record of the actual reaction of willing and able buyers to an offer of the properties by a willing and able seller with each acting at arm’s length*”.⁸²³ However, Claimants fabricate this purely for the purposes of this arbitration.

⁸¹⁶ Statement of Claim dated 18 May 2011, paras. 69-72.

⁸¹⁷ First Witness Statement of Mr. Stati, para. 33.

⁸¹⁸ Ibid.

⁸¹⁹ Witness Statement of Mr. Suleimenov, para. 2.12.

⁸²⁰ First Witness Statement of Mr. Stati, para. 33.

⁸²¹ First Witness Statement of Mr. Lungu, para. 55; Second Witness Statement of Mr. Stati, para. 21 et seqq.

⁸²² Statement of Claim dated 18 May 2011, paras. 186-188.

⁸²³ Statement of Claim dated 18 May 2011, para. 73.

779 To begin with, the offers made in Phase I – ranging from \$0.5 billion to \$1.5 billion –⁸²⁴ were in no way representative of the actual value of KPM and TNG at the time. The offers were made on a very limited factual basis.⁸²⁵ They were indicative only, non-binding and submitted on the condition that further due diligence would take place.⁸²⁶

780 Even more importantly, the bids were in fact the result of strategic considerations rather than considerations based on an actual valuation of the assets. As Mr. Suleimenov, the head of M&A at KMG EP, explains:

“I should explain that indicative pricing in a transaction is really no guide at all to fair market value or even just the market price. [...] [T]he process of establishing an indicative price includes a healthy dose of individual strategy of a bidder. For instance, depending on the tactic of the bidder, a bidder may bid relatively high in an attempt to gain the attention of the potential seller but then adopt a strategy of knocking the price down as they get access to the data room and are able to further their due diligence. Alternatively, a bidder might go in very low with the prospect of perhaps increasing its price in the future.”⁸²⁷ (emphasis provided)

781 These reasons alone would be sufficient to discard the bids entirely and to not take them into account for the valuation of the companies. However, there is also another and even more striking reason why the bids are completely irrelevant. As Mr. Chagnoux, the managing director of TOTAL’s exploration and production company, indicates, Claimants’ bank Renaissance Capital in fact tweaked the numbers by conditioning access to the data room on higher offers:

“On 26 September 2008, TOTAL sent an offer in the amount of USD 900 million to Renaissance Capital. This

⁸²⁴ Overview of non-binding offers prepared by Renaissance Capital (**Exhibit C-17**).

⁸²⁵ Considering the information submitted by Claimants, the bidders only received a nine page teaser from Renaissance Capital (**Exhibit C-16**), a vendor due diligence report prepared by KPMG (**Exhibit C-69**) and an information memorandum on the properties (**Exhibit C-70**), cf. Statement of Claim dated 18 May 2011, paras. 69 et seq.

⁸²⁶ Cf. e.g. TOTAL’s bid dated 26 September 2008 (**Exhibit C-75**).

⁸²⁷ Witness Statement of Mr. Suleimenov, para. 2.8 to 2.9.

*amount was revised to USD 1.000 million on 6 October 2008 because Renaissance Capital demanded such figure as a pre-requisite to give us access to the data room. Renaissance Capital was adamant that the only way to obtain access to the data room was making a non-binding offer with a figure in line with their target price.*⁸²⁸

782 Clearly, mere indicative bids that the responsible bank pushed up by threatening not to give access to the data room cannot form the basis of any serious valuation.

3. The lack of interest of potential buyers in 2009 is not to be blamed on the Republic

783 Claimants suggest that none of the original bidders for Phase I was finally willing to follow through with a transaction because the Republic allegedly started a harassment campaign.⁸²⁹ Again, Claimants arguments do not withstand scrutiny.

a) Reasons why several of the original bidders did not engage in the next stage of the sales process

784 As set out above, several of the original bidders in Phase I of Project Zenith did not engage in the bidding process initiated by Claimants at the beginning of 2009.⁸³⁰ This cannot be blamed on the Republic.

785 In fall and winter of 2008, there were several external reasons that negatively affected the business prospects of KPM and TNG. In particular, there were sharp drops in energy prices and in demand which made investments in the energy sector very unattractive.⁸³¹ In addition, at the beginning of 2009, the global financial crisis was still making the obtaining of financing very difficult. Under these circumstances, a successful sale of KPM and TNG was unlikely from the very beginning.

⁸²⁸ Witness Statement of Mr. Chagnoux, para. 2.2.

⁸²⁹ Reply on Jurisdiction and Liability dated 7 May 2012, paras. 397, 401.

⁸³⁰ See above C.XI.1.

⁸³¹ See above C.XI.3. See also Statement of Defence dated 21 November 2011, para. 16.7.

786 Claimants have tried to argue that for those bidders that made bids in September 2008 but that did not show interest in early 2009, these circumstances could not have played a role because the obstacles already existed in September 2008.⁸³² According to Claimants, only the alleged harassment campaign can have led these bidders not to engage in the bidding process in 2009.⁸³³ This argument clearly has no merit. To begin with, energy prices were much lower at the beginning of 2009 than in September 2008,⁸³⁴ thus deterring potential buyers from engaging in the sales process. Moreover, the impact, persistence and global nature of the financial crisis were not immediately clear when indicative offers for Project Zenith were handed in on 26 September 2008. After all, this was only 11 days after Lehman Brothers filed for bankruptcy. Naturally, a few months into the crisis, bidders were even less willing to participate in a sales process.

b) Reasons why all bidders eventually dropped out in 2009

787 As explained, in the end, none of the bidders who engaged in the 2009 sales process submitted a binding offer for a sale.⁸³⁵ Again, this was not the Republic's fault. Rather, what happened was that once the bidders retained more information on KPM's and TNG's business during the due diligence process, they lost interest.⁸³⁶ As can be seen both from the example of TOTAL and KMG EP, the newly retained information showed that the companies were simply not worth what Claimants wanted to get paid for the assets.

788 Regarding TOTAL, the information they obtained from the data room and from a management presentation simply did not meet their expectations. Mr. Chagnoux from TOTAL explains:

⁸³² Reply on Jurisdiction and Liability dated 7 May 2012, para. 398.

⁸³³ Reply on Jurisdiction and Liability dated 7 May 2012, para. 401.

⁸³⁴ For example, the price of Brent crude oil **more than halved**. It dropped from \$103.53 per barrel on 22 September 2008, shortly before the indicative offers for Project Zenith were handed in, to \$43.75 on 5 January 2009, cf. Financial Times Crude Oil Price Overview (**Exhibit R-269**).

⁸³⁵ See above C.XI.1.

⁸³⁶ See Statement of Defence dated 21 November 2011, para. 16.10.

*“After consideration of the available additional information, we were very disappointed both with the data regarding the existing field production (for the Borankol field) and with the potential for additional reserves. The numbers were far below from what we had expected when we had made our indicative offer in September 2008 and we were never in a position to make a firm offer in that range.”*⁸³⁷

789 For this reason, TOTAL did not negotiate an SPA with Claimants and subsequently dropped the matter in July 2009.⁸³⁸

790 The same and several further problems ultimately led KMG EP not to submit a bid for KPM and TNG. To begin with, KMG EP was very worried about the extensive amount of debt accrued under the Tristan bond structure, the Laren loan facility and the Montvale loan.⁸³⁹ Further, as Mr. Suleimenov explains:

*“KMG EP had the suspicion that TNG had dramatically sped up the extraction of hydrocarbon in 2009 on the oil field Tolkyn. This could have lead to a drop of reservoir pressure that would have adversely affected the field and thus the whole business of TNG.”*⁸⁴⁰

791 Mr. Suleimenov also mentions another reason that kept KMG EP from further pursuing the purchase:

“As part of the due diligence, we also learned about the removal of the property of Casco, the service company on the fields which was doing all service work in the fields and which belonged to the Stati group. In 2009, Casco redeployed its machinery (work-over machines and rigs, drilling rigs, pipe-layers, etc.) to other developments of the Stati group. Any new owner of KPM and TNG would

⁸³⁷ Witness Statement of Mr. Chagnoux, para. 2.5.

⁸³⁸ Witness Statement of Mr. Chagnoux, para. 2.7.

⁸³⁹ Witness Statement of Mr. Suleimenov, para. 2.17, 2.23.

⁸⁴⁰ Witness Statement of Mr. Suleimenov, para. 2.19

have needed to invest substantial time and money to address issues of the service on the field.”⁸⁴¹

792 In addition, there are several other reasons that may have led the bidders to drop out of the process:

- (a) The local demand for TNG’s gas dropped significantly in 2008 and 2009. In addition the largest customer Kemikal was lost.⁸⁴²
- (b) According to independent auditors, the companies’ ability to continue as a going concern was doubtful.⁸⁴³
- (c) The Laren loan in the amount of nearly US\$ 70 million (including interest) had to be repaid by the end of the year 2009.⁸⁴⁴

793 It stands to reason that for the other bidders still involved in 2009 (PSA Energy Holding SPC, Turkish Petroleum), the same or comparable issues hindered them from going through with a purchase of KPM and TNG. As Claimants themselves admit, PSA Energy Holding SPC and Turkish Petroleum dropped from the bidding process after having examined the data room.⁸⁴⁵ That these bidders lost interest because of what they had found in the data room is the obvious conclusion.⁸⁴⁶

c) Claimants’ theories regarding the failure of the sales process do not add up

794 Despite this clear evidence, Claimants still suggest that it was the Republic’s allegedly illegal actions that caused the bidders to exit from the bidding process. However, none of the reasons submitted by Claimants can convince.

⁸⁴¹ Witness Statement of Mr. Suleimenov, para. 2.22

⁸⁴² See above C.X.6.

⁸⁴³ Tristan Oil Ltd., Interim Report For the Three Months Ended March 31, 2009, F-2 et seq., F-71 et seq., F-111 et seq. (**Exhibit R-262**).

⁸⁴⁴ See above C.X.8.

⁸⁴⁵ Statement of Claim dated 18 May 2011, para. 186; Reply on Jurisdiction and Liability dated 7 May 2012, para. 402.

⁸⁴⁶ Cf. already Statement of Defence dated 21 November 2011, para. 16.10 (b).

aa) Burden of proof

795 To begin with, Claimants have not brought forward any direct evidence showing that any bidder lost interest because of the actions of the Republic. No statement by bidders was provided that supports the allegation. However, under the *onus probandi* maxim,⁸⁴⁷ it would obviously be Claimants that would need to prove in the first place that the bidders were deterred from making firm offers by actions of the Republic.

bb) Alleged press release of 18 December 2008

796 Instead of providing proof, Claimants simply speculate. In that regard, Claimants' suggestion that "*Kazakhstan publicized in a press release on December 18, 2008*" allegations of illegalities regarding KPM and TNG and that this deterred the companies from further bidding⁸⁴⁸ is completely unsupported. As set out above, there was no press release of MEMR and the independent press item of INTERFAX cannot be attributed to the Republic in any way.⁸⁴⁹

cc) Kazakh authorities did not talk bidders out of making bids

797 Further, Claimants suggest that TOTAL and KNOC only withdrew from the bidding process after speaking with "*Kazakh authorities*".⁸⁵⁰

798 With regard to KNOC, it should first of all be noted that Claimants have not provided any documentary proof of the contention⁸⁵¹ that KNOC was involved in Phase II of Project Zenith in the first place.⁸⁵² The Republic maintains its position that KNOC was never involved in Phase II but dropped out for good at the end of 2008 after the initial bidding in Phase I.

⁸⁴⁷ The *onus probandi* principle, according to which each party has to prove those facts on which it relies, has been generally accepted by investment tribunals, cf. *Asian Agricultural Products Ltd. (AAPL) v. Democratic Socialist Republic of Sri Lanka*, ICSID Case No. ARB/87/3, Award, 27 June 1990, para. 56 (**Exhibit C-255**).

⁸⁴⁸ Reply on Jurisdiction and Liability dated 7 May 2012, paras. 400, 402.

⁸⁴⁹ See above C.X.5.

⁸⁵⁰ Statement of Claim dated 21 November 2011, paras. 187 et seq.; Reply on Jurisdiction and Liability dated 7 May 2012, paras. 403 et seqq.

⁸⁵¹ Reply on Jurisdiction and Liability dated 7 May 2012, para. 405.

⁸⁵² Claimant Anatoli Stati alleges that KNOC had initially not participated but joined the process again in June 2009, cf. Second Witness Statement of Mr. Stati, paras. 20, 23. No documents proving this have been provided.

This has also been confirmed by KNOC itself.⁸⁵³ For this reason, it is impossible in any event that the Kazakh authorities hindered a sale to KNOC.

799 With regard to TOTAL, Claimants' accusations remain completely unsubstantiated. Claimants have not named the supposed "Kazakh authorities" that allegedly spoke to TOTAL, nor have they given information on the date of these alleged conversations or what the "Kazakh authorities" said so that TOTAL dropped out of the bidding.

800 Nonetheless, Claimants seriously argue that "*Kazakhstan has not presented any witness to dispute that its personnel met with representatives of Total, and persuaded them not to pursue the acquisition.*"⁸⁵⁴ This is a ridiculous argument: How is the Republic supposed to provide testimony from its officials that they have not spoken to representatives of TOTAL? Do Claimants ask the Republic to submit witness statements of each and every Kazakh official to that effect? Without any further information on the alleged talks with TOTAL, in particular on who supposedly attended them on behalf of the Republic, the Republic is simply not in a position to even find out whether talks actually took place.

801 In any event, Mr. Chagnoux from TOTAL explains that even if there were talks between Kazakh officials and TOTAL, these did not play a role in TOTAL's decision not to further pursue the purchase of KPM and TNG:

*"I am not aware of such a discussion. It might have occurred locally in Kazakhstan with personnel of our affiliate, but this business opportunity was managed by my team in Paris and we had no report from our affiliate about such a discussion. In any case, it would not have had any influence on our decision not to pursue this matter with Renaissance because this decision was entirely based on technical grounds."*⁸⁵⁵

⁸⁵³ Letter of Korea National Oil Corporation regarding project Zenith dated 12 August 2011 (**Exhibit R-41.2**).

⁸⁵⁴ Reply on Jurisdiction and Liability dated 7 May 2012, paras. 406.

⁸⁵⁵ First Witness Statement of Mr. Chagnoux, para. 2.9.

- dd) TOTAL's reasons for dropping out of the bidding process
- 802 Claimants have also questioned the reasons given by TOTAL for dropping out of the bidding process. Allegedly, TOTAL did not indicate its serious concerns about either the technical and geological conditions of the properties at the management meeting⁸⁵⁶ or with the letter with which TOTAL withdrew from the bidding process.⁸⁵⁷ Claimants suggest that TOTAL had other reasons than are communicated now and that it gave no explanation in the withdrawal letter in order "*to avoid making statements that could strain its relationship with Kazakhstan*".⁸⁵⁸
- 803 Claimants allegations are wrong as a matter of fact. First of all, TOTAL's experts attending the management presentation repeatedly challenged the assumptions and statements made by Claimants,⁸⁵⁹ thus clearly communicating TOTAL's concerns.
- 804 Second, Claimants' theory with regard to the withdrawal letter is contradicted by the statements of its own CFO, Mr. Artur Lungu. Mr. Lungu stated in his first witness statement: "*in late July of 2009, Total sent us a letter withdrawing from the bid process, allegedly **for technical reasons relating to the properties.***"⁸⁶⁰ Hence, Mr. Lungu himself admits that TOTAL had clearly communicated at the time that the reasons for its withdrawal were of a technical nature.
- ee) KMG EP's reasons for dropping out of the bidding process
- 805 Claimants also mischaracterise the reasons for which KMG EP dropped out of the bidding process.⁸⁶¹ In so doing, they deliberately misread the letter from KMG EP submitted with the Statement of Defence.⁸⁶²
- 806 The real reasons for KMG EP to drop out have been set out in detail above.⁸⁶³ These include the enormous debt that KPM and TNG had

⁸⁵⁶ Reply on Jurisdiction and Liability dated 7 May 2012, paras. 403;

⁸⁵⁷ Letter from TOTAL to Renaissance Capital dated 24 July 2009 (**Exhibit C-296**).

⁸⁵⁸ Reply on Jurisdiction and Liability dated 7 May 2012, paras. 403 et seq.

⁸⁵⁹ Witness Statement of Mr. Chagnoux, para. 2.8.

⁸⁶⁰ Witness Statement of Mr. Lungu, para. 57.

⁸⁶¹ Reply on Jurisdiction and Liability dated 7 May 2012, paras. 408 et seqq.

⁸⁶² Letter of KMG EP regarding project Zenith dated 21 October 2011 (**Exhibit R-41.1**).

⁸⁶³ See above C.XI.3.b).

accrued, the risks deriving from the Tristan bond structure, technical problems with the wells and the necessity of further investment due to the service company Casco being withdrawn from KPM and TNG. These reasons are clearly sufficient to show that the Republic had nothing to do with KMG EP dropping out of the bidding process.

807 Claimants try to avoid this conclusion by blaming the companies' enormous debt on the Republic.⁸⁶⁴ However, this attempt fails. The Republic is not to be blamed for the enormous debt Claimants accrued.

(a) The Tristan bond structure entailing the issue of \$420 million of Tristan bonds was freely implemented in 2006 and 2007, long before even Claimants allege that "harassment" occurred.

(b) The Montvale debt also is not related to the Republic and Claimants have never argued otherwise. Claimants try to sidestep the issue by arguing that the Montvale debt is irrelevant because the prepayment terms under which it was accrued were already mentioned to bidders in Phase I of Project Zenith.⁸⁶⁵ This argument is ludicrous. Quite clearly, the disclosure of the prepayment terms is not the same as the disclosure of the actual debt accrued under those terms. Given the enormous amount of \$95 million, after learning about this debt, KMG EP had good reason to reconsider their participation in the bidding process .

(c) Moreover, as set out above, the Laren loan and the further issuance of \$111.1 million of Tristan bonds can also not be blamed on the Republic. Rather, these debts were the result of a drop in sales, a drop of energy prices and perfectly legal tax assessments which not even Claimants dispute.⁸⁶⁶

808 With regard to Casco being withdrawn from KPM and TNG, Claimants also, and again unsuccessfully, try to make the Republic's alleged harassment campaign responsible for this development.⁸⁶⁷ Yet, Claimants themselves admit that the reason for their instructions to Casco was mainly

⁸⁶⁴ Reply on Jurisdiction and Liability dated 7 May 2012, paras. 409 et seq.

⁸⁶⁵ Reply on Jurisdiction and Liability dated 7 May 2012, fn. 737.

⁸⁶⁶ See above C.X.8.

⁸⁶⁷ Reply on Jurisdiction and Liability dated 7 May 2012, para. 409.

a “cash flow shortfall”.⁸⁶⁸ As set out above, this cash flow shortfall was due to a number of circumstances (such as a drop in demand, energy prices and perfectly legal tax assessments) for which the Republic was in no way responsible.⁸⁶⁹ Hence, the Republic cannot be reproached for Casco’s role in the production being reduced.

809 Finally, Claimants also allude to what is called in KMG EP’s letter “risks related to claims from Kazakhstan’s government authorities”.⁸⁷⁰ Of course, it is acknowledged that such risks existed, brought about by Claimants’ illegal operation of a main pipeline as well as the incorrect deduction of drilling expenses.⁸⁷¹ Mr. Suleimenov sets out these risks in his witness statement, alluding to the court claim resulting from the illegal operation of the main pipeline as well as to the corporate back tax claim and the export duties claim.⁸⁷² These risks were one part of KMG EP’s whole assessment and Claimants’ suggestion that these were the decisive reasons for withdrawing from the process lacks any basis.

4. Letters from the bidders

810 With its Statement of Defence, the Republic submitted several letters from bidders which showed that these bidders had left the bidding process for reasons not associated with the Republic’s actions.⁸⁷³ Claimants’ attempts to question the evidentiary value of these letters should not be accepted by the Tribunal.

811 First, Claimants have tried to discredit the statements made by the bidders by arguing that the bidders in question have sizeable investments in Kazakhstan,⁸⁷⁴ apparently suggesting that the economic interests of these companies would dictate their statements in the arbitration. However, if

⁸⁶⁸ Ibid.

⁸⁶⁹ See above C.X.

⁸⁷⁰ Letter of KMG EP regarding project Zenith dated 21 October 2011 (**Exhibit R-41.1**).

⁸⁷¹ See above C.IV. and C.VIII.

⁸⁷² Witness Statement of Mr. Suleimenov, para. 2.23.

⁸⁷³ Letter of KMG EP regarding project Zenith dated 21 October 2011 (**Exhibit R-41.1**); Letter of Korea National Oil Corporation regarding project Zenith dated 12 August 2011 (**Exhibit R-41.2**); Letter of OMV E&P regarding project Zenith dated 22 August 2011 (**Exhibit R-41.3**); Letter of Total E&P Activites Petrolieres regarding project Zenith dated 23 August 2011 (**Exhibit R-41.4**).

⁸⁷⁴ Reply on Jurisdiction and Liability dated 7 May 2012, paras. 404, 407.

Claimants actually consider that economic dependency undermines the value of testimony in arbitration, they should first and foremost think of their own witness statements. These were prepared in their entirety by employees of Claimants and thus by people economically depending on Claimants.

812 Second, as to the general issue of what Claimants have spuriously dubbed “sleeper” witness statements, this will be addressed in a separate section below.⁸⁷⁵ At this stage, it shall suffice to say that the Republic has acted in accordance with the Tribunal’s orders and has produced the relevant documents.

813 Third, Claimants are not correct in suggesting that the MOG “dictated” to KMG EP or the other bidders the answers it wanted to get in response.⁸⁷⁶ MOG’s letter to KMG EP⁸⁷⁷ was an open request for information about KMG EP’s involvement in the bidding process. Of course, the letter referred to MOG’s interest in finding information that could be used “*to substantiate the line of defense of the rights and interests of the Republic*”.⁸⁷⁸ This, however, is hardly surprising. Of course, the MOG had to explain why it was seeking the information in the first place.

5. Claimants’ own inactivity and failure to cooperate prevented the sale to Cliffson from going forward

814 Claimants further complain that the Republic allegedly blocked the sale of KPM and TNG to Cliffson.⁸⁷⁹ According to Claimants’ calculations, this offer had a value of more than US\$ 920 million of which Claimants were allegedly deprived.⁸⁸⁰ However, on a close look at the facts, Claimants’ theories and allegations again turn out to be unfounded.

⁸⁷⁵ See below section E.

⁸⁷⁶ Reply on Jurisdiction and Liability dated 7 May 2012, para. 406.

⁸⁷⁷ Letter from the Ministry of Oil and Gas to KMG NC (**Exhibit C-537**).

⁸⁷⁸ Ibid.

⁸⁷⁹ Reply on Jurisdiction and Liability dated 7 May 2012, para. 409.

⁸⁸⁰ Reply on Jurisdiction and Liability dated 7 May 2012, para. 418; Claimants’ Reply on Quantum, para. 6.

- a) The Republic did not hinder the sale to Cliffson from going forward
- 815 On 13 February 2010, Claimants and the company Cliffson S.A. entered into a contract for the sale of KPM, TNG, Tristan Oil and Caspian Asia Service Company LLP.⁸⁸¹ As explained above, under the applicable legislation, the sale of shares in a subsoil user has to be approved by the MOG.⁸⁸² Moreover, the sale triggers the Republic's pre-emptive right to acquire the shares instead of the buyer, at the price foreseen in the sales contract.
- 816 Claimants allege that the MOG failed to give its consent and that the Republic failed to declare a waiver of its pre-emptive rights.⁸⁸³ In point of fact, however, the opposite is true: The Republic's authorities fully cooperated with Claimants. It was Claimants themselves which delayed and ultimately failed at providing all information necessary for an approval and a waiver. Hence, the sale could never go forward.
- 817 Claimants' careless approach to the issue of state approval and waiver of pre-emptive rights is apparent from the very beginning of the attempted transaction. Claimants applied to the authorities only two months after the conclusion of the Cliffson contract, on 12 April 2012.⁸⁸⁴ This delay of the sale is wholly attributable to Claimants and Claimants have offered no explanation as to why they needed this long to make the applications. Even worse, Claimants failed to submit all necessary information with their application, making it necessary for the authorities to direct further questions at Claimants.
- 818 Hence, on 30 April 2012, the MOG replied by requesting information necessary for determining whether an exercise of the pre-emptive right was in order.⁸⁸⁵ In the reply, the MOG clearly set out which information it needed, namely in particular audited financial statements of the buyer

⁸⁸¹ Cliffson Sale Agreement dated 13 February 2010 (**Exhibit C-540**).

⁸⁸² See above B.III.4.a).

⁸⁸³ Reply on Jurisdiction and Liability dated 7 May 2012, paras. 388 et seqq.

⁸⁸⁴ Letter from KPM to Ministry of Oil and Gas dated 12 April 2010 (**Exhibit C-524**); Letter from KPM to Ministry of Industry and Technologies dated 12 April 2010 (**Exhibit C-525**); Letter from TNG to Ministry of Oil and Gas dated 12 April 2010 (**Exhibit C-526**); Letter from TNG to Ministry of Industry and Technologies dated 12 April 2010 (**Exhibit R-527**).

⁸⁸⁵ Letter from Ministry of Oil and Gas to KPM dated 30 April 2010 (**Exhibit C-528**); Letter from Ministry of Oil and Gas to TNG dated 30 April 2010 (**Exhibit C-529**).

Cliffson and information regarding the debt of KPM, TNG and other companies involved.

- 819 The Law on Subsoil and Subsoil Use specifically allows for the state to make a request for such information.⁸⁸⁶ As was stated in the letter, the information was required in order to “*determine the capability of [the buyer] to perform the obligations imposed on the subsoil user under the Subsoil Use Contract*”. And as Mr. Ongarbayev explains, this is a standard request usually made when the Subsoil User fails to submit all necessary information with its application.⁸⁸⁷
- 820 Yet again, the Claimants did not respond, causing a further delay of the waiver. The authorities cooperated fully with Claimants and made every reasonable effort to make the sale possible but Claimants forewent the possibility to obtain the waiver by not responding.
- 821 On 1 June 2010, MOG sent a further letter specifying the information required and now also requesting technical information regarding the operation and regarding the fields.⁸⁸⁸ Claimants seem to complain that this was a rather “voluminous” request for additional information, sent in a “*2-page, single-spaced list for each company*”.⁸⁸⁹ However, this additional request is actually standard procedure.⁸⁹⁰ In fact, it was based on a standard form, containing many standard questions, and is sent to many subsoil users in case of a planned share transfer.⁸⁹¹
- 822 After the second request, Claimants let another three weeks pass before they finally responded. Even more damaging, when Claimants finally replied with letter of 23 June 2010,⁸⁹² they did not provide all information asked for and necessary to decide on the exercise of the pre-emptive rights waiver.⁸⁹³ Most importantly, Claimants did not submit any information on

⁸⁸⁶ Cf. Article 13 para. 5 of the 2010 Law on Subsoil and Subsoil Use (**Exhibit R-257**).

