In the matter of an arbitration
under the Rules of Arbitration
of the Arbitration Institute of the
Stockholm Chamber of Commerce

No: V (116/2010)

ICC Hearing Centre
112, avenue Kléber
75016, Paris

Day 1 Monday, 1st October 2012
Hearing on Jurisdiction
and the Merits

Before:

PROFESSOR KARL-HEINZ BÖCKSTIEGEL
PROFESSOR SERGEI LEBEDEV
MR DAVID R HAIGH QC

BETWEEN:

ANATOLIE STATI
GABRIEL STATI
ASCOM GROUP SA
TERRA RAF TRANS TRAIDING LIMITED

Claimants

-v-

THE REPUBLIC OF KAZAKHSTAN

Respondent

REGINALD SMITH, KENNETH FLEURIET, KEVIN MOHR, HÉLOÏSE HERVÉ, AMY ROEBUCK FREY, ALEXANDRA KOTLYACHKOVA and VALERYA SUBOCHEVA, of King & Spalding, appeared on behalf of the Claimants.

DR PATRICIA NACIMIENTO, JOSEPH TIRADO, SIMON RAMSDEN, ZHANIBEK SAURBEK, MAX STEIN and SVEN LANGE, of Norton Rose LLP, and PROFESSOR IGOR V ZENKIN, of Moscow Regional Collegium of Advocates, appeared on behalf of the Respondent.

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ALSO APPEARING

FOR CLAIMANTS

ZHENNIA SILVERMAN, King & Spalding
VICKI MASON, King & Spalding
MIHAIL POPOVICI, Ascom Group SA

FOR RESPONDENT

ANASTASIA MALTSEVA, Norton Rose LLP
NATALIA NIKIFOROVA, Norton Rose LLP
MARAT BEKETAYEV, Secretary of the Ministry of Justice and Deputy Minister of Justice
YERLAN TUYAKBAYEV, Director of the Department of Legal Support and International Cooperation of the Financial Police
ALAN TLENCHIEV, Head of the Division on the Supervision over Compliance with Environmental Legislation of the Department of Supervision over Compliance with Legislation in the socio-economic sphere of the General Prosecutor's Office
AMAN SAGATOV, Senior Prosecutor of the Division on the Supervision over Compliance with Environmental Legislation of the Department of Supervision over Compliance with Legislation in the socio-economic sphere of the General Prosecutor's Office
GANI BITENOV, Chief Expert of the Department of Protection of State Property Rights of the Ministry of Justice
PROFESSOR MARTHA BRILL OLCOTT, Carnegie Endowment for International Peace

FOR THE TRIBUNAL

KATHERINE SIMPSON, Secretary to the Tribunal

INTERPRETERS

ALEXANDRE TCHEKHOV, Russian-English Interpreter
NATALY HOLM, Russian-English Interpreter
DANIELA IONESCU, Romanian-English Interpreter
SILVIA STATESCU, Romanian-English Interpreter

09:30 Monday, 1st October 2012

(9.32 am)

THE CHAIRMAN: Good morning, ladies and gentlemen. I see all chairs occupied, so that seems to indicate that everybody is here who should be here. So may I welcome you to this hearing in the SCC Arbitration 116 of 2010 between four claimants, Anatolie Stati, Gabriel Stati, Ascom Group and Terra Raf Trans Traiding, versus the Republic of Kazakhstan.

May I introduce the Tribunal: on my left, David Haigh QC, and on my right, Professor Sergei Lebedev. I am Karl-Heinz Böckstiegel, as you probably have guessed by now. And behind us is Katherine Simpson, the Secretary to the Tribunal, of whom you have heard before as well.

I welcome you here. We have distinguished parties in this case, as well as distinguished lawyers representing them. I therefore have no doubt that it should be, in spite of the many disputed areas and large financial relevance of this case, to conduct this hearing from the side of all concerned in a professional way.

Let me first recall that this hearing is on jurisdiction and liability only, and that a further hearing will take place in January 2013 on quantum.

09:34 To avoid any misunderstanding during the hearing, and in order to have just one reference document, the Tribunal, in its Procedural Order No. 5 of 18th September, has recalled all earlier rulings still relevant for the hearing and added all new rulings for this hearing. I will not repeat all this here, but I suggest that we use Procedural Order No. 5 as our reference document.

But let me just recall the following nevertheless: first, the agenda.

Number 1 is introduction by the Chairman: that is obviously what is happening right now.

Number 2: opening statements of not more than a total of two hours for each party; first on jurisdiction, the respondent up to 30 minutes and the claimants up to 30 minutes; and thereafter on all other issues including the merits, for which the claimants have up to 90 minutes and the respondent has also 90 minutes.

Regarding the examination of fact witnesses, also from Procedural Order No. 5: in order to make most efficient use of time at the hearing, written witness statements shall generally be used in lieu of direct oral examination, though exceptions may be admitted by the Tribunal. Therefore, insofar as at the hearing

witnesses are invited by the presenting party or asked to attend at the request of the other party, the presenting party may introduce the witness for up to five minutes, and add a short direct examination on issues, if any, which have occurred after the last written statement of the witness has been submitted. The remaining time shall be reserved for cross-examination and re-direct examination, as well as for questions by the arbitrators.

Unless otherwise agreed by the parties, first there will be the examination of claimants' fact witnesses, in the order set by claimants. For each witness, the examination will be conducted as follows: (a) an affirmation of the witness to tell the truth -- I have prepared a text for that declaration that I will put on the table there; (b) a short introduction by claimants; (c) cross-examination by respondent; (d) re-direct examination by claimants, but only on issues raised in cross-examination; (e) re-cross-examination by respondent, but only on issues raised in re-direct examination; and (f) thereafter, remaining questions by members of the Tribunal, but we may raise questions at any given time if we feel it fits better at that time.

Then we will have the examination of the respondent's fact witnesses in the order set by the

09:37 respondent. For each, the examination will be conducted as mentioned for the claimants' witnesses just a minute ago.

Regarding the examination of experts, following a little dispute, it has been established that no experts will be examined orally at the hearing. I draw attention to the respective rulings in the Tribunal's letter of 11th September 2012 regarding experts.

Any witness may only be recalled for rebuttal examination by a party or the members of the Tribunal if such is announced at the time of the first examination, to ensure the availability of the witness during the time of the hearing.

6 -- we are still on the agenda -- remaining questions by the members of the Tribunal, if any.

7. A discussion regarding the timing and details of post-hearing submissions and other procedural issues, including the question whether post-hearing briefs shall be submitted soon after the October hearing, or only after the January hearing.

Furthermore, let me recall from Procedural Order No. 5 the following: as ruled in section 4.11 of Procedural Order No. 4, the hearings shall be held from today, 1st October, to 5th October; and, if found necessary by the Tribunal after consultation with the

parties, extended to continue to 8th and 9th October. No extension of the hearing will be possible beyond that time.

To give sufficient time to the parties and the arbitrators to prepare for and evaluate each part of the hearings, the daily sessions will not go beyond the period from 9.30 am to 5.30 pm. However, the Tribunal, in consultation with the parties, may change that, depending on where one is at the time of the hearing.

In accordance with section 10.5 of Procedural Order No. 1 -- this is still from Procedural Order No. 5 -- the Tribunal established the following maximum time periods which the parties shall have available for their presentations and examination and cross-examination of all witnesses. Taking into account the calculation of hearing time attached to Procedural Order No. 5, the total maximum time available for the parties, including their opening statements and closing arguments, if any, shall be as follows: 15.5 hours for claimants and 15.5 hours for respondent.

It is left to the parties how much of their allotted total time they want to spend on their various agenda items which are mentioned, as long as the total time period allotted to a party is maintained. Our Tribunal Secretary will keep track of the time used by each side

09:40 and can inform us at the end of each day where we are, if you are interested.

In addition to this recollection of earlier rulings and agreements, may I point out the following regarding the intention and scope of the hearing.

Since the beginning of this arbitration, many and voluminous submissions have been filed, including extensive arguments and many exhibits. Furthermore, procedural orders and other rulings have provided further opportunities for the party to submit more arguments and more exhibits. This was done to ensure that, with regard to all issues, every party had a full opportunity to present all factual and legal aspects of its case and answer fully to what the other party has presented. This exchange was intended to lead to an oral hearing at which as much as possible, so to speak, all the facts are already on the table.

It is therefore not the intention of this hearing, nor is there time available during these days, to orally repeat all the material submitted in writing. To assure equal opportunity for both parties, the Tribunal has told both parties well before this hearing how much time they will have available for that purpose. The long and detailed procedure and the relevant orders of the Tribunal follow the common intention that as much as

09:42 possible the impression and evaluation of this hearing should not depend on surprises to the other party, but on a prepared, balanced exchange between the parties and with the Tribunal on the facts and the law of this case.

We must also recall that we are here not under the procedure as it is used before the courts of our home countries, but that we are here in an international arbitration procedure. As you know, the procedure shall be in accordance with the relevant provisions of the SCC Arbitration Rules, and that lacking provisions therein in respect of a given procedural issue, the procedure shall be determined by the Arbitral Tribunal.

In order to have a productive hearing, the Tribunal would be grateful if we would not use major parts of the limited time available in this hearing on procedural battles between the parties, but could concentrate on the factual and legal issues in this case.

In the same spirit, I suggest that we give each party time to finish their respective presentations as provided for in our agenda, and within the time given for these presentations, and that only thereafter the other party takes up procedural or substantive objections which it may have.

In the same spirit, finally, we, as members of the Tribunal, though we may raise a question at any time, as

09:43 I mentioned before, intend to normally wait with our questions until the respective presentation by the party has been finished. Experience in arbitration hearings of this kind shows that often a spontaneous question one may have at a given point of a party's presentation may be answered at a later stage within the same presentation or may pose itself differently after one has heard the comments of the other party. Therefore, often the question does not even have to be posed anymore once the presentation is finished.

Two remarks on logistics: for the benefit of the court reporter -- welcome again; we have met on other occasions before -- but also to ensure that everybody understands clearly what has been said, all oral communications in this hearing should be made into the microphones that you have in front of you.

Another trivial matter: please turn off your mobile phones or put them on vibration. It is very disturbing and embarrassing when you have these things going on all the time.

Further, the parties are also invited to provide us as soon as possible with a list indicating the order in which first claimants' and then respondent's witnesses shall be examined at this hearing.

Let me recall from my letter of 28th September the

09:45 following rules.

As far as the exclusion of documents not translated into English is concerned, we have some sort of a settlement, I have seen that, but I will ask you in a minute whether you have any further procedural matters in that regard.

Let me see whether I have the next point still open.

I think the matters raised in my letter of 28th September are to a great extent solved by now, but I will give you the opportunity, as soon as we are finished with this introduction and the introduction of the people in the room, to raise any other procedural matters that you have. I understand we did receive a motion from the respondent this morning which I haven't even read, but you will have an opportunity to present it and I'm sure you want to respond to that as well.

Alright. That's as far, I think, as I have to go. The parties have provided us, as I requested, this morning a list of the people attending on their respective sides in this room, but it would be nice to be able to connect names with faces; some faces we know, most we don't know. Therefore I would like to ask you to introduce the persons on your respective sides first. After that, I will give you a chance to raise any

09:46 procedural matters that are still open.

Alright. Having said that, could we start with the claimants' side, please.

MR SMITH: Thank you, Mr Chairman, members of the Tribunal. I am pleased to introduce my colleague Ken Fleuriet. To my right, Kevin Mohr. To his right, Amy Frey, to Kevin's right. Then Héloïse Hervé and Rick Toher. Continuing with members of my law firm down the table -- and you can just raise your hand -- I'd also like to introduce Alexandra Kotlyachkova, as well as Valerya Subocheva. Further down the table, also with the law firm of King & Spalding, Zhennia Silverman, as well as Vicki Mason. I'd also, members of the Tribunal, like to introduce our clients in this matter: Mr Anatolie Stati, Artur Lungu, Grigore Pisica, as well as Alexandru Condorachi.

THE CHAIRMAN: Thank you very much. Respondent?

DR NACIMIENTO: On respondent's side, I am starting with the representatives of the Republic. It's Marat Beketayev, the executive secretary of the Ministry of Justice -- you may raise your hand -- Yerlan Tuyakbayev, the director of the department of legal support and international cooperation of the financial police; Alan Tlenchiev, head of the division on the supervision of compliance and environmental legislation of the

09:48 General Prosecutor's Office; Aman Sagatov, the senior prosecutor of the division also from the General Prosecutor's Office --

MR HAIGH: Excuse me. I didn't see the hands going up on the last two names.

DR NACIMIENTO: Okay, they are outside of the room. I'm sorry for this.

Gani Bitenov, he is from the Ministry of Justice; Professor Zenkin; and Professor Olcott. And from Norton Rose legal team, I have to my left Joe Tirado, Max Stein, Simon Ramsden, Natalia Nikiforova, Anastasia Maltseva and Zhanibek Saurbek, to my right Sven Lange, and I am Patricia Nacimiento.

THE CHAIRMAN: Thank you very much indeed.

Alright. That brings us to the point where I wanted to ask anyway, and now I know it's necessary, whether the parties have any procedural matters to raise at this time. Claimants?

(9.49 am)

Discussion re procedural matters

MR SMITH: Yes, Mr Chairman. I believe there are three matters that need to be addressed this morning, and I believe that we have agreement in essence on two of them.

The first relates to a request submitted by the

09:49 claimant on Friday, September 28th to introduce two additional exhibits into the record. Those are preliminarily marked as Exhibits C-718 and C-719. This is a letter exchange that occurred in 2008 and 2009 between the financial police authority in Kazakhstan and the Ministry of Energy and Natural Resources. The author of C-718 is a witness in this proceeding with the financial police office, Mr Rakhimov.

Mr Fleuriet, in communication with the Tribunal, set forth very briefly why the claimants view these documents to be highly relevant to the proceeding. I am happy to get into as much detail on that issue as possible. However, we received an email communication last night from counsel for the respondent and, while objecting to what they view as the delinquency in the submission of these exhibits in advance of the proceeding, they have proposed what I understand to be a compromise, which is that Mr Rakhimov be permitted to introduce a third witness statement, as well as several additional documents that they have provided, both in Russian and English, I think with one exception. And there was a promised translation on the last document today.

The claimants have no objection to the third witness statement of Mr Rakhimov, have no objection to the

09:51 introduction of the new exhibits, and I believe with that understanding then the parties are now in agreement that Exhibits C-718 and C-719 will come into the record, as well as the third witness statement of Mr Rakhimov and the additional exhibits that the respondent proposes to enter into the record.

THE CHAIRMAN: Thank you. Respondent?

DR NACIMIENTO: I would like to put this into the chronological order --

THE CHAIRMAN: I'm sorry, I don't want to repeat it all the time, but somehow you are much more difficult to understand. Either you speak up more or move closer.

DR NACIMIENTO: Is this better?

THE CHAIRMAN: Yes.

DR NACIMIENTO: I would like to put it into the chronological order of what happened as of last week. We are only speaking about the events of a week, starting on 15th September, when claimants requested leave to submit a new document. Procedural Order No. 5 allowed claimants to submit those new documents, and they were submitted on 21st September. We saw that there were 400 pages, most of them or a large part of it in Russian, and we therefore requested to exclude the non-translated exhibits.

THE CHAIRMAN: But we know all that, so you don't have to

09:52 repeat it. We know it.

DR NACIMIENTO: Yes, and I am coming to the point: it has then been superseded by the events, because this is when we asked to be informed of which parts of the documents claimants are going to rely on. And I confirm that we have received the list this morning, and I would say this issue is settled. It is also settled that the Russian documents are being withdrawn.

We then replied to the email received last Friday, and we have submitted the further documents, and they are in direct reply to those documents, they refer to them. The missing translation is going to be submitted later today. And we have also a letter that was submitted over the weekend without a signature; we will submit it with a signature now because we received it this morning.

THE CHAIRMAN: So do I understand correctly that therefore the matters are settled between the parties by now?

DR NACIMIENTO: Yes. For the time being they are settled, and those documents, as I understand it, are introduced now into the proceedings.

THE CHAIRMAN: Well, I am grateful to both sides for settling this between them. It is obviously much better to do it that way than having us going back and forth between the parties on these matters.

09:54

In principle I think it is also preferable to have whatever documents are still available at this time available to the Tribunal, rather than excluding them and then have due process questions coming up and so on. So I am very grateful to both parties as far as that is concerned.

MR SMITH: Mr Chairman, we have, at least on our side, one other procedural matter, and we may or may not have a dispute regarding this.

In connection with a newly admitted exhibit, not the two that were admitted this morning but C-111.1 -- the respondents -- to which claimants did not object and do not object -- submitted a new witness statement from a witness addressed to the content of that document; that is from a Mr SD Rakhimov, who I understand is not to be confused with the Mr Rakhimov that I referred to earlier, who has submitted prior statements in this proceeding.

As I said, Mr Chairman, the claimants do not object to the new statement from Mr Rakhimov in response to C-111.1. We have, however, sent a communication to counsel for the respondent requesting that Mr Rakhimov be made available for a brief cross-examination regarding that new statement.

We believe that the entitlement of the claimant in

09:55 this particular instance to cross-examine this witness is especially important because the witness essentially -- if I read his statement correctly -- is disputing the authenticity of the document. Therefore, we believe that if that challenge has been made to the document that has been submitted by the claimant, then the claimant certainly should be permitted an opportunity to cross-examine this new witness on the subject-matter. We don't believe that it will unduly prolong the proceedings: we understand that cross-examination of course will have to happen within the time limits that have already been imposed on the claimant.

THE CHAIRMAN: Do you have any reply to that?

DR NACIMIENTO: We are in contact with Rakhimov, and he is available for cross-examination. He is obviously not here, he doesn't have a visa. We propose to examine him via video conference, and that could be done the same day on which we have also Dr Kim by video conference.

THE CHAIRMAN: Would that be okay?

MR SMITH: It certainly would be our preference to cross-examine him in person, particularly given the nature of the allegations that he has made in his statement. Obviously I think we all understand that this is a new request, and there are visa issues.

09:56 I guess what I would ask of the respondent is to try, to the extent possible, to expedite his visa, and then let's find out where we are perhaps later in the week.

THE CHAIRMAN: Alright. So I take it that if he can't come, it can be done by video conference, and I'm sure the parties will arrange it the same way as for Mr Kim. For which day is that, by the way?

DR NACIMIENTO: For the time being, we propose to do it next Monday.

THE CHAIRMAN: Alright.

MR HAIGH: Mr Chairman, could I just ask Dr Nacimiento: is the visa issue something that you are in fact pursuing?

DR NACIMIENTO: Actually this is just a very new development. Rakhimov submitted his witness statement in reply to a new document, and this happened only last week. We can pursue it, but we know also from experience that it will take a few days to obtain the visa.

MR HAIGH: Thank you.

THE CHAIRMAN: Alright.

Then I think without further ado we come to the opening statements, and that would mean that the respondent starts first on jurisdiction.

(9.57 am)

09:57

Opening statement on jurisdiction by MR TIRADO

MR TIRADO: Good morning, distinguished members of the Tribunal. Good morning, ladies and gentlemen. We have presented a presentation essentially in three parts on the jurisdiction issue, covering: there is in fact no real investor here; there hasn't been an investment, or indeed a qualifying investment; and a third category dealing with further objections. I will deal with the first two issues of no real investor and no investment, and my colleague Patricia Nacimiento will finish up the presentation dealing with the further objections.

Without further ado, it is the [respondent's] case that there are no real investors within the meaning of the ECT. For this reason alone, the claimants cannot be granted protection under the ECT. The Statis -- Anatolie and Gabriel -- are no investors because it must be presumed that they were mere front-men for political interests.

In this regard, we have the evidence of Professor Martha Olcott, a renowned specialist for Central Asia, and for Kazakhstan in particular, who has been doing research and writing on Kazakhstan since the 1970s. She is currently working for Carnegie Endowment for International Peace in Washington DC, one of the most prominent think-tanks on international policy

09:59 worldwide. Of course, the parties have chosen not to hear Professor Olcott and her counterpart Mr Horton at this hearing; nonetheless we will go through some of Professor Olcott's key findings now.

To begin with, Professor Olcott tells us that in her intensive studies of the Central Asian oil and gas industry, she has never come across Mr Anatolie Stati; neither have people she knows in the industry. He is thus certainly no prominent figure in the industry. In fact, Mr Stati came to money not in the oil and gas sector but in the construction business. As Professor Olcott tells us, and I refer to the quote here on the screen:

"Stati himself came out of the construction business in the USSR, and was reported to have had close ties with 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 ..."

She goes on to say:

"Many post-Soviet era fortunes were erected on this fundament."

This can be found at paragraph 94 of Professor Olcott's report.

Also --

10:01 THE CHAIRMAN: By the way, just a logistic question. These obviously will be useful; will we receive them on paper later?

MR TIRADO: Yes, sir.

THE CHAIRMAN: And on a USB as well at some stage?

MR TIRADO: Yes, sir.

THE CHAIRMAN: Because then we don't have to take all these notes.

MR TIRADO: Of course.

We also know from Professor Olcott that Anatolie Stati is very close to leading Moldovan politicians, in particular Pyotr Luchinskii. Again I refer you, if I may, to the quote on the slide, where Professor Olcott says, at paragraphs 98 and 101 of her report:

"... [Anatolie Stati] 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."

She goes on to say:

"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

10:02 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."

From all of that, we can conclude that the Statis in fact merely act as a front for various political interests. Again I refer the Tribunal, if I may, to the quote on the slide from the expert report of Professor Olcott -- this can be found at paragraph 109 -- where she states:

"[Stati's] success is based on Moldovan state leader, 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."

Notably this also extends to Gabriel Stati. The Tribunal will no doubt have noted that Gabriel Stati is not present in this hearing and that he has not submitted a witness statement. Claimants have not shown even the hint of any active involvement of Gabriel Stati in the Kazakh oil and gas endeavours of his father. In fact he is better known for being a hard partier than a hard working businessman.

Then turning on to the next slide. We will not go

10:03 into the details of these arguments, since these have been developed extensively by the parties in written submissions, but suffice to say that Ascom is denied the benefits of the ECT under Article 17(1), and it is the respondent's case that even if the claimants can prove that Anatolie Stati owns Ascom, the Republic asserts that Ascom is controlled by a citizen of a third state, in this case Romania, and has no substantial operations in the territory of Moldova. As for Terra Raf, this is incorporated in Gibraltar, to which the ECT does not apply.

Turning on to the second limb of the respondent's objection: this is that there has not been an investment or a qualifying investment. This is an equally important jurisdictional objection.

Claimants have not proven that they have made an investment. For this reason, the Tribunal again has no jurisdiction to hear the dispute. It is the Republic's position that the term "investment" in the ECT has an inherent meaning beyond the literal definition of Article 1(6) of the ECT. It requires -- and this was set out in the case of Phoenix Action Limited v The Czech Republic, an ICSID case arbitration number 06/5. This was from the award dated 15th April 2009 and can be found at Exhibit R-31.

10:05 The test is: (1) a substantial contribution in money or other assets; (2) a certain duration; (3) an inherent risk; (4) the furthering of the host state's economic development; (5) the investment being in accordance with the host state's law; (6) the investment being made in good faith; and in addition, a final requirement, the regularity of profit and return. This is picked up by Schreuer in his commentary on the ICSID Convention.

The claimants have questioned these well-established requirements of an investment. They argue that these criteria could only apply in ICSID cases and they say that any kind of asset was enough. However, this theory does not add up.

Firstly, the ECT definition of "investment" does not simply refer to every kind of asset; instead, it in turn refers to the term "investment", namely in the subparagraphs 2 and 3 of Article 1(6), and we have thrown these up on the screen for you by way of reminder.

In fact, on first sight this may seem somewhat tautological. In fact, however, this technique of defining "investment" by reference to investment is found in many BITs, particularly in US BITs. In the context of these BITs, it is generally accepted that because of the investment reference, not every kind of

10:07 asset but rather only assets with the character of an investment would be covered. We refer you to KJ Vandevelde, US International Investment Agreements, Oxford University Press, 2009, at pages 114-115 and 121-122.

Hence there is some inherent meaning in the term "investment". This inherent meaning is precisely contained in decisions of other investment tribunals dealing with the term "investment", be it in the ICSID or any other context. In these decisions, all of the requirements we put up on the screen just a moment ago can be found.

Secondly, if we look the Article 2 of the ECT, we see that the ECT aims to promote "long-term cooperation in the energy field". This requires much more than any kind of asset; it could also be a mere commercial transaction.

Thirdly, one should be mindful that the ECT, in Article 26, offers three different dispute resolution mechanisms: namely, ICSID, SCC and UNCITRAL arbitration.

For ICSID arbitration, the so-called Salini criteria are well established and are applied regularly. It would lead to random and unjustifiable results if the Salini criteria were only applied in ICSID cases but not in SCC cases. We refer you to the case of

10:08 Romak v Uzbekistan at paragraph 194.

There is no reason to apply criteria initially developed in ICSID jurisprudence, especially since the ECT uses the term "investment" to define investment. All of these arguments are well accepted in arbitral practice, and on the slide you will see the names of some of the relevant cases that we would refer the Tribunal to.

As mentioned before, investments have to be made legally and in good faith. In that regard, some additional considerations apply. Of course, the "investment" definition of the ECT does not explicitly require that investments be made in accordance with the host state's law. Nonetheless, it is generally accepted that even if the applicable investment treaty does not say so explicitly, compliance with the host state's laws is required.

This was stated only very recently, in fact this year, by the Tribunal in the case of SAUR v Argentina, again referred to on the slide, and also by the Phoenix Tribunal that I've already mentioned.

According to the SAUR Tribunal:

"... it is inconceivable that the State offers the benefits of protection by way of investment arbitration if the investor, in obtaining this protection, acted

10:10 against the law."

This can be found at the decision of jurisdiction and liability at paragraph 308.

This was also confirmed by the Tribunal in the Plama v Bulgaria case, specifically with a view to the ECT.

In addition, investments have to be made in good faith, as the Tribunal in Phoenix stated:

"... States cannot be deemed to offer access to the ICSID dispute settlement mechanism to investments not made in good faith."

So, based on what we have just established, the Republic makes five main objections to the existence of a protected investment: first, there was no substantial contribution by the claimants; second, there was no risk undertaken by the claimants; third, there was no contribution to the development of the Kazakh economy; fourth, there were numerous illegalities in the making and life of the alleged investment; and fifth, claimants made their alleged investment not in good faith.

With regard to this latter contention, due to time constraints we refer the Tribunal to the Republic's arguments in the statement of defence, in particular paragraphs 9.36-9.50, and in the rejoinder at paragraphs 205-215.

10:12 So the claimants only made very minor contributions in this case. Only with their reply have the claimants chosen to provide the Tribunal and the Republic with some documentary evidence on their contributions. These documents, however, are presented somewhat obscurely in footnote 162 at page 43, and are far from clear.

For example, there is evidence of Ascom making payments to a company called Kaihar-Limited in the amount of roughly US$1.5 million. I refer you to Exhibit C-383. Claimants allege that this has nothing to do with the acquisition of shares in TNG. Yet there is no documentary proof of this. In particular, there is no SPA between Kaihar and Ascom; the payments could have been for anything.

