ARBITRATION V (116/2010)

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

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

Claimants

- and -

REPUBLIC OF KAZAKHSTAN

Respondent

Rejoinder Memorial on Quantum

1 December 2012

INDEX

A. Introduction

1 Claimants have suffered no damage in this case. The result of a proper valuation taking into account the required deductions is zero.

I. Claimants grossly inflated their damage claim

2 Claimants claims are grossly inflated and to a large extent based on methods and assumption which can hardly be considered serious or thorough.

3 In fact, the billions of USD claimed by Claimants in this arbitration, are reached by a blatant breach of universally accepted valuation standards. Moreover, they are reached by simply disregarding a whole range of inconvenient facts and substituting reality by wishful thinking.

4 In this introduction, the Republic first addresses the most shocking and unacceptable examples of how Claimants inflated their damage claim before addressing in the following the details of the Republic's case.

1. Claimants disregard universally accepted valuation standards in order to inflate their claim

5 The largest part of Claimants' damages claim is taken up by the claim relating to Contract No. 302. Claimants demand a whopping USD1.58 billion in compensation for the "loss of opportunity" to develop the Contract 302 Properties. However, as even Claimants' expert confirms, the chances of success were minimal and this must be reflected in the valuation.

6 There is a wide range of flaws in Claimants' Contract No. 302 claim which the Republic will take up in more detail below. For now, the Republic will concentrate on the most blatant error, namely a complete disregard of risk in Claimants' valuation.

7 Claimants' own geological expert Ryder Scott estimates the geological chance of success for the Interoil Reef, which takes up 93% of prospective gas resources of the Contract 302 Properties, at a mere 5%. Any serious valuation aiming to abide by internationally accepted valuation standards would take account of such low chance of success. The standard approach is to simply multiply the unrisked value of the asset with the geological chance of success. Claimants, however, do not take this route. They simply put to the Tribunal that it should award what they consider to be the unrisked value of the Contract 302 Properties. Even worse, they specifically instruct their valuation expert FTI Consulting to disregard the risk in its entirety. This speaks volumes about the credibility of Claimants' case on damages. Moreover, the fact that FTI Consulting accepts Claimants' instruction puts into doubt their professional ethics and the reliability of their calculations in general.

2. Claimants deliberately fail to mention important facts that would diminish their claims considerably

8 One of Claimants' key methods in putting together their damage claim is presenting only a very limited selection of the relevant facts to the Tribunal. Claimants try to hide certain inconvenient facts that lead to considerable deductions from their claims.

(a) Claimants base their valuation on the valuation date of 14 October 2008. While this choice of valuation date is untenable in itself, what makes Claimants use of the valuation date outright disingenuous is something else: Claimants do not take account of the production and the resulting income in the 21 months between 14 October 2008 to 21 July 2010. The Republic's expert Deloitte calculated that applying Claimants' own numbers, the income from the sale of oil, condensate and gas during that phase would amount to USD 226.6 million. Completely disregarding such large amounts of income pocketed by Claimants is exemplary for Claimants' attempts at inflating their damage claim.

(b) Claimants' instructed their expert FTI Consulting to conduct an asset valuation of the LPG Plant. Without any limitations, they put forward the FTI calculated asset value to be the amount of

compensation that they may demand. At first sight, this may seem like a sensible approach since the LPG Plant was to be 100% owned by TNG. However, in so arguing, Claimants completely fail to take into account that the LPG Plant was to be operated as a joint venture with Vitol and that profits were to be shared on a 50/50 basis with Vitol. Disregarding such profit sharing claim of Vitol is entirely disingenuous and leads to a considerable inflation of their claim for the LPG Plant.

3. Claimants prefer wishful thinking to hard facts

9 Throughout their valuation arguments, Claimants prefer not to argue based on hard facts but instead based on what they deem to be "legitimate expectations" – and what is probably best described as a wish list. The reason for this is simple: The actual facts of the case do not support Claimants' exorbitant claims.

10 The central element of Claimants' wishful thinking approach is Claimants' improperly early valuation date. Claimants set their valuation date to 14 October 2008, a date on which no state action had any actual effect on KPM and TNG and, moreover, a date which is months or even more than a year prior to many of the state measures Claimants complain of. By choosing 14 October 2008 as their valuation date, Claimants find a way to disregard many developments after that date which drive down the value of their assets. In particular, Claimants ignore the sharp drop in oil prices, the sharp drop in demand for TNG's gas and the failure to conclude the so-called tri-partite agreement with KazAzot. Taking into account these developments, as international law requires, Claimants' claims shrink decisively.

11 There are also other instances throughout Claimants' case on damages in which Claimants completely disregard the existing facts or the legal framework surrounding KPM and TNG. For example, Claimants ignore that KPM and TNG were never able to export gas because they could not secure a contract for export. Claimants simply apply export prices – even though their own reserves reports from 2008 and 2009 reveal that at the time of events, they did not actually expect that they would be able to achieve export prices.

4. Claimants claim at least USD270 million in moral damages

12 In a final attempt at inflating their damage claims, Claimants demand the compensation of moral damages in the amount of "at least" 10% of compensatory damages awarded. Since Claimants inflated damage claim comprises approximately USD 2.7 billion, their moral damages claim thus amounts to at least USD 270 million. This further inflation of Claimants' claim borders on the ridiculous as is reflected by the fact that the highest amount of moral damages ever awarded by an investment tribunal was USD 1 million.

II. The Republic's case on quantum

13 As a result of the above, Claimants' claims fail for a lack of damage. In the following, the Republic will establish through serious and thorough experts that

(a) the asset value of Contract No. 302 is zero;

(b) the LPG Plant may at best have salvage value which Claimants failed to determine;

(c) the asset value of the Borankol field is USD 62.8 million;

(d) the asset value of the Tolkyn field is USD 123.2 million

(e) debt under the Tristan notes in the amount of USD 531.1 million as well as other debt must be deducted from any asset value assigned to the assets in question.

(f) the final result after proper valuation and deductions is zero.

B. 21 July 2010 is the proper valuation date in the present case

14 Claimants assert that the appropriate valuation date for their assets is 14 October 2008.[1] According to the Claimants, this is the date on which, through a presidential "order", a harassment campaign was started that ultimately led to an expropriation of Claimants' assets.[2] Claimants' intention in relying on this date is readily apparent: They attempt to push up the valuation date as far to the past as possible since this helps inflate their claim.

15 The Republic denies that any expropriation occurred or that a harassment campaign was ever started against Claimants. The following discussion of the Claimants' assertions is hence strictly without prejudice to the Republic's position on jurisdiction and liability.

16 Moreover, already in its Statement of Defence, the Republic explicitly denied that the appropriate valuation date can be 14 October 2008 and instead argued that any valuation must be based on the situation on 21 July 2010.[3] In the following, the Republic will elaborate on this argument.

I. Claimants chose an improperly early valuation date in order to inflate their claim

17 Uncontestedly, 14 October 2008 is a date on which no state measures against KPM and TNG were executed. No contracts were cancelled on this day. No searches were conducted. No judgements were rendered. No promises were given or broken. The only thing that happened was that President Nazarbayev forwarded a letter by Moldova's President Voronin as an attachment to a note which stated that the state authorities should

---

1 Claimants' Statement of Claim, paras. 405 et seqq.; Claimants' Reply on Jurisdiction and Liability, paras. 582 et seqq.

2 Claimants' Reply on Jurisdiction and Liability, paras. 210 et seqq.

3 Respondent's Statement of Defence, para. 47.3 et seq.

"thoroughly check" President Voronin's accusations.[4] From this fact alone, it is blatantly apparent that 14 October 2008 cannot be the proper valuation date.

18 Why do Claimants rely on this date nonetheless? Quite simply in order to inflate their claim in this arbitration:

(a) For one, the inappropriately early 14 October 2008 date allows them to disregard a whole range of later developments, all of which had nothing to do with the Republic and all of which drove down the value of KPM and TNG. The Republic has set out these developments already in its Rejoinder Memorial on Jurisdiction and Liability[5] and has in particular referred to the sharp drop in energy prices beginning in autumn of 2008 and a sharp drop in demand due to a loss of the key customer Kemikal.[6] Moreover, the failure to conclude the tri-partite agreement with KazAzot comes to mind. Taking into account these developments by applying a proper valuation date, Claimants' claim shrinks considerably.

(b) Further, the inappropriately early valuation date also allows Claimants to disregard significant income that KPM and TNG created between 14 October 2008 and the termination of the contracts on 21 July 2010. In a blatant attempt to obtain double compensation, Claimants, through the setting of their valuation date, do not take account of the income during that period, even though this income runs into hundreds of millions of USD –[7] which were transferred out of the Republic and not subjected to Kazakh taxation. If one instead applies a proper valuation date, such double compensation is avoided.

19 The Republic submits that these facts alone show that Claimants' 14 October 2008 valuation date is set far too early and should not be accepted by the Tribunal.

---

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

5 Respondent's Rejoinder on Jurisdiction and Liability, paras. 722 et seqq.

6 The Republic will further deal with the consequences of these developments below in a separate section addressing Claimants' valuation calculations, cf. paras. 425 et seqq.

7 For a more detailed calculation, cf. below paras. 442 et seqq.

II. 21 July 2010 is the proper valuation date regarding the alleged direct expropriation

20 In their Reply Memorial on Jurisdiction and Liability, Claimants mischaracterise the actions taken by the Republic upon termination of Contracts No. 210 and 305 as a direct expropriation.[8] As already argued, the transfer of the contractual territory into trust management, which occurred on 21 July 2010, was in fact the lawful consequence of KPM's and TNG's misconduct under the Contracts and hence no direct expropriation.[9]

21 However, if one assumes for the sake of argument that there was a case of direct expropriation on 21 July 2010, it is clear that 21 July 2010 would have to be the valuation date for such direct expropriation. The international law standard of compensation for expropriation prescribes the date of the expropriation as the valuation date. Moreover, in the practice of international tribunals, the valuation date of direct expropriations is usually identical to the date of the respective state act.[10]

22 Even if a direct expropriation becomes effective only at a later date, the date of the state act that is deemed to be directly expropriatory is decisive. For example, the Iran-US Claims Tribunal stated, in relation to the nationalisation of the Iranian insurance industry by the law of 25 June 1979, almost self-evidently, that

> *"the relevant date for valuation is that of the nationalization, 25 June 1979".*[11]

23 In the present case, the respective State act, i.e. the decision to terminate Contracts No. 210 and 305[12] was taken on 21 July 2010. Therefore, 21 July 2010 should be regarded as the appropriate date for valuation.

---

8 Claimants' Reply on Jurisdiction and Liability, paras. 449 et seqq.

9 Respondent's Rejoinder on Jurisdiction and Liability, paras. 879 et seqq.

10 *Marboe*, Calculation of Compensation and Damages in International Investment Law, Oxford International Arbitration Series, 2009, p.127 (**Exhibit R-324**).

11 *American International Group, Inc. and Amercian Life Insurance Company v. Iran*, Award No. 93-2-3, 4 Iran-US Cl. Trib. 96, 106 (**Exhibit C-51**).

12 Order No. 255 of the Ministry of Oil and Gas (**Exhibit C-189**).

III. 21 July 2010 is the proper valuation date regarding the alleged indirect expropriation

24 Claimants also allege an indirect expropriation based on a wide variety of events following a presidential "order" of 14 October 2008. According to Claimants, the date of this presidential "order" must be taken as the valuation date for their indirect expropriation claim.

25 In response, the Republic first of all points out that – as it was shown and explained in detail in the Republic's Rejoinder Memorial on Jurisdiction and Liability – it did not indirectly expropriate Claimants.[13]

26 Moreover, the Republic rejects Claimants' suggestion for an improperly early valuation as of 14 October 2008 and submits that also with regard to Claimants' indirect expropriation claim, 21 July 2010 is the only conceivable valuation date.

1. Under international law, the valuation date is to be determined with a view to the actual expropriatory effect

27 International practice indicates that in cases of indirect expropriation, the valuation date must be identified at a relatively late stage, that is, when the deprivation of property rights has turned out to be irreversible. It is this point in time that usually represents the valuation date and that is usually situated only at the end of a chain of actions and omissions by the state.[14]

28 The Iran-US Claims Tribunal, for example, held in the case of *International Technical Products v. Iran*:

> *"Where the alleged expropriation is carried out by way of a series of interferences in the enjoyment of the property, the breach forming the cause of action is deemed to take place on the day when the* ***interference has ripened into more or less irreversible deprivation*** *of the property*

---

13 Respondent's Rejoinder on Jurisdiction and Liability, paras. 899 et seqq.

14 Cf. *Marboe*, Calculation of Compensation and Damages in International Investment Law, Oxford International Arbitration Series, 2009, p.135 (**Exhibit R-324**), with further references.

rather than on the beginning dated of events".[15] *(emphasis provided)*

29 This position was also taken in the *Tippets* case:

> *"While assumption of control over property by a government does not automatically and immediately justify a conclusion that the property has been taken by the government … such a conclusion is warranted* ***whenever events demonstrate that the owner was deprived of fundamental rights of ownership*** *and it appears that this deprivation is not merely ephemeral".*[16] *(emphasis provided)*

30 In another case, *Philips Petroleum v. Iran*, the Iran-US Claims Tribunal also held that

> *"…where the taking is through a chain of events,* ***the taking will not necessarily be found to have occurred at the time of either the first of the last such event,*** *but* ***rather when the interference has deprived the Claimant of fundamental rights of ownership*** *and such deprivation is 'not merely ephemeral', or when it becomes an 'irreversible deprivation'".*[17] *(emphasis provided)*

31 Likewise, in the ICSID Case of *Santa Elena v. Costa Rica*, the tribunal stated that:

> *"[t]he expropriated property is to be evaluated as of the* ***date on which the government 'interference' has deprived the owner of his rights or has made those rights practically useless****".*[18] *(emphasis provided)*

---

15 *International Technical Products Corporation vs. Iran*, 9 Iran-US Cl. Trib. Final Award, IUSCT Case No. 302 (196-302-3), 28 October 1985 in Albert Jan van den Berg (ed), Yearbook Commercial Arbitration 1987 - Volume XII, pp.343-344 (**Exhibit R-325**).

16 *Tippetts, Abbett, McStratton v. TAMS-AFFA*, Iran U.S. Claims Tribunal Case, Award No. 141-7-2, 29 June 1984, p.5 (**Exhibit C-225**).

17 *Phillips Petroleum vs. Iran*, Iran-US Cl. Trib., Award No. 425-39-2, para 101 (**Exhibit C-158**).

18 *Compania del Desarrollo de Santa Elena S.A. v. Costa Rica*, ICSID Case No. ARB/96/1, 39 I.L.M 1317 (2000), para. 78 (**Exhibit C-213**).

2. Looking at the alleged expropriatory effect, only 21 July 2010 is appropriate as valuation date

32 Taking into account the above enumerated principles of international law, the proper valuation date for the allegation of indirect expropriation is 21 July 2010. Only on this day could Claimants have possibly been deprived of their rights of ownership in KPM and TNG.

33 Claimants refer to four allegedly expropriatory measures taken by the Republic prior to 21 July 2010:

(a) Firstly, according to Claimants, the Republic allegedly interfered with the day-to-day management of KPM and TNG when the Financial Police *"commandeered"* KPM's and TNG's offices from October 2008 to March 2009;[19]

(b) secondly, the Republic allegedly deprived Claimants of their ability to manage their companies by arresting KPM's General Director in April 2009 and *"hunting"* other KPM and TNG senior officials;[20]

(c) thirdly, the cumulative effect of Kazakhstans's alleged harassment campaign, including the refusal to execute the extension of Contract No. 302, supposedly deprived Claimants of their ability to prove their reserves;[21]

(d) finally, the Republic's alleged reversal of its pre-emptive rights waiver and its supposed announcement of irregularities are said to have deprived Claimants of their ability to dispose of their investment.[22]

34 However, none of these alleged actions either for themselves, or taken in conjunction, amount to an indirect expropriation. Hence, neither of these dates can serve as the valuation date in the present case:

(a) The Republic already explained in it Rejoinder Memorial on Jurisdiction and Liability that the interference with the management through audits, inspections and investigations was minimal, that

---

19 Claimants' Reply on Jurisdiction and Liability, para. 476.

20 Ibid., para. 477.

21 Ibid., para. 478.

22 Ibid.

their were less audits and inspections of KPM and TNG than of comparable firms and that the state took all necessary measures not to disturb daily business.[23] The audits, inspections and investigations could hence not have had any expropriatory effect.

(b) No "*hunting*" of KPM's and TNG's representative occurred. Moreover, KPM and TNG had managers appointed by Claimants until the contracts were terminated on 21 July 2010. In addition, Claimants had full control of the daily business from their base in Moldova. This is evidenced, for example, by the testimony of Mr. Pisica who explained at the October hearing that he was in contact with KPM's and TNG's offices and was given incoming and outgoing documents, so that he could analyse the situation on a daily basis.[24]

(c) Claimants' reference to the non-extension of Contract No. 302 is the most brazen suggestion in the context of indirect expropriation. Claimants themselves have effectively admitted that they had no right to demand an extension; instead, Claimants argue that the state's refusal to extend was made in bad faith.[25] According to Claimants' own case, there is thus no right that they could have been deprived of. This undermines any expropriation claim.

(d) Claimants have not proven that any potential buyer refrained from buying the companies because of the revocation of the pre-emptive rights waiver. Instead, several potential buyers gave testimony to the Tribunal and they all referred to other reasons for their ultimate lack of interest – in each case reasons outside of the sphere of influence of the Republic.[26]

---

23 Respondent's Rejoinder on Jurisdiction and Liability, para. 291, Second Witness Statement of Arman Rakhimov, paras. 4.13-4.16.

24 Testimony of Mr. Pisica, Transcript Day 2, p.67, lines 4-17.

25 Claimants' Reply on Jurisdiction and Liability, para. 242; Claimants' Statement of Claim, paras. 175 et seqq.

26 Cf. Witness Statement of Mr. Chagnoux, paras. 2.4 et seqq.; Witness Statement of Mr. Suleimenov, paras. 2.12 et seqq. The witnesses also confirmed their statements at the hearing in October, cf. Transcript Day 4, p.1 et seqq. and p.122 et seqq. At the hearing, Dr. Kim of KNOC also confirmed that circumstances outside the Republic's influence made them not enter into a purchase agreement, cf. Transcript Day 6, p.19, lines 3-14, and p.21, line 16 - p.22, line 19.

35 As a result, assuming that there was indeed an indirect expropriation, only the day of the actual termination of the subsoil use contracts can possibly be seen as the valuation date in the present case.

3. Claimants cannot name any specific state action against them associated with their choice of valuation date

36 Interestingly, instead of clearly defining when and by what measures they consider themselves to have been expropriated, Claimants avoid the issue. They do not rely on any of the measures set out above. Instead, they rely on a date prior to any of these allegedly expropriatory acts, namely the date of 14 October 2008, when President Nazarbayev forwarded President Voronin's letter to the Financial Police.[27]

37 To support their suggestion, Claimants apodictically postulate that in case there is a "*campaign of unlawful, interfering measures*" by the host state "*equity and full compensation fairly demand that the intentional commencement date of that campaign be chosen as the valuation date*."[28] Thus, Claimants make fully clear that under their own argument, the Tribunal can only rely on 14 October 2008 as the valuation date if it actually finds that there was a harassment campaign against Claimants. This alone is fatal to their valuation date because, as the Republic explained in its Rejoinder Memorial on Jurisdiction and Liability,[29] and as the Republic's witnesses at the hearing in October confirmed, there was no such harassment campaign.

38 Irrespective of this fact, international law neither supports Claimants' apodictic statement and their choice of valuation date. To begin with, Claimants cite no case in which alleged government intentions or an internal government letter prior to any actual state action would have been considered a proper valuation date by a tribunal. The Republic is not aware of such case. Given the clear practice of international tribunals set out above,[30] the non-existence of such case comes as no surprise and the

---

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

28 Claimants' Reply on Jurisdiction and Liability, para. 615.

29 Cf. Respondent's Rejoinder on Jurisdiction and Liability, paras. 272 et seqq.

30 Cf. above paras. 27 et seqq.

Republic submits that the present Tribunal should not be the first tribunal deviate from this practice.

39 Furthermore, the authorities Claimants rely on do not support their early valuation date.

40 For example, Claimants support their improper choice of valuation date by citing the *Sedco v. NIOC* decision of the Iran-U.S. Claims Tribunal. In this case, the state first appointed temporary managers for the companies in question before outright nationalising the companies. The tribunal thus held that

> *"when the seizure of control by appointment of 'temporary' managers clearly ripens into an outright taking of title, the date of appointment presumptively should be regarded as the date of taking"*.[31]

41 This case does clearly not support Claimants' position because it describes a much harsher state interference as could possibly be argued in the present case. As the Claimants themselves admit, no temporary managers were appointed in the present case.[32] Moreover, the level of state interference never came remotely close to such harsh interference as the appointment of temporary managers by the state. Claimants constantly remained able to control their assets, were able to create sizeable income in the time prior to the termination of the contracts and even had the companies pay out dividends for Claimants' benefit.[33]

42 Further, the Claimants try to support their choice of a valuation date by citing Professors *Reisman* and *Sloan*.[34] However, Claimants can only find support from these authorities by being very "picky" when choosing citations. Namely, Claimants completely disregard Professor *Reisman's* and Professor *Sloan's* clear denunciation of improperly early valuation dates:

---

31 *Sedco Inc. vs. NIOC*, Interlocutory Award No. 55-129-3, 28 October 1985, 9 Iran-U.S. Cl. Trib. Rep. 248, Section III.B.3. (at the end) (**Exhibit C-597**).

32 Claimants' Reply on Jurisdiction and Liability para 613.

33 Cf. below paras. 442 et seqq.

34 Claimants' Reply on Jurisdiction and Liability, para. 614.

> *"[A]ll this is not to suggest, however, that investors should, or should be entitled to, cry 'expropriation' at the first sight of adverse governmental conduct"*.[35]

43 However, this is precisely what the Claimants try to do: they cry "expropriation" at the earliest moment because this seems most convenient and profitable to them. The Republic submits that the Tribunal should not support such approach.

44 In order to hide their lack of supporting authority, Claimants also try to rely on the accepted principle of full compensation which requires wiping out the effects of expropriatory state action as set out in the *Chorzów* case.[36] While the Republic agrees to the applicability of this principle, it objects to the suggestion that this principle would support Claimants' improperly early valuation date. Full compensation and wiping out the effects of expropriatory state action do precisely not require using a valuation date on which, objectively, no state measures could have affected KPM and TNG. Rather, wiping out the effects of expropriatory state action *presupposes* that there are measures with actual effect on the companies, not mere purported intentions of state bodies. Thus, also under *Chorzów* principles, the Tribunal should rely on actual state conduct and not on the beginning of some purported harassment campaign.

45 Moreover, when applying the *Chorzów* principles, the Tribunal should be mindful not to award double compensation. Yet, relying on an unduly early valuation date such as 14 October 2008 would have just that consequence. As will be set out in detail below, KPM and TNG were producing oil and gas and were creating income for Claimants up until the termination of the contracts on 21 July 2010. Thus, Claimants' improperly early valuation date leads to double counting of income running into hundreds of millions of USD.[37] This further undermines any suggestion that the valuation date should be set prior to 21 July 2010.

46 In an act of desperation, Claimants suggest that President Nazarbayev's 14 October 2008 *note "was in and of itself a violation of the ECT's fair and*

---

35 *Reisman/Sloan*, Indirect Expropriation and its Valuation in the BIT Generation, 74 BRIT. Y.B. INT'L L. 115 (2004), p.44 (**Exhibit C-230**).

36 Claimants' Reply on Jurisdiction and Liability, paras. 607 et seqq.

37 For a more detailed calculation of potential overcompensation, cf. below paras. 442 et seqq.

equitable treatment standard, most constant protection and security, and impairment provisions."[38] This argument is obviously absurd, and that for several reasons:

(a) To begin with, the argument is absurd because a mere note containing an instruction to investigate possible illegal conduct is regular state business and not a fundamental breach of international law.

(b) The argument is even more absurd because apparently, Claimants are suggesting that the President's note alone caused them upwards of USD 2 billion of damage.

(c) However, what is most absurd about the argument is the fact that apparently, Claimants themselves do not consider President Nazarbayev's note to amount to an indirect expropriation. Nonetheless, Claimants still claim that they should be compensated as if the order had the effect of such indirect expropriation. This cannot be correct.

[38] Claimants' Reply on Jurisdiction and Liability, para. 609.

C. The Republic's valuation as of 21 July 2010

I. Contract 302 Properties

47 The most blatant instance of Claimants inflating their damage claim is their valuation of the Contract 302 Properties. Claimants do not stop short of ignoring logic, universally accepted principles of valuation and their own conduct at the time of events to arrive at a blown up claim of USD 1.58 billion. A thorough valuation, however, can lead to no other conclusion but that the value of the Contract 302 Properties is zero.

48 The series of flaws in Claimants' Contract No. 302 claim is impressive in itself and speaks volumes about the brazenness with which Claimants try to trick their way into obtaining compensation where no compensation is due:

(a) Claimants argue that the Republic agreed to extend Contract No. 302 and thus refused to extend the contract in bad faith.[39] In fact, however, Contract No. 302 was never extended beyond 30 March 2009 and the Republic was under no obligation to grant such extension, as Claimants have effectively admitted.

(b) Even assuming that the Republic agreed to an extension of Contract No. 302, no compensation can be granted. Claimants fail to consider that in their own application for extension, they did not plan for any exploratory work on the so-called "Interoil Reef". Without such exploratory work, no discovery could have been made on the Interoil Reef. This in turn means that in any event, the contract would have ended with regard to the Interoil Reef on 30 March 2011 and that no production would ever have been started there. This manifestly undermines the Contract No. 302 claim because the Interoil Reef contains 93% of all prospective gas reserves Claimants allege to exist in the Contract 302 Properties.

---

[39] Claimants' Statement of Claim, para. 179; Claimants' Reply on Jurisdiction and Liability, paras. 240 et seqq.

(c) Even disregarding the fact that Claimants did not plan to explore the Interoil Reef, the value of the Contract 302 Properties still remains zero. That is because the geological chance of success of the supposedly large Interoil Reef is, at most, 5%. Claimants cannot contest this number because it was provided by their own expert Ryder Scott.[40] What they do instead is to simply disregard this minimal geological chance of success in their valuation and to instruct their valuation expert FTI Consulting to do the same. In so doing, Claimants ignore the universally accepted principle of valuation that potential risks – and especially huge risks such as the geological risk of the Interoil Reef – have to be taken into account.