⁸⁸⁷ Witness Statement of Mr. Ongarbayev, paras. 6.2 et seq.

⁸⁸⁸ Letter from Ministry of Oil and Gas to KPM dated 1 June 2010 (**Exhibit C-530**); Letter from Ministry of Oil and Gas to TNG dated 1 June 2010 (**Exhibit C-531**).

⁸⁸⁹ Reply on Jurisdiction and Liability dated 7 May 2012, para. 389.

⁸⁹⁰ Witness Statement of Mr. Ongarbayev, paras. 6.2 et seq.

⁸⁹¹ Examples of comparable requests can be seen in Witness Statement of Mr. Ongarbayev, Annex I.

⁸⁹² Reply on Jurisdiction and Liability dated 7 May 2012, para. 390.

⁸⁹³ Cover Letter from KPM to Ministry of Oil and Gas dated 23 June 2010 (**Exhibit C-532**); Cover Letter from TNG to Ministry of Oil and Gas dated 23 June 2010 (**Exhibit C-533**).

the financial situation of Cliffson, as requested in the letters of 30 April 2010.⁸⁹⁴ Based on this insufficient information, MOG was in no position to properly assess whether Cliffson was able to ensure that KPM and TNG would fulfil their obligations under the subsoil use contracts in the future. In fact, given the enormous debt that Tristan, KPM and TNG had accrued under the Tristan bond structure,⁸⁹⁵ such request was particularly important. There were reasonable doubts that any investor could stem such enormous debt and fulfil the subsoil use contract at the same time.

823 Against this background, it is apparent that it was Claimants' unwillingness to cooperate that made it impossible to declare a waiver of the pre-emptive rights. The Republic simply did not have the relevant information to make this decision because Claimants withheld it.

824 Nonetheless, Claimants try to evade this simple conclusion by alleging that they "provided everything that Kazakhstan had reasonably requested."⁸⁹⁶ Yet, Claimants give no explanation as to why they consider their response reasonable and the Republic's requests for information as going too far. As set out above, the MOG acted perfectly reasonable in requesting this information. Quite simply, this information was needed for an informed decision about the waiver of the pre-emptive rights.

825 In any event, it should be noted that the delay between February and July 2009, caused solely by Claimants, may in fact have even led to a termination of the Cliffson contract. As set out in section 4.5 lit. a and 4.1 lit. b and c of the Cliffson contract, the contract was to be terminated automatically if an approval of the transfer and a waiver of the state's pre-emptive right could not be obtained on or before 30 April 2012.⁸⁹⁷ Admittedly, this automatic termination was subject to the parties' written agreement on a later date. However, it is Claimants that are put to proof that this automatic termination on 30 April 2012 did not happen. So far, Claimants have not provided any documentation of how the Cliffson contract fell through in the end.⁸⁹⁸ It is thus reasonable to assume that the

⁸⁹⁴ Letter from Ministry of Oil and Gas to KPM dated 30 April 2010 (**Exhibit C-528**); Letter from Ministry of Oil and Gas to TNG dated 30 April 2010 (**Exhibit C-529**).

⁸⁹⁵ See above C.X..

⁸⁹⁶ Reply on Jurisdiction and Liability dated 7 May 2012, para. 390.

⁸⁹⁷ Cliffson Sale Agreement dated 13 February 2010 (**Exhibit C-540**).

⁸⁹⁸ See already Statement of Defence dated 21 November 2011, para. 16.10 (h) (v).

Cliffson contract had terminated already at the end of April 2010 because of Claimants' own delays.

b) No link between the Cliffson offer and the termination of the contracts

826 Claimants' usual fixation on conspiracy theories does not stop with their portrayal of the Cliffson offer. Spuriously, Claimants suggest that it was the Cliffson offer which triggered the Republic to ultimately terminate KPM's and TNG's subsoil use contracts. Allegedly, the MOG did not waive the pre-emptive rights and instead looked for a termination reason so that the Republic could save the money for exercising the pre-emptive rights.⁸⁹⁹

827 To support their allegations, Claimants raise a number of unrelated facts and accusations without any clear purpose. The Republic will not respond to these points, quite simply because they are outside of the Republic's sphere of knowledge.⁹⁰⁰ Instead, the Tribunal should simply keep in mind two very simple points:

828 First, as set out above, KPM and TNG were in serious violation of their subsoil use contracts, leaving the Republic no other choice but to terminate the contracts.⁹⁰¹ This had nothing to do with the Cliffson offer.

829 Second, as explained, due to Claimants' own incomplete submission of information, the Republic was never in a position to decide on the waiver of its pre-emptive rights. This excludes any notion of a sinister plan to forego having to pay the price of exercising pre-emptive rights.

830 Hence, there is no connection between the Cliffson offer and the contract termination.

c) Value of the Cliffson offer

831 Claimants also make several observations on the value they place on the Cliffson offer.⁹⁰² The Republic denies that Claimants' valuation is correct

⁸⁹⁹ Reply on Jurisdiction and Liability dated 7 May 2012, para. 392 et seqq.

⁹⁰⁰ For example, Claimants explain that they tried to agree with Cliffson that they could pursue investment arbitration despite the planned sale of the companies, cf. Reply on Jurisdiction and Liability dated 7 May 2012, para. 394. It remains Claimants' secret why this would mean that the Republic needed to urgently terminate the subsoil use contracts.

⁹⁰¹ See above C.IX.

and will set this out in detail in its Rejoinder on Quantum due in November 2012.

XII. Alleged Damages

832 Claimants have chosen to address several issues of quantum already with their Rejoinder on Jurisdiction and Liability.⁹⁰³ In accordance with the Tribunal's Procedural Order No. 4, the Republic will address these issues, as well as the quantum issues addressed in Claimants' Reply on Quantum, with its Rejoinder on Quantum due on 21 November 2012.⁹⁰⁴

⁹⁰² Reply on Jurisdiction and Liability dated 7 May 2012, paras 418ff.; Reply on Quantum dated 28 May 2012, para. 6.

⁹⁰³ See Reply on Jurisdiction and Liability, paras. 556 et seqq.

⁹⁰⁴ Tribunal's Procedural Order No. 4, para. 4.13.

D. NO VIOLATION OF THE ECT OR INTERNATIONAL LAW

I. Applicable law

833 In their Reply Memorial on Jurisdiction and Liability Claimants allege that “Kazakh domestic law simply has no role to play as a body of law to be applied by the Tribunal in judging the various issues before it.”⁹⁰⁵ This reasoning is flawed because the host state’s domestic law is highly relevant in investment arbitrations in general and Kazakh law is of decisive significance in the context of this particular dispute.

1. Importance of considering the host state’s domestic law in investment treaty arbitrations

834 As Claimants agree, pursuant to Articles 22(1) of the SCC Rules and 26(6) of the ECT, the arbitral tribunal shall decide the merits of a dispute in accordance with the ECT and applicable rules and principles of international law. However, many aspects of a complex investment arbitration case are not covered precisely enough by the ECT and international law. These lacunae need to be filled in by the host state’s domestic law.⁹⁰⁶

835 International law lacks the clarity and detail required to determine technical facts and intricate legal obligations.⁹⁰⁷ Therefore, international law contains considerable gaps:

“[I]nternational law does not have fully developed laws of contract or commercial codes similar to those found in the municipal legislation of most countries. Nor has

⁹⁰⁵ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, paras. 426.

⁹⁰⁶ Ege, The unclear yet inevitable application of domestic law under Energy Charter Treaty arbitration, *International Business Law Journal* 2012, 173 (183) (**Exhibit R-270**).

⁹⁰⁷ Schreuer, *The ICSID Convention: A Commentary* (Cambridge University Press, 2009), page 558 (**Exhibit R-271**).

international law developed detailed rules governing corporations and other commercial actors. In short, international law alone may not address a commercial dispute with sufficient precision.”⁹⁰⁸

836 These lacunae do not allow for a decision of a complex investment arbitration dispute to be based on international law alone. They need to be filled in by a supplementary, more accurate legal framework.

837 In investment treaty arbitrations, the body of law best suited for filling in the gaps of international law is the host state’s domestic law because foreign investment always requires compliance with the domestic law of the host state.⁹⁰⁹ Private and public international law aspects are intrinsically linked:

“Investment disputes are about investments, investments are about property, and property is about specific rights over things cognisable by the municipal law of the host state.”⁹¹⁰

838 Since international law and domestic law are intertwined with respect to foreign investments, the host state’s domestic law is highly relevant for determining any dispute.

839 The relevance of domestic law in investment treaty arbitrations has been observed by the tribunal in *Goetz v. Burundi*:

“[The] internalization of investment relationships - whether they be contractual or otherwise - has certainly not led to a radical denationalization of the legal relations springing from international investment, to the point that the domestic law of the host State would be deprived of all relevance or application in the interests of an exclusive role for international law. It merely signifies that these relations relate at once - in parallel, one might

⁹⁰⁸ Kinnear, *Treaties as Agreements to Arbitrate: International Law as the Governing law*, ICCA Congress Series No. 13, 2006, page 401 (**Exhibit R-272**).

⁹⁰⁹ Sacerdoti, *Bilateral Investment Treaties and Multilateral Instruments on Investment Protection*, 269 *Recueil des Cours* 251, 423 (1997) (**Exhibit R-273**).

⁹¹⁰ Douglas, *The Hybrid Foundations of Investment Treaty Arbitration*, 2003, 74 *British Yearbook of International Law* 151, page 194 (**Exhibit R-274**).

say - to the sovereign supremacy of the host State in domestic law and to the international undertakings to which it has subscribed.”⁹¹¹

840 Hence, in view of the lacunae present in the international legal framework, tribunals are obliged to take into account the host state’s law.⁹¹²

841 The host state’s domestic law is highly relevant to a number of issues. In particular, it is relevant to the question of whether an investment exists. Furthermore, as noted by Newcombe and Paradell, it is relevant to:

“whether the investment is held in the territory of the host State, its validity, the nature and scope of the fights making up the investment and whether they vest on a protected investor, the conditions imposed or assurances granted by national law for the operation of investment, as well as the government measures allegedly in breach of the investment treaty.”⁹¹³

842 These issues are pivotal in investment treaty arbitrations because they concern the criteria against which the host state’s conduct is to be assessed.⁹¹⁴

843 According to Article 1 of the ECT, an investment includes any right conferred by law or by contract or by virtue of any licenses and permits issued pursuant to the law to conduct business in the energy sector. Therefore, the host state’s domestic laws as well as the contracts, licenses and permits determine whether an investment exists.

2. Decisive significance of Kazakh law in this dispute

844 The Subsoil Use Contracts explicitly provide that both Kazakh law and international law are applicable in relation to the relationship between

⁹¹¹ Antoine Goetz et consorts v. Republic of Burundi, ICSID Case No. ARB/95/3, Award, 10 February 1999, para. 69 (**Exhibit C-227**).

⁹¹² Ege, The unclear yet inevitable application of domestic law under Energy Charter Treaty arbitration, *International Business Law Journal* 2012, 173 (184) (**Exhibit R-270**).

⁹¹³ Newcombe and Paradell, *Law and Practice of Investment Treaties*, Kluwer Law, 2009, page 76 (**Exhibit R-275**).

⁹¹⁴ Ege, The unclear yet inevitable application of domestic law under Energy Charter Treaty arbitration, *International Business Law Journal* 2012, 173 (183) (**Exhibit R-270**).

Claimants and the Republic.⁹¹⁵ Hence, Kazakh law is key in assessing whether an investment exists pursuant to Article 1 of the ECT and also in relation to related points in the case at hand.

845 Kazakh law is decisive for determining the legitimacy of audits, inspections and investigations as well as of the criminal proceedings resulting in the prosecution of KPM and TNG because these circumstances constitute the factual situation upon which Claimants base their claims with respect to:

- (a) indirect expropriation;
- (b) absence of most constant protection and security in respect of Claimants' investment;
- (c) breach of the Fair and Equitable Treatment standard;
- (d) impairment of Claimants' investments by unreasonable and discriminatory measures; and
- (e) absence of effective means of asserting claims and enforcing rights against the Republic.

846 Moreover, the question of whether KPM's and TNG's Subsoil Use Contracts were legitimately terminated can only be assessed according to Kazakh law. This issue concerns Claimants' allegations with respect to:

- (a) direct expropriation; and
- (b) failure to observe contractual obligations concerning Claimants' investments.

847 Claimants never challenged the legitimacy of any of the Republic's laws from the viewpoint of the ECT or other international law. As a result, there can be no breach of the ECT or other international law if the Republic abided by its own laws. The Republic's conduct has been lawful under Kazakh law at all times.⁹¹⁶ In particular, the classification of Claimants' pipelines as trunk pipelines, the transfer of TNG to Terra Raf, the decision to not prolong the exploration period under Contract No. 302, the assessment of Crude Oil Export Duties and the criminal proceedings

⁹¹⁵ Cf. Contract No. 305, para. 27.1; Contract No. 302, paras. 22.1 and 22.2; Contract No. 210, paras. 22.1 and 22.2.

⁹¹⁶ See section C. above.

against Mr. Cornegruta were completely in accordance with Kazakh law. Therefore, the Republic did not breach international law and Claimants' accusation that the Republic tries to avoid liability under international law by relying upon its domestic law⁹¹⁷ is wrong.

848 Furthermore, Claimants themselves assume the applicability of Kazakh law when they allege violations of the Kazakh Constitution as well as Kazakh statutes and regulations by stating that “[t]hroughout their Statement of Claim and this Reply Memorial, Claimants have listed a number of instances in which Kazakhstan undertook contractual, as well as legal and regulatory obligations with respect to Claimants and Claimants’ investments”.⁹¹⁸ For this reason, Claimants admit that Kazakh law is highly relevant in this dispute, thus contradicting their propositions on the governing law in their Reply Memorial on Jurisdiction and Liability.

3. Irrelevance of new legal arguments for the assessment of applicable law

849 In their Reply Memorial on Jurisdiction and Liability, Claimants contend that the Republic relies “on domestic legal arguments that it never made contemporaneously.”⁹¹⁹ This reasoning is not even remotely relevant to the question of applicable law.

850 Claimants devote almost five pages to their contention that the Republic “excuse[s] its prior unlawful conduct by retroactively conjuring up new legal arguments that allegedly might have justified its prior conduct, but did not actually motivate its conduct at the relevant time”.⁹²⁰ However, they fail to explain why this alleged conduct should have any impact on the applicable law pursuant to Articles 22(1) of the SCC Rules and 26(6) of the ECT. New legal arguments for prior conduct do not change anything about the high relevance of the host state’s domestic law in investment treaty arbitrations and the decisive significance of Kazakh law with respect to claims in the dispute at present. Claimants fail to establish a connection

⁹¹⁷ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, para. 546.

⁹¹⁸ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, para. 546.

⁹¹⁹ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, para. 440.

⁹²⁰ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, para. 441.

between this argument and their argument on applicable law because it does not exist.

- 851 Apart from the fact that Claimants reasoning is not relevant to the assessment of applicable law, Claimants' proposition is also wrong with regard to content.
- 852 Claimants complain that the Republic has brought forward new legal arguments with respect to the illegality of their investments in the Republic.⁹²¹ However, the illegality of Claimants' investments is the reason why the Tribunal has no jurisdiction over the case at present. The issue of jurisdiction only arises once the arbitration proceedings have been initiated. The arguments brought forward with respect to jurisdiction are therefore not new, but are significant to these arbitration proceedings.
- 853 In particular, the failure to timely register KPM's initial share issue, KPM's re-registration as a commercial company, the lack of consents from the Licensing and Competent Authorities for transfers of shares, the failure to comply with the obligation to amend KPM's and TNG's Subsoil Use Licenses and the re-organisation of KPM and TNG into LLPs are all arguments which the Tribunal has to take into consideration for determining its jurisdiction. They have been brought forward after the initiation of arbitration proceedings because the issue of jurisdiction arose only from then on. Furthermore, the Republic only became aware of many of the breaches after the commencement of these proceedings.
- 854 The assessment and imposition of export duties on KPM, the classification of segments of TNG's and KPM's field pipelines as trunk pipelines and the termination of the Subsoil Use Contracts allegedly on grounds that were never raised in July 2010 concern measures which were lawful from the beginning. The legal arguments which were brought forward to support these measures at the time when the measures were taken already justify the Republic's actions. After the measures were taken, Claimants tried to concoct arguments of why the imposition of export duties on KPM, the classification of segments of TNG's and KPM's field pipelines as trunk pipelines and the termination of Subsoil Use Contracts were not justified.

⁹²¹ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, para. 440.

The Republic needed to rebut these arguments by new legal arguments in order to show that Claimants' logic was flawed.

855 In relation to the classification of the KPM Pipeline in particular, Claimants complain that new arguments have been introduced by the Republic in an attempt to retroactively improve its arguments. This is not the case. For the avoidance of doubt, the arguments presented in the Statement of Defence responded to Claimants' undisciplined analysis of the "correct" method of classification of pipelines. For the reasons set out directly above, such an analysis is not strictly necessary where the Kazakh court has already ruled on the issue in a perfectly appropriate manner. In any event, to the extent that many arguments are new, these are not inconsistent with the premise of the decision in the Aktau court which was confirmed by the Mangystau Court on appeal.⁹²² For this reason, the Republic had to bring forward new arguments in order to further support its already lawful measures and to reveal Claimants' false argumentats as such.

856 As to the termination of the Subsoil Use Contracts, it is not clear to what Claimants refer when they state that the Republic has (supposedly) raised "new" arguments in the Statement of Defence. The Republic validly terminated the contracts under the Subsoil Law 2010 for a number of grounds. Claimants chose not to challenge this in the Kazakh courts and/or commercial arbitration and instead decided to commence proceedings under the ECT on what was essentially a contractual dispute. In doing so, it was they who decided to raise various new arguments in the Statement of Claim, whilst distorting the legal issues before the Tribunal by confusing the factual events leading up to, and following on from, termination. Evidently, the Republic had to respond to these issues in the Statement of Defence and further fully set out the grounds for termination. This has inevitably resulted in highlighting the unlawful conduct of Claimants in relation to the Republic's subsoil resources. This process was entirely appropriate, particularly as the issues have never been heard in another forum. Claimants are free to challenge the substantive allegations made against them in the normal way. However, it is telling that they instead focus on the supposed procedural issues.

⁹²² See above section C.VIII.

II. General approach under International Law: Deference

- 857 Before addressing Claimants' arguments on the ECT in detail, the Republic suggests that the Tribunal take a step back and consider the task of dealing with Claimants' allegations.
- 858 Claimants make various allegations about purported state misconduct. Their allegations centre on inspections and investigations from October 2008 onwards, and on the termination of KPM's and TNG's subsoil use contracts in July 2010.
- 859 When addressing the conduct of the Republic from an international law perspective, the Tribunal should consider the policy reasons that generally guide the Republic in the regulation of subsoil use. These policies specifically guided the Republic in its dealings with Claimants. As was set out in detail in the Statement of Defence, the Republic has a reasonable expectation that foreign investors make and manage their investments in a lawful manner and in a manner which furthers the wealth of the Kazakh people.⁹²³ Through its laws and through the authorities applying its laws, the Republic implements a policy that aims to ensure that these expectations are being met by foreign investors.
- 860 Over the years, investment tribunals have constantly recognised that they need to apply a healthy dose of deference when dealing with states implementing such policies through laws, executive action and judicial rulings. This is due to the fact that it is not the purpose of broad investment treaties to implement specific policies for states and even less to allow a panel of arbitrators to do so. As the tribunal in *S.D. Myers v. Canada* held, the determination on whether a state has acted unfairly or inequitably "*must be made in the light of the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their own borders.*"⁹²⁴
- 861 In particular, in order for the workings of the courts and administrative agencies of a state to be relevant from an international law perspective, they must "involve or condone":

⁹²³ Statement of Defence dated 21 November 2011, para. 4.5.

⁹²⁴ *S.D. Myers, Inc. v. Government of Canada*, UNCITRAL, Partial Award, 13 November 2000, para. 263 (**Exhibit C-287**).

- (a) “arbitrariness”;
- (b) “discriminatory behaviour”;
- (c) “lack of due process”; or
- (d) “other characteristics that shock the conscience, are clearly ‘improper or discreditable’ or which otherwise blatantly defy logic or elemental fairness.”⁹²⁵

862 Or, as another tribunal put it: There is no breach of international law if the decisions (in this case of the state’s courts) are “*reasonably tenable and made in good faith*”.⁹²⁶

863 The Republic suggests that the Tribunal should apply such healthy dose of deference in dealing with the case at hand.

III. Expropriation

1. Introduction

864 Claimants allege that “*in July 2010*” the Republic directly expropriated Claimants’ investment⁹²⁷ after already having indirectly expropriated it “*over the October 2008-July 2010 period*”.⁹²⁸ Claimants go as far as claiming that in this period, the Republic took several measures and “*any number of them individually constitute an act of indirect expropriation*”⁹²⁹. In making these assertions, Claimants effectively defeat their own argument. Simple logic prescribes that something that has been taken once cannot be taken again unless it has been returned. However, Claimants were not expropriated once, twice or even several times – they were not expropriated at all.

⁹²⁵ *Reinhard Unglaube v. Costa Rica*, ICSID Case No. ARB/09/20, Award, 16 May 2012, para. 258 (**Exhibit R-276**).

⁹²⁶ *Frontier Petroleum Services Ltd. v. The Czech Republic*, UNCITRAL, Award, 12 November 2010, para. 527 (**Exhibit R-277**).

⁹²⁷ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 449.

⁹²⁸ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 469.

⁹²⁹ Statement of Claim dated 18 May 2011, para. 285.

2. Exhaustion of available remedies

865 As the Republic set out in its Statement of Defence⁹³⁰, any claim for expropriation is meritless because Claimants failed to pursue remedies reasonably available to them. As explained in the Statement of Defence, such a requirement exists particularly because, were this not the case, investors could invoke any minor mistake at the local level in order bring investment arbitration claims.⁹³¹

866 Claimants have opposed this mainly by arguing that the exhaustion of available remedies could not be a substantive requirement,⁹³² recourse to local courts was precluded in the contracts⁹³³ and in any event would have been futile.⁹³⁴

867 First, it has to be noted that Claimants misrepresent the contents of the decision taken by the *Helnan* annulment committee. Apodictically, they allege that the committee “*explicitly rejected any requirement to pursue available remedies as an element of showing a Treaty breach.*”⁹³⁵ This is plainly wrong. As was explicitly stated in the decision:

*“Of course, a claimant's prospects of success in pursuing a treaty claim based on the decision of an inferior official or court, which had not been challenged through an available appeal process, should be lower, since the tribunal must in any event be satisfied that the failure is one which displays insufficiency in the system, justifying international intervention.”*⁹³⁶

868 Claimants try to mislead the Tribunal into believing that *Helnan* was an easy one-way decision when it was in fact a very nuanced ruling, striking a balance between an investor’s interest in pursuing treaty arbitration and a

⁹³⁰ Statement of Defence dated 21 November 2011, paras. 33.7 et seqq.

⁹³¹ Statement of Defence dated 21 November 2011, para. 33.15.

⁹³² Reply Memorial on Jurisdiction and Liability dated 7 May 2012, paras. 453 et seqq.

⁹³³ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 456.

⁹³⁴ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 457.

⁹³⁵ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 453.

⁹³⁶ *Helnan International Hotels A/S v. Arab Republic of Egypt*, ICSID Case No. ARB/05/19, Decision of the ad hoc Committee, para. 48.

state's interest not to be held liable for any decision of its lowest-ranking officials.⁹³⁷

869 Further, in a completely unsupported passage, Claimants also allege that the Republic failed to differentiate between treaty claims and contract claims.⁹³⁸ Obviously, a claim under a treaty is something quite different to a claim under a contract. However, this in no way precludes the fact that available remedies have to be pursued. As was stated in the Statement of Defence, non-performance of a contract – and thus also termination of a contract – does not amount to an expropriation of the rights stemming from the contract as long as the loss of the right is not final, i.e. ultimately determined by the appropriate forum.⁹³⁹ Notably, Claimants have not even tried to differentiate or rebut any of the cases the Republic has presented for this argument.⁹⁴⁰

870 Claimants' basic counter-argument to the requirement to pursue available remedies is the fork-in-the-road clause in Art. 26 (3) (b) (i) ECT. This argument is severely flawed.

871 Under the subsoil use contracts as well as in relation to all other claims, it would not have been Claimants that could have invoked the contractually agreed remedies or taken recourse to the local courts. Instead it would have been TNG and KPM. TNG and KPM are distinct parties from Claimants in this arbitration. Therefore, if TNG and KPM had pursued their available remedies, this would not have triggered the fork-in-the-road clause for Claimants. This has been explicitly held by the tribunal in *CMS v. Argentina*:

“[...] even if TGN had done so [i.e. applied to local courts], - which is not the case -, this would not result in triggering the “fork in the road” provision against CMS.

⁹³⁷ See for more details below, Rejoinder Memorial on Jurisdiction and Liability dated 13 August 2012.

⁹³⁸ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 452.

⁹³⁹ Statement of Defence dated 21 November 2011, para. 33.15.

⁹⁴⁰ Statement of Defence dated 21 November 2011, para. 33.8-33.14.