There are some other numbers floating around, such as the US$9 million payment for 38% of the shares in KPM. What is important in that regard: there is a clear disconnect between the alleged contribution and the amounts claimed in this arbitration. The claimants' claims runs into billions, yet they bought the companies in question for only a fraction of the amounts claimed. This is frankly irreconcilable.

Of course, some capital was put into the companies post-acquisition. However, if there were contributions, they did not come from the claimants but from

10:13 bondholders under the Tristan bond structure. We will look more closely at the Tristan bond structure in just a moment.

For now it should suffice to say that there is an affiliated company of the claimants called Tristan Oil Limited, which is registered in the BVI. Tristan issued bonds and effectively forwarded the monies raised to KPM and TNG via loans. Against this background, it is clear that any post-acquisition contributions effectively came from the bondholders and not from the claimants. Claimants have not provided proof of their own capital being contributed to the companies.

If I can refer the Tribunal to the next slide. "Risk" means the investor has to undertake a risk, and in that we rely on the case of Toto v Lebanon in the decision of jurisdiction at paragraph 84, where it is quoted:

"[The concept of investment] 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."

So again, if I may refer the Tribunal to the next slide, this deals with the basic bond structure.

10:15 Bondholders provided US$420 million in 2006 and 2007, and further amounts in 2009. The funds were handed down from Tristan via loans to Ascom and Terra Raf, which in turn lent the monies to KPM and TNG. KPM and TNG had to pay interest on the loans, as did Ascom and Terra Raf. The interest was used to make coupon payments on the bonds.

Under the Tristan bond structure, all risks were borne by the bondholders. Claimants did not undertake any risks. First of all, neither of the Statis was a party to the bond transactions, and neither of the Statis gave any kind of security for the bondholders. In case of a default on the bonds, neither Stati was to pay anything.

Second, claimants Ascom and Terra Raf acted as guarantors for the bonds, but only had to pledge their shares in KPM and TNG as collateral. If I may refer the Tribunal to Exhibit C-585. Of course, the vast majority of the capital in KPM and TNG was from the bondholders in the first place. Thus also Ascom and Terra Raf effectively did not undertake any risk.

Claimants' activities further did not contribute to the development of the Kazakh economy. That is firstly because [claimants'] business was structured in a way to divert income away from the Kazakh economy. As

10:16 Professor Olcott explains, and you'll see the quote from her report on the slide:

"While the complainant states that he made a nearly billion dollar investment in this project ... 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 maximise income for the principals that could not be taxed by the Kazakh government ..."

This was done by creating numerous companies in offshore havens. Claimants structured their business in a way so that KPM and TNG became indebted to these offshore companies. This led to KPM and TNG being liable for less tax in Kazakhstan. Moreover, even though they had reduced their tax burden to a large extent, claimants still tried to pay less, and incorrectly amorticised drilling expenses. Of course this led to a dispute with the Kazakh tax committee. Ironically claimants now try to paint this dispute as a government harassment. We were later shown that there was in fact nothing improper about the tax committee's assessments.

It is also noteworthy that claimants failed to fulfil their obligation to train and educate Kazakh

10:17 specialists, as was established during inspections in June and July 2010.

Just the last couple of slides. Terra Raf has never become the legal owner of TNG. Claimants repeatedly failed to comply with the relevant provisions of the 1995 Law on Oil, and the Subsoil Use Law, and thus also failed to become the legal owners of TNG.

Prior to December 2004, any transfer of a controlling block of shares in a company with subsoil rights required the consent of the licensing and competent authorities; this comes from Article 53 of the Law on Oil. That's provided for on the slide, so I will skip that just to save a little time.

In particular, when Gheso and Terra Raf agreed on the transfer of 100% of the shares in TNG on 12th May 2003, they failed to seek this consent from the competent authorities. Claimants refute this applicability of Article 53 with two baseless allegations.

Claimants first state that Gheso and Terra Raf were affiliated companies, and thus did not require the state's consent. However, they failed to substantiate this allegation.

Mr Pisica has merely purported that at this time Gheso and Terra Raf had been subsidiaries of Ascom, but

10:19 has failed to provide a shred of evidence for this assertion. In fact, the only explanation Mr Pisica gives for why Terra Raf and Gheso should be affiliated is blatantly wrong. He claims that Ascom had the possibility to control the decisions taken by Terra Raf because both shared the same manager and shareholder: that is Mr Anatolie Stati.

But clearly Ascom is not a shareholder of Terra Raf, and the claimants have provided no other documents to suggest it had the ability to control Terra Raf. Ascom and Mr Anatolie Stati cannot simply be equated even if Mr Stati holds 100% of the shares in Ascom. Hence Ascom had no possibility whatsoever to control the decisions taken by Terra Raf, and therefore Gheso and Terra Raf cannot be considered affiliates.

Second, claimants challenge the applicability of Article 53 of the Law on Oil by referring to the hierarchy of laws and stating that the Subsoil Use Law governed instead. However, as Professor Ilyasova explained at page 38 of her report: the Decree on Oil explicitly states that in case of any discrepancy between the Law on Oil and other legislative acts of the Republic regulating petroleum operations, the Law on Oil shall prevail.

Hence it is clear that any transfer in 2003, and in

10:20 particular the transfer from Gheso to Terra Raf, required the state's prior consent. Still claimants refrained from seeking this consent. This was not the first time the claimants acted in this manner, and it failed to obtain consent too in relation to a total of eight transfers of TNG involving its companies. Professor Ilyasova explains that such transfers are null and void.

I think in the interests of time I would just refer the Tribunal, if I may, to the points actually made on the slides themselves. We say that Terra Raf never became the legal owner of TNG. TNG only applied for the state's consent after the Republic had prompted it to do so in February 2007. The Republic only authorised the transfer from Gheso to Terra Raf because it had been made to believe that it did not have a preemptive right. Once the Republic learnt about Terra Raf's registration as sole shareholder in TNG LLP, it decided to look into transfer.

Finally, Terra Raf never became the legal owner of TNG. Any transfer after 8th December 2004 would only be effective after the Republic's waiver of its preemptive right according to Article 71, section 3 of the Subsoil Use Law which claimants never sought, and the Republic rightfully revoked the prior authorisation of the

10:22 transfer because the claimants obtained this authorisation in circumvention of the Republic's preemptive rights.

I apologise for having to canter through the last few slides, but I think with that I will hand over to Dr Nacimiento for the last part of the presentation. Thank you for your attention.

(10.22 am)

Opening statement on jurisdiction by DR NACIMIENTO

DR NACIMIENTO: In the context of jurisdiction, the Republic raises also further objections, and these objections relate to the claimants' handling of evidence in these proceedings. It is the intentionally misleading translation of important documents, the documents that were obtained illegally, and finally claimants submitted documents that seem not to be genuine.

I am just going to lead you through some major examples here, starting with the intentionally misleading translation. I've put up on the screen C-98, claimants' exhibit. They characterised this exhibit in their statement of claim:

"... the Financial Police notified [KPM and TNG] that their complaints were rejected and that TNG ... was now the subject of a criminal investigation on the same basis."

10:23

If you look at the translation of C-98 on the left, this is the translation submitted by claimant. We have put up the Russian translation so this can also be reviewed. The Russian actual translation reads very differently. Actually it is saying that:

"The arguments ... will be considered and evaluated..."

So it is actually saying the opposite of what claimants purport that it's saying.

Another example is claimant's Exhibit C-8: that is President Nazarbayev's letter dated 14th October 2008. Here again a very significant difference in the meaning, and in particular in view of the fact that this letter is a main element of Stati's theory of conspiracy and harassment that was allegedly directed against Stati.

I put up the Russian version so that can be reviewed. In claimants' list of exhibits that letter is also described as the President's "investigating instructions". The translation of claimant also reads "investigate". The accurate translation actually is "thoroughly check", and that makes a big difference.

Let's turn to documents obtained illegally. We have a lot of inter-governmental documents presented in this case. Those were documents passing between government departments to which neither Stati or the other

10:25 claimants or KPM or TNG would have access to and should have access to. Many documents appear to be internal file copies or they purport to be official documents or official communications, and they are nevertheless presented without headings, stamps, or signatures.

I have put on the screen some examples, and you can read for yourself. The last one, C-711, is a document that we only received last week: it's an alleged report submitted by Rakhimov. We have submitted the reference showing that such report never existed.

It must be concluded that those documents were obtained illegally and in breach of Kazakh law.

The most serious and the most far-reaching objection relates to the most serious and far-reaching violations committed by Stati and the other claimants. Claimants submitted documents that are not genuine, and they submitted them as proof for their claims. Some of those documents were submitted only last week.

It's C-704, the transcript of the Cornegruta trial. Claimants' transcript is not signed, and it contains additions to or deletions from the true transcript. The Republic submitted the correct and actual transcript, and it also submits that this transcript was never sent outside of the court, meaning that the claimants not only obtained the transcript illegally but they also

10:27 submitted it with their own amendments as evidence in this case.

Here you can see on the right claimants' transcript, no signature; the original transcript, with signature and handwriting.

I have put up also some examples for you to review with more detail later regarding amendments that have been made, and I've put up the Russian and the English translation, and you can see that changes in the questions and in the answers have been made.

What is happening here is that documents submitted by Stati pretend to be simply the signed version of previously existing documents.

I just want to guide you very quickly to another example of documents that seem not to be not genuine. It is a [proof of payment] submitted only last week and now withdrawn. It's Exhibit C-702 of claimant. They are saying as an explanation in the letter to the Tribunal dated 23rd September that it is simply the signed and stamped version of C-459.

These are the two documents and if you compare them, we can see it's the same invoice number but a different date. Here you can see that on the right there are differences as to the left document. You see on the right there is no sending bank; on the left document

10:29 there is, and this is how it should be. C-702 has been withdrawn, and by doing so basically claimants have withdrawn apparently the only [proof of payment] that they have submitted in this case.

This (C-520) is a further short example of a letterhead where we can see differences, and that is purporting to be an official letterhead, and we see differences in the number. There is a different registration number and the date is missing.

MR HAIGH: Excuse me, Dr Nacimiento. As you refer to these documents, it will help our transcript if you would just mention the numbers as you go along with your comments. Thank you.

DR NACIMIENTO: Yes. Some of them actually are very new exhibit numbers, and of course you will receive them also in hard copy.

So, coming to the conclusion, claimant submitted numerous documents which are not genuine, which cannot have been obtained by legal means. What are the consequences and the conclusions to be drawn therefrom?

First of all, obtaining governmental documents without being entitled to is a violation of Kazakh law and it can constitute a criminal offence. That's the domestic law side and that is the material law side of these issues.

10:31

What are the procedural consequences? Let's take a look at what claimants are actually doing. They are trying to prove their case with documents that are not genuine and which may be forged. They also try to prove their case with documents that they obtained illegally.

So what does it say about Stati's attitude regarding the law and compliance with the law? What does it say about Stati's own view about the case if it takes recourse to such means to prove it? It can only mean that no real evidence exists, and simply this is because the claim is groundless.

Such actions have far-reaching consequences: they simply destroy Stati's and the other claimants' credibility. By submitting forged evidence, claimants are actually committing an attempted procedural fraud. We do not have to discuss the applicable law here; that is an attempted fraud under any conceivable aspect.

I am not implying here that Stati's counsel knew it when they submitted those documents. They know it now. And we must ask ourselves: why is Stati using forged and illegally obtained documents to attempt to prove his case? We must also ask: why is Gabriel Stati seeking protection as an investor from this Tribunal, but actually there is no trace of him, there is no trace of him in this arbitration, and there was never a trace of

10:33 him in Kazakhstan as an investor?

It is also worthwhile to mention that Stati's attitude as an investor to Kazakh laws and to procedural rules has nothing to do with the attitude of the real investors in Kazakhstan. You will see in this hearing examples of those typical investors: you will see a witness from Total, and you will see a witness from Korean National Oil Company. They reflect the typical Kazakh oil and gas business. Such business is international and it is in cooperation with the major worldwide oil companies.

Not only can claims not be proven by fraudulent means; such means must also be considered as scattering Stati's and the other claimants' complete credibility, and thus, as such, taking any basis for the claim.

The use of fraudulent means in arbitration must be sanctioned severely. Illegal acts and bad faith conduct bars any jurisdiction of this Tribunal. There must be an inference as to claimants' general approach to compliance with laws, and there must be further inference as to claimants' own view as to the merits of their case. Not only can claims not be proven by fraudulent means, but they must be dismissed, they must be sanctioned severely, and this means they must be dismissed at this very stage, and at this stage of

10:34 jurisdiction.

THE CHAIRMAN: Thank you very much. You have gone slightly beyond your 30 minutes, as you probably realise, but I won't argue about five minutes with you.

Can we go right away, or do you want a five-minute break? Okay, we will have a five-minute break.

(10.35 am)

(A short break)

(10.45 am)

THE CHAIRMAN: We continue with the hearing, and with claimants' opening presentation on jurisdiction, please.

Opening statement on jurisdiction by MR MOHR

MR MOHR: Good morning. I do not have time to address all of the defects in Kazakhstan's jurisdictional arguments, so I want to focus on several of the main themes.

First, Kazakhstan argues that the claimants are not investors under the ECT. As to the Statis, claimant Anatolie Stati is the ultimate indirect investor in KPM through his ownership of Ascom. He is also the ultimate indirect investor in TNG through his ownership of Terra Raf, along with his son, who is a passive investor in Terra Raf. Both Statis are nationals in permanent residence of Romania and Moldova. That is all that is required to show that they are investors under the Energy Charter Treaty.

10:46 In its rejoinder, Kazakhstan argues for the first time that the Statis do not qualify as ordinary investors under the ECT because of various incendiary accusations regarding their political and personal activities in Moldova, and other business activities abroad. To begin with, Kazakhstan points to no basis in law making any of these supposed facts relevant to whether the Statis qualify as investors under the treaty. More importantly, Kazakhstan has no evidence to support these accusations. This is based entirely on hearsay, rumour and innuendo. It is simply character assassination, nothing more, and it should not be countenanced by this Tribunal.

Regarding Ascom, respondent argues that Ascom is not an investor under the denial of benefits clause in Article 17(1) of the ECT because it is incorporated in Moldova but its owner, Mr Stati, is a Romanian national. This argument, however, is nonsensical because Mr Stati is also a national of Moldova, and Romania is also a contracting party under the ECT.

The denial of benefits clause serves to deny protection of the treaty to nominal entities that are little more than a front for nationals of non-contracting states. It makes no sense to apply that provision to an entity whose ultimate owner has dual

10:47 nationality, and both of those nations are contracting parties.

Moreover, this argument is moot because Ascom itself has substantial business activities in Moldova. Mr Stati, Mr Lungu and Mr Pisica all have explained in their witness statements how they oversee Ascom's global business operations from its headquarters in Moldova. I invite respondent and the Tribunal to address any further questions on this topic to those witnesses.

As to Terra Raf, claimants have explained in their submissions and expert reports why the ECT provisionally applies to Gibraltar, where Terra Raf is incorporated. We maintain that position. But this issue ultimately is moot also because Article 1 of the ECT protects investments that are owned or controlled directly or indirectly by investors; and since Anatolie and Gabriel Stati own and control Terra Raf, they indirectly own and control all of Terra Raf's investments, even if Terra Raf itself is not an investor under the treaty.

Next, Kazakhstan argues that claimants have not made investments that are protected by the Energy Charter Treaty. Article 1(6) of the ECT defines the term "investments" very broadly as:

"... every kind of asset, owned or controlled directly or indirectly by an Investor ..."

10:48 And it includes an illustrative list, identifying investments such as tangible and intangible assets, a company or other business enterprise, including both the equity participation and the debt of a company or business enterprise. And that list also includes returns.

Respondent argues for a narrower definition of "investment" that is not found in the text of the ECT itself. Rather, respondent seeks to import the definition of "investment" applied by tribunals in Salini, Phoenix v Czech Republic and Bayindir v Pakistan. This is ironic given that respondent argues elsewhere in its rejoinder that there is no doctrine of precedence in international investment treaty arbitration. It seems that the respondent only wants to recognise the precedential value of prior arbitration decisions when it suits it.

Regardless, claimants have adequately explained in their reply why the so-called Salini test does not apply to claims under the ECT that are not subject to the ICSID Convention. Claimants maintain that position. I want to focus today on the factual errors in respondent's argument, because the claimants' investments easily satisfy the so-called Salini test, even if it applies.

10:50 Kazakhstan argues that claimants' investments were opaque, suggesting that they were structured to conceal profits and disguise who was the "real investor". This position either is completely disingenuous, or the respondent understands nothing about finance. These companies created annual financial statements between 2003 and 2009 that were audited by "Big Four" accounting firms. They raised debt on the public debt markets, and banks such as Goldman Sachs and UBS deemed the companies to be transparent and reliable enough to loan hundreds of millions of dollars to them.

This slide shows only a partial list of the different international banks, accounting firms and law firms that audited or performed diligence on these companies, or purchased the notes issued by Tristan in respect of these companies' assets. I submit that these companies were far more transparent than is typical for a privately held enterprise. Kazakhstan's sole witness on these issues, Martha Brill Olcott, is a political science professor who has no significant experience in finance or accounting. She simply is not qualified to opine on the financial structure or results of these companies.

The fact is that claimants made substantial investments in KPM and TNG through the form of their

10:51 acquisition of the shares, shareholder loans to the companies, the reinvestment of profits, and then by risking their investments to secure the companies' debts.

First, between 1999 and 2004 the claimants invested over $12 million to acquire 100% of the shares of KPM and TNG. The respondent basically admits this at pages 38-39 of its rejoinder. These share acquisitions alone suffice for claimants to hold investments protected by the ECT. And the claimants held those shares for approximately ten years, until the assets were seized in 2010, which certainly satisfies any duration requirement, if one applies.

Respondent makes much of the fact that claimants staged their acquisition of the shares. Professor Olcott says:

"The subsoil contracts ..."

I think she means the shares in the subsoil users, but she says:

"The subsoil contracts appear to have been purchased through staged payments, buying a controlling ... stake initially and then using the earnings from the project to purchase the rest."

The implication is that when claimants reinvested their earnings to acquire a larger stake, that was

10:52 somehow not a contribution by the claimants. But obviously once the claimants earned money from their original investment, they were free to invest that profit elsewhere, or spend it how they pleased. When they chose to invest that profit to acquire additional shares in KPM and TNG, that was clearly a contribution by the claimants. Moreover, Article 1(6)(e) of the ECT explicitly states that returns are an investment.

Respondent also argues that this purchase price seems small compared to the damages claimed in the arbitration. To begin with, this issue goes to quantum, not to jurisdiction. But moreover, this argument ignores the claimants' significant investments in these companies after they acquired the shares.

You will hear more in our introduction on liability about the fallow condition of these fields when claimants acquired them, and the work claimants did to turn those into productive valuable assets. I will respond to Kazakhstan's arguments that claimants invested little of their own money in those projects.

One primary source of post-acquisition financing was shareholder loans. In 2000 Terra Raf extended credit lines in excess of $100 million to finance the initial operations of KPM and TNG. This is admitted by respondent's own evidence in Exhibit R-37.2. Claimants

10:54 in fact loaned almost $70 million to the companies under those credit facilities. Yet respondent completely ignores this in its repeated accusations that claimants put in little of their money to finance the growth of these companies. Loans to companies are every bit as much of an investment, and in fact shareholder loans are essentially economically equivalent to an equity contribution.

The fact that loans are investments is explicit in Article 1(6)(b) of the ECT itself, and numerous tribunals have reached this exact conclusion, such as the Nykomb v Latvia tribunal, which found the extension of credit to be an investment under the ECT.

Claimants also financed the operations of KPM and TNG through the reinvestment of profits. As the financial statements demonstrate, the companies earned over $460 million in net profits between 2003 and 2008. That's profits after expenses, after interest and after taxes. But they only paid dividends once during that timespan: a $25 million dividend by KPM in 2007.

Claimants reinvested the remainder of the companies' profits back into the companies: drilling wells, building infrastructure, building the LPG plant. This is reflected in the retained earnings line of the financial statements, which reached nearly $400 million

10:55 by the end of 2008. Again, those were profits that the claimants could have invested elsewhere. When they chose to reinvest those [profits] back into the companies in order to grow the companies, that was an investment and a contribution by the claimants.

Respondent argues that the debt used to finance KPM and TNG somehow makes the debt-holders the real investors in those companies. It is true that the claimants financed the companies in part with third-party debt, in addition to shareholder loans and reinvested profits. It is completely normal and prudent to capitalise a business with a mixture of equity and debt.

Prior to 2006 the third-party debt was primarily loans from Kazkommertsbank. In 2006 and 2007 the claimants were able to refinance the companies' debt on the international debt markets. The claimants formed Tristan Oil, which is owned 100% by Mr Stati, to raise $420 million on the public debt markets. The claimants raised this money through Tristan because that was the best way to package the assets of KPM and TNG together for a single-note offering on the markets. Tristan then loaned most of those funds to KPM and TNG, which used the money to retire its existing debt and to finance substantial capital projects and operations of the

10:57

companies.

Respondent's argument that this somehow makes Tristan the real investor in KPM and TNG borders on nonsense. First, KPM and TNG were not financed entirely with debt. Claimants continued to have a sizeable equity stake, and I will show you a chart reflecting that in a minute.

Second, Mr Stati owns 100% of Tristan, and thus indirectly owned or controlled Tristan's loans to KPM and TNG.

Third, Ascom and Terra Raf pledged 100% of their participatory interests in KPM and TNG to secure the Tristan notes. Thus the claimants risked literally their entire investment in KPM and TNG in order to obtain that Tristan debt from the public markets.

Fourth, importantly, under those share pledges, any recovery in this arbitration also is security for the Tristan debt.

Fifth, tribunals have repeatedly concluded that the use of debt to finance investments is irrelevant to jurisdiction. I refer to the Paushok v Mongolia case, which is Exhibit C-348, where the Tribunal said:

"Whether most of the money used in the creation and the development of GEM ..."

The local subsidiary in that case:

10:58

"... was borrowed or originated from Claimants themselves is irrelevant for the purpose of jurisdiction in this case."

The bottom line, as this slide shows, is that the claimants at all times had a significant equity investment in these companies. That's represented by the blue portion at the bottom of those charts. I have no doubt that the proper treatment of the debt financing will be an issue at the quantum phase, and I believe that we have already addressed that adequately. But there is no question that the claimants have proven an investment for purposes of jurisdiction.

I also want to touch on respondent's argument that claimants' investments did not contribute to the Kazakhstan economy. This argument is belied by the evidence and by common sense. First of all, KPM and TNG paid over $200 million in income taxes to the Kazakhstan Treasury. That does not include all the royalties, export taxes and other payments to the government the companies made over the years.

Kazakhstan's sole argument on this issue, in paragraph 139 of the rejoinder, is that KPM and TNG paid little of the taxes that were due to the Republic. But the only support they offer for that is a reference to the dispute over the $60 million in back-taxes that were

10:59 imposed in 2009 as part of the respondent's harassment campaign. The fact that the claimants disputed a $60 million tax bill that was imposed in that manner certainly does not support the argument that the companies paid little of the taxes that were owed to Kazakhstan.

Second, there is no evidence for respondent's argument that the business was structured to take profits offshore, putting aside whether there would be anything wrong with that if it were true. The only support offered for this is the opinion of Ms Olcott, who is simply not qualified to opine on the financial structure or results of these companies. As we've shown, the financial statements of KPM and TNG, which were audited by "Big Four" accounting firms, demonstrate that the companies retained nearly $400 million in earnings between 2003 and 2008.

During our opening on liability we will talk more about the various ways that the claimants' investments benefited Kazakhstan, through employment, the supply of gas, the building of infrastructure. I think the point is well illustrated by respondent's own arguments regarding why it seized claimant's investments in July 2010. Respondent has consistently justified that seizure based on the strategic importance of the assets

11:01 and the risk of social unrest if large numbers of Kazakhs lost their jobs as a result of the companies shutting down. For respondent to simultaneously argue that those investments did not benefit the Kazakhstan economy is, frankly, the height of dishonesty.

Respondent next argues that the claimants' investments were made illegally and in bad faith, and are not entitled to protection under the ECT, and they point to various alleged defects in how the shares in KPM and TNG were registered and transferred.

To be clear, claimants deny that their investments breach Kazakh law in any way. Much ink has been spilled in the parties' submissions and expert reports on what Kazakhstan's securities and subsoil laws actually required at that time. I think any reasonable observer would have to agree that the laws were, at best, confusing.

Rather than re-plough that ground here today, I want to discuss the high points of what actually transpired, because those facts clearly demonstrate that the claimants endeavoured to comply with a confusing and constantly changing legal regime; that Kazakhstan's own agencies repeatedly recognised that the claimants had complied with the law. Kazakhstan cannot and does not articulate any harm from the technical violations it

11:02 alleges, and Kazakhstan did not complain about any of these issues until it commenced its harassment campaign in October 2008. These issues, quite frankly, are ex post facto fabrications designed to avoid liability for its own violations of international law.

First, Kazakhstan argues that Ascom's investment in KPM was illegal because the original founders of KPM failed to apply for registration of KPM's shares as required by Article 16(1) of the Law on Securities Markets in force at the time. It is true that KPM's founders failed to register those shares, but Kazakhstan mis-states the import of this fact. As Dr Peter Maggs's explains in his expert report, there is no concept of a transaction void ab initio under Kazakhstan law. Invalid transactions are voidable, but only by a court upon the application of an interested party. That never happened here.

But more importantly, Ascom did not acquire any invalid shares. Rather, Ascom fully recognised this problem when it first acquired its interests in KPM in 1999 and cured that defect at the time. By that time, Kazakhstan's legislation had changed, abolishing the requirement for joint stock companies like KPM to register share issuances with the Ministry of Justice. In its place, the new law required a joint stock company

11:03 to obtain a national identification number for shares and to register shareholdings with a private registrar.

So in connection with that initial acquisition of shares, Ascom first caused KPM to re-register as a legal person with the Ministry of Justice on December 13th 1999, which was granted. KPM then applied for a national identification number, as required by the law in force at that time, which the National Securities Commission issued on January 24th 2000. The next day, KPM recorded its shareholdings, 62% by Ascom and 38% by Aksai, with its share registrar.

Thus the 62% of KPM shares that Ascom initially acquired were properly registered in January 2000 in accordance with the law in effect at that time, and so were the other 38% of the shares that Ascom subsequently acquired in 2004.

Moreover, on May 13th 2005 KPM reorganised from a joint stock company into a limited liability partnership, and the Kazakhstan Ministry of Justice approved that change. So as of that date Ascom no longer owned any shares in KPM at all; it was a partner.

Thus, by the time Kazakhstan seized KPM in 2010, any issue regarding their registration of shares had been moot for more than five years. Kazakhstan does not argue that it suffered any injury as a result of this

11:05 registration error by KPM's original founders. Kazakhstan never raised this issue until its statement of defence in November 2011, some 14 years after the fact. In the meantime, Kazakhstan signed the subsoil use contract with KPM; it allowed Ascom to invest millions of dollars in the development of the Borankol field; it accepted KPM's taxes; it enjoyed KPM's employment of hundreds of Kazakhstan's citizens; and it repeatedly inspected KPM, never once raising this issue. Kazakhstan new-found reliance on minute aspects of its own laws long after the fact in order to escape liability for its own violations of international law can only be considered an abuse of right.