49 Consequentially, as will be set out in more detail in the following, the Contract 302 Properties, and the Interoil Reef in particular, have turned out to be worthless and Claimants have saved and not lost money by not developing them.

50 Grasping for the last straw, Claimants try to hide the worthlessness of the Contract 302 Properties behind the legal argumentation of a so-called claim for "loss of opportunity". While in itself not an accepted concept in international law, the casting of their claim as a "loss of opportunity" does not help Claimants. The Contract 302 Properties are worthless and no legal concept can create damages where none exist.

1. Overview of the Contract 302 Properties

51 The Contract 302 Properties consist of several areas of different size and with different prospects of success, namely:

(a) Bahyt;

(b) Munaibay Main;

(c) Munaibay North;

(d) Tabyl;

(e) Tabyl West; and

[40] The Republic's experts of GCA estimate the geological chance of success for the Interoil Reef to be an even lower 4%, cf. GCA Technical Report, para. 102.

(f) the Interoil Reef (also referred to as the "Carboniferous Reef").

2. The Contract 302 Properties are Worthless

a) Primary Valuation Scenario: Expiration of exploration period

52 TNG's exploration licence and the corresponding subsoil use contract for the Contract 302 Properties expired on 30 March 2009 and thus prior to the valuation date of 21 July 2010. As explained in the Rejoinder Memorial on Jurisdiction and Liability, both the licence and the corresponding contract were not renewed.[41] Therefore, TNG was not entitled to explore the Contract 302 Properties. [42]

53 Without any entitlement to explore the Contract 302 Properties and without any licence for development, their prospective value is zero.[43]

b) Secondary Valuation Scenario: Extension of the exploration period according to TNG's 14 October 2008 application

54 Even if it is assumed for the sake of argument, that Claimants application for an extension of the exploration period under Contract 302 had been granted – which it was not – the alleged Interoil Reef would still have no value for Claimants.

55 That is because in its application, TNG submitted a working programme which was limited to exploration work on Munaibay and Bahyt. Consequently, TNG could only have made additional discoveries on these prospects. As a result, TNG would have been obliged to relinquish the rest of the contract area, including the area with the supposedly valuable Interoil Reef, to the Republic by 30 March 2011.

---

41 Cf. Respondent's Rejoinder on Jurisdiction and Liability, paras. 411 et seqq.

42 In fact, Claimants may be reminded that they still have not fulfilled their obligaton of returning the Contract Area to the Republic as set out in paragraph 439 of the Rejoinder on Jurisdiction and Liability.

43 Deloitte & Touche Expert Report, para. 325.

aa) TNG's application contained a working programme which was limited to exploratory work on Munaibay and Bahyt

56 By letter of 14 October 2008, TNG applied for an extension of the exploration period under Contract 302 by two years until 30 March 2011.[44] In this application, TNG specified the working programme, i.e. the exploration work on the Contract 302 areas it intended to undertake over the course of the extended exploration period.

57 The working programme is not only a commitment but it also limits the scope of possible exploration work. Any work project not specified in the working programme cannot be undertaken without specific approval from the competent authorities.

58 The Republic's experts Gaffney, Cline & Associates (GCA) give an overview of the exploration that TNG committed and thereby also limited itself to undertake during the extension period until 30 March 2011:

> *"This plan outlined the completion of two wells (Munaibay-1 and Bahyt-1) and the commencement of (but not completion) of another two wells (Munaibay-2 and Bahyt-2) prior to the end of the extension period (31st March, 2011)."*[45]

59 It is obvious that while TNG intended to conduct some exploration work on Munaibay and Bahyt, it did not intend to undertake any exploration work on the other prospects, in particular in the area where Claimants speculate a structure they call the Interoil Reef exists.

bb) Any area without discovery and respective application for a development licence needs to be relinquished at the end of the exploration period

60 Assuming that TNG's application for an extension had been granted, TNG would have been obliged to conduct the intended work on Munaibay and Bahyt but would also have been obliged not to conduct any exploration work on the other Contract 302 areas and in particular the Interoil Reef.

---

44 Application from TNG to the MEMR of 14 October 2008 (**Exhibit C-67**).

45 GCA Supplemental Technical Report, para. 80.

61 This means that even if TNG's application had been granted, TNG could only possibly have made any discoveries on Munaibay and Bahyt but not on the Interoil Reef or any other areas of the Contract 302 properties.

62 Whether a discovery is made is of utmost importance for the prospects of subsoil user. Subsoil users can only apply for a prolongation of the contract with regard to those areas in which discoveries have been made (and for which commercialisation has been indicated). These specific areas will be carved out and the subsoil user can apply for a conversion to a development license. The rest of the contract area that is not carved out for appraisal needs to be returned to the Republic.

63 TNG's Contract No. 302 explicitly stipulates this principle. Under section 4.2, it states:

> *"Relinquishment of contract area: the Contractor has the right to relinquish at any time the whole or a part of the Contract Area, provided, however, that he has fulfilled all the requirements set forth in the License and this Contract.* ***Pursuant to the License requirements, the Contractor shall relinquish to the Republic at the expiration of the first phase of Exploration Period 25 % (twenty- five per cent) of the Contract Area and the remainder at the expiration of second phase of the Exploration Period, except for the territory of Commercial Discovery and Appraisal area.****"*[46] (emphasis added)

64 As only a maximum of two extensions for the exploration period are permissible,[47] TNG's exploration would in any case have ended on 30 March 2011. TNG could only enter the appraisal phase if it made a commercial discovery. This is described in section 8.1 of Contract No. 302:

---

46 Contract No. 302 issued pursuant to the License for the right to use subsoil, series NG No. 243-D (**Exhibit C-53**).

47 Cf. section 3.3 of Contract No. 302 (**Exhibit C-53**): *"Under the provisions of the License, the Exploration Period is made of 6 years from the date such License becomes effective. Exploration Period can be extended by no more than two periods of up to two years each upon mutual agreement of the Parties, in accordance with the current Legislation, provided, however, that the Contractor shall submit to the Competent Body a new Minimum Work Program."*

> *"If the Contractor discovers an oil Deposit, which, in its opinion, is economically sound for conduct of appraisal operations, the latter shall immediately inform the Competent Body of this deposit and within 60 (sixty) days shall prepare the application for introduction of the Appraisal Stage and the Appraisal Program and submit them to the Competent Body for approval in accordance with the item 3.4 of this Contract."*[48]

65 It is noteworthy that the discovery does not only concern oil deposits but also gas deposits. Claimants' translation is incorrect in that it uses the word "*oil deposit*". In the original Russian version, the word oil does not appear. It only says "Месторождение" (Mestorozhdenie) which means deposit and thus refers to both oil and gas deposits.

66 As stated above,[49] any such discovery could only have been made on Munaibay and Bahyt as TNG would only have been allowed to conduct any exploratory work on these two areas.

67 The contract is very explicit as to what happens to parts of the Contract area on which no discovery is made and thus no application to enter into the appraisal stage can be made:

> *"If following the conduct of Exploration Operations the Contractor shall not declare a Commercial Discovery on terms established in item 8.4 of this Contract, the latter shall have no right to reimbursement of its expenses incurred during the Exploration and/or Production Testing and* ***shall lose all its rights to the Field****. Such a Field shall be subject to relinquishment to the Republic."*[50] (emphasis added)

68 Thus, even if TNG's application for an extension of the exploration period had been granted – which it was not –, TNG would in any case have needed to return the whole Contract 302 properties apart from Munaibay and Bahyt

---

48 Contract No. 302 issued pursuant to the License for the right to use subsoil, series NG No. 243-D (**Exhibit C-53**).

49 Cf. above paras. 56 et seqq.

50 Contract No. 302 issued pursuant to the License for the right to use subsoil, series NG No. 243-D, Section 8.9 (**Exhibit C-53**).

and possibly Tabyl by 30 March 2011 to the Republic. Naturally, this means, that TNG could not expect to get any return on investment on the Interoil Reef.

cc) It was foreseeable on 14 October 2008 that TNG could not possibly conduct any production on the Contract No. 302 area apart from Munaibay and Bahyt

69 It is also clear that already on 14 October 2008, Claimants must have been aware that they would only possibly be able to enter into the appraisal stage and thus possibly later into production for Munaibay and Bahyt but not for the Interoil Reef.

70 Claimants' chosen valuation date is exactly the date on which TNG submitted its application for an extension of the exploration period and TNG specifically only applied for conducting exploration work on Munaibay and Bahyt.

71 As Claimants must have been aware that they would have to return the Contract 302 properties apart from the areas in which discoveries are made, they must also have been perfectly aware that they could not expect to ever produce oil or gas from the Interoil Reef.

72 In any case, an informed third person would have known this as the terms of the contract on this issue are crystal clear.

dd) Ryder Scott and FTI Consulting completely disregard TNG's application for extension

73 Nonetheless, Ryder Scott – in their assumed drilling plans – and FTI Consulting – which base their valuation on these drilling plans – disingenuously ignore TNG's application of 14 October 2008. This becomes clear from a chart provided by the Republic's expert GCA which compares the number of wells that Ryder Scott have suggested and the actual number of wells in TNG's application:[51]

[51] GCA Supplemental Technical Report, para. 88, Table 1.

Drilling Schedule	2009	2010	2011	2012	2013
RS + FTI Schedule					
Tabyl Main	2 + 3	4	-	-	-
Munaibay Main	2 +2	9	10	9	9
Tabyl West	2	3	-	-	-
Munaibay North	2	3	1	-	-
Carboniferous Reef 6,000 m	2	2	1	1	2
Carboniferous Reef 8,000 m	-	1	2	1	1
Carboniferous Reef 10,000 m	-	1	1	2	1
Bahyt	2	2	2		
Total	**17**	**25**	**17**	**13**	**13**
TNG Extension[52]					
Tabyl Main	-	-	-	-	-
Munaibay Main	0.13	0.22	0.22	-	-
Tabyl West	-	-	-	-	-
Munaibay North	-	-	-	-	-
Carboniferous Reef 6,000 m	-	-	-	-	-
Carboniferous Reef 8,000 m	-	-	-	-	-
Carboniferous Reef 10,000 m	-	-	-	-	-
Bahyt	0.33	-	0.33	-	-
Total	**0.46**	**0.22**	**0.55**	**-**	**-**
GCA Schedule					
Tabyl Main	-	-	-	-	-
Munaibay Oil	-	1+5	6	6	6
Munaibay Gas	-	1	-	3	3
Tabyl West	-	-	-	-	-
Munaibay North	-	1	1	-	-
InterOil Reef	-	-	-	1	1
Bahyt	-	1	1		
Total	**0**	**9**	**8**	**10**	**10**

74 As is obvious from the chart, the Ryder Scott and FTI Consulting Schedule bears no resemblance to the working programme that TNG actually committed itself to. This manifestly undermines Claimants' damage claim with regard to the Contract 302 Properties.

75 If FTI Consulting and Ryder Scott had provided genuine assessments, they could not have ignored TNG's application of 14 October 2008.

76 Ryder Scott and FTI Consulting were asked by Claimants to make their assessments as of 14 October 2008 and thus as of the very day on which TNG submitted its applicaton for an extension of the exploration period

[52] Footnote by GCA: *"Wells are recorded as part wells. In 2009, it was planned to complete Munaibay-1 and Bahyt-1. TNG planned to start operations at Munaibay-2 in 2010 and continue drilling in 2011 (0.22 + 022), and to commence drilling Bahyt-2 in 2011. Neither Munaibay-2 nor Bahyt-2 were scheduled to be completed prior to the end of the Exploration Extension (31st March, 2011). Hence 0.22 + 0.33."*

under Contract No. 302. Clearly, on 14 October 2008, Claimants could in no case expect to be granted more than what they applied for.

77 In fact, FTI Consulting make very clear what they were asked to do by Claimants with regard to the valuation of the Contract 302 area:

> *"We have been asked to conduct a valuation of the Contract 302 Properties and the LPG Plant based upon the assumption that the Claimants would have been permitted to explore and prove the Contract 302 Properties without interference from the Kazakhstan Government, and that they would have processed the extracted gas, in combination with gas from Borankol and Tolkyn field, in the newly built LPG Plant."*[53]

78 FTI Consulting were asked to assume that Claimants would have been admitted to explore and prove the Contract 302 properties without interference from the Republic. However, the one alleged interference that Claimants complain of regarding Contract No. 302 is the non-extension of the exploration period.

79 If FTI Consulting really intended to conduct the valuation based upon the assumption that Claimants could have explored without the alleged interference from the Republic, they clearly would have needed to apply the situation that would exist if TNG's application for the extension had been granted.

80 If TNG's application had been granted, Claimants could not simply have conducted the extensive and unrealistic drilling that Ryder Scott suggest. Instead, as stated above, TNG would have been bound by its own working programme. This is the scenario that FTI Consulting would need to base its valuation on.

81 Any valuation of the Contract 302 properties therefore needs to take into consideration that Claimants would have needed to return everything but the Munaibay and the Bahyt prospects and possibly the Tabyl Oil prospect at the latest on 30 March 2011 and this before any revenues could possibly be achieved.

---

[53] FTI Consulting Expert Report, para. 15.1.

82 Hence, FTI Consulting would have needed to come to a valuation of the Interoil Reef of zero. However, FTI Consulting attempt to avoid this by simply ignoring TNG's actual application for an extension and by assuming a drilling plan which TNG never planned and which TNG would never have been approved to implement as they never applied for it.

83 The Tribunal should not allow Claimants to once again ignore reality by making spurious assumptions.

c) Third Valuation Scenario: Extension of the exploration period irrespective of TNG's 14 October 2008 application

84 Even if the exploration period had been extended – which it was not – and TNG's application dated 14 October 2008 had not limited the exploration to Munaibay and the Bahyt areas – which it did –, the prospective value of the Contract 302 Properties would still be zero. This follows from three main reasons:

(a) Geological chance of success (GCoS) and economic chance of success (ECoS) are very low for the Interoil Reef.

(b) Capital expenditure for the exploration of the properties, and in particular of the Interoil Reef, would have been exorbitant, given the specific geological conditions of this supposed reservoir.

(c) The exploration of the properties, and in particular of the Interoil Reef, would have taken several years. During this time, costs would have accrued but no income would have been made. The costs of financing thus further decrease the profitability of any business venture on the Contract 302 Properties.

85 As the Republic's expert Deloitte demonstrates, the Interoil Reef in particular is an overall unprofitable investment opportunity.[54]

86 Based on the figures provided by GCA, Deloitte calculated a negative value for the Interoil Reef area of USD -83.7 million as at the valuation date of 21 July 2010.[55]

---

54 Deloitte & Touche Expert Report, para. 440.

55 Deloitte & Touche Expert Report, para. 439.

aa) Vanishingly low chance of success

87 The main reason for the negative values calculated by Deloitte is the vanishingly low probability that there are reserves to be found in the Contract 302 Properties (so-called "GCoS" or "Geological Chance of Success"). Importantly, both parties' geology experts agree that the chances of finding reserves in the Interoil Reef, taking up 93% of prospective gas resources[56] and thus by far the largest part of Claimants' Contract No. 302 claim, are marginal. Ryder Scott places the geological chance of success at 5%,[57] GCA at 4%.[58] In other words, both experts agree that in at least 19 out of 20 cases, no reserves would be found in the Interoil Reef. Considering further factors such as uncertainty about the reservoir quality, technical limitations or environmental concerns (part of the so-called "ECoS" or "Economic Chance of Success")[59], there is an even slighter probability that such reserves could ever be commercially exploited.

88 Under any proper valuation method, this uncertainty has to be factored in. This is usually done by determining an unrisked value for the asset which is then multiplied by the risk factor.[60] Naturally, in the present case, such approach leaves only a fraction of the potential value of the Contract 302 Properties. Under these circumstances, considering the high costs associated with any attempt to develop the properties, no positive value could ever be assigned to them.

89 Faced with this insurmountable obstacle to their Contract 302 claim, Claimants find a surprising "solution": They ignore entirely the risk determined by their own expert Ryder Scott and they instruct their valuation expert to do the same.[61]

---

56 Cf. Respondent's Statement of Defence, para. 52.12, referring to Ryder Scott Expert Report, Exhibit 12.

57 Ryder Scott Expert Report, p.6.

58 GCA Technical Report, para. 102.

59 For a further explanation of the concept of ECoS, cf. GCA Supplemental Technical Report, paras. 16 et seqq.

60 It is precisely for this reason that geology experts provide unrisked oil or gas reserve estimates together with GCoS figures. This has been GCA's practice for many years. Ryder Scott have apparently been following the same approach, as can be seen from publicly available reports of Ryder Scott, cf. Exploration Portfolio Review Blocks A and E prepared for Max Petroleum PLC dated July 2010, p.55 (**Exhibit R-326**).

61 FTI Consulting Expert Report, para. 15.6.

90 Based on Claimants' instruction, FTI Consulting implicitly assumes a probability of 100% or complete certainty that the "*best estimate*" deposits will actually be found when exploring the properties.[62] The values presented by FTI Consulting are thus only seemingly the result of a conventional state-of-the-art valuation exercise and only seemingly represent the value of the Interoil Reef Property. To make things worse, FTI Consulting did not clarify in their reports that their values do not result from a conventional valuation exercise.

91 Claimants thus claim the unrisked value of the Contract 302 Properties as if there were 100% certainty. Such approach is disingenuous and contrary to fundamental valuation principles.

92 The Republic's expert Deloitte uses an analogy to illustrate the unforgiving mistake that Claimants and their expert FTI Consulting makes.[63] Given the low probability of finding deposits, the Interoil Reef exploration project might be compared to a lottery ticket. The holder might win the first prize but the probability of this outcome is not high and he is far more likely to lose his investment. The first prize for the Interoil Reef project is finding the best estimate volume of gas that might be there according to both technical experts Ryder Scott and GCA. Stating that the value of the Interoil Reef is represented best by a discounted cash flow calculation which assumes that 100% of the potential deposits will actually be found and will be developed fully, is equivalent to stating that the lottery ticket is worth the value of the first prize. In the view of the Republic's expert Deloitte, nobody would be prepared to pay the prospective seller the value of the first prize when offered a lottery ticket. The true value of the lottery ticket is only a fraction of the value of the first prize. It is the probabilities of winning or losing as well as the amount of the potential win that determines the true value of the lottery ticket.

bb) High capital expenditure and long time span for development

93 In addition to the minimal chance of success, the development of the Contract 302 Properties is further hindered by the high costs associated

---

62 Deloitte & Touche Expert Report, paras. 115 et seq.

63 Deloitte & Touche Expert Report, paras. 47 and 117.

with its development and the long time-span that the development would take.

94 The length of time it takes to drill exploration, appraisal, and development wells targeted at the prospects and discoveries in the Contract 302 Properties stems from technical and environmental difficulties. The Republic's expert GCA comments:

> *"The wells proposed by [Ryder Scott] in its exploration and appraisal of the InterOil Reef would be some of, if not the, deepest wells drilled to date in Kazakhstan. Only a few wells in Kazakhstan have been drilled to depths of greater than 6,000 m; the deepest that GCA is aware of being the Dolinsakaya UGS-03 well, which is reported to have reached a total depth of 7,006 m, and took 1,403 days to reach that depth. Wells in the challenging Tengiz field are drilled typically to a depth of 5,500 m. Drilling wells to 8,000 m and 10,000 m would represent record breaking achievement in Kazakhstan."*[64]

In these depths, wells encounter an abnormally high pressure which will either cause the well to be lost or to take significantly longer times to drill.[65] Therefore, the development of the Interoil Reef would require very high specification drilling rigs, and other special equipment. Sourcing of drilling rigs capable of drilling to this depth would be difficult and time consuming.[66]

95 In addition to the difficulties associated with the highly demanding depth of the alleged gas or gas condensate reserves environmental issues have to be expected because gas in these depths would most likely contain high quantities of Carbon Dioxide (CO_2) and the highly toxic Hydrogen Sulphide (H_2S).[67] This would require gas sweetening and sulphur disposal facilities.

96 Further, the development would take extensive amounts of time. A necessarily extensive programme of acquisition, processing and

---

64 GCA Supplemental Technical Report, para. 104.

65 GCA Supplemental Technical Report, para. 106.

66 GCA Supplemental Technical Report, para. 110.

67 GCA Supplemental Technical Report, para. 107.

interpretation would take a year.[68] In the following year, the exploration well could be drilled (assuming that a well location could be selected, the well could be designed and get approval of the authorities).[69] If this well were successful, the results of such a well would be analysed, and possibly one or more appraisal wells drilled in the subsequent years.[70] It would take at least a further year to prepare the Field Development Plan, the Environmental Impact Assessment and achieve the necessary regulatory approvals, complete appropriate gas sales agreements and establish a sulphur disposal programme.[71] Finally, there would have to be a three year period to design, procure, construct and commission the facilities and infrastructure before production would commence.[72]

97 In that regard, it should be noted that Ryder Scott's schedule for the Interoil Reef is completely unachievable. Ryder Scott argue that production on the Interoil Reef would start in 2010[73] – i.e. before the prospect could have ever been explored.

98 As Deloitte have shown, all of these additional costs and the delay would render the development of the Contract 302 Properties unprofitable.[74]

3. Claimants' disingenuously rely on the benefit of the doubt

99 Claimants suggest in their Reply Memorial on Quantum that "*the benefit of the doubt concerning the outcome of [the] valuation [of the Contract 302 Properties] must accrue to the Claimants*" because allegedly, the Claimants are the *"victims"* and the Republic is the *"wrongdoer"*.[75] This statement is another brazen attempt to justify their unsustainable Contract No. 302 damage claim which turns the facts of this case on its head.

100 To begin with, there is no actual doubt in the present case. Both parties' experts agree that the geological chance of success for the Interoil Reef is not higher than 5%. Any potential reserve estimate has to be multiplied by

68 GCA Supplemental Technical Report, para. 113.
69 GCA Supplemental Technical Report, para. 114.
70 GCA Supplemental Technical Report, para. 114.
71 GCA Supplemental Technical Report, para. 115.
72 GCA Supplemental Technical Report, para. 116.
73 Cf. FTI Consulting Expert Report, Exhibit L.
74 Deloitte & Touche Expert Report, para. 205.

this exceedingly small probability which greatly diminishes the value of the properties.

101 Moreover, even if there was relevant doubt to be dispelled, Claimants could not rely on any alleged wrongdoing of the Republic in their favour. Claimants themselves did not undertake to explore the Interoil Reef which they now claim to be worth more than USD 1 billion. Their own actions thus hindered Claimants from ever making a discovery on the field before the contract expired on 30 March 2009 or before it would have expired on 30 March 2011, assuming a 2-year-extension. If anyone would have to be blamed for the supposed uncertainty, it would thus be Claimants. Or, in other words: if the Tribunal should have any doubts about the value, Claimants' own apparent lack of interest in exploring the Interoil Reef in 2008 should give good guidance in resolving that doubt in the Republic's favour.

102 In any event, as a matter of international law, the burden of proof lies with Claimants. The principle *actori incumbit onus probandi* is

> *"[t]he broad basic rule of the burden of proof, according to which each party has to prove its own claim or defence [...] in international procedure"*[76].

It is Claimants who allege an entitlement to compensation in the amount of USD 1.58 billion for the Contract 302 Properties. Therefore it is Claimants' task to establish the existence and the extent of that compensation, irrespective of the legal qualification of their claim as one for loss of opportunity or as one for loss of profits.

103 The applicability of the principle *actori incumbit onus probandi* to damage claims has been confirmed by numerous arbitral tribunals in investment treaty cases.[77] The tribunal in *Gemplus v Mexico*, for example, underscored that:

> *"Under international law and the [applicable investment treaties], the Claimants bear the overall burden of*

---

75 Claimants' Reply on Quantum, para. 57.

76 *Kazazi*, Burden of Proof and Related Issues (Kluwer, 1996), p.371 (**Exhibit R-327**).

77 Cf. *Archer Daniels Midland Company and Tate & Lyle Ingredients Americas, Inc. v. United Mexican States*, ICSID Case No. ARB(AF)/04/5, Award, 21 November 2007, para. 285 (**Exhibit R-280**).

> *proving the loss founding their claims for compensation. If that loss is found to be too uncertain or speculative or otherwise unproven, the Tribunal must reject these claims, even if liability is established against the Respondent."*[78]

The burden of proof on the investor is the main reason why tribunals in investment treaty arbitrations decline to award compensation for future profits.[79]

104 As laid down in further detail below,[80] Claimants have not discharged their burden of proof – neither with respect to a claim for lost opportunity nor with respect to a claim for lost profits.

4. Claim for loss of opportunity

105 Claimants emphasize more than once that their claim is one for lost opportunity.[81] Their insistence stems from a keenness to apply an assumedly more lenient standard of certainty. Yet, the standard of sufficient probability required for a claim for loss of opportunity has not been established by Claimants. Moreover, the concept of loss of opportunity is not even generally accepted by tribunals in investment treaty arbitrations.

a) No general acceptance of the concept of loss of opportunity

106 In their Reply Memorial on Quantum, Claimants insist on their claim for loss of opportunity as if the mere reiteration of the phrase counterbalanced the lack of acceptance shown to this concept by scholars and tribunals alike.

---

78 *Gemplus S.A., SLP S.A. and Gemplus Industrial S.A. de C.V. v The United Mexican States* and *Talsud S. A. v. The United Mexican States*, ICSID Cases No. ARB (AF)/04/3 and ARB (AF)/04/4), Award, 16 June 2010, para. 12-56 (**Exhibit C-309**).

79 *Kantor*, Valuation for Arbitration: Compensation Standards, Valuation Methods, And Expert Evidence, Kluwer Law International 2008, page 79 (**Exhibit R-328**).

80 Cf. below paras. 113 et seqq., 129 et seqq.

81 Claimants' Reply on Quantum, para. 53.

107 The principle of lost opportunity is particularly rejected when an investment project in its early stage is concerned. Professor Marboe explains:

> *"[Awarding compensation for the loss of opportunity] is [...] neither a widely accepted nor a very precise practice."*[82]

The lack of preciseness being criticised by Professor Marboe is the reason why so few tribunals have ever awarded compensation for loss of opportunity in investment treaty arbitrations.