Both the parties and the causes of action under separate instruments are different.”⁹⁴¹

872 Claimants’ position that their contracts precluded them from submitting breaches of contract before domestic courts is equally untenable. Their argument is that Contracts No. 210 and 302 provided that disputes be resolved as provided in the Kazakh Law on Foreign Investments and that this Law obliged the parties to arbitrate contract disputes at the Stockholm Chamber of Commerce.⁹⁴² Claimants base this allegation on a footnote in which they cite a chapter in the treatise “Oil and Gas Law in Kazakhstan”. They do not go the extra mile to even provide a page number to identify where in the 12-paged long chapter Maiden Suleymenov allegedly states that the Kazakh Law on Foreign Investments obliged the parties to arbitrate. Claimants may have chosen not to mention the page number because the dispute resolution provision in the Kazakh Law on Foreign Investments is only mentioned once in the chapter. On page 59, Maiden Suleymenov states that the Kazakh Law on Foreign Investments contains

“(d)ispute resolution between the investor and state through the courts or administrative tribunal at the investor’s choosing (ECT Art. 26, Art. 27 of the Foreign Investment Law)” (emphasis added)

873 Mr. Suleymenov thus states the exact opposite of what Claimants allege.

874 Article 28 (2) of Contract No. 305 does indeed refer the parties, i.e. KPM and the Republic, to the SCC. However, the requirement for KPM to refer disputes to the SCC does not mean that “*KPM and TNG would first have to commence arbitration proceedings at the Stockholm Chamber of Commerce for another international tribunal to determine whether Kazakhstan’s actions amount to a breach of contract under Kazakh law*”⁹⁴³. Firstly, only KPM is a party to Contract No. 305. Secondly, Claimants seem to suggest that the tribunal in the SCC proceedings would need to render a declaratory award in favour of KPM and on that basis, Claimants could then pursue their claim under the ECT. This is clearly not the case.

⁹⁴¹ *CMS Gas Transmission Company v. Argentina*, Case No. ARB/01/8, Decision on Jurisdiction, 17 July 2003, para. 80 (**Exhibit R-278**).

⁹⁴² Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 456.

⁹⁴³ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 456.

Instead, there would only be two proceedings if KPM were unsuccessful in the SCC arbitration and Claimants then decided to pursue their claim under the ECT nonetheless. This is not at all “*absurd*”.

875 Finally, Claimants’ assertion that any resort to local remedies would have been futile also fails.⁹⁴⁴ In this regard, it should be noted that it is for the Republic to show available remedies and for Claimants to prove that these would have been futile.⁹⁴⁵ Claimants clearly fail to do so.

876 With regard to recourse to local courts against the acts which Claimants deem to amount to indirect expropriation, Claimants have not even alleged that recourse to arbitration would have been futile. They have not provided a single reason as to why the local courts would not have addressed the issues at question.

877 With regard to arbitration as a remedy against termination of the contracts, it is refuted that any such attempt would have been futile from the outset. First of all, Claimants have not explained why an arbitration tribunal constituted in accordance with the terms of the subsoil use contracts could not have addressed their complaints. Their argument fails for this reason alone.

878 Moreover, Claimants’ argument on the futility of pursuing claims in contract arbitration is based on mere tendentious quoting of the Republic’s Statement of Defence.⁹⁴⁶ In the relevant passage of the Statement of Defence,⁹⁴⁷ the Republic never states that the termination notices were the result of a notification by the President of the Republic, as Claimants seem to insinuate. Hence, Claimants cannot base any argument on this alleged assertion.

⁹⁴⁴ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 457.

⁹⁴⁵ Chevron Corporation and Texaco Petroleum Company v. The Republic of Ecuador, UNCITRAL, Partial Award, 30 March 2010, para. 326 (**Exhibit C-285**).

⁹⁴⁶ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 457.

⁹⁴⁷ Statement of Defence dated 21 November 2011, para. 31.129.

IV. Direct expropriation

879 Claimants allege that the Republic cannot avoid a finding of direct expropriation based on an absence of transfer of title⁹⁴⁸ and that the Republic's expropriation of Claimants' assets were not a proper exercise of its regulatory power⁹⁴⁹. Claimants' allegations are wrong. The Republic has already demonstrated that the finding of a direct expropriation requires a transfer of title and that no such transfer occurred. In any event, the alleged measures of expropriation are merely legitimate regulatory acts.⁹⁵⁰

1. Direct Expropriation requires a transfer of title

880 It is generally accepted that direct expropriation requires a transfer of title. In the absence of such a transfer, no direct expropriation occurred.

881 Claimants misrepresent the position of the tribunals in *Telenor v. Hungary*, *Metalclad* and *Tecmed* when trying to defend their untenable position that direct expropriation did not require a transfer of title.⁹⁵¹

882 The section of the award in *Telenor v. Hungary* cited by Claimants does not deal with direct expropriation but with expropriation in general. This is highlighted by the tribunal's introductory sentence

*"Expropriation can take various forms"*⁹⁵²

883 The tribunal then goes on to describe creeping expropriation because the Claimant *Telenor* did not allege direct expropriation but only creeping expropriation, by stating that:

*"In the present case, Telenor has asserted that Hungary was guilty of conduct amounting to indirect, creeping expropriation, that is, expropriation taking forms other than the divestment of assets [...]."*⁹⁵³

⁹⁴⁸ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, paras. 459 et seqq.

⁹⁴⁹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, paras. 462 et seqq.

⁹⁵⁰ Statement of Defence dated 21 November 2011, paras. 34.1 et seqq.

⁹⁵¹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 460.

⁹⁵² *Telenor Mobile Communications A.S. v. Hungary*, ICSID Case No. ARB/04/15, Award, 13 September 2006, para. 63 (**Exhibit C-560**).

⁹⁵³ *Ibid.*

884 Claimants' reference to *Metalclad* is similarly misleading. The full quote of the *Metalclad* tribunal reads:

*“Thus, expropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host State, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State.”*⁹⁵⁴

885 As can be seen from the full quote, the tribunal in that case does not differentiate between direct and indirect expropriations but simply enumerates all the actions which it considers to be expropriations (be it direct or indirect). So that passage cannot be relied upon to identify the requirements for direct expropriation.

886 Likewise, the *Tecmed* tribunal does not even discuss direct expropriation in the quoted passage at all. Claimants insert “direct expropriation” in square brackets when in fact they would have needed to insert “indirect expropriation” into the square brackets to correctly quote the tribunal in that case. Again, this can be seen from putting the passage quoted by Claimants into a little more context:

“Therefore, it is understood that the measures adopted by a State, whether regulatory or not, are an indirect de facto expropriation if they are irreversible and permanent and if the assets or rights subject to such measure have been affected in such a way that “...any form of exploitation thereof...” has disappeared; i.e. the economic value of the use, enjoyment or disposition of the assets or rights affected by the administrative action or decision have been neutralized or destroyed. Under international law, the owner is also deprived of property where the use or enjoyment of benefits related thereto is

⁹⁵⁴ *Metalclad Corp v. Mexico*, ICSID Case No. ARB(AF)/97/1, Award, 30 August 2000, para. 103 (**Exhibit C-226**).

exacted or interfered with to a similar extent, even where legal ownership over the assets in question is not affected, and so long as the deprivation is not temporary.”⁹⁵⁵
(emphasis added)

887 Clearly, the tribunal does not discuss direct expropriation, it discusses indirect de facto expropriation.

2. No direct expropriation

888 The Republic did not directly expropriate Claimants’ investments because there was no forced transfer of property from Claimants to the Republic.

889 Claimants allege that the Republic directly expropriated Claimants’ investments when it “*announced the unilateral termination of Claimants’ Subsoil Use Contracts, Contract No. 302, and the transfer of KPM’s and TNG’s assets and operations into State control.*”⁹⁵⁶

890 The Republic has explained that neither of these actions constitutes a direct expropriation due to a lack of a transfer of title.⁹⁵⁷ Claimants sole ground of opposition to the Republic’s argument is that the fact that no transfer of title took place was “*immaterial as a matter of international law*”⁹⁵⁸. They have thus conceded that no transfer of title to the Republic took place. Since, as explained above, there is no basis for Claimants’ contention that transfer of title is not required for direct expropriation to occur, the only available conclusion is that the Republic did not directly expropriate Claimants investments.

3. The Republic’s measures were legitimate regulatory actions

891 The termination of the Subsoil Use Contracts, the non-extension of Contract 302 and the transfer to trust management of KPM’s and TNG’s

⁹⁵⁵ Técnicas Medioambientales (Tecmed) S.A. v. Mexico, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003, para. 116 (**Exhibit C-209**).

⁹⁵⁶ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 449.

⁹⁵⁷ Statement of Defence dated 21 November 2011, paras. 34.1 et seqq.

⁹⁵⁸ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 353; See also Reply Memorial on Jurisdiction and Liability dated 7 May 2012, paras. 459 et seqq.

assets were dictated by and consistent with Kazakh law⁹⁵⁹ and thus a legitimate exertion of the Republic's regulatory power.

892 It is an established fact that expropriatory actions need to be differentiated from valid governmental activity.

*“In the Tribunal’s view, the essential determination is whether the actions of the Mexican government constitute an expropriation or nationalization, or are valid governmental activity. If there is no expropriatory action, factors a-d [i.e. (a) for a public purpose; (b) on a non-discriminatory basis; (c) in accordance with due process of law and article 1105(1); and (d) on payment of compensation] are of limited relevance, except to the extent that they have helped to differentiate between governmental acts that are expropriation and those that are not (...).”*⁹⁶⁰

893 From the outset, it is obvious that the non-extension of contract 302 cannot constitute an expropriation. The non-extension of a contract does not take anything from the investor.

894 The termination of the Subsoil Use Contracts cannot constitute a direct expropriation either. As has been established above, the termination of the Subsoil Use Contracts was not only legal, it was mandated by Kazakh law.⁹⁶¹ It is especially surprising that Claimants complain about the fact that the contracts were terminated under the 2010 Subsoil Law.⁹⁶² Clearly, in order to be legal, the contracts needed to be terminated in accordance with the law in force at the time.

895 Likewise, the transfer of the contractual territory into trust management was the lawful consequence of KPM's and TNG's misconduct under the Contracts.⁹⁶³

⁹⁵⁹ See above sections C.V. and C.IX.

⁹⁶⁰ Marvin Feldman v. Mexico, ICSID Case No. ARB (AF)/99/1, NAFTA Award, 16 December 2002, para. 98 (**Exhibit C-283**).

⁹⁶¹ See above section C.IX.

⁹⁶² Reply Memorial on Jurisdiction and Liability dated 7 May 2012, paras. 338 et seqq.

⁹⁶³ See above section C.IX.

- 896 An action that is legal under the local law cannot constitute a treaty breach unless the law itself breaches the treaty. By their silence on this issue, even Claimants concede that the relevant Kazakh laws are in accordance with international law.
- 897 Claimants’ argument that that the Republic could not point to its domestic law to “legalize” its expropriation by way of the “regulatory powers” doctrine, because the Republic would still be required to compensate Claimants for such a taking,⁹⁶⁴ is beside the point. The Republic has explained in detail that, according to the mechanisms of the trust transfer management, neither the Republic nor another state entity ever owned the contractual territories or any of their property and any term providing for compensation would only be in the contract entered into with the new subsoil user that would be compensating KPM and TNG.⁹⁶⁵
- 898 Finally, any claim for expropriation must fail because only the Claimants’ own actions and external events were relevant in the demise of the companies.⁹⁶⁶

V. Indirect expropriation

- 899 The Republic did not indirectly expropriate Claimants. Even Claimants do not seem to be certain which measure is supposed to have indirectly expropriated them when they refer to “*expropriatory conduct over the October 2008-July 2010 period*”.⁹⁶⁷ They later enumerate four allegedly expropriatory measures taken by the Republic but remain very elusive as to whether each of these measures is supposed to have constituted an expropriation or whether they collectively expropriated Claimants: Firstly, the Republic allegedly interfered with the day-to-day management of KPM and TNG when the Financial Police “*commandeered*” their offices from October 2008 - March 2009,⁹⁶⁸ secondly, the Republic allegedly deprived Claimants of their ability to manage their companies by arresting KPM’s

⁹⁶⁴ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 466.

⁹⁶⁵ See section C.IX.2.

⁹⁶⁶ See section C.X.

⁹⁶⁷ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 470.

⁹⁶⁸ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 476.

General Director in April 2009 and “*hunting*” other KPM and TNG senior officials,⁹⁶⁹ thirdly, the cumulative effect of Kazakhstan’s alleged harassment campaign, including the refusal to execute the extension of Contract No. 302 supposedly deprived Claimants of their ability to prove their reserves⁹⁷⁰ and finally, the Republic’s alleged reversal of its pre-emptive rights waiver and its supposedly false announcement of irregularities are said to have deprived Claimants of their ability to dispose of their investment.⁹⁷¹

900 Claimants mischaracterise the Republic’s actions in each of the above cases. Ironically, in the first two cases, the Republic’s actions related to the need to investigate and later to punish the Claimants own misdeed or that of KPM and TNG and their employees. In each case, all measures taken by the Republic were legitimate and a legal applications of Kazakh law which were not expropriatory in nature. In any event, none of the measures even came close to the effect of a taking.⁹⁷²

901 In *Azurix v Argentina*, a case in which the investor had obtained a concession agreement with the Argentine Province of Buenos Aires for the provision of water and sewerage services in the province and later terminated this concession allegedly due to a series of measures by the province, the Tribunal held that no indirect expropriation had occurred because

*“(...) the impact on the investment attributable to the Province’s actions was not to the extent required to find that, in the aggregate, these actions amounted to an expropriation; Azurix did not lose the attributes of ownership, at all times continued to control ABA and its ownership of 90% of the shares was unaffected”.*⁹⁷³

902 Likewise in *LG&E v Argentina* even though the state - unlike the Republic in this case - had breached the conditions of a concession agreement for gas

⁹⁶⁹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 477.

⁹⁷⁰ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 478.

⁹⁷¹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 478.

⁹⁷² See Statement of Defence dated 21 November 2011, paras. 35.1 et seqq.

⁹⁷³ *Azurix Corp. v. Argentine Republic*, ICSID Case No. ARB/01/12, Award, 14 July 2006, para. 322 (**Exhibit C-245**).

supply the tribunal found that there was no expropriation because the investor had not lost control of the investment.⁹⁷⁴

903 None of the measures of the Republic affected the ownership of Claimants.

1. Regulatory acts do not constitute a compensable indirect expropriation

904 It has already been expressed in Article 1 of Protocol 1 to the European Convention of Human Rights which was concluded in 1952 and entered into force in 1954 that the enforcement of laws, necessary to control the use of property in accordance with the general interest cannot constitute a compensable taking by stating that

“Every natural or legal person is entitled to the peaceful enjoyment of its possessions. No one should be deprived of his possessions except in the public interest and subject to the conditions provided for by the law and by the general principles of international law.

The preceding provisions shall not, however, in any way impair the right of a state to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties”⁹⁷⁵

905 All of the actions concerned were lawful acts of enforcement of laws such as the Subsoil Law and these laws are necessary to regulate the hazardous and strategically important exploration and extraction of oil and gas.

906 Claimants only challenge this by stating that the measures taken “*consisted of an egregious campaign of harassment and coercion designed to undermine and interfere with Claimants’ management and control of KPM and TNG*”⁹⁷⁶. The Republic has demonstrated in detail that no such

⁹⁷⁴ LG&E v. Argentina, ICSID Case No. ARB/02/1, Decision on Liability, 3 October 2006, para. 199 (**Exhibit R-63**).

⁹⁷⁵ Protocol to the Convention for the Protection of Human Rights and Fundamental Freedoms (**Exhibit R-279**).

⁹⁷⁶ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 470.

campaign existed⁹⁷⁷ and Claimants' argument of expropriation is bound to fail for that reason alone.

2. No interference with the day-to-day management

907 The Republic did not interfere with the day-to-day management of KPM and TNG when the Financial Police allegedly “*commandeered*” their offices from October 2008 - March 2009. As has been demonstrated above, the inspections and audits were not only conducted in accordance with Kazakh law but the inspecting agencies also made every attempt not to disrupt the business of KPM and TNG.⁹⁷⁸ Claimants have failed to prove that the day-to-day business was seriously disrupted. Despite the Republic's reminder of their burden of proof,⁹⁷⁹ they have deliberately chosen not to substantiate the allegation that their business was disrupted.⁹⁸⁰ In order to constitute an indirect expropriation, Claimants would have needed to demonstrate that the alleged interference was in fact equivalent to an expropriation. It is a general rule that the party who alleges any proposition must prove it and the onus probandi lies upon the party who seeks to support its case by a particular fact of which it is supposed to be cognizant.

908 To prove an indirect expropriation, Claimants would have needed to demonstrate that the inspections led to a situation

*“where a party no longer is in control of the investment, or where it cannot direct the day-to-day operations of the investment.”*⁹⁸¹

909 After all,

*“(...) the taking of property (...) is still the essence of expropriation, even indirect expropriation.”*⁹⁸²

⁹⁷⁷ See section C.II.

⁹⁷⁸ See section C.II.2.

⁹⁷⁹ Statement of Defence dated 21 November 2011, para. 35.22.

⁹⁸⁰ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 474.

⁹⁸¹ LG&E v. Argentina, ICSID Case No. ARB/02/1, Decision on Liability, 3 October 2006, para. 188 (**Exhibit R-63**).

910 Clearly, occasional and legitimate inspections and audits do not prevent investors from directing the day-to-day operations of the investments and Claimants have not proven otherwise.

3. No deprivation of the ability to manage

911 The Republic did not deprive Claimants of their ability to manage by arresting KPM's General Director in April 2009 and allegedly "*hunting*" other KPM and TNG senior officials.

912 It is generally accepted that

*"a penal measure following the violation of a criminal statute cannot give rise to a compensatory taking."*⁹⁸³

913 As has been demonstrated above, Mr. Cornegruta was prosecuted and convicted in accordance with due process and Kazakh law.⁹⁸⁴ Therefore, his conviction cannot constitute an indirect expropriation. Claimants have also failed to substantiate in how far Mr. Cornegruta's absence affected the "promoting, financing and managing" of the investment.⁹⁸⁵ Claimants' allegation of any "*hunting*" of other KPM and TNG senior officials is so unsubstantiated that the claim must fail for this reason alone. Additionally, the cases brought forward by Claimants do not support their arguments at all.

914 In *Benvenuti & Bonfant v. Congo* the Tribunal held that the investor had been expropriated because the army had seized the premises of a bottling factory. The only relevance of the fact that the manager had fled the country due to the risk of criminal proceedings was that this was one of the arguments to refute Congo's allegation that the investor could return anytime to take repossession of his property.⁹⁸⁶

⁹⁸² PSEG Global Inc. v. Turkey, ICSID Case No. ARB/02/5, Award, 19 January 2007, para. 279 (**Exhibit C-261**).

⁹⁸³ UNCTAD, Taking of Property (2000), p. 2, (**Exhibit C-231**).

⁹⁸⁴ See sections C.VI. - C.VIII.

⁹⁸⁵ Despite the Republic's express reminder in Statement of Defence dated 21 November 2011, paras. 35.18 et seq.

⁹⁸⁶ *Benvenuti & Bonfant v. Congo*, ICSID Case No. ARB/77/2, Award, 8 August 1980, 21 I.L.M. 740, 758, paras. 4.57 et seqq. (**Exhibit C-564**).

915 Likewise, the facts in *Biwater Gauff (Tanzania) Ltd. v. Tanzania* bear no resemblance to the case at hand. In this case, the investor's senior management was forcibly deported from Tanzania while simultaneously the premises of the investor were seized.⁹⁸⁷ This does not compare to the lawful prosecution and conviction of Mr. Cornegruta.

4. No deprivation of the ability to prove reserves

916 The cumulative effect of Kazakhstan's alleged harassment campaign, including the refusal to execute the extension of Contract No. 302 did not deprive Claimants of the ability to prove reserves.

917 The Republic has demonstrated that no such harassment campaign existed.⁹⁸⁸ The non-extension of Contract 302 cannot constitute an indirect expropriation.⁹⁸⁹ It is telling that Claimants' consider the non-extension to be both a direct and an indirect expropriation when in fact it does not constitute a taking at all. Contract 302 expired on 30 March 2009. Vain hope to prolong a contract cannot constitute a taking and as demonstrated above, Claimants did not obtain a right to prolong the contract.⁹⁹⁰

5. No deprivation of the ability to dispose of the investment

918 The Republic's alleged reversal of its pre-emptive rights waiver and its supposedly false announcement of irregularities did not deprive Claimants of their ability to dispose of their investment.

919 Again, the Republic never reversed an alleged pre-emptive rights waiver, the Republic had never waived its pre-emptive right regarding the share transfer from Gheso to Terra Raf because it had been made believe that it did not possess a pre-emptive right. Instead the Republic lawfully revoked its authorisation of the transfer. In essence, Claimants seek to blame the Republic for their own shortcomings.⁹⁹¹ Any alleged problems incurred in

⁹⁸⁷ *Biwater Gauff (Tanzania) Ltd. v. Tanzania*, ICSID Case No. ARB/05/22, Award, 24 July 2008, paras. 223 et seq. (**Exhibit C-270**).

⁹⁸⁸ See section C.II.

⁹⁸⁹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 449 and para. 478.

⁹⁹⁰ See section C.V.

⁹⁹¹ See section B.IV.4.a)

disposing of their investment were not caused by the Republic. In fact, as has been demonstrated above, the allegedly illegal actions of the Republic did not play a role in Claimants' failure to sell the companies.⁹⁹²

920 It is also noteworthy that Claimants have clandestinely dropped all relevant tax measures from the list of alleged expropriations and only mention them in a footnote in this section in which they claim that they had been deprived of their ability to dispose of the investment.⁹⁹³ Apparently, Claimants have come to the conclusion that the tax measures cannot constitute an expropriation and quite rightly so. The taxation measures do not fall within the jurisdiction of the Tribunal.⁹⁹⁴ In any event, the tax measures do not constitute expropriations under Article 13 ECT.

*“Despite the limitations regarding taxation to the extent of expropriation, normal bona fide taxation is considered to be within the regulatory power of the host state government and does not constitute a compensable indirect expropriation.”*⁹⁹⁵

921 It has been shown that the Tax Committee's assessment of corporate back taxes was legitimate, the 2008 crude oil export duties were lawful and in any event not paid for by TNG and the 2009 duties were withdrawn before either KPM or TNG made any payment.⁹⁹⁶ Hence, the taxation measures were not expropriatory because neither was an “*acquired right*”⁹⁹⁷ taken from Claimants nor could the tax measures be said to “*frustrate the complete operation of [Claimants'] activities in [Kazakhstan]*”⁹⁹⁸.

⁹⁹² See section C.X.

⁹⁹³ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 478, footnote 848.

⁹⁹⁴ Statement of Defence dated 21 November 2011, paras. 30.19 - 30.36.

⁹⁹⁵ Expert Opinion of Professor Tietje dated 8 August 2012, p. 25.

⁹⁹⁶ See section C.IV.

⁹⁹⁷ See Expert Opinion of Professor Tietje dated 8 August 2012, p. 26.

⁹⁹⁸ See Archer Daniels Midland Company and Tate & Lyle Ingredients Americas, Inc. v. United Mexican States (ICSID Case No. ARB(AF)/04/5), Award, 21 November 2007, para. 247 (**Exhibit R-280**).

VI. Any allegation of expropriation is overridden by the Republic's right to regulate

1. The sovereignty of the state includes the right to regulate

922 It is trite that sovereign equality of states demands sovereignty of states over natural resources. Such sovereignty is highlighted in the Preamble to the 1991 European Energy Charter⁹⁹⁹. Both under the first and the second title of the Charter State sovereignty and sovereign rights over energy resources are recognized.

923 It should be noted that as early as 1975, the Helsinki Declaration¹⁰⁰⁰ stipulated that state sovereignty included the right “*to determine its laws and regulations*”.

924 Thus, state sovereignty over natural resources presumes the right of the state to provide for a national legal framework for effecting foreign investments to the energy sector.

925 Other treaties of the Republic relevant to the Claimants’s activities in the Republic contain similar provisions. This is particularly the case for the “Cooperation Agreement in the Sphere of Investment Activity” of 1993¹⁰⁰¹ which among others was signed by the Republic and the Republic of Moldova. Article 4 provides that “investments” shall exclusively mean activity that does not contradict the legislation of the host state.

926 Further, the “Convention for the Protection of Investors’ Rights” of 1997¹⁰⁰² proceeds from the fact that relations concerning investments and protection thereof are governed by the national law of the host state. The investor is entitled to compensation of damages caused to it only by those decisions and actions (or omissions) of state bodies or officials which are contrary to the legislation of the host state.

⁹⁹⁹ 1991 European Energy Charter (**Exhibit R-105**).

¹⁰⁰⁰ The Final Act of the Conference on Security and Cooperation in Europe, Aug. 1, 1975, 14 I.L.M. 1292 (Helsinki Declaration) (**Exhibit R-68**).

¹⁰⁰¹ Cooperation Agreement in the Sphere of Investment Activity (**Exhibit R-99**).

¹⁰⁰² Convention for the Protection of Investors’ Rights (**Exhibit R-100**).

2. Regulatory actions do not constitute compensable expropriations

927 A definition of the term “expropriation” that can be found in contemporary international law is contained in Article 11 a) ii) of the 1985 Seoul Convention Establishing the Multilateral Investment Guarantee Agency.¹⁰⁰³

928 The Convention establishes the Multilateral Investment Guarantee Agency (“MIGA”) which guarantees eligible investments against a loss resulting from expropriation or “*similar measures*”. A definition of expropriation is contained in Article 11 a) ii) of the Convention. This definition is formulated in general, non-specific terms. There is no provision in the Convention that requires this definition to be used solely for the purposes of this Convention (and not others). The provision defines expropriation and similar measures by describing them as

“any legislative action or administrative action or omission attributable to the host government which has the effect of depriving the holder of a guarantee of his ownership or control of, or a substantial benefit from, his investment, with the exception of non-discriminatory measures of general application which the governments normally take for the purpose of regulating economic activity in their territories”

929 It is notable that at present 176 states are party to the MIGA Convention, including all the states involved in the present dispute (Great Britain - since 1988, Romania - since 1992, Moldova - since 1993, Kazakhstan - since 1993).¹⁰⁰⁴

930 In similar terms, the European Court of Human Rights (“ECtHR”) accepts that regulatory actions do not constitute an expropriation.

931 Article 1 of Protocol 1 to the ECtHR¹⁰⁰⁵ highlights that the protection of possessions may not impair the right of a state to enforce such laws as it deems necessary to control the use of property in accordance with the

¹⁰⁰³ Convention Establishing The Multilateral Investment Guarantee Agency (**Exhibit R-281**).

¹⁰⁰⁴ List of member states to the Convention Establishing The Multilateral Investment Guarantee Agency (**Exhibit R-282**).

¹⁰⁰⁵ Protocol to the Convention for the Protection of Human Rights and Fundamental Freedoms (**Exhibit R-279**).

general interest or to secure the payment of taxes or other contributions or penalties.