Kazakhstan next argues that claimants' acquisition of the companies was illegal because they did not get consent from the competent and licensing authorities. It would be an understatement to say that Kazakhstan's laws were confusing on this issue between 1999 and 2004.

Between 1996 and 1999 there had been two different inconsistent laws addressing the same general issue. Article 53 of the 1995 Law on Oil required consent from the competent and licensing authorities for either the transfer of subsoil rights or for the transfer of a majority shareholding in a subsoil user. Article 14(1) of the 1996 Subsoil Use Law, however, only

11:06 required consent from the competent authority, not the licensing authority; and it only required that consent for the transfer of subsoil use rights, not for the transfer of shares in a subsoil user.

In August 1999, before claimants ever invested in either of these companies, Kazakhstan replaced its dual licensing and contracting system with a contract-only system of subsoil use, and it abolished the licensing authority. The logical conclusion from this was that this amendment was intended to supersede Article 53, which continued to refer to the licensing authority that no longer existed.

But given that uncertainty, and given that it was a very new change in the law, when claimants acquired their first interest in Kazakhstan, the 62% interest in KPM, in 1999, Ascom did request consent from the competent authority, and in November 1999 the competent authority answered that no consent was required from the competent authority because the change in shareholders was a matter for the shareholders themselves. The Agency on investments did, however, say that once the change was complete, KPM should apply to the competent authority to obtain a change to its licence.

In December 1999 KPM did what it had been told, and it applied to the competent authority for a change in

11:08 its licence. The Agency on investments then reversed its position on that issue and informed KPM that there was no need to modify the licence because the licensing regime had been abolished.

In short, Kazakhstan's own responsible agency informed claimants that consent was not required from either the competent authority or the licensing authority for a change in shareholders. Claimants relied on that information in good faith in all of their subsequent share transfers.

In its statement of defence, respondent argued that the claimants should not have relied on that information from the Agency of Investments because that agency was not the competent authority at the time. It turns out that's just plain wrong, and you will see that that argument is not repeated in the respondent's rejoinder.

If the respondent does not even know who its competent authority was, and if the competent authority at the time did not know what consent was required, then how were investors supposed to know? The fact is clear that the claimants endeavoured to comply with the law, and Kazakhstan's own agencies at all times believed that they complied with the law.

Moreover, Kazakhstan's competent authority inspected the companies repeatedly in the years after claimants

11:09 acquired them, clearly knew who owned them, and in fact in February 2007 the Ministry of Energy and Mineral Resources actually granted consent for Terra Raf's ownership of TNG. That ministry, which you will hear much about -- it's commonly called the MEMR -- became the competent authority for subsoil use after the Agency of Investments.

For reasons that were never particularly clear, the MEMR requested that TNG apply for consent in 2007 for the transfer of shares from Gheso to Terra Raf that had occurred in May 2003. Claimants did not agree that that consent was required, for all the reasons I've just discussed; but it requested the consent as directed, the MEMR granted it, and the MEMR never raised this issue again for almost two years.

Which brings me to perhaps the most outrageous of Kazakhstan's arguments regarding the supposed illegalities of these investments, and that is the argument that the claimants should have applied for a waiver of the state's preemptive right with respect to the transfer of shares in TNG from Gheso to Terra Raf that occurred in May 2003.

The law creating Kazakhstan's preemptive right took effect in December 2004, and while that law applied to subsoil contracts that existed prior to that date, it

11:11 applied only to transfers that occurred after the law took effect. The MEMR agrees with this position. In February 2007, when the MEMR instructed TNG to seek consent for the transfer of shares from Gheso to Terra Raf, it also instructed TNG to request a waiver of the preemptive right with respect to that transaction.

In response, TNG asserted that the preemptive right didn't apply because that transfer from Gheso to Terra Raf occurred in May 2003, before the Preemptive Rights Law took effect. The MEMR's own expert commission concurred, saying that part III of Article 71 of the law:

"... does not have retroactive value and does not apply to the relationships appeared as a result of the concluded contract prior to its coming into force ..."

Nearly two years later, on December 18th 2008, the MEMR reversed its position on this issue and asserted that the Preemptive Rights Law did apply to the transfer of shares from Gheso to Terra Raf because that transaction was not completed until May 16th 2005. The basis for this position was utterly unclear until the respondent filed its rejoinder in this case, when the state asserted for the first time that claimants had not registered the share transfer until May 16th 2005. That appears to be the sole basis for this argument.

11:12 That is simply wrong. Two different registry reports in the respondent's own evidence, in Exhibit R-18, confirm that the share transfer was registered on May 28th 2003. The transaction was complete at that time, more than 18 months before the Preemptive Rights Law took effect. The only thing that happened on May 16th 2005 was that TNG reorganised from an open joint stock company into a limited liability partnership. That was a completely separate transaction from the transfer of shares from Gheso to Terra Raf, and it did not involve any change in ownership; just the reorganisation of the company from one form to another.

Kazakhstan concocted this whole issue in December 2008 as a way to cast a cloud on the claimants' title to TNG. In our opening on liability we will talk more about that and the impact of this fabrication on the claimants.

Finally, I want to touch on respondent's argument that the Tribunal lacks jurisdiction because the claimants failed to comply with the cooling-off period in the ECT. Claimants have fully explained in their submissions that that waiting period is not a bar to jurisdiction and that the claimants in fact complied with that requirement, and we stand by that position.

I want to draw the Tribunal's attention to a brazen

11:13 misrepresentation that Kazakhstan has made to the Tribunal regarding its argument that the parties' agreement to suspend the arbitration for three months in early 2011 to address this issue was somehow without prejudice to the jurisdictional issues that this defect would later cause. In support of this, Kazakhstan cites one sentence from its letter proposing that stay. That sentence, however, is quoted entirely out of context.

That sentence does refer to respondent's position that the waiting period issue could result in dismissal after briefing on the merits; a position, obviously, that claimants disagreed with at the time and continue to disagree with. What's important is that the rest of respondent's letter on this issue makes clear that the stay was proposed by respondent precisely to address that issue promptly, before the parties engaged in full briefing and hearing on the merits.

In the sentence immediately preceding the sentence that Kazakhstan quotes out of context, Kazakhstan plainly proposed the three-month suspension in satisfaction of the jurisdictional requirement. I'm sorry, respondent said in the sentence immediately preceding the sentence that it quotes that respondent plainly proposed the three-month suspension in satisfaction of the jurisdictional requirement.

11:15 Claimants would obviously not have agreed to this suspension otherwise.

For Kazakhstan now to argue that the agreed suspension did not cure any jurisdictional defects is brazen disregard for the truth, and unfortunately that is, frankly, emblematic of the respondent's level of candour on numerous issues in this case.

Regarding the other grounds for lack of jurisdiction that respondent raised for the first time today, I'd like to defer to Mr Smith on those issues.

(11.16 am)

Opening statement on jurisdiction by MR SMITH

MR SMITH: Thank you, and I will be brief. We've heard for the first time from respondent's counsel three pretty brazen accusations that nowhere appear in the parties' submissions and certainly nowhere appear as it relates to jurisdiction in this matter.

The first relates to inaccurate translations. Let me just say at the outset that if there is any claim being made by respondent of an intent to mislead on the part of claimants through an inaccurate tradition, that is simply flatly denied. The translations were submitted on our documents, the claimants' documents, both with the statement of claim and the reply, and it is interesting that this is the first time we have heard

11:16 anything from this respondent in the nature of a jurisdictional objection ostensibly based on an inaccurate translation.

Secondly, let's put the respondents to their proof. Let them submit where they believe that there are inaccurate translations and the substantive meaning of the inaccuracy they claim. It is pure sophistry at the end of the day. We will work with the respondent's translation of any document that they challenge the claimants' translation on. It is simply a distraction.

Secondly, the accusation that the claimants illegally obtained documents, internal documents of the government, under the domestic law of Kazakhstan.

Number one, there is absolutely no proof of that allegation whatsoever, and we put the respondent to its proof on that accusation.

Secondly, there are apparently employees within the Government of Kazakhstan who are very sympathetic to the claimants' position, and there are apparently employees within the Government of Kazakhstan that have provided documents to the claimants regarding the illegal activities of other representatives of the Government of Kazakhstan in connection with the activities and actions at issue in this case. If a governmental employee in Kazakhstan violated local Kazakh law in providing

11:17 documents to the claimants, then we presume that Kazakhstan will engage the engine of its prosecutorial powers in order to prosecute those efforts. But at the end of the day, claimants cannot be accused of any wrongdoing by receiving documents provided to them by sympathetic governmental employees that are now in this proceeding.

What is most interesting about this accusation, and most brazen about it, is as to 99.9% -- and we'll come to the 0.1% -- there is no dispute as to the authenticity of the documents.

There is no dispute that President Nazarbayev gave a directive to thoroughly investigate our claimants' companies. The distinction between to "thoroughly look into" and "thoroughly investigate" is lost to me, and I would assume it's lost to most in this room. But at the end of the day, there is no dispute as to the authenticity of that document.

There is no dispute as to the authenticity of the internal documents between the financial police and the Ministry, for example, of Energy and Natural Resources, or the Ministry of Emergency Situations, that Kazakhstan is obviously extraordinarily embarrassed to be before the Tribunal in this proceeding.

At the end of the day, if there is any party that

11:19 has made misrepresentations and omissions in this case, it is the respondent. The respondent has put in witness statements in this case under the belief that internal governmental documents would not be presented to this Tribunal to challenge the accuracy of sworn testimony in the case, and now this is their reaction to it, which is: those documents must have been illegally obtained. Not that the documents aren't authentic; not that it doesn't put the lie to many of the statements in the witness statements that have been submitted in this case.

Therefore, this objection, and certainly as to jurisdiction -- it's not a jurisdictional objection to my knowledge, but it is simply a reaction to the truth being laid bare before this Tribunal.

Thirdly, as to fabrication, and that is a different allegation: that the claimants apparently have now been accused of fabricating documents. We would agree that is an extraordinarily serious allegation. It's curious it has never been raised until now, never raised in the pleadings, and it is flatly denied. The claimants flatly deny that there has been any fabrication of any document in connection with this proceeding, and counsel should be put to proof and hold counsel responsible for the statements that it made in its opening submission.

11:20 It should question the claimants' witnesses on these documents and it should be put to its proof on making that type of allegation in this case.

One example of that is apparently the trial transcript. It is an interesting accusation that because the claimants have submitted a draft copy of the trial transcript that they were provided from those in Kazakhstan, that Kazakhstan has now submitted the original transcript, that now somehow claimants are being accused of some wrongdoing.

At the end of the day, in a denial of justice case, where denial of justice claims are being made, the respondent never saw fit to put in the transcript of the trial that is at issue in this case, and therefore the claimants provided a draft of that transcript. We are now happy finally for Kazakhstan to have come clean and submit the trial transcript in its authentic form, and it will now be in the evidence in this proceeding and the witnesses can be asked about it.

Thank you.

THE CHAIRMAN: Thank you very much. I suppose this is an appropriate time for a coffee break. So we will have a coffee break of 15 minutes and then come to the second part of the opening statements. Thank you.

DR NACIMIENTO: Sir, just one question. Is it possible to

11:21 have a very short rebuttal, just on the last issue, and fine after the coffee break? And of course it is going off our time.

THE CHAIRMAN: No, I think we should have the opening statements as they are prepared, and then at a later stage we can deal with that.

DR NACIMIENTO: Okay.

(11.21 am)

(A short break)

(11.41 am)

THE CHAIRMAN: We resume the hearing, and start with the opening statement on the merits by claimants.

Opening statement on the merits by MR FLEURIET

MR FLEURIET: Members of the Tribunal, good morning.

I would like to begin claimants' presentation on liability by providing the Tribunal with an overview of claimants' investments in Kazakhstan; claimants' purchase of KPM and TNG; their substantial investment of money and effort over a decade, which turned KPM and TNG into very profitable and productive companies; and the significant contributions that claimants made to Kazakhstan and its economy through their investments.

My focus will be on the period from inception of claimants' investments in 1999 through October 2008, when President Nazarbayev issued his order and touched

11:42 off Kazakhstan's campaign of coercion and destruction of claimants' investments. My partner Mr Smith will focus on the period after October 2008, and that campaign itself.

I will begin by pointing out to the Tribunal that respondent has taken a remarkably inconsistent and contradictory approach to describing claimants' investments in this case. On the one hand, respondent refers to the investments in its statement of defence as:

"... not worth very much (if they were worth anything at all)."

That's the statement of defence, paragraph 16.10. And Professor Olcott describes the KPM and TNG oil and gas fields as "minor" and "among the smaller deposits in western Kazakhstan".

On the other hand, though, respondent repeatedly refers to KPM and TNG in its statement of defence as "strategic assets". Kazakhstan argues that its seizure of KPM and TNG was necessary because of the "strategic role" that the companies played in the Mangystau region. That's in the statement of defence at paragraph 31.52.

In reality, the Kazakh State clearly viewed the companies as strategic assets. TNG supplied the vast majority of gas for local utility companies and

11:43 residents of the Mangystau region, and KPM and TNG provided employment for nearly 1,000 Kazakh workers. As of February 2010, TNG employed 543 workers, 93% of whom were local Kazakh citizens; KPM employed 378 workers, 94% of whom were Kazakh. And those nearly 1,000 employees only represented the permanent workforce. Hundreds more Kazakhs were employed from time to time on specific projects, such as construction of claimants' LPG plant.

Indeed, respondent itself has put an exclamation point on the importance of the companies' role in the region by stating:

"Shutdown of production of 'Tolkynneftegaz' LLP and 'Kazpolmunay' LLP could lead to formation of social tension in the region ..."

That's statement of defence, paragraph 31.59.

In addition to its strategic regional importance, TNG was of national interest to Kazakhstan in light of the government's stated intention to ramp up its overall gas production and gas exports. TNG held not only the Tolkyn gas field but also the enormous potential of the Tabyl block, as well as one of the largest LPG plants in the country.

As you can see from this 2010 Bloomberg article, Kazakhstan has declared its intention to ramp up its gas

11:45 production, and TNG is listed among the four gas producers that accounted for almost 90% of the country's total gas output in 2009.

But TNG certainly did not start out as a strategic asset that caught the attention of Kazakhstan's ruling clan. When claimants acquired TNG in 2000, the company's gas field was fallow, with no production at all and little infrastructure. The same was true of KPM at the time claimants acquired that company. It was solely and exclusively through claimants' massive efforts and investments over ten years that KPM and TNG were transformed into profitable, strategic state assets.

Respondent also attempts to denigrate claimants' oil and gas expertise, suggesting that claimants were amateurs at the business with ulterior motives. But that is simply false. Claimants commenced their Kazakh investments with considerable development expertise. As you will hear from Mr Stati, before commencement of the projects in Kazakhstan, he had transformed Ascom into a technically proficient exploration and production company through the project he undertook in Turkmenistan.

The Turkmen project was complex but very successful. It involved working five oil and gas fields, using

11:46 14 work-over rigs, to rehabilitate several hundred previously abandoned deep wells. With the Turkmenistan contract set to expire at the end of 2000, and with considerable profits from the project, Mr Stati began looking in 1999 for new projects to invest in that would utilise Ascom's considerable expertise.

Here is a map showing you some of the locations of the fields at issue. Claimants first identified KPM in the Borankol field in western Kazakhstan. As you can see, the Borankol field is in the vicinity of the Caspian Sea oil and gas fields, and the onshore Tengiz field operated by Chevron Tengiz.

As the Kazakh Ministry of Energy and Mineral Resources, the MEMR, noted in Exhibit C-691, exploration on the Borankol field started in 1956. Between 1956 and 1992, 28 prospecting wells were drilled. By 1999, however, 26 of those wells had been plugged and only two of them were in preservation. In short, Borankol had been previously explored for 36 years with little success, and then left idle.

Borankol was widely viewed as having only marginal development potential, but Mr Stati and Ascom thought otherwise. They saw significant potential reserves, obscured by poor Soviet-era operation and management.

In addition, as you can see, Borankol is in close

11:48 proximity to rail transport at Opornaya, as well as the KazTransOil main pipeline, a main oil pipeline that is approximately 1,380 kilometres long. That proximity meant straightforward access to long-distance delivery of the field's oil production to purchasers and product brokers.

KPM held the exploration and production rights to the Borankol field under contract 305. Ascom bought its initial interest in KPM in 1999, paying cash for 62% of KPM's stock; and it bought the remaining 38% of KPM in 2004.

Shortly after acquiring their initial interest in KPM, claimants identified the Tolkyn field, held under licence by TNG, as another attractive prospect. As you can see on the slide above and in your handouts, Tolkyn is in the same vicinity as Borankol; or, to be more precise, only 50 kilometres away.

As described by the MEMR in Exhibit C-683, there had been some seismic exploration on Tolkyn in the late 1980s and one exploratory well had been drilled in the early 1990s. Two more exploratory wells had been commenced in 1996, but work in the field was then halted for lack of financing.

As with Borankol, Tolkyn was widely viewed as having only marginal development potential. But Mr Stati and

11:49 his colleagues saw significant potential reserves. They also realised that, like Borankol, Tolkyn benefited by close proximity to a main gas pipeline, the Central Asia-Center pipeline. The Central Asia-Center main gas pipeline is more than 4,800 kilometres long, and its proximity to Tolkyn enabled direct access to export markets for gas.

TNG held the exploration and production rights to the Tolkyn field under contract 210, which expressly permitted gas exports and guaranteed free and unfettered access to the regulated main gas pipelines in Kazakhstan. Those were very attractive provisions that should have permitted TNG to acquire considerably higher export prices for gas, as opposed to the low state-regulated price for local sales, and that should have prevented monopolistic exclusion of TNG from pipeline access.

In addition to the Tolkyn field, TNG also held the exploration rights to the adjacent Tabyl block under contract 302. As made abundantly clear in claimants' statement of claim and claimants' reply on quantum, Tabyl was a prospect with remarkable potential.

Claimants acquired their initial interest in TNG in May 2000, paying cash for 75% of TNG's stock. By 2002, claimants had acquired the remaining 25% of TNG. So by

11:51 the spring of 2000, claimants had acquired their initial majority interests in both KPM and TNG. Thereafter, between 2000 and 2009, with massive effort and investment, claimants took KPM and TNG, with their effectively fallow oil and gas fields, and transformed them into highly successful producers of oil and gas; or, in the state's words, into "strategic assets".

Accomplishing this transformation required extraordinary commitment and levels of investment. Mr Mohr has gone through the cash investments in some detail. But I will add here, importantly, that the MEMR explicitly recognised the magnitude of claimants' investments.

In this chart that you see on the screen, taken from the MEMR's February 2010 report on KPM's compliance with its contractual obligations, Exhibit C-385, the MEMR summarises both KPM's required development expenditures through 2009 under its contractual minimum work programme, as well as KPM's actual development expenditures through 2009.

Incidentally, this report is one of nine governmental reports on KPM and TNG that are included in the Tribunal's binders. I believe you will find them referenced at page 5 of the index.

As you can see here, KPM's actual expenditures of

11:52 US$473 million considerably exceeded its minimum work programme requirement of $71 million. As the MEMR noted on page 5 of this report, KPM's actual expenditures were 6.6 times greater than the level of its contractual obligations. Its expenditures were 6.6 times greater than what it was obliged to expend on the project.

In this next chart, taken from the MEMR's February 2010 report on TNG's compliance with its contractual obligations, Exhibit C-386, the MEMR summarises TNG's minimum contractual obligations, and TNG's actual expenditures. As with KPM, TNG's actual expenditures of US$640 million vastly exceeded its minimum work programme requirement of $187 million. As the MEMR noted, TNG's actual expenditures were 3.4 times greater than its contractual obligations.

So, as Kazakhstan explicitly recognised, claimants fully complied with -- indeed, they vastly surpassed -- their contractual investment obligations, investing in total more than US$1.1 billion in development of the Tolkyn and Borankol fields. A considerable portion of that sum consisted of reinvested earnings that Mr Stati and claimants ploughed back into KPM and TNG.

Precisely the same was true with respect to claimants' actual exploration expenditures for the Tabyl block, where again claimants substantially exceeded

11:54 their investment obligations. As the MEMR reported, TNG's exploration expenditures for the Tabyl block exceeded its contractual obligations by more than $22 million.

As an aside, I would encourage the Tribunal to review these two reports and the seven other inspection reports on KPM and TNG that are included in the Tribunal's binders. These reports date from May 2007 to July 2010, and they are well worth the Tribunal's independent review and consideration. They tell a story markedly at odds with respondent's assertions in this case. They document a level of compliance by KPM and TNG with their principal contractual obligations that is a telling recognition by the state itself that its campaign against claimants, and its ultimate seizure of claimants' investments, were entirely unjustified.

Now, claimants' development of Borankol and Tolkyn began immediately upon their acquisition of KPM and TNG. As the MEMR noted in Exhibit C-86, Borankol production tests began in 2000 and 2001, free gas extraction began in July 2002, and pilot operations started in December 2003.

The development of Borankol involved a concerted drilling programme. The top chart here on this slide is from the MEMR's November 2008 KPM inspection report,

11:56 Exhibit C-86. As you can see, between 2001 and 2008, KPM drilled a total of 62 combined output and injection wells -- that's the sum of the "is drilled" line at the top of the chart -- that brought the total well count on Borankol to 90 wells.

Now, the bottom quotes are from the geology committee's July 16th 2010 report, which is Exhibit C-689. This report was issued just five days before the state directly expropriated claimants' investments, and it is effectively an inventory, performed by the state, on what the state was about to seize. The report shows that by 2008 KPM had an active well stock of 57 output wells and four injection wells. By 2009 KPM had an active well count of 66 output wells; one more than as planned in KPM's work programme; and four injection wells, the number called for in the work programme.

At the time the state seized KPM in 2010, it had a total output well count of 92, with 73 in operation. And recall that KPM had no operating wells at all at the time claimants acquired the company in 1999.

This substantial drilling programme was accompanied by construction of field infrastructure for gathering, treatment, de-watering, testing, measurement, pumping and pre-heating in advance of the oil's delivery into

11:57 the KazTransOil main pipeline. The principal design document for this infrastructure, a raw materials base plan, was prepared by NIPI Neftegaz in 2001. That plan is Exhibit C-465.

NIPI Neftegaz is a Kazakh oil and gas research and design institute associated with the MEMR, and it was the design institute responsible for the overall Borankol exploration and development plans. The plan included the design of the field pipeline that the state later reclassified as a main pipeline in its trumped-up criminal case against KPM's general manager Mr Cornegruta. Mr Smith will go into that discussion in a bit more detail shortly.

Suffice it to say for now that the MEMR concluded in its November 11th 2008 report -- Exhibit C-86 -- that KPM's actual field development conformed with the development design in all respects.

As with Borankol, claimants commenced work on the Tolkyn field and Tabyl block promptly upon acquisition of TNG. As the MEMR notes in Exhibit C-683 and Exhibit C-386, TNG's exploration and infrastructure development began in 2000. TNG started de-mothballing and restoration of the wells on the field; it commenced the drilling of new exploratory wells; it conducted detailed 3D seismic survey work on the Tolkyn field, and

11:59 2D seismic work on the Tabyl block; and it began construction of field infrastructure for gas transport and treatment.

The MEMR summarised TNG's actual well count on the Tolkyn field and Tabyl block in its February 5th 2010 report, Exhibit C-386, which you can see on the screen. TNG, as you can see, had restored or drilled a total of 40 wells by 2009, including a completed test well in the Munaibay resource area of the Tabyl block and a partial well in the Tabyl block's Bahyt area.

In July 2008 claimants discovered substantial oil and gas deposits in Munaibay, and they reported this discovery to the MEMR. That's one of the important facts of this case. In October 2008 claimants commenced the exploratory well in the Bahyt area, which showed evidence of substantial gas deposits.

In the same February 2010 report, the MEMR gave TNG what can only be described as a complete bill of health in terms of its compliance with its contractual obligations. I've highlighted some of the key findings here. You will see that it says there's been "strict compliance with [state-approved] design documents" and "required corrections to [certain] parameters and main exploitation indicators being made in due time"; "full compliance", and in certain cases excess compliance,

12:00 with standards for production, treatment, storage and loading of product, and I'll note there in the bottom -- we'll come back to this later in the hearing, I'm sure -- that with respect to gas and oil pipelines, the state notes that "all of these elements [are] part of a single technological process".

In the same report, MEMR notes fulfilment of requirements to state normative standards for production quality control and measurement systems, and a resource-based and operational system that:

"... insure[s] reliable and stable operation of the entire system, as well as fulfil[s] the need for energy resources of the population and enterprises in [the] Mangistau region."

Similarly, in its February 2010 report for KPM, the MEMR gave KPM an equally clean bill of health, and I'll note again that the MEMR here refers again, with respect to KPM, to "the single technological process".

These contemporaneous conclusions from Kazakhstan's Energy Ministry are directly at odds with Kazakhstan's allegations in this arbitration. Again, these various reports are noted at page 5 of your index and they're included in your binders, and they're well worth a careful review by the Tribunal.

I am now having handed out separately -- it's

12:02 included in your binder, but I'd ask the Tribunal to keep this diagram out and the photos that go with it out because I'm going to try and take the Tribunal slowly through some of the infrastructure in a moment that's at the heart of this dispute.

The diagram that I've handed out shows the basic field transport and processing infrastructure that claimants constructed for the Borankol and Tolkyn fields. That field infrastructure, or part of it, is central to a good portion of this dispute, so again I'd like to spend a moment walking you through it. It is important background and context for much of what you will hear in testimony this week.

Now, to begin with, if you'll look at the diagram, gas and condensate from the Tolkyn field went to the gas processing facility for treatment, and I've marked that facility as A on this diagram for ease of reference. Gas was then delivered through one of two pipelines to the Central Asia-Center main pipeline, which I've marked here as B for ease of reference.

Condensate, meanwhile, was sent to the condensate warehouse. The condensate warehouse and the oil warehouse make up the warehouse facility that is marked C on this diagram, and that facility is of some importance to the underlying facts of the case. The

12:03 condensate was then delivered to the Opornaya rail head, which I have marked on this diagram as D.

That's the process flow for gas and condensate.

Oil, meanwhile, mainly came from Borankol, but there was some oil production from Tolkyn as well. Oil from both fields went to the oil treatment facility, which is marked E in the diagram. From there, the oil went through a 17.9-kilometre pipeline to the oil warehouse section of the warehouse facility. That 17.9-kilometre pipeline is highlighted in orange on your diagram, and is at the heart of this case. After the warehouse, oil then went through another 1-kilometre pipeline, highlighted in green here, that joined up with the KazTransOil main pipeline. The KazTransOil main pipeline is marked here with an F.