108 Indeed, tribunals have rejected claims for lost opportunity time and again. In *Chevron v Ecuador*, for example, the tribunal observed that

> *"the 'loss of chance' principle does not have wide acceptance across legal systems such that it can be considered a 'general principle of law recognized by civilized nations'. At most it can be said that the "loss of chance" principle is applied in exceptional situations where there exists a 'harm whose existence cannot be disputed but which [...] is difficult to quantify.'"*[83]

The tribunal in *Chevron v Ecuador* found no exceptional difficulties in coming to a conclusion as to what should have occurred but for the breach of the investment treaty and what damages result from these events.[84] Accordingly, the tribunal declined to apply the loss of opportunity principle.

109 The few tribunals which did not reject the concept of loss of opportunity were prudent enough to award comparably minor amounts of compensation. In *Sapphire International v NIOC*, a case on which Claimants place much reliance, the investor was awarded USD 2 million for the loss of opportunity, only 40% of the amount claimed.[85] This amount

---

82 *Marboe*, Calculation of Compensation and Damages in International Investment Law, Oxford International Arbitration Series, 2009, page 116 (**Exhibit R-324**).

83 *Chevron Corporation and Texaco Petroleum Company v. The Republic of Ecuador*, UNCITRAL, Partial Award, 30 March 2010, para. 382 (**Exhibit C-285**).

84 *Chevron Corporation and Texaco Petroleum Company v. The Republic of Ecuador*, UNCITRAL, Partial Award, 30 March 2010, para. 382 (**Exhibit C-285**).

85 *Sapphire International Petrol. Ltd. v. National Iranian Oil Co.*, Award, 15 March 1963, 35 ILR (1967) 189, 190 (**Exhibit C-308**).

contrast starkly with the exorbitant claim of USD 1.58 billion at stake in the dispute at hand.

110 When calculating the amount of lost profits, the tribunal in *Sapphire International v NIOC* took into account

> *"[...] all the risks inherent in an operation in a desolate region, to which it is difficult to gain access and which has an unfavourable climate [and] the troubles [...] which could affect the operation during the several decades [...] during which the agreement was to last."*[86]

These unmanageable risks associated with a long-term investment like Claimants' are the reason why the tribunal in this case awarded only 40% of the amount claimed as compensation.

111 It is also noteworthy that the sole arbitrator in *Sapphire International v NIOC* determined the amount of compensation by reference to his powers *ex aequo et bono*.[87] It is undisputed that in the present arbitration proceedings, the parties have not agreed to vest the Tribunal with such powers. Therefore, the case at present can be distinguished from the case *Sapphire International v NIOC* and the latter does not lend itself as authority.

112 In conclusion, the singular cases in which tribunals have awarded comparatively marginal compensation for the loss of opportunity have not found acclaim by scholars and have not served as guidance to the overwhelming majority of tribunals.

b) Standard of sufficient probability

113 Claimants repeatedly ignore the fact that the standard of sufficient probability applicable to a claim for lost opportunity – although in relative terms lower than the standard of reasonable certainty applicable to a claim for lost profits – is still too high to be established in the present case. In fact, the claim for loss of opportunity is a subcategory of the claim for loss

---

86 *Sapphire International Petrol. Ltd. v. National Iranian Oil Co.*, Award, 15 March 1963, 35 ILR (1967) 189 (**Exhibit C-308**).

87 *Sapphire International Petrol. Ltd. v. National Iranian Oil Co.*, Award, 15 March 1963, 35 ILR (1967) 189, 190 (**Exhibit C-308**).

of profits.[88] Thus, with the exception of the applicable standard, the same considerations hold true.

114 Irrespective of the legal qualification of the investor's claim, tribunals in investment treaty arbitrations seek to ensure that investors are barred from unjustly enriching themselves. Accordingly, the standard of sufficient probability is still high in absolute terms and poses a hurdle to the investor which is difficult to clear.

115 The standard of sufficient probability has been paraphrased as "*very strong chance*"[89] that deposits of commercially workable oil exist in the concession area. A very strong chance is tantamount to a probability of significantly more than 50%. Claimants' own expert submits that the Interoil Reef, representing 93% of the prospective gas resources,[90] only has a GCoS of 5% and its chance of success is even smaller taking into account ECoS. Hence, Claimants have not established with sufficient probability that deposits of commercially workable gas condensate exist in the Contract 302 Properties.

116 In addition to the prerequisite of establishing with sufficient probability the existence and extent of the alleged future profits, tribunals in investment treaty arbitrations have carved out further criteria for loss of opportunity claims.

117 In *Sapphire International v NIOC*, the singular case which Claimants cite time and again, the tribunal emphasized the <u>mutual</u> reliance of investor and state on the probability of future profits:

> "*[T]he plaintiff had an opportunity to discover oil [...] which <u>both</u> parties regarded as very favourable.*"[91]

The tribunal inferred the reliance of the state-owned entity on the probability of future profits from the extensive documentation available

---

88 *Ripinsky/Williams*, Damages in International Investment Law (BIICL, 2008), page 291 (**Exhibit C-307**).

89 *Sapphire International Petrol. Ltd. v. National Iranian Oil Co.*, Award, 15 March 1963, 35 ILR (1967) 188 (**Exhibit C-308**).

90 Respondent's Statement of Defence, para. 52.12, referring to Ryder Scott Expert Report, Exhibit 12.

91 *Sapphire International Petrol. Ltd. v. National Iranian Oil Co.*, Award, 15 March 1963, 35 ILR (1967) 187 (**Exhibit C-308**).

before the concession was made and the required minimum investment.[92] It concluded that the state-owned entity would not have made a concession and required a minimum investment from the investor if they themselves had not relied on the sufficient probability of discovering and commercially exploiting oil.[93]

118 In contrast to the factual background in *Sapphire International v NIOC*, the Republic had not accumulated extensive documentation of the Contract 302 Properties before it granted the exploration license to Claimants. Rather, in Claimants own words, the exploration block had previously been neglected by the Republic.[94] In fact, until these arbitration proceedings were initiated by Claimants, neither the Republic nor KMG EP (which Claimants seek to equate with the Republic) had ever valued the Contract 302 Properties.[95] As far as KMG EP is concerned, they did not valuate the Contract 302 Properties in Phase I of Project Zenith because the exploration block was not included in the assets for sale. Regarding Phase II of Project Zenith, Mr. Suleimenov of KPM EP testified as follows:

> *"[KMG EP] did not carry out the valuation of this block because this block was at the initial stages of prospecting and there were no premises to carry out evaluation because nothing specific was known about it; nothing much had been done by that time, something that would indicate to us the value of this block."*[96]

Mr. Suleimenov's testimony is confirmed by the fact that the Contract 302 Properties play nearly no role in KMG EP's Due Diligence Report of summer 2009. KPM EP and the Republic had thus long neglected the Contract 302 Properties because both considered them unsuitable for valuation and not very promising.

119 Furthermore, every investor venturing into the oil and gas industry of the Republic of Kazakhstan is required to make a minimum investment in

---

92 *Sapphire International Petrol. Ltd. v. National Iranian Oil Co.*, Award, 15 March 1963, 35 ILR (1967) 189 (**Exhibit C-308**).

93 *Sapphire International Petrol. Ltd. v. National Iranian Oil Co.*, Award, 15 March 1963, 35 ILR (1967) 189 (**Exhibit C-308**).

94 Cf. Claimants' Reply on Jurisdiction and Liability, para. 2.

95 Testimony of Medet Suleimenov, Transcript Day 4, p.129, lines 8-9.

96 Testimony of Medet Suleimenov, Transcript Day 4, p.129, lines 10-16.

accordance with a working programme. Hence, the minimum investment requirement under the working programme does not qualify as indication of the Republic's reliance on the probability of discovering and commercially exploiting the Contract 302 Properties.

120 These differences in factual background provide all the more reason why the case *Sapphire International v NIOC* should not serve as guidance to this Tribunal.

121 In summary, Claimants have not cleared the high hurdle of sufficient probability. They have not shown that future profits would have been made and, even less, that the Republic relied thereon.

5. Claim for loss of profits

122 Although Claimants insist that their claim refers to the alleged loss of opportunity instead of a loss of profits, they continue to elaborate on loss of profits and the corresponding standard of reasonable certainty.[97] Taking into consideration that the claim for loss of opportunity is a subcategory of the claim for loss of profits,[98] Claimants apparently seek to establish loss of profits as a fallback position. For the purpose of rebuttal of Claimants' statements regarding loss of profits, the Republic will subsequently discuss its diverging positions with respect to the principle of loss of profits. These concern, in particular, the rejection of lost profits as speculative and the high standard of reasonable certainty.

a) Rejection of speculative lost profits

123 In their Reply Memorial on Quantum, Claimants neglect to mention that it is one of the best settled rules of the law of state responsibility to deny reparation for speculative damage.[99]

---

97 Claimants' Reply on Quantum, para. 59; Claimants' Statement of Claim, para. 430.

98 *Ripinsky/Williams*, Damages in International Investment Law (BIICL, 2008), page 291 (**Exhibit C-307**).

99 *Amoco International Finance Corp. v Islamic Republic of Iran*, Iran-United States Claims Tribunal Case No. 56, Chamber 3, Partial Award, 14 July 1987, para. 238 (**Exhibit C-153**).

124 This rule is reflected in many international arbitral decisions.[100] Professor Marboe explains the reason for the rejection of speculative lost profits where long-term investments in their early stages are concerned:

> *"[A] breach of an investment contract by one party does not inevitably or automatically cause loss of profits to the other party. [...] [I]nvestment contracts are often closely linked to large projects and are dependent on the economic, political, and social situation of the country and other factors. A causal link between the breach and a lost profit is, therefore, difficult to establish. Tribunals would not award 'speculative profits' and tend to reject profits on projects which were only in their early stages."*[101]

To accommodate the economic, political and social vulnerability of a long-term investment project – such as the exploration and exploitation of the Contract 302 Properties over 20 years – investors are therefore required to show that the alleged future profits are not speculative.

125 The Iran-United States Claims Tribunal has repeatedly rejected alleged future profits which they deemed only theoretical.[102] In *Levitt v Iran*, for example, the tribunal commented:

> *"[T]he basis of the claim [...] under this head is highly speculative. [...] By the time the [c]ontract came to an end only the initial stages of clearing and grading had been completed, and no construction work had begun on*

---

100 Cf. *Asian Agricultural Products v Sri Lanka*, ICSID Case No. ARB/87/3, Final Award, 27 June 1990, para. 104 et seq. (**Exhibit C-255**); *American Manufacturing and Trading, Inc. v Zaire*, ICSID Case No. ARB/93/1, Award, 21 February 1997, para. 7.14 (**Exhibit C-256**); *Metalclad Corp. v. The United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award, 30 August 2000, para. 121 (**Exhibit C-226**); *Lemire v Ukraine*, ICSID Case No. ARB/0618, Award, 28 March 2011, para. 246 (**Exhibit C-61**); *Railroad Development Corporation v. Republic of Guatemala*, ICSID Case No. ARB/07/23, Award, 29 June 2012, para. 269 (**Exhibit R-329**).

101 *Marboe*, Calculation of Compensation and Damages in International Investment Law, Oxford International Arbitration Series, 2009, page 110 (**Exhibit R-324**).

102 Cf. *Dadras International v The Islamic Republic of Iran*, Award in Cases Nos. 213/215 (567-213/215-3) of 7 November 1995 in Albert Jan van den Berg (ed), Yearbook Commercial Arbitration 1997 - Volume XXII, Volume XXII (Kluwer Law International 1997) pp. 505 (**Exhibit R-330**).

the buildings. The project had therefore reached only a very early stage."[103]

Consequently, the tribunal in *Levitt v Iran* rejected the claim.

126 The tribunal in *Autopista Concesionada v Venezuela* emphasized that a claim for lost profits is to be rejected if such claim cannot be calculated due to an insufficient base of numbers and projections:

> *"In these circumstances, the Tribunal considers that [the investor's] claim for future profits does not rest on sufficiently certain economic projections and thus appears speculative. Hence, it does not meet the standards for an award of lost profits under Venezuelan law, nor would it meet these standards under international law, if the latter were applicable."*[104]

As a result, the tribunal did not award compensation for the loss of profits.[105]

127 Neutral market participants confirm that exploration blocks in the oil and gas industry cannot be valued due to their speculative character. The testimony of a neutral third person, Dr. Kim of KNOC, provides a good example for the prevailing view in the industry:

> ***Mr. Mohr**: "How many different holdings does your company [currently] have in Kazakhstan? [...]"*
>
> ***Dr. Kim**: "[...] Five."*
>
> ***Mr. Mohr**: "Do you know the approximate value of those holdings?"*
>
> ***Dr. Kim**: "Yes. We have two explorative zones and three production zones, and **with regard to the explorative zones, there is no oil discovered yet, we can't put a value***

---

103 *William J. Levitt v Iran*, 14 Iran-US CTR (1987) 191, para 56 et seq. (**Exhibit R-331**).

104 *Autopista Concesionada de Venezuela CA v Bolivarian Republic of Venezuela*, ICSID Case No. ARB/00/5, Award, 23 September 2003, para 362 (**Exhibit R-42**).

105 *Autopista Concesionada de Venezuela CA v Bolivarian Republic of Venezuela*, ICSID Case No. ARB/00/5, Award, 23 September 2003, para 352 et seq. (**Exhibit R-42**).

> ***on that****; but for the production sites, approximately $900 million.*"[106] (emphasis provided)

The rejection of loss of profits as too speculative by investment treaty arbitration tribunals thus reflects the deficiencies in valuation with respect to exploration fields in the oil and gas industry.

128 In conclusion, the rule of the law of international responsibility of States to deny reparation for speculative damage has been duly followed by investment arbitration tribunals for many years and – especially regarding explorations blocks in the oil and gas industry – with good reason.

b) Standard of reasonable certainty

129 The flipside of the rejection of speculative lost profits is the high threshold of reasonable certainty required by an investor to establish such a claim.

130 This high barrier has been carved out over time and is widely acknowledged. *Kantor* observes:

> *"Some investment treaty arbitration tribunals have set the "reasonable certainty" threshold very high."*[107]

Again, the high barrier has been set to accommodate the economic, political and social vulnerability of a long-term investment project as well as the insufficient base of numbers and projections typical for such an investment project, especially in its early stage.

131 In *Vivendi v Argentina II*, the panel drew attention to the increased economic, political and social exposure of long-term investment projects:

> *"A claimant which cannot rely on a record of demonstrated profitability requires to present a thoroughly prepared record of its (or others) successes, based on first-hand experience (its own or that of qualified experts) or corporate records which establish on the balance of the probabilities that it would have*

---

106 Testimony of Dr. Kim, Transcript Day 6, p.16, lines 10-22.

107 *Kantor*, Valuation for Arbitration: Compensation Standards, Valuation Methods, And Expert Evidence, Kluwer Law International 2008, p.74 (**Exhibit R-328**).

> *produced profits from the concession in question in the face of the particular risks involved, other than those of Treaty violation."*[108]

The tribunal emphasized that an investor must provide convincing evidence of its ability to produce profits in the particular circumstances it faced.

132 According to investment arbitration practice, investors who seek to overcome the high barrier of reasonable certainty with respect to an investment project in its early stage need to show that their project either has a track record of profitability rooted in a perennial history of operations or has binding contractual revenue obligations in place which establish the expectation of profit at a certain level and over a given number of years.

133 These prerequisites are picked up by Crawford's Commentaries on the International Law Commission's Articles on State Responsibility:

> *"In cases where lost future profits have been awarded, it has been where an anticipated income stream has attained sufficient attributes to be considered a legally protected interest of sufficient certainty to be compensable. This has normally been achieved by virtue of contractual arrangements or, in some cases, a well-established history of dealings."*[109]

Hence, scholars and investment treaty arbitration tribunals alike perceive a well-established history of operations or binding contractual revenue obligations respectively to be paramount, in particular with regard to investment projects in the oil and gas industry.[110]

134 In fact, the threshold for reasonable certainty is so high that even in cases where an investment enterprise had a track record of dividends covering more than ten years, compensation for future loss was declined as too

---

108 *Compañía de Aguas del Aconquija and Vivendi Universal v. Argentine Republic*, ICSID Case No. ARB/97/3, Award, 20 August 2007, para. 8.3.10 (**Exhibit C-253**).

109 *Crawford*, The International Law Commission's Articles on State Responsibility, Cambridge University Press (2002), Article 36, page 241 (**Exhibit R-332**).

110 *Kantor*, Valuation for Arbitration: Compensation Standards, Valuation Methods, And Expert Evidence, Kluwer Law International 2008, page 79 (**Exhibit R-328**).

uncertain.[111] Accordingly, the tribunal in the *PSEG v Turkey* case emphasized the significance of a well-established history of dealings:

> *"[I]n cases where lost profits have been awarded [...] this measure has been based on a long history of operations."*[112]

As was remarked in this case, the only way to overcome the lack of a history of operations are binding contractual revenue obligations provided they do not contain price adjustment clauses or other possible variations with time.[113]

135 Claimants have not contended, let alone proven, that they had negotiated binding contractual revenue obligations for their allegedly huge amounts of commercially exploitable gas condensate from the Contract 302 Properties.

136 Even where an enforceable guarantee of purchases over the whole period of the contract is in place, there are numerous risks associated with investment projects in an early stage and these risks reduce their value. One such risk is the creditworthiness of the purchaser.[114] Claimants have not named any purchaser who would have taken their allegedly commercially exploitable masses of gas condensate from the Contract 302 Properties. *A fortiori*, Claimants have not accounted for the risks associated with such purchaser.

137 Furthermore, the tribunal in *Autopista Concesionada v Venezuela* clarified that the standard of certainty applies to both the existence and the amount of lost profits.[115] Unlike Claimants suggest, even the standard of certainty relating to the amount of lost profits needs to be determinable with "*reasonable confidence*".[116] As a matter of course, this second barrier is irrelevant when the investor cannot overcome the first barrier of establishing with reasonably certainty that lost profits exist at all.

---

111 *LG&E Energy Corp. v. Argentina*, ICSID Case No. ARB/02/1, Award, 25 July 2007, para. 39 (**Exhibit C-314**).

112 *PSEG Global et al. v. Republic of Turkey*, ICSID Case No. ARB/02/5, Award, 19 January 2007, para. 311 (**Exhibit C-261**).

113 *PSEG Global et al. v. Republic of Turkey*, ICSID Case No. ARB/02/5, Award, 19 January 2007, para. 312 (**Exhibit C-261**).

114 *Kantor*, Valuation for Arbitration: Compensation Standards, Valuation Methods, And Expert Evidence, Kluwer Law International 2008, p.77 (**Exhibit R-328**).

115 *Autopista Concesionada de Venezuela CA v Bolivarian Republic of Venezuela*, ICSID Case No. ARB/00/5, Award, 23 September 2003, para. 352 (**Exhibit R-42**).

116 *Lemire v. Ukraine*, ICSID Case No. ARB/06/18, Award, 28 March 2011, para. 246 (**Exhibit C-61**).

138 In conclusion, Claimants have not overcome the high barrier of reasonable certainty and have not shown that future profits would have been made. As a result, their claim relating to the Contract 302 Properties must be dismissed.

II. LPG Plant

139 In 2006, Claimants decided to construct an LPG Plant on the Borankol field premises. Claimants may have taken this decision lightheartedly as they intended to pursue their usual *"business model"* of keeping their own financial exposure at a minimum. With an equity investment of merely USD 20 million, Claimants intended to construct a fully operating LPG Plant by the third quarter 2007.[117]

140 For a mere USD 20 million investment it may have been worth the risk but what Claimants ultimately created was a stilborn child. The worth of the LPG Plant, which almost two years after Claimants' projected operation date was still unfinished when Claimants decided to abandon the project, is zero.

141 Speculative from the very beginning, any vague hopes Claimants may have had in obtaining sufficient amounts of gas to economically run the LPG Plant haven proven to be wrong. The minimal amounts of gas from Borankol and the ever decreasing amounts of gas from Tolkyn would only suffice to operate the plant for four years before it would need to be shut in.

142 Assuming that the LPG Plant could be operated with gas from the Contract 302 Properties adds lottery to speculation. Claimants have no right to Contract No. 302 and even under the hypothetical case that their exploration period had been extended, they would still not have been able to economically extract any gas from the Contract 302 area.

143 Claimants demand of compensation for the LPG Plant in the amount of USD 408.5 million or of USD 208.5 million – Claimants do not appear to be certain what the value should be – is baseless.

---

117 Ascom LPG Plant - Business Plan (**Exhibit R-333**).

144 Claimants present two valuation scenarios concerning the LPG Plant. Both of them are undermined by severe factual and methodolical flaws. Claimants' USD 408.5 million claim is based on a prospective value of the LPG Plant with respect to the processing of gas volumes not only from the Borankol and Tolkyn fields but also from the Contract 302 Properties. Thus, this valuation is tainted by the serious flaws depicted above.[118] The USD 208.5 million claim is allegedly determined by applying the net book value – which is no accepted method under international law.

1. The LPG Plant has a negative value

145 The LPG Plant only has a negative value. Due to a lack of gas supply, the plant could only be operated for a period of four years which makes the finishing of the construction uneconomical.

146 Deloitte arrive at a negative value for the unfinished PLG Plant by applying the discounted cash flow method. To perform a discounted cash flow valuation, projections of future sales revenues and expenses are required, including, *inter alia*, the capital expenditure required to build up and further develop the production infrastructure and taxes.[119] The net cash flow derived as the balance of revenues and expenses projected over several years has to be converted into a single amount, the net present value. If a positive amount, the net present value represents the value of an asset. If negative, alternative uses for the asset need to be analysed. These might include liquidation.[120]

147 For Claimants' unfinished LPG Plant, projections of future cash flows clearly indicate that the value is negative.

148 When calculating the net present value of the LPG Plant, it is of decisive significance that the LPG Plant would only operate for four years for lack of sufficient gas supplies.[121] After these four years, capacity utilization will

---

118 See above paras. 47 et seqq.

119 Deloitte & Touche Expert Report, para. 30.

120 Deloitte & Touche Expert Report, para. 30.

121 Deloitte & Touche Expert Report, para. 94.

fall below the minimum level required for technical operation.[122] As a consequence, negative cash flows would be generated.

149 Deloitte make very clear what the decisive factor is:

> *"According to the GCA reports, the LPG plant has an input gas capacity of 7.1 mln m³ per day. Assuming 365 days of operation per year, gas input required to operate the plant at full capacity is approximately 2.59 bln m³ per year (as stipulated by FTI65) and approximately 648 mln m³ to operate the plant at minimum capacity placed at 25% of capacity according to GCA.*
>
> *According to FTI and the witness statement by Mr. Broscaru, the supply to the LPG plant was depending on the gas production of the Tolkyn field and – given the declining production of the Tolkyn field – on the (potential) gas production of the Contract 302 Properties.*
>
> *As is evident from the declining estimated future production of the Tolkyn field and the contingent gas resources of the various Contract 302 Properties, the supply to the LPG plant would depend on the production of the Interoil Reef.* ***The viability of the LPG plant stands or falls with the development of the Interoil Reef property****."*[123] (emphasis added)

150 This means that the viability of Claimants' alleged "*strategic asset*" depended on the development of a structure which even under the Claimants' case has a geological chance of success of a mere 5%, a structure which Claimants could never have explored because their contract expired, a structure which Claimants forewent to explore even if their application for an extension had been granted and a structure which even if it existed could only start producing gas in 2019.[124]

151 Clearly, under such circumstances, no gas from the Interoil Reef could be contemplated for the valuation of the LPG Plant.

---

122 Deloitte & Touche Expert Report, para. 94.

123 Deloitte & Touche Expert Report, paras. 181 et seqq.

124 Cf. above paras. 47 et seqq.

152 Considering the high capital expenditure of USD 100 million to finish the production and the low amount of available gas, the Republic's expert Deloitte has estimated a negative enterprise value of USD -89.8 million for the LPG Plant at the valuation date.[125]

153 Given the negative value based on the projected future cash flow and the fact that the LPG Plant has been partly completed, the value of the LPG Plant may be determined based on the salvage value of its components.[126]

2. Claimants are at best entitled to the Salvage Value

154 In their Reply Memorial on Quantum, Claimants call the assumption of salvage value an "*inappropriate premise*".[127] However, Claimants confuse premise and result. The salvage value is not a premise for compensation but the result of the negative value of the LPG Plant.

155 The salvage value or liquidation value is defined as

> *"the amounts at which individual assets comprising the enterprise or the entire assets of the enterprise could be sold under conditions of liquidation to a willing buyer less any liabilities which the enterprise has to meet."*[128]

The World Bank Guidelines on the Treatment of Foreign Investment recommend using the salvage value for the valuation of companies which do not have a proven record of profitability.[129]

156 Scholars agree that the salvage value must be used when a company lacks a track record of profitability. As Professor Marboe explains:

> *"The liquidation value becomes relevant if the valuation object does not have future profitability and its highest and best use would be the sale of it."*[130]

---

125 Deloitte & Touche Expert Report, para. 463.

126 Deloitte & Touche Expert Report, paras. 32, 37, 55, 91, 97, 208 and 463.

127 Claimants' Reply on Quantum, para. 66.

128 The World Bank, Guidelines on the Treatment of Foreign Direct Investment, Guideline IV(6) (**Exhibit R-334**).

129 The World Bank, Guidelines on the Treatment of Foreign Direct Investment, Guideline IV(6)(ii) (**Exhibit R-334**).

Consequently, tribunals in international arbitrations usually refer to the salvage value if they consider the business to lack future prospects according to a DCF analysis which results in a negative cash flow.

157 The award of the Iran-United States Claims Tribunal in *Eastman Kodak v Iran* is an exemplary decision illustrating the concept of salvage value:

> *"In Eastman Kodak v Iran [...] the Iran-US Claims Tribunal did not accept the book value method as submitted by the claimant. It rather relied on the liquidation value for valuing the plant and equipment. Despite the fact that this represented only a small portion (USD 400.000) of the (inflation adjusted) book value (USD 3.2 million), the tribunal was correct in applying it because the liquidation value better corresponded to the economic reality than the book value."*[131]

The case *Eastman Kodak v. Iran* is not the only example of awards by the Iran-United States Claims Tribunal which determine the salvage value of an expropriated asset.

158 In *Sola Tiles v. Iran* the tribunal awarded the salvage value because it found that the company, which was selling luxury tiles, would not have future business prospects considering the social and economic changes in the wake of the Iranian revolution.[132]

159 The tribunal in *Sedco v. IMICO* referred to the salvage value of the barges in question in order to determine their fair market value. The tribunal also accounted for the outstanding debts of the company so that the investor did not receive any compensation for its expropriated barges.[133]

---

130 *Marboe*, Calculation of Compensation and Damages in International Investment Law, Oxford International Arbitration Series, 2009, p.287 (**Exhibit R-324**).