932 The ECtHR has developed an extensive practice under Article 1 of Protocol 1. The following cases are examples of compulsory alienation of property which were not found to be expropriatory:

933 In *Saccoccia v. Austria* the Court came to the conclusion that the execution of a forfeiture order did not amount to a disproportionate interference with the applicant's property rights.¹⁰⁰⁶ The confiscation of the applicant's assets, of a total value of about 80,000,000 Austrian schillings (ATS – approximately 5,800,000 euros), in cash, bearer bonds and a bank account served the purpose of ensuring that money derived from drug dealing was not retained illegally.

934 *Phillips v. the United Kingdom* concerned the case of an applicant who had been convicted of being involved in the importation of a large quantity of cannabis resin and was sentenced to nine years' imprisonment. He was assessed to have received, as the proceeds of drug trafficking, 91,400 pounds sterling (GBP) and a confiscation order was made for this amount. The Court held that this confiscation order was a penalty that did not constitute an expropriation because the interference suffered by the applicant with the peaceful enjoyment of his possessions was not disproportionate given the importance of the aim pursued.¹⁰⁰⁷ A similar reasoning was applied in *Butler v. the United Kingdom*¹⁰⁰⁸ and *Grayson and Barnham v. the United Kingdom*¹⁰⁰⁹.

935 The seizure of smuggled goods does not constitute an expropriation either, as held in *AGOSI v. the United Kingdom*.¹⁰¹⁰ In this case, some individuals had defrauded the applicant and thus gained possession of gold coins. They then tried to smuggle the coins out of the UK but the UK customs

¹⁰⁰⁶ *Saccoccia v. Austria*, Application no. 69917/01, 18 December 2008, para. 91 (**Exhibit R-283**).

¹⁰⁰⁷ *Phillips v. United Kingdom*, Application no. 41087/98, 5 July 2001, paras. 48 et seqq. (**Exhibit R-284**).

¹⁰⁰⁸ *Butler v. United Kingdom*, Application no. 41661/98, 27 June 2002, pp. 10 et seqq. (**Exhibit R-285**).

¹⁰⁰⁹ *Grayson and Barnham v. United Kingdom*, Application nos. 19955/05 and 15085/06, 23 September 2008, paras. 51 et seqq. (**Exhibit R-286**).

¹⁰¹⁰ *AGOSI v. the United Kingdom*, Application no. 9118/80, 24 October 1986, paras. 47 et seqq. (**Exhibit R-287**).

authorities detected and seized the coins. Subsequently, the customs authorities refused to restore the coins to the defrauded company. The defrauded company which had retained ownership over the coins applied to the ECtHR. Even though the applicant had not taken part in the smuggling, the Court held the confiscation of the owner's property to be compatible with Article 1 of Protocol No. 1.

- 936 Likewise, in *Air Canada v. the United Kingdom* an aircraft had been seized by customs authorities because it had been used for drug-trafficking and the customs authorities made the release subject to payment. While Air Canada had not known of the use of the airplane to transport drugs, security lapses had made this use possible. The Court held that the measures taken were proportionate and therefore did not constitute an expropriation.¹⁰¹¹
- 937 The imposition of a duty on the applicant to demolish an illegally erected building was held to be in accordance with Article 1 of Protocol No. 1 in *Saliba v. Malta*.¹⁰¹²
- 938 The ECtHR also held that the withdrawal of a licence to serve alcoholic beverages did not constitute an expropriation in *Tre Traktörer AB v. Sweden*.¹⁰¹³ In this case, the licence to serve alcoholic beverages granted for the applicant company's restaurant had been withdrawn because of some discrepancies in the restaurant's book-keeping. The Court declared Article 1 of Protocol No. 1 applicable but found that the withdrawal did not amount to a deprivation of property. While the withdrawal did constitute a measure of control of the use of property, it was lawful and pursued in the general interest and there was no disproportionality between the economic interest of the applicant company and the general interest of the society.
- 939 The Court has also been firm on the point that tax sanctions for violation of tax legislation cannot constitute an expropriation. For example, this has been highlighted in *Georgiou v. the United Kingdom*.¹⁰¹⁴

¹⁰¹¹ *Air Canada v. the United Kingdom*, Application no. 18465/91, 5 May 1995, paras. 39 et seqq. (**Exhibit R-288**).

¹⁰¹² *Saliba v. Malta*, Application no. 4251/02, 8 November 2005, paras. 23 et seqq. (**Exhibit R-289**).

¹⁰¹³ *Tre Traktörer AB v. Sweden*, Application no. 10873/84, 7 July 1989, paras. 56 et seqq. (**Exhibit R-290**).

¹⁰¹⁴ *Georgiou v. the United Kingdom*, Application no. 40042/98, 16 May 2000, p. 9, (**Exhibit R-291**).

- 940 *Gasus Dosier- und Fördertechnik GmbH v. the Netherlands* concerned the case of an applicant company which had agreed to sell a machine to another company but had retained ownership until the full payment of the purchase price. The applicant company delivered the machine and the authorities subsequently seized all movable property on the other company's premises for non-payment of taxes due, including the applicant company's machine. The Court held the seizure to be compatible with Article 1 of Protocol No. 1 because it served the aim of securing the payment of taxes.¹⁰¹⁵
- 941 When assessing the decisions of the ECtHR it should be recognised that the ECtHR does not only examine claims of national owners against a state, it has also examines cases related to the protection of foreign investments in the territory of a state.¹⁰¹⁶
- 942 The practice of the ECtHR (as set out above) clearly demonstrates that a deprivation of property in the form of fines, taxes, etc. does not constitute expropriation and does not require compensation.
- 943 The ECtHR grants the states a wide margin of discretion in determining the public interest and the measures required in the pursuance of these interest.¹⁰¹⁷ At the same time, the ECtHR proceeds from the fact that in certain cases such kind of measures can be internationally wrongful. Therefore, before deciding on whether an expropriation occurred, the Court takes the following steps:
- 944 First, the Court looks at whether these measures are lawful under the laws of the host state:

¹⁰¹⁵ *Gasus Dosier- und Fördertechnik GmbH v. the Netherlands*, Application no. 15375/89, 23 February 1995, (**Exhibit R-292**).

¹⁰¹⁶ E.g. *Bimer S.A. v. Moldova*, Application no. 15084/03, 10 July 2007 (**Exhibit R-293**).

¹⁰¹⁷ See e.g. *AGOSI v. the United Kingdom*, Application no. 9118/80, 24 October 1986, para. 52 et seq. (**Exhibit R-287**): "(...) the Court recognises that the State enjoys a wide margin of appreciation with regard both to choosing the means of enforcement and to ascertaining whether the consequences of enforcement are justified in the general interest for the purpose of achieving the object of the law in question." and *Gasus Dosier- und Fördertechnik GmbH v. the Netherlands*, Application no. 15375/89, 23 February 1995, para. 60 (**Exhibit R-292**): "In passing such laws the legislature must be allowed a wide margin of appreciation (...) The Court will respect the legislature's assessment in such matters unless it is devoid of reasonable foundation.".

*“The Court reiterates that the first and most important requirement of Article 1 of Protocol No. 1 is that any interference by a public authority with the peaceful enjoyment of possessions should be lawful.”*¹⁰¹⁸

945 In deciding this, the Court also evaluates whether a domestic law was sufficiently available, specified and predictable.¹⁰¹⁹

946 The ECtHR frequently emphasized that its competence for the assessment of the lawfulness of the actions of state authorities (i.e. their compliance with national law) is limited.¹⁰²⁰ This is due to the fact that according to Article 1 of the ECHR, the obligation to ensure the human rights guaranteed by the ECHR primarily rests with the state parties to the Convention.

947 Secondly, the Court assesses these measures in respect of their proportionality,¹⁰²¹ i.e. whether they contribute to a fair balance between the interests of the host state and the investor, between the requirements of public interests and the requirements of protection of fundamental freedoms of a person.

948 When assessing the proportionality of measures, the ECtHR takes into account the wrongfulness of an applicant’s conduct:

*“The striking of a fair balance depends on many factors and the behaviour of the owner of the property, including the degree of fault or care which he has displayed, is one element of the entirety of circumstances which should be taken into account.”*¹⁰²²

949 The approach of the ECtHR should be of guidance for this Tribunal.

¹⁰¹⁸ Belvedere Alberghiera S.r.l. v. Italy, Application no. 31524/96, 30 May 2000 para. 56 (**Exhibit R-294**).

¹⁰¹⁹ Ibid, para. 57.

¹⁰²⁰ Saccoccia v. Austria, Application no. 69917/01, 18 December 2008, para. 87 (**Exhibit R-283**): “(...) It has to be borne in mind that the Court’s power to review compliance with domestic law is limited”.

¹⁰²¹ AGOSI v. the United Kingdom, Application no. 9118/80, 24 October 1986, para. 52 (**Exhibit R-287**): “(...) the Court must determine whether a fair balance has been struck between the demands of the general interest in this respect and the interest of the individual or individuals concerned”.

3. Scholarly opinion

950 The position that legitimate regulatory actions do not constitute a compensable expropriation is confirmed by prominent scholars of international law. As Ian Brownlie has stated the following:

*“State measures, prima facie a lawful exercise of powers of governments, may affect foreign interests considerably without amounting to expropriation. Thus, foreign assets and their use may be subjected to taxation, trade restrictions involving licences and quotas, or measures of devaluation. While special facts may alter cases, in principle such measures are not unlawful and do not constitute expropriation.”*¹⁰²³.

951 Professor Sornarajah formulates a list of measures which have always been recognized as being uncompensable takings:

“Quite apart from the categorisation of taking, one further issue that has become important is the identification of a category of taking described as “regulatory” taking for which no compensation needs to be paid. The law has always recognised this category. It has always been recognised that ordinary measures of taxation, or the imposition of criminal penalties or export controls, do not constitute taking that is compensable.”

¹⁰²⁴

952 Professor Böckstiegel gives another example by stating that from the outset, a taking in the course of an enforcement is not compensable because the state merely enforces an existing title and the title ceases to exist after successful enforcement. Thus, nothing is taken from the owner.¹⁰²⁵

¹⁰²² AGOSI v. the United Kingdom, Application no. 9118/80, 24 October 1986, para. 54 (**Exhibit R-287**).

¹⁰²³ Ian Brownlie, “Public International Law”, 7th edition 2003, p. 532 (**Exhibit R-295**).

¹⁰²⁴ M. Sornarajah, “The International Law on Foreign Investment” 3rd edition 2010, p. 374 (**Exhibit R-296**).

¹⁰²⁵ Böckstiegel, “Die allgemeinen Grundsätze des Völkerrechts über Eigentumsentziehung – Eine Untersuchung zu Art. 1 des Zusatzprotokolls der Europäischen Menschenrechtskonvention”, 1963, p. 81 (**Exhibit R-297**).

4. The Practice of investment arbitration

953 Arbitral tribunals concur with the ECtHR by confirming the right of states to regulate. In the case of *Too v. Greater Modesto Insurance Associates*, which was examined by the Iran-United States Claims Tribunal it was noted that a state is not responsible for loss of property or for any other economic disadvantage resulting from *bona fide* general taxation or any other action which is commonly accepted to be within the police powers of states, provided it is not discriminatory and is not designed to cause the alien to abandon the property to the state or to sell it at a distress price.¹⁰²⁶

954 In the case of *Feldman v. Mexico* the tribunal examined a dispute concerning the application of the tax legislation in respect of export of tobacco products by the investor. The claimant challenged the lawfulness of a refusal of the Mexican authorities to grant the investor a tax abatement on the excise duties on cigarettes exported from Mexico based among others on the violation of Article 1110 (expropriation and reimbursement) of the North American Free Trade Agreement.

955 In its award, the tribunal distinguished between expropriation and state regulation and noted that

“many business problems are not expropriations” 1027.

956 The tribunal did not recognize the refusal to grant tax benefits (as a result of a change in tax legislation) to be an expropriation, in other words, the tribunal acknowledged that the refusal to grant tax benefits constituted a legitimate measure of state regulation.

VII. Most constant protection and security

957 Claimants contend that the Republic violated the standard of most constant protection and security as stipulated in Article 10(1) of the ECT. This reasoning is flawed because Claimants misconceive the scope of this provision and have not established that its prerequisites are fulfilled.

¹⁰²⁶ Emanuel Too v Greater Modesto Insurance Associates, Case No. 880: Award No. 460-880-2, Award of 19 December 1989, para. 26 (**Exhibit R-298**).

¹⁰²⁷ Marvin Feldman v. Mexico, ICSID Case No. ARB (AF)/99/1, NAFTA Award of 16 December 2002, paras. 112 et seq. (**Exhibit C-283**).

1. Scope of Article 10(1) of the ECT

958 In their Reply Memorial on Jurisdiction and Liability Claimants allege that the scope of Article 10(1) of the ECT extends not only to physical security, but also to legal security.¹⁰²⁸ Furthermore, Claimants contend that the level of protection provided by Article 10(1) of the ECT is considerably higher than the standard of implementation of reasonable measures of protection and security.¹⁰²⁹ However, these considerations do not have any merit.

a) Physical protection and security

959 Claimants' allegation that "*the standard [of most constant protection and security] today clearly encompasses legal security*"¹⁰³⁰ does not correspond with the prevailing view of tribunals in investment treaty arbitrations. According to their ruling, the standard comprises solely physical protection and security of investors and their investments solely:

*"The practice of arbitral tribunals seems to indicate [...] that the "full security and protection" clause is not meant to cover just any kind of impairment of an investor's investment, but to protect more specifically the physical integrity of an investment against interference by use of force."*¹⁰³¹

960 This traditional understanding of the duty to provide full protection and security¹⁰³² has not expanded over time and it has been repeatedly affirmed by more recent awards:

*"[t]he full protection and security standard [...] obliges the State to provide a certain level of protection to foreign investment from physical damage."*¹⁰³³

¹⁰²⁸ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 482.

¹⁰²⁹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 488.

¹⁰³⁰ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 482.

¹⁰³¹ *Saluka Investments BV (The Netherlands) v. The Czech Republic*, Partial Award, 17 March 2006, para 484 (**Exhibit C-259**).

¹⁰³² Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law*, 2008, page 150 (**Exhibit R-299**).

¹⁰³³ *Rumeli v. Kazakhstan*, ICSID Case No. ARB/05/16, 29 July 2008, Award, para. 668 (**Exhibit C-236**).

961 There are a number of reasons for restricting the scope of the duty to provide full protection and security to physical damage and violence are manifold.

962 Some tribunals draw comparisons with the duty under customary international law relating to aliens to provide for protection and security of foreign nationals:

*“With regard to the Claimant’s argument that the Respondent breached Art. II 2(a) of the BIT which stipulates that the “Investment shall ... enjoy full protection and security”, the Tribunal notes: that it seems doubtful whether that provision can be understood as being wider in scope than the general duty to provide for protection and security of foreign nationals found in the customary international law of aliens.”*¹⁰³⁴

963 Foreign nationals can reasonably expect to be protected by a state other than their home country on its sovereign territory from physical damage and violence, but not from legal instability because the customary international law of aliens only establishes only a minimum standard of protection. There is no reason why investors should be in a position to expect anything more from a host state if the investment treaty does not explicitly include a guarantee of full legal security.

964 Another reason for the need to restrict the scope of the provision of full protection and security to physical damage and violence is the fact that this guarantee must have a meaning beyond, and distinct from, the standard of fair and equitable treatment. Legal protection in terms of an investor’s legitimate expectation and its interest in a stable and predictable business environment is already encompassed by the provision on fair and equitable treatment. Claimants’ assumption that both provisions can be read as comprising legal protection although they are stipulated separately from each other violates the principle of systematic interpretation, whereby a legal system is self-consistent and therefore no provision can be contrary to another. Furthermore, Claimants’ assumption violates the principle of effective interpretation, requiring a purpose and object oriented

¹⁰³⁴ Noble Ventures, Inc. v. Romania, ICSID Case No. ARB/01/11, Award, 12 October 2005, para. 164 (**Exhibit R-66**).

interpretation¹⁰³⁵, because the separate stipulation of two provisions aims at establishing two distinct guarantees.

965 In the words of Schreuer:

*“The view that the two standards, FET and protection and security, are to be seen as different obligations is clearly the better one. As a matter of interpretation, it appears unconvincing to assume that two standards listed separately in the same document, have the same meaning. An interpretation that deprives a treaty provision of its independent meaning is implausible to say the least.”*¹⁰³⁶

966 While the fair and equitable treatment standard obliges the host state to abstain from a certain course of action, the full protection and security standard obliges the host state to actively create a framework which grants security.¹⁰³⁷ Therefore, both provisions have are substantively distinct from one another.

967 The ECT provides an inherently coherent framework of rules whose individual meanings have been carved out by tribunals over the years. Notwithstanding the fact that the interpretations of these rules by tribunals are ever-evolving, investors and states rely on the traditional approach of assigning a definable, different content to each individual provision. Hence, blurring the boundaries between most constant protection and security on one hand and fair and equitable treatment on the other hand undermines the principle of legal certainty.

968 Furthermore, tribunals keep emphasizing the duty’s origin as a means of protection of investors against physical harm by third parties:

“As the Tribunal understands it, the criterion in Art. 3(2) of the BIT concerns the obligation of the host state to protect the investor from third parties in the cases cited by the Parties[:] mobs, insurgents, rented thugs and

¹⁰³⁵ Eureko B. V. v. Republic of Poland, Partial Award, 19 August 2005, para. 248 (**Exhibit C-260**).

¹⁰³⁶ Christoph H. Schreuer, Investment Protection and the Energy Charter Treaty, page 68 (**Exhibit R-300**).

¹⁰³⁷ Ibid.

*others engaged in physical violence against the investor in violation of the state monopoly of physical force. Thus, where a host state fails to grant full protection and security, it fails to act to prevent actions by third parties that it is required to prevent.”*¹⁰³⁸

- 969 In view of the fact that many tribunals are mindful of the duty’s restricted origin, the concept resists overstressing its applicability. Rather, the provision on most constant protection and security should be read as traditionally understood, that is to solely encompass physical protection.
- 970 The origin of the duty as a means of protection of investors against physical harm by third parties is reflected by numerous instructive examples where tribunals have considered the scope of most constant protection and security to be applicable: adverse social demonstrations¹⁰³⁹, protests by employees¹⁰⁴⁰ and so on. These typical acts of physical violence define the core of the provision in Article 10(1) of the ECT.
- 971 By contrast, some of the awards Claimants cite to support their allegation that the standard of most constant protection and security includes legal security have been based on exceptional wording in the respective treaty provision which does not lend itself to generalisations. For example, Claimants cite the case *Siemens v. Argentina*¹⁰⁴¹, which - at first glance - seems to confirm their contention. However, Claimants fail to disclose that the Argentina-Germany BIT being the basis of the claim included the qualified term of “*legal security*” in the relevant provision on full protection and security.¹⁰⁴²
- 972 The ECT does not expressly refer to legal security in particular. By argumentum e contrario, Claimants’ conveniently partial quotation of *Siemens v. Argentina* illustrates once more that the guarantee of most constant protection and security does not encompass legal security unless

¹⁰³⁸ Eastern Sugar v. Czech Republic, SCC No. 088/2004, Partial Award, 27 March 2007, para. 203 (**Exhibit R-301**).

¹⁰³⁹ Tecmed, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003 (**Exhibit C-209**).

¹⁰⁴⁰ Asian Agricultural Products Ltd. (AAPL) v. Democratic Socialist Republic of Sri Lanka, ICSID Case No. ARB/87/3, Award, 27 June 1990 (**Exhibit C-255**).

¹⁰⁴¹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 483.

¹⁰⁴² Siemens v. Argentine Republic, ICSID Case No. ARB/02/8, Award, 6 February 2007, para. 303 (**Exhibit C-232**).

the investment treaty explicitly states otherwise. Rather, it requires the host state solely to provide protection from physical damage and violence.

b) Implementation of reasonable measures of protection and security

973 In their Reply Memorial on Jurisdiction and Liability Claimants deny that the duty to ensure the most constant protection and security requires a host state to diligently implement reasonable measures of protection and that the Republic provided such measures.¹⁰⁴³ However, this is the prevalent view of scholars and tribunals alike:

*“There is broad consensus that the standard does not provide an absolute protection against physical or legal infringement. In terms of the law of state responsibility, the host state is not placed under an obligation of strict liability to prevent such violations. Rather, it is generally accepted that the host state will have to exercise ‘due diligence’ and will have to take such measures protecting the foreign investment as are reasonable under the circumstances.”*¹⁰⁴⁴

974 Tribunals consistently emphasize the fact that the guarantee of full protection and security is concerned with the implementation of reasonable measures and not with the erroneous practice by individual state officials.

975 In the Noble v. Romania case the tribunal observed:

*“[V]iolations of protection standards are not easily to be established. [The host state is required] to exercise due diligence in protecting the [investor].”*¹⁰⁴⁵

976 The tribunal in AAPL v. Sri Lanka explained:

“The ‘due diligence’ [required] is nothing more nor less than the reasonable measures of prevention which a well-

¹⁰⁴³ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 488.

¹⁰⁴⁴ Rudolf Dolzer and Christoph Schreuer, Principles of International Investment Law, 2008, page 150 (**Exhibit R-299**).

¹⁰⁴⁵ Noble Ventures, Inc. v. Romania, ICSID Case No. ARB/01/11, Award, 12 October 2005, para. 165/ 166 (**Exhibit R-66**).

administered government could be expected to exercise under similar circumstances. [...] It is not an absolute obligation which guarantees that no damages will be suffered, in the sense that any violation thereof creates automatically a “strict liability” on behalf of the host State.”¹⁰⁴⁶

977 In *AMT v. Zaire* the tribunal confirmed this understanding of the provision:

“[T]he obligation incumbent on [the host state] is an obligation of vigilance, in the sense that [the host state] shall take all measures necessary to ensure the full enjoyment of protection and security of its investments and should not be permitted to invoke its own legislation to detract from any such obligation.”¹⁰⁴⁷

978 Claimants acknowledge that these cases confirm that State’s duty to comply with its obligation to provide full protection and security requires the state only to take reasonable measures.¹⁰⁴⁸ Surprisingly, they then contend that the cases only confirm the duty to implement reasonable measures because the “*tribunals needed to determine whether the acts in question were attributable to the host state [whereas in the case at present] [t]here is no issue of state attribution [...]*.”¹⁰⁴⁹ Claimants fail to explain why the individual factual circumstances of each case should have an impact on the general principles generated and expounded by tribunals at all. Tribunals have always been and have always had to be in a position to establish and rely on general principles irrespective of the case at hand because of the principle of legal certainty. Notwithstanding a lack of formal precedent, tribunals in investment disputes do rely on decisions of previous tribunals wherever they can to strengthen the predictability of decisions and to enhance their authority.¹⁰⁵⁰ Therefore, the facts of the case do not alter

¹⁰⁴⁶ Asian Agricultural Products Ltd. (AAPL) v. Democratic Socialist Republic of Sri Lanka, ICSID Case No. ARB/87/3, Award, 27 June 1990, para. 320/ 545 (**Exhibit C-255**).

¹⁰⁴⁷ American Manufacturing and Trading, Inc. v. Zaire, ICSID Case No. ARB/93/1, Award, Award, 21 February 1997, para. 28 (**Exhibit C-256**).

¹⁰⁴⁸ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 489.

¹⁰⁴⁹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 489.

¹⁰⁵⁰ Christoph Schreuer and Matthew Weiniger, *Conversations Across Cases - Is There a Doctrine of Precedent in Investment Arbitration?*, 2007, page 1 (**Exhibit R-302**).

the general principle that the duty of full protection and security is restricted by a concept of reasonableness.

979 23 The Claimants allege that a limited interpretation of the scope of Article 10(1) of the ECT (whereby it is necessary but also sufficient to implement reasonable measures) “*effectively conflates the “most constant protection and security” standard with the obligation to provide effective means to assert claims and enforce rights under Article 10(12) of the ECT.*”¹⁰⁵¹

980 Article 10 (12) of the ECT stipulates:

“Each Contracting Party shall ensure that its domestic law provides effective means for the assertion of claims and the enforcement of rights with respect to Investments, investment agreements, and investment authorizations.”

981 Whilst Article 10 (12) of the ECT requires the host state to implement reasonable measures of assertion of claims and enforcement of rights, Article 10(1) of the ECT requires the host state to implement reasonable measures of protection and security.¹⁰⁵² In particular, the guarantee under Article 10(12) of the ECT refers to the legislative obligation of a host State to provide a fair and efficient system of justice. This illustrates the systematic coherence of the individual provisions within the ECT, not their conflation. By drawing the comparison between Article 10(1) of the ECT and Article 10(12) of the ECT, Claimants thus reinforce the fact that the implementation of reasonable measures is sufficient in terms of Article 10(1) of the ECT.

2. The Republic’s provision of most constant protection and security of Claimants’ investments

982 As established above, the duty of most constant protection and security requires a host state to diligently implement reasonable mechanisms of protection.¹⁰⁵³ Claimants have not challenged that the Republic disposes of the necessary legal framework to provide protection to foreign investors

¹⁰⁵¹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 488.

¹⁰⁵² See above section D.VII.

and investments from physical damage or violence. Yet, it is Claimants who need to prove the absence of reasonable measures. Since they have failed to establish such absence, their claim fails on this ground alone.

983 Apart from this, the legal and administrative system of the Republic is indeed sufficiently developed and refined to the extent which can be expected from a vigilant state exercising due diligence. The Republic has enacted sufficient laws to protect nationals and foreign investors alike from any physical harm.

984 Even if the scope of Article 10(1) of the ECT was not restricted to the duty to implement reasonable measures for protection - which, as explained above, it is¹⁰⁵⁴ - Claimants still fail to establish that prerequisites of this provision have not been met in this case. In their Reply Memorial on Jurisdiction and Liability Claimants contend that the Republic violated the guarantee by not providing the necessary physical security of Claimants' assets.¹⁰⁵⁵ This reasoning is flawed.

985 It is undisputed that Claimants and their assets have not been physically harmed and that not a single one of their representatives has been hurt. In particular, Mr. Cornegruta and the other senior in-country managers of KPM and TNG were not injured. As explained above, Mr. Cornegruta received a fair trial and the verdict was upheld upon appeal.¹⁰⁵⁶ The alleged harassment of company staff during the investigations did not result in any physical harm of the employees either. Although Claimants contend that the investigations rendered KPM and TNG an unsafe place to work¹⁰⁵⁷, they have not offered any proof thereof because, again, not a single employee has been injured during these inspections and investigations. Apart from that, as has been established above, company staff have never been harassed but have rather experienced ordinary concomitants of lawful investigations.