Much of this case, as the Tribunal will be aware, is about the 17.9-kilometre pipeline highlighted in orange between the oil treatment facility and the warehouse facility, specifically whether the 17.9-kilometre pipeline highlighted in orange is a field pipeline or a main pipeline, and the lack of consistency, transparency and logic that surrounds Kazakhstan's claim that the pipeline is a main pipeline. I'm going to show you a small picture of a small section of that pipeline in just a moment.

12:05

Also of some relevance is the short pipeline shaded in green, the 1-kilometre pipeline between the warehouse facility and the KazTransOil main pipeline. Very tellingly, before this arbitration Kazakhstan had never alleged that that 1-kilometre pipeline was a main pipeline.

So please keep this diagram handy as I now show you some of the photos of what's in the diagram.

MR HAIGH: Mr Fleuriet, sorry to interrupt you. Do you know the diameter of the 1-kilometre pipeline that goes from the oil warehouse to the KazTransOil pipeline?

MR FLEURIET: I will get that for you.

MR HAIGH: Thank you.

MR FLEURIET: I believe it is roughly similar to the diameter of the orange highlighted 17.9-kilometre pipeline, but I will come back and confirm that for you.

Now, in the first picture here I'd just like to show you some of the infrastructure necessary for the Borankol and Tolkyn fields, and underscore that it was very impressive in scope. This is just a part of the gas processing facility, what is marked A on your diagram. When we talk about the LPG plant, it's partially shown in the background of this photo. I will come back to that in a minute. But as the Tribunal can see, the construction of the LPG complex was very

12:06 advanced by the time it was halted in the spring of 2009, in the midst of the state's coercion campaign.

Now, this is a photo of just part of the oil treatment facility, or E on your diagram. Again, it's just up there to show you portions of what is talked about or what is listed on the diagram and some of the scope of the construction that went into the various facilities.

I want to spend a minute on this photo because it's critical to the case. This is another photo of part of the oil treatment facility from a different angle, and what is circled in orange is the first few metres of the 17.9-kilometre pipeline at the heart of much of this arbitration. Again, that's the pipeline highlighted in orange on your diagram. This is actually the point here where the 17.9-kilometre pipeline starts upon leaving the oil treatment facility. The point you are looking at in the photo is marked with an orange star on your diagram.

You can see only see the first few metres of the 17.9-kilometre pipeline because the rest of it is underground, and actually -- and it goes to Mr Haigh's question -- you cannot even see the pipeline itself in this picture because it is covered with an insulated metal casing. The actual 17.9-kilometre pipeline is

12:07 only 15.9 centimetres in diameter, just over 6 inches; about this big (indicating). It is smaller in diameter than the field pipeline that you see to the right of the connecting valve in this photo.

Now, for some additional perspective, and to go to Mr Haigh's question, this is the connection of the 1-kilometre field pipeline, the one that's shaded in green on your diagram, to the KazTransOil main pipeline marked as F. This point of connection is marked with a green star on the diagram that I've handed out. You can see here the end of the small field pipeline circled in green -- and I will get the diameter of it -- connecting to the vastly larger main pipeline, which is a full metre in width and cannot even be fully seen through this hole. [What] you see through the hole there is a portion of the KazTransOil main pipeline.

Now, as I mentioned earlier, during the course of this arbitration Kazakhstan first alleged that this 1-kilometre field pipeline was also a main pipeline, and if you look back at your diagram, you can see why they did so. Without relabelling this 1-kilometre pipeline as "main", their position in this dispute would have been that you go from main pipeline to field pipeline, back to main pipeline, which makes absolutely no sense.

But that senseless position was actually

12:09 Kazakhstan's position contemporaneously back in the real time. In their zeal to convict Mr Cornegruta and devastate KPM, Kazakhstan's financial police forgot to relabel the pipeline between what they were relabelling as "main pipeline" and the real main pipeline. They bungled the job and omitted to relabel this little pipeline circled in green, which simply serves to underscore the contrived, confused nature of the whole prosecution exercise.

Finally, this is the very KazTransOil main pipeline which we just saw heading for the horizon. It is 1,380 kilometres in length, and its size is apparent.

Now, let me return finally to the first photo I showed you. In addition to the infrastructure for Tolkyn and Borankol production, some of which you've just seen, the Tribunal will recall that in 2006 claimants commenced construction of an LPG plant. The LPG plant was integrated with the gas and condensate processing facilities at the Borankol field, and it can be partially seen here in the background of this photo, what is circled.

The LPG plant was designed to process propane, butane and pentane plus from Tolkyn and Tabyl gas production. Claimants invested more than $240 million, just under a quarter of a billion dollars, in

12:10 construction of the LPG plant. It was nearly complete when they decided to halt further expenditures in May 2009, in the midst of the state's coercion campaign. Upon its completion, which the state clearly intends to accomplish, the LPG plant will be one of the largest in Kazakhstan, and Kazakhstan certainly recognises the vital importance and strategic value of the plant.

I'll just show the Tribunal quickly this slide [19], where the geology committee of the government refers to the LPG project and says:

"... in case of its complete fulfillment, [it] would be of great regional and industrial importance for development of the region."

Now, I will conclude briefly with two more topics. The first has to do with inspections, examples of which I've already shown you.

In its pleadings, in an effort to put a benign gloss on its ugly coercion campaign, Kazakhstan has argued that there was nothing unusual about the myriad inspections it carried out between October 2008 and July 2010. Kazakhstan observes that it had always conducted inspections of KPM and TNG, and that it had a right to do so.

What was different about the inspections after October 2008 was their nature and purpose, as well as

12:12 their impact upon claimants' investments. But claimants otherwise agree with respondent: the state had inspected KPM and TNG thoroughly and regularly since the inception of claimants' investments, and indeed some regulatory deficiencies have been noted in those inspections. No company operates to absolute perfection, especially in this industry. The deficiencies that inspecting agencies found before 2008, however, were minor, and they were immediately corrected by KPM and TNG.

For example, as you can see here, in its November 2008 report the MEMR noted that there had been 28 minor violations by KPM between April 2001 and July 2008, and the MEMR noted, as you can see highlighted in yellow at the bottom, that each of the 28 minor violations had been eliminated.

It was the same story for TNG. Here in this slide the MEMR noted -- this is again from its November 2008 report -- that there had been 12 violations between June 2001 and July 2008, all of which again had been eliminated, as noted on the slide.

In short, Kazakhstan had routinely and thoroughly inspected KPM and TNG for years, had found nothing untoward or unconscionable or uncorrectable, and it had received the full cooperation of KPM and TNG at every turn. That, I would submit, is the normal give-and-take

12:14 of regulatory oversight in a regulated industry.

What happened after October 2008 was dramatically different. Kazakhstan allegedly "uncovered" an issue that it claimed to have missed for years, and it used that issue as the predicate for its coercion campaign. It later in 2010 used its regulatory authority as a pretext for its outright direct expropriation of claimants' investments. That is markedly different from the normal regulatory oversight and interaction with KPM and TNG that took place between 2000 and the third quarter of 2008.

The final topic I will cover brings us to the summer of 2008, when Mr Stati decided to explore a sale of the Tolkyn field, the Borankol field and the LPG plant. Oil and gas prices, as the Tribunal will recall, were very high in mid-2008, making the market attractive for a sale, and Mr Stati wanted to re-direct his energies to other exploration opportunities. Those included the Tabyl block, which he withheld from the sale process at this time so that he could continue to explore the block and establish the full extent of its deposits and value.

To put together the sale process, claimants retained Renaissance Capital, a leading investment bank focused on the emerging markets in Russia, Ukraine and Kazakhstan. They named the sale process Project Zenith, and

12:15 teasers were sent out to prospective purchasers in July 2008.

By October 1st 2008, claimants had received eight indicative offers. Respondent suggests that eight offers for the properties constituted a poor response, but it presents no evidence that eight offers ranging from $550 million to $1.55 billion was anything other than a significant response, especially given the worldwide economic crisis that was accelerating by that time.

The top four bids that claimants received in Project Zenith were: $1.55 billion from KNOC, the Korean National Oil Company; $1.3 billion from OMV; $1 billion from Total; and $916 million from the Turkish Petroleum Corporation. As we have noted on the slide, state-controlled KazMunaiGas also made a bid for $754 million.

Mr Stati felt at the time that the offers were not going to lead to a sale of the properties at their full value. Between July 2008, when Project Zenith was initiated, and October 1st 2008, when the offers were received, oil and gas prices had dropped, and the trend showed continued decline. Mr Stati felt that the declining price trend undercut his bargaining position, and that he would not be able to negotiate an acceptable

12:17 selling price from those starting points. Consequently Mr Stati decided to suspend the sale process in the first part of October 2008, and not to open the full data room to bidders or enter the binding bid phase of Project Zenith.

It was only after that decision had been made that Mr Stati learned about President Nazarbayev's October 14th 2008 order to thoroughly investigate Mr Stati and his Kazakh investments. It was that order that marked the commencement of Kazakhstan's campaign that ultimately destroyed claimants' investments.

I will now turn over to my partner Reggie Smith to address that order and its aftermath. Thank you.

(12.17 pm)

Opening statement on the merits by MR SMITH

MR SMITH: As Mr Fleuriet has told you, from 1999 until mid-2008 the claimants had operated a successful oil and gas business in Kazakhstan. They had invested hundreds of millions of dollars, they had reinvested almost all of their profits, they had made substantial discoveries, and they were in the process of attempting to sell those successful companies on the open market. Both companies had significantly exceeded their investment obligations, as Mr Fleuriet has shown, and TNG in fact had discovered a potentially significant find in its Tabyl exploratory

12:18 block further enhancing the value of the companies.

Therefore, as of mid-2008 the ability to establish a fair market value for the claimants' significant investments in Kazakhstan existed without the entanglements caused by pervasive governmental interference from thereafter. Everything changed in October 2008.

As you will see on the next slide, on October 6th 2008 the President of Moldova, Vladimir Voronin, wrote a letter to the President of Kazakhstan raising vague allegations of improper activity that were only loosely connected, at best, to Mr Stati's operations in Kazakhstan, and they appear primarily directed at slandering Mr Stati through unsubstantiated allegations and accusations of misconduct taking place outside of Kazakhstan.

Interestingly, Kazakhstan's own expert in this case, Professor Olcott, uses basically a similar approach in advancing baseless speculation about Mr Stati's business activities and motivations outside of Kazakhstan. We invite you to carefully review her report; she relies almost exclusively on rank hearsay, including blog posts, and her own speculation based on alleged conversations that she has had with unidentified sources. We ask you to closely examine her references.

12:18

Notwithstanding her academic background, her report in this matter is anything but academic. And rather than respond to really what are essentially tabloid tactics used in her report in maligning Mr Stati, we would rather simply invite you to ask any questions you would like to ask Mr Stati about the allegations made in Professor Olcott's report.

Now, if we look back at the Voronin letter and take a minute to look at the allegations, there are two things that should be clear: firstly, despite the intense inspection wave that occurred as a result of the letter sent by President Voronin, none of the allegations contained in his letter were actually investigated by the Kazakhs at all, much less substantiated by the Kazakhs. And secondly, the letter, we think, fairly read, is a pretty transparent political attack on Mr Stati, whom clearly Mr Voronin viewed as a political opponent.

Let's look at slide 2. Upon receiving President Voronin's letter on October 14th 2008, President Nazarbayev personally gave an order for Kazakh officials to:

"... thoroughly check ..."

That is our translation:

"... [the] company's activities and determine its

12:20 further operations in the best interest of the country."

In response to President Nazarbayev's directive on October 16th, the Deputy Prime Minister issued an order two days later to the financial police to investigate Mr Stati's companies in Kazakhstan. Kazakhstan interestingly has not produced a copy of this order from the Prime Minister, so we are unable to determine precisely what the financial police were told to investigate or whether a desired outcome was suggested. What we do know is that this order kicked off a barrage of inspections, investigations and harassment that quickly destroyed the alienability of claimants' investments and ultimately led to the demise of the companies.

The extent of Kazakhstan's misconduct has been thoroughly briefed by the parties in this case, and much of it is beyond dispute. I don't plan and I don't have the time to [review] every aspect of the harassment campaign, and I really want to focus in my opening remarks on three key events that stand out to claimants as the most egregious violations. But before I do that, I'd like to say a few things about the motivation behind President Nazarbayev's order.

There has been much debate in the pleadings on why Nazarbayev gave the order that he gave to investigate

12:22 KPM and TNG. The respondent's position is that essentially he was legally obliged to conduct a full-scale investigation because he had received vague allegations from another head of state. Chief Investigator Rakhimov in his statement goes even further, and in his first witness statement says the investigation would have taken place based on similar allegations by an "ordinary citizen". That's sheer nonsense.

It is claimants' case that the Voronin letter simply created a pretext for President Nazarbayev -- and a thin one at that -- for Kazakhstan to search for a basis to divest claimants of their investments.

For example, claimants do not think it coincidental that the Nazarbayev order in response to the Voronin letter came right on the heels of two events: (1) the Tabyl block discovery by TNG; and (2) Project Zenith, where the claimants received several attractive indicative offers, several over $1 billion, from foreign companies to purchase a 100% interest in their companies. Even state-owned KazMunaiGas, KMG, made a three-quarters-of-a-billion-dollar offer, but likely was not to be among the higher offers and was unlikely to be a successful bidder, therefore having the state acquire the interest through its state-owned company.

12:23 Additionally, it appears actually that Nazarbayev requested Voronin to send him the letter, presumably so that he would have legal cover to commence the investigation campaign that he commenced.

The transcript of a television interview of President Voronin is our evidence, and that is in the record as C-78. In that interview, President Voronin indicates that his letter was solicited by President Nazarbayev, and notably Kazakhstan does not deny that fact. In fact, in its statement of defence, Kazakhstan asked the following question, which is on the slide:

"Can such kind of request be considered as the prosecution campaign launched by the President of the Republic of Kazakhstan? ... Perhaps, to the contrary, the President ... was interested in the investments into Kazakhstan on the part of Stati and just wanted to make sure that [he was] a worthy businessman."

In other words, Kazakhstan doesn't deny that President Nazarbayev requested President Voronin to write him a letter that served as the basis for its order of investigation, but in fact says that there was nothing wrong with that.

Now, while the claimants would clearly concede that President Nazarbayev was obviously interested in Mr Stati's investments in Kazakhstan, we don't think

12:24 that interest had anything to do with whether or not Mr Stati was a worthy businessman. If the Kazakh administration had been truly concerned about the activities of claimants in their country, they could have simply reviewed the reports that Mr Fleuriet referred to, which were frequent inspections by the MEMR and other governmental agencies of KPM and TNG's operations, all of which the companies passed with flying colours. In fact, the routine investigations of the companies showed the companies to be greatly in excess of their investment and fiscal infrastructure commitments.

Mr Stati, who will testify in this proceeding, has very clear views on why he thinks that President Nazarbayev targeted his businesses, and I would ask that you ask any questions of Mr Stati that you would like in order to solicit his views on why he believes he was the target of the Kazakh state machinery.

At the end of the day, however, it is important to note that it is not incumbent on the claimants to prove why President Nazarbayev gave his order. There is no question that the Voronin letter has provided the legal cover that the respondent is now seeking in this proceeding for what happened. And we believe that what happened following that letter demonstrates clear

12:25 evidence of multiple breaches of the Energy Charter Treaty.

For example, Kazakhstan does not dispute that President Nazarbayev's order led to a comprehensive investigation of the company, inspections of the companies by over a dozen governmental agencies. There has been much debate in the pleadings and in the witness statements about how invasive and intrusive and disruptive those investigations [were], and the witnesses will be heard on that in the course of this proceeding.

Suffice it to say that by November 7th 2008, the inspections were so troubling to Mr Stati that he felt compelled to write President Nazarbayev directly on this topic. He received no response, not only to this written enquiry of President Nazarbayev but multiple efforts that he made, both directly as well as through emissaries, to get an audience with President Nazarbayev. He was ignored.

While I don't plan to spend much more time on the inspections that were done, I do think it is important for the Tribunal to appreciate the cold efficiency and precision with which Kazakhstan undertook to inspect KPM and TNG. Recall that both of these companies had for ten years been subject to routine state inspections, without never once an iota of a suggestion of any

12:26 criminal activity or any other material breach of an obligation. Ten years of inspections, routine course, without the oversight of the President or financial police. Never once a suggestion of any impropriety. This all changed completely in November 2008, when the financial police were sicced on our clients.

I am going to show now a timeline of the 2008 inspections. You will see from that that after the Nazarbayev directive and the Prime Minister's order, the financial police ordered a half-dozen inspections before the end of October.

As you have seen from our pleadings, the financial police attended many of these inspections. It is our position that their attendance was not only highly unusual but it was improper. In fact, two agencies of the government -- the National Bank of Kazakhstan and the tax committee -- actually refused to allow the financial police to sit in on their investigations; that is in C-15 and C-38. However, whether they were there or not, there is no dispute in the record in this proceeding that the financial police orchestrated the entire operation.

Now, it is the claimants' position that the financial police influenced the inspections,

12:27 particularly with respect to their insistence that the geology committee of the MEMR, the Ministry of Energy and Mineral Resources, includes statements in its report in November 2008 that KPM and TNG did not own main pipeline licences, and ultimately that became the basis for the criminal investigation that led to the enormous fine to KPM and the imprisonment of its country manager.

Now, while Kazakhstan has stated in its last rejoinder that it would have been improper and in fact illegal for the financial police to influence an inspection report in this way -- a position with which we agree -- they have simply no evidence in the record to dispute Mr Cojin's recollection -- the country manager for TNG -- that that's precisely what happened.

You will hear from Mr Cojin in his testimony at this proceeding, and he has testified in his witness statement that he was there when the financial police ordered the geology committee to include a statement in both the KPM and TNG reports that they did not possess main pipeline licences.

Also look at the prior routine inspection reports conducted by the Ministry of Energy and Mineral Resources of the companies: no reference at all to the absence of a main pipeline licence. The first time that that language ever appeared was not in a routine

12:29 inspection, but it was an inspection overseen by the financial police.

The only evidence that the respondent has in the record is that Mr Turganbayev, who conducted the pre-investigation for the financial police, says it would have been improper, and he doesn't believe his employees would have requested the inclusion of such a statement in the report. That is hardly evidence in response to Mr Cojin's response.

The respondent clearly had the opportunity to present witness evidence from the members of the financial police that were actually engaged in the inspection, to deny that they requested that the main pipeline caveat be put in the report. There is no evidence that has come forward on that point.

Here is what the evidence will show. First, the geology committee completed its investigation on November 11th 2008. However, before presenting its report -- which would have been the normal course -- for signature by the country managers, the financial police wrote the agency that's in charge of licensing main pipelines -- that's the Agency for the Regulation of Natural Monopolies -- to confirm that KPM and TNG did not have licences to operate main pipelines. Once it received written confirmation of this undisputed fact,

12:30 because the companies didn't operate main pipelines, the financial police then instructed the geology committee to note that fact in its report.

Management at the time thought this was a relatively innocuous statement, because of course they knew they didn't operate a main pipeline. In fact, no prior geology committee report, as I have noted, had ever made that notation in the past; only the one at the direction of the financial police.

Otherwise the November 2008 inspection, which had been ordered ultimately by President Nazarbayev, gave the companies a clean bill of health. It essentially noted that the companies, as before, were fully compliant with their subsoil use contract obligations, and in fact were greatly exceeding their minimal work programme commitments.

What happened next is that on November 17th 2008 the financial police then ordered the tax committee to calculate so-called "illegal profits" that KPM may have earned through the operation of a main pipeline. Quickly the tax committee came up with a report to the financial police that within a three-year period, from 2005 through 2007, the company earned about $274 million in total revenues associated with its operations. Now, keep in mind that is the total revenues of the company,

12:31 not the profits of the company; and that was an amount earned by KPM over three years of operation.

So within a period of 30 days from President Nazarbayev's order, the financial police had already concocted its prosecution strategy. It had established a devastating find for the company, predicated on the notion that the company was illegally operating a main pipeline.

However, there was one omission: at this point in time no governmental authority had ever suggested or concluded that any of the pipelines that KPM and TNG operated were main pipelines. And the financial police had no competency whatsoever to make that determination, and that has been stipulated by the respondent.

But what the financial police did know is that with this size of fine, it would give them the leverage of a crippling multi-million-dollar fine against the company that essentially would devastate the company, or force it to sell at a fire-sale price. And as we know, the rest of the story, as they say, is history.

Let me turn back to the three bad acts that I want to focus on today. These are just the most egregious examples of state misconduct under the Energy Charter Treaty. First is Kazakhstan's allegation that the share transfer from Gheso to Terra Raf, which took place in

12:32 2003, was unlawful, and the effect of that was that it clouded claimants' title to TNG. The second is the main pipeline criminal prosecution, which I will come back to in some detail. And the third is Kazakhstan's bad faith refusal, in claimants' view, to extend contract 302, which again prevented the claimants from both proving those fields as well as marketing them.

It is important to recognise that each of those three acts standing alone, in claimants' view, constitutes breaches of the Energy Charter Treaty, not the least of which because each was unfair, each was unreasonable, and each fundamentally deprived the claimants of the attributes of their investment.

In addition to these three acts that I'll focus on, I will close by addressing the final treaty breach that occurred in July 2010, when the subsoil use contracts of the claimants were unfairly and unlawfully terminated by the state.

Let's turn first to the revocation of the waiver of preemptive rights. This occurred in December 2008, and it is claimants' case that the intended purpose of the revocation of waiver of rights was to cloud claimants' title to TNG, and therefore prevent a transfer of that company to a third-party buyer.

Recall from Mr Mohr's comments that the transfer

12:33 that was at issue between Gheso and Terra Raf occurred between Mr Stati's affiliated companies back in 2003. Mr Mohr has also demonstrated that at the time of that transfer in 2003, Kazakhstan did not actually have any preemptive rights under Kazakh law because all of those preemptive rights that Kazakhstan would have had in connection with a share transfer arose only in 2004 as a result of the change in the law.

Yet on the heels of President Nazarbayev's directive, less than a month after that directive, in December 2008 the state retroactively asserted a preemptive right and it retroactively asserted a need to improve the now-stale transactions that had occurred in 2003 between Gheso and Terra Raf. And for the reasons that Mr Mohr has already told you, and that have been briefed extensively by the claimants in this proceeding, that was just plain wrong.

It was wrong for two principal reasons: (1) Kazakhstan had no preemptive right. The share transfer took place in 2003, it was properly registered in 2003, and Kazakhstan concedes that the transfer took place in 2003 and was properly registered at that time. Then the 2004 amendments to its laws do not have retroactive effect and do not come into play at all.

Secondly, even if Kazakhstan had preemptive rights,

12:35 even if the 2004 law were to be deemed to apply -- which it did not -- it had twice waived those rights. And, as Mr Mohr has noted, both times that occurred in 2007.

Yet on December 18th 2008, the MEMR informed TNG that it was "cancelling" the previous approvals that it had given, and demanding that TNG reapply for approval of the transfer. It is no coincidence that this letter from the MEMR was written to our clients within [two months] after President Nazarbayev gave his order. And it was essentially revoking not one but two prior waivers of whatever preemptive rights existed. Of course, in claimants' view those rights existed not at all because the transfer had been properly registered in 2003.

Now, it doesn't take a lot of imagination to see what Kazakhstan was trying to do. What Kazakhstan was trying to do was clearly reassert preemptive rights that it did not have in order to acquire the company pursuant to those preemptive rights at what was an inter-affiliate share transfer price between Gheso and Terra Raf.

The state obviously, at the time that it did this, had the benefit of knowing, through Project Zenith, that the company in fact, from an arm's length transaction standpoint, had already received indicative offers valuing the company between one of the lower values

12:36 attributed by the state-owned oil company, KMG, of $750 million, three-quarters of a billion dollars, to the high from the Korean National Oil Company of $1.5 billion. But rather than participate in that process in any legitimate way to exercise its preemptive rights, it was seeking, through the revocation of its preemptive rights, to essentially get an inter-affiliate transfer price that had occurred back in 2003.

Now, if Kazakhstan had honestly believed that there was a problem with the share transfer between Gheso and Terra Raf in 2003, it could simply have addressed that at the MEMR and client level and tried to get to the bottom of the issue to try to better understand why it was our client's position that in fact the share registration had properly occurred in 2003, as Mr Mohr has shown you. But the state had no interest whatsoever in learning the truth associated with that. Its objective was not to remedy a perceived error that had taken place in the past, but rather it was to place a cloud over the title of claimants' investment.

Why do we think this? We know this because the very day that the MEMR sent our clients its letter challenging the share transfer from 2003 -- and this was again in December 2008 -- there was a press report that appeared in the financial press quoting unnamed sources

12:37 within the MEMR not only publicising the preemptive rights dispute, but also just defaming the claimants, in making baseless allegations of forgery. We'll see that at slide [-9-].

Obviously the press report had the immediate and -- in claimants' view -- intended effect of clouding TNG's title to the assets from any prospective buyer that might have been interested in acquiring those assets. Now, the state says, "Well, we didn't make an official press release announcing that we were challenging the preemptive rights waiver that had occurred in the past." But it doesn't deny that sources within the MEMR in fact talked with the financial press and not only disclosed the fact of this dispute but also made allegations that our clients had been engaged in forgery; allegations which, by the way, have never been proven, have not even been reasserted again, but simply were asserted for the effect that they were intended to have at the time, which again was to cloud title.

Now, if the Tribunal has any question about what was the effect of this press report that appeared, it need look only to C-625 and the testimony that has been given in the witness statements and will be given at this proceeding by Mr Lungu, the vice president of finance for the companies.

12:39 The companies were on the cusp of securing a loan from Crédit Suisse, a bridge loan, at the time that these allegations were made public. And the evidence will show that Crédit Suisse, in response to the allegations of the state's reassertion of preemptive rights, in response to the allegations of forgery, withdrew its offer to make a loan to our client. In other words, our client was unable to secure the financing through the financial institution of Crédit Suisse.

Now, it is claimants' view that the actions of the state as it relates to the preemptive rights waiver were both unreasonable and inconsistent treatment with respect to their actions on the plaintiffs.

Before I move on, I think maybe what's most telling about Kazakhstan's conduct with respect to the preemptive rights waiver is the cynicism with which it handled this accusation after it made it in December 2008 and after the press report appeared: it didn't do anything. It dropped the issue with TNG. There was never any formal enquiry. There was never any attempt by the state to assert title pursuant to the preemptive rights waiver. It was not even raised in 2010 as one of the grounds for terminating TNG's contracts.

12:40

The reason for that, in the claimants' view, is very simple: it had had its intended effect. It had put a placeholder in the market that our clients may not have a legitimate claim of ownership to TNG, and therefore it would have prevented any arm's length transaction from taking place. Again, this occurred in December 2008, literally within [two months] of President Nazarbayev's order.

Now, the second issue that I would like to turn to is the main pipeline issue, and this is a bit more complicated.

It is claimants' position that the main pipeline licensure allegation, the failure to hold a licence, was a completely fabricated claim by the state, and as a result of that fabricated claim, it ultimately led to a baseless criminal conviction of KPM's general manager and a devastating fine for the company.

Now, as you will recall, the main pipeline allegation, including all the way to the penalty phase of that allegation, had been fully formulated within the financial police in about 30 days after they received their order from the Prime Minister to investigate KPM and TNG. Now, why do we say it was a fabrication?