131 *Marboe*, Calculation of Compensation and Damages in International Investment Law, Oxford International Arbitration Series, 2009, p.274 (**Exhibit R-324**).

132 *Sola Tiles Inc v. Iran*, IUSCT Case No. 317 (298-317-1), Award, 22 April 1987, para. 51 et seq. (**Exhibit R-335**).

133 *Sedco, Inc. v. Iran Marine Industrial Company (IMICO)*, IUSCT Case Nos. 128 and 129 (419-128/129-2), Award, 30 March 1989, para. 45 et seq. (**Exhibit R-336**).

160 In *Tavakoli v. Iran*, the Iran-United States Claims Tribunal valued the different assets on the basis of their achievable sales price which again represented a valuation based on the liquidation value.[134]

161 Finally, Claimants' own expert FTI Consulting shares the view that salvage value is decisive if the business lacks future prospects according to a DCF analysis, resulting in a negative cash flow:

> *"We assume that the plant would not continue to operate under negative cash flow conditions and would be sold to another producer of natural gas."*[135]

Claimants' own expert thus acknowledges that salvage value must be used for the valuation of companies which do not have a proven record of profitability.

162 Therefore, Claimants' and Respondent's experts, scholars and investment arbitration tribunals agree that the salvage value must be determined if a business lacks future prospects reflected by a negative cash flow. The negative value of the LPG Plant as shown by Deloitte's DCF analysis thus means that Claimants can only be awarded its salvage value, if any.

163 According to the principle *actori incumbit onus probandi*, each party has to prove its own claim or defence in international procedure.[136] It is Claimants who allege an entitlement to compensation in the amount of USD 245 million or USD 408 million respectively for the LPG Plant. Therefore, it is Claimants' task to establish the existence and the extent of such compensation.

164 However, Claimants have neglected to calculate the salvage value of the LPG Plant, although they are in the possession of all relevant data. Their failure must redound to Claimants' own disadvantage.

---

134 *Tavakoli v. Iran*, IUSCT Case No. 832 (580-832-3), Award, 23 April 1997, para 129 et seq. (**Exhibit R-337**).

135 FTI Consulting Expert Report, para. 16.5.

136 *Kazazi*, Burden of Proof and Related Issues (Kluwer, 1996), p.371 (**Exhibit R-327**).

3. Prospective value regarding gas volumes from Borankol and Tolkyn fields and from the Contract 302 Properties

165 In their Reply Memorial on Quantum, Claimants have increased their estimate of the LPG Plants' prospective value to USD 408.3 million.[137]

166 According to Claimants' expert FTI Consulting and the witness statement of Mr. Broscaru, the supply of the LPG Plant with gas volumes depends on the gas production of the Tolkyn field and the Contract 302 Properties. Considering the declining production of the Tolkyn field, the value of the LPG Plant stands or falls with the development of the not fully explored Contract 302 Properties, especially the Interoil Reef property.

167 However, Claimants misconceive that TNG was not entitled to explore the Contract 302 Properties at the time of the valuation date. Hence, gas volumes from the Contract 302 Properties could not have been fed into the LPG Plant.

168 Even if TNG had been entitled to explore the Contract 302 Properties – which they were not – the Contract 302 Properties would not have been commercially exploitable. Regarding the Interoil Reef, it is highly uncertain whether the estimated deposits would be found at all (GCoS) and can technically and economically be developed (ECoS). These uncertainties make the LPG Plant a markedly speculative investment.

a) No extension of the exploration period for the Contract 302 Properties

169 TNG's exploration licence and the corresponding Subsoil Use Contract for the Contract 302 Properties expired prior to the valuation date on 30 March 2009. The exploration licence and the corresponding Subsoil Use Contract were not renewed. Therefore, TNG was not entitled to explore the Contract 302 Properties.[138]

170 Since TNG was not entitled to explore the Contract 302 Properties, gas volumes from the Contract 302 Properties could not have been processed in the LPG Plant.

---

137 Claimants' Reply on Quantum, para. 73.

138 Cf. Respondent's Rejoinder on Jurisdiction and Liability, paras. 411 et seqq.

b) It was already foreseeable at Claimants' valuation date that gas from the Contract 302 could not be processed

171 Even under Claimants' valuation date, it would have been clear that no considerable amounts of gas from the Contract 302 area could ever be processed in the LPG Plant. As has been established above,[139] on Claimants's valuation date, TNG applied for an extension of the exploration period which limited itself to exploratory work on Munaibay and Bahyt and therefore forewent any chance – however minimal it was – to develop the Interoil Reef.

c) No gas from Contract 302 Properties because they are not commercially exploitable

172 Even if neither the expiration of the exploration term nor TNG's self-imposed restrictions are taken into account for the sake of argument, as explained above,[140] the net present values of all the Contract 302 Properties are negative. This means it is not profitable to fully explore, assess and develop these properties because the cash flow would not compensate Claimants appropriately for the expenses to be made and the risk to be assumed.[141]

173 Therefore, Claimants could not commercially exploit the Contract 302 Properties and feed gas volumes from the Contract 302 Properties into the LPG Plant.

4. Book value regarding gas volumes from Borankol and Tolkyn fields

174 With respect to the processing of gas volumes from the Borankol and Tolkyn fields, Claimants' valuation scenario concerning the LPG Plant is to determine the book value of the LPG Plant. In fact, FTI state that this methodology would be the "*most appropriate valuation methodology under the circumstances*"[142] but FTI are readily ignored by Claimants who clearly aim for the even more inflated prospective value.

---

139 Cf. above paras. 54 et seqq.

140 Cf. above para. 98.

141 Deloitte & Touche Expert Report, para. 301.

142 FTI Consulting Expert Report, para. 13.1.

175 FTI label this book value of the LPG Plant as a "*proxy for fair market value*"[143] in order to seemingly meet the applicable valuation standard. Yet, Claimants apply a book value which is identical to the total capital invested into the LPG Plant ("*investment value*"). They ignore that neither the book value, nor the investment value is relevant for determining the fair market value. Therefore, Claimants' reasoning is without merit.

a) Irrelevance of the Investment Value of the LPG Plant

176 In their Reply Memorial on Quantum, Claimants contend that, at a minimum, they should recover the total capital originally invested into the LPG Plant, assessed by FTI Consulting to amount to USD 245 million.[144] However, the alleged investment value of the LPG Plant does not meet the applicable standard of fair market value.

177 Indeed, Claimants' investments into the LPG Plant and the fair market value of the LPG Plant are utterly disproportionate to each other.

178 The LPG Plant turned out to be a black hole for Claimants' investments which grew into a paralyzing financial burden over the years:

- In 2006, Claimants envisaged the total investment into the LPG Plant to amount to USD 105 million.[145]
- By the end of 2006, Claimants expected to spend USD 151.5 million.[146]
- By the end of 2007, the amount Claimants planned to invest had increased further to USD 232 million.[147]
- By the end of 2008, Claimants already calculated to spend USD 241 million for the completion of the plant.[148]
- In the end, Claimants invested USD 245 million for the unfinished LPG Plant.[149]

---

143 FTI Consulting Expert Report, para. 13.1; Claimants' Statement of Claim, para. 419.

144 Claimants' Reply on Quantum, para. 69, footnote 179; FTI Consulting Supplemental Expert Report, para. 2.39, 2.40.

145 Ascom LPG Plant - Business Plan (**Exhibit R-333**).

146 Deloitte & Touche Expert Report, para. 186.

147 Tristan Oil Ltd., Annual Report For the Year Ended December 31, 2007, p. F-15 (**Exhibit R-37.4**).

148 Tristan Oil Ltd., Annual Report For the Year Ended December 31, 2008, p. 13 (**Exhibit R-37.5**).

Taking into account that the costs to finish are between USD 24.1 million (FTI Consulting) and USD 100 million (GCA),[150] the LPG Plant would have cost a whopping USD 269 million to USD 345 million instead of the USD 105 million which Claimants originally envisaged to spend.

179 The investment value of the LPG Plant does not meet the applicable standard of fair market value because a hypothetical willing buyer will calculate its purchase offer depending on the profits the buyer expects the business to generate in the future. This expectation of the hypothetical willing buyer will regularly differ significantly from the expectation the investor had when the investment project began. The hypothetical willing buyer will not be interested in how much cash was invested in the business but only in the question of how much cash he will get out of the business in the future.

180 This issue is exemplified by mergers and acquisitions every day. For example, only recently German steelmaker ThyssenKrupp tried to sell its steel mills in the United States and Brazil, in which ThyssenKrupp invested approximately EURO 12 billion. After deducting accumulated depreciation, the book value of the mills plummeted to EURO 7 billion. Although ThyssenKrupp tried to sell the steel mills at this price, business analysts report that the steel mills have a fair market value of only EURO 3 to 4 billion.[151] This example illustrates that a hypothetical willing buyer of the LPG Plant would not take its investment value as indication of the fair market value.

181 Furthermore, the investment value comprises of the total capital originally invested into a business. It thus refers to a point in time in the past when the investor began to use its capital to fund the development and construction of the business. In the case at hand, TNG entered into the agreement with Vitol to construct and operate the LPG Plant in 2006.[152]

182 The fair market value, by contrast, refers to the price a hypothetical willing buyer would pay a hypothetical willing seller for the business on the valuation date. In the dispute at present, Claimants contend that the

---

149 Tristan Oil Ltd., Annual Report For the Year Ended December 31, 2009, p. F-14 (**Exhibit R-37.6**).

150 Deloitte & Touche Expert Report, para. 187.

151 Reuters, "Bidders line up for Thyssen Steel Americas mills-source", 10 October 2012 (**Exhibit R-338**).

152 Cf. Claimants' Statement of Claim, para. 62.

valuation date falls on the day of 14 October 2008, while the Republic asserts that it falls on the day of 21 July 2010. In any event, a minimum of two years elapsed after Claimants began investing into the construction of the LPG Plant.

183 The determination of the investment value does not account for any developments within the two to four years until the valuation date was reached. It thus blinds factors like inflation or deflation and fluctuations of currencies.

184 Renowned authors of treatises on valuation in investment treaty arbitrations share the rejection of the investment value by valuation experts. Kantor summarizes the reasons for this widespread critique:

> *"The compensation amount could therefore differ significantly from the market value of the company, up or down. Unless the investment expenditures were made very recently, the impact of the conduct at issue on the market value of what was acquired with the funds may have grown or fallen depending upon a number of factors. For example, the market value of the acquired assets may depend on the nature of the asset purchased (oil and gas reserves are a good example [...]) and the efficacy of the use to which it has been put. Moreover, no value is attributed in this approach to goodwill – management skills, name, reputation, customer loyalty, location and other such intangibles."*[153]

For these reasons, the investment value and the fair market value of a business usually diverge substantively from each other.

185 Other scholars confirm that the investment value of a business does not reflect its fair market value:

> *"There is, however, serious doubt whether the amount of investments actually undertaken could in fact be regarded as a proxy for the fair market value of the project. It is not certain that a hypothetical willing buyer would have paid*

[153] *Kantor*, Valuation for Arbitration: Compensation Standards, Valuation Methods, And Expert Evidence, Kluwer Law International 2008, p.49 and 50 (**Exhibit R-328**).

> *to the investor all the expenses actually spent. He would only do so if the value of the investment was in fact equal to the expenses undertaken. This is, however, not necessarily the case. [...] [T]he repayment of [the investment value] might even be to the advantage of the injured party because the amounts actually invested do not necessarily reflect the actual value of the investment. If the investor has spent more than the investment was eventually worth, he might not be dissatisfied, if he gets back the investment and expenses undertaken"*[154]

Considering that the investment value is not regarded as proxy for the fair market value of a business by economic valuation experts, it is not suitable to serve as an indication for the fair market value in investment treaty arbitrations either.

186 Contrary to Claimants' allegations, the investment value of the LPG Plant is not a proxy for its fair market value and is thus irrelevant for its valuation.

b) Irrelevance of the Book Value of the LPG Plant

187 In their submissions, Claimants equate the investment value they request at a minimum with the book value of the LPG Plant so that both values amount to USD 245 million.[155] Like the investment value, the book value of the LPG Plant does not meet the applicable standard of fair market value.

188 The World Bank Guidelines on the Treatment of Foreign Direct Investment define the book value as

> *"the difference between the enterprise's assets and liabilities as recorded on its financial statements or the amount at which the taken tangible assets appear on the balance sheet of the enterprise, representing their cost*

---

154 *Marboe*, Calculation of Compensation and Damages in International Investment Law, Oxford International Arbitration Series, 2009, p.280 and 397 (**Exhibit R-324**).

155 Claimants' Statement of Claim, para. 420; FTI Consulting Expert Report, para. 13.4; FTI Consulting Supplemental Expert Report, paras. 2.39, 2.40.

after deducting accumulated depreciation in accordance with generally accepted accounting principles."[156]

In short, the book value of a business is the investment value less accumulated depreciation.

189 The purpose of the book value method is not the determination of the price a hypothetical willing buyer would pay a hypothetical willing seller for a business. Rather, the book value method was created for different purposes. As Professor Marboe comments:

> *"The main problem of using book value for valuation purposes is that the numbers appearing in the account books or the balance sheet of the business reflect the application of accounting principles that usually serve other purposes than those of valuation, such as financial reporting or tax purposes. [...] Valuation experts, therefore, are against using book values for valuation purposes. They emphasize that it is only by coincidence that the book value reflects the actual value of an object."*[157]

Therefore, the book value does not reflect the fair market value of a business.

190 This point of view is not only taken by authors of treatises on valuation in investment treaty arbitrations but is also shared by business valuation experts. Kantor observes:

> *"[...] valuation professionals do not consider unadjusted book values, recorded on financial statements in accordance with accounting precepts, to be related in any way to market values."*[158]

Hence, authors of treatises on valuation in investment treaty arbitrations merely echo the convictions of business valuation experts.

---

156 The World Bank, Guidelines on the Treatment of Foreign Direct Investment, Guideline IV(6) (**Exhibit R-334**).

157 *Marboe*, Calculation of Compensation and Damages in International Investment Law, Oxford International Arbitration Series, 2009, p.269 (**Exhibit R-324**).

191 Other scholars confirm that the book value method does not lend itself for the valuation of assets:

> *"In view of the fact that book value and related approaches to valuation are based on mistaken notions of value, it is hardly surprising that they are incapable of producing useful results in valuing expropriated property. It is also worth noting that the phrase 'book value' is itself a misnomer, because it has nothing to do with 'value' properly defined, but refers instead to the manner in which certain accounting conventions treat assets recorded on a firm's balance sheet using a variety of assumptions and decisions having little or nothing to do with 'value'. The balance sheet does not measure the ability of a firm's assets to generate cash, and therefore does not measure their economic value. There are several reasons for this. First, assets are recorded on the balance sheet at their historical cost, which may diverge considerably from their current cost because of inflation or other reasons. [...] Second, the rate at which an asset's original cost is depreciated for accounting purposes may bear little relationship to the reduction in its economic productivity. Third, the balance sheet fails to reflect certain intangible assets and other important elements of a firm that may contribute importantly to its success. [...] Finally, [...] assets and other elements of a firm are economically productive only when used as part of an integrated whole. It is therefore not meaningful to attempt to determine a business's value by deriving a value for each asset or element separately, and then adding them together. An enterprise can be valued only with reference to the cash that the total enterprise is expected to generate in the future."*[159]

---

158 *Kantor*, Valuation for Arbitration: Compensation Standards, Valuation Methods, And Expert Evidence, Kluwer Law International 2008, p.233 (**Exhibit R-328**).

159 *Lieblich*, Determining the Economic Value of Expropriated Income-Producing Property in International Arbitrations, Journal of International Arbitration, (Kluwer Law International 1991 Volume 8 Issue 1) p.68 (**Exhibit R-339**).

Hence, the book value never reflects the fair market value of an asset.

192 Since the book value method does not lend itself for the valuation of assets in general, it should not be applied in investment treaty arbitrations. McCosker agrees:

> *"Overall, generally accepted principles of accounting result in a book value of owners' equity that [...] only by coincidence is equal to fair value. Book value is not intended to be an equitable basis for settling nationalization claims and should not be used for that purpose."*[160]

The book value is therefore not a suitable valuation method to assess the value of an expropriated asset.

193 Investment treaty arbitration practice has picked up on the difference between the book value and the fair market value of an asset. The vast majority of tribunals thus regard the book value as an inappropriate basis for the calculation of compensation.

194 For example, the tribunal in *Aminoil v. Kuwait* confirmed that the book value is not acceptable as a basis for the calculation of compensation.[161] Similarly, the tribunal in *LIAMCO v. Libya* held that the book value should not be applied even in cases of lawful expropriations.[162]

195 Claimants and their experts are aware that the book value is not a suitable valuation method to assess the fair market value of the allegedly expropriated LPG Plant. Why do Claimants still use this method? Because "*the value of the LPG Plant, assuming the use of Borankol and Tolkyn field volumes only, is less than the book value of assets which is the total incurred capital expenditures of the LPG*".[163] In other words, Claimants use the book value method because the fair market value method leads to a lower amount of compensation than they would like to take away from this dispute.

---

160 Cf. *McCosker*, Book Values in Nationalization Settlements in Lillich (ed), Valuation of Nationalized Property in International Law, Volume 2, University Press of Virginia 1973, 36, 51 (**Exhibit R-340**).

161 *Aminoil v. Kuwait*, Award, 24 March 1982, (1982) 21 ILM 976, para 155 et seq. (**Exhibit R-341**).

162 *LIAMCO v. Libya*, Award, 12 April 1977, (1982) 62 ILR 141, 208 (**Exhibit R-342**).

163 FTI Consulting Expert R, para. 13.1-13.4; Claimants' Statement of Claim, para. 419.

196 It is noteworthy that the book value may truly reflect the fair market value of a business if it is adjusted accordingly. Such adjustments will be achieved by means of a so-called impairment test or a continuing mark-to-market process. Such adjustments to the book value are required by all authoritative international accounting standards:

> *"[...] US Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements, and International Accounting Standard 19 now require periodic revaluations of investments held on the books of private equity funds. The US Private Equity Industry Guidelines Group, for example, recommends that valuations of investments in private equity portfolios generally be updated quarterly to comply with SFAS 157. On those revaluation dates, the fund must adjust the book value of the investments to their "fair value" at current market prices."*[164]

Adjustments by means of an impairment test or a mark-to-market process ensure that the adjusted book value approximates the fair market value of a business.

197 In the case at present, however, Claimants and their experts have not presented an adjusted book value of the LPG Plant. Claimants have not alleged, let alone proven that they have applied an impairment test or a mark-to-market procedure. *A fortiori*, Claimants have not alleged, nor proven that such adjustments have been applied correctly. Quite the contrary, the equalization of the book value and the investment value of the LPG Plant shows that no adjustments were carried out.

198 For the fair market value to be equivalent to the book value of the LPG Plant, there would have to be a reasonably immediate prospect of generating a return on those assets through operation of the plant. Otherwise no buyer would be interested in purchasing a collection of ageing assets constituting an incomplete plant, since the assets themselves would be worth less on the open market than the price paid. However, there is no reasonably immediate prospect of generating profit through the

---

164 *Kantor*, Valuation for Arbitration: Compensation Standards, Valuation Methods, And Expert Evidence, Kluwer Law International 2008, p.231 (**Exhibit R-328**).

operation of the LPG Plant because the plant has been mothballed since 2009.

199 In conclusion, in accordance with international valuation principles and concerns of valuation experts, tribunals in investment treaty arbitrations reject the book value method for determining the value of entire companies or investment projects because it does not reflect the fair market value of a business.[165] Therefore, the book value determined by Claimants does not approximate the fair market value of the LPG Plant.

5. Further false assumptions

a) Irrelevance of values assigned to the LPG Plant in indicative offers

200 In their Reply Memorial on Quantum, Claimants contend that the value of the LPG Plant is "*clearly reflected in the indicative offers made by interested buyers in 2008, which valued the LPG Plant at USD150 million on average*".[166] However, Claimants neglect to mention that the informative value of indicative offers is extremely low because they are based on insufficient data. Therefore, the values assigned to the LPG Plant in indicative offers are irrelevant.

201 This fact is confirmed by the offers that were made based on the information memorandum and the vendor due diligence. These offers varied from USD 70 million[167] to USD 280 million.[168] This absurdly large span in prices shows that the informative value of indicative offers is in fact very low due to the lack of data underlying such indicative offers.

202 In the hearing on jurisdiction and the merits, Claimants tried to establish that Total E&P had valued the LPG Plant at USD 100 million.[169] However,

---

165 *Marboe*, Calculation of Compensation and Damages in International Investment Law, Oxford International Arbitration Series, 2009, p.273 (**Exhibit R-324**).

166 Claimants' Reply on Quantum, para. 65.

167 Indicative Offer for Project Zenith from Meridian Petroleum dated 1 October 2008 (**Exhibit C-71**).

168 Indicative Offer for Project Zenith from Korea National Oil Corporation dated 26 September 2008 (**Exhibit C-18**).

169 Testimony of Mr. Chagnoux, Transcript Day 4, p.17 et seqq.

Mr. Chagnoux of Total E&P explained that this was not the case.[170] In fact, Total E&P considered the LPG Plant to be worthless:

> ***Mr. Mohr:*** *"So the process letter instructed the bidders to provide a value for each of the assets, and in the first bid you do not provide a value for the LPG plant, right?"*
>
> ***Mr. Chagnoux:*** *"Yes. The LPG has a negative value in our estimates."*[171]

b) No intention of the Republic to complete the construction of the LPG Plant

203 In their Reply Memorial on Quantum, Claimants allege that "*Kazakhstan is in fact gearing up to finally open the LPG Plant in 2012*".[172] Yet, the Republic never had any intention of completing the construction of the LPG Plant. Rather, the status quo of the LPG Plant is merely being preserved.

204 The Director of the Department for Development of Fields and Production of Hydrocarbons at JSC MNC KazMunaiTeniz, Mr. Khalelov, *inter alia* supervises the preservation of the status quo of the LPG Plant. He confirms:

> *"The LPG Plant is not part of the trust management. However, as it has been abandoned by the owners, we protect the premises and the equipment by employing guards. Ever since the unfinished LPG Plant was abandoned, no further work has been conducted on the Plant."*[173]

Therefore, as the end of the year is drawing nearer, it is obvious that the Republic is not and never has been gearing up to open the LPG Plant in 2012.

205 Claimants mention that "*[i]n a document entitled "List of Investment projects of the Mangistauskoi Region, which are being supervised in*

---

170 Testimony of Mr. Chagnoux, Transcript Day 4, p.17 et seqq.

171 Testimony of Mr. Chagnoux, Transcript Day 4, p.18, lines 14-17. Upon further questioning by Claimants, Mr. Chagnoux reaffirmed this statement, cf. p.21, lines 13-15.

172 Claimants' Reply on Quantum , para. 67.

173 Witness Statement of Mr. Khalelov, para. 4.1.

2011", there is a specific reference to the LPG Plant under "Regional Projects"[174]. However, the Republic has not arranged for such a document to be published. Therefore, the content of this document cannot be attributed to the Republic and it is to be considered as mere promotional material.

206 Furthermore, Claimants contend that "*Kazakhstan is training specialists for operation of the LPG Plant*"[175] which they perceive as indication that the Republic was planning to complete the plant and put it into operation. However, Mr. Khalelov contradicts:

> *"I have been informed that Claimants allege that Kazakhstan is training specialists for the operation of the LPG plant. However, no such training has taken place and I have never heard about any programme to this objective either. In addition, I do not know of any intention to finish the construction of the plant. As our lawyers told us, we are not entitled to incur any expenses for the plant or to make investments into the plant in any form because the plant neither belongs to KMT nor to KMG NC."*[176]

207 In conclusion, the Republic never had any intention of completing the construction of the LPG Plant but merely preserves the status quo.

6. Claimants fail to take into account the Vitol joint venture agreement

208 In order to determine the potential damage allegedly suffered by Claimants, the valuation of the Assets of KPM and TNG is only the first step. Aspects to be taken into account include claims of third parties to the cash flows generated by the assets. Such a claim to the cash flow generated by the LPG Plant arises from the joint venture with Vitol.

209 According to Ascom's own Business Plan for the LPG Plant, Vitol and Ascom invested into the construction of the LPG Plant on the basis of a joint venture agreement. Under the agreement, Vitol and Ascom agreed to

---

174 Claimants' Reply on Quantum, para. 67.

175 Claimants' Reply on Quantum, para. 67.

176 Witness Statement of Mr. Khalelov, para. 4.2.

establish a new fifty-fifty joint venture company which shall purchase 100% of the products produced by the LPG Plant and act as the main profit centre handling the majority of revenues and expenses for the joint venture.[177]

210 In their valuations of the LPG Plant, Claimants have not taken account of the fact that they would not have kept all of the future profits allegedly arising from the operation of the unfinished LPG Plant. Simply ignoring that the profits from the LPG Plant were to be shared is highly disingenuous. Claimants cannot be allowed to take this approach.

211 At the same time, due to the limited amount of information on the record about the specifics of the Vitol Joint Venture, the Republic cannot assess itself to what extent the agreement would decrease a potential damages claim regarding the LPG Plant. In such circumstances, Claimants are put to proof that the proceeds they could have earned operating the LPG Plant under the Joint Venture Agreement are more than half of whichever asset value they are claiming.

III. Valuation of the Borankol and Tolkyn fields

1. Valuation of the Borankol field

212 Based on calculations by the Republic's experts GCA and Deloitte, the Republic submits that the value of the Borankol field amounts to **USD 62.8 million**.

213 Claimants overestimate the value of the Borankol field by a large margin.[178] They manage to inflate their numbers with one of their typical tricks – relying on presumed future developments which objectively could never have been expected.

214 In the following, the Republic will set out its case on the valuation of Borankol and will provide its critique of Claimants' calculations.

---

177 Cf. Ascom LPG Plant - Business Plan (**Exhibit R-333**).

178 In their Reply on Quantum, Claimants estimated a value of USD231.5 million for the Borankol field, cf. Claimants' Reply on Quantum, para. 79.

a) The Republic's case

215 The Republic's expert GCA provided an update on its production forecast for the Borankol field. GCA now estimates that until 2022, when Contract No. 305 for the exploration of the Borankol field was set to expire, gas in the amount of 94 MMm^3 and oil and condensate in the amount of 1,185.2 Mtonnes could have been produced as of the valuation date of 21 July 2010.[179] For gas, this number is unchanged, whereas for oil, this represents a slight increase.