986 Moreover, the Republic has not taken over KPM and TNG by use of force. Instead, their assets have been held in trust management ever since they

¹⁰⁵³ See above section D.VII.

¹⁰⁵⁴ See above section D.VII.

¹⁰⁵⁵ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 493.

¹⁰⁵⁶ See above sections C.VI., C.VII., C.VIII.

¹⁰⁵⁷ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 485.

had been abandoned by Claimants.¹⁰⁵⁸ But even if the Republic had taken over KPM and TNG by use of force - which it has not - this would not amount to physical violence. As has been decided recently by the tribunal in *SAUR International SA v. Republic of Argentina*, the take-over of an investment does not violate the guarantee of full protection and security, even if the host state safeguards civil peace by police presence in the area as a precautionary measure.¹⁰⁵⁹

987 Therefore, the Republic did not violate Article 10(1) of the ECT.

988 Finally, to demonstrate a breach of Article 10(1) of the ECT, the investor needs to establish that the host state has not provided reasonable measures of protection and security and in addition that the alleged losses and injuries would have been prevented but for the alleged insufficiency of reasonable measures:

*“[E]ven if one concluded that there was a certain failure on the side of the [host state] sufficiently grave to regard it a violation, it [needs to be] established that non-compliance with the obligation prejudiced the Claimant, to a material degree.”*¹⁰⁶⁰

989 Claimants have not addressed this issue at all. Therefore, they have failed to establish that the prerequisites of Article 10(1) of the ECT are not fulfilled.

VIII. Fair and equitable treatment

990 The Republic acted throughout its dealings with KPM and TNG in a way which was consistent with the expectations of investors and consistent with any legitimate expectations that KPM and TNG could reasonably have had.

991 The allegation that the Republic is in breach of fair and equitable obligations under the ECT is a typical example of how Claimants try to

¹⁰⁵⁸ See above sections C.IX.2.

¹⁰⁵⁹ *SAUR International SA v. Republic of Argentina*, ICSID Case No. ARB/04/4, Award, 6 June 2012, para. 510 (**Exhibit R-303**).

¹⁰⁶⁰ *Noble Ventures, Inc. v. Romania*, ICSID Case No. ARB/01/11, Award, 12 October 2005, para. 166 (**Exhibit R-66**).

pass off the Republic's adherence to due process as part of a so-called "strategy of obstructionism"¹⁰⁶¹, a figment of Claimants' imagination.

1. No case that the Republic acted unfairly and inequitably where available remedies were not pursued

992 In their Reply Memorial on Jurisdiction and Liability, Claimants challenge the Republic's argument that local law remedies were not pursued, barring Claimants from invoking a breach of the fair and equitable standard.¹⁰⁶²

993 To reiterate the Republic's position, the standard of fair and equitable treatment needs to be considered against all the factual circumstances. In a situation where the state action that the injured party claims of is one which the aggrieved party has been granted a right to resolve at a local level, there can be no conclusion that the state has acted unfairly and inequitably if the aggrieved party has not actually pursued those rights. In other words, a state (acting fairly and equitably) may provide an opportunity (through the provision of contractual protection or through the court system) for the claimant to seek redress of actions taken by the state that may have been incorrect. This might apply to a decision of a first instance court or the actions of an administrative official. This is a fundamental part of providing a fair and equitable as well as stable and predicable environment for the investment. As set out in *Helnan v Egypt*,¹⁰⁶³ a treaty claim for the breach of fair and equitable treatment is likely to be less successful where the claimant has not been able to show that the system of investment protection in the host state has been unfair and inequitable *vis-a-vis* the aggrieved party.¹⁰⁶⁴

994 Claimants say that *Helnan v Egypt* does not support this contention.¹⁰⁶⁵ This is incorrect. The basic principle in international law is that the parties should exhaust local law remedies first prior to pursuing rights through diplomatic protection. In investor-state arbitration as a matter of

¹⁰⁶¹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 24.

¹⁰⁶² Statement of Defence dated 21 November 2011, section 37.2 to 37.23.

¹⁰⁶³ *Helnan International Hotels A/S v Arab Republic of Egypt*, ICSID Case No. ARB/-5/19, Decision on the Application of the Annulment, 14 June 2010 (**Exhibit R-88**).

¹⁰⁶⁴ Statement of Defence dated 21 November 2011, para 37.11.

¹⁰⁶⁵ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, paras 498.

jurisdiction, the exhaustion of local remedies is often not required since the parties agree in advance to resolve their disputes through arbitration. Therefore, this rule is dispensed with unless the parties agree otherwise.¹⁰⁶⁶

995 However, the Republic's argument here is not (as Claimants seem to suggest)¹⁰⁶⁷ a question of jurisdiction, nor that the "exhaustion of local remedies" as such is required. Rather, this situation concerns circumstances where the claimant alleges that certain domestic laws have been breached, and that accordingly, the standard of fair and equitable treatment has been not been met. The Republic's contention is that the claimants have not established that a breach of the standard of fair and equitable treatment (judged at an international level) has occurred simply by alleging that there have been breaches of law at a domestic level. This is all the more the case when there are available to the claimant, avenues of recourse which have not in fact been pursued. As set out comprehensively in the Statement of Defence, this is precisely the case here.

996 Therefore the fact that *Helnan* Annulment Committee emphasises this distinction does nothing to lessen the force of the Republic's assertion.¹⁰⁶⁸

2. Claimants accept that available remedies were not pursued

997 Claimants do not challenge the Republic's assertions that the remedies available against the Republic were not in fact pursued. They actually say that "*further pursuit of domestic remedies would have been futile.*"

998 Instead they choose to describe the Republic's stance that the treatment was not unfair or inequitable as "farcical". This characterisation dismisses this issue as if it were a minor technical hitch and quickly go on to simply reiterate their grievances against the Republic. However, if Claimants fail to demonstrate that they pursued remedies available, then the claim is, in effect, barred. There is no legal basis for recovery. In any event, considering all the facts of the case, there is no breach of the fair and equitable standard.

¹⁰⁶⁶ Douglas, Z., *The International Law of Investment Claim*, paras. 56 to 59 (**Exhibit R-304**).

¹⁰⁶⁷ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, paras. 499 and 500.

¹⁰⁶⁸ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, 498.

999 As to the Republic’s other legal arguments, Claimants respond by simply saying that “*literally dozens of treaty tribunals*” have found violations of the standard in cases where the treatment was, in their view, “*less severe*” than that experienced by Claimants here and also say that the fair and equitable treatment standard is a “dominant” standard of investment treaty law. However, notably Claimants leave unchallenged the Republic’s observations as to the high bar for a finding of breach in relation to this standard.¹⁰⁶⁹

1000 Further, they say nothing to counter the Republic’s observation that the vagaries of the standard mean that the specific facts of the case and all the surrounding facts are important: it is not good enough to simply trot out again (repeating the Statement of Defence) examples where tribunals may have come to a finding that helps Claimants’ arguments.¹⁰⁷⁰

3. Fair and Equitable Standard was not breached in this case

1001 As to the “facts” that give rise to the alleged breach, Claimants now focus on four events.¹⁰⁷¹ In each case, no breach of fair and equitable treatment can be established for two reasons. Firstly, each is a case where Claimants could have and should have pursued the issue further using the official systems put in place by the Republic.¹⁰⁷² Secondly, Claimants misconstrue the facts to create a distorted and fictional picture in their favour.

1002 Claimants allege that the “reclassification” of the KPM Pipeline breached fair and equitable standards.¹⁰⁷³ The Republic refers to Section C.VI of this Rejoinder Memorial on Jurisdiction and Liability which explains in detail how Claimants have misconstrued the events that comprised the Financial Police’s inspection and investigation of the pipeline issue, suggesting, wrongly that the Republic had premeditated the outcome that resulted in the prosecution of Mr Cornegruta on behalf of KPM. In any case, there was

¹⁰⁶⁹ Statement of Defence dated 21 November 2011, paras. 37.24 to 37.28

¹⁰⁷⁰ Statement of Defence dated 21 November 2011, paras. 37.32 to 37.34. Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, para 501.

¹⁰⁷¹ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, paras. 503 to 516.

¹⁰⁷² See Statement of Defence dated 21 November 2011, paras 37.19 and 37.20 for further detail.

¹⁰⁷³ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, paras. 504 to 507.

no “reclassification” and therefore it is not possible that this activity was unfair or inequitable. The pipeline was always a trunk pipeline.

- 1003 The Financial Police’s inspection and investigation was carried out in accordance with due process and the laws prevailing at the time. The classification of pipelines is a legal question and one that in the case of a dispute should be resolved by reference to the judicial authorities. As such, classification decisions are not finally determined by industry specialists, technical court experts in pipeline design, the MEMR, ARNM, or, for that matter, TNG or KPM. Moreover, the Financial Police is not a competent authority for the classification of pipelines, nor as it ever held itself out to be such. This is why the Financial Police spent a number of months in late 2008 and early 2009 collating the necessary evidence regarding the pipeline and its operation by KPM.
- 1004 Claimants suggest that the Republic admits that its laws are confusing, citing reference to the Judicial Executor’s decision. This misconstrues the Republic’s assertion which was simply that the way in which the Judicial Executor referred to the pipeline did not make it clear whether the pipeline was trunk or field: there was no statement by the Judicial Executor that the law was confusing. On the facts of this case, it is accepted that there were different views as to the correct classification of the pipeline. Since the application of the law always depends on the facts, it is not uncommon for there to be disagreement as to whether or not a particular law does or not apply, or how it applies. However, this does not lead to the inevitable conclusion that the law is unclear. More importantly, it does not absolve KPM and Mr Cornegruta from the consequences of their illegal operation of the KPM Pipeline.
- 1005 Claimants continue to contend that Mr Cornegruta’s conviction and the recovery of income from KPM was contrary to fair and equitable treatment standards. For the reasons set out in Section C.VI to C.VIII, this is not the case. In any event, Mr Cornegruta could have appealed any decision against him to the Supreme Court. Similarly, KPM had an opportunity to challenge the recovery order and failed to do this within the correct time limits. Since he did not, Claimants are not now entitled to complain that the Republic’s treatment of him was unfair.

- 1006 In relation to the “*harassment and coercion campaign*”¹⁰⁷⁴ there simply was no such campaign against KPM or Claimants. The Republic refers to Sections C.I and C.II of this Rejoinder Memorial on Jurisdiction and Liability in particular. In any case, Claimants’ case is contradictory. On the one hand, they say that there was a “Playbook” employed by the Republic and wheeled out against systemically every foreign investor. At the same time, they argue that the campaign was unfair. At the very least, it must be recognised that if there was such a “Playbook” that was employed by the Republic (which is denied), its employment cannot, by definition, be “unfair” or “inequitable”.
- 1007 Finally, with regard to the non-extension of Contract 302, Claimants’ allegations equally amount to zero.¹⁰⁷⁵ It is not correct that the Republic ever agreed to an extension of the contract or that Claimants could rely on such an extension being granted. That is because the process for an agreement had simply not been gone through.¹⁰⁷⁶ The document that Claimants rely on as “proof” of a promise to extend the contract was a mere intermediate step in the process of reaching an agreement. It could not cause any reliance on the part of Claimants. Rather, the simple fact that no extension was agreed and signed created all the legal security that Claimants could expect, though to a different effect as they may have hoped for.
- 1008 Claimants’ further arguments with regard to the termination of Contract 302 are downright confusing.¹⁰⁷⁷ Claimants seem to allege that the MOG’s notice of infringement of obligations prior to the contract termination somehow created reliance on the side of Claimants that the contract would be extended. It should be self-explanatory that a statement noting contract infringements cannot create any expectation of contract extension.

¹⁰⁷⁴ Reply Memorial on Jurisdiction and Liability dated 21 November 2011, paras. 508 to 511.

¹⁰⁷⁵ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, para. 514, 516.

¹⁰⁷⁶ See above section C.V.

¹⁰⁷⁷ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, para. 516.

IX. Unreasonable or discriminatory measures

1009 In their Reply Memorial on Jurisdiction and Liability, Claimants allege that the Republic has violated the duty to refrain from unreasonable or discriminatory measures impairing the investments pursuant to Article 10(1) of the ECT.¹⁰⁷⁸ They begin their section by listing five cases in which the tribunals found the respective host state to have violated this duty.¹⁰⁷⁹ However, whilst other host states may well have breached the impairment clause, the Republic has adhered to its obligations under Article 10(1) of the ECT at all times. Its measures were neither unreasonable nor discriminatory, nor was the management, maintenance, use, enjoyment or disposal of Claimants' investments impaired in any way.

1. The Republic's measures were not unreasonable

1010 Claimants contend that the high threshold for unreasonableness carved out by the ICJ in the ELSI case is not authoritative and that the Republic's acts and omissions need to be regarded as unreasonable, even if the ELSI threshold was applicable.¹⁰⁸⁰ This reasoning is flawed.

a) Meaning of "unreasonable"

1011 According to Article 31(1) of the Vienna Convention, a treaty shall be interpreted in accordance with the ordinary meaning of its terms. The ordinary meaning of "*unreasonable*" is "*irrational; foolish; unwise; absurd; silly; preposterous; senseless; stupid*".¹⁰⁸¹

1012 In contrast, the conventional approach in investment treaty arbitrations introduces an element of shocking or at least surprising effect to the ordinary meaning of "*unreasonable*". This effect has been instructively described by the ICJ in the ELSI case:

"[B]y itself, and without more, unlawfulness cannot be said to amount to arbitrariness. [...] To identify

¹⁰⁷⁸ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, para. 517.

¹⁰⁷⁹ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, para. 517.

¹⁰⁸⁰ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, paras. 519, 524.

¹⁰⁸¹ National Grid P.L.C. v. The Argentine Republic, UNCITRAL, Award, 3 November 2008, para. 197 (**Exhibit C-269**).

arbitrariness with mere unlawfulness would be to deprive it of any useful meaning in its own right. [...] Arbitrariness is not so much something opposed to a rule of law, as something opposed to the rule of law. [...] It is a willful disregard of due process of law, an act which shocks, or at least surprises, a sense of judicial propriety."¹⁰⁸²

1013 As Claimants agree¹⁰⁸³, the term “unreasonable” is interchangeable with the term “arbitrary”.¹⁰⁸⁴ For this reason, the definition of the term “arbitrariness” by the ELSI court can be transferred onto the term “unreasonable” in the sense of Article 10(1) of the ECT.

1014 The relationship between the ordinary meaning of the term “unreasonable” on one hand and its meaning as described by the ICJ in the ELSI case is not completely clear.

1015 Claimants contend that the definition in the ELSI case does not accord with the ordinary meaning of the term as required by customary international law¹⁰⁸⁵, whereas some tribunals point out the striking similarities in both definitions:

*“The tribunal finds that the definition in ELSI is close to the ordinary meaning of arbitrary since it emphasizes the element of wilful disregard of the law.”*¹⁰⁸⁶

1016 While Claimants seem to have noted such similarities,¹⁰⁸⁷ they overlook the apparent conclusion: given the similarities of both definitions, customary international law and the ELSI case both establish a high threshold for measures to be “unreasonable”.¹⁰⁸⁸ This is illustrated by the fact that in

¹⁰⁸² Elettronica Sicula S.p.A. (ELSI), Judgement (20 July 1989), I.C.J. Reports 1989, page 15, para. 124, 128 (**Exhibit R-81**).

¹⁰⁸³ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, para. 518.

¹⁰⁸⁴ Schreuer, Protection against Arbitrary or Discriminatory Measures, in: C. A. Rogers/ R. P. Alford (Eds.), The Future of Investment Arbitration, 2009, page 183 (**Exhibit R-180**).

¹⁰⁸⁵ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, para. 519.

¹⁰⁸⁶ Azurix Corp. v. Argentine Republic, ICSID Case No. ARB/01/12, Award, 14 July 2006, para. 392 (**Exhibit C-245**); c.f. Siemens v. Argentine Republic, ICSID Case No. ARB/02/8, Award, 6 February 2007, para. 318 (**Exhibit C-232**).

¹⁰⁸⁷ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, para. 520, 522.

¹⁰⁸⁸ Cf. Stone, Leiden Journal of International Law 2012, 77 (77) (**Exhibit R-305**).

three of the cases, which Claimants cite to support their view that the term “*unreasonable*” should be read in accordance with its ordinary meaning, tribunals have ruled that the respective measures of the host state have not reached the allegedly low threshold of unreasonableness.¹⁰⁸⁹ In *National Grid v. Argentina*, for example, the tribunal explained:

*“It is clear from the evidence before the Tribunal that the Measures were taken by the Respondent in the context of an unfolding crisis. They may have contradicted commitments made to the Claimant but each one of them provided the reasons why it was taken.”*¹⁰⁹⁰

1017 However, the majority of scholars and tribunals are of the view that the definition carved out in the ELSI case entails a higher threshold than the definition according to customary international law referring to the ordinary meaning of the term “*unreasonable*”:

*“[T]he non-impairment standard imposes a standard of conduct on governments that is arguably substantially higher than that required by customary international law.”*¹⁰⁹¹

1018 The fact that the ELSI standard establishes a higher threshold than the ordinary meaning of “*unreasonable*” under customary international law suggests is supported by anecdotal evidence. Whilst approximately 30 percent of arbitral tribunals find certain state measures to amount to unreasonable or arbitrary conduct overall, only 22 percent of those that applied the ELSI standard or a similar higher threshold arrive at the same conclusion.¹⁰⁹² Vice versa, it is because of the high threshold established in the ELSI case that findings of unreasonableness or arbitrariness are rare.¹⁰⁹³

¹⁰⁸⁹ LG&E v. Argentine Republic, ICSID Case No. ARB/02/1, Award, 25 July 2007, para. 162 (**Exhibit C-314**); National Grid P.L.C. v. The Argentine Republic, UNCITRAL, Award, 3 November 2008, para. 198 (**Exhibit C-269**); EDF (Services) Ltd. v. Romania, ICSID Case No. ARB/05/13, Award, 8 October 2009, para. 305 (**Exhibit C-576**).

¹⁰⁹⁰ National Grid P.L.C. v. The Argentine Republic, UNCITRAL, Award, 3 November 2008, para. 198 (**Exhibit C-269**).

¹⁰⁹¹ Veijo Heiskanen, *Arbitrary and Unreasonable Measures* in: A. Reinisch (Ed.), *Standards of Investment Protection*, Oxford University Press, 2008, pages 101, 110 (**Exhibit R-306**).

¹⁰⁹² Stone, *Leiden Journal of International Law* 2012, 77 (97) (**Exhibit R-305**).

¹⁰⁹³ Stone, *Leiden Journal of International Law* 2012, 77 (107) (**Exhibit R-305**).

1019 The required effect of shock or at least surprise included in the ELSI standard introduces a “*something more criterion*”¹⁰⁹⁴ to the irrational conduct sufficing within the ordinary meaning of “*unreasonable*”. Therefore, most tribunals and scholars agree that the definition carved out in the ELSI case entails a higher threshold than the definition according to customary international law referring to the ordinary meaning of the term “*unreasonable*”.

1020 Claimants allege that “*the ELSI standard for arbitrary treatment has been the target of much criticism.*”¹⁰⁹⁵ This is not true. Whilst there may exist scattered voices of dissent like in the wake of probably every decision by an international court or tribunal, the overwhelming majority of scholars and tribunals in later cases have applauded the reasoning in the ELSI case:

“*[ELSI] is the landmark case for the definition of arbitrariness at international law.*”¹⁰⁹⁶

1021 Many tribunals have readily adopted the definition of the ELSI court.¹⁰⁹⁷ In the words of the tribunal in *Siemens v. Argentine*:

“*[T]he Tribunal considers that the definition in ELSI is the most authoritative interpretation of international law [...].*”¹⁰⁹⁸

1022 The adoption of a lower threshold would result in classifying all governmental regulations adversely affecting foreign investors as inherently suspect, thereby shifting the burden of proof from the foreign investor to the host state.¹⁰⁹⁹ Forcing host states to demonstrate that their measures were not unreasonable because there were no less restrictive alternatives available would clearly contradict the *onus probandi* rule. For this reason the ELSI standard is widely deemed to be the most authoritative interpretation of the term “*unreasonable*”. Furthermore, in view of the

¹⁰⁹⁴ Stone, *Leiden Journal of International Law* 2012, 77 (88) (**Exhibit R-305**).

¹⁰⁹⁵ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, para. 519, 522.

¹⁰⁹⁶ Stone, *Leiden Journal of International Law* 2012, 77 (88) (**Exhibit R-305**).

¹⁰⁹⁷ Stone, *Leiden Journal of International Law* 2012, 77 (94) (**Exhibit R-305**).

¹⁰⁹⁸ *Siemens v. Argentine Republic*, ICSID Case No. ARB/02/8, Award, 6 February 2007, para. 318 (**Exhibit C-232**).

¹⁰⁹⁹ Veijo Heiskanen, *Arbitrary and Unreasonable Measures in: A. Reinisch (Ed.), Standards of Investment Protection*, Oxford University Press, 2008, page 106 (**Exhibit R-306**).

vagueness of all definitions of “*unreasonable*”, the legal assessment of whether a certain measure is unreasonable or not remains a subjective process prone to unequal treatment and misjudgement.¹¹⁰⁰ This forms another reason why a high threshold is justified.

1023 In some cases, the ELSI standard has even been further developed and refined.

1024 In *Genin v. Estonia*, for example, the tribunal picked up on the requirement of the wilful disregard of due process of law established by the ELSI court and explained:

*“[I]n order to amount to a violation of the BIT, any procedural irregularity that may have been present would have to amount to bad faith, a wilful disregard of due process of law or an extreme insufficiency of action.”*¹¹⁰¹

1025 The tribunal in *CME v. The Czech Republic* emphasized the significance of the host state’s intention to deprive the investor of its investment under the pretext of a decision based on law:

*“On the face of it, the [host state’s] actions and inactions in 1996 and 1999 were unreasonable as the clear intention of the 1996 actions was to deprive the foreign investor of the exclusive use of the Licence under the MOA and the clear intention of the 1999 actions and inactions was collude with the foreign investor’s Czech business partner to deprive the foreign investor of its investment.”*¹¹⁰²

1026 In *Enron v. Argentina* and *Sempra v. Argentina*, the tribunals also elaborated on a subjective element which formed an integral part of their understanding of the term “*arbitrary*”:

“They were not, however, arbitrary in that they responded to what the Government believed and understood to be the

¹¹⁰⁰ Stone, *Leiden Journal of International Law* 2012, 77 (107) (**Exhibit R-305**).

¹¹⁰¹ *Genin, Eastern Credit Ltd. Inc. and AS Baltoil v. The Republic of Estonia*, Award, 25 June 2001, para. 371 (**Exhibit R-107**).

¹¹⁰² *CME Czech Republic B.V. v. The Czech Republic*, UNCITRAL, Partial Award, 13 September 2001, para. 612 (**Exhibit C-229**).

best response to the unfolding crisis. Irrespective of the question of intent, a finding of arbitrariness requires that some important measure of impropriety be manifest. This is not found in a process which, although far from desirable, is nonetheless not entirely surprising in the context in which it took place.”¹¹⁰³

1027 According to the tribunal in *Noble v. Romania*, an action is not unreasonable if proceedings of the kind in question are provided in all legal systems and for much the same reasons, especially if the proceedings are conducted in accordance with domestic law.¹¹⁰⁴ This approach reflects the fact that all states are comparable to the extent that they equally prohibit arbitrary conduct in principle. By argumentum e contrario, only a measure which falls short of even such minimum standard will be unreasonable.

b) Prerequisites not fulfilled

1028 In their Reply Memorial on Jurisdiction and Liability Claimants allege that “*Kazakhstan’s conduct was so egregiously arbitrary that it falls well within the ELSI standard, even if that standard were applicable.*”¹¹⁰⁵ Quite the contrary, the Republic’s measures did not reach the threshold of unreasonableness incorporated by the ordinary meaning of the term, let alone the one stipulated by the ICJ in ELSI.

1029 First, Claimants allege that the Republic’s classification of KPM’s and TNG’s pipelines as trunk pipelines was unreasonable.¹¹⁰⁶ However, Claimants had operated trunk pipelines without a licence. This was confirmed by the Republic’s independent courts, warranting criminal proceedings and the levy of a fine. The due amount of this fine was equally assessed by an independent court. Also, the Republic only took enforcement measures and froze KPM’s assets upon non-payment of the fine. In conclusion, the Republic applied the law correctly and its

¹¹⁰³ *Enron v. The Argentine Republic*, Award, 22 May 2007, para. 281 (**Exhibit C-263**); *Sempra v. The Argentine Republic*, Award, 28 September 2007, para. 318 (**Exhibit C-265**).

¹¹⁰⁴ *Noble Ventures, Inc. v. Romania*, ICSID Case No. ARB/01/11, Award, 12 October 2005, para. 178 (**Exhibit R-66**).

¹¹⁰⁵ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, para. 524.

¹¹⁰⁶ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, para. 524.

classification of KPM's and TNG's pipelines as trunk pipelines was not unreasonable.

- 1030 Claimants continue by suggesting it was unreasonable of the Republic to arrest, convict and incarcerate Mr. Cornegruta.¹¹⁰⁷ As to arrest, Mr. Cornegruta had been identified by the Financial Police as the likely individual responsible on behalf of KPM for illegal entrepreneurship under Section 190(b) of the Criminal Code of Kazakhstan. The decision to arrest him was taken on valid ground by the court in accordance with the relevant provisions of the criminal code. As to the reasonableness of the decision to convict Mr. Cornegruta, the sections on “Criminal investigation: Inspections, Investigations, Trial” above describes in detail the extensive inspection and investigation procedure that took place prior to the trial. During trial, process was a key part of the way in which the decision and the later appeal of the decision against Mr. Cornegruta was taken. The actions of the various authorities were taken within the law.
- 1031 Subsequently, Claimants contend that the Republic's “*criminal verdict against the non-party KPM*” amounted to an unreasonable measure.¹¹⁰⁸ However, as set out above,¹¹⁰⁹ the recovery order was necessary in order to correct the unjust enrichment of KPM resulting from the criminal act of operating the main pipeline without a license. Importantly, contrary to Claimants' allegations, the recovery order was made in a perfectly proper procedure in which KPM was represented through its manager, Mr. Cornegruta.
- 1032 Claimants also contend that it was unreasonable for the Republic to “*retroactive[ly] revers[e] [its] approval of the transfer of TNG to Terra Raf and the waiver of its pre-emptive rights*”.¹¹¹⁰ However, Claimants actually failed to apply for the Republic's consent at the time of the transfer itself and they failed to prove that their belated request (after being prompted by the MEMR) was legitimate under Kazakh law. Furthermore, under Kazakh law, the Republic had the discretion to either approve or disapprove the transfer. Even if the Republic had approved of the transfer in the first place, a revocation of this approval was completely

¹¹⁰⁷ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, para. 524.