Well, first, it is not disputed by the parties that the claimants constructed and operated all of the

12:41 infrastructure for KPM's oil production and processing facilities from 2000 to 2008, with absolutely no allegation whatsoever that any part of those activities were being operated by it without a proper licence. In fact, KPM held proper licences to carry out all of its activities.

KPM had a general subsoil use contract for exploration and production; that's in the record at C-45. Under that contract it is important to note that KPM not only had the right to carry out exploration and production activities within the contract area, but also the express right to build facilities outside of the contract area connected with its production operations so long as it received state approval, and that is in C-45 at paragraphs 7.1.1 and 7.1.4.

KPM also had all of the required state approvals to build the facilities relating to its production activities both inside and outside the contract area, including the pipeline at issue in this case; that is at C- [469].

KPM had a specialised licence for hazardous activities in connection with the operation of its pipeline, which was first issued in 2002 and was again renewed by the state in 2005; that is at C-81 and C-83.

After a change in the licensing law took place in

12:43 2007, KPM received a new licence for the pipeline segment at issue in 2008 that covered its oil and gas production activities; that is in the record at C-472.

The MEMR issued each one of these licences.

In addition, KPM also had specific approvals for the pipeline in question. As Mr Romanosov has testified in his witness statement, Kazakhstan in fact approved the design plans for the pipeline at issue, and they were expressly based within those approved design plans approved by the state based on specifications for a field pipeline.

Sometimes you will hear on the record it not referred to as a "field pipeline" but referred to as a "contractor's pipeline", sometimes you will hear it referred to by some of the experts in some of the documents as a "gathering manifold", but those are all different ways to say that this was a field pipeline.

In fact, five different governmental agencies reviewed and approved the design, the construction and the operation of the pipeline in 2002. At no time did any of those governmental agencies ever raise any question as to whether this was a main pipeline or whether it required a main pipeline licence.

In fact, to the contrary, both specialists with the national oil company, KMG, as well as specialists within

12:44 the Kazakh Ministry of Emergency Situations, which is the agency responsible for monitoring pipeline safety in Kazakhstan, issued letters to the claimants in 2008, after the Nazarbayev order, indicating and confirming that KPM did not operate a main pipeline. Those documents are in the record at C-99 and C-90.

Although the financial police, as the evidence has shown in the record, forced the Ministry of Emergency Situations to withdraw its letter, the MES nonetheless wrote again to the claimants in January 2009 and again opined that the KPM pipeline was not a main pipeline; that is at C-103 in the record.

So now you have experts within the national oil company, experts within the Ministry of Emergency Situations, both notifying the claimants in response to their question that they did not operate a main pipeline.

Similarly MEMR -- and remember, this is the agency actually responsible in Kazakhstan for applying the Law on Oil, and also at the time, up until 2007, the licensing authority for the main pipelines -- never once, in any of its inspections of KPM's operations, suggested the company needed a main pipeline licence.

In fact, it's interesting to note that the MEMR, the geology committee, which conducted the inspection in

12:45 November 2008, did not even say it needed a main pipeline licence in its inspection report as a result of the financial police inspection. Instead what it said -- and it is claimants' case that it said that because it was told to say that by the financial police -- is the simple fact that KPM did not have a main pipeline licence.

If you read the inspection report by the geology committee, it is notable that no one from the MEMR said, "And that licence is required," and the reason for that, very simply, is the MEMR didn't believe it. The MEMR knew that the pipeline that ultimately KPM was prosecuted for was not a main pipeline; it was a field pipeline.

Now, you have to ask yourself -- it's now the respondent's case that licensure of a main pipeline is a matter of critical national importance because main pipelines are critically important to the government, they're critically important to the people, there are safety concerns regarding the operation of a main pipeline. So then ask yourself: why did the governmental agency that was responsible for main pipeline licensure, the MEMR, that was responsible for conducting inspections of the pipeline, as well as the Ministry of Emergency Situations, which also is

12:47 responsible for monitoring pipeline safety, never once in eight years of operation, ever suggest, ever intimate, ever even question whether the KPM pipeline segment at issue was a main pipeline? The answer is very simple: they knew it wasn't a main pipeline.

The main pipeline determination was made by the financial police. It was a concoction, it was a contrivance. It was made merely in order to put the company out of business, and that is precisely what happened.

Now, how does Kazakhstan respond to this? And we think the response is both convenient and very, very telling.

First, Kazakhstan now, in its pleadings, dismisses the technical specifications. According to its defence in this case, it doesn't matter how small the pipeline is; it doesn't matter how short it is; it doesn't even matter that it forms part of a single technological process for the oil production in KPM's fields. That's because Kazakhstan now argues that the question of whether the KPM pipeline was a main pipeline is purely a legal question, not a factual question, and therefore a layman can't even answer the question.

But respondent goes even further. Not only can a layman not answer the question but a pipeline

12:48 specialist can't answer the question. Technical specialists, such as employees of NIPI Neftegaz, which is the state pipeline design company that actually designed the pipeline at issue here, nor even specialists within the national oil company, who had been working in the industry for decades, can answer the question as to whether a pipeline is or is not a main pipeline.

Nor, apparently, do agencies of the government know that. The Ministry of Emergency Situations, whose very job is to go out and inspect pipeline safety -- inspect field pipelines with one team, inspect main pipelines with another team -- has [no] clue, apparently, as to whether a pipeline is or is not a main pipeline.

Now, what's most ironic about that position -- and we understand fully the reasons for the state's change in position or shift in position on this -- is that that's completely at odds with the position they took in the Cornegruta trial, when they criminally prosecuted both Cornegruta and then assessed a fine against KPM.

If you look at the forensic expert report in connection with that trial -- and that is the only one report they submitted, and that is at C-110 -- and if you look at the trial court's ruling in that case, that's at C-117, you'll find discussion of nothing but

12:49 technical specifications. In fact the predicate for the forensic expert's report -- and it's understandable that that's the predicate because that's the only thing he knew anything about -- was that because of the technical specifications that were applied to this pipeline, it was therefore a main pipeline.

The government has completely invented a new position, and it invented that position for purposes of this proceeding because it can't defend what happened in connection with the trial.

Now, we've excerpted some of Kazakhstan's pleadings of the position as to who is and is not a competent authority on the issue of main pipeline, and it's actually a pretty remarkable position. I would submit to you: you can look at this slide and basically say that through its arguments and its pleadings, Kazakhstan has essentially stipulated that the legal regime in the country is not transparent and is extraordinarily ambiguous.

Kazakhstan admits that the financial police is not the competent authority. We agree with that. It also claims that neither the Ministry of Emergency Situations, nor even the Agency for Regulation of Natural Monopolies -- that's the agency that had responsibility for pipeline licensure after 2007 -- is

12:50 a competent authority to classify a pipeline. So essentially the agency that's responsible for issuing licences has not a clue what is and what is not a main pipeline, nor the agency responsible for inspecting those lines, nor the financial police.

It is also apparent from the evidence -- remember, if you will recall from the record, that the financial police on their own deemed inadmissible all of the expert evidence that Mr Cornegruta presented in his defence in advance of his trial. There were four reports, recall, that he submitted: two from the Ministry of Emergency Situations, one from the design institute of the national oil company, one from the design institute of the pipeline design company, all of which concluded that this was not a main pipeline. What does Chief Investigator Rakhimov do? Let's just throw that off the table. None of those are competent to render [an opinion] on the question of whether this is or is not a main pipeline.

In fact, the position of the state now is that the only authority competent to render an opinion is a legal authority. It doesn't matter whether that legal authority has a clue as to oil and gas business. On Kazakhstan's case, the question is simply a matter of law.

12:51 Here is apparently, as a foreign investor, how you get your answer to that question: you either go to the Ministry of Justice and talk with one of its forensic experts -- of course, you can't do that, because only the financial police or the prosecutor can do that -- or you literally, as Mr Cornegruta was, have to be shackled in front of a judge in Kazakhstan to be told whether you have violated the law by operating a main pipeline, when there is no one within the government, in terms of agencies of the government, no one with the technical organisations that can tell you whether you have to have a pipeline licence or not.

So essentially, as a foreign investor, it is truly buyer beware, or you can go to prison for four years for operating a main pipeline, notwithstanding everything you've been told by the government in the past. That's essentially their case.

Yes?

PROFESSOR LEBEDEV: You say "in her discretion". The judge was a lady?

MR SMITH: The judge, as we understand, was a female. Yes, it was a lady. And that's essentially what they say in their rejoinder at paragraph 581:

"Ultimately, the decision on the classification of pipelines is one for the Judge to take in her

12:52 discretion..."

Now, let's assume that they are right -- and we disagree with all of that, but let's assume that they're right -- that this is purely a matter of law. Then on Kazakhstan's best case here, the law is simply incredibly unclear.

Even its own expert, Professor Didenko, recognises this. I don't have time to read fully what he has presented on this; we have presented a slide on it. But at the end of the day what he says is:

"The definitions of the trunk pipeline can be found in various judicial acts and technical documents. They differ from each other, and therefore you have to employ interpretations of the appropriate norms and regulations."

He then goes on to say:

"[F]rom a technical point of view, it's difficult to define a clear distinction between the concepts of trunk pipeline and non-trunk pipeline ..."

And then he employs four criteria that he personally employed to lead him to the conclusion, as the state's expert, this is a main pipeline. A couple of points I'd like to make about that.

You won't find any of those four in the Law on Oil. You won't find any of those four within the laws of the

12:53 Republic of Kazakhstan. This is the opinion of a paid expert in this case as to why he thinks this is a main pipeline, but I will challenge Kazakhstan to point out in their law where you find these criteria.

Also, his views are fundamentally at odds with the Ministry of Emergency Situations, the national oil company, NIPI Neftegaz, who designed the pipeline, and the experts retained by the claimants both in connection with the Cornegruta trial as well as in this proceeding.

Now, if Kazakhstan is going to rely on its law and say this is a matter -- purely a legal question, then it is incumbent on them to ensure that its laws are both clear and can be implemented as clear. Now, it is our view, in fact, that the claimants' case was entirely contrived. In fact, it was built solely on the strength of the financial police's handpicked forensic expert at the Ministry of Justice, a gentleman who had never once classified a pipeline in his life at the time he made that determination, and he will testify in this proceeding.

We submit that the Ministry of Emergency Situations, who had never once suggested we had a main pipeline, is in fact an authority that at least should be looked to on the issue, and certainly could be relied upon by the claimants on the issue of whether or not they operated a

12:54

main pipeline.

It's interesting: until today, essentially, we hadn't heard a peep from the Ministry of Energy on this issue. Not a witness statement from the other side, not a document produced by the other side as to what its views are/were on whether we operate a main pipeline. That's true notwithstanding the fact that the financial police actually wrote a letter asking both the Agency for [Regulation of] Natural Monopolies as well as the MEMR, specifically asking them for a determination of the type of pipelines operated by KPM and TNG.

So the financial police thought at the time it was doing its investigation: it is very important to hear from the MEMR on this. Well, they did hear from the MEMR, we have learned, but they didn't disclose it in this proceeding until today.

They heard from the MEMR in response to this letter and in C-718/C-719 -- 719 is the response -- the MEMR responded:

"The pipeline working as a gathering manifold is not a main pipeline ...

"Considering the above, the above-named pipelines..."

So this includes the KPM pipeline segment:

"... belong to pipelines working as a gathering

12:56 manifold."

This evidence was withheld from this Tribunal. And the reason it was withheld from this Tribunal is because they didn't like the answer they got from the MEMR -- this was during the criminal investigation -- just like they didn't like the answer they got from the Ministry of Emergency Situations. So they instructed the Ministry of Emergency Situations to withdraw their letter.

Now, there is a new witness statement, the third witness statement of Mr Rakhimov, that was presented this morning, and he'll be here to be cross-examined. But the reason apparently this was not produced is that he also requested that this be withdrawn as well. In other words, he got an opinion, didn't like it, asked that it be withdrawn so he could continue with his prosecution, with his handpicked expert, in the Department of Justice.

Let's move to the trial for a moment. Once it was armed with its forensic expert report that did find that this was a main pipeline, the government had two options. The first option was to initiate an administrative proceeding against KPM. The second option was to initiate a criminal proceeding, not against KPM, because you can't prosecute in Kazakhstan

12:57 companies for crimes, but against Mr Cornegruta. It didn't do either one. In effect what it did is a hybrid of the two, which is completely unlawful.

It brought a criminal proceeding against Mr Cornegruta, found him guilty of the crime of illegal entrepreneurial activity, sentenced him to four years in jail, and then turned around and assessed a crippling fine against KPM, who was never a party to the proceeding, never a party to the criminal case; never given an opportunity to appear in the criminal case represented by counsel; never given an opportunity to present, on its own behalf, evidence on the main pipeline issue; never entitled to present its own financials to explain to the government -- which apparently either didn't understand or didn't want to understand -- the issue that revenues do not equal profits. None of that happened.

In fact, KPM wasn't even delivered a copy of the judgment. It learned of a judgment in the case that it had been assessed a $145 million fine in a proceeding to which it was not a party.

Now, for the reasons discussed by the experts for the claimants in this case, and briefed, there were just multiple violations of due process in connection with this proceeding, and a denial of justice. And I won't

12:58 go through those today.

What I would like to do is focus on a couple of comments that Professor Olcott has made, which may be helpful to the Tribunal if it has any questions about what goes on in the Kazakh courts. There are two quotes from her book. One is:

"In the absence of an independent judiciary and commercial arbitration system, the concessions granted to investors cannot be guaranteed to survive the life of the projects."

That's one of her comments about the atmosphere that foreign investors find in Kazakhstan. But secondly, I think this is even more pertinent:

"... Kazakhstan has many good laws, but no one in authority is particularly interested in enforcing them. It also lacks an independent parliament, an independent judiciary, and popularly accountable local governments."

That's coming out of the mouth of the respondent's expert on the Kazakh legal system: it doesn't have an independent judiciary. No one is particularly interested in enforcing all of the beautiful laws that were put in, in connection particularly with the respondent's rejoinder. They've got this very nice legal system, they've got all of these nice criminal procedures. But according to their own expert, no one

12:59 in the country is particularly interested in enforcing those laws.

In fact, when you look at the trial of Mr Cornegruta, it is the poster child for denial of justice. His experts were struck both by the prosecutor before the trial commenced as well as by the court, on the ostensible basis that his witnesses didn't appear in person to testify; and we'll get into that in the course of this proceeding. It assessed a crippling criminal fine against a company that was not even invited to attend the proceedings. It could have pursued administrative remedies against KPM; chose not to do it. Instead it adopted a hybrid approach that was entirely illegal.

I want to talk for a moment about the penalty of KPM. That was $145 million. And I just want the Tribunal to look at two benchmarks to assess the fairness of that penalty and its reasonableness. One is: look at KPM's net profits in 2007 and in 2008. The net profits of the company in 2007 were $23.5 million. The net profits for the company in 2008, a very good year, with very high oil prices, was $66 million. Those are annexed to the financial statements that are included with the FTI report.

Thus the penalty that Kazakhstan assessed against

13:01 the company were well more than double the net profits of the company in 2007 and 2008. And the reason I've picked that period is because that's the period of time in which the fine was assessed from Mr Cornegruta's alleged illegal entrepreneurial activity in connection with the operation of the pipeline. It is, very plainly, a death-penalty sanction. And it was known by the financial police, as well as by the other organs of the government, that that's exactly what it was.

I want to put it in further perspective. The state's own national transportation company, KazTransOil, is the largest main oil pipeline operator in the country. It operates the pipeline that traverses Kazakhstan and leads into Russia. It's the pipeline into which our clients placed their product for transport. This is at C-708 in the record. In 2007, KazTransOil's net profits for the year were 14 billion tenge, and in 2008 they were 20 billion tenge. The judgment assessed against KPM for operating about an 18-kilometre segment of pipeline was over 21 billion tenge.

Let's let that sink in for a second. KPM's penalty for operating an 18-kilometre segment of pipeline in a legal regime that is, at its best, completely ambiguous as to whether or not you have to have a main

13:02 pipeline licence, its conviction in a trial, and a penalty assessed in a proceeding KPM didn't even participate in, they were sanctioned an amount that is greater than the net profits of the state's own largest main pipeline operator in the oil segment. It is an enormous denial of justice, it is completely unfair and unreasonable, and we believe it constitutes severe breaches of the Energy Charter Treaty.

Now, what happened after they got that fine? Exactly what you would expect. They began enforcing the penalty against KPM: the seized their bank accounts, they seized their motor vehicles. With very cold precision, the state essentially eliminated KPM as a going concern.

Now I want to turn to the third egregious violation.

THE CHAIRMAN: Let me just ask: are you aware of your time? I think you have about ten minutes left.

MR SMITH: I think that's right, yes.

The third violation -- I'm going to be very brief on this -- is the extension of the contract for contract area 302. Because I do want to reach one other issue.

Our case is that the state clearly breached an undertaking it made with respect to extending contract 302, and it was bad faith for it to do so.

You will see on this slide essentially the documents

13:03 that we rely upon. In October 2008, application was made to extend the contract; on April 2nd 2009 the expert commission for the MEMR made a recommendation granting the extension; and then on April 9th 2009 the MEMR sent a letter to our clients that said, in our view, that the contract was extended.

There are competing translations on that issue in the record: at C-27 as well as at R-163.1. Maybe I'm slow on the uptake; I don't see a meaningful difference between the letters. I think the letters both very clearly indicate to our client -- and our client could rely on it -- that its contract was going to be extended, and that an addendum to the contract was going to be entered into by the state.

What happened is, notwithstanding that signal to our client, the addendum was never executed by the state, therefore our clients were never able to prove and exploit their reserves in the Tabyl block because they were paralysed because of the state's inaction with respect to executing the addendum. And we believe the failure of the state to execute the addendum was unreasonable, was in fact a breach of a commitment that it had made, and it forms the basis for the third prong of what I wanted to discuss today in terms of breach of the ECT.

13:05 Now I want to turn quickly to the expropriation that took place. At the end of 2008 it was very clear to our clients that their companies were under complete assault by the government. In early 2009, notwithstanding the global financial crisis, Mr Stati went back to the markets because of the incredibly hostile environment in Kazakhstan. And Mr Stati and Mr Lungu are here to answer your questions and the questions of the respondent regarding their unsuccessful efforts to sell the company in the spring of 2009.

However, Kazakhstan had no interest in seeing these companies sold to other foreign investors, and in fact this is the rare case where their expropriatory goals in 2009 were outlined in writing. Those writings, as an example of putting more precision on President Nazarbayev's order, are at C-23, C-293 and C-294.

The first is C-23, which is a letter that has been referred to in the case as the "Blagovest letter". It's a letter written by Mr Yuri Zakharov, who was the head of this public interest organisation, to the head of the MEMR. Professor Olcott even notes that Mr Zakharov not only was the head of this organisation, but also was the deputy head of Kazakhstan's assembly of nations.

The letter proposes possible ways -- and I want to

13:06 quote here -- to:

"... resolve the question of nationalisation of the assets [of Mr Stati] posed in 2008."

I've rarely seen that in written in a case before.

The letter then has attached to it a personal instruction by President Nazarbayev that is directed to the Prime Minister, to the Ministry of Energy, as well as to his son-in-law, Mr Kulibayev, that basically is complaining about disruptions in the production from KPM and TNG because of social unrest. And he attributes correctly that disruption caused:

"... as a result of inspections by law enforcement bodies."

Now, Kazakhstan attempts to dismiss the Zakharov letter as: he's a meddler, he didn't know what he was writing, he didn't know what he had signed. He even submitted a statement in this case to that effect, but he's refused to attend to be cross-examined on that statement. So essentially what we are left with is his letter, and the letter will have to speak for itself.

I think it is important to note that notwithstanding the dismissive nature that the state has made toward Mr Zakharov's connections with the government, the fact is that he wrote a letter that was essentially a description of what happened in 2008 and 2009, and he

13:07 attached to that letter a personal instruction from the President, which would suggest a very close personal relationship and a very close personal knowledge of what is going on at the time.

The second and the third letters that we would like you to focus on are C-293 and C-294. One is written by the head of the local government in the region, the other by the executive secretary of the MEMR, and both of those letters confirm internal government discussions to acquire KPM and TNG.

The MEMR refers to: if KPM and TNG will not agree to a "free of charge transfer of assets", which I've never quite heard of before. And then the letters go on to say: if the companies can't be acquired, then we need to look at terminating the subsoil use contracts. Look at the MEMR letter in particular, because in that letter it's very prescient: it warns that there's likely to be an international arbitration if they go the termination route because "no direct grounds for termination" exist, because KPM and TNG have been in compliance with their contracts. And of course we know the MEMR's view on that, because they had given us clean bills of health in their prior reports.

KMG, the state oil company, made further efforts in 2009 and into 2010 to try to acquire the company for

13:08 a fire-sale price, as you've heard in Mr Stati and Mr Lungu's statements. They even went behind the claimants to our creditors in Amsterdam and basically tried to cram down a sale by saying, "We'll pay you 25 cents on the dollar of your debt." And they were unsuccessful. Mr Stati, if he is nothing else, is stubborn, and he wasn't going to see this happen to his companies. And therefore KMG, the state company, was unable to acquire the companies.

Therefore the state went, just as the MEMR predicted, to plan B: they terminated the contracts, and they did that in the summer of 2010.

Now, I don't have time to go through all of the grounds for termination that were outlined. There will be plenty of time, and there's been plenty in the record on that point. But I do want to make a couple of points.

One is: the predicate given by the state for re-initiating another barrage of inspections of the companies in the summer of 2010, was that it received what we now know is a handwritten complaint from four local residents that had no relationship whatsoever to KPM and TNG. And just like they did with the Voronin letter, the state therefore was compelled to act, is the position of the respondent. We could not [fail to] respond to

13:09 these local resident complaints, just as President Nazarbayev apparently could not fail to respond to the letter from President Voronin.

So what did they do? Another inspection barrage, very similar to the one that had taken place in 2008, took place in 2010: very rushed; most of the reports were never finalised. And on July 14th, notices were sent to the companies of infringements, and they were given five days to respond. When they were unable to respond to a litany of new allegations of infringements of the contracts, the Minister of Oil and Gas and the Prime Minister of Kazakhstan showed up at the fields, held a big meeting, and announced that they were taking over the companies and the contracts were terminated. That was on July 21st 2010. A complete ruse, in the claimants' position.

This letter was written three days before this letter was written by these local residents. There is a document in the record that the representative from the financial police actually sent from the computers of our clients, because the financial police had the run of our offices at that point in time, a memo which indicates that the inspections that were being carried out were pursuant to an order from the Prime Minister dated June 25th 2010, three days before this letter was

13:11 marked as received.

At the end of the day, whether it was in fact in response to these resident complaints -- we don't believe that it was -- or it was in response to the Prime Minister, the fact is that what happened in connection with the events in the summer of 2010 constitutes very clearly a direct expropriation. We believe that the expropriation actually occurred far earlier as a result of the conduct of the government through death through a thousand nicks earlier. But it clearly occurred in the summer of 2010, when the Prime Minister ordered the inspections, and ultimately the contracts were terminated.

This was just as predicted by the Ministry of Energy in 2009: that the contracts may need to be terminated to get control of the assets. And this proceeding in fact was just as predicted by the Ministry of Energy when it said that an international arbitration proceeding may be the result of this.

In closing, the claimants submit that the actions of the government, commencing in 2008, based on the directive of the President himself, constituted multiple and severe breaches of the Energy Charter Treaty.

Many of the actions that we've talked about and we will talk about in the course of these proceedings

13:12 standing alone would and do constitute separate breaches of the Energy Charter Treaty. But we would implore the Tribunal that it must examine these actions in their totality in order to appreciate the devastating effect they had on the claimants' investments from the very outset, from the fall of 2008 when the directive was given.

Therefore, we thank you very much for your attention.

THE CHAIRMAN: Thank you very much indeed. We now have a one-hour break for lunch, and then we will hear the respondents.

You look at me as if you want to say something?

MR FLEURIET: I have a response to Mr Haigh's question.

THE CHAIRMAN: Please go ahead.

MR FLEURIET: If we can just put it into the record. I am informed that the 1-kilometre pipeline that connects into the KazTransOil main pipeline was 200 millimetres in diameter from the warehouse to the metering station, and then 150 millimetres from the metering station to the KazTransOil main pipeline. 150 millimetres would have been what you would have seen in the photo. That can be found in the base plan that I believe is Exhibit C-465 at paragraph 4.2.4.

Thank you.

13:13 THE CHAIRMAN: Thank you very much indeed. So we'll meet again at 2.15.

(1.13 pm)

(Adjourned until 2.15 pm)

(2.20 pm)

THE CHAIRMAN: Alright, we will resume the hearing. I hope you had an opportunity to have a decent lunch in that one hour. It does not give sufficient time to go into a real Paris restaurant, but if you do that you need two to three hours and we don't have time to do that.

Before we come to the respondent's opening statement, as a matter of housekeeping, may I just ask: after that we will start with the witness examination obviously, with the claimants' witnesses. Is there any agreed order by now in which they will be heard? So that we have an idea what's coming up.

MR SMITH: Yes, we have an agreement as to the order. Do you want a ...?

THE CHAIRMAN: Yes.

MR SMITH: Bear with me for just one moment. The first witness will be Mr Lungu. The second witness presented will be Mr Stati. Then Mr Pisica, Mr Romanosov, Mr Condorachi, Mr Cojin, Mr Stejar and Mr Calancea.

THE CHAIRMAN: Okay, and we will see how far we get on them. Alright. Thank you very much.

14:21 The respondent has the floor for the opening statement. Please go ahead.

(2.21 pm)

Opening statement on the merits by MR TIRADO

MR TIRADO: Thank you, Mr Chairman. As we did this morning, Dr Nacimiento and I will divide our submission on liability. You will see on the slide, the contents slide, there are eight areas to cover. I will cover the first three, Dr Nacimiento will deal with IV and V, I will look at VI, and Dr Nacimiento will finish with VII and VIII.

THE CHAIRMAN: I take it that we again will receive the slides?

MR TIRADO: Correct, sir, yes.

So, looking at the "No Harassment Campaign", the claimant certainly paints an extremely oversimplified picture of Kazakhstan, and of course we understand why they need to do so. Claimants' case is based on the allegation that they were harassed by the government so that President Nazarbayev or Timur Kulibayev could take control of the assets. This would require that these two can do whatever they see fit. In order to even be able to suggest that, claimants have to look past the realities of the very complex country that is the Republic.

14:23 First of all, President Nazarbayev is not the all-controlling political power in the country. Of course the Republic has a strong presidential system. However, as Professor Olcott tells us in her report:

"... President Nazarbayev has grown weaker over time, both because of modifications to the constitution that have made the Prime Minister, the Cabinet and the Parliament stronger institutions, and because President Nazarbayev has himself grown older and less interested in managing the daily events in an increasingly more complex country."

You will find that reference at paragraph 25 of Professor Olcott's report.