216 GCA based its forecast on the field development plan existing on the valuation date of 21 July 2010, the mapping contained in this plan as well as on the actual production numbers of wells on the valuation date.[180] This approach led GCA to a number of important conclusions relevant for the ultimate value of Borankol:

(a) Taking a look at the field development plan, it becomes clear that most reservoir units have already produced significant percentages of the estimated – and approved – ultimate recoverable reserves.[181]

(b) The production so far has largely been taken from wells located in the best parts of the reservoir. This means that recompletions, i.e. the use of existing wells to access regions higher up in the reservoir (so-called "behind pipe reserves"), will be located in poorer regions and will not perform as well.[182]

(c) Historical production figures and in particular a high water cut indicate that less reserves than initially planned in the field development plan will be eventually produced. In particular, the drilling of new wells is not to be expected.[183]

217 Applying GCA's numbers in a DCF calculation and taking into account such various factors as oil price development, transportation costs, capital

179 GCA Supplemental Technical Report, Appendix II, Table AII.2.

180 Cf. GCA Supplemental Technical Report, para. 56. It should be noted that the same field development plan existed on 14 October 2008.

181 GCA Supplemental Technical Report, para. 64.

182 GCA Supplemental Technical Report, paras. 63 et seqq.

183 GCA Supplemental Technical Report, paras. 67 et seqq.

expenditure and operational expenditure, Deloitte concluded that the Borankol field is to be valued at USD62.8 million.[184]

b) Observations on Claimants' valuation of the Borankol field

218 Claimants use several very target-oriented assumptions to inflate the market value of the Borankol field. As will be shown in the following, these assumptions are not sustainable.

219 To begin with, Claimants do not take account of oil and gas production in the period between the parties' valuation dates.[185] This leads to a marked inflation of available reserves and in turn, to a marked inflation of the value of the field. Naturally, the Tribunal should not follow Claimants in ignoring this substantial period of production. The Republic will set out the production between the two valuation dates in more detail further below.[186]

220 Moreover, Claimants make field development assumptions which are not at all supported by the facts at hand. Most importantly, Claimants – based on Ryder Scott's contentions – rely on four new wells and 58 recompletions being implemented by the end of the contract in 2022.[187] As a consequence, there is a substantial increase in Claimants' total production forecasts, in particular for the time from 2014 to 2016.[188] This is one of Claimants' many fairytale assumptions not based on reality but instead on wishful thinking:

(a) Ryder Scott does not take account of the fact that historical production was largely taken from the best parts of the reservoir. Thus, Ryder Scott ignores that recompletions will, on average, be made in poorer regions and will thus, on average, perform worse than current non-recompleted wells.[189]

(b) Further, Ryder Scott overestimate the potential for the drilling of new wells. The field development plan foresaw the drilling of 45

184 Deloitte & Touche Expert Report, para. 297.

185 Deloitte & Touche Expert Report, paras. 193 et seq.

186 See below paras. 442 et seqq.

187 Claimants' Reply on Quantum, para. 27; Ryder Scott Second Expert Report, p.9.

188 Cf. Comparison of Historical and Forecast Oil Production Rates, GCA Supplemental Technical Report, para. 73.

189 GCA Supplemental Technical Report, para. 63.

new wells between 2007 and 2011,[190] 25 of which were completed by the end of 2009.[191] The remaining 20 wells would have had to be drilled in the period from the end of 2009 until 2011. Such development is rather unlikely given that all new wells were planned for a part of the reservoir that was already producing at a high water cut.[192]

221 Taking all of these factors in conjunction, it becomes clear that Claimants largely overstate the potential of the Borankol field. This fully undermines their damage claim with regard to this field.

2. Valuation of the Tolkyn field

222 As of 21 July 2010, the Tolkyn field had a value of **USD 123.2 million** based on the discounted cash flow valuation methodology applied by Deloitte.[193]

223 Deloitte arrive at this conclusion by taking into account three essential factors: production profiles, realistic gas prices and capital expenditure.

a) Production profile

224 Deloitte make their assumptions based on GCA's production profile. The Tolkyn field produces oil, gas and condensate. However, gas and condensate are the main hydrocarbons produced at the field.[194]

225 The gas production already reached its peak in 2008, when 2.36 Bm^3 were produced by Claimants in an effort to ramp up the production of the field. Gas production decreased significantly in 2009. GCA forecasts show that the gas production would remain stable in 2010 and decrease continuously from then onwards. GCA estimates that until 2018, 60.9 MTonnes of oil, 574.4 MTonnes of Condensate and 5.8131 Bm^3 of gas may be produced.[195]

---

190 Cf. GCA Supplemental Technical Report, paras. 65 et seq.

191 GCA Supplemental Technical Report, para. 65.

192 GCA Supplemental Technical Report, para. 66.

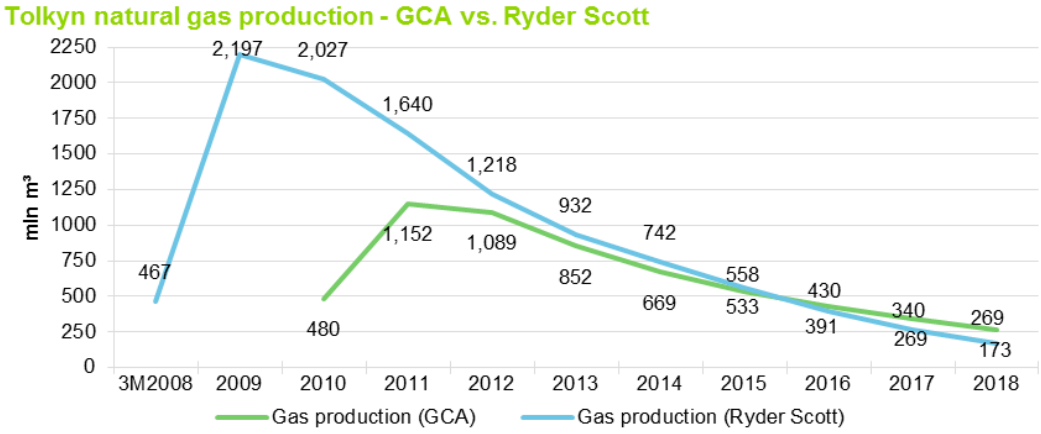
193 Deloitte & Touche Expert Report, para. 324.

194 GCA Technical Report, para. 4.

195 GCA Supplemental Technical Report, Appendix II, Table AII.1.

Taking Ryder Scott's comments into consideration GCA has increased the total gas sales by 0.13 Bm^3.[196]

226 The differences between the GCA and the Ryder Scott forecasts for the gas production are depicted in the following graph:



227 GCA base their forecasts of future gas and condensate production on a lower recovery factor than Ryder Scott. This is necessary as well deliverability declines because of both declining reservoir pressure and a considerable increase in water production.[197]

228 As was already pointed out in the first GCA Report,

> *"[w]ater production associated with gas and condensate is commonly deemed to be a significant (problematic) issue. The production of water in a gas well can lead to an immediate reduction in the productivity of the well, and ultimately to a reduction in the total volume of gas (and condensate) produced from the well. If water production is predicted, the production method and system for the gas well is commonly modified in order to reduce this outcome."*[198]

229 The increasing water production is indeed a significant problem which Ryder Scott in their first report simply chose to ignore. In their first Expert

---

196 GCA Supplemental Technical Report, para. 51.

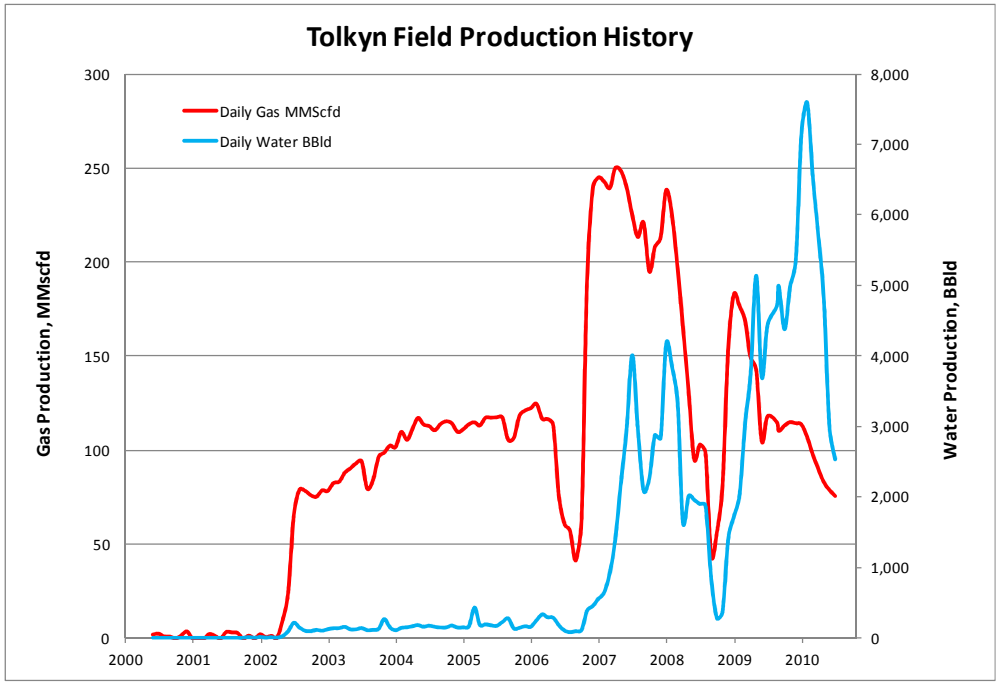
197 GCA Technical Report, para. 51.

198 GCA Technical Report, para. 30. As Claimants indirectly acknowledge, the increasing water production is also readily apparent from the inspections undertaken by the Geology Committee in July 2010, Exhibts C-315 and C-650.

Report GCA described the situation at the Tolkyn field with the following words:

> *"At the Tolkyn Field, initial gas / condensate production commenced in 2003 with only small volumes of produced water being recorded. Gas production was significantly increased in 2007 to meet the production plan approved in the Field Development Plan. This increase in gas and condensate production was followed by a rapid increase in the volume of water produced, which ultimately resulted in a dramatic reduction in the volume of gas and condensate being produced. The increase in 2007 in gas production was achieved by increasing individual well rates, and not by drilling additional wells. This rapid increase in individual well rates may have accelerated water production."*[199]

230 In addition, GCA have demonstrated with the following graph, how water production increased significantly shortly after gas production was increased in 2007 and 2009, and water production declined as gas production was reduced to 2006 production rates[200]:



199 GCA Technical Report, para. 32.

200 GCA Technical Report, para. 33.

231 In their second report, Ryder Scott try to refute having ignored the imminent water production by referring to one document contained in one of their several submitted DVDs.[201] Clearly, this is not an adequate response to such a grave problem.

232 Ryder Scott then briefly address the water production but trivialize it by concluding that as of October 2008, water production had been a localised formation problem, and not a field wide problem.[202]

233 This is not the case. Increasing water production is a known problem in reservoirs like Tolkyn and indeed Claimants ignored this when they ramped up production in 2008:

> *"The water cut cannot necessarily be expected to subside with reduction in gas production; only time will tell if this is the case. It is a common feature of fractured and fissured reservoirs for the water to travel up to the well perforations preferentially through the fractures and fissures, rather than through the rock, thereby by-passing the oil or gas and leaving it trapped in the formation. Once these water channels have been established, it can be very difficult to arrest the problem. The best way to prevent this potential problem in the first place is to restrict gas rates for these types of reservoirs, and increasing gas production during 2008 (whether or not it was in compliance with the [Field Development Plan]) was not in keeping with good oil field practice."*[203]

234 GCA have also correctly assessed the future oil production from Tolkyn.

235 Claimants' allege that GCA did not take into account allegedly "significant" behind pipe reserves in the Tolkyn field.[204] However, the recovery of such behind pipe reserves is dependent on the performance of the wells on the field.

---

201 Ryder Scott Second Expert Report, p.6.

202 Ryder Scott Second Expert Report, p.7.

203 GCA Supplemental Technical Report, para. 50.

204 Claimants' Reply on Quantum, paras. 23 et seqq.

236 Such behind pipe reserves can only be recovered within the contract term if the well performance is high. If the performance of the wells is low, the operator of the field may attempt to recover certain behind pipe reserves but he will then need to leave more easily accessible reserves unrecovered.

237 As GCA point out in their Supplemental Report, there are strong indicators which suggest a low recovery rate of the wells which Ryder Scott choose to ignore

> *"[Ryder Scott's] assessment of behind pipe potential in the Jurassic and Triassic does not appear to give consideration to the performance of wells produced to date from these reservoirs. The total recovery to 21st July, 2010 from the Asselian, Jurassic and Triassic was 128 Mtonnes from 23 wells, less than an average of 6 Mtonnes per well (including pilot production). The 2007 FDP target was for 694.1 Mtonnes to be produced over a five year period from 12 wells in the Asselian, Jurassic and Triassic. The fact that this was not achieved demonstrates that the [Field Development Plan] forecast was overly optimistic. It also puts into serious doubt [Ryder Scott's] forecast oil production of 10.3 MMBbl (c. 1.4 MMtonnes) and questions the validity of any reserve estimate for these reservoirs based on RS's volumetrics."*[205]

238 In particular, the low recovery of less than an average of 6 MTonnes per well on the Asselian, Jurassic and Triassic reservoirs, the disappointing results of appraisal wells in the Triassic reservoir and the high water cuts need to be taken into account when assessing potential oil recoveries.[206] GCA have taken this into acccount while Ryder Scott have failed to do so.

239 As a matter of due course, it should be mentioned that Claimants further alleged that GCA did not incorporate Material Balance and Volumentric analyses into their study.[207] This allegation is incorrect. In their

---

205 GCA Supplemental Technical Report, para. 22.

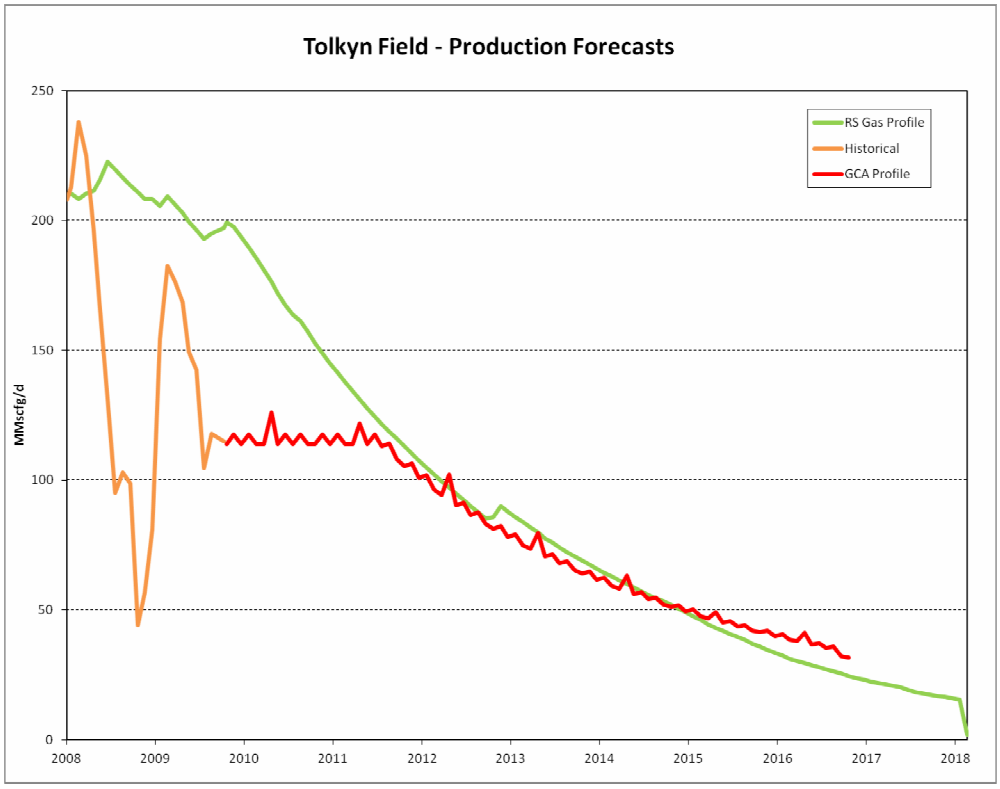
206 GCA Supplemental Technical Report, paras. 23 et seqq.

207 Claimants' Reply on Quantum, para. 25.

supplemental report, GCA describe in detail how they have taken these analyses into account.[208]

240 GCA's profile also fails to take into account the significant decline in production in 2009 even though it could be anticipated that demand would break away.

241 The following graph from GCA's first report demonstrates how production from the Tolkyn field plummeted in 2009.[209]



242 As Deloitte show, based on Tristan Oil's annual reports, in 2008 TNG and KPM supplied 61.5% of its total gas production to Kemikal.[210] The contract was due to expire by the end of September 2008 and Claimants seem to have been unwilling to extend the contract because of alleged erratic payment behaviour. On 15 September 2008, the contract was eventually extended but for a mere three months and after this Claimants allegedly

208 GCA Supplemental Technical Report, paras. 42 et seqq.

209 GCA Technical Report, para. 29.

210 Deloitte & Touche Expert Report, para. 74.

decided not to extend the contract any further which left them without their main customer.

243 Ryder Scott, however, simply disregard that TNG's contract with Kemikal would have expired at the end of 2008 and that TNG would therefore not have been able to produce the amounts of gas it had produced in 2009 even if the apparent obstacles to this due to the significant water production are disregarded for the sake of argument.

244 Mr. Lungu states that

> *"Kemikal's payment history throughout 2008 was very erratic, and Kemikal consistently ran very large arreages. Furthermore, as part of its payment obligations, Kemikal was required to issue bank guarantees set against the anticipated deliveries of the current month.(…) In the fall of 2008, Kemikal inexplicably stopped putting its required bank guarantees in place. Because of its erratic payment history, and its refusal to put its required bank guarantees in place, we did not renew the Kemikal contract at the end of 2008."*[211]

245 It is obvious that Mr. Lungu omits to say when exactly in the autumn of 2008 Kemikal stopped putting its required bank guarantees in place but his silence can only be interpreted to mean that this took place before Claimants' valuation date. In any case, as Mr. Lungu explains the non-renewal of the contract with erratic payment behaviour throughout 2008, it must have been foreseeable as of 15 October 2008 that there would be no contract with Kemikal for the year 2009 and thus no customer for more than 60% of TNG's gas.

b) Gas prices

246 In evaluating the Tolkyn field, Deloitte calculated three scenarios with different gas price assumptions. These scenarios were weighted according to Deloitte's estimate of the relative likelihood of each outcome.[212]

---

211 Second Witness Statement of Mr. Lungu, para. 6.

212 Deloitte & Touche Expert Report, para. 243.

247 The first scenario that Deloitte apply is the scenario *"Contracts"*:

> *"The existing gas sales contracts of KPM and TNG for 2010 – as detailed in the 2009 audited financial statements – allow the companies to sell gas merely to the domestic market at defined prices. Therefore, we consider a scenario based on the gas sales contracts for 2010 and take into account future price increases according to the expected consumer price inflation as our main scenario."*[213]

248 For this scenario, Deloitte apply a probability of 65%.

249 Deloitte apply a second scenario called *"Transition"* and explain it in the following words:

> *"We have taken note of the discussions in Kazakhstan about the pros and cons of increasing the regulated prices in the domestic market. However, we understand that plans of the MOG to this end (increase in domestic gas prices to netback prices based on prevailing gas prices in export markets by 2020) have not been implemented yet. Taking into account that certain industries and the residents of Kazakhstan may oppose price rises in the order of several hundred per cent by 2020, we deem this scenario possible (scenario "Transition")."*[214]

250 The scenario *"Transition"* is given a probability of 30%.

251 The third scenario is called *"Export"*:

> *"Based on our understanding that the subsoil use contracts no. 210, no. 302 and no. 305 do not legally bar direct exports a scenario may be conceivable according to which, after the existing gas sales contracts terminate (i.e. after 2010), KPM and TNG export 80% of their gas at*

---

213 Ibid.

214 Ibid.

international prices and sell 20% in the domestic market as before."[215]

252 Deloitte weighs this scenario at 5%.

253 Deloitte's assessment in fact is a very optimistic one for Claimants.

254 In Kazakhstan, subsoil users cannot just export gas. As Professor Olcott explains:

> *"To export gas from Kazakhstan is a considerable challenge. While Kazakh sub-soil license holders may be given the right to export their oil or gas in the contracts that they negotiate, this does not guarantee them the ability to export their gas, which requires finding a purchaser who has the capacity to get the gas to market. For Tolkyn and Borankol these options were limited to Kazakh and or Russian government owned gas companies and their affiliates. No direct route to Europe (including Moldova) was available otherwise."*[216]

255 The reason for this situation is historical:

> *"The Soviet Union built the Central Asian Central (CAC pipeline system) which runs from Turkmenistan, through Uzbekistan and then through Kazakhstan into Russia, and funds from the Soviet Union were used to develop Central Asia's gas industries, which were already quite mature in both Turkmenistan and Uzbekistan. Given the value of this gas, the Kremlin has sought to maintain control of this valuable revenue stream since the first years of independence, using what many in the U.S. and EU have argued is excessive pressure to control the flow of gas from the three Central Asian countries, including underpricing it, and for this reason they have supported the building of a Trans Caspian gas pipeline system, and the Nabucco Pipeline, respectively, to allow trade with Europe that by-passes Russia. However, neither pipeline*

---

215 Ibid.

216 Supplemental Expert Report Martha Olcott, para. 8.

is yet built, and may never be built, especially given the lack of legal definition of the status of the Caspian sea, which has kept the Kazakh government from firmly committing to the TransCaspian pipeline. This leaves Russia, and more specifically Gazprom, the majority state-owned and state-run gas company of Russia as the dominant actor in the westward marketing of Central Asian gas."[217]

256 Every subsoil user may theoretically have the possibility to export gas. But in order to be able to sell gas internationally, the subsoil user needs to find an agreement with a purchaser. As Gazprom only allows a limited amount of gas from Kazakhstan, this proves to be very difficult.

"As Kazakhstan is a land-locked country Kazakh gas producers are effectively completely dependent upon access to land-based gas pipelines. Intergas of Central Asia, a subsidiary of Kaztransgas, manages Kazakhstan's nationally owned pipelines, but the greater challenge is to gain access to export pipelines which allow for international sales.

Intergas of Central Asia controls the west-bound pipelines as far as the Russian border, and then the gas is sold to Gazprom, which sets limits on both the pricing and volumes of gas that it will purchase from the agents of the Kazakh government, who in turn purchase it from the country's producers."[218]

257 Without any agreements for the export of gas, gas producers are bound to deliver gas domestically.

258 Whether or not the subsoil use contract stipulates a right to export is irrelevant in this regard. Indeed, the subsoil user is entitled to export its gas but in order to do so, it must come to an agreement with Gazprom. If Gazprom refuses to accept the gas, there is nothing the gas producer can do:

---

217 Supplemental Expert Report Martha Olcott, para. 18.

218 Supplemental Expert Report Martha Olcott, paras. 9 et seq.

> *"In this environment, the provisions of Tolkyn's Contract 210 (paragraphs 6.1.10, 6.1.11, 6.1.12) according to which it had the right to export gas, and access the pipeline system on a commercial basis can only be seen as permission to export, but no guarantee that the owners of Tolkyn would be able to export as much as they wanted at a price that they were happy with."*[219]

259 In fact, Claimants have not even argued that KPM or TNG at any point in time during their operation exported gas to Gazprom. FTI Consulting explicitly accept this and even provide a table which demonstrates that TNG and KPM only sold gas domestically.[220]

260 As Deloitte put it:

> *"From 2007 until the termination of the subsoil use contracts in July 2010 KPM and TNG have been players in the domestic gas market. KPM's and TNG's sales depend on the terms and conditions prevalent in the (highly regulated) domestic gas market. Selling their gas to domestic and local customers at prices below the prices that were available to players on international markets was part of the business environment in which KPM and TNG were operating in the period 2007 until the Valuation Date."*[221]

261 Given the fact that TNG has never exported gas, it is entirely reasonable, or even generous towards Claimants to base the valuation of Tolkyn field on only a 65% probablity that the prices achieved for the gas would be in accordance with TNG's exclusively domestic 2010 contracts for the delivery of gas.

262 As will be discussed in more detail below, FTI Consulting on the other hand completely disregard the domestic gas sales when they assume export for Tolkyn's gas.

---

219 Supplemental Expert Report Martha Olcott, para. 91.

220 FTI Consulting Expert Report, para. 5.19.

221 Deloitte & Touche Expert Report, para. 82.

c) Capital expenditure

263 As far as capital expenditure is concerned, it is necessary to take into account the costs of USD 40 million for the installation of compression on the Tolkyn field.

264 This compression is necessary due to the declining flowing well head pressures on many of the wells.[222] Without compression, gas from the Tolkyn field would eventually not be able to enter the Center Asia-Central pipeline because it would not have the sufficient pressure. As GCA explain:

> *"27. The gas / condensate / water reservoir fluids from Tolkyn flow under natural reservoir drive to the gas processing facilities located at Borankol Field, comprising separation, gas sweetening and dehydration. The CAC pipeline operates at approximately 45 bar in the summer months when demand is lower, and a pressure of approximately 25 bar in the winter months when demand and hence offtake is higher. For the Tolkyn field to operate year round, as assumed in the GCA and [Ryder Scott] profiles, the gas from Tolkyn must arrive at the pipeline at 45 bar.*
>
> *28. Allowing for an estimated pressure drop in the multiphase line from Tolkyn to Borankol of approximately 10 bar (which will vary depending on throughput and fluid composition), the minimum flowing wellhead pressure (FWHP) required at the Tolkyn wells must be in the order of 55 bar to allow arrival at Borankol at approximately 45 bar.*
>
> *29. Furthermore, as the water knock out and condensate separation facilities are located at Borankol, the total produced well stream for the Tolkyn gas wells (gas, water and condensate) is flowed along the c. 50 km line to Borankol. With increasing water cut, the pressure loss down this line will increase and there could also be liquids drop out in the line, resulting in slug flow, erratic*

222 GCA Supplemental Technical Report, para. 26

> *flow line pressures and fluctuating gas production levels."*[223]

265 If such a compression is not installed, wells will need to be shut in once they fall below the required pipeline operating pressure, which would, of course, reduce the overall production rate of the field.