¹¹⁰⁸ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, para. 524.

¹¹⁰⁹ See above C.VIII.7.a).

lawful because Claimants wrongly informed the Republic about the significant details of the transfer including the date when the transfer occurred, which impacted on whether a waiver to its pre-emptive right was required.¹¹¹¹ Hence, the revocation of the alleged approval was not unreasonable.

1033 Moreover, Claimants complain that the Republic's refusal to extend TNG's exploration period in the Contract 302 Properties was unreasonable.¹¹¹² In fact, under Kazakh law, the Republic was not legally bound to extend or refuse to extend the exploration period in the Contract 302 Properties. Also, since the Republic had not signed the necessary addendum, Claimants could not rely on a prolongation of the exploration period.¹¹¹³ Thus, the refusal to extend TNG's exploration period in the Contract 302 Properties was not an unreasonable measure.

1034 Claimants continue by alleging that the Republic's imposition of the Crude Oil Export Duties on KPM was another unreasonable measure.¹¹¹⁴ In reality, Claimants' invoked tax deductions which were provided for under Kazakh law or were withdrawn by the relevant authorities before any payment was made by KPM. This was confirmed by the independent Kazakh courts which found KPM to be liable for paying the Crude Oil Export Duties.¹¹¹⁵ Therefore, the Republic's assessment of Crude Oil Export Duties was lawful and not unreasonable.

1035 Finally, Claimants contend that it was unreasonable to repudiate KPM's and TNG's Subsoil Use Contracts.¹¹¹⁶ The Republic was entitled to terminate these contracts because of valid grounds for termination.¹¹¹⁷ Hence, the termination of KPM's and TNG's Subsoil Use Contracts cannot be deemed an unreasonable measure.

1036 In particular, as more specifically set out in the introduction to the section on direct expropriation, Claimants were in continuing and serious breach of

¹¹¹⁰ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, para. 524.

¹¹¹¹ See section B.IV.4.a)

¹¹¹² Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, para. 524.

¹¹¹³ See section C.V.

¹¹¹⁴ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, para. 524.

¹¹¹⁵ See section C.IV.

¹¹¹⁶ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, para. 524.

¹¹¹⁷ See above section C.IX.

the Contracts. In accordance with its rights to do so, the Republic terminated the Contracts and Claimants' assets were taken into a specific trust arrangement. Claimants could have resolved this issue amicably by invoking one of the mechanisms in the Contracts or, indeed, complying with the voluntary mechanism in the Subsoil Law at article 72(10) for handing over of assets to the trust and appealing the decision in accordance with Article 73 of the Subsoil Law. The opportunity to resolve this issue in accordance with the Contracts themselves and/or the Subsoil Law was sidestepped by Claimants by filing substantive proceedings only five days after the terminations. It is difficult to see how this behaviour can be considered unreasonable under the relevant test.

1037 In summary, the Republic's actions and inactions were lawful and not irrational or senseless in terms of the ordinary meaning of "unreasonable". *A fortiori*, the Republic's measures were not surprising, let alone shocking to a sense of judicial propriety in terms of the ELSI standard. Therefore, the Republic has not undertaken any unreasonable measures with respect to Claimants. This is confirmed by the fact that unlike the Czech Republic in the CME case the Republic had no intention of depriving Claimants of their investments. Moreover, the measures undertaken by the Republic are provided in all legal systems and for much the same reasons, just like Romania's measures were in *Noble v. Romania*.

2. The Republic's measures were not discriminatory

1038 Claimants allege that the burden of proof regarding discriminatory measures has shifted to the Republic and that the Republic's actions and inactions need to be qualified as discriminatory measures.¹¹¹⁸ However, these considerations do not have any merit.

1039 As Claimants agree, a state conduct is discriminatory, if similar cases are treated differently and without reasonable justification.¹¹¹⁹

1040 Numerous tribunals have confirmed that the foreign investor needs to prove that its case and a reference case are similar and that the host state has

¹¹¹⁸ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, paras. 525, 527.

¹¹¹⁹ *Saluka Investments B.V. v. The Czech Republic*, Partial Award, 17 March 2006, para. 313 (**Exhibit C-259**).

treated these cases differently.¹¹²⁰ Once this has been demonstrated by the foreign investor, the host state is required to prove there is a reasonable justification for the differential treatment of the cases.¹¹²¹

1041 First, Claimants contend to have proven that the Republic treated similar cases differently with respect to the classification of pipelines.¹¹²² They allege that neighbouring companies to KPM and TNG, including KazakhTurkMunai and companies throughout Kazakhstan own and operate similar pipelines as part of their in-field gathering system.¹¹²³ Claimants try to support this proposition by reference to the First Romanosov Statement and the letter from KazakhTurkMunai to the Ministry of Oil and Gas dated 19 October 2011.¹¹²⁴ However, neither the First Romanosov Statement nor the letter from KazakhTurkMunai establishes that the pipelines owned and operated by KazakhTurkMunai show the features which require them to be classified as trunk pipelines nor have they demonstrated that, if such a pipeline is trunk, that KazakhTurkMunai do not hold trunk pipeline licences.

1042 Second, Claimants contend to have proven that the Republic treated similar cases differently with respect to the convictions following from the “main” pipeline charge.¹¹²⁵ However, Claimants do not offer any proof of this allegation. Instead, they quote statements by scholars on general ideas about discriminatory measures.¹¹²⁶ Claimants also seem to overlook the fact that the Republic has never conceded and will never concede that it singled out KPM and TNG for some campaign of harassment. In fact, Claimants have not named a single case where authorities did not initiate criminal proceedings after they had discovered the operation of a trunk pipeline without a license.

¹¹²⁰ BG Group Plc v. The Argentine Republic, UNCITRAL, Award, 24 December 2007, para. 357 (**Exhibit C-268**).

¹¹²¹ Nykomb Synergetics Technology Holding AB v. Latvia, SCC, Award, 16 December 2003, para. 4.3.2., lit a (**Exhibit C-281**); Feldman v. Mexico, ICSID Case No. ARB(AF)/99/1, Award, 16 December 2002, para. 183, (**Exhibit C-283**).

¹¹²² Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, paras. 526.

¹¹²³ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, paras. 526.

¹¹²⁴ First Romanosov Statement, para. 32; Letter from KazakhTurkMunai to the MoG dated 19 October 2011 (**Exhibit R-135.1**)

¹¹²⁵ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, paras. 528.

¹¹²⁶ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, paras. 528.

1043 In conclusion, Claimants have failed to prove the similarity between the cases of classification of pipelines and the conviction of Mr. Cornegruta and respective other cases. Even if they had demonstrated such similarity, Claimants have further failed to prove differential treatment of such cases.

3. No Impairment of investments

1044 In their Reply Memorial on Jurisdiction and Liability Claimants allege that the Republic's conduct impaired their investments.¹¹²⁷ This is not true.

1045 Again, contrary to the *onus probandi* rule, Claimants have failed to prove that the Republic's actions or omissions had any negative impact on the management, maintenance, use, enjoyment or disposal of their investments given Claimants' own mismanagement of KPM and TNG.

1046 First, Claimants allege that intrusive audits and inspections impaired the management, use and enjoyment of their investments.¹¹²⁸ Yet, companies of KPM's and TNG's size operating in the subsoil sector must be prepared to handle audits and inspections. The Republic has demonstrated that KPM and TNG were not subject to any more audits and inspections in the relevant period than other subsoil users. Further, when companies fail to comply with the law they must expect to be subject to audits and inspections, such as those initiated by the Financial Police in October and November 2008 and the General Prosecutor's Office in June and July 2010. The Republic has demonstrated that those audits and inspections were no more intensive than similar audits and inspections undertaken in relation to other companies that did not comply with the law. In addition, Claimants have still not proven how their daily management activities were affected, whether there was a cut in dividends and how and why Claimants could no longer dispose of KPM and TNG. Hence, the audits and inspections did not impair Claimants' management, use and enjoyment of their investments.

1047 Claimants continue by suggesting that a press release, which notified potential buyers that the Republic would assert a pre-emptive right over TNG and accused Claimants of having forged documents in order to

¹¹²⁷ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, paras. 529.

¹¹²⁸ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, paras. 530.

defraud Kazakhstan, impaired the disposal of their investments.¹¹²⁹ The so-called press release Claimants refer to is in fact the INTERFAX-KAZAKHSTAN news agency piece about the reversal of the pre-emptive rights waiver dated 18 December 2008.¹¹³⁰ Claimants ignore that the reversal of the pre-emptive rights waiver was perfectly lawful. Moreover, they have not provided sufficient proof that it was this news agency piece that caused Credit Suisse to step back from providing the bridge loan. Finally, the news agency piece is not attributable to the Republic.¹¹³¹ For this reason the so-called press release did not impair Claimants' disposal of their investments.

1048 Furthermore, Claimants contend that the financial burden of corporate back taxes, export duties and the audit of KPM and TNG with respect to transfer pricing impaired Claimants' management, use and enjoyment of their investments.¹¹³² However, neither KPM nor TNG paid any of the corporate back taxes or transfer price taxes. . Claimants have made no complaint and produce no evidence concerning payments of export duties by TNG. Furthermore, the evidence suggests that Claimants were not prevented from managing and enjoying their investments in the period in question. In any event, Claimants could not reasonably expect that no back taxes would be assessed and that the export duties would not be imposed because the Republic was entitled to the payment of these levies.¹¹³³ Therefore, the financial burden resulting from these taxes did not impair Claimants' management, use and enjoyment of their investments.

1049 Subsequently, Claimants allege that the Republic's refusal to extend the exploration period for the Contract 302 Properties impaired the management, use and enjoyment of their investments because this prohibited Claimants from establishing the full market value of these properties.¹¹³⁴ Claimants ignore that KPM and TNG could not reasonably expect the exploration period under Contract 302 to be extended because

¹¹²⁹ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, paras. 531.

¹¹³⁰ INTERFAX-KAZAKHSTAN news agency piece dated 18 December 2008 (**Exhibit C-141**).

¹¹³¹ See above section C.X.

¹¹³² Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, paras. 532.

¹¹³³ See above section C.IV.

¹¹³⁴ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, paras. 533.

the Republic was free to decide whether to prolong the contract or not.¹¹³⁵ Hence, the Republic's refusal to extend the exploration period for the Contract 302 Properties did not impair the management, use and enjoyment of their investments.

1050 Also, Claimants complain that the “*criminal proceedings against four then-existing and former general managers of KPM and TNG and a sham trial, conviction, and incarceration of Mr. Cornegruta*”¹¹³⁶ impaired the management, use and enjoyment of their investments because top personnel left the country and the Republic froze KPM's assets. Again, Claimants have failed to prove to the necessary standard how the criminal proceedings affected their daily management activities, whether there was a cut in dividends and how and why Claimants could no longer dispose of KPM and TNG. Therefore, it is not evident that the criminal proceedings really impaired Claimants' management, use and enjoyment of their investments. In particular, in respect of the repudiation of the alleged pre-emptive rights waiver, and the press release on the same day, Claimants have produced no evidence to suggest that the Republic was wrong in highlighting its concerns about the legality of Terra Raf's activities. As set out in the Statement of Defence at paragraphs 13.47(e)(ii) and (iii) it was perfectly appropriate to air its concerns to INTERFAX, given the suspicions that Claimants had. It cannot be concluded from this that Claimants' investments were affected (or that if they were, that this was inappropriate). In respect of paragraph 534, Claimants have not produced any persuasive evidence that the top management left the country by reason of the Republic's investigations into Claimants' illegal activities or that this impaired their investments.

1051 In *Lauder v. The Czech Republic* the tribunal found the measures to be arbitrary (and discriminatory) but it eventually concluded that no compensation was due because the losses sustained by the claimant were not directly or proximately caused by the measure which the tribunal found to be arbitrary:

¹¹³⁵ See above section C.V. .

¹¹³⁶ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, paras. 534.

*“The 1993 breach of the Treaty was too remote to qualify as a relevant cause for the harm caused.”*¹¹³⁷

1052 The case shows that Claimants need to establish that the alleged arbitrary measures have caused their alleged loss. This has not been addressed by Claimants, let alone demonstrated.

X. Observance of Obligations in terms of the Umbrella Clause

1053 In their Reply Memorial on Jurisdiction and Liability, Claimants allege that the umbrella clause embodied in the last sentence of Article 10(1) of the ECT covers not only contractual but also statutory and regulatory obligations, that the Subsoil Use Contracts and Contract No. 302 are relevant under the umbrella clause and that the Republic has violated the umbrella clause.¹¹³⁸ However, these arguments have no merit.

1. Scope of the Umbrella Clause

1054 Claimants deny that the scope of the umbrella clause is limited to contractual obligations because allegedly *“the language of the umbrella clause does not differentiate between contractual obligations as opposed to legislative or regulatory undertakings”*.¹¹³⁹ This is false.

1055 The determination of the scope of the umbrella clause hinges on the proper interpretation of its wording. It reads:

“Each Contracting Party shall observe any obligation it has entered into with an Investor or an Investment of an Investor of any other Contracting Party.”

1056 According to the Vienna Convention, the wording of the umbrella clause must be interpreted such that its scope is limited to contractual obligations. Indeed, it has consistently been interpreted in such way by scholars and tribunals alike.

¹¹³⁷ Ronald S. Lauder v. The Czech Republic, UNCITRAL, Award, 3 September 2001, para. 235 (**Exhibit R-307**).

¹¹³⁸ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, para. 536.

¹¹³⁹ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, para. 537.

a) Interpretation of the Umbrella Clause in accordance with the Vienna Convention

1057 According to Article 31(1) of the Vienna Convention, a treaty needs to be interpreted in compliance with the ordinary meaning of its terms:

“A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.”

1058 The ordinary meaning of the term “*to enter into*” in the umbrella clause according to Article 10(1) of the ECT is “*to undertake to bind oneself by (an agreement)*”¹¹⁴⁰. This meaning illustrates the consensual nature of the obligations in question. The use of the term “*with*” further indicates contractual obligations because statutes and regulations are not concluded *with* an individual party in one individual case. To the contrary, they apply in a general and abstract way to a multitude of people in a multitude of cases.

1059 Claimants explain their proposition that the scope of the umbrella clause extends to statutory and regulatory obligations along with contractual obligations by emphasizing the term “*any obligation*”.¹¹⁴¹ However, as Article 31(1) of the Vienna Convention clarifies, the context of the term is crucial. When taking into consideration the ordinary meaning of “*to enter into*”, the reference to “*any obligation a party enters into*” means “*any obligation a party has undertaken to bind itself to perform by an agreement*” and thus “*any contractual obligation*”.

1060 Claimants contend that four versions of the ECT refer not to “*obligations entered into*” but to “*obligations assumed with regard to*”.¹¹⁴² In reality, the term in the German version corresponds with the English wording “*to enter into*”¹¹⁴³ and the French and Spanish versions even contain the equivalents

¹¹⁴⁰ Oxford Concise Dictionary, 10th edition 2001, page 475 (**Exhibit R-308**).

¹¹⁴¹ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, para. 537.

¹¹⁴² Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, para. 537.

¹¹⁴³ The German equivalent for „*to enter into*“ is „*eingehen*“.

of the verb “*to contract*”.¹¹⁴⁴ Only the Italian and the Russian version refer to “*obligations assumed with regard to*”¹¹⁴⁵.

1061 According to Article 50 of the ECT, its text is equally authoritative in each language:

“In witness whereof the undersigned, being duly authorized to that effect, have signed this Treaty in English, French, German, Italian, Russian and Spanish, of which every text is equally authentic [...].”

1062 For this reason, the ordinary meaning of “*to enter into*” and “*to assume with regard to*” are of equal significance for the interpretation of the umbrella clause and the determination of its scope.

1063 The ordinary meaning of “*to assume with regard to*” in the context of Article 10(1) of the ECT is “*to take upon oneself; undertake*”.¹¹⁴⁶ When a party takes an obligation upon itself, the party commits voluntarily to performing the obligation. Therefore, both terms, “*to enter into*” and “*to assume with regard to*” contain an element of voluntary collaboration. This element of voluntary collaboration makes sense when referring to a contractual obligation because, self-evidently, both parties are free to enter into a contract. It makes no sense when referring to a statutory or regulatory obligation because these apply notwithstanding the intention of those involved. Furthermore, it is general linguistic usage to say that a party enters into a contract and assumes obligations with regard to a contract, but it is not commonly heard that a party enters into a statute or assumes obligations with regard to a regulation.

1064 Even if the Italian and the Russian versions referring to “*to assume with regard to*” meant statutory and regulatory obligations along with contractual obligations - which they do not -, the interpretative principle set out in Article 33(1) of the Vienna Convention would not permit an extension of the scope of the umbrella clause. Article 33(1) of the Vienna Convention stipulates:

¹¹⁴⁴ The French equivalent for „*to contract*“ is „*contracter*“, the Spanish equivalent for „*to contract*“ is „*contraer*“.

¹¹⁴⁵ The Italian equivalent for “*to assume with regard to*” is “*assuntirer*”, the Russian equivalent for “*to assume with regard to*” is „*принять*“.

¹¹⁴⁶ Webster’s New World College Dictionary, 4th edition 2001, page 86 (**Exhibit R-309**).

“Except where a particular text prevails in accordance with paragraph 1, when a comparison of the authentic texts discloses a difference of meaning which the application of articles 31 and 32 does not remove, the meaning which best reconciles the texts, having regard to the object and purpose of the treaty, shall be adopted.”

1065 If four equally authentic versions of the ECT limited the scope of the umbrella clause to contractual obligations only but two versions extended its scope to encompass contractual, statutory and regulatory obligations, there would be a difference in meaning between the texts. The meaning “contractual obligations only” constitutes the common denominator of both meanings, best reconciling the texts. Thus, this meaning should be adopted.

1066 This interpretation of the umbrella clause (arrived at in accordance with Articles 31(1) and 33(1) of the Vienna Convention) is confirmed by the object and purpose of the ECT. According to Article 2 of the ECT the treaty shall promote long-term cooperation of investors and host states:

“This Treaty establishes a legal framework in order to promote long-term cooperation in the energy field, based on complementarities and mutual benefits, in accordance with the objectives and principles of the Charter.”

1067 If the scope of the umbrella clause were to encompass not only contractual obligations but also statutory and regulatory obligations, every breach of the host state’s domestic law would form a breach of the ECT. Had the contracting parties to the ECT really wished to commit themselves to such a large extent, they would have amended the wording of the umbrella clause accordingly. Construing the scope of the umbrella clause to encompass also statutory and regulatory obligations would alienate the contracting parties to the ECT and might ultimately cause them to withdraw from the treaty. This would run counter to the ECT’s purpose of promoting long-term cooperation of investors and host states.

b) Interpretation of the Umbrella Clause by Scholars and Tribunals

1068 The reasoning that the scope of the umbrella clause is limited to contractual obligations only is confirmed by renowned scholars and tribunals alike.

1069 Schreuer, for example, emphasizes the close connection between a breach of contractual obligations and the umbrella clause:

*“The crucial point lies in the recognition that certain (or all) types of violations of contracts between the state and the investor will, in the presence of an umbrella clause, amount to a violation of the investment treaty.”*¹¹⁴⁷

1070 This statement illustrates that the scope of the umbrella clause is limited to contractual obligations.

1071 In *CMS v. Argentina*, the tribunal confirmed that the term “entered into” refers to consensual obligations which do not apply *erga omnes* but with regard to individual persons:

“(a) In speaking of “any obligations it may have entered into with regard to investments”, it seems clear that [the umbrella clause] is concerned with consensual obligations arising independently of the BIT itself (i. e. under the law of the host State or possibly under international law). Further they must be specific obligations concerning the investment. They do not cover general requirements imposed by the law of the host State.

*(b) Consensual obligations are not entered into erga omnes but with regard to particular persons. Similarly the performance of such obligations or requirements occurs with regard to, an as between, obligor and obligee.”*¹¹⁴⁸

1072 In a surprising move, Claimants cite this case in their favour, indicating that the phrase “under the law of the host State or possibly under international law” would conflict with the fact that the scope of the umbrella clause is limited to contractual obligations only.¹¹⁴⁹ However, the tribunal in *CMS v. Argentina* clearly referred to consensual obligations under the law of the host State or under international law, such as contracts

¹¹⁴⁷ Dolzer and Schreuer, *Principles of International Investment Law*, Oxford University Press 2008, page 160 (**Exhibit R-299**).

¹¹⁴⁸ *CMS Gas Transmission Company v. The Argentine Republic*, ICSID Case No. ARB/01/8, Annulment Decision, 25 September 2007, para. 95, lit. a and b (**Exhibit R-182**).

¹¹⁴⁹ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, para. 538.

between the investor and the host State which are governed by the host State's domestic law. Statutes and regulations are not of a consensual nature, only contracts are. Hence, the reasoning in *CMS v. Argentina* cannot be regarded to support Claimants proposition. Rather, it demonstrates that tribunals take the view that the scope of the umbrella clause is limited to contractual obligations.

1073 This is confirmed by the ruling of the tribunal in *Al-Bahloul v. Tajikistan*, which had to deliberate on the umbrella clause in Article 10(1) ECT:

*“[I]t is clear that the obligation must have been entered into “with” an Investor or an Investment of an Investor. Therefore, this provision does not refer to general obligations of the State arising as a matter of law.”*¹¹⁵⁰

1074 This case is another example for a tribunal which endorses the prevailing view that the scope of the umbrella clause does not extend to statutory and regulatory obligations.

1075 Claimants' proposition that “*a number of investment treaty tribunals have held that not only contractual obligations, but also obligations undertaken through law or regulation, falls [sic!] within the scope of an umbrella clause*”¹¹⁵¹ is flawed. In fact, the cases Claimants quote to support their reasoning even contradict their proposition.

1076 Claimants cite the case *Eureko v. Poland* in their favour although the tribunal merely stated:

*““Any” obligations is capacious; it means not only obligations of a certain type - that is to say, all - obligations entered into with regard to investments of investors of the other Contracting Party.”*¹¹⁵²

1077 This statement does not mention statutory or regulatory obligations. It thus can be read to mean that the tribunal regarded any contractual obligations with regard to investments as encompassed by the scope of the umbrella

¹¹⁵⁰ Mohammad Ammar Al-Bahloul v. Republic of Tajikistan, SCC Case No. V (064/2008), Partial Award on Jurisdiction and Liability, 2 September 2009, para. 257 (**Exhibit R-181**).

¹¹⁵¹ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, para. 539, footnote 941.

¹¹⁵² *Eureko B.V. v. Republic of Poland*, Ad Hoc, Partial Award, 19 August 2005, para. 246 (**Exhibit C-260**).

clause. Indeed, the tribunal continued by assessing whether the host State's conduct regarding the investor's contractual arrangements under a Share Purchase Agreement and its First Addendum could be considered a violation of the umbrella clause.¹¹⁵³ The tribunal did not deliberate on whether the host State's conduct regarding statutory or regulatory obligations towards the investor constituted a breach of the umbrella clause. For this reason, the case *Eureko v. Poland* does not support Claimants' reasoning.

1078 Another case Claimants quote in their favour is *SGS v. Philippines*, where the tribunal had to decide whether “*the issue of how much is payable for services provided under the CISS Agreement*”¹¹⁵⁴ was covered by the scope of the umbrella clause. This issue clearly arose from obligations of a consensual nature. Hence, this case also does not support Claimants' proposition.

1079 In the remaining two cases cited by Claimants in their favour, *LG&E v. Argentina*¹¹⁵⁵ and *Enron v. Argentina*¹¹⁵⁶, the tribunals found that Argentina's Gas Law and its regulations were encompassed by the scope of the umbrella clause but they contrasted them from “*legal obligations of a general nature*”¹¹⁵⁷. Unlike statutes and regulations of a general nature, the Gas Law and its regulations were “*very specific in relation to [the foreign investor's] investment in Argentina*”¹¹⁵⁸. The tribunal in *LG&E v. Argentina*, for example, concluded:

“Argentina made these specific obligations to foreign investors, such as LG&E, by enacting the Gas Law and other regulations, and then advertising these guarantees

¹¹⁵³ *Eureko B.V. v. Republic of Poland*, Ad Hoc, Partial Award, 19 August 2005, para. 250 (**Exhibit C-260**).

¹¹⁵⁴ *SGS Société Générale de Surveillance S.A. v. Republic of the Philippines*, ICSID Case No. ARB/02/6, Decision of the Tribunal on Objections to Jurisdiction, 29 January 2004, para. 128 (**Exhibit C-282**).

¹¹⁵⁵ *LG&E v. Argentine Republic*, ICSID Case No. ARB/02/01, Award, 25 July 2007, para. 169 et seq. (**Exhibit C-314**).

¹¹⁵⁶ *Enron Corporation v. Argentine Republic*, ICSID Case No. ARB/01/3, Award, 22 May 2007, para. 269 et seq. (**Exhibit C-263**).

¹¹⁵⁷ *LG&E v. Argentine Republic*, ICSID Case No. ARB/02/01, Award, 25 July 2007, para. 174. (**Exhibit C-314**).

¹¹⁵⁸ *LG&E v. Argentine Republic*, ICSID Case No. ARB/02/01, Award, 25 July 2007, para. 174 (**Exhibit C-314**).

in the Offering Memorandum to induce the entry of foreign capital to fund the privatization program in its public sector. These laws and regulations became obligations within the meaning of [the umbrella clause], by virtue of targeting foreign investors and applying specifically to their investments, that gave rise to liability under the umbrella clause.”¹¹⁵⁹

1080 However, the Republic has not advertised guarantees under a statute specifically targeted at foreign investors in an offering memorandum to Claimants. Therefore, *LG&E v. Argentina* and *Enron v. Argentina* do not support Claimants’ reasoning that the scope of the umbrella clause covers statutory and regulatory obligations in general.

2. Irrelevance of Subsoil Use Contracts and Contract No. 302 under the Umbrella Clause

1081 Claimants deny that the exclusive arbitration agreements in the Subsoil Use Contracts as well as in Contract No. 302 bar their claims relating to these contracts under the umbrella clause.¹¹⁶⁰ They are mistaken.