Government bureaucrats do not falter to pressure from high up. We know this from the testimony also of Professor Olcott, who has spent a lot of time in Kazakhstan on the ground, and who has firsthand experience of dealing with Kazakh bureaucrats. She tells us at paragraph 38 of her report:

"... I gained a new appreciation of the power and autonomy of bureaucrats, the rigidity with which some execute their tasks, not because they have been ordered to do so, but because this is their sphere of power and they will not have it denied. I ... do not see evidence of bureaucrats trying to guess what their superiors

14:24 might want and bend their performance of their duties to any such expectation ... Rather I find the opposite to be true; most bureaucrats I encounter are literalists, eager to enforce the very letter of Kazakh law, with no notion that there might be a spirit of the law that demands some flexibility from them."

The claimant also oversimplifies matters when they describe the financial police. They argue that the financial police is the personal instrument of the President, which ensures that inspections and investigations lead to the desired results. However, as just explained, this fails to acknowledge that, firstly, the President does not meddle with everyday bureaucracy in Kazakhstan and does not control every aspect of the Republic's politics; and secondly, that bureaucrats are mindful of their own personal competencies and of the letter of the law.

Finally, in their most blatant oversimplification, claimants, throughout their written submissions, failed to even mention that there is a difference between KMG NC and KMG EP. NC stands for national company; EP stands for exploration and production. As Mr Suleimenov, the head of the new projects department at KMG EP explains, there is a marked difference between the two. He states that in his witness statement at

14:26 paragraph 2.1, and it's there on the slide for convenience:

"KMG NC is a separate legal entity which is owned entirely by the Government of Kazakhstan. By contrast, KMG EP is owned both by the Government but also by a selection of private investors: 62% of KMG EP's shares are owned by KMG NC, the second largest shareholder is the Chinese fund 'Chinese Investment Corporation' which owns approximately 11% of KMG EP and the rest of the shares are distributed among public shareholders ... KMG EP global depository receipts are listed on the London Stock Exchange ... KMG EP acts like a normal private commercial company and not like a stateowned entity."

So quite a difference.

Even if one looked past all of these realities of Kazakh politics and simply assumed with claimants that the President does as he pleases, their allegation of a harassment campaign does not make any sense. That is because there is no credible motive for such harassment.

First of all, there are no political motives in play. Claimants on their own account were not involved in Kazakh politics. For this reason alone, the Kazakh Government, and President Nazarbayev in particular, simply did not have any reason to initiate some form of

14:27 harassment campaign. Of course, as already mentioned, the claimants are major players in Moldovan politics, yet Moldovan politics certainly did not play a role here.

President Nazarbayev may have forwarded the letter of President Voronin to the relevant authorities; however, doing so was really the minimum that was required from him from a foreign policy perspective. As Professor Olcott explains, it is really the etiquette between leaders of CIS states to follow up on requests sent by one to the other, and I refer you to paragraph 177 of her report. Not doing so would really be an affront.

There is another serious flaw in claimants' conspiracy theory. To put it quite simply, the Republic had no financial or strategic motives that could have been a reason for starting a harassment campaign. The claimants' businesses were worth much less than claimants want the Tribunal to believe, and they were of no national importance. The Republic has already stated so in its statement of defence, and it will address this more extensively in its rejoinder on quantum and in the January hearing.

In that regard, it is most noteworthy that no one is turning a profit from the current trust management

14:29 solution. The Minister of Oil and Gas, Mr Mynbaev, will be here to testify as a witness, and he tells us that -- from his witness statement at paragraph 6.2:

"Trust management does not include any political purpose. It is intended to ensure the continuation of the technical process and industrial safety. Since money obtained in the course of the trust management cannot be subject to taxation and may only be used for the maintenance of the assets itself, the MOG had no financial interest in the transfer of the assets into trust management. Further, with regard to KMG NC, it currently seems very much possible that it will lose money from the trust management process."

Lastly, claimants also suggest that somehow alleged personal interests of Timur Kulibayev caused the government to start a full-on harassment campaign against the claimants. Claimants' theory for an involvement of Mr Kulibayev is, at best, confusing, and the evidence they have provided is really laughable.

First of all, claimants have not even come up with a theory as to how Mr Kulibayev would personally profit from KPM and TNG coming under state control. With state control, only the state could profit. There is no reason to assume that this would somehow enrich Mr Kulibayev. In fact, as just stated, no one is

14:30 turning a profit from the current trust management situation, least of all Mr Kulibayev. Why he would be involved in concocting a harassment campaign for this outcome is really a mystery. The claimants have not addressed this at all.

Moreover, claimants have not proven that Mr Kulibayev was even interested in KPM and TNG. They argue that some companies controlled by him wanted to acquire KPM and TNG. However, they have not provided any evidence that these companies were controlled by Mr Kulibayev.

Many of the instances claimants try to paint as signs of government harassment are in fact signs of fair and reasonable approach by the authorities. The officials were clearly worried about KPM's and TNG's increasingly distressed finances, and they saw a threat of nonpayment of workers and social unrest. Such threats are very real and long strikes have repeatedly led to violence and riots in Kazakhstan. As will be set out below, the situation was entirely due to claimants' mismanagement of this investment.

The governor of Mangystau oblast sent two letters to Prime Minister Massimov in August 2009, Exhibit C-293, and again in February 2010, Exhibit C-665. In the letters, the governor basically asked about the

14:32 possibility of buying -- not of expropriating -- the companies of KPM and TNG. The reason for this request was that the governor hoped that would resolve the issue of social tension.

In a further letter of September 2009, the MEMR stated that, together with KMG, it was planning to negotiating with KPM's and TNG's owners an acquisition of the assets. I refer the Tribunal to Exhibit C-294.

This is precisely what followed, with KMG NC taking the role of a white knight, as Mr Suleimenov said, trying to resolve the crisis. I refer you to his witness statement at paragraph 2.30.

Turning now to the question of tax, export duties and transfer pricing, I will just spend no more than about a minute or so on this issue.

First of all, let me state that this is in fact a non-issue because taxation measures are exempted from the investment regime of the ECT under Article 21. We have addressed this in our written submission, and I do not want to bore you with the legal details now. In any event it is the Republic's position that the authorities, namely the tax committee and the customs committee, did not violate Kazakh law when dealing with the claimants; that is, neither during any audits, nor in the tax and customs assessments themselves. In fact,

14:33 claimants have not provided any serious explanation as to why there should have been illegal tax and customs assessments.

Interestingly, claimants have not provided an expert opinion on these matters, and that is the case even though some very intricate and complicated considerations of Kazakh law apply. Their claim remains totally obscure, and the Tribunal should dismiss it for this reason alone.

Despite the shortcomings in claimants' pleadings, the Republic has rebutted claimants' allegations with witness statements by Mr Rahimgaliev of the tax committee and Ms Zhanbekova of the customs committee. Again, interestingly, claimants chose to not even call these witnesses for this hearing and to challenge them on their statements.

It should also not go unnoticed that they did not raise this issue during their opening submissions this morning and this afternoon. As such, claimants' tax and customs arguments can only be dismissed.

Turning now to the third point of the submission, looking at contract no. 302.

Claimants allege that the Republic had agreed to the extension of the exploration period under contract no. 302 -- that's at Exhibit C-53 -- and then in bad faith,

14:35 they say, refused to execute this allegedly agreed extension period. In fact, the Republic never agreed to an extension to contract no. 302.

Claimants' allegations are exemplary for an alleged investor who has insufficient knowledge of Kazakh law. Claimants have presented two lawyers as witnesses: the former head of TNG's and KPM's legal department, Mr Condorachi, and the head of Ascom's legal department, Mr Pisica. [Neither] of them have received their legal education in Kazakhstan, and they have not shown that any of the members of their departments did. It is therefore not surprising that claimants appear to see an agreement to an extension of a contract why there is none.

Claimants opine that when the MEMR informed TNG about the expert commission's recommendation to extend contract no. 302 on 9th April 2009 -- reference Exhibit R-163.1 -- this constituted an agreement to extend the contract. However, as Mr Ongarbaev explains, the recommendation of the expert commission -- and this can be seen at Exhibit R-163.2 -- is only an intermediary step in the process of agreeing to an extension.

The procedure in fact consists of seven distinct steps:

14:36

First, the subsoil user applies for an extension of the contract.

Second, the MEMR -- now the MOG -- forms an expert commission to consider the application.

Third, the expert commission issues a recommendation to the MOG as to whether or not to extend the contract.

Fourth, the MOG communicates the decision to the subsoil user in case it wishes to follow the recommendation, and informs him about the need to prepare a draft addendum to the contract.

Fifth, the subsoil user submits a draft addendum to the MOG.

Sixth, the MOG forms a working group comprised of representatives from all interested ministries in order to consider the addendum to the contract.

Seventh, an extension is finally granted once the addendum to the contract is signed by both parties.

Hence the MEMR's letter of 9th April 2009 is only the fourth of seven necessary steps to extend a subsoil use contract. As Professor Ilyasova confirms, the resolution of the expert commission is only a recommendation which is part of the formation of the will of the state on whether to enter into an agreement to extend the contract.

You will see the slide refers to her report at

14:38

page 26, where she says:

"The proposal of the expert committee on mineral resources and the decision of the competent authority on extension of the contract are internal procedures in the process of generation of [the] will of one of the parties (state represented by the competent authority) and precede the negotiations between the parties on conditions of the extension of the contract ..."

Claimants try to reinforce their misperception by providing a translation of the MEMR's letter that does not consider the process of extending contracts for subsoil use. In this context, the MEMR's letter can only be translated to mean that it has resolved to initiate the process of an extension; it cannot be interpreted to mean that an extension is already granted. It only says that the MEMR decided to initiated the process of an extension. This extension was never granted, and contract no. 302 therefore expired on 30th March 2009.

Claimants have not substantiated their claim that the Republic had been under an obligation to agree to an addendum to contract no. 302. Claimants argue that the Republic had been under an obligation to sign the addendum by claiming that the Republic had already agreed to an extension. Clearly this is not the case,

14:39 as I have just demonstrated.

Claimants' only other purported proof of promises that the Republic would agree to the addendum is an invitation to attend to a meeting with the MEMR; that can be found at Exhibit C-461. However, an extension of contract no. 302 is not mentioned in this letter, and it is therefore inconceivable how this invitation should have been a promise to sign the addendum.

Also claimants failed to apply for an extension of the underlying licence no. 243(d). As Professor Ilyasova explains, such an extension of the licence is necessary to effectively extend a contract for subsoil use.

In addition, claimants never challenged the alleged bad faith conduct of the Republic in the Kazakh courts. Even though the contract already expired on 30th March 2009 -- that is to say almost 16 months before claimants filed their request for arbitration -- claimants never challenged the non-extension of the contract in the Kazakh courts. Hence for almost 16 months, claimants refrained from taking an issue to the competent court, which they now consider to be a measure of indirect expropriation. Surely no true investor would let 16 months pass before taking recourse against an alleged expropriation.

14:40 In essence, this issue is very simple: TNG's contract expired because the MEMR did not agree to an extension, and it was under no obligation to do so.

(2.41 pm)

Opening statement on the merits by DR NACIMIENTO

DR NACIMIENTO: Let's turn to the inspections now. We heard throughout the proceedings, including this morning, some very melodramatic accounts of the Republic's inspections. I think it's time now to look at the specific facts within the specific timeframe, turn away from emotional descriptions, and simply look at the specific facts at hand here.

There are basically two principal phases of inspections, and claimants are making very sure to confuse everyone on which act was performed in regard to which phase, and in regard to which timeframe.

In phase 1, the financial police initiated inspections in October and November 2008, resulting finally in a criminal investigation of KPM and TNG in 2009.

In phase 2, the General Prosecutor's Office initiated inspections in June and July 2010, resulting in infringement notices issued to KPM and TNG from various competent bodies.

Claimants do agree that the subsoil use is a heavily

14:42 regulated area, that it's normal practice and that in any oil and gas state you will find this kind of inspection and regulation, and by no means have claimants been singled out or has there been any specific action directed specifically against them.

All subsoil users are subject to inspection, and you will hear later this week Mr Kravchenko from the General Prosecutor's Office showing that KPM and TNG by no means were singled out. Rather, the Republic has a right to monitor and to regulate the exploitation of its natural resources. Unlike any subsoil user, it cannot simply move away, turn to another project or leave the country if something goes wrong. And of course, the inspections relating to the suspected criminal conduct are in addition to the standard inspections, and it needs to be distinguished which actions relate to which phase, and the specific actions taken within that phase.

Generally the General Prosecutor's Office acts as a safety net to ensure that state bodies act lawfully. This includes the supervision of the conduct of the financial police, and also the various inspecting agencies. However, the GPO's supervision is largely reactive: it relies on people complaining about an infringement of rights. And again, KPM and TNG wrote to many people, they complained to many people, but they

14:44 largely missed out the GPO and its regional offices. Again, you will hear Mr Kravchenko explaining to you the function of the General Prosecutor's Office.

We heard a lot about the Voronin letter. As we can see now, it was certainly borne out of legitimate concern, and this has been shown by subsequent events. We heard about the involvement of Andrei Bastovoi, the former director of Ascom and KPM, in funding clandestine operations in Africa using funds from the exports. I refer you to the expert report of Professor Olcott, paragraphs 152-154.

Interestingly, the tax committee and everything that the tax committee uncovered is simply left out in claimants' submissions. We will not hear a tax expert; we will not hear the witnesses from the tax committee that the respondent offered in this arbitration. Interestingly enough, this is an area where apparently claimants seem to concur with respondent that it had missed out on the evidence with regard to transfer prices and all the tax offences which the tax committee had unearthed.

When speaking about the President's letter of October 2008, we also need to see what happened afterwards. It is by no means simply the President starting any actions. We have spoken about the

14:46 translation: there is by no means an order to investigate, but simply it is the reaction to another state organ, and the reaction is to thoroughly check. And this is what was done, and it was done within the area and within the hierarchy of the Kazakh legal system.

The request went from the President to the Prime Minister, to the head of the financial police, and then finally to all the competent people. And we will hear the witnesses: we will hear Mr Turganbayev and we will hear Mr Rakhimov, who were personally involved, and you can ask them the questions that you are interested in asking.

Let's take a look at the inspections initiated by the financial police. We submitted the evidence of Mr Turganbayev, Mr Rahimgaliev, Ms Balzhan. They demonstrate that there is a clear legal basis for initiating -- first of all -- inspections, but then also conducting them, and bringing them to an end and bringing them to a conclusion. And in contrast, what we have heard from the claimants' witness[es], there is very little to rebut this.

We do not have any substantiated allegations of the alleged disruption. There is a significant exaggeration regarding the duration of the inspections, and again

14:48 this is something that is simply proven by the facts. There is also a significant misrepresentation of the outcome of inspections. And there are no documents that the witnesses can refer to; we only have unsubstantiated witness testimony, without specific facts.

Again, claimants try to confuse. They blur the distinction between the financial police inspections and the criminal investigations. Those need to be completely separate, and they need to be taken into completely separate consideration.

In reality, there is a clear division. The inspection results are independently reviewed. Certain potential charges may be dropped; others may be pursued. And there is also a logical structured flow from inspections to investigations, and we will hear Mr Rakhimov explaining the current events.

Let's turn to the criminal investigation in 2009. Here again we have a very dramatic account of events, blurring again the differences between the various inspections, and without distinguishing clearly what is criminal and what is simply the normal course of inspections. Respondent witnesses that you will hear contradict that account. Claimants suggest a cloak-and-dagger approach by the financial police, and there is nothing in the record to support this

14:50 statement.

The claimants present all inspections as part of one coordinated attack. They call the July 2010 inspections even the financial inspection blitz. These inspections originated with the General Prosecutor's Office, they have nothing to do with the financial police, and the financial police is who the claimants say are at the centre of the conspiracy. You will hear again Mr Kravchenko, who can explain the structure.

Rather laughable, I have to say, is the reference to the new subsoil law in 2010. There is of course no relationship whatsoever between changing the law and claimants' event. The law was changed. The minister, Mr Mynbaev, will be here to testify as to the process of the law, the time it takes, the reason behind that, and the result, and he makes clear that there is nothing related to claimant.

The inspections initiated by the General Prosecutor in June 2010 actually resulted from complaints against KPM and TNG. This time they were correctly addressed to the General Prosecutor, and the General Prosecutor's decision to inspect was justified. The involvement of each inspecting authority was justified, and the inspection revealed multiple breaches of the law and of the contracts. Part of this included nonpayment of

14:52 salaries, mass redundancies, maladministration of subsoil assets, potential environmental harm, the absence of any management of KPM and TNG. Again, Mr Kravchenko will be here to testify on this.

Let's turn to the criminal process. The trial of Mr Cornegruta was held after the financial police thoroughly inspected and investigated the crime of illegal entrepreneurship. This is Article 190 of the Criminal Code of Kazakhstan. The trial was conducted across at least ten hearings in the local court of Aktau under a competent judge. The sentence was confirmed.

There's nothing in this forum that could form a basis for this Tribunal to proceed to an appeal of local law. The judge dealt with the charges against Mr Cornegruta, and this is a matter of local law. She was within her competence.

As we heard today, it seems that the claimant seemed to take exception from the fact that the judge decides on legal issues. Of course a judge decides on legal issues, and of course a judge decides independently and within the power that the system confers to a judge. There is nothing laughable about it, and this is part of all systems. It's part of the judicial system.

If you do not like what the judge decides, there are legal means, and then you have to take those legal

14:54 means. Under those means, you have to take the appropriate recourse: you have to use the means that the specific system offers you. It's very interesting that today we heard not a single word on appeals, and there is a simple reason for that: no appeal was filed here, no appeal was filed in time. It is difficult to understand that in such a case a claimant would simply miss the deadline for appeal.

And still claimants contend -- and this is also what we heard this morning -- that this case is a denial of justice case. And here it is established that denial of justice requires the exhaustion of local remedies.

The evidence in this case shows that the financial police took a bottom-up approach to the investigation. The financial police were not involved in the trial; again a confusion that the claimants try to submit to the Tribunal. Rather the claimants simply ignored significant and elementary rules of the Kazakh system, in particular regarding expert evidence.

The judge exercised proper discretion in reaching her decision, and, as we will come to later, the claimants ignored the routes to appeal, and were also finally then not granted reinstatement to the law.

We heard throughout the proceedings the unsupported allegation by claimants that it was the financial police

14:56 which decided the outcome of the investigation first, and then manufactured evidence to suit. Initial inspections, as I mentioned before, revealed many grounds to open an investigation, and the investigation built on those foundations. The indictment as such was the conclusion of the process, and not the beginning. At that point in time the financial police had no further involvement.

In the criminal process itself, again it's necessary to comply with the applicable law, to comply with the procedural requirements, and here claimant failed to comply with the rules for expert evidence. The expert evidence was considered to be inadmissible, although there are very clear procedural rules governing the procurement of expert evidence at the trial: the expert evidence must be produced by recognised institutions, lawfully engaged, and not affiliated to the parties. Again, we will have Mr Kravchenko and Mr Rakhimov who can answer questions in this regard.

It is also important to mention that the rules governing expert evidence are a matter of public record, and they have been here wilfully ignored; they could also have been complied with.

The judge was entitled and she was requested to assess the evidence herself. This is what judges do.

14:57 Article 25 of the Criminal Procedural Code states:

"The judge, the procurator, detective, investigator shall evaluate evidence on the bases of their internal convictions, based on a sum of evidence considered, guided in this respect by the law and their conference."

Nothing surprising in this.

The expert was appointed in accordance with the procedure. You will hear later from Mr Baymaganbetov, who was fully qualified to be appointed as an expert in this matter.

And finally, the judge made the decision based on the evidence put forward before her, and based on whatever she found within the material rightfully and lawfully put forward.

We hear a lot about Mr Cornegruta. He is not here. He is mentioned in every witness statement, but somehow he failed to appear here and to state his story. He had access to the criminal file, and he had time to prepare. The claimants complain that Cornegruta was denied access to information regarding the case. Actually he was not identified as the defendant until 29th April, and on 19th May he and his counsel were given access to the entire criminal file relating to the charges against him in order to prepare a defence. Cornegruta concluded that preparation on 15th June 2009.

14:58 The claimants also state that Cornegruta was denied access to legal representation. Actually he was represented by various lawyers, Mr Musir and Mr Kaunev, during the first trial and the pre-trial preparation. Both are qualified Kazakh lawyers. The report of the trial shows that Cornegruta's counsel made submissions, cross-examined witnesses in a manner that you would expect from each competent counsel.

In regard to trial, let me just pick up on what we heard this morning which I find quite a mischaracterisation of the expert opinion of Martha Olcott. Apart from simply the malicious description, I would say, it simply shows that apparently claimants decided to simply pick whatever they want in order to substantiate their claims or their statements on the allegations, but without really considering the proper context.

They refer to a quote of Professor Olcott saying:

"... Kazakhstan has many good laws, but no one in authority is ... interested in enforcing them."

Actually this is a quote from the first edition of her book; it was published in 2001. Professor Olcott had then decided that it was unfairly critical and did not take into account the significant changes in the Kazakh law system, in its political, economic and legal

15:01 system. This is why she submitted a new chapter in 2009. The book was reissued. The book as such state[s], but there is a new chapter describing the developments, and this is what claimant simply chose to ignore.

Professor Olcott first of all, to indicate the developments in Kazakhstan, changed the title by adding a question mark: "Kazakhstan: unfulfilled promise?" Let me state a quote on pages 258 and 259:

"The Kazakhs again, in rather typical post-Soviet style, introduced an elaborate programme to combat corruption over the 2006 to 2010 period, pinpointing what forms of corruption each ministry or department was supposed to address from 2006 to 2008. While this kind of strategy may not be optimal, legislation honestly not being a surefire way to achieve rule of law, it has been accompanied by an increased effort by the government to introduce international standards. This has taken many forms, including Kazakh sponsorship ... and an OECD-sponsored project on combating corruption."

Another quote on page 256 on the judicial reform:

"The international community has paid less attention to the broad progress of the judicial system. The judicial reform is also progressing, albeit more slowly than many in the West would like. The ABA's Rule of Law

15:03 Initiative continues to have an impact in Kazakhstan directly through the ABA's own programmes, as well as through some 20 partner organisations."

This is from 2009. Claimants apparently simply chose to ignore that there has been a development, and that this has also been laid down in a new edition or a new chapter of the book.

Let's turn to the classification of pipelines. In this regard, respondent described in detail the legal tests that the court was required to consider in order to establish that Mr Cornegruta was guilty of illegal entrepreneurship. It has also tested the facts against that legal framework. The Tribunal is invited to review the rejoinder in this respect, paragraphs 489-627.

In brief, the key questions it considered were: was Mr Cornegruta an entrepreneur? Was he engaged in illegal activity, which in this case concerned illegal use of a trunk pipeline without a licence? And (3) if so, were the monies gained from this illegal activity large enough to trigger this particular offence, which carries with it particularly serious consequences?

To address claimants' arguments briefly, put plainly, the claimants' case is: KPM's pipeline is a gas-gathering pipeline and, as such, it should never have been classified as trunk. This is a statement;

15:06 there is no proper analysis or any proper legal basis to support it.

A key definition of "trunk pipeline" is set out in the Law on Oil, and it's worthwhile looking at it:

"'Main pipeline' means an engineering structure consisting of lineal part and linked surface facilities, communications, controlled guidance and connections designed for transportation of Oil from the places of Prospecting ... to the places of reshipment to another type of transport, processing and consumption. The Main pipeline does not include the pipeline working in the mode of main collector."

We submitted an expert report of Professor Didenko dealing with these issues. But what we should not ignore here: there is a law, and the law provides a definition, and of course this is the first step and the first basis to look at.

If I understood claimants correctly this morning, they seem to take exception from the fact that this has been treated as a legal issue. If you look at the law, this is the first place that you have to look for, and it contains a definition.

The Law on Oil has been updated a number of times since 1995, there have been clarifications to the language, but the key purpose of a trunk pipeline is

15:07 clear: it transports oil from the contractor's pipeline to a place of onward sale or transshipment. It is also clear from the definition that a trunk pipeline is not a gathering pipeline or vice versa. So the trunk pipeline begins where the contractor's pipeline ends, and it is also evident that the contractor's pipeline is not by definition a trunk pipeline.

Applying this definition to the case, the first of these is a legal consideration that turns on a legal interpretation of the relevant provisions, and you cannot simply ignore a law providing a clear definition of a trunk pipeline. So the clause indicates that where a pipeline leaves the contract area, and its purpose is to transport the oil to another type of transport processing or consumption, then it will not be classified as a trunk pipeline.

This arises very simply also from the fact that it can no longer be the contractor's pipeline when the pipeline leaves the area which the contractor has been licensed to use; and in this case it's common ground that the KPM pipeline does leave the contract area which KPM has been granted.

The second key consideration is the use and purpose of the pipeline. The purpose for which it was intended to be used is set out in the working programme and the

15:09 construction documentation of the pipeline and the facility. These are all a matter of fact.

The design documents are essential documents for understanding the purpose of the pipeline, and therefore to the proper classification of the pipeline. Respondent has submitted a technical expert report by Mr Latifov on these issues. In this case it was designed to transport commercial oil from the central processing facility into the tank farm at the raw materials base, and also the pipeline carries third-party oil from TNG.

Anything else that is on record, any other consideration does not contradict this and does not prove that the pipeline is a gathering pipeline. The claimants' arguments are premised on a number of generalisations, some of which I would like to highlight here.

They argue that anyone in the oil and gas industry would not have come to the conclusion that it was a trunk pipeline. They observe that the pipeline is very small compared to other main pipelines. They state that the Agency for the Regulation of Natural Monopolies did not regulate the KPM pipeline and, as such, it was clear that it's not a trunk pipeline.

To rebut this very briefly, fundamentally the

15:11 classification of a pipeline is a legal issue. Technical characteristics are important, but they are not determining. This is even admitted by claimants' own experts, and I think it is worthwhile to look at quote:

"[A]ny conclusion that a pipeline is a trunk pipeline based only on certain technical parameters ... finds no support in Kazakh law."

That's claimants' own expert.

Let's turn to the sentence and to the fine of $145 million.

Under Kazakh law -- and this is similar to many other legal systems -- income obtained through illegal activity can be recovered for benefit of the state. This is very simple: to ensure that no one remains unjustly enriched from the crimes.

Where this is a company which is unjustly enriched through the actions of its manager, the recovery has to be directed against the company, and this is what Kazakh courts have done frequently in the past. Claimants have tried to argue that the recovery of illegal income from a company requires that so-called civil proceedings against the company are initiated. This position is wrong under Kazakh law.

Let's take a look at a quote from the expert report

15:13 of Professor Kogamov submitted by respondent on page 8:

"[W]hen 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."

And this was the case here.

It also seems that claimants take fault with the amount of income recovered from KPM. Again, these objections cannot convince. The amount ordered for recovery was calculated based on an expert report which was introduced as evidence in the hearing. For the period in question, illegal profits from the transport and subsequent sale of oil in the amount of US$145 million were calculated.

Claimants try to question the calculation by submitting a fictitious profit calculation. According to claimants, only the amount KPM could have charged for the transport of oil through the pipeline could be the illegal profit. Claimants failed to name a single rule of Kazakh law or any decision that would support such a calculation, and there is no reason for it. The transport through the pipeline was the condition

15:14 sine qua non for making profits from the sale of oil. Any sale of oil that was transported through the pipeline necessarily entails an illegal profit.