266 As a matter of fact

> *"[t]he average reservoir pressure will not need to decline much further before many of the wells will be at too low a pressure to produce under natural flow into the export system."*[224]

3. Claimants' vaulations of the Tolkyn and Borankol fields are inflated for wrong assumptions regarding the possibility to export gas

267 Claimants' valuations of Tolkyn and Borankol are inflated because they wrongly assume that a willing buyer would have expected KPM and TNG to achieve international export prices. Moreover, they are inflated because FTI Consulting, in order to assess the value of the fields, applies the prices and quota of an Undated 2008 Draft Agreement which was not even signed by all parties.

a) As of 21 July 2010 a willing buyer of TNG and KPM could not expect the companies to export and to achieve international export prices for gas

268 As has been demonstrated above, the correct valuation date is 21 July 2010.[225] On this date, it could not be expected that TNG and KPM could export their gas or could achieve export prices for their gas on the domestic market. That is because on 21 July 2010 TNG and KPM did not export gas and Claimants have not even indicated any prospect of exporting gas at this point in time. Instead, TNG still only supplied gas to domestic users for domestic prices.

---

223 GCA Supplemental Technical Report, paras. 27 et seqq.

224 GCA Supplemental Technical Report, para. 38.

225 Cf. above paras. 14 et seqq.

b) On 14 October 2008, a willing buyer of TNG and KPM could not expect the companies to export gas and thus to achieve international export prices

269 FTI Consulting and Claimants err when they make the assumption that as of 14 October 2008, a willing buyer of TNG and KPM would expect them to be able to sell gas on the export market and to achieve prevailing international export prices for those sales.

270 FTI Consulting make this assumption based on the allegation that "*TNG and KPM would have been allowed to sell their gas to KazAzot at a higher price and eventually at the export price, and that any excess volumes would be allowed to be sold on the export price*"[226].

271 When making this allegation, FTI Consulting rely on an undated 2008 Tripartite Agreement (*"Undated 2008 Draft Agreement"*)[227] which was only signed by two of the three parties. FTI Consulting then even calculate the prospective gas revenues based on this (Non-)Agreement.

272 However, this undated document could not have led any willing buyer to expect as of 14 October 2008 that TNG and KPM would be able to sell gas on the export market and to achieve international export prices.

aa) KPM could never expect to benefit from the Undated 2008 Draft Agreement

273 First, KPM could never have profited from the Undated 2008 Draft Agreement.

274 The inclusion of KPM into the assumptions regarding future gas export is exemplary for FTI Consulting's disregard of simple but very important facts: KPM was never supposed to be a party to the Undated 2008 Draft Agreement. Under the Undated 2008 Draft Agreement, only TNG was supposed to be the supplier of gas to KazAzot. Likewise, only TNG was supposed to be able to deliver gas to the exporter. There is no mentioning of KPM and neither FTI Consulting nor Claimants have made any attempt at demonstrating how KPM would have profited from the Undated 2008 Draft Agreement.

---

226 FTI Consulting Expert Report, para. 11.16.

227 Undated Draft Agreement between KazAzot, TNG and KazTransGaz (**Exhibit C-302**).

bb) A willing buyer could not expect that TNG would be able to export gas under the Tripartite Agreement

275 With regard to TNG, a willing buyer could still not have expected that the company would be able to export its gas: first, the Undated 2008 Draft Agreement was never signed by all Parties (A), second, the Undated 2008 Draft Agreement could never have come into force in the first place, even if signed (B), third, in October 2008, no willing buyer could assume that KazAzot would enter into the agreement at the given terms (C), fourth, and finally, TNG could never have fulfilled its obligations under the 2008 Agreement (D).

(A) The Undated 2008 Draft Agreement FTI Consulting rely on was never signed by all Parties

276 FTI Consulting derive the volumes used for their estimate of future volumes sold to KazAzot, the local market and for export from the Undated 2008 Draft Agreement (**Exhibit C-302**).[228] In so doing, FTI Consulting make a number of blatant mistakes and misstatements which completely undermine their assessment.

277 To begin with, FTI Consulting describe the Undated 2008 Draft Agreement as "*made between KazAzot, KazMunaiGaz, and ASCOM*".[229] In reality the parties to this Agreement were neither KazMunaiGas nor Ascom but KazTransGas and TNG.

278 However, this flaw in FTI Consulting's assessment is comparatively minor compared to another statement of FTI Consulting, according to which the Undated 2008 Draft Agreement was

> "*signed by representatives of all three parties*".[230]

279 This assertion is blatently false and it casts doubt on FTI Consulting's reliability. The Undated 2008 Draft Agreement is obviously not signed by the representative of KazTransGas as can be seen from the last page of the agreement.

---

228 FTI Consulting Expert Report, para. 11.21

229 FTI Consulting Supplemental Expert Report, para. 2.5.

230 FTI Consulting Expert Report, para. 5.28.

280 The nature of a Tripartite Agreement means that all three parties need to sign the Agreement before it can have any effect. The Undated 2008 Draft Agreement on which FTI Consulting base their assumptions was never signed by all three parties concerned. Hence, there was no solid ground to base the expectation for the export of gas on. No potential buyer would just have paid a price based on the assumption that the gas could be exported. In any case, a potential buyer would have insisted on making the signature of the Undated 2008 Draft Agreement a condition precedent for a purchase agreement.

281 Existing gas delivey contracts are pivotal for any potential buyer who is seriously interested in the acquisition of a gas field. This was expressly stated by Dr. Kim of Korea National Oil Company:

> *"The assets in question were gasfields, and gasfields require a prior sales agreement in place in order to establish any market value on those assets."*[231]

282 It is for this reason, that KNOC, in its indicative offer, wrote that

> *"[b]efore submitting a definitive and binding offer, KNOC would like to conduct detailed due diligence on the Tristan Group and its assets and liabilities. Such due diligence shall include, but not limited to:*
>
> *a. Satisfactory review of documents in the data room and physical inspection of the facilities and equipment;*
>
> *b. <u>Due diligence of the natural gas sale contracts</u> ; and*
>
> *c. Due diligence on the implications of the proposed changes to the Kazakhstan's petroleum tax regime."*[232] (emphasis added)

283 Even in Claimants' Information Memorandum which was handed to the potential bidders for Project Zenith, it is only stated that:

> *"TNG has had a series of negotiations with KazTransGas and KazAzot, which <u>could</u> result in a binding agreement,*

231 Testimony of Dr. Kim, Transcript Day 6, p.19, lines 4-6.

232 Indicative Proposal for Project Zenith from Korea National Oil Corporation (**Exhibit C-18**).

> *allowing TNG to export 7 bcm of gas starting in 2009 through 2018 and realize netbacks significantly higher than those available domestically"*[233] (emphasis added)

284 Despite these clear facts, Claimants rely on the Undated 2008 Draft Agreement as a basis for their gas price expectations, stating that

> *"[…] a preliminary agreement signed by representatives of all three parties set out in careful detail the two explicit export pricing methodologies for deliveries of gas to KazAzot and to KazMunaiGas."*[234] (emphasis added)

285 When making this statement, Claimants obviously refer to the Undated 2008 Draft Agreement as can be seen from their reference to paragraphs 5.30 and 5.31 of the FTI Consulting Expert Report dated 17 May 2011.[235]

286 This statement is remarkable because it makes two false and one very revealing assertion.

287 The statement is wrong because the Undated 2008 Draft Agreement was never signed by KazTransGas.

288 The statement is also wrong because under the Undated 2008 Draft Agreement, TNG would not be delivering gas to KazAzot and KazMunaiGas but to KazAzot and KazTransGas.

289 The statement is revealing because Claimants themselves consider the Undated 2008 Draft Agreement to be of *preliminary* nature. How Claimants can reasonably rely on the further existence of an agreement that they themselves consider to be preliminary remains to be explained. Further, from what they conclude that the Undated 2008 Draft Agreement was supposed to be preliminary is entirely unclear. Apparently, Claimants even disagree with their witness Mr. Lungu who makes no mention that the Undated 2008 Draft Agreement was supposed to be preliminary.[236]

290 In summary, it has to be highlighted that Claimants rely on an undated agreement which they consider to be preliminary and which contrary to

---

233 Project Zenith Information Memorandum, p. 10 (**Exhibit C-70**).

234 Claimants' Reply on Quantum, para. 14.

235 Claimants' Reply on Quantum, para. 14, footnote 49.

236 First Witness Statement of Mr. Lungu, para. 21.

their assertions was not signed by all parties. In reality, there was no signed Tripartite Agreement on 14 October 2008 and there still is no signed Tripartite Agreement even today. This manifestly undermines Claimants' gas pricing argument.

(B) Even if signed by all parties, the Undated 2008 Draft Agreement could never have come into force in the first place

291 Even if signed by KazTransGas, the Undated 2008 Draft Agreement could have never come into force because of the role of Gazprom.

292 Under the Undated 2008 Draft Agreement, KazTransGas was supposed to be one of the parties. However, KazTransGas never signed the contract because the conditions under para. 2.2 of the agreement were unattainable. Para. 2.2 stipulated that KazTransGas would have needed to become the exclusive exporter of Kazakh gas:

> *"The current contract is in force after it is signed by all parties, under the conditions that the Exporter receives permission from its parent company (AO KazMunaiGas) to enter into this deal, and also after the designation of the exporter as the exclusive operator for export of gas originating in Kazakhstan from the Republic of Kazakhstan."*[237]

293 Gazprom would never have accepted this to happen as Gazprom wants its 50% affiliate KazRosGas to participate in the export of Kazakh gas. It may be added here that Claimants still have not proven in how far Mr. Kulibayev should be able to control KazRosGas[238] given that it was established on equal terms between Gazprom and KazMunaiGas.[239]

294 This became readily apparent when Gazprom – by letter of 27 October 2008 – rejected to agree to KazTransGas exporting the gas.[240] Gazprom simply refused to buy gas from KazTransGas and insisted on KazRosGas instead:

---

237 Undated 2008 Draft Agreement (**Exhibit C-302**).

238 Claimants' Reply on Quantum, para. 20.

239 Cf. also Supplemental Expert Report Martha Olcott, para. 74.

240 Letter from Gazprom to KazMunaiGas dated 27 October 2008 (**Exhibit R-343**).

> *"In order to increase the profitability of the LLC 'KazRosGaz' taking into account the delivery of part of the Karachaganak gas to the domestic market of the Republic of Kazakhstan at fixed prices we consider it expedient to consider the conclusion of a contract of purchase of the above mentioned Kazakh gas volumes from LLC 'KazRosGaz'."*[241]

295 This refusal is also clear proof that not even MazMunaiGaz National Company could simply decide to export more gas. All depended on Gazprom.

296 Hence, there was no realistic prospect of the Undated 2008 Draft Agreement ever being put into reality. For this reason, KazTransGas had to be replaced by KazMunaiGas as a party to the contract. This is reflected by the subsequent 17 November 2008 Agreement which was negotiated with KazMunaiGas but in the end not signed by KazAzot.[242]

(C) It could not be expected that KazAzot would pursue the Project and without the KazAzot fertiliser plant Claimants could not expect to achieve export prices

297 It could never be expected that the Tripartite Agreement would come into force. Claimants draw a simplistic picture of the whole process of negotiation.

298 The KazAzot fertiliser plant would have been a strategic project in the Mangystau Region.

299 As Professor Olcott explains:

> *"This project, first announced in October 2006, during a visit that President Nazarbayev made to Mangystau oblast, and the president's presence at its unveiling gave it a sense of greater priority.*

---

241 Letter from Gazprom to KazMunaiGas dated 27 October 2008 (**Exhibit R-343**).

242 Tri-Partite Agreement between TNG, KazMunaiGas and KazAzot (did not enter into legal force) (**Exhibit C-97**).

Nazarbayev's trip was designed to support the goals of economic diversification in resource dependent regions like Mangystau."[243]

300 As a fertiliser plant depends on significant amounts of gas, KazAzot approached TNG regarding the supply of gas by letter of 29 December 2007.

301 KazAzot explained that it needed gas for this politically desired project and emphasized that it needed a long-term supplier:

> *"Acting on the instructions of the Akim of the Mangistau Province Mr. K.Ye. Kusherbayev, KazAzot LLP is writing to you to request that you consider the possibility of entering into a long-term contract, for a period of at least ten years, for the supply of natural gas to meet the needs of an investment project involving the construction of an Ammonia-Urea Complex."*[244]

302 At first, TNG refused to supply the gas but they later agreed under the condition that they would be allowed to export gas in return.

303 Hence, the reasoning behind the Tripartite Agreement was never that TNG should be able to export gas. It was simply a bargain: If TNG were to deliver gas to this strategic project, TNG could be assisted in being given the opportunity to sell gas. This is explicitly accepted by Mr. Lungu who states:

> *"In early 2007, Kazakhstan approached TNG with a proposal for the provision of gas to KazAzot, a local chemical company. […] This project was considered a priority on a national level. However, KazAzot needed to secure a gas supply and TNG was the ideal candidate: it was the fourth largest producer of gas; it was locally situated; and it was a reliable provider of gas in large quantities. Therefore, the Kazakh MEMR drafted and sent to us a memorandum of understanding. Mr. Stati used this opportunity to negotiate the inclusion of a right for TNG*

243 Supplemental Expert Report Martha Olcott, paras. 55 et seq.

244 Letter from KazAzot to TNG dated 29 December 2007 (**Exhibit R-344**).

> *to export its gas at international market prices and, in exchange, TNG would provide certain volumes of gas to KazAzot at market prices.*"[245] (emphasis added)

304 It is therefore apparent that Claimants' wish of exporting gas was dependent on the strategically important fertiliser plant being built. Claimants choose to ignore this clear statement by their own witness when they bring forward that a prospective buyer could have had the reasonable expectation that gas exports at international prices would have been available to TNG because KazMunaiGas "*did execute the November 17, 2008 Agreement*".[246]

305 First, this statement does come as a surprise as Claimants' make it only one paragraph after explaining that what is "*vitally important*" were the reasonable expectations of TNG and a prospective buyer on 14 October 2008.[247] Clearly on 14 October 2008, KMG had not signed the agreement and Claimants have not shown that the 17 November 2008 Agreement was even being negotiated.

306 Apparently, Claimants mean signature when they talk about "*execution*" of the agreement. However, Claimants continue to say that gas exports and export prices could reasonably be assumed "*irrespective of the existence of an appurtenant fertilizer plant*"[248] because it was KazMunaiGas and not KazAzot that would take delivery of TNG's export gas and pay the export prices. Claimants consider the export provisions to be a separate component and even go so far as to say that if KazAzot needed less gas, this would only mean that more of TNG's gas could be exported.[249]

307 Again, Claimants' argumentation disregards the rationale of the Tripartite Agreement. The supply of gas and the export of gas were entirely interdependant. KMG would have had no incentive to export TNG's gas had it not been for the purpose of supporting the strategically important fertiliser plant. As Mr. Lungu states, the importance of the project was the

---

245 First Witness Statement of Mr. Lungu, para. 19.

246 Claimants' Reply on Quantum, para. 17.

247 Claimants' Reply on Quantum, para. 16.

248 Claimants' Reply on Quantum, para. 17.

249 Claimants' Reply on Quantum, para. 17.

opportunity for Mr. Stati to negotiate the possibility for TNG to export its gas.[250]

308 In fact, as Professor Olcott explains:

> "*Tolkyn was being offered the opportunity to export gas, not because KazTransGas had a real need for their gas, but because they were seeking to incentivize the owners of Tolkyn to supply gas to the Kazazot plant.*"[251]

309 As can be seen from KazMunaiGas's request to Gazprom of 15 September 2008,[252]

> "*[t]he Kazakh government was willing to allocate part of its export quota, potentially cutting off one of its own gas producing companies from gaining part of the quota to secure the gas supply for what was then judged as a potentially profitable strategic project. The structure of the contract (C-097) makes that quite clear, as it places the goal of supplying gas to Kazazot as the first goal, and the granting of a right to uninterrupted export of gas, is placed second. There would be no obligation for KazTransGaz to take on the responsibility for purchasing or marketing this gas.*"[253]

310 However, in October 2008, it could not be expected that KazAzot would have further pursued the project of building the fertiliser plant under the given conditions.

311 That is because under the Undated 2008 Draft Agreement, KazAzot was to pay USD 100 per 1000 m^3 which is an extremely high price for domestic sales.[254] This would have been almost double the amount that Kemikal and

---

250 First Witness Statement of Mr. Lungu, para. 19.

251 Supplemental Expert Report Martha Olcott, para. 70.

252 Letter from KazMunaiGas to Gazprom of 15 September 2008 (**Exhibit R-345**).

253 Supplemental Expert Report Martha Olcott, para. 75.

254 Interestingly, FTI wrongly state that *"the 2008 Agreement between TNG, KazAzot, and KazTransGaz, specifies a price to be paid by KazAzot which is significantly higher than the regular domestic prices for gas. This price is 12,000 Tenge per 1000 cubic meters which using the specified exchange rate conversion, is to approximately $120 per 1000 cubic meters."* (emphasis added), cf. 1st FTI Report, para. 11.19. However, the price payable by KazAzot under the pricing formula would always have been USD 100.

The pricing formula stipulated in section 6.1 of the 2008 Agreement is the following:

more than 3 times the amount that Aktaugazservice paid to TNG.[255] In the fall of 2008, it became clear that KazAzot would not be able to pay such prices. At the time, the prices for fertilisers dropped sharply. In October 2008 alone, the prices for urea dropped by more than 40%.[256] In November 2008, the prices for urea, again, dropped by almost another 40%. In fact, the price went from USD 706.25 per Metric Ton in September 2008 to USD 245.75 in November 2008.

312 Under such circumstances, KazAzot could not be expected to sign the November 2008 Agreement. It simply would not have been profitable for KazAzot.

313 Accordingly, KazAzot wrote to KazMunaiGas on 27 November 2008:

> *"Due to the signing of a long-term contract to supply the necessary natural gas for the construction of a new ammonia-urea complex, as well as substantial changes in the macroeconomic indicators of the global economy, the Supervisory Board of KazAzot LLC has resolved to conduct a financial audit of the entire project."*[257]

314 KazAzot made it very clear that the reason for not signing the agreement was that

---

"The price for 1000 cubic meters of gas, provide by the suppler to the User according to the current Agreement for the period from 01 January 2011 through 31 December 2013 is set in Tenge and it calculated using the following formula:

Pm = Pg X In , where:

Pm= The monthly price for 1000 cubic meters of gas, not including VAT

Pg=the base price for 1000 cubic meters, not including VAT, which is 12,000.00 Tenge;

In= index, which is determined by dividng [sic] KNBRK/120, where KNBRK - the official exchange rate of the Tenge to the US Dollar, as set by the national bank of the Republic of Kazakhstan on the last working day of the month of delivery, for which the price is being determined.", cf. Undated 2008 Draft Agreement (**Exhibit C-302**).

This means that the monthly price is 12,000 Tenge muliplied by the official exchange rate of Tenge to Dollar and divided by 120. In other words, the price would always have been the Tenge equivalent of USD 100.

255 Cf. FTI Consulting Expert Report, para. 5.19, Table 3.

256 Cf. Indexmundi - Urea Monthly Price (**Exhibit R-346**).

257 Letter from KazAzot to KazMunaiGas dated 27 November 2008 (**Exhibit R-347**).

> *"[i]n the existing gas supply addendum, the price is set at a certain level that cannot guarantee the profitability of the project."*[258]

315 KazAzot therefore asked to postpone the signature of the Agreement by six months. Contrary to Claimants' allegations, KazAzot did not "*indicate that it would sign the Agreement within six months subject to the new audit being performed*".[259] KazAzot simply asked to postpone the deadline for the signature but made no commitment that it would then sign the agreement.

316 After KazAzot had conducted the audit it wrote again to KazMunaiGas on 28 April 2009 and asked for another postponement by 6 months. Again, it very clearly stated the reasons:

> *"The preliminary results of financial audit of investment construction project of the ammonium-carbamid complex taking into account the negative changes on the mineral fertilizers market resulted by the world financial crisis has shown unprofitableness of the project at the market conjuncture for this moment. The mineral fertilizers market monitoring has shown more than double landslide of prices for all types of fertilizers at IV quarter of 2008 and stable tendency of prices drop in the first 4 months of 2009. At the same time, the prices for natural gas and its transportation are growing stably, as well as the electricity rates which are the fundamental component in ammonium and nitric mineral fertilizers production."*[260]

317 A further factor is very likely to have played a role for KazAzot's business decision. In September 2008, Uzbek authorities planned to expand their own ammonia based fertilizer industry in Navoi and signed a memorandum of understanding with a company from the Emirates in September 2008.[261]

318 The impact of this project on KazAzot would have been considerable:

---

258 Ibid.

259 Claimants' Reply on Quantum, para. 16.

260 Letter from KazAzot to KazMunaiGas dated 28 April 2009 (**Exhibit R-213**).

258 Cf. Supplemental Expert Report Martha Olcott, Exhibit 39.

> *"The new Uzbek factory would have made the Kazazot project less profitable, as Uzbekistan would have much cheaper energy costs (less than half those set out in the Kazazot contract), cheaper labor, and easier access to international rail, the preferred shipping method for these kinds of products. The Uzbek project was also put on hold during the global crisis of 2008-2009, and was revived again in 2010, with even larger quantities of new production planned."*[262]

319 The fact that the plant still has not been built is further proof that KazAzot is a company with a long history of persisting problems which could never have trusted to manage to build the plant in the first place.[263]

(D) TNG could never have fulfilled its obligations under the Undated 2008 Draft Agreement

320 Lastly, any reliance on the Undated 2008 Draft Agreement running for a long term is undermined by the fact that it was impossible for TNG to fulfill its obligations under the Undated 2008 Draft Agreement. In all likelihood, a hypothetically signed Tripartite Agreement would have been terminated as early as 2009.

321 Deliveries under the Undated 2008 Draft Agreement were supposed to start in the year 2009. At this point, Claimants' own experts estimate the proved and probable reserves to be 358.4 Bcf[264] which translates into about 10.15 Bm^3. However, the total volume under the Undated 2008 Draft Agreement was supposed to be 19.25 Bm^3, i.e. almost double the reserves of Tolkyn. As TNG had negotiated the right to export gas from 2009 - 2013, i.e. in the first 5 years of the term, TNG's inability to deliver would have been to the detriment of KazAzot. Consequently, TNG was not the long-term gas supplier which it purported to be towards KazAzot.

322 At the envisaged total annual volume of 2.7 Bm^3 in the first five years, the reservoir would already have been depleted after less than four years which means that instead of receiving gas from TNG for eight years, KazAzot

---

262 Supplemental Expert Report Martha Olcott, para. 64.

263 Cf. Supplemental Expert Report Martha Olcott, Exhibits 28-30.

264 Ryder Scott Expert Report, p.1.

could only have been supplied by TNG for less than two years. Clearly, TNG could not have become the strategic long-term supplier, it was supposed to be. Rather, it sought to reap the profits in the first four years of the contract and then to leave KazAzot and the domestic users empty-handed.

323 In addition, the annual volume of 2.7 Bm^3 not only disregards the total reserves of Tolkyn but also the maxium amount of gas extracable per year.

324 Even Claimants' experts Ryder Scott, which disregard the increasing water production on Tolkyn, assumes that Tolkyn could never have achieved an annual production of 2.7 Bm^3. For example, for the year 2012, Ryder Scott predicted an annual producton of 43,0480 MMcf of gas[265] which translates into 1.22 Bm^3, i.e. less than half the amount TNG was obliged to deliver under the Agreement.

325 Applying the correct numbers from GCA[266], in the year 2012, TNG would only have been able to deliver 1.08 Bm^3, little more than one third of the amount TNG would have needed to deliver.

326 The distribution formula of section 3.2 of the Undated 2008 Draft Agreement also needs to be taken ito account. According to this formula, TNG would first have needed to deliver gas to KazAzot and to the domestic market and only any remaining gas could have been exported.

> *"The distribution between the Consumer and the Exporter of the total gas volume produced by the Supplier specified in the clause 3.1. of this Agreement shall be based on a forecast of gas extraction on the well site existing at the time of signature of this Agreement. In case of discrepancy of the actual and projected amount of the produced gas, the Supplier shall first make delivery to the Consumer in the volume in accordance with the clause 3.1. of this Agreement, then deliver to the domestic market of the Republic of Kazakhstan in the volume under the*

265 Ryder Scott Expert Report, Exhibit No. 7.

266 GCA Supplemental Technical Report, Appendix II, Table A.II.1.

clause 3.1 of this Agreement and the remaining amount shall be delivered to the Exporter."[267]

327 This distribution would mean that for example in 2012, TNG could not have exported any gas because TNG was obliged to deliver gas to KazAzot first. KazAzot demanded 1.1 Bm^3 and TNG could only have produced 1.08 Bm^3, thus not even entirely fulfilling KazAzot's demand.

328 Even applying the Ryder Scott numbers, TNG would not have exported gas because after KazAzot, the needs of the domestic market would have needed to be satisfied and TNG was obliged to deliver an additional 0.47 Bm^3 to the domestic market. Hence, assuming the annual production of 1.22 Bm^3 in 2012, TNG would only have been able to satisify its obligations towards the domestic users by about one fourth because after delivering 1.1 Bm^3 to KazAzot, it would only have 0.12 Bm^3 for the domestic market left.

329 All of this must have been known to Claimants at the time they entered into negotiations regarding the Tripartite Agreement. That is because in April 2008, Claimants' received a report prepared by Miller Lents upon instruction from Mr. Stati which clearly set out the available reserves.[268]

330 As an example, for the year 2012, this report states that the total proved producing reserves would be 30,230 MMCf which translates into about 0.85 Bm^3 of gas, i.e. less than one third of the total amount TNG was obliged to deliver and 0.25 Bm^3 less than KazAzot required.[269]

331 The fact that TNG intended to enter into a long-term agreement it could never fulfill becomes even more obvious by looking at the numbers for 2018, the last year of the Undated 2008 Draft Agreement in which nonetheless, TNG would still have been obliged to deliver 1.1 Bm^3 to KazAzot as the necessary gas for its plant.

332 According to the information available to Claimants at the time they negotiated the agreement, i.e. the Miller Lents 2008 report, TNG did not have any proved producing reserves for the year 2018.[270] Even the proved

---

267 Undated 2008 Draft Agreement (**Exhibit C-302**).

268 Miller Lents Report 2008 (**Exhibit R-348**).

269 Miller Lents Report 2008, Exhibit 16 (**Exhibit R-348**).

270 Miller Lents Report 2008, Exhibit 16 (**Exhibit R-348**).

non-producing reserves for the year 2018 only amounted to 247.5 MMCf which translates into 0.006 Bm^3, i.e. 0.5% of what it was obliged to deliver to KazAzot.[271]

333 Consequently, TNG's negotiations regarding the Tripartite Agreement were disingenuous because they pretended to be a long-term supplier of a considerable amount of gas even though they could never have fulfilled their obligations.