1082 Article 28(2) of KPM’s Subsoil Use Contract provides:

“If any dispute cannot be resolved through negotiations within 30 days from the time it arises, the parties shall refer the dispute for its resolution to [...] The Arbitration Institute of the International Chamber of Commerce in Stockholm.”¹¹⁶¹

1083 Likewise, Article 23(2) No. 2 of TNG’s Subsoil Use Contract stipulates:

“If within 120 (one hundred twenty) days of the moment of the dispute arising it cannot be settled by negotiations, Parties shall address the dispute for its resolution to [...]”

¹¹⁵⁹ *LG&E v. Argentine Republic*, ICSID Case No. ARB/02/01, Award, 25 July 2007, para. 175 (**Exhibit C-314**).

¹¹⁶⁰ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, para. 540.

¹¹⁶¹ KPM’s Subsoil Use Contract, Article 28 (**Exhibit C-45**).

*international arbitration bodies according to the Law of the Republic “On foreign investments”.*¹¹⁶²

1084 Finally, Article 23(2) of Contract No. 302 states:

*“If the dispute cannot be resolved by negotiations within 30 days from its occurrence, the Parties shall refer it for resolution to [...] international arbitration in accordance with the Law of the Republic “On foreign investments”.*¹¹⁶³

1085 Hence, the Subsoil Use Contracts and Contract No. 302 contain arbitration clauses which oblige both parties to resort exclusively to international commercial arbitration once a dispute arises from these agreements, including their alleged unlawful termination.

1086 Contrary to these provisions, Claimants never referred the disputes regarding the Subsoil Use Contracts and Contract No. 302 to international commercial arbitration. Instead, Claimants initiated the present investment treaty arbitration proceedings under the ECT only five days after the contracts had been terminated. Claimants have not even tried to explain this hasty reaction.

1087 However, tribunals in investment treaty arbitrations have ruled that foreign investors need to comply with exclusive forum selection clauses before they may rely on the umbrella clause.

1088 The tribunal in *SGS v. Philippines*, for example, emphasized the effective and binding nature of a contractual stipulation to accept the exclusive forum:

“In accordance with general principle, courts or tribunals should respect such a stipulation in proceedings between those parties, unless they are bound ab exteriore, i.e., by some other law, not to do so. Moreover it should not matter whether the contractually-agreed forum is a municipal court (as here) or domestic arbitration (as in SGS v. Pakistan) or some other form of arbitration, e. g.

¹¹⁶² TNG’s Subsoil Use Contract, Article 23 (**Exhibit C-52**).

¹¹⁶³ Contract No. 302, Article 23 (**Exhibit C-53**).

*pursuant to UNCITRAL or ICC Rules. The basic principle in each case is that a binding exclusive jurisdiction clause in a contract should be respected, unless overridden by another valid provision.*¹¹⁶⁴

1089 The tribunal continued by clarifying that a standard jurisdiction clause in an investment treaty between two states does not override the binding selection of a forum by the parties to determine their contractual claims, because the contract between the parties needs to be regarded as *lex specialis* in relation to an investment treaty between two states.¹¹⁶⁵

1090 This notion is confirmed by Schreuer:

*“A document containing a dispute settlement clause which is more specific in relation to the parties and to the dispute should be given precedence over a document of more general application.”*¹¹⁶⁶

1091 This statement supports the reasoning of the tribunal in *SGS v. Philippines* and illustrates why foreign investors need to comply with exclusive forum selection clauses before they may rely on the umbrella clause.

1092 The tribunal’s reasoning in the *SGS v. Philippines* case, received much acclaim by other tribunals as well as scholars. Douglas, for example, commented:

“The careful analysis by the ICSID Tribunal in SGS v. The Philippines of its jurisdiction over contractual claims, the significance of an exclusive forum selection clause in an investment contract and the resolution of competing

¹¹⁶⁴ SGS Société Générale de Surveillance S.A. v. Republic of the Philippines, ICSID Case No. ARB/02/6, Decision of the Tribunal on Objections to Jurisdiction, 29 January 2004, para. 138 (**Exhibit C-282**).

¹¹⁶⁵ SGS Société Générale de Surveillance S.A. v. Republic of the Philippines, ICSID Case No. ARB/02/6, Decision of the Tribunal on Objections to Jurisdiction, 29 January 2004, paras. 140, 141 and 153 (**Exhibit C-282**).

¹¹⁶⁶ Schreuer, *The ICSID Convention - A Commentary*, Cambridge University Press 2001, page 362, para. 34 (**Exhibit R-271**).

jurisdictions over contractual claims (symmetrical jurisdictional conflicts) deserves full endorsement.”¹¹⁶⁷

1093 Not only scholars but other tribunals have adopted the reasoning of the tribunal in the *SGS v. Philippines* case.

1094 The tribunal in *BIVAC v. Paraguay* shared the findings of the tribunal in *SGS v. Philippines* and added:

“The parties could have included a provision in [the forum selection clause in the contract] to the effect that the obligations it imposed were without prejudice to any rights under the BIT, including the possible exercise of jurisdiction by an ICSID Tribunal to any matters rising under the Contract which could fall to be determined under [the jurisdiction clause] of the BIT. The fact that they did not do so is not without relevance: it indicates, at the very least, that the parties to the Contract [...] intended the exclusive contractual jurisdiction of the Tribunals of [domestic arbitration] to be absolute and without exception, and for it to mean what it says.”¹¹⁶⁸

1095 The tribunal thus seized upon the suggestion of the tribunal in *SGS v. Philippines* that forum selection clauses need to be regarded as a “voluntary waiver”¹¹⁶⁹.

1096 It continued by pointing out another reason why foreign investors need to comply with exclusive forum selection clauses before they may rely on the umbrella clause:

“The broader point, however, having regard to the fundamental principle that the autonomy and will of the parties is to be respected, is that the parties to a contract

¹¹⁶⁷ Douglas, Hybrid Foundations of Investment Treaty Arbitration, (2003) 74 BYIL 151, page 288 and 289 (**Exhibit R-185**).

¹¹⁶⁸ Bureau Veritas, Inspection, Valuation, Assessment and Control (BIVAC) B. V. v. Republic of Paraguay, ICSID Case No. ARB/07/9, Decision of the Tribunal on Objections to Jurisdiction, 29 May 2009, para. 146 (**Exhibit R-184**).

¹¹⁶⁹ *SGS Société Générale de Surveillance S.A. v. Republic of the Philippines*, ICSID Case No. ARB/02/6, Decision of the Tribunal on Objections to Jurisdiction, 29 January 2004, para. 150 (**Exhibit C-282**).

are not free to pick and choose those parts of the contract that they may wish to incorporate into an “umbrella clause” provision [...] and ignore others. [...] [This] would seriously and negatively undermine contractual autonomy. If the parties to a contract have freely entered into commitments, they must respect those commitments, and they are entitled to expect that others, including international courts and tribunals, also respect them, unless there are powerful reasons for not doing so.”¹¹⁷⁰

1097 In conclusion, foreign investors need to comply with exclusive forum selection clauses before they may rely on the umbrella clause because this conforms to and enforces the maxim *pacta sunt servanda*.¹¹⁷¹ Therefore, the Subsoil Use Contracts and Contract No. 302 are utterly irrelevant in terms of the umbrella clause.

3. The Republic’s compliance with domestic law

1098 Even if the umbrella clause covered not only contractual but also statutory and regulatory obligations - which it does not - and if the Subsoil Use Contracts and Contract No. 302 were relevant under the umbrella clause - which they are not - the Republic would still not have violated the umbrella clause because it acted in compliance with its own domestic law. Hence, Claimants’ case has no basis.

1099 In their Reply Memorial on Jurisdiction and Liability, Claimants allege that a variety of the Republic’s measures were taken in violation of contractual, statutory and regulatory obligations.¹¹⁷² This is not the case.

1100 Claimants begin by alleging that the classification of KPM’s and TNG’s pipelines as trunk pipelines constitutes a breach of Kazakhstan’s Law on Oil and relevant regulations.¹¹⁷³ As more specifically explained above¹¹⁷⁴,

¹¹⁷⁰ Bureau Veritas, Inspection, Valuation, Assessment and Control (BIVAC) B. V. v. Republic of Paraguay, ICSID Case No. ARB/07/9, Decision of the Tribunal on Objections to Jurisdiction, 29 May 2009, para. 148 (**Exhibit R-184**).

¹¹⁷¹ Cf. Newcombe/Paradell, Law and Practice of Investment Treaties: Standards of Treatment, page 472 (**Exhibit R-60**).

¹¹⁷² Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, para. 546.

¹¹⁷³ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, para. 546.

there was no “reclassification” of the KPM pipeline. Rather, it was found that KPM were operating a trunk pipeline without the relevant licence. As a consequence, Mr. Cornegruta, its representative, was found guilty of illegal entrepreneurship under Section 190(2)(b) of the Criminal Code of Kazakhstan. This decision was confirmed on appeal on 12 November 2009. by the Regional Court of Mangistau. It was Claimants that were in breach of Kazakh law, not the Republic.

1101 Subsequently, Claimants contend that the arrest, conviction and incarceration of Mr. Cornegruta violate general principles of due process and Articles 12 and 16 of the Kazakh Constitution recognizing each person’s human rights and freedoms.¹¹⁷⁵ As further set out above¹¹⁷⁶, due process was strictly adhered to in the investigation of the crime committed by Mr. Cornegruta on behalf of KPM and in the trial. The decision was appealed and confirmed and if Mr Cornegruta wished to seek further redress he should have done so through the proper and available channels. Therefore, the arrest, conviction and incarceration of Mr. Cornegruta are not in breach of general principles of due process and Articles 12 and 16 of the Kazakh Constitution.

1102 Claimants continue by arguing that the criminal proceedings against the alleged non-party KPM violate principles of due process and Article 77(3) of the Kazakh constitution.¹¹⁷⁷ Yet, as explained above,¹¹⁷⁸ the procedure for the issue of the recovery order was at all times in accordance with Kazakh law. As explained by the Republic’s expert, Professor Kogamov, the recovery of illegal income of a company resulting from the crime of its manager is in conformity with Kazakh legislation. Moreover, the procedural participation was safeguarded at all times through the presence of Mr. Cornegruta.

1103 It has thus been demonstrated that the criminal proceedings against KPM do not infringe principles of due process and Article 77(3) of the Kazakh constitution.

¹¹⁷⁴ Sections C.VI., C.VII. and C.VIII.

¹¹⁷⁵ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, para. 546.

¹¹⁷⁶ Sections C.VII. and C.VIII.

¹¹⁷⁷ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, para. 546.

¹¹⁷⁸ See above section C.VIII.7.a).

- 1104 Claimants also allege that the Republic’s termination of KPM’s and TNG’s Subsoil Use Contracts breached the respective contract terms.¹¹⁷⁹ However, as explained above¹¹⁸⁰, it was KPM and TNG that seriously breached the terms of the Subsoil Use Contracts on a number of grounds. Claimants were aware of many of these breaches for some time and had unsuccessfully contested some of them in the Kazakh courts. After notifying those companies of these breaches, the Republic rightly terminated the Subsoil Use Contracts in accordance with Kazakh law and the terms of the contracts themselves. In conclusion, the Republic’s termination of KPM’s and TNG’s Subsoil Use Contracts did not violate the respective contract terms. Rather, it was Claimants who breached the contractual terms, thus leading to a legitimate termination.
- 1105 Finally, Claimants argue that the Republic illegally seized their investments in violation of general principles of law and Articles 6 and 26 of the Kazakh Constitution protecting private property.¹¹⁸¹ As already explained above¹¹⁸², there was no seizure of Claimants investments but instead a legitimate transfer into trust management in accordance with the Subsoil Law 2010, which is the lawful consequence following the termination of the subsoil use contracts. This transfer in any event only took place well after Claimants had abandoned their investment. Since the Republic did not illegally seize Claimants’ investments, it follows that the Republic did not violate general principles of law and Articles 6 and 26 of the Kazakh Constitution protecting private property.
- 1106 Claimants also list measures taken by the Republic which allegedly violate its contractual, statutory and regulatory obligations without specifying which contracts, statutes or regulations exactly were allegedly breached. For example, Claimants complain about the revocation of the Republic’s approval and waiver regarding the transfer of TNG to Terra Raf and the Republic’s pre-emptive rights but they fail to mention the legal base for this claim.¹¹⁸³ Similarly, Claimants deny the legality of the Republic’s refusal to extend TNG’s exploration period in the Contract No. 302

¹¹⁷⁹ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, para. 546.

¹¹⁸⁰ See above section C.IX.1.

¹¹⁸¹ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, para. 546.

¹¹⁸² See above section C.IX.2.

¹¹⁸³ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, para. 546.

Properties but do not unveil the contracts, statutes or regulations which, in their view, prohibit the Republic from refusing to extend the exploration period.¹¹⁸⁴ The reason for this omission is simple: there are no such contracts, statutes or regulations. In conclusion, the Republic complied with its domestic law at all times.

XI. Effective means of Asserting Claims and Enforcing Rights

1107 Claimants allege that the Republic has failed to ensure that its domestic law provides effective means for the assertion of claims and the enforcement of rights with respect to their investments, investment agreements and investment authorizations in violation of Article 10(12) of the ECT. Their reasoning is flawed.

1. Meaning of the duty arising from Article 10(12) of the ECT

1108 The guarantee under Article 10(12) of the ECT refers to the legislative obligation to provide a fair and efficient system of justice and does not encompass isolated failures of the judicial system in individual cases. Yet, the Claimants misconceive the meaning of the duty arising from Article 10(12) of the ECT. Instead of addressing the adequacy of domestic legislation, the Claimants focus on the judicial proceedings in one individual case. In fact, the Claimants have not even contended, let alone proven that the Republic has enacted legislation which does not provide a fair and efficient system of justice.

a) Legislative obligation to provide a fair and efficient system of justice

1109 In their Reply Memorial on Jurisdiction and Liability, Claimants take up their argument from the Statement of Claim that the decision in *Chevron v. Ecuador* is authoritative for determining the meaning of the guarantee in

¹¹⁸⁴ Reply Memorial on Jurisdiction and Liability, dated 7 May 2012, para. 546.

Article 10(12) of the ECT.¹¹⁸⁵ They base this contention on the fact that the case “involved a similar worded provision”¹¹⁸⁶.

1110 The investment treaty arbitration in *Chevron v. Ecuador* was based on the BIT between the USA and Ecuador. Although the wordings of Article 10(12) of the ECT and of the corresponding provision in the BIT between the USA and Ecuador seem similar at first glance, Claimants ignore “the elephant in the room”: the decisive difference in the wording of both provisions.

1111 The relevant provision in the BIT between the USA and Ecuador, Article II(7), reads:

*“Each Party shall provide effective means of asserting claims and enforcing rights with respect to investment, investment agreements, and investment authorizations.”*¹¹⁸⁷ (emphasis added)

1112 In contrast, Article 10(12) of the ECT stipulates explicitly:

“Each Contracting Party shall ensure that its domestic law provides effective means for the assertion of claims and the enforcement of rights with respect to Investments, investment agreements, and investment authorizations.” (emphasis added)

1113 In contrast to the guarantee in the BIT between the USA and Ecuador, in Article 10(12) of the ECT the duty’s scope is clearly limited to the host State’s legal framework.

1114 The wording of Article 10(12) of the ECT is unambiguous. For this reason, Article 10(12) of the ECT establishes a legislative obligation to provide a fair and efficient system of justice and does not encompass isolated failures of the judicial system in individual cases.

¹¹⁸⁵ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 548; Statement of Claim dated 18 May 2011, para. 374.

¹¹⁸⁶ Statement of Claim dated 18 May 2011, para. 374.

¹¹⁸⁷ Article II(7) of the Treaty Between the United States of America and the Republic of Ecuador Concerning the Encouragement and Reciprocal Protection of Investment dated 27 August 1993, entered into force 11 May 1997 (**Exhibit R-237**)..

1115 The tribunal in *Amtó v. Ukraine* assessed the meaning of Article 10(12) of the ECT as opposed to an allegedly similar worded provision such as Article II(7) of the BIT between the USA and Ecuador and concluded:

*“The fundamental criteria of an ‘effective means’ for the assertion of claims and the enforcement of rights within the meaning of Article 10([1])2 is law and the rule of law. There must be legislation for the recognition and enforcement of property and contractual rights. This legislation must be made in accordance with the constitution, and be publicly available. An effective means of the assertion of claims and the enforcement of rights also requires secondary rules of procedure so that the principles and objectives of the legislation can be translated by the investor into effective action in the domestic tribunals.”*¹¹⁸⁸

Hence, the tribunal in *Amtó v. Ukraine* clarified that the prerequisites of Article 10(12) of the ECT are fulfilled if the foreign investor contends and proves legislative failures by the host State to provide a fair and efficient system of justice.

1116 The tribunal then continued to contrast such legislative failures with individual failures of the judicial system:

*“[T]he State must provide an effective framework or system for the enforcement of rights, but does not offer guarantees in individual cases. Individual failures might be evidence of systematic inadequacies, but are not themselves a breach of Article 10(12) [of the ECT].”*¹¹⁸⁹

Notwithstanding the impracticality to fully separate the formal existence of the system from its operation in individual cases, the tribunal thus expressed a firm attitude that the legislative obligation to provide a fair and efficient system of justice is the characteristic content of Article 10(12) of the ECT and must be contrasted from isolated failures of the judicial system in individual cases.

¹¹⁸⁸ *Amtó v. Ukraine*, SCC No. 080/2005, Award, 26 March 2008, para. 87 (**Exhibit R-310**).

¹¹⁸⁹ *Amtó v. Ukraine*, SCC No. 080/2005, Award, 26 March 2008, para. 88 (**Exhibit R-310**).

1117 Unlike Claimants imply, the decision in *Amto v. Ukraine* is not contradictory to the decision in *Chevron v. Ecuador* because of the decisive difference in the wording of their respective underlying provisions. This is confirmed by the fact that the tribunal in *Chevron v. Ecuador* concluded that it did not share the view of the Respondent Ecuador that Article II(7) of the BIT between the USA and Ecuador does not allow review of investor treatment in individual cases. In contrast, the tribunal refrained from stating that it did not share the view of the tribunal in *Amto v. Ukraine* with regard to Article 10(12) of the ECT. Hence, the meaning of Article 10(12) of the ECT is in accord with the decision of the tribunal in *Chevron v. Ecuador*.

1118 Even in cases where Article II(7) of the BIT between the USA and Ecuador was the basis of the claim and thus allowed the tribunals to consider individual failures of the judicial system, tribunals paid special attention to legislative failures by the host State to provide a fair and efficient system of justice. The tribunal in *Duke Energy v. Ecuador*, for example, emphasized:

*“Such provision guarantees the access to the courts and the existence of institutional mechanisms for the protection of investments.”*¹¹⁹⁰

When tribunals in such cases where the underlying provision does not even explicitly mention domestic law paid special attention to the legal framework of the host State, *a fortiori* it follows that in cases which are based on Article 10(12) of the ECT the legislative obligation to provide a fair and efficient system of justice is of paramount significance.

b) No contention nor proof of a legislative failure to provide a fair and efficient system of justice

1119 According to the onus *probandi* rule, Claimants need to contend and prove that the Kazakh law is inadequate and does not live up to the standard required by international law. With respect to the prerequisites carved out by the tribunal in *Amto v. Ukraine*, Claimants are required to contend and prove in particular that there was no legislation for the recognition and enforcement of property and contractual rights or that this legislation was

¹¹⁹⁰ *Duke Energy Electroquil Partners & Electroquil S.A. v. Republic of Ecuador*, ICSID Case No. ARB/04/19, Award, 18 August 2008, para. 391 (**Exhibit C-306**).

not made in accordance with the constitution or was not publicly available or that there were no secondary rules of procedure so that the principles and objectives of the legislation could not be translated by Claimants into effective action in the domestic tribunals.¹¹⁹¹

1120 However, Claimants have failed to contend any of these facts, let alone offer any proof thereof. They did not even provide any comparative analysis of Kazakh legislation or identify any international standards against which the law of Kazakhstan might be assessed.

1121 Even if the meaning of Article 10(12) of the ECT extended to individual failures of the judicial system - which it does not -, Claimants would still be required to contend and prove procedural irregularity or interference.

1122 Again, Claimants have failed to contend procedural irregularity or interference and have thus also not offered any proof thereof. They have not even contended that the criminal proceedings involving Mr. Cornegruta on behalf of KPM were delivered with undue delay or that Mr. Cornegruta was not properly heard.

1123 Rather, Claimants' objection to the criminal proceedings against Mr. Cornegruta on behalf of KPM is simply that they are wrong in law. Yet, a tribunal in investment treaty arbitration is not a court of appeal for the decisions of the Kazakh courts.

1124 Therefore, Claimants have not contended and proven that the Republic has not sufficiently ensured that its domestic law provides effective means for the assertion of claims and the enforcement of rights with respect to investments, investment agreements, and investment authorizations.

2. Claimants' failure to exhaust remedies

1125 In their Reply Memorial on Jurisdiction and Liability, Claimants allege that they made a "*reasonable if not exhaustive effort to obtain correction*"¹¹⁹² of lawful circumstances which Claimants mistake as injustice. In reality, Claimants' effort was far from being reasonable, let alone exhaustive.

¹¹⁹¹ Amto v. Ukraine, SCC No. 080/2005, Award, 26 March 2008, para. 87 (**Exhibit R-310**).

¹¹⁹² Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 550.

1126 Provided that the domestic law of a host State establishes a fair and efficient system of justice but the foreign investor does not pursue all remedies afforded by this system, any damage resulting thereof is the investor's own fault. For this reason, a foreign investor may only invoke the guarantee under Article 10(12) of the ECT once it has exhausted all available remedies.

1127 This rationale behind the duty to exhaust all remedies is confirmed by the tribunal in *Amto v. Ukraine* which ruled with respect to the guarantee under Article 10(12) of the ECT:

*“The investor that fails to exercise his rights within a legal system, or exercises its rights unwisely, cannot pass his own responsibility for the outcome to the administration of justice, and from there to the host State in international law.”*¹¹⁹³

For this reason, foreign investors are required to contend and prove that they have exhausted all remedies available to them.

1128 Regarding the guarantee under Article 10(12) of the ECT, the duty to exhaust all remedies needs to be interpreted more strictly because of its specific meaning whereby it creates a legislative obligation to provide a fair and efficient system of justice. Hence, Claimants need to contend and prove that they have exhausted all available remedies, including an attempt to challenge the inefficiency of certain legislative provisions before the constitutional court of the host State.¹¹⁹⁴

1129 Even in investment treaty cases which were not based on Article 10(12) of the ECT but on provisions which did not explicitly refer to the host State's domestic law, tribunals have emphasized that they have to consider whether a claimant has done its part by properly using the means placed at its disposal and that a high likelihood of success of these remedies is not required in order to expect a claimant to attempt them.¹¹⁹⁵

¹¹⁹³ *Amto v. Ukraine*, SCC No. 080/2005, Award, 26 March 2008, para. 88 (**Exhibit R-310**).

¹¹⁹⁴ Mavluda Sattorova, *Denial of justice disguised? Investment arbitration and the protection of foreign investors from judicial misconduct*, I.C.L.Q. (2012), page 240 (**Exhibit R-311**).

¹¹⁹⁵ *Chevron Corporation and Texaco Petroleum Company v. The Republic of Ecuador*, UNCITRAL, Partial Award, 30 March 2010, para. 324 and 326 (**Exhibit C-285**).

- 1130 In the case at present Claimants have not exhausted all remedies made available to them by Kazakh law to assert claims and enforce rights. Although the Republic ensured that its domestic law provides a fair and efficient system of justice, Claimants failed to exercise all of their rights within that legal system. Furthermore, Claimants have not even contended that they made an attempt to challenge the alleged inefficiency of legislative provisions before the Supreme Court of Kazakhstan or explained why they failed to do so. For Claimants' own failures, the Republic cannot be held responsible.
- 1131 In their Reply Memorial on Jurisdiction and Liability, Claimants concede not to have pursued all available appeals.¹¹⁹⁶ Although they allege that they were either denied the possibility to appeal by the relevant courts or precluded from pursuing their pending lawsuits before the local courts by the termination of the Subsoil Use Contracts and the alleged seizure of their investments, they offer no proof for these statements.¹¹⁹⁷ In reality, Claimants have not pursued all available appeals to the Supreme Court, in particular with respect to a challenge of the respective Kazakh laws before the Constitutional Council.¹¹⁹⁸ Moreover, Claimants have offered no evidence that such an appeal would have been ineffective or futile.
- 1132 Moreover, with respect to the exclusive arbitration agreements in the Subsoil Use Contracts and in Contract No. 302, Claimants have not initiated arbitration proceedings although this had been contractually agreed between Claimants and the Republic.
- 1133 In their Reply Memorial on Jurisdiction and Liability, Claimants have not even tried to explain why they did not resort to international commercial arbitration proceedings for the resolution of the dispute despite their previous free decision to enter into the arbitration agreements in the Subsoil Use Contracts and in Contract No. 302. Instead, they allege that they had the right to choose the forum with the more comprehensive jurisdiction.¹¹⁹⁹ This is not the case.

¹¹⁹⁶ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 550.

¹¹⁹⁷ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 550.

¹¹⁹⁸ See above section C.VIII.9.

¹¹⁹⁹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 549.

1134 As explained above, tribunals in investment treaty arbitrations have ruled that foreign investors need to comply with exclusive forum selection clauses before they may rely on guarantees arising out of an investment treaty. They arrived at this conclusion because the arbitration agreement between a foreign investor and a host state is the *lex specialis* compared with an investment treaty between two host States. In accordance with the principle of party autonomy, a foreign investor and a host State may enter into an arbitration agreement at their free will. Such arbitration agreements are binding in line with the maxim of *pacta sunt servanda*. As *legis speciales*, they take priority over a standard jurisdiction clause in an investment treaty between two states. For this reason, foreign investors need to comply with exclusive forum selection clauses before they may rely on guarantees arising out of an investment treaty.

3. No violation of Article 10(12) of the ECT with regard to the criminal proceedings against Mr. Cornegruta

1135 A tribunal's review of the host State's legislation is limited. This follows *a fortiori* from the fact, that even in cases which do not involve Article 10(12) of the ECT tribunals have concluded that their review of the decisions by local courts is limited. In *Chevron v. Ecuador*, for example, the tribunal stated that a measure of deference needs to be afforded to the domestic justice system and that the tribunal was not empowered to act as a court of appeal reviewing every alleged failure of the local judicial system *de novo*.¹²⁰⁰

1136 Due to this limited review, investment treaty cases in which tribunals have concluded that Article 10(12) of the ECT has been violated are rare. In the case *Amto v. Ukraine*, for example, the tribunal decided that the host State had not breached the guarantee under Article 10(12) of the ECT because Amto had not demonstrated that the Ukrainian Bankruptcy Law in question did not provide an effective means to enforce a creditor's right in the Ukraine.¹²⁰¹

¹²⁰⁰ Chevron Corporation and Texaco Petroleum Company v. The Republic of Ecuador, UNCITRAL, Partial Award, 30 March 2010, para. 247 (**Exhibit C-285**).