Claimants also have suggested that since the judgment was against Mr Cornegruta, only an amount corresponding to his personal income could be subject to recovery. Again, there is no basis whatsoever for this statement.

We have mentioned before, KPM could have appealed the Aktau City Court decision, and failed to do so in time. The decision was issued on 18th September 2009. Under Article 399 of the Criminal Procedural Code, the appeal had to be filed within 15 days from the announcement of the verdict; that is on 4th October 2009. Nevertheless, KPM filed its appeal on 25th January 2010.

On appeal the court refused to reinstate the missed deadline. There was simply no basis for reinstating. Mr Cornegruta, KPM's manager, was served with the judgment. At the hearing a number of KPM's employees were present and therefore would have known the substance of the judgments against KPM. KPM could have appealed the recovery order immediately, but chose not to.

Let me finish this part, taking up another point

15:16 that we heard from claimants this morning relating to evidence allegedly withheld from the Tribunal. This relates to the documents submitted last week and where we have submitted overnight a reply document.

Claimant stated: Rakhimov got an opinion, did not like it and had it withdrawn. Let's take a look at what happened really. We have submitted the letters, and I think you all have a package of the letters of Mr Rakhimov's witness statement with the attachments.

Mr Rakhimov explains that the MEMR letter of 4th February -- C-719 -- was withdrawn by MEMR because it was not reviewed by the legal department prior to sending it. If you look at the letter, this is in fact what it says:

"The Ministry of Energy and Mineral Resources wishes to recall its letters which have failed to pass a legal review by the Ministry's legal and human resources services department. A reply to the Kazakhstan Economic Crimes and Corruption Control Agency's enquiry will be provided in a statutory manner."

And it was provided in the statutory manner. First, we have another letter confirming in fact that this report and this letter was withdrawn. It was by no means withdrawn because Mr Rakhimov did not like it; the reason why it was withdrawn is set out in the letter.

15:18 We have the letter then stating that the withdrawn letter is being returned, so that the effect is as if it had never come into existence.

It is then replaced, and this is the last letter that you find in the package, the attachment. You will see that there is a report, and it replaces -- and this has been reviewed legally and it has followed the legal requirement, and is replacing the former letter. So there is by no means what claimants mischaracterise as something that a person does not like and simply gets it withdrawn.

We will have Mr Rakhimov here; you will have the opportunity to cross-examine him on this.

So my partner will continue with contract termination.

(3.19 pm)

Opening statement on the merits by MR TIRADO (continued)

MR TIRADO: Looking at contract termination, KPM and TNG's numerous serious contract violations entitled the Republic to terminate the contracts. These violations are listed there on the slide: KPM operated a main pipeline without a licence; KPM and TNG had been violating tax legislation; KPM and TNG were in breach of the minimum work programmes. And there were also a number of other violations, such as nonpayment of past

15:20 costs under an additional agreement to a contract, in this case more than US$100 million, a failure to train Kazakh specialists, and also a failure to purchase Kazakh goods, just to name but a few.

We would refer the Tribunal to the notices of infringement, which you will find at Exhibits C-2, C-6 and C-7.

These violations had been going on for a substantial time. Claimants' responses to the notices of infringement were entirely insufficient. For example, claimants did not challenge that they had not paid taxes and had not made additional payments under the contracts. Instead they claimed a lack of funds leading to force majeure. However, claimants themselves had been stripping the companies of cash in 2009 and 2010.

Also force majeure did not arise, as claimants' inability to pay was as a result of their own violation of Kazakh law by operating a main pipeline. Claimants claimed they were not operating a main pipeline even though this had been determined by a court judgment, and they had failed to appeal the judgment in time.

The non-fulfilment of tax obligations and additional payment obligations we deal with in our statement of defence at paragraph 31.122(b). And I should also mention that we will shortly look at the question of

15:22 causality and stripping of cash in a few moments.

Claimants argue that the contract terminations were premature because the inspection of KPM and TNG should have been formally terminated by way of so-called acts of inspections. Acts of inspections are established by the Law on Private Business: they mean that the results of an inspection are sent to a company for signature or, for a special appeals procedure if the company does not approve of the results. Yet claimants have not at all shown that this procedure takes precedence over a contract termination procedure under the Subsoil Use Law and the specific contracts.

In fact, the law does not state at all that contract termination has to be based on inspections at all. Rather, if there is sufficient reason for termination, there can be termination in accordance with the contracts. Hence the acts of inspections do not play a role.

The claimants suffered no prejudice in the termination procedure. The claimants were well aware of their breaches and had chosen not to address them for a long time. Claimants have not explained which additional explanations they would have made with more time.

The situation was serious, given the regional

15:23 importance of KPM and TNG for the local workforce and local gas supply.

Upon termination of the contracts, trust management is the logical consequence. Trust management ensures the continuation of production and the preservation of assets in question. Article 72.10 of the Subsoil Use Law provides for the transfer of the property, structures and equipment necessary for the continuation of production. These assets are to be transferred into temporary possession of KMG NC until a new subsoil user is found.

As Mr Ongarbaev tells us:

"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 ... 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 ... 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."

15:25 Article 73 of the Subsoil Use Law 2010 provides for a procedure according to which the contract can be renewed if the termination was based on incorrect information or the breach was out of the control of the subsoil user. Claimants could have initiated commercial arbitration proceedings under the arbitration clauses of the contracts. Instead, claimants did not wait more than five days to hastily initiate this arbitration.

I think Dr Nacimiento is going to take us through the next stage.

(3.26 pm)

Opening statement on the merits by DR NACIMIENTO (continued)

DR NACIMIENTO: Let's take a look at causality, again an area that is not really taken up in detail in claimants' submissions.

Over the course of 2008 and 2009 the companies KPM and TNG significantly lost in value. The reason for this [was] not the actions of the Republic, but in fact circumstances completely outside of the Republic's spheres of interest or influence.

Claimants overburdened KPM and TNG with debt from Tristan bond structure. There were drops in oil and gas prices and in demand in 2008 and 2009. Claimants continuously withdrew cash from the companies. They also accrued a high tax debt which they have accepted to

15:26 be legal. And finally, they had to take out a substantial loan with an extremely high interest rate.

Let's take a look at the first point. We have explained the basics of the Tristan bond structure. As explained, the proceeds of the bond issue were in part lent to KPM and TNG at very high interest rates of 15-16%. This created a continuously high debt burden for KPM and TNG.

The debts were further increased by a sales agreement with the affiliate Montvale. Under this agreement, oil was pre-sold to Montvale until eventually a debt of US$80 million had accrued.

To put it in very simple terms, claimants devised a business model in which all risks and liabilities were moved to KPM and TNG, and all profits were moved to BVI companies.

As a second issue, there was a sharp drop in energy prices and demand. The price of Brent crude oil more than halved from the end of September to the beginning of January. The claimants explicitly admit that there was a shortage of demand in the spring of 2009, and overall the decline was dramatic, sales in 2009 amounting to only 35% compared to the sales in 2008.

Finally, at the end of 2008, TNG's contract with its largest non-local customer Kemikal expired. TNG decided

15:29 not to extend the contract because there had been a dispute about payment. Kemikal apparently had failed to post bank guarantees, leading TNG to have the contractual relation end.

In 2009, claimants tried to secure a contract for the delivery of gas with KazRosGaz. This contract was supposed to counteract the shortage of demand that had been the result of the Kemikal contract ending, but again negotiations failed.

Claimants have tried to make the Republic appear responsible for this development, and that leads us back to the claimants' baseless allegation of an harassment campaign. According to claimants, Kemikal and KazRosGaz were controlled by Timur Kulibayev. Kulibayev supposedly tried to deliberately weaken TNG so as to make a takeover for his personal gain.

First of all, claimants have not provided a single shred of proof that Kemikal was actually controlled by Mr Kulibayev. All they have is some anecdotal evidence. In any event, even if it were true, Kazakhstan could not be held responsible. Kemikal is a private company. Whatever Kemikal does, for whatever reason, is not to be blamed on Kazakhstan.

The same applies to KazRosGaz: there is no responsibility of the Republic. KazRosGaz simply

15:30 decided not to conclude a contract with TNG; it's as simple as that. Whether the non-conclusion of a contract could create liability for a state is something for claimants to explain.

We heard about the tax issues and the tax problems of KPM and TNG. In fact, in 2009 there were significant tax obligations. Both companies in the summer of 2009 had to pay a total of $32 million of excess profits tax. Claimants at no point in time have complained that this tax assessment was illegal.

We have established that in early summer of 2009 the financial situation of KPM and TNG, and of Tristan in general, was dire. Coupon payment obligations, as well as tax obligations, were rather pressing. In order to bridge their liquidity needs, claimants decided to enter into new debt under the so-called Laren loan facility. What they did is they issued $111 million in new Tristan bonds, but only raised $30 million in cash for them. Their affiliate Laren took out a loan on which it had then to pay 35% of interest. So these conditions were absolutely horrendous. They show a great mistrust of the market with regard to the claimants' business.

Again, at this point in time claimants cannot blame any of this on the Republic's alleged illegal actions. The tax debt has not even been questioned by claimants.

15:32 Not even claimants can claim that inspections/investigations caused a disruption of the kind to create such serious financial trouble.

This is also confirmed by the auditors. In 2009 Tristan's auditors issued several disclaimers stating that despite their dire financial situation, KPM and TNG extended payment terms to customers. And KPM declared $52.6 million in dividends, which was prohibited under the bond regime. And on top of this, Anatolie Stati received a $4 million bonus at the end of 2009.

Let's turn to the attempts of the claimants to sell KPM and TNG.

In the summer of 2008 claimants started their first attempt to sell KPM and TNG as part of the so-called Project Zenith. The sales project was handed by the Russian bank Renaissance Capital, and several potential buyers gave indicative offers.

What is an indicative offer? It's a non-binding offer. We heard many numbers today. We heard numbers and the allegations as if those numbers corresponded to the value of the companies. That is by no means the case. These were simply non-binding offers before the potential buyer had any information on the company. They have no indication and no indicative value whatsoever as with regard to the value of the company.

15:34 This is also confirmed by the witness statement of Mr Suleimenov, who will also be here to testify. You will also hear Mr Chagnoux of Total, who will tell you the same: that a non-binding offer by no means is an indication of the value of a company.

In fact the sale did not conclude in phase 1, and in phase 2 claimants tried again. It's now claimants' argument that the Republic's actions somehow deterred potential buyers from the sale. Look at the evidentiary proof that this was not the case, and in fact there is not a single confirmation, not a single document, not a single hard evidence proving this allegation.

A look at the evidence rather shows that there are numerous other reasons that made potential buyers turn away. There was a drop in energy prices, and effects of the financial crisis in general. We also know from Mr Chagnoux that there were many reasons why Total dropped out of the sales process, and the main reason was they were simply disappointed with the information in the data room.

Mr Suleimenov of KMG EP mentions also some further reasons, such as the suspicion of damage to the fields due to speeding up the production in order to increase the price, thereby damaging the oilfields. Further elements could be the companies' large amount of debt,

15:36 and also the loss of Kemikal as a key customer.

There were no talks between the Kazakh authorities and the potential buyers. There is no evidence to support this, and there is rather evidence to the contrary, and you will hear the witnesses confirming that Kazakh authorities have not approached them.

As a last point on causation, let's turn to the Cliffson sale. Again, the failed Cliffson sale, the claimants are trying to blame the Republic for such failure.

On 13th February, the claimants concluded a contract for the sale of KPM and TNG to Cliffson. The Kazakh law provided for the approval of the transfer by the MOG and for a waiver of preemptive rights. We submitted evidence into the record that MOG -- the Ministry of Oil and Gas -- asked for information that was decisive to make that decision, namely information regarding the financial capabilities of Cliffson, and yet the Ministry of Oil and Gas at no point in time received that information. Finally, Cliffson informed the Ministry of Oil and Gas of the contract termination on 7th June 2010, and this is one of the new documents that we have submitted to the record.

So let's conclude with some legal considerations. Regarding the legal analysis of this case under

15:39 international law, and before looking into the details of the individual guarantees under the ECT, I would like to make some general remarks on how the Tribunal should, in our view, approach this case from an international law perspective.

The approach should be, in our view, the deference, and let me explain why. Like every state, the Republic is in principle free in the decision which policies it wishes to implement. With regard to subsoil use, the Republic has implemented the policy that aims to ensure that the Republic's national resources are used for the benefit of the Republic's population. We have been talking about the Law on Subsoil and Subsoil Use, about the Law on Oil and other laws, and this is precisely what those laws are for.

The ECT member states -- and among them the Republic -- have not enacted the ECT so as to meddle with their right to implement specific policies in the energy sector, and this is not the purpose of the ECT. For this reason, tribunals should apply what the SD Myers Tribunal called a "high measure of deference". To be upheld, state action only needs to be reasonably tenable; it must not be perfect or ideal.

Let's take a look at claimants' indirect expropriation claim. This claim relates to the period

15:40 of the first inspections at the end of 2008 to the contract terminations in July 2010. For claimants to establish an indirect expropriation, they need to prove three things, none of which they can in fact prove in this case.

First, they need to show that the Republic did not merely exercise its police powers when it inspected and investigated KPM and TNG. The police powers exception has long been recognised by investment arbitral tribunals.

Second, claimants need to prove that the Republic's actions were of such gravity as to be equivalent to an expropriation, and this is really the main element of an indirect expropriation. As we will establish, this requires a high threshold which was not met in this case.

Finally, to establish indirect expropriation, claimants need to show that they have pursued the available remedies in order to address the Republic's alleged wrongdoing. The relevance of remedies under local law was established in significant cases in investment arbitration.

Let's start with the exercise of police powers. As part of its police powers, a state may implement laws which call for the regular inspection of companies.

15:42 Kazakhstan takes its Subsoil Use Law very seriously so as to ensure a proper use of the natural resources.

There is nothing improper with routine inspections implemented. The inspections led to the suspicion that the law had been breached, and of course this required the authorities to conduct an investigation and ultimately a trial. Again, this is a proper exercise of police power.

Lastly, other actions taken by the Republic, such as tax assessment, were also a legitimate exercise of the state's police power, as we have explained earlier.

Let's take a look at indirect expropriation. In this regard, claimants have simply not substantiated their claim. Their witnesses make over-broad statements as to the alleged effects on the daily business. We have some very vague witness statements, but there are no specific facts. None of the witnesses really explained what the allegedly disruptive effects on claimants' business were. There are no examples of how the daily work could have been interrupted. On the other hand, we have a detailed description of Mr Turganbayev and Mr Rakhimov, both of whom were present and conducted those investigations.

There are no other state actions that did have an effect equivalent to expropriation. The conviction

15:44 of Mr Cornegruta did not deprive claimants of the ability to manage KPM. The non-extension of contract 302 was not equivalent to expropriation because claimants simply did not have a right to its extension. And problems in disposing of KPM and TNG were not due to the Republic's actions, as I have just described.

Lastly, claimants' arguments on indirect expropriation also fail because claimants did not pursue available remedies. When assessing arguments of indirect expropriation, investment tribunals have long been taking into account an investor's failure to pursue available remedies. It is interesting we have heard now many times that claimants seem to believe that this is a denial of justice case; and as we all know, denial of justice requires the exhaustion of local remedies, and that has not been the case here, which is an undisputed fact.

It makes sense for a tribunal to look at whether an investor failed to pursue available remedies. It makes sense when one looks at what an indirect expropriation is. As explained, there is an indirect expropriation when the actions of a state lead to a right having practically ceased to exist, and this cannot be assumed when a right can still be safeguarded through available remedies. A right that can be saved

15:46 by pursuing remedies cannot be deemed to have been destroyed.

I invite the Tribunal to look very thoroughly into the remedies that claimants could have taken and failed to. In the present case, KPM could have appealed the Aktau City Court judgment, and it failed to do so. It's difficult to understand, but claimants missed the deadline. And as I said previously, the request to reinstate the deadline was rightfully refused. There was simply no valid reason for this, because it had simply been missed.

So, to summarise the requirements for a direct expropriation: in this case the state does not exercise its right to regulate, that is the police powers; a formal transfer of title; and the pursuit of available remedies by the investor. Let's address those requirements.

We have explained that the audits and inspections in June and July 2010 had shown a whole range of breaches by claimants of Kazakh law and contract term. This included the nonpayment of taxes, the nonfulfilment of working programmes, and the operation of the main pipeline without a licence.

As we have mentioned before, the Republic takes its Subsoil Use Law and the policy behind it very seriously,

15:48 and it will not accept breaches of the law by subsoil users. The contract termination was therefore the appropriate reaction to safeguard state policy.

In this regard, trust management is also a legitimate regulatory measure. Trust management serves a legitimate public purpose. After termination, the assets of the subsoil user are taken into trust management, with the simple aim to ensure that production can be continued, so that the workforce does not need to be discharged, and that there is a continued supply of oil and gas for the region.

As to the available remedies, many investors have tried to bring investment claims based on contractual actions of states. In such instances, investment tribunals require, for a finding of expropriation, that the investor goes through the contractually agreed upon remedy first. And the reason is the same: a loss of title has not become manifest as long as there is a remedy to address the alleged taking of the title.

Presently, all the contracts in question refer to a specific dispute resolution mechanism. The contracts 210 and 302 refer to the Kazakh Law on Foreign Investment. Contract 305 refers to the SCC.

Claimants did not address the contract termination in Kazakh courts, nor did they bring an ICC arbitration

15:49 based on the SCC arbitration clause in contract 305. So the claims of direct expropriation are barred too.

To conclude the legal analysis, there is generally no liability of the Republic also with regard to the most constant protection and security. The standard of most constant protection and security is simply not suited for addressing the wrongdoings that claimants allege here. The standard only aims to protect against physical violations. The standard only requires the implementation of reasonable measures of protection. Investors are referred to remedies under local law and the contracts.

Let me finish here, and refer you for the remaining legal analysis to our written submission. Thank you.

THE CHAIRMAN: Thank you very much indeed. This concludes the opening statements. We now need a little break. We deserve that, I think.

Is 15 minutes okay for the coffee break? 20? All right. 4.15.

MR HAIGH: Mr Chairman, just before we adjourn, as a matter of logistics, I am going to ask the respondents in particular: are you going to be using overheads similar to the ones that you've used in your opening statement in other matters or other evidence that you're going to be presenting? If you are, I was going to suggest that

15:52 we could at least pull a couple of blinds down at the end. That would make it far easier to read. There's quite a glare, and it's difficult for me to read it.

THE CHAIRMAN: It is indeed a bit far away.

DR NACIMIENTO: We do not intend to use further slides.

THE CHAIRMAN: Since we are at logistics, what is the intention of the parties and their witness examination now? There are different ways of doing that, obviously. Will you give us specific hearing binders per witness, or will we rely on what we have behind us? Just so that we get prepared before we hear the first witness.

MR SMITH: For the claimants, for our cross-examinations we will be providing separate witness binders. I can't promise you we won't stray from those, but we'll try not to.

THE CHAIRMAN: Alright. And for cross, obviously you will see.

DR NACIMIENTO: We will refer you to the hearing binder, and in some instances we may have copies of the exhibits.

THE CHAIRMAN: Okay. Alright. But we will have something in our hands when we go on?

DR NACIMIENTO: Yes.

THE CHAIRMAN: Okay. Thank you very much. 4.15.

(3.53 pm)

(A short break)

15:53 (4.15 pm)

MR ARTUR LUNGU (called)

(Evidence interpreted)

THE CHAIRMAN: Alright. Everybody is here, I take it, or should be here.

Mr Lungu, welcome. Do you speak English, or which language will you speak? Or can the parties tell us?

THE WITNESS: (In English) I would prefer to speak in Romanian.

THE CHAIRMAN: Romanian, okay. And we have an interpreter into English. Very good.

Well, Mr Lungu, the very first thing -- and you are the first witness, so you are the first one to do it -- is that you please read out the declaration that you have on the sheet of paper in front of you. Now, the interpreter has the same sheet and they will tell you in Romanian, I take it, what you are supposed to confirm. So perhaps you just listen to the interpreter and, if that is agreeable to you, you just confirm the statement.

Could I ask the interpreters to do this now into Romanian.

THE WITNESS: (Interpreted) Excuse me, forgive me. The statement, the declaration is in English. Am I going to read it out in English or am I going to translate it

16:18 into Romanian?

THE CHAIRMAN: No, the witness is not supposed to translate anything if he speaks Romanian. I asked the interpreter to read out the English statement into Romanian so that he can listen to it and then he can say "Yes" or whatever. So if the interpreters would be kind enough to do that.

THE INTERPRETER: I am aware that in my testimony I know --

THE CHAIRMAN: Does she understand?

THE INTERPRETER: Yes, I understand that I will follow the witness's words.

THE CHAIRMAN: No. You should please read out the sheet of paper into Romanian.

THE INTERPRETER: Okay. Then I will read it out into Romanian, okay.

THE WITNESS: I am aware that in my testimony I have to tell the truth and nothing but the truth. I am also aware that if I do not comply with this obligation, I may face, I may be submitted to severe legal consequences.

THE CHAIRMAN: Thank you very much indeed.

Now the claimant will shortly introduce the witness, I take it.

(4.20 pm)

Direct examination by MR MOHR

Q. Would you please introduce yourself to the Tribunal?

16:20 THE CHAIRMAN: I'm sorry, what do you mean by "introduce"? We know he is Mr Lungu. What else do you want him to say? A CV or whatever? We have a statement on his background in the witness statement, so I don't think we have to spend time on that.

MR MOHR: Mr Lungu, you have submitted two witness statements in this arbitration; correct?

A. Yes, it is true.

Q. Do you confirm those witness statements are accurate?

A. Yes, both of them are accurate. Just one more clarification in connection with one of my statements related to the sale process that was initiated with Cliffson and the request for information, additional information, from the part of the Ministry of Gas.

In connection with that, I declared that on the request of the ministry, I submitted all required information. This clarification of mine is that I did submit all the information and all the data that I had and were under our control.

Q. Please tell the Tribunal about your educational and work background.

A. I graduated from the Academy of Economic Sciences in the Republic of Moldova in 1995. Then I worked for six years with the municipality of Chisinau, when I was promoted as a head of the department for international

16:22 affairs. And then I pursued two years in the Master's degree at the University of Delaware, and I graduated from the public finance Master's programme. And then in my capacity as consultant I worked in Romania, in the financial area, and in 2004 I was employed by Ascom.

Q. What have your job duties been since you joined the Ascom Group?

A. In Ascom from the very beginning I dealt with corporate finances, but my role was relatively limited between 2004 [and] early 2006. But once the decision of the management was issued about issue of bonds, I am talking about the Tristan bonds, I was promoted in the position of executive vice president and financial manager of Tristan Oil Company. And since then, I've been actively involved in all financial decisions that were taken.

Q. How were the claimants' acquisitions of KPM and TNG capitalised after their initial acquisition?

A. Our group acquired shares in [Kazpolmunay and Tolkynneftegaz] since 1999 up until 2004, and as for the shares that were acquired, money was paid. And then for fulfilment of the minimal works, and then for the annual works and programmes, the companies were capitalised by use of loans of shareholders, and use of loans from the local banks of Kazakhstan up until the end of 2006, as well as by reinvestment of the profits generated by the oil activity in Kazakhstan

16:25 .

Q. Why did the claimants decide to enter into the Tristan note offering?

THE INTERPRETER: Will you please repeat the question?

Q. Why did the claimants decide to enter into the Tristan note offering?

A. I'm sorry, I did not get the translation. Your question was not translated correctly.

Q. In 2006, did the claimants enter into a note offering on the public debt markets?

A. Yes. Any company, as a result of its activity, and as a result of growth of its assets, wants to diversify its financing options. At the time, in 2006, we had traversed a relatively stable development period with important growth possibilities. That is why we deemed it necessary to diversify our financing sources, and also hoping that we will get better financing conditions.

Q. Why was that note offering structured involving a special purpose entity, Tristan?

A. This was the outcome of a very detailed analysis that we conducted together with our advisors at the time, I am referring to our investing bankers Jefferies, and our attorneys, Salans. Any issuance of a bond is also a marketing effort which is quite important, and each and every detail is important; that is, the basis of reserves is

16:28 also important: the guarantees, the aggregate production that could be generated by the companies that are interested in attracting financial resources. And from this perspective, coupled with a more serious reserve base, and with potential, quite large potential future earning, would enable investors to feel comfortable, so to say, and offer more attractive financing conditions. That was the reason why we structured it this way. Also because of some constraints that existed at that time.

Q. And what were the advantages of borrowing that money through the special purpose vehicle Tristan, rather than having KPM and TNG borrow the money individually?

A. First, costs are important. As you know, the issuance of bonds is quite expensive. And if we think of a package of guarantees, and we combine the transaction so as to turn it into one entity, we could keep costs at a reasonable level. And then this also enabled us to attract a comfortable amount for financing the works for the prognosis of 2007 and 2008, which were rather important.

Q. Who was the underwriter on that transaction?

A. Jefferies Investment Bank was the investment bank. But the investors were numerous funds coming from all over the world.

Q. And what due diligence, if any, did Jefferies conduct in connection with the Tristan note offerings?

A. Under such circumstances, the analysis, the due diligence analysis is made very seriously. Those who

16:31 are familiar with this would know that they are duty-bound to make sure that once marketing process is underway, the assets and the guarantees are confirmed.

And it is the bank indeed which conducted the analysis and the computation of the reserves, and in connection with the future production throughout the term of the licence and the potential cash that could have been managed.

Legally speaking, due diligence was performed both by Salans, our attorneys, and by the attorneys of the investment bank, who were, I think, if I remember well, White & Case.

Q. What was the interest rate on the Tristan notes?

A. The annual interest rate was 10.5%.

Q. Respondent argues in its rejoinder that the 10.5% interest rate indicates that claimants' activities in Kazakhstan were given only a limited chance by the markets. Do you agree with that?

A. I do not agree. I think that 10.5% was a reasonable interest rate, and it reflected the reality existing in the company and in the economy, the national economy, at the time.

Q. Respondent also argues in its rejoinder that the ratings given from ratings agency such as Moody's and Fitch, which were B2 and B+ respectively, indicate that claimants' activities in Kazakhstan were given only

16:33 a limited chance by the markets from the beginning. Do you agree with that?

A. Could you please repeat your question?

Q. Respondent argues in its rejoinder that the B2 rating from Moody's and the B+ rating from Fitch indicate that the investments in Kazakhstan were somehow speculative. Do you agree with that?

A. I totally disagree. They were not speculative in the direct sense of the word. This is the technical language of the rating agencies in order to classify the various types of investment and give the possibility to various types of investors to participate or not in such investment. But they were not speculative investments at all.

Q. Respondent also argues that the debt structure of the companies caused KPM and TNG to be over-leveraged. Do you agree with that?

A. No, it was not like that. When we issued the bonds, we took into consideration several parameters proforma, such as the total debt as per the total reserve, the EBITDA as against the interest, the total debt to EBITDA, and according to these ratios we were in line with the market average for oil companies.