334 Naturally, TNG's inability to perform would also have affected the contract. Under section 10.1 of the Undated 2008 Draft Agreement – which, incidentally Claimants have failed to translate – it is stipulated:

> *"This Agreement may be terminated by either Party unilaterally in case of failure and/or inability of another Party/other Parties to perform its obligations according to the present Agreement, within 60 (sixty) calendar days, and the Terminating Party shall undertake to inform the other Parties within 7 (seven) calendar days prior to the unilateral termination of this Agreement."*[272]

335 This means that KazAzot or KazTransGas could have terminated the agreement as soon as TNG started failing to fulfill their obligations. Even assuming Ryder Scott's highly unrealistic numbers which do not take into account the water production on Tolkyn, KazTransGas could already have terminated the agreement in 2009. Even Ryder Scott make a forecast of 77,649 MMcf of gas which translates into about 2.2 Bm^3 and thus 0.5 Bm^3 less than TNG would have been obliged to deliver to KazTransGas and the domestic market.

336 The fact that the Undated 2008 Draft Agreement, even if signed and come into effect, would not have survived the year 2009 is even more apparent from looking at the actual production number for the year 2009 of about 1.32 Bm^3 which is less than half of what TNG would have been obliged to supply.[273]

---

271 Miller Lents Report 2008, Exhibit 17 (**Exhibit R-348**).

272 Undated 2008 Draft Agreement (**Exhibit C-302**).

273 Cf. Minutes on the results of the extraordinary verification of the fulfillment of the contractual and licensing obligations by TOO Tolkynneftegaz, para. 5, Table 5 (**Exhibit C-599**).

337 Again, this must have been known to Claimants as even the 2008 Miller Lents report procured by Claimants only assumed total proved producing reserves of 63,013 MMcf for the year 2009 which translates into about 1.78 Bm^3 and thus almost 1 Bm^3 less than TNG was obliged to deliver.

c) Claimants further reasons for assuming gas export are equally baseless

338 In their Reply Memorial on Quantum, Claimants try to back FTI Consulting's untenable assumptions by adding some equally untenable arguments which are supposed to show that export of gas could be expected:

(a) TNG's and KPM's alleged contractual right to export gas under the terms of their Subsoil Use Contracts;[274]

(b) Proximity of the Central Asia-Center Pipeline;

(c) Indicative offers received by Claimants for the Tolkyn field.

339 Claimants complain that Respondent has not addressed these issues in its Statement of Defence. However Claimants themselves made these arguments for the first time in the Reply Memorial on Quantum.[275]

340 In fact, it is obvious that TNG's alleged contractual rights to export and the proximity of the Central Asia-Center Pipeline cannot and do not play a role in Claimants' argumentation.

341 The specific wording of the contracts themselves has not changed since they were concluded in 1998 (Contract No. 210) and 1999 (Contract No. 305). Still, Claimants have not even argued that they should simply have been able to export their gas. The same applies for the proximity to the Central Asia-Center pipeline. The mere proximity does not give rise to any expectation that the gas could be exported. In particular, it does not in any way convey a right to export.

342 It is also questionable in how far the indicative offers received by Claimants for the Tolkyn field should be an indicator for reasonable expectations regarding the possibility to export gas. If bidders assumed that

---

274 Claimants' Reply on Quantum, para. 9

275 Claimants' Reply on Quantum, para. 12.

TNG would be able to sell gas, they made this assumption based on Claimants' statements in the "Project Zenith Information Memorandum". It is not a reflection of what a fully informed party would pay. It is merely a reflection of what an only partly and subjectively informed party would be willing to offer in order to get access to the data room of a company.[276]

4. Claimants' vaulations of Tolkyn and Borankol are inflated for wrong assumptions regarding gas prices

343 Claimants are not only mistaken about the alleged expectation to be exporting gas. They also apply the wrong prices.

344 FTI Consulting in their export report assume prices of USD 180 per 1000 m^3 of gas.[277] This assumption is unrealistic. As Deloitte point out, TNG's contractual obligations have to be taken into consideration.[278]

345 In addition, a price of USD 180 per 1000 m^3 of gas would not be achievable by a field operator.

346 Even today,

> *"the Kazakh government agreed to sell its gas for $170 per 1000 cm for 2010, delivered to Aleksandrov Gai in an agreement signed in April 2010. And in January 2011 they agreed to sell the gas to Russia for $185 per 1000 cm for 2011. Once again in December 2011 the same price of $185 was agreed for deliveries for 2011-2012. All of these prices cover all Kazakh gas exports to Russia, excepting those going from the Karachaganak oil field to Orenburg."*[279]

347 These prices are the prices payable by Gazprom to the exporter, i.e. KazRosGas of which among others, considerable costs for transport need to be deduced.

---

276 See also below paras. 447 et seqq.

277 FTI Consulting Expert Report, para. 11.22.

278 Deloitte & Touche Expert Report, paras. 43 et seq., 73 et seq. and 103 et seq.

279 Supplemental Expert Report Martha Olcott, para. 30.

348 Claimants have not demonstrated in how far they could have achieved the same price as KazRosGas. In order to do this, they would have needed to negotiate directly with Gazprom and they have failed to provide proof of any such prospect. Also, clearly, Gazprom would be more willing to pay a higher price to a company in which it owns 50% of the shares than an unrelated party like TNG.

349 Claimants also grossly misrepresent the expected price development when they state that a flat price of USD 180 were "*conservative estimate given the fact that export prices were set to be raised at the time to US $305 per 1000 cubic meters in January of 2009*".[280] The source Claimants cite does not say that prices were "*set to be raised*" but KMG NC merely indicated that its own price "*could increase by 60-70 percent from January 2009 to up to $ 306 per tcm*".[281]

350 In addition, this vague hope soon proved to be wrong. As Professor Olcott explains,

> *"[a]t one point in March, 2008 the KMG leadership even boasted that they might be able to get over $300 for 1000 cm from Moscow in 2009, but that year began with the Russian-Ukrainian gas price war, which resulted in a shutdown in the main gas pipeline to western Europe, and the Europeans becoming increasingly more interested in diversifying their gas supplies away from Russia.*
>
> *As a result in August 2009, Gazprom announced that its first quarter profits were down by 62 percent, and that Gazprom's sales volumes were anticipated to drop 40 percent for the year as a whole given a dramatic drop in European demand. And, as noted above, the prices for Kazakh gas never went beyond US$185."*[282]

351 Claimants price assumptions are also seriously flawed because they do not take into account the domestic prices. As a sidenote, it may be mentioned that domestic prices are set by the Agency for Natural Monopolies and

---

280 Claimants' Reply on Quantum, para. 10.

281 FTI Consulting Expert Report, Scope of Review No. 76 (emphasis added).

282 Supplemental Expert Report Martha Olcott, paras. 39 et seq.

> *"they are highly differentiated, with different rates for households, non-profit public services, established industries and industries that are being developed under state incentive programs. And all of these rates are publically available on the website of the Agency for the Regulation of Natural Monopolies."*[283]

352 None of the prices Claimants achieved could therefore be called discriminatory. And in fact not only Claimants were dissatisified with their inability to export gas.

> *"Kazakhstan's state owned oil and gas companies have had to forgo meeting projected profit targets to meet their required shifts in production from the export to the domestic market. For example, Kaztransgaz announced that its 2011 profits were going to be 25 percent below planned because of production that was redirected to the Kazakh market."*[284]

353 Assuming realistic prices like the prices achieved by GasTradeInternational LLP does not constitute some form of an illegitimate "*export gas racket*".[285]

> *"In Kazakhstan it is perfectly legal for the state's designated purchase agent, which is either KazTransGaz, or KazRosGaz to take part of the purchase price as fees or commissions for the service performed. And there is legislation on transfer pricing which offers some overall guidance for regulating them."*[286]

354 Claimants may have been unhappy with their inability to achieve international export prices for their gas but this is what they bargained for when they entered the Kazakh market. Claimants were treated not less favourable than any other market players. If anything, bad planning and the pursuit for unrealistic profits may have prevented them from noticing that

---

283 Supplemental Expert Report Martha Olcott, para. 83.

284 Supplemental Expert Report Martha Olcott, para. 84.

285 Claimants Reply on Quantum, para. 19.

286 Supplemental Expert Report Martha Olcott, para. 25.

> *"[t]he realities of the gas business in Kazakhstan were that few people were happy with the prices offered. Gazprom offered a price for exports that was lower than press reports suggested were the case, and these prices reflected the destinations that the gas was bound for. Those producing gas in Kazakhstan were bound by these prices, and transit fees that reflected the high maintenance expenses that Intergas CA was experiencing to keep capacity up.*
>
> *Everyone was forced to sell on the domestic market, for lower prices, and were often stuck accepting clients who were at the lowest end of the domestic tariff scale.*
>
> *Added to this were the other challenges of doing business in Kazakhstan, which included increasing labor costs and rather strictly defined obligations of local content. So while there were some potentially attractive projects on offer, the decision for an experienced international oil and gas operator to decide whether or not to engage in a project was a difficult one."*[287]

5. Claimants themselves assumed significantly lower gas prices over the years 2008 and 2009

355 The allegedly reasonable gas prices applied by FTI Consulting are also far removed from the prices Tristan itself asked Miller Lents to apply when Mr. Stati instructed Miller Lents to make a so called estimation of the net oil, condensate, gas, and gas plant liquid (LPG) reserves and future net revenues for Tolkyn and Borankol.

356 Mr. Stati instructed Miller Lents to draft such a report for the year 2008 and for the year 2009. Both reports contain the following provision regarding the gas prices that Miller Lents used:

[287] Supplemental Expert Report Martha Olcott, paras. 93 et seqq.

> *"The oil, condensate, LPG, and gas prices employed in the computations of gross revenues were provided by Tristan."*[288] (emphasis added)

357 Hence, Tristan instructed Miller Lents to apply certain gas prices. Even though these reports were drafted at a time when Claimants were obviously planning to sell the shares in KPM and TNG and thus they certainly were not modest in the prices they assumed, these prices were still considerably lower than the USD 180 per 1000 m^3 applied by FTI Consulting.

358 The prices assumed by Miller Lents in both reports start at USD 1.40 per Mcf in the year 2008 and the year 2009 respectively, escalated by 10% per year. Applying the 2009 Miller Lents report, this leads to a price of USD 3.30 per Mcf in the year 2018.[289] In turn, this translates into a price of USD 49 per 1000 m^3 in the year 2009 and up to USD 115 in the year 2018.

359 It is refuted that an escalation of the prices is adequate but even so, Claimants' assumed prices are far from the flat price of USD 180 per 1000 m^3 for the entire period of time which FTI employ.

360 It is astonishing that Claimants purport that a flat price of USD 180 per 1000 m^3 is reasonable when both at the end of 2007 and at the end of 2008,[290] Claimants themselves, for the purpose of receiving an estimate of "*the future net revenues*", instructed Miller Lents to employ prices that were considerably lower.

361 Claimants instructed Miller Lents to use one instructed price case and three instructed price case sensitivities. In the instructed price case and in two of the instructed price case sensitivites, the starting price is USD 1.40 per Mcf as stated above. In the 2008 report, Claimants then instructed Miller Lents to employ a starting price of USD 4.11 starting from the year 2009 and again escalated by 10% per annum.[291] Obviously, Claimants considered this price case sensitivity less probable as this price was only applied in one of four price scenarios.

---

288 Miller Lents Report 2008, p.4 (**Exhbit R-348**) and Miller Lents Report 2009, p.4 (**Exhbit R-349**).

289 Miller Lents Report 2008, Exhibit 1 (**Exhbit R-348**) and Miller Lents Report 2009, Exhibit 1 (**Exhbit R-349**).

290 Both the 2008 and the 2009 Miller Lents Report are dated 14 April. It is thus reasonable to assume that Claimants must have instructed Miller Lents to draft the reports at the end of 2007 and 2008, respectively.

291 Miller Lents Report 2008, Attachment 1 (**Exhbit R-348**).

362 It is even more interesting to note that for the 2009 Miller Lents report, Claimants instructed Miller Lents to employ a different, much lower price for this fourth and least probable price sensitivity. This time Claimants asked Miller Lents to apply a base price of USD 2.00 starting from the year 2009.[292] This translates into about USD 70 per 1000 m^3.

363 While Respondent is unaware of when exactly Claimants instructed Miller Lents to prepare the 2009 report, it is certain that probably towards the end of 2008 but certainly before April 2009, when Miller Lents issued their report, Claimants assumed that even for a company that is trying to sell itself it would only be justifiable to assume a price of USD 1.40 per Mcf, i.e. USD 49 per 1000 m^3, as a realistic price scenario and a price of USD 2.00 per Mcf, i.e. USD 70 per 1000 m^3 as the less probable scenario. This is in stark contrast to Claimants' assertion that through August of 2009, the Tripartite Agreement "*remained a viable prospect and confirmatory reason for a belief that TNG would be able to export gas at international prices*".[293] In fact, the Tripartite never was a viable prospect and Claimants knew this.

364 It is also interesting to note that the price of about USD 70 per 1000 m^3 which Claimants instructed to employ as the less probable price for the 2009 report is exactly the export price GasTradeInternatonal LLP received and which Claimants call "*brazen and revealing*".[294]

365 The only possible conclusion from Claimants own price assumptions is that Claimants themselves, even at the time of their own valuation date, never believed that USD 180 per 1000 m^3 of gas would be a realistic price. Hence, Claimants should not now be allowed to trick the Tribunal into believing that it would be.

IV. Damages relating to tax claims

366 Claimants have based their claim also on the allegedly improper assessment of taxes and duties against them. In particular, Claimants allege that the Republic's Tax Committee improperly imposed taxes and wrongly assessed

---

292 Miller Lents Report 2009, Attachment 1 (**Exhibit R-349**)

293 Claimants' Reply on Quantum, para. 16.

294 Ibid, paras. 18 et seq.

approximately 3.2 billion tenge and 5.9 billion tenge (approximately USD 22 and 40 million) in back corporate income taxes and penalties against KPM and TNG respectively.[295] Allegedly, these tax assessments were contrary to contractual provisions in the subsoil use contracts and to previous tax assessments.

367 The Republic maintains the position that the assessments were made in accordance with the law and no contractual or legal obligations were violated by the Tax Committee when making its assessments.[296] Hence, the Republic is not liable for any tax payments made by the Claimants because of these assessments.[297]

368 Specifically, the Republic's position is the following:

(a) For KPM, during the period from 1 January 2005 to 31 December 2007 (Act of 10 February 2009 № 28), the Republic's assessment revealed that an additional 3,257,446.0 thousand Tenge was payable, including taxes of 2,255,207.8 thousand Tenge and penalties of 1,002,238.2 thousand Tenge. The unpaid taxes KPM failed to pay related to corporate income tax (as a result of it improperly allocating expenditure relating to exploration and geological prospects as a deduction) and investment income tax (as a result of it making payments for training for individuals that were not employees).

(b) For TNG, during the period from 1 January 2005 to December 31, 2007 (Act of 10 February 2009 № 29), the Republic's assessment revealed that TNG was liable to pay an additional 5,906,027.2 thousand Tenge, including taxes of 4,007,727.4 thousand Tenge and penalties of 1,898,299.8 Tenge. TNG was also required to reduce its losses by 1,558,600.2 thousand Tenge. The taxes KPM failed to pay related to corporate income tax (as a result of it improperly allocating expenditure relating to exploration and geological prospects as a deduction) and royalty tax (as a result of it incorrectly

295 Claimants' Statement of Claim, para. 157; Claimants' Reply on Jurisdiction and Liability, para. 233.

296 Cf. already Respondent's Statement of Defence, paras. 30.48 et seqq. and Respondent's Rejoinder on Jurisdiction and Liability, paras. 369 et seqq.

297 For further considerations regarding taxation, cf. also First and Second Witness Statement of Mr. Rahimgaliev. Cf. also Kazakh Legislation Relating to Tax Issues (**Exhibit R-350**).

identifying transportation costs, and therefore applying a lower tax base for calculating the royalty for the audited period).

369 Broadly, the dispute relates to the question of which amortization rate applied to the companies' exploration expenses for

(a) the drilling of wells,

(b) geophysical research,

(c) mobilization and demobilization of wells,

(d) development of wells and

(e) well-kill operations

for the years 2005 to 2007.[298]

370 Whereas the Tax Committee applied the amortization rate stated in Article 23 of the applicable tax law, Claimants allege that the rate set out in Article 20 should have been applied. Article 23 foresees a rate of 25% and thus only gradual depreciation of the costs over a period time. Article 20 allows the subsoil user to apply a 100% amortization rate (i.e. full deduction in the year in which costs are incurred).

371 The Republic has retained the internationally renowned tax law specialist Tomas Balco to address this question in an expert report.[299] Professor Balco studied KPM's and TNG's subsoil use contracts as well as the amendments thereto and identified one issue as central to the tax claims, namely an issue of interpretation of the contracts:

> *"All the three Contracts contain Supplements signed in 2004 […]*
>
> *[T]hese 2004 Supplements contain a special Appendix named 'Tax regime application procedure', […] which elaborates in further detail on the application of the relevant substantive tax law provisions and provides detailed guidance on their application. […]*

298 Cf. Expert Report of Tomas Balco, B.2.1.

299 Cf. Expert Report of Tomas Balco.

The Procedure contains specific Section 4 – Deductions, which establishes the rules, under which the Companies were entitled to claim deductible expenses. Specific Subsection 4.4.7. dealt with Depreciation deductions on depreciable assets and capitalized expenses.

It specifically provided for the following principles: […]

- *Assets and capitalized expenses subject to depreciation shall be divided into groups with the following maximum depreciation rates […]*

  8. Processing equipment, acquired to be used in production purposes, and expenditures for own-account construction.

    - In accordance with item 10, Article 20 of the Tax Law (at the discretion of Contractor)

  9. Expenditures, capitalized in accordance with Article 23 of the Tax Law, set forth in item 4.4.7.12 of this Supplement.

    - 25% […]

From the above overview the critical to this dispute are points 8 and 9. Depreciation rate in accordance of point 8 was used by the Companies, while Tax Committee enforced application of depreciation in accordance of point 9 above."[300]

372 Professor Balco then goes on to analyse into which categories Claimants' expenses belong:

(a) He refers to Section 4.4.7.12 of the "Tax regime application procedure" which effectively determines that "*geological prospecting and geological exploration expenditures, as well as*

[300] Ibid., B.2.3.2.1. and B.2.3.2.2.

preparatory works for Production" are subject to item 9 of Section 4.4.7 and thus to the 25% depreciation rate of Article 23.[301]

(b) A definition of such *"geological prospecting and geological exploration expenditures, as well as preparatory works for Production"* is contained in Section 6.2.5 of the "Tax regime application procedure".[302] The definition refers to exploration expenses related to, *inter alia*, the

- monitoring of subsoil state, acquisition of seismic data and their subsequent interpretation, geological, geophysical, hydro-geological, engineering-geological and geoecological surveys;
- examination of geological structure of the Geological allotment territory, determining hydrocarbons potential;
- scientific-geological investigations;
- search and exploration of hydrocarbon fields, their assessment;
- laboratory, topographic-geodesic, plotting, drilling works, re-entry with the view to conduct Exploration of earlier plugged and abandoned wells and any other works relative to geological prospecting operations;
- operations relative to development of the Field with the view to extract hydrocarbons.

(c) Based on these clear definitions, Professor Balco concludes that KPM's and TNG' expenditures in question are *"expenditures for geological exploration and geological prospecting operations as well as expenditures for operations relative to development of the field with the view to extract hydrocarbons as is also dully documented in the work programs and relevant protocols. These expenditures are specifically foreseen to constitute a separate pool of capitalized expenditures to be covered by the treatment of Article 23, which permits amortization at the rate of 25% as was correctly*

301 Ibid., para. B.2.3.4.2.

302 Ibid.

claimed by the Republic and not at the rate of 100% as was claimed by the Claimants."[303]

373 It must therefore be concluded that the Tax Committee's assessment of corporate back taxes against KPM and TNG was lawful.[304]

V. Debt under the Tristan notes and other debts needs to be deducted from the values calculated for the assets

374 As set out in detail in the Rejoinder Memorial on Jurisdiction and Liability, Claimants created a huge pile of debt, in particular under the Tristan note issuance, for which KPM and TNG were liable as guarantors.[305] Any award for compensation must take into account this debt when assessing the amounts due to Claimants. Spuriously ignoring this fact, Claimants take a different approach. They simply let their valuation experts calculate several asset values and combine these values to one oversized claim, ignoring any debt accrued. This approach cannot be accepted.

375 In the following, the Republic will set out the Tristan note structure as it presents itself from the evidence brought forward by Claimants. Based on these facts, the Republic will then show that this debt – and other debts – cannot be ignored but have to be deducted from any claim brought by Claimants.

1. The Tristan note structure

376 The basics of the Tristan note structure have already been explained in the Republic's Rejoinder Memorial on Jurisdiction and Liability.[306] For convenience, the most important features shall be set out again in the following:

---

303 Ibid., B.2.4.

304 On a sidenote, it should be mentioned that Claimants' characterisation of the dispute, qualifying it as relating to the application of a tax stabilisation provision (cf. e.g. Claimants' Reply on Jurisdiction and Liability, para. 16), is utterly wrong and in fact disingenuous. The application of Article 23 of the tax code was always foreseen as a possibility in the contracts. Hence, no tax stability issues arose.

305 Respondent's Rejoinder on Jurisdiction and Liability, paras. 727 et seqq.

306 Respondent's Rejoinder on Jurisdiction and Liability, paras. 728 et seq.

(a) The Tristan notes were issued by Tristan Oil Ltd., a BVI special purpose vehicle incorporated solely for the purpose of issuing the notes. Tristan Oil is 100% owned by Anatoli Stati.[307] The note issuance was governed by an indenture under New York law, which foresaw Wells Fargo Bank as a Trustee.[308] As the place of trade, the Luxembourg Stock Exchange was chosen.[309]

(b) The first note issuance at the end of 2006 amounted to USD 300 million, the second note issuance in Summer of 2007 amounted to USD 120 million.[310] Further, in the summer of 2009, Tristan issued another USD 111.1 million in notes.[311]

(c) The Tristan notes yielded an annual interest rate of 10.5%, with interest payments being made each half year. On 1 January 2012, the principal of the notes was to become due for repayment.[312]

(d) Earlier repayment was only possible against a surcharge. For any repayment in the period from 1 July 2009 to 1 July 2010, the redemption price was to amount to 105.25% of the note principal. In case of repayment between 1 July 2010 to 1 July 2011, 102.625% of the note principal had to be redeemed to the noteholders.[313]

(e) Further, the indenture foresaw specific rules in case of a change of control in KPM and TNG. As Renaissance Capital put it in the August 2008 information memorandum: *"If Tristan Oil, KPM or TNG experiences a change of control, each holder of the Notes will have the right to require Tristan Oil to repurchase all or any part of the holder's Notes at a price equal to 101% of the aggregate principal amount thereof, plus accrued and unpaid interest, if any, and additional amounts, if any"*.[314]

---

307 First Witness Statement of Mr. Lungu, para. 6.

308 Cf. Tristan Indenture dated 20 December 2006 (**Exhibit C-584**).

309 Tristan Oil Ltd., Annual Report For the Year Ended December 31, 2008, p. F-34 (**Exhibit R-37.5**).

310 Cf. Project Zenith – Information Memorandum by Renaissance Capital, p.65 (**Exhibit C-70**).

311 Tristan Oil Press Release dated 19 June 2009 (**Exhibit R-268**).

312 Cf. Project Zenith – Information Memorandum by Renaissance Capital, p.65 (**Exhibit C-70**).

313 Tristan Indenture dated 20 December 2006, Section 3.07(c) (**Exhibit C-584**).

314 Project Zenith – Information Memorandum by Renaissance Capital, p.66 (**Exhibit C-70**). This was set out in more detail in Section 4.16 of the Tristan Indenture (**Exhibit C-584**).

(f) Lastly, the securing mechanisms are central to the understanding of the debt structure. The obligations under the Tristan Indenture were secured with pledges by Tristan Oil, KPM and TNG as well as with pledges by the stockholders in these companies, i.e. Anatoli Stati, Ascom and Terra Raf.[315] Importantly, the pledges by Anatoli Stati, Ascom and Terra Raf were limited to their shares in Tristan Oil, KPM and TNG, respectively. For Ascom and Terra Raf, this follows from the fact that the collateral pledged in Section 2 of the respective pledge agreements[316] is not the full capital of Ascom and Terra Raf but rather only the shares in KPM and TNG.[317] For Anatoli Stati, Claimants have not provided the respective pledge agreements. However, it can be seen from other evidence on the record that Mr. Stati's pledge was limited to his shares in Tristan Oil.[318]

2. Debt needs to be deducted from the enterprise values calculated by the experts

377 In their valuation, Claimants have completely failed to take account of KPM's and TNG's liabilities under the Tristan note structure and have not made any deductions for this debt. This lack of thorough valuation is completely disingenuous and should not be supported by this Tribunal.

378 Under the *Chorzów* principles, the Tribunal has the task of awarding a sum which would "*wipe out all the consequences of the illegal act and reestablish the situation which would, in all probability, have existed if that act had not been committed.*"[319] In order to do so, the Tribunal has to take

---

315 Tristan Indenture dated 20 December 2006, Section 10.01 (**Exhibit C-584**).

316 Ascom and Terra Raf Pledge Agreements dated 20 December 2006 (**Exhibit C-585**).

317 The "Collateral" for the purposes of the Ascom and Terra Raf pledge agreements is defined in Section 1 of the pledge agreements as the "Participatory Interest and all dividends and other distributions connected to the Participatory Interest". The term "Participatory Interest" itself is defined in the same section as "the participatory interest in the charter capital of [KPM and TNG, respectively] in the amount of 100% which represents the same percentage in the assets of [KPM/TNG] and the voting rights on the general meetings of the participants of [KPM/TNG]", cf. Ascom and Terra Raf Pledge Agreements dated 20 December 2006, Section 1 (**Exhibit C-585**).