¹²⁰¹ Amto v. Ukraine, SCC No. 080/2005, Award, 26 March 2008, para. 89 (**Exhibit R-310**).

- 1137 In the only published case in which the tribunal found a host State to have violated Article 10(12) of the ECT, in *Petrobart v. The Kyrgyz Republic*, the tribunal focussed on the operation of the legal framework in that individual case in disregard of the explicit wording in Article 10(12) of the ECT which refers to “*domestic law*”. The tribunal did not provide any arguments as to why it disregarded the express reference to domestic law in Article 10(12) of the ECT. For this reason, the decision is not very convincing and does not lend itself to provide guidance on the understanding of Article 10(12) of the ECT.
- 1138 Arguably, the tribunal in *Petrobart v. The Kyrgyz Republic* felt impelled to weigh equity over dogmatic considerations and take the individual failure of the Kyrgyz Republic into account by way of exception because the case involved a blatant measure of interference into judicial proceedings. The tribunal was confronted with a letter by the Vice Prime Minister of Kyrgyzstan to the Chairman of the local court, which gave support for a stay of execution of a valid judgment in favour of Petrobart.¹²⁰² In contrast, Claimants have not contended and proven such interference by high ranking officials of the Republic Kazakhstan in the criminal proceedings against Mr. Cornegruta on behalf of KPM.
- 1139 Also, circumstances in investment treaty cases which are not based on Article 10(12) of the ECT but on a provision encompassing individual failures - like Article II(7) of the BIT between the USA and Ecuador, for example - can be clearly distinguished from the circumstances in the case at present.
- 1140 In *Chevron v. Ecuador*, the tribunal was confronted with an undue delay of judicial proceedings because Chevron’s cases had been pending in the Ecuadorian courts for 13 to 15 years at the time of the commencement of the investment treaty arbitration proceedings without being deemed extraordinarily complex.¹²⁰³
- 1141 Another case, *White Industries v. India*, was based on the BIT between Australia and India whose most favoured nation clause incorporated a

¹²⁰² *Petrobart Limited v. The Kyrgyz Republic*, SCC No. 126/2003, Award, 29 March 2005, page 77 (**Exhibit C-204**).

¹²⁰³ *Chevron Corporation and Texaco Petroleum Company v. The Republic of Ecuador*, UNCITRAL, Partial Award, 30 March 2010, para. 270 (**Exhibit C-285**).

provision of the BIT between India and Kuwait which did not explicitly refer to the domestic law of the host State, just like Article II(7) of the BIT between the USA and Ecuador in the case *Chevron v. Ecuador*. The tribunal in *White Industries v. India* concluded that the Indian judicial system's inability to deal with White Industries' jurisdictional claim in over nine years and the Supreme Court's inability to hear White Industries' jurisdictional appeal for over five years amounted to undue delay.¹²⁰⁴

1142 Here, the case is different. Claimants have not contended, let alone proven that the criminal proceedings against Mr. Cornegruta on behalf of KPM suffered from any undue delay. In fact, the criminal proceedings against Mr. Cornegruta lasted only a very reasonable amount of time. Details of the trial and prosecution process are set out above.¹²⁰⁵ The hearing itself lasted from 30 July 2009 to 18 September 2009. Any delay prior to that was only to ensure that Mr Cornegruta had proper access to the case being set out against him. In this respect, it is acknowledged that the case was put on hold for some time prior to the hearing.

1143 In their Reply Memorial on Jurisdiction and Liability, Claimants allege that the decisions of the Kazakh criminal courts in the trial against Mr. Cornegruta on behalf of KPM were unfair and partial.¹²⁰⁶ In particular, they complain about the alleged conviction of KPM as legal entity and about the reason for the trial, the classification of Claimants' pipelines as trunk pipelines.¹²⁰⁷ They continue by alleging that the judge did not consider all the evidence before it and disregarded multiple expert reports from Claimants.¹²⁰⁸ Finally, they argue that an impartial court "*would not have based its decision on a conclusory opinion drafted in a couple of days by an unqualified employee of the Ministry of Justice*".¹²⁰⁹ None of Claimants' allegations are true.

1144 It is accepted that certain evidence had to be excluded from the trial. This was for a number of reasons including the lack of attendance of witnesses

¹²⁰⁴ *White Industries Australia Limited v. The Republic of India*, UNCITRAL, Award, 30 November 2011, para. 11.4.20 (**Exhibit R-267**).

¹²⁰⁵ See above sections C.VII. and C.VIII and Second Witness Statement of Mr Rakhimov, section 6.

¹²⁰⁶ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 551.

¹²⁰⁷ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 551.

¹²⁰⁸ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 551.

¹²⁰⁹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 551.

at trial and the non-compliance with the necessary procedures for the appointment of witnesses. This is the case with the expert reports procured by Claimants. None of these statements complied with Article 243 of the Criminal Code which requires that experts be drawn from a limited and specific pool of expertise. This is discussed further at Section C.VI. 4(c). Simply because these cases came out against Claimants does not automatically mean that they are unfair.

XII. Obligation to Permit Employment of Key Personnel

1145 In their Reply Memorial on Jurisdiction and Liability, Claimants allege that the Republic has failed to permit them to employ key persons of their choice contrary to their obligation pursuant to Article 11(2) of the ECT.¹²¹⁰ However, Claimants content themselves with drawing the conclusion that the Republic violated this provision and do not bother subsuming any facts under Article 11(2) of the ECT. Such conclusion has not merit.

1. Meaning of the duty arising from Article 11(2) of the ECT

1146 Article 11(2) of the ECT stipulates:

“A Contracting Party shall permit Investors of another Contracting Party which have Investments in its Area, and Investments of such Investors, to employ any key person of the Investor’s or the Investment’s choice regardless of nationality and citizenship provided that such key person has been permitted to enter, stay and work in the Area of the former Contracting Party and that the employment concerned conforms to the terms, conditions and time limits of the permission granted to such key person.”

¹²¹⁰ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 553.

1147 In short, Article 11(2) of the ECT permits foreign investors to employ key personnel of their choice, so long as such personnel have the required work and residence permits.¹²¹¹

1148 The gist of the provision is straightforward and unambiguous. Article 11(2) of the ECT forbids the host State to prevent the foreign investor from hiring key personnel of its choice, for example by enacting any domestic employment legislation of such content or by ousting the key personnel with force. Thus, the provision does not require interpretation.

1149 The unambiguous gist of Article 11(2) of the ECT is confirmed by renowned scholars. The late leading scholar and practitioner in the area of international energy and resources law, Professor Thomas W. Wälde, for example, described the meaning of Article 11(2) of the ECT as follows:

*“The only hard obligation [...] in Article 11 is an obligation of administrative consistency: once the permits are issued, investors can keep employing such key staff.”*¹²¹²

There simply is no other understanding of Article 11(2) of the ECT and thus there is no need and no room for a determination of its gist by means of interpretation.

1150 Professor Wälde continues by explaining:

*“This provision would appear to override local legislation limiting the ability of foreign nationals to work in certain jobs or giving nationals of the host country priority in employment. [...] [The provision protects] an investment against local employment legislation that purported to deny its right to hire key personnel with regard to nationality and citizenship.”*¹²¹³

¹²¹¹ Energy Charter Secretariat, The Energy Charter Treaty - A Reader's Guide, page 26 (**Exhibit R-312**).

¹²¹² Thomas W. Wälde, The Energy Charter Treaty: An East-West Gateway for Investment and Trade, Kluwer Law International, 1st edition 1996, page 297 and 298 (**Exhibit R-230**).

¹²¹³ Thomas W. Wälde, The Energy Charter Treaty: An East-West Gateway for Investment and Trade, Kluwer Law International, 1st edition 1996, page 344 (**Exhibit R-230**).

This statement draws attention to the fact that the duty arising from Article 11(2) of the ECT is primarily a legislative obligation of refraining to enact any domestic employment legislation which prevents foreign investors from employing their key personnel of choice.

1151 Despite the evidently unambiguous nature of the gist of Article 11(2) of the ECT, Claimants imply that the quintessence of Article 11(2) of the ECT is equivocal - which it is not - by arguing that the provision needs to be interpreted in accordance with the ordinary meaning of its terms pursuant to Article 31(1) of the Vienna Convention. The ordinary meaning of “to employ” is “to hire”¹²¹⁴ or “to engage the services or labour of someone”¹²¹⁵. In this sense, Article 11(2) of the ECT forbids the host State to prevent the foreign investor from hiring key personnel of its choice, for example by enacting any domestic employment legislation of such content or by ousting the key personnel with force.

1152 By citing Article 31(1) of the Vienna Convention, Claimants seem to agree that there is one element of Article 11(2) of the ECT which is ambiguous and thus requires interpretation. This element is the term “*key personnel*”. It is not defined in the ECT or in any other investment treaty. Hence, the term needs to be interpreted in accordance with its ordinary meaning pursuant to Article 31(1) of the Vienna Convention.

1153 The ordinary meaning of “*key personnel*” refers to employees of the foreign investor which are indispensable to the running of the investment project. The term is limited to persons who are decisive to the success of the investment. Its meaning cannot be extended to persons which have only an important role to play in the operation of the business.

2. No contention nor proof of any failure to permit the employment of key personnel

1154 Claimants have not offered any proof that Mr. Cornegruta and the unnamed other four general managers form part of the exclusive group of key personnel in terms of Article 11(2) of the ECT. They failed to even contend that these persons were indispensable to the running of KPM and TNG.

¹²¹⁴ Webster’s New World College Dictionary, 4th edition 2001, page 466 (**Exhibit R-309**).

¹²¹⁵ Webster’s New World College Dictionary, 4th edition 2001, page 466 (**Exhibit R-309**).

- 1155 Moreover, Claimants have failed to contend and prove that the Republic enacted any domestic employment legislation whereby KPM's and TNG's alleged key personnel were prevented from being hired. Also, Claimants have failed to contend and prove that the Republic ousted KPM's and TNG's alleged key personnel with force.
- 1156 Instead, Claimants allege that the criminal proceedings against Mr. Cornegruta on behalf of KPM as well as against four other general managers and the interrogation of other employees violate Article 11(2) of the ECT because "*Claimants had no choice but to recall all their key personnel from Kazakhstan*".¹²¹⁶ This is not true.
- 1157 The criminal proceedings against Mr. Cornegruta on behalf of KPM as well as against four other general managers and the interrogation of other employees were lawful.
- 1158 The proper treatment of Mr Cornegruta during the inspections has been dealt with in Sections C.VII and C.VIII of the Rejoinder Memorial on Jurisdiction and Liability by explaining how due process was followed in all the actions of the Republic. For example, in respect of the arrest of Mr Cornegruta, he was convicted of a serious crime, and the penalty was imprisonment. It is notable that Claimants suggest that this should require the removal of their key personnel from the country. This suggests that Claimants are willing to assist their key personnel from facing the consequences of illegal behaviour. In turn this suggests that the detention of Mr Cornegruta in April 2009 (on suspicion that he would flee the country) was well-founded.
- 1159 In conclusion, the criminal proceedings and interrogations of KPM's and TNG's employees have not hindered Claimants from employing key personnel of their choice.

¹²¹⁶ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 555.

E. ARBITRATION PROCEDURE

1160 In their Reply Memorial on Jurisdiction and Liability Claimants allege that the Republic tried to “*railroad [the] Tribunal [...] with a barrage of obstructionism, procedural misconduct, and outright deceit.*”¹²¹⁷ However, every example Claimants give to illustrate such behaviour is flawed.

I. The Republic acted properly in the arbitration procedure

1161 In particular, the mutual request for a suspension of arbitration proceedings for three months in early 2011 and the objections to the jurisdiction of the arbitral tribunal raised by the Republic in its Statement of Defence are not an expression of obstructionism or procedural misconduct but rather of rightful and common conduct in investment treaty arbitrations.

1. Stay of proceedings in early 2011

1162 The example given for alleged “procedural misconduct”¹²¹⁸ refers to the Republic’s request for the suspension of the arbitration for three months to allow for a settlement negotiation in early 2011. Claimants label this “procedural misconduct” even though the reason for the request was that the parties had made recent progress in settling the matter amicably. This is confirmed by the fact that Claimants agreed to the stay of proceedings. Therefore, the Republic’s reason for the stay was not to delay proceedings as Claimants allege, but quite to the contrary to end proceedings by settlement agreement.

1163 Claimants try to intertwine the stay of proceedings with their failure to comply with the period for amicable resolution requirement in Article 26 of the ECT. But the period for amicable resolution refers to the period the Investor party needs to wait before the dispute may be submitted to arbitration, not afterwards. Here, the settlement discussions occurred after

¹²¹⁷ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 22.

¹²¹⁸ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 23.

the Request for Arbitration was submitted. Therefore, the period for amicable resolution and the stay of proceedings during the proceedings are completely independent of each other and the former cannot be replaced by the latter.¹²¹⁹ Furthermore, the Republic proposed the settlement period *expressis verbis* without prejudice to the jurisdictional issues that this defect could later cause.¹²²⁰

2. Objections to jurisdiction

1164 In their Reply Memorial on Jurisdiction and Liability Claimants complain about the Republic's alleged "strategy of obstructionism"¹²²¹, citing as example the Republic's objections to the jurisdiction of the arbitral tribunal raised in its Statement of Defence. Claimants ignore the fact that lack of jurisdiction is a very common and decisive issue in investment treaty arbitrations. In many prominent investor-state disputes under the ECT have tribunals held a preliminary hearing on jurisdiction¹²²² and in one decided in favour of the state¹²²³. In other investment treaty arbitrations, awards on jurisdiction ending the proceedings are being rendered on a regular basis.¹²²⁴ The Republic raises objections to the jurisdiction of the arbitral tribunal because these have merit. The Republic protects its rights and at the same time observes the arbitral procedure by respecting the tribunal's Kompetenz-Kompetenz. This is not obstructionism, but perfectly common and rightful behaviour in investment treaty arbitrations.

¹²¹⁹ See section B.V. above.

¹²²⁰ C-350, page 3: "*We offer this as a practical solution that best serves the interests of the parties notwithstanding the fact that this jurisdictional defect could result in dismissal after full briefing and hearing on the merits.*"

¹²²¹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 24.

¹²²² For example *Petrobart Ltd. (Gibraltar) v. Kyrgyzstan* (2003); *Yukos Universal Ltd. (UK - Isle of Man) v. Russian Federation* (2005); *Hulley Enterprises Ltd. (Cyprus) v. Russian Federation* (2005); *Veteran Petroleum Trust (Cyprus) v. Russian Federation* (2005); *Ioannis Kardassopoulos (Greece) v. Georgia* (2005); *Mohammad Ammar Al-Bahloul (Austria) v. Tajikistan* (2008).

¹²²³ *Caratube International Oil Company LLP v. Kazakhstan* (2011).

¹²²⁴ E. g. *ICS Inspection and Control Services Limited (United Kingdom) v. Republic of Argentina*, UNCITRAL, PCA Case No. 2010-9 (UK/Argentina BIT); *Canadian Cattlemen for Fair Trade v. United States*, UNCITRAL (NAFTA); *RosInvestCo UK Ltd. v. The Russian Federation*, SCC Case No. Arb. V079/2005 (UK/Soviet BIT); *Joy Mining Machinery Limited v. Egypt*, ICSID Case No. ARB/03/11 (United Kingdom/Egypt BIT); *Phoenix Action, Ltd. v. Czech Republic*, ICSID Case No. ARB/06/5 (Israel/Czech Republic).

3. “Sleeper” reports

1165 Another example for the Republic’s alleged obstructionism is, in Claimants’ view, the contention that the “Sleeper” reports do not meet the requirements of Article 4(5) and Article 5(2)(e) IBA Rules and that the Republic failed to comply with its procedural duties.

a) IBA Rules on the Taking of Evidence in International Arbitration (“IBA Rules”)

1166 According to Article 4(5) IBA Rules each fact witness statement shall contain certain information such as a description of his or her relevant background, qualifications, training and experience as well as an affirmation of the truth and the signature. Claimants allege in their Reply Memorial on Jurisdiction and Liability that these requirements have not been met with respect to the “Sleeper” reports.¹²²⁵

1167 However, the IBA Rules do not apply to the case at present because they only serve as additional guidelines pursuant to Section 6 Procedural Order No. 1 of 12 January 2011. This provision stipulates:

*“The Parties and the Tribunal may use, as an additional guideline, the 2010 version of the “IBA Rules on the Taking of Evidence in International Arbitration”, always subject to the SCC Rules and changes considered appropriate in this case by the Tribunal.”*¹²²⁶

1168 The wording “may” means that the use of the IBA Rules is not mandatory in the arbitral proceedings at present. The Republic chooses to rely solely on the SCC Rules, which do not set such narrow limits to the submission of witness statements as the IBA Rules. Therefore, the allegation that the documents do not meet the requirements of Article 4(5) IBA Rules is irrelevant.

1169 Moreover, in Annex 1 of Procedural Order No. 2 of 3 February 2012 the Tribunal had clearly outlined the next steps the Republic needed to take with regard to the documents on which the “Sleeper” Reports rely:

¹²²⁵ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 25.

¹²²⁶ Procedural Order No. 1 regarding the further procedure of 12 January 2011, page 4.

*“Further, the Tribunal clarifies that, in so far as Respondent has submitted exhibits, in particular statements and reports (which Claimants refer to as “Sleeper” Reports and Statements), the Tribunal has admitted Claimants’ requests that documents on which such exhibits rely, etc., shall be produced. However, if Respondent chooses not to produce such documents, this will be taken into account by the Tribunal regarding the evidentiary value of such exhibits. The same may apply, if persons who have produced such exhibits and who are called for cross examination by Claimants, do not appear at the hearing for cross examination.”*¹²²⁷

1170 Considering this detailed roadmap on the production of documents on which the “Sleeper” reports rely and the adverse procedural consequences looming in case of disregard, the arbitration proceedings have not at all been obstructed. Quite the contrary, the Republic is committed to procedural transparency and has been advancing the proceedings by complying with its procedural duties in general and the aforementioned request of the Tribunal to produce the documents in particular. This is acknowledged by Claimants in their Reply Memorial on Jurisdiction and Liability, where they admit that the backup documents have been disclosed by the Republic on 2 April 2012.¹²²⁸

1171 Claimants contend that prior to 2 April 2012 the Republic withheld the documents on which its experts reports including the “Sleeper” reports rely, thereby violating Article 5(2)(e) of the IBA Rules.¹²²⁹ According to this provision party-appointed experts shall include into their reports all documents on which they relied that have not already been submitted. As shown above, the IBA Rules serve only as additional guidelines to the arbitration proceedings at hand and are not binding for either party. Hence, a possible violation of the IBA Rules is irrelevant in this context.

¹²²⁷ Annex I to Procedural Order No. 2 regarding Claimants’ request for production of documents of 3 February 2012, page 1.

¹²²⁸ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 26.

¹²²⁹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 26.

b) Compliance with procedural duties

1172 Furthermore, it should be noted that the Republic withheld the documents not to irritate Claimants but with good cause. As counsel to the Republic, Professor Zenkin, explained in his email to the Arbitral Tribunal dated 11 April 2012:

*“A state is a very complex mechanism. It requires certain time to obtain any document from a state body, especially if the document is abstractedly identified. T[o]ns of documents may fall under one and the same request. At the same time we draw your attention to the fact that the documents which were submitted to the Claimant on 2 April 2012 were not in possession of the Ministry representing the Republic in this arbitration, inter alia many of them were deposited in custody of the state archive.”*¹²³⁰

1173 Due to the prerequisite to coordinate the various public authorities to get access to the vast amount of documents requested by Claimants, it was technically not feasible to produce these any sooner than 2 April 2012. What is crucial is that the Republic disclosed the documents before the expiration of the deadline set out in Procedural Order No. 3 of 24 March 2012.¹²³¹

1174 Alas, Claimants do not acknowledge the production of documents within the period prescribed by the Tribunal. Instead, they draw into focus the not yet demonstrated and, above all, irrelevant allegation that the reason for disclosing the documents on 2 April 2012 was not the Republic’s aspiration to comply with its procedural duties but a meticulously thought out plan to force Claimants to seek extensions. What Claimants fail to explain is why such alleged action plan should even matter given the deadline set by the Tribunal. How is the Republic supposed to be in a position where it is able to make the arbitration “as costly, time-consuming and difficult as possible”¹²³² for Claimants when the Tribunal has set a deadline and the

¹²³⁰ Email by Professor Zenkin to the Arbitral Tribunal dated 11 April 2012, page 3 (**Exhibit R-313**).

¹²³¹ Procedural Order No. 3 of 24 March 2012, page 2.

¹²³² Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 30.

Republic met this deadline? It is not. Indeed, for the extension Claimants sought they have only themselves to blame.

1175 Seeking an extension despite the Republic's compliance with the deadline was a motion of Claimants' own choice. It stems from Claimants' shortcomings in engaging a bilingual counsel to analyze the documents in their original language Russian and from their lack of aptitude or willingness to identify and discard any irrelevant information in the documents.¹²³³ Such information concerns documents which had already been in the possession of Claimants (for example results of conducted audits) or originate from Claimants (for example technological schemes of field development and estimate documentation) as well as vast parts of documents in which only very few paragraphs are of interest to Claimants.¹²³⁴ This is a typical example of how Claimants try to pass off the Republic's adherence to due process as part of a so-called "strategy of obstructionism", a figment of Claimants' imagination.

II. Claimants did not act properly in the arbitration procedure

1176 Whilst Claimants readily accuse the Republic of procedural misconduct, it was in fact solely Claimants who have not acted properly in the arbitration procedure.

1177 In particular, Claimants contend that the Republic's Statement of Defence "is riddled not only with exaggerations and implausible inferences, but also with outright misstatements of fact and law".¹²³⁵ This egregious accusation is not only false but seems ironic because Claimants themselves have been exposed to various misstatements and misquotations:

- (a) Along with their Reply Memorial on Jurisdiction and Liability Claimants have submitted new translations of a number of exhibits in the Statement of Claim, for example of C-8.

¹²³³ Email by Professor Zenkin to the Arbitral Tribunal dated 11 April 2012, page 4 and 5 (**Exhibit R-313**).

¹²³⁴ Email by Professor Zenkin to the Arbitral Tribunal dated 11 April 2012, page 5 (**Exhibit R-313**).

¹²³⁵ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 29.

- (b) Complete copies of important Russian original documents such as C 39¹²³⁶, C-45¹²³⁷, C-115, C-139 or parts of documents such as in C-486 to C-499¹²³⁸ are missing.
- (c) English translations are missing, for instance of C-50, C-52¹²³⁹, C-97, C-155¹²⁴⁰, C-156 and C-441.
- (d) In some cases English translations of documents are not only inaccurate but partially wrong, as in C-8,¹²⁴¹ C-23¹²⁴², C-45¹²⁴³, C-52¹²⁴⁴, C-98¹²⁴⁵, and C-133.¹²⁴⁶
- (e) Also, some of the documents seem to be fabricated, for example C-459¹²⁴⁷ and C-520.¹²⁴⁸

1178 Claimants further allege that the Republic produced more than 17,000 documents comprising more than 30,000 pages and sent them to Claimants only eleven days before Claimants' Reply Memorial was originally due.¹²⁴⁹ Since Claimants seem to have spent a considerable amount of time on counting pages, the Republic would like to address this accusation. The

¹²³⁶ The Russian original does not refer to the Articles of Association of TNG but of KPM.

¹²³⁷ All Russian documents are scanned copies, not originals of the requested documents.

¹²³⁸ Minutes of arrest regarding Contract No. 305, 210 and 302, TNG's condensate pipeline and KPM's property are missing.

¹²³⁹ English translation of the letter by Goriumov is missing which is included in the Russian original.

¹²⁴⁰ There is no English translation of the 45-paged Notice No.28.

¹²⁴¹ „Тщательно проверить“ means “thoroughly check”, not “investigate”.

¹²⁴² “Прошу Вас“ means „I ask you to“, not „I request“.

¹²⁴³ English translation contains two pages on the minimum work program and additional Appenixes which are not included in the Russian original and six pages on geological allotment instead of two pages in the the Russian original.

¹²⁴⁴ “Джандосов“ means „Dzhandosov“, not „Saidenov“.

¹²⁴⁵ “Доводы, указанные в жалобе, [...] будут проверены и оценены с точки зрения относимости, допустимости и достоверности в ходе предварительного следствия“ means „the arguments set forth in the complaints [...] will be considered and evaluated in terms of relevance, admissibility and credibility during the preliminary investigation“, not „the arguments stated in the complaint are inconsistent“.

¹²⁴⁶ English translation does not mention the words which have been stroked out in the Russian original.

¹²⁴⁷ In C-459 the sentences were copied from another document and then put on the blank white paper.

¹²⁴⁸ On Terra Raf's letters there is usually displayed the number of incorporation of Terra Raf No. 68069, but the letter of C-520 is undated and shows a different number of incorporation No. 2257.

¹²⁴⁹ Reply Memorial on Jurisdiction and Liability dated 7 May 2012, para. 27.

Republic estimates that the pages of documents disclosed amount to only 25,000, the lion's share of which - approximately 22,000 pages - only contained technical data or supported the GCA and Deloitte reports respectively. This leaves only approximately 3,000 pages of non-technical documents like contracts, acts of inspections, reports and letters. Considering that Claimants themselves produced approximately 2,000 to 3,000 documents of such nature, there is not much difference to their own procedural conduct.

F. Requests for Relief

The Republic requests the Arbitral Tribunal to issue:

- (a) **an order from the Arbitral Tribunal that dismisses all of Claimants' claims;**
- (b) **an order from the Arbitral Tribunal of all of its costs incurred and to be incurred as a result of this arbitration. The Republic thus requests that the Claimants be ordered to reimburse the Republic for, inter alia, the fees and/or expenses of the experts, consultants, witnesses, and legal counsel. The Republic hereby reserves the right to detail and document its claim for such foregoing costs, which by their very nature are continuing, at the appropriate future time as directed by the Arbitral Tribunal.**

Respectfully submitted on behalf of Respondent,

I. V. Zenkin



NORTON ROSE LLP

Dr. Patricia Nacimiento

Joseph Tirado