Q. Did the banks that invested or participated in the Tristan note offering indicate in any way that they

16:35 believed the companies were over-leveraged?
A. Well, no. Judging by the success of the bond issuance -- the first bond issuance but also the demand of the market for the second issuance of June 2007 -- I can say with certainty that investors thought our companies were worth investing in.
Q. Why did the claimants seek a bridge loan beginning around the fall of 2008?
A. There were several reasons why they did that. In the fall of 2008, at the beginning of the fall, we were at the end of the second stage for the sale of the assets, the Zenith Project. The money we got from that, we wanted to reinvest that money into other investment opportunities in the area of oil and gas in Iraq. Any opportunity should be used as soon as it comes up, and we needed a limited bridge loan that would be guaranteed by the future money we would get from the sale of the assets.

We relied on the statements and the estimations of our bankers, who said that a normal process like that should be over at the end of November 2008.
Q. At some point did the claimants consider seeking bridge financing because of concerns about cashflows?
A. Well, that happened a little bit later. Well, it happened towards the end of 2008, in December, when we

16:38 were negotiating with Crédit Suisse. But the rationale -- there was a dual rationale here: on the one hand, we still had opportunities that justified the bridge loan at the beginning of the fall, and which from the discussions we had with potential partners, we were not able to restructure them fully, to postpone them; and on the other hand, we saw that the prices on the international market were going down, and we thought it would be reasonable for us to make our ourselves -- to protect ourselves in case this downfall in prices would continue.

Q. The respondent has asserted in its rejoinder that KPM and TNG's liquidity problems in the 2009 time period were caused by factors outside of the influence of the Republic of Kazakhstan. What do you think caused those cashflow problems?

A. There were such problems. But the reasons that generated such problems and the severity of the problems was of two types: on the one hand, we had objective reasons, such as the prices, the oil price went down on the world market, and this affected us; and then the seasonality of the gas demand on the local market.

The extraordinary reasons, on the other hand, that contributed the most, in our opinion, to the difficult financial situation at the end of spring 2009/the beginning of summer 2009 were the actions of Kazakhstan that were started in October and November 2008, such as the controls they

carried out in the company, as well as starting criminal proceedings [on the] main pipeline that never existed, as well as re-evaluating new taxes for our previous activity.

And on the other hand, we could not continue with the contract with Kemikal. We terminated that contract at the end of December 2008. Kemikal was the company which in 2008 would purchase the gas difference we manufactured, after delivery to local consumers. So we terminated the contract because Kemikal failed to meet its obligations. And on the other hand, we knew who was behind Kemikal and we knew that when Kemikal refused to renew the contract under the same conditions, such as issuing bank guarantees to guarantee the payments, we understood that Kemikal intended not to pay us for the gas we supplied.

In my opinion, the financial situation that was generated at the end of spring 2009 and the beginning of summer 2009 was caused by objective factors, and we could have dealt with that quite easily, more or less easily; but we were affected, impacted, the most by the actions of the State of Kazakhstan, and I mentioned the actions against us.

Q. Why do you attribute the issues with Kemikal to Kazakhstan?

A. I have two reasons to do that. First of all, the State

16:43 of Kazakhstan did not ensure the necessary environment for us to exercise our contractual rights. We had the right to sell freely on the export markets to any buyer who would offer a reasonable price for the gas. This never happened, never during our activity. It didn’t happen when we sold to KazRosGaz, joint venture between KazMunaiGas and Gazprom, or when we were selling our product to an affiliate of that company, Gazimpex. And it didn’t happen when we sold to Kemikal. Because all those companies were managed by actually the same people. So this right of ours was violated.

On the other hand, we knew that there were people very close to Mr Kulibayev behind Kemikal, and we saw the responsibility of the State of Kazakhstan.

Q. I think this will be my last question. Why did KPM pay a dividend in 2009 if it was experiencing cashflow problems?

A. What dividend do you mean?

Q. Did KPM pay a dividend of around $59 million towards the end of 2009?

A. That's right. That's correct.

Q. And why did KPM pay a dividend in 2009 if it was experiencing cashflow problems? Wouldn't that just make a bad situation worse?

A. Well, this happened at the end of 2009 and the beginning of 2010, when we already knew that the State of Kazakhstan had decided to take over

16:45 Kazpolmunay, when the legal order against Mr Cornegruta became effective and when they applied the penalty of $145 million, and the company could not pay such an amount at that time. It was unreasonable, and we understood that they had made their decision and we tried to protect what we could still protect at that time.

MR MOHR: Thank you.

THE CHAIRMAN: Thank you very much. That obviously was quite a bit more than five minutes, but I take it that that was in rebuttal to new developments that came after the last statement from the witness.

MR MOHR: Correct.

THE CHAIRMAN: Alright. We turn to cross-examination right away, please.

MR TIRADO: Thank you, sir.

(4.46 pm)

Cross-examination by MR TIRADO

Q. Good afternoon, Mr Lungu. I wonder if we could start, please, with what we call the preemptive rights waiver.

Do you remember the issue of the preemptive rights waiver?

A. You mean the transactions of 2003? What preemptive rights?

Q. It was the transfer of shares in TNG from Gheso to Terra Raf.

16:47 A. Yes, I do recall that.

Q. And is it correct that there was some dispute about the waiver of preemptive rights by the state concerning this dispute?

A. The State of Kazakhstan had a different view concerning the transaction. We never thought that the position of the State of Kazakhstan was the right one. We thought and we still think that we didn't need to request the State of Kazakhstan to have a preemptive right waiver, this was always our position, but at the insistence of the State of Kazakhstan, we just tried to prove that we were acting in good faith.

Q. I see. Perhaps, Mr Lungu, could I ask you to refer to your first witness statement, please, paragraph 38 in particular. Perhaps if you'd like to take a moment to refresh your memory of that paragraph.

A. Yes, thank you. (Pause) [Yes.]

Q. Are you saying in this paragraph 38, Mr Lungu, that with the preemptive rights waiver in December 2007, the state waived all of its preemptive rights also with regard to the transfer from Gheso to Terra Raf?

A. No. I refer to the request I made. So we expressly requested the transfer. We anticipated that we would make -- issue capital on the London market, and we requested the State of Kazakhstan to waive the preemptive rights so that we had the right – if we decided to do this – to have the right for Ascom and Terra Raf to transfer to an affiliate the rights they had. So this referred to

16:50 that particular case only.

Q. Okay. Thank you, Mr Lungu.

I wonder, as you still have your witness statement in front of you, could I ask you to look at paragraphs 47-50. This deals with the non-extension of contract no. 302. (Pause)

A. [Yes.]

Q. Thank you. The question is a simple one. Is it correct that in 2009 TNG applied for an extension of this contract 302?

A. In my witness statement I said that TNG submitted its application on October 14, 2008, and we repeated that in March 2009. That's true; it's correct.

Q. Thank you. In that regard, do you remember that an inter-ministerial commission ever decided on the extension of contract 302? If it helps, I am referring to a commission consisting of representatives from the Ministry of Finance, the Ministry of Economics, the geology committee and other entities.

A. Unfortunately I don't know any details about the commissions or representatives of various entities or their procedures. What I know is that we submitted the application, we were notified by the ministry that the decision had been made to extend the contract as we had requested, and we were asked to submit the

16:53 amendment to the contract whereby the procedure would have been made logical in the end.

Q. I see. Perhaps I could ask you to look at Exhibit R-163.1. Do you have it in front of you, Mr Lungu? Do you have that exhibit?

A. (In English) I think so. It's R- ...

(Interpreted) Yes, it's R-163.1, right?

Q. Correct, yes. Is this the document that you were just referring to?

A. Yes, that's the letter, yes.

Q. Do you see this document as being issued by an inter-ministerial commission?

A. From what I can see, it was signed by Mr Batalov on the heading of the Ministry of Energy and Mineral Resources of the Republic of Kazakhstan.

Q. Correct. It is a letter on the letterhead of the Ministry of Energy and Mineral Resources, rather than from an inter-ministerial commission?

A. Correct.

Q. Thank you. Mr Lungu, I wonder, is it correct that in 2005 and 2006 TNG sold gas to GazImpex and KazRosGaz?

A. From what I recall, yes, it is correct.

Q. It may help you if I refer you to your second witness statement, paragraph 2. Do you have that there, the second one?

16:56 A. Could you provide a copy of that, please?
Q. It's paragraph 2; that may help refresh your memory.
A. Yes, it is so.
Q. It's correct, isn't it, that these companies then exported the gas, and could sell it for a substantially higher amount?
A. Yes. Yes, it is written so.
Q. Yes. And I think, going on to paragraph 3, you also considered the differences in prices inequitable?
A. Yes, because prices -- the prices that we sold at those companies and the prices that we knew were current in exports, there were substantial differences between these two types of prices.
Q. Yes. And so for that reason TNG suspended the contract with KazRosGaz at the end of 2006 and terminated the contract with GazImpex in March 2007; correct?
A. With KazRosGaz it was in December 2006, and indeed in March 2007with GazImpex.
Q. And TNG then negotiated a new contract with Kemikal; correct?
A. A longer period of negotiations followed, with a view to obtaining better prices. And in the autumn of 2007 we signed another contract with Kemikal.
Q. Yes. And under that contract, deliveries were only going to begin in October 2007; isn't that right?

16:59 A. Yes.

Q. Then surely it's not true that there was a substantial gap of several months during which sales in 2007 were rather low due to a lack of contracts?

A. If you refer to the period of 2007, it is true that between March 2007 and October 2007 there were negotiations with a hope of obtaining better prices from KazRosGaz and GazImpex.

And because the teams were the same, were identical, we received another company -- another proposal, the Kemikal company, but the people were the same.

Q. Mr Lungu, I put it to you: could TNG not have avoided that gap and kept up steady income if it had not terminated the contracts before the new contract came into force?

A. Could you please reformulate your question?

Q. Sure, I'll try to. The point is there was this gap in time that could have been avoided, could it not, had TNG kept up -- had not terminated the contracts before the new contract came into force.

A. Yes, this vacuum could have been avoided if KazRosGaz and GazImpex had negotiated under conditions of good faith and a price formula related to export prices or international gas prices would have been offered, but this formula did not exist. Suspension, termination of the contract was our sole possibility of trying to negotiate a better price for the gas and oil that we sold.

17:01 Q. Okay, thank you.

Is it correct to say that the drop in oil prices from a high point in 2008 to a low point at the beginning of 2009 played a role in this?

A. Drop of prices did and does have a role, and such a substantial drop indeed was important.

Q. Yes. I think, just to clarify, moving on from the last point that in terms of the effect on your alleged loss was due to the drop in oil prices, I just want to be clear, it was slightly different -- the question goes to causation.

MR MOHR: Perhaps you could just reformulate the question entirely.

MR TIRADO: In fact we had moved on to a different subject, in terms of what was causing damage or problems was that there was a significant drop in oil prices [from] the high point in 2008 to the low point at the beginning of 2009.

THE CHAIRMAN: I'm sorry, that was a statement, not a question.

MR TIRADO: Sorry.

Is that correct? Is it correct that the impact of the fall in the price of oil from the high point in 2008 to the low point in 2009 played a role in the loss you claim you sustained?

17:03 A. Let me make a clarification. In 2009 we recorded no losses. The financial year finished in good conditions, profitable conditions. If you refer to the impact of the price, of the price drop in the latter part of 2008, yes, drop of prices did have an impact,on the revenue and the sales of the companies. But for 2009 there was no significant loss.

Q. But it was a significant drop in price; in fact it halved during that time, did it not?

A. Yes. But the average of prices for 2008 was very good. And if we refer to the financial reports, you could see, you would see that we recorded the best sales in 2008.

Q. Could you just clarify, please: when you say "we" did not record a loss in 2009, who are you referring to?

A. We recorded no losses in 2008, not in 2009. The end of 2008.

Q. And when you say "we", who are you referring to?

A. I am referring to the companies and to the combined financial reports for our benefit and for the benefit of the shareholders.

Q. I'm sorry, could you repeat that last answer? I'm not sure I understood that, to whom you were referring.

A. When I say "we", that is Kazakhstan project. I am referring to the group of companies, the way it was conceived of when Tristan shares were issued, namely Kazpolmunay, Tolkyneftegas and Tristan Oil

17:06 so to the combined financial reports, and partially to the financial reports that are called stand-alone for each and every company.

Q. Okay. And is it correct that a drop in local demand -- if I can go back to that question -- also affected the cash situation of TNG?

A. The respective problem occurred in 2009, not in 2008. That is a dramatic decrease of sales of crude oil because of lack of demand on the local market, starting from March and continuing in the summer of 2009, this happened in 2009. In 2008 we had no such problems. In 2008 we had stable sales of crude oil and of gas as well.

Q. Understood. But also TNG lost its largest customer, Kemikal; that's correct, isn't it?

A. It is correct. Kemikal was the company which, throughout 2008, purchased the difference of gas that remained after we supplied the local consumers. But I mentioned, I stated the reasons why we wanted to terminate the contract with Kemikal.

Q. Yes, I understand. But that must have affected the cash situation too, isn't that right, losing Kemikal?

A. Yes, this affected the revenue coming from sale of gas. But at the moment, while knowing who was behind Kemikal and seeing what were the claims of the Kazakh State toward the end of December 2008, we

17:09 understood that even if we did keep the contract with Kemikal, this would not help us in any way. Because we would not get anything.

Q. Further, is it correct that in the summer of 2009 TNG had to pay excess profits tax in the amount of some $20 million?

A. I know the total amount that had to be paid, but can you refer, please, in more precise terms which part of the declaration, where in the statement, which is the figure? I knew that the total amount of excess profit tax in the summer of 2009 was approximately $32 million.

Q. Mr Lungu, I am just about to hand over to you a copy of the Tristan Oil Limited annual report for the financial year 2009, and if I could ask you to look at page 4.

THE CHAIRMAN: Would you just always mention the exhibit number for the record.

MR TIRADO: Yes, sir. That's Exhibit R-37.6.

THE WITNESS: Could you please repeat your question?

MR TIRADO: Yes. My question was specifically in relation to TNG having to pay excess profits tax in the amount of some $20 million. It actually indicates $20.8 million in the annual report.

THE CHAIRMAN: What page?

MR TIRADO: Page 4, sir.

A. Yes, it is true.

17:11 Q. And this affected the cash situation too, didn't it?
A. Of course.
Q. Were these tax demands legal?
A. Yes, they were legal.
Q. So would you describe the financial situation of TNG in the spring and summer of 2009 as rather dire, to put it mildly?
A. The situation was difficult indeed. But I explained the reasons and the factors that led to such a situation.
Q. Yes, thank you. So there were cash constraints at that point in time?
A. There was a certain cash deficit that was motivated by those factors, the drop of prices and a lack of contracts and demand on the local market, a lack of demand. But there were also extraordinary factors that led to the creation of this situation because in our opinion, if the environment had been normal, even if there are such financial temporary constraints, they can be sorted out, they can be solved.
Q. Okay, thank you.
Turning to the construction of the LPG plant, is it correct that around late spring/summer of 2009, TNG stopped constructing the LPG plant?
A. It is true. In May 2009 we decided to stop investments in LPG.

17:13 Q. Okay, thank you.

Mr Lungu, perhaps if we could explore with you the question of the Cliffson sale. The initial Cliffson contract, dated 13th February 2010, provided for a closing date of 30th April 2010; is that correct?

A. Yes. The contract was signed on 13th February and it was going to end on 13 April.

Q. Perhaps I can refer you to Exhibit C-540. Section 4 of the contract sets out the conditions. And in particular if I can refer you to section 4.5, which states:

"This Agreement automatically terminates, if

"(a) subject to clause 4.6, the conditions in clause 4.1 have not been fulfilled or waived on or before 30 April 2010 ..."

That means that by that date, 30th April 2010, certain conditions had to be met, otherwise the contract would automatically terminate; is that correct?

A. Yes, there were some conditions to be met for the contract to become effective, and the most important one was the waiver by the state of the preemptive rights.

Q. Yes. There are a number of other conditions set out in Article 4.1.

A. Yes, there are other conditions set out there.

Q. And is it correct that this closing date of 30th April 2010 was extended by agreement between the sellers,

17:16 Ascom and Terra Raf, and the buyer, Cliffson, to 31st May 2010?

A. Yes, that period was extended, but I don't recall if it was 31st May 2010. But it was extended, indeed.

Q. So it is fair to say that the conditions had not been met by 30th April 2010?

A. It is correct that the conditions were not met until 30th April. But because the buyers were reassuring us that it was just a bureaucratic matter, so we extended our agreement for a longer period.

Q. It is correct also that not all closing conditions had been met by 31st May 2010 either?

A. It is correct to say that.

Q. And would you agree that the closing date was not extended further than the end of May, or 31st May 2010?

A. Unfortunately -- could you provide the document whereby we extended until 31st May? I only know that after we learned about the Cliffson letter, the conditions of the contract would not be extended any longer.

Q. Yes. I am going to hand the witness a copy of Exhibit C-701.2. (Handed)

A. Yes, that's correct.

Q. You can see in the second paragraph the extension to 31st May 2010?

A. Yes, correct.

17:19 Q. My question was: it is also correct, isn't it, that the contract ended on 31st May 2010?
A. It would be fair to say that we did not receive the preemptive right and the preconditions were not met. But other discussions with the potential buyers continued even after 31st May 2010 because we tried to understand if it was worthwhile extending the contract again. But then we learned about the Cliffson letter to the ministry whereby they said that they withdrew from the process.
Q. If I could refer you to that letter: this is Exhibit R-314. This is a letter from Cliffson to the MOG. It's probably worth noting that it's not clear actually who the addressee is.
Mr Lungu, if you could look at the date, what does it say?
A. The letter is dated 7th June 2010, and the second paragraph says that the contract, the purchase contract, is terminated unilaterally as of 7th June 2010 by the company.
Q. Sure. So the simple point here really is that it is correct, isn't it, that on 7th June 2010 the MOG knew that the Cliffson contract had ended?
A. I do not know what the ministry knew, but that's what the letter writes. We never received a copy of the

17:22 letter from Cliffson, but that -- before that, prior to that date.

Q. If this was known to the MOG by 7th June 2010, did the MOG not act perfectly legally by not declaring an approval of the transfer?

THE CHAIRMAN: I'm sorry, that's a legal question. The witness is not really the right person to ask that.

MR TIRADO: Okay. Perhaps this is less ...

Would it not have been at least then senseless to declare an approval -- okay, I'll scrub that, because I think they're both going to be legal questions.

Sir, I am mindful of the time. I probably have another ... I'm just trying to be economical here. I think we can skip a couple of these questions.

In that case -- thank you for that -- we have just one more set of questions that relate to the failure to sell KPM and TNG.

In phase 1 of Project Zenith in the summer/autumn of 2008, were you in direct contact with the potential bidders?

A. Less in the initial stage. We had a direct contact through our investment bank, Renaissance Capital, and we would receive regular reports from them.

Q. So Renaissance Capital was the contact for the potential bidders and controlled the early information of the

17:24 potential bidders?

A. Yes, that's correct.

Q. And it was also Renaissance Capital that prepared the information memorandum of August 2008 that was handed out to the potential bidders?

A. The memorandum was drafted based on the information we produced, and it was a joint work between the company and our bankers.

Q. Is it correct that at the beginning of 2009 you started the sales process for KPM and TNG in earnest?

A. Yes, it is true that we decided to start the second stage of the Zenith Project at the end of 2008/the beginning of 2009.

Q. And is it correct that RenCap was also involved in this phase 2 of Project Zenith?

A. Yes, that's true. We continued with our investment bank, RenCap.

Q. In fact, RenCap was instructed to contact the potential bidders, wasn't it?

A. Yes, we asked them to contact the potential bidders, to contact the people who submitted preliminary offers or bids.

Q. Okay. And in your first witness statement you say at paragraph 57 -- I think you have it in front of you:

"... Total informed us that they were going to talk

17:26 about the Kazakh authorities about the companies before they would be willing to move ahead with a bidding proposal."

MR HAIGH: Excuse me, was that the full sentence that you were intending to read or just a part of the sentence?

MR TIRADO: No, that's the quote I was reading.

MR HAIGH: Thank you. I thought it began with:

"After its examination of the data room and our management presentation ..."

MR TIRADO: Mr Haigh, you are quite right, yes. But it's the part of the sentence I wanted Mr Lungu to concentrate on.

MR HAIGH: Thank you.

MR TIRADO: The question, Mr Lungu, is: did you receive a letter from Total which said so?

A. Saying what? Saying what? Could you rephrase your question, please?

Q. Yes. You say in paragraph 57 that you were informed by Total that:

"... they were going to talk with the Kazakh authorities about the companies before they would be willing to move ahead with a binding proposal."

My question is: how was that communicated to you? Or rather, did you receive a letter from Total which said they were going to do that?

17:28 A. We never received such a letter. But that was the comment at the end of the management presentation that we delivered at the headquarters of Total in February of 2009. That was the statement of the head of Total delegation, a verbal declaration that he made.

Q. So this declaration was made personally to you?

A. It was made in my presence. I don't recall if it was made to Mr Stati or myself, but I was there.

Q. But it was a verbal statement?

A. Yes, correct.

Q. Thank you.

A last point: do you recall who was the head of the Total delegation?

A. From what I can remember now, at the moment when we made the management presentation it was Mr Kayar.

MR TIRADO: Kayar, okay. Thank you.

No further questions, Mr Chairman.

Thank you, Mr Lungu.

THE CHAIRMAN: Thank you very much. How about re-direct?

MR MOHR: I do have some re-direct questions.

THE CHAIRMAN: How long do you think it would take?

MR MOHR: I would expect it to take 10 or 15 minutes.

THE CHAIRMAN: Then I would suggest we do that now, rather than restart tomorrow morning, if that's okay. It fits together better. So please go ahead.

17:30 (5.30 pm)

Re-direct examination by MR MOHR

Q. Mr Lungu, can you please tell the Tribunal more about why you believe Timur Kulibayev was behind Kemikal?

THE CHAIRMAN: I'm sorry, the rules say that you can only address things that were addressed in cross, and I don't recall that this was mentioned in cross. You mentioned it yourself in direct, but I don't remember that this was mentioned in cross.

MR MOHR: I thought that the cross had asked a number of questions about the relationship between TNG and Kemikal.

THE CHAIRMAN: We can look at the transcript, but I am pretty sure that that was not mentioned in cross.

MR TIRADO: Mr Kulibayev was not mentioned once.

THE CHAIRMAN: Exactly.

MR MOHR: Mr Lungu, was there any agreement between the claimant parties and the Cliffson company regarding who would approach the Government of Kazakhstan for a waiver of its preemptive rights?

A. Yes, of course. It was obvious at the moment when we signed the contract with them and when we were negotiating with them that the biggest problem would occur after the contract, to obtain the preemption rights, and our then-relations with the Kazakh State and with the ministry were such that we knew we did not have the

17:32 slightest chance -- we had no chance to come to an understanding with them. But the understanding was that the purchaser, the family that we knew was a respectful, reputed family in Kazakhstan.

So it was the buyer, it was upon the buyer to solve this problem, to approach the Kazakh authorities, and then tell us when we were to comply with the formal part, after general agreement with the representatives of the ministry.

Q. Why did you think getting a preemptive rights waiver from the government was a significant obstacle to closing that transaction?

A. Because throughout the two years of activities in Kazakhstan, our belief was and still is that the Kazakh State did their utmost that we should not sell the assets, and that the assets should get transferred in some way or another, directly or indirectly, to the Kazakh State. And being convinced about that, and knowing already that multinational companies such as Total or KNOC were interested at first, and then they withdrew out of reasons that we guess -- we suspect which reasons they had, because they did that after they had talks with the representatives of the Kazakh State.

So we understood that it was only the buyer, the purchaser, and because that was a family from Kazakhstan, they would be the only ones to perform this,

17:34 to accomplish this. We would not have been able.

Q. Did you have any conversations or any agreements with Cliffson regarding who would provide any information about Cliffson's financials to the government?

A. When we got the requests for information and data that we pertained to Cliffson, and which we did not have of course, we asked Cliffson, the buyer, to provide promptly that information to the ministry, in order to answer their request. And they assured us that they would do it.

Q. Can you please refer to Exhibits C-530 and C-531.

A. Yes.

Q. Do you recognise these letters?

A. Yes, I remember them.

Q. And what are these letters?

A. They are request letters, asking for further information, additional information from the part of the Ministry of Gas and Oil.

Q. Further information regarding what?

A. Regarding our request concerning the Cliffson transaction with regard to the waiver from the part of the Kazakh ministry of preemptive rights. And additional information was required so that such a decision should be taken about waiving or not waiving -- waiving the preemption rights. So they are extended information, geological, exploration information, and of management of resources.

Q. Now, can you also refer to Exhibits C-532 and C-533.

17:37 A. Yes.

Q. What are these documents?

A. They are the answers of the companies Kazpolmunay and Tolkynneftegaz to the letters of the ministry dated June 1, 2010 regarding requests for information, where we submitted all the information that had been requested by the ministry, the information and the data we had at the time.

Q. What was the date on those two letters again?

A. The date on the response letters from Kazpolmunay and Tolkynneftegaz is 12th June 2010.

Q. At that point in time, did the claimants still believe there was a possibility that the Cliffson deal could be closed?

A. Could you please repeat your question?

Q. As of 12th June 2010, when the claimants provided this additional information to the government, did you still feel that there was a possibility that the Cliffson transaction could be closed and a preemptive rights waiver obtained from the government?

A. Yes. Obviously, yes. Because, although our talks with the potential buyer had not been that dynamic, we did not know about their letter. We still had talks with them, and we still hoped that a transaction was possible.

MR MOHR: Thank you.

THE CHAIRMAN: Thank you very much. Any questions in

17:39 re-cross?

MR TIRADO: No, sir.

THE CHAIRMAN: No. Any questions by my colleagues?

PROFESSOR LEBEDEV: No.

MR HAIGH: No, thank you.

THE CHAIRMAN: None from me.

Alright. Well, thank you very much for being here and being patient, which is always a quality required of witnesses. But we did finish today, so thank you very much for coming.

That is all we can do today, obviously, so we will meet at 9.30 tomorrow morning. Thank you.

I forgot one thing: I would be grateful if representatives of both sides could meet with the Secretary of the Tribunal so that we can reorganise the files behind us in a way which is easier for us to use.

(5.41 pm)

(The hearing adjourned until 9.30 am the following day)

INDEX

PAGE

Discussion re procedural matters 11

Opening statement on jurisdiction by 18
MR TIRADO

Opening statement on jurisdiction by 34
DR NACIMIENTO

Opening statement on jurisdiction by 41
MR MOHR

Opening statement on jurisdiction by 63
MR SMITH

Opening statement on the merits by 68
MR FLEURIET

Opening statement on the merits by 92
MR SMITH

Opening statement on the merits by 139
MR TIRADO

Opening statement on the merits by 152
DR NACIMIENTO

Opening statement on the merits by 172
MR TIRADO (continued)

Opening statement on the merits by 176
DR NACIMIENTO (continued)

MR ARTUR LUNGU (called) 191

Direct examination by MR MOHR 192

Cross-examination by MR TIRADO 203

Re-direct examination by MR MOHR 221