318 See e.g. Tristan Oil Ltd., Annual Report For the Year Ended December 31, 2009, p.4 (**Exhibit R-37.6**), where it states with regard to the purported sale of KPM and TNG to Cliffson that, *inter alia*, the equity interests in Tristan Oil serve as collateral for Tristan Oil's obligations under the notes. It follows that Mr. Stati pledged his shares in Tristan Oil as collateral.

319 *Factory at Chorzów (Germany v. Poland)*, Judgment, 1928 PCIJ Rep Series A No. 13, para. 125 (**Exhibit C-165**).

account of the actual situation resulting from all consequences of the allegedly illegal state action, be they damaging or beneficial for the investor. This situation then has to be compared with a hypothetical situation without a breach.

379 Under this approach, assuming that the alleged breach did not occur, Claimants would have kept control of KPM's and TNG's assets. At the same time, they would have remained guarantors of the debt accrued under the Tristan note structure. Assuming the state's actions were a breach, the situation is markedly different: KPM's and TNG's assets were transferred into trust management, which Claimants claim as their loss. At the same time – and this has so far not been acknowledged by Claimants –[320] Claimants were *practically* freed from all obligations under the pledge agreements. This release from obligations has to be taken into account in the damage calculation by deducting the debt under the Tristan note structure from any amounts claimed for KPM's and TNG's assets.

380 Under Claimants' own case, due to the alleged breach of the ECT, the Claimants, i.e. Gabriel Stati, Anatoli Stati, Ascom and Terra Raf, are *practically* not liable to the noteholders. For Gabriel Stati, this is obvious from the fact that he did not participate in any pledge agreement. For the other Claimants, this follows from the fact that – as set out above – the pledges they gave were limited to their shares in KPM, TNG and Tristan Oil, respectively.[321] From the information available, these shares must – due to the Republic's allegedly illegal action – be worthless so that any claim by noteholders against these shares cannot create loss for the Claimants:

(a) Under Claimants' own case, the shares in KPM and TNG must be essentially worthless today. Claimants' allege an indirect expropriation, which, under international law, requires that there must be a situation as if the rights related to an investment had ceased to exist.[322] Claimants thus cannot disagree that the shares in KPM and TNG must be worthless and that any claim by a

---

320 In fact, Claimants even allege that they remained liable for debts guaranteed by Tristan Oil, cf. Claimants Reply on Jurisdiction and Liability, para. 578.

321 See above para. 376(f).

322 Cf. *Técnicas Medioambientales Tecmed, S.A. v. United Mexican States*, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003, para. 115 (**Exhibit C-209**).

noteholder against the shares in KPM and TNG would not create loss for Claimants.

(b) Tristan Oil is a special purpose vehicle incorporated solely for the purpose of issuing the Tristan notes[323] for which it is liable to the noteholders. From Tristan Oil's financial statements, it is apparent that essentially all assets Tristan Oil holds are claims against KPM, TNG and Terra Raf.[324] As set out above, under Claimants' own case, claims against KPM and TNG are practically worthless. The same must go for claims against Terra Raf which itself appears to be only a Gibraltar based holding company for the shares in TNG. As a result, the claims by the noteholders against Tristan Oil must be deemed to outweigh the actual assets of Tristan Oil. Hence, Tristan Oil itself must be considered to have zero value. This is also confirmed by Claimants' own breakdown of the value of their assets as of 8 April 2010. According to this breakdown, the **100% stake in Tristan Oil is worth a mere USD 0.05 million**.[325] In their Reply on Jurisdiction and Liability, Claimants also admitted that Tristan "has no operating assets with which to repay the notes."[326] Hence, any claim of a noteholder against Anatoli Stati based on Mr. Stati's pledge of his shares in Tristan Oil would not cause damage to Mr. Stati.

381 It must therefore be assumed that Claimants are functionally no longer liable to the noteholders in any way. Assuming there was a breach of the ECT by the Republic, this is a financial gain which must be taken into account as advantageous to Claimants. In that regard, it does not matter that the Republic did not assume or perform KPM's and TNG's guarantee obligations, as Claimants allege.[327] The decisive fact is that Claimants are practically no longer liable.

---

323 First Witness Statement of Mr. Lungu, para. 6.

324 Cf. Tristan Oil Ltd. Annual Report for the Year Ended December 31, 2009, p. F-59, F-69 (**Exhibit R-37.6**).

325 Email confirming Cliffson's agreement (per Assaubayev Aydar Kanatovich) to Artur Lungu's proposed allocation of equity values in the Cliffson transaction dated 8 April 2010 (**Exhibit C-541**).

326 Claimants' Reply on Jurisdiction and Liability, para. 571.

327 Claimants' Reply on Jurisdiction and Liability, para. 578.

382 As a result, under *Chorzów* principles, the debts under the Tristan note structure must be deducted from the asset values claimed by Claimants in this arbitration.

383 To look at this from a different perspective: By not deducting the debt under the Tristan notes from the asset values calculated by their expert, Claimants are essentially claiming damages that only the noteholders could allege to have suffered. Such approach would be correct if Claimants were themselves liable to the noteholders for such alleged damage. However, as set out above, due to the peculiarities of the securing mechanisms implemented, Claimants can practically no longer be liable. As a result, Claimants cannot claim the noteholders' alleged damage. If at all, the noteholders would have to bring their own claim to a new tribunal which would have to review on its own the issues of jurisdiction, liability, causality and existence and extend of damage.[328]

3. Further debt accrued by KPM and TNG

384 From the information on the record, it is apparent that KPM and TNG accrued more debt than only the guarantees under the pledge agreements regarding the Tristan notes. Under *Chorzów* principles, these debts must also be deducted from any enterprise value claimed.

385 Due to Claimants' obscure corporate and debt structure and due to a lack of sufficient information as of the valuation date of 21 July 2010, the Republic is in no position to specify the precise amount of KPM's and TNG's debt. However, there is information available for the situation on 31 December 2009 and on 13 February 2010. The Republic submits that in all likelihood, a comparable amount of debt persisted as of the valuation date.

---

328 For this reason, it is clearly disingenuous for Claimants to suggest that "the Tristan Note holders may seek to enforce their claims on the Tristan Notes against any award in this proceeding.", cf. Claimants' Reply on Jurisdiction and Liability, para. 572. This suggestion is simply wrong. As set out above, the Tristan noteholders cannot bring a claim against Gabriel Stati because he never acted as a guarantor. Further, while the noteholders may bring a claim against the other claimants, such claim would be limited to the value of the shares pledged. The noteholders would hence precisely not be able to claim against an award in Claimants' favour.

386 On 31 December 2009, total guarantees issued by KPM and TNG exceeded USD100 million.[329] For one, KPM and TNG guaranteed debt of Montvale Invest Ltd. ("Montvale") under a prepayment arrangement between Montvale and Vitol S.A. As of 31 December 2009, the amounts due by Montvale to Vitol amounted to USD54.4 million.[330] Further, KPM and TNG also guaranteed obligations of Laren Holdings Ltd. (Laren), on a subordinated basis, under the 6 months USD60 million loan bearing interest at 35%, used in part to finance Laren's acquisition of the 2009 Notes.[331] As of 31 December 2009, the outstanding principle of the loan amounted to USD51.8 million.[332]

387 Moreover, on 13 February 2010, according to calculations of FTI Consulting, the debt outstanding in addition to the debt from the Tristan notes amounted to roughly USD119 million.[333]

388 There may well be further liabilities on the actual valuation date. Under *Chorzów* principles, such debt would also need to be deducted. Claimants have not brought forward the relevant information and have not provided an appropriate valuation that would take account of all debt accrued. This manifestly undermines and renders unreliable Claimants' damage calculation.

4. Spuriously, Claimants try to claim compensation for debt under the Tristan notes

389 In their Reply Memorial on Quantum, Claimants spuriously try to turn economic reality on its head. Instead of dealing with the issue of deducting the debts from the Tristan note issuance from their claims, Claimants actually demand the recovery of

> *"a total sum that will satisfy all the debts guaranteed by KPM and TNG, which includes the Tristan note principal, interest, and penalties."* [334]

---

329 For an overview of debts guaranteed, cf. also Claimants' Reply on Jurisdiction and Liability, para. 573.

330 Tristan Oil Ltd., Annual Report For the Year Ended December 31, 2009, p.F-48 (**Exhibit R-37.6**).

331 Claimants' Reply on Jurisdiction and Liability, para. 573.

332 Tristan Oil Ltd., Annual Report For the Year Ended December 31, 2009, p.F-48 (**Exhibit R-37.6**).

333 FTI Consulting Expert Supplemental Report, para. 3.5.

390 Obviously, considering the above set out facts, this attempt must fail. If anything, Tristan debt needs to be deducted, not added to Claimants' claim because Claimants were practically freed from their own guarantees of the debt. Claimants do not have to pay either the principal, interest or any penalties and can thus not claim any of these items in these proceedings.

391 However, even assuming, for the sake of argument, that Claimants were not practically freed from liability, their claim would fail:

a) No recovery of the Tristan note principal

392 First of all, Claimants cannot claim compensation for the payment of the Tristan note principal from any conceivable perspective. Under the *Chorzów* principles, one always needs to look at the situation that exists and at the situation that would have existed without the alleged breach of international law. Yet, without the supposed breach of international law, Tristan Oil would have been equally liable for the Tristan note principal and Claimants would have equally been acting as guarantors for this debt. The situation did thus not get any worse through the allegedly illegal actions of the Republic. This excludes any liability of the Republic for the Tristan note principal.

393 Interestingly, Claimants still seem to have been aware of this fact when preparing their Statement of Claim in which only a claim for interest and penalties under the notes had been made.[335] Only in their Reply Memorial on Quantum did Claimants include a claim for the principal – in passing and without providing any explanation.[336]

b) No damages proven

394 This leaves Claimants' claim for the Tristan note interest and penalties. However, these claims are equally without merit. Claimants have not shown that one Tristan noteholder has actually brought a claim against Claimants for note interest or penalties (or the principle, for that matter),

---

334 Claimants' Reply on Quantum, para. 93.

335 Claimants' Statement of Claim, para. 467. In fact, Claimants even expressly stated that if they make a claim based on the enterprise value, they have to remain liable for the debts guaranteed by KPM and TNG, cf. para. 578.

336 Claimants' Reply on Quantum, para. 93.

nor that Claimants paid anything to the noteholders. Due to a lack of proven damage, their claim must therefore be dismissed.

c) No causation proven

395 Further, even if there was a successful claim by a noteholder for interest and penalties under the notes, the Republic would not be required to compensate Claimants. Claimants have simply not proven causation. The Republic strongly disagrees with Claimants' allegation that

> *"The additional interest and penalties on the Notes would not otherwise have been incurred had Tristan been able to make timely payments, payments that now cannot be made as direct consequence of Kazakhstan's expropriation of KPM and TNG."*[337]

396 Rather, any damage Claimants may have suffered with respect to the Tristan notes could have occurred for a variety of reasons. The late payment and thus the additional interest and penalties could have been a result of the global economic crisis, or falling oil prices, or Tristan's poor business decisions, or the Guarantors' debt overload.[338]

VI. Irrelevance of the Cliffson SPA

397 Claimants have never even attempted to provide a thorough valuation for the correct valuation date. While Claimants do provide an extensive valuation analysis for the improper date of 14 October 2008, they completely fail to do so for the correct date of 21 July 2010. Instead, for their 21 July 2010 analysis, Claimants simply refer to the Cliffson SPA of 13 February 2010 and allege that this SPA reflects a value of USD 924 million for KPM and TNG.[339]

398 As will be set out below in more detail, Claimants' calculation is fundamentally flawed for several reasons:

---

337 Claimants' Statement of Claim, para. 467.

338 In its Rejoinder on Jurisdiction and Liability, the Republic explained in detail how external circumstances and Claimants' own actions led to a deterioration of value of KPM and TNG. Rejoinder on Jurisdiction and Liability, paras. 722 et seqq.

(a) The Cliffson SPA is no reflection of the fair market value. From its contents and from the little time the parties took to enter into it, the Cliffson SPA appears as a highly atypical agreement that raises doubts as to whether there were serious negotiations regarding the value of the companies and as to whether a proper due diligence was conducted. It can hence not be described as an arm's length transaction.

(b) In fact, from documentary evidence and the statements made by Claimants' witnesses at the hearing, it appears that soon after the conclusion of the SPA, Cliffson itself realised that it had agreed to an inappropriately high purchase price. As a result, Cliffson tried to wiggle its way out of the SPA later on.

(c) In any event, the Cliffson SPA does not contain information sufficient in order to allow a proper assessment of its value.

1. Cliffson had insufficient time for a proper assessment of KPM's and TNG's value

399 The evidence on record shows that the Cliffson SPA was concluded in a hurry and without a proper assessment of the value of KPM and TNG being made. At best, only half a month of due diligence and negotiations were conducted before the SPA was concluded. At the same time, Cliffson was granted no guarantees of any kind in the SPA and no specifics of the companies were set out. For an agreement purportedly to be valued at USD1 billion, such kind of negotiation process and agreement is extremely atypical. It cannot be assumed that this was actually an arm's length transaction reached on a full information basis.

400 From the evidence on record, it appears that the negotiations and due diligence before the conclusion of the SPA were conducted in not more than 13 days. This follows from Mr. Stati's witness statements, in which he stated that Cliffson contacted Claimants only in February 2010.[340] While Mr. Stati does not provide the exact date at which negotiations started, it is in any event clear that the SPA was concluded already on

339 Claimants' Reply on Quantum, paras. 5 et seqq.

340 First Witness Statement of Mr. Stati, para. 21; Second Witness Statement of Mr. Stati, para. 27.

13 February 2010, leaving no more than 13 days for negotiations and due diligence.

401 Such short time span was clearly not sufficient for Cliffson to properly assess the value of KPM and TNG. A proper due diligence and negotiation, conducted by a serious oil and gas business, takes much longer. In fact, in 2009, both Total E&P and KMG EP had conducted due diligence reviews for a potential purchase of the companies and had needed substantially more time to make their final assessments.[341]

(a) Total E&P needed about half a year before it decided to not pursue the purchase any further.[342]

(b) KMG EP was slightly faster but still needed four months of analysis before it came to its decision.[343]

402 In addition, it seems that much of the short span of time before the conclusion of the Cliffson SPA was not spent on analysis and negotiations regarding the purchase price but instead on side issues. As Mr. Stati tells us, Claimants' insistence on a clause reserving Claimants' right to bring investment arbitration claims against the Republic created an impasse that stalled the negotiations for several days and that could only be resolved on 12 February 2010.[344] Hence, of the few days between the beginning of February and 13 February 2010, several days passed with stalled negotiations and thus not with due diligence or price negotiations.

403 The lack of proper due diligence can also be seen from the unusual brevity and vagueness of the SPA. In the Cliffson SPA, only the most basic characteristics of the companies are being guaranteed (such as due

---

341 After the conclusion of the SPA, Cliffson was granted an additional five days, until 18 February 2010, to conduct due diligence regarding the debts of KPM and TNG, cf. Article 4.1 lit. a of the SPA (**Exhibit C-540**). With regard to this specific issue, there may thus have been five more days of due diligence. Nonetheless, a maximum of 18 days is still not enough for a proper valuation of KPM and TNG.

342 Negotiations started in January 2009 and formally ended on 24 July 2009, cf. Witness Statement of Mr. Chagnoux, para. 2.4 and Letter from Total E&P to Renaissance Capital dated 24 July 2009 (**Exhibit C-296**).

343 Renaissance Capital invited KMG EP to enter the bidding process with a letter received on 24 March 2009; KMG EP decided not to pursue the purchase further in July 2009, cf. Witness Statement of Mr. Suleimenov, paras. 2.12, 2.28.

344 Second Witness Statement of Mr. Stati, para. 30. Mr. Stati does not make mention of the date of 12 February 2010. The date is however mentioned in Claimants' Reply on Jurisdiction and Liability, at para. 393.

incorporation or legality of accounting).[345] Major contracts and licenses, pending law suits, major debt or other characteristics of the companies that could be important for their value are either not mentioned at all or not set out in any detail. On the contrary, in a very broad *"Sellers Disclosure Schedule"*, there are general references to all kinds of information, all of which was allegedly disclosed to Cliffson. For example, the schedule simply incorporates all information contained in financial statements[346] and also includes all information regarding the loans and the Tristan notes facilities.[347]

404 Such lack of specification is completely atypical for any kind of proper M&A transaction. Usually, the specifics of a target company are neatly set out, so as to create clear cut rules as to whether there is liability or not. The fact that no such clear specification was included in the Cliffson SPA leads to the conclusion that the specifics of KPM and TNG had not been properly analysed by Cliffson, presumably because there was not enough time to do so.

405 Obviously, such very brief due diligence and negotiations cannot be the basis for an SPA that can be described as an arm's length transaction on a fully informed basis.[348]

2. Cliffson tried to hinder the closing of the SPA

406 Apparently, some time after the conclusion of the SPA, Cliffson itself concluded that it had agreed to pay more than it should have. This can be seen from Cliffson's post-signing conduct. After 13 February 2010, Cliffson itself hindered the closing of the deal. Such conduct can be best explained by assuming that Cliffson only had had a short period of time to assess the value of the companies before signing the SPA. Presumably, once Cliffson further assessed the deal they had agreed to, they had to

---

345 Cf. Schedule 3 to the Cliffson SPA, Exhibit C-540.

346 Notably, this does not include the audited 2009 Financial Statement for Tristan Oil. The auditor's letter to this financial statement was only written on 25 May 2010, cf. 2009 Financial Statement for Tristan Oil (**Exhibit R-37.6**).

347 Ibid., no. 1-5.

348 The Republic' experts Deloitte analysed the documents on record and found that certain peculiarities, such as a low degree of detail as to the liabilities the buyer was supposed to assume, rule out any definitive conclusion as to the quality of the transaction as an arm's length deal. They thus concur that *"cannot be used as a reasonable basis to establish a comparable value for the Assets"*, cf. Deloitte & Touche Expert Report, paras. 52, 219.

notice that it was paying much more than the fair market value, and wanted to get out of the deal.

407 Cliffson's lack of cooperation was obvious already soon after the SPA was concluded. Under the SPA, two important closing conditions had to be fulfilled: the Republic had to declare a waiver of its pre-emptive rights and the Ministry of Oil and Gas ("MOG") had to approve the transfer.[349] The SPA foresaw that it was Cliffson which was supposed to make the necessary applications to obtain the MOG's approval to the transfer of the shares and the state's waiver of pre-emptive rights.[350] This was also the common understanding between the parties, as was explained by Mr. Lungu during the October 2012 arbitration hearing in Paris.[351] Yet, the necessary applications were in fact made by Claimants, and only on 12 April 2010,[352] two months after the SPA was concluded. This is a clear sign that Cliffson already tried to get out of an SPA it no longer wanted.

408 This lack of cooperation by Cliffson was also perfectly obvious to the Claimants themselves. In a letter to Cliffson dated 9 March 2010, Anatoli Stati complained that Terra Raf and Ascom

> *"have not seen so far any material progress in the implementation of the Agreement provisions […]."*[353]

409 In the following three months, Cliffson's lack of cooperation became ever more apparent. Cliffson simply never provided information which would have been crucial for realising a closing of the transaction, namely information about Cliffson's own financial resources and ability to operate KPM and TNG. Such information was asked for by the MOG with several letters because the MOG could only approve the transfer of the shares and the waiver of the state's pre-emptive rights if it knew that Cliffson would

---

349 Cf. clause 4.1 lit. a and lit. b of the Cliffson SPA (**Exhibit C-540**).

350 According to clause 4.3 of the SPA, the sellers were obliged to provide to Cliffson all information necessary to make the appropriate applications in relation to the fulfillment of the closing conditions in, *inter alia*, clause 4.1 lit. a and lit. b of the SPA, i.e. the MOG's approval to the transfer of the shares and the state's waiver of pre-emptive rights. Thus, clause 4.3 of the SPA presupposed that it was for Cliffson to solicit MOG's approval and the state's waiver.

351 Hearing Transcript Day 1, p.221, line 17 - p.222, line 8.

352 Letter from KPM to Ministry of Oil and Gas dated 12 April 2010 **(Exhibit C-524)**; Letter from KPM to Ministry of Industry and Technologies dated 12 April 2010 **(Exhibit C-525)**; Letter from TNG to Ministry of Oil and Gas dated 12 April 2010 **(Exhibit C-526)**; Letter from TNG to Ministry of Industry and Technologies dated 12 April 2010 **(Exhibit R-527)**.

353 Letter of Mr. Stati to Cliffson dated 9 March 2010 (**Exhibit C-701.1**).

be able to shoulder KPM's and TNG's operations.[354] Moreover, such information would also have been necessary to obtain the approval of the transfer by the noteholders.[355]

410 As Mr. Lungu explained, it was the common understanding of the parties that Cliffson would provide this information.[356] In fact, by not providing the information, Cliffson may have breached Section 4.2 of the SPA which requires the parties to endeavour procuring the fulfillment of the closing conditions. In a letter in June 2010, Anatoli Stati complained in no uncertain terms about Cliffon's failings:

> *"The Buyer has been non-responsive to the Seller Representative and* ***is not complying with Section 4.2*** *of the Purchase Agreement.*
>
> *[…]*
>
> *The Seller Representative is deeply troubled by the current state of the sale process contemplated in the Purchase Agreement. Any fraud, wilful misconduct on bad faith on the part of the Buyer will not be taken lightly."*[357] (emphasis provided)

411 Yet, until the very end of the transaction, Cliffson did not provide the necessary information. Thereby, Cliffson effectively hindered the deal from being closed. Such behaviour can only be explained with the fact that Cliffson tried to get themselves out of an SPA it had come to realize to not reflect a fair market value of the target companies.

3. The Cliffson SPA does not provide sufficient information for a proper valuation

412 Even assuming that the Cliffson deal was a fair market transaction at arm's length, FTI Consulting's assessment of the value of the Cliffson SPA

---

354 Respondent's Rejoinder on Jurisdiction and Liability, paras. 817 et seqq.

355 For this reason, Cliffson was in fact obliged under the SPA to "provide all necessary information regarding its […] financial resources and ability to operate [KPM and TNG]", cf. Article 13.1 lit. a of the Cliffson SPA (**Exhibit C-540**).

356 Testimony of Mr. Lungu, Hearing Transcript Day 1, p.223, lines 2 - 8.

357 Letter of Mr. Stati to Cliffson dated 15 June 2010 (**Exhibit C-701.3**).

cannot be accepted. As the Republic's experts Deloitte explain, the Cliffson SPA does not provide sufficient information for a proper valuation.[358] Given this lack of information, any calculation reached by FTI Consulting cannot be accepted as the actual value of the Cliffson SPA.

VII. Further observations

1. Claimants' incorrect assertions regarding the coming into existence of the field development plan

413 In their Reply on Quantum, Claimants try to create the impression that the field development plans for the Tolkyn and Borankol fields were unilaterally imposed on them by the Republic.[359] Repeatedly, Claimants assert that the field development plans were "authored and approved by the state".[360] This is a very misleading presentation of the actual facts.

414 Claimants are correct in pointing out that the field development plans are drafted by Kazakh state research institutes.[361] What Claimants however fail to mention is that these institutes are commissioned by the subsoil user and that the subsoil user fully pays for their work. In the case of the 2008 Tolkyn Development Plan[362], which TNG commissioned to be prepared by the research institute KazNIPIMunaigaz, TNG and KazNIPIMunaigaz even created a form of success fee. The parties agreed that payment of 20% of the fee would only be made after KazNIPIMunaigaz had defended their development plan and after the plan had been approved by the Central Commission.[363]

415 Claimants are thus clearly wrong when they speak of a "state-authored" development plan. To obtain a development plan, TNG did not have to apply to a state body on whose decisions TNG was not able to take any influence. Rather, TNG hired a scientific institute, which it paid and to

358 Deloitte & Touche Expert Report, paras. 52 et seq., 219 et seq.

359 Claimants' Reply on Quantum, paras. 34 et seqq.

360 Claimants' Reply on Quantum, paras. 34, 45.

361 Claimants' Reply on Quantum, para. 35.

362 Tolkyn Field Development Plan (**Exhibit C-681**).

363 Addendum No. 1 to the Contract between KazNIPIMunaigaz and TNG dated 22 July 2006 (**Exhibit R-351**).

which it fed the necessary information,[364] to draft a plan that TNG approved of. Only this plan was then provided to the Central Commission which approved it as the 2008 Tolkyn Field Development Plan.

2. Alleged export of TNG's gas by TNG's customers

416 Claimants assert that a "significant proportion" of the gas production from the Borankol and Tolkyn fields was sold by TNG's customers on the export market.[365] Specifically, Claimants seem to be referring to the years 2005 to 2008.[366] While ultimately, this contention is irrelevant to the dispute at hand, the Republic points out that Claimants have not provided a shred of evidence supporting their suggestion. In fact, they are putting forward mere speculation by Tristan's CFO Mr. Lungu. The relevant quotes are clear in this regard:

> *"It is **our understanding** that Gaz Impex and KazRosGas in turn sold on the export market the gas that they reveived from TNG. […]*
>
> *Although **we have no direct evidence, we believe** that that Kemikal was also exporting some, if not all, of the gas it was receiving under its contract with TNG."*[367] (emphasis provided)

417 In any event, even assuming that TNG's customers had been exporting TNG's gas, this would not help Claimants' case. There can be a myriad of reasons why these companies could export gas, none of which must apply to TNG, and none of which can be blamed on the Republic. In particular, it is conceivable that these companies could export because they could secure contracts with Gazprom, which Claimants apparently could not.[368]

418 Claimants also assert that the domestic market was never fully able to absorb the gas volumes produced from the Tolkyn and Borankol fields.[369]

---

364 Cf. Second Witness Statement of Mr. Cojin, para. 3.

365 Claimants' Reply on Quantum, para. 8.

366 Second Witness Statement of Mr. Lungu, paras. 2 et seqq.

367 Second Witness Statement of Mr. Lungu, paras. 2 and 4.

368 See above paras. 254 et seqq., 338 et seqq.

369 Claimants' Reply on Quantum, para. 8.

This is another unproven contention and in this case, Claimants do not even try to provide any proof thereof.[370]

3. Alleged tender for Borankol, Tolkyn and the Contract 302 Properties

419 In their Reply Memorial on Quantum, Claimants allege that the Republic *"effectively contend[s] that none of [the Contract 302] resource areas [except for Munaibai] will, in the future, be subject to any further exploration or development, and that Kazakhstan will not re-offer to any oil and gas company the full Contract 302 Properties that it illegally seized from Claimants. Any such contention is, however, belied by the fact that Kazakhstan promptly entertained bids from interested oil and gas companies, including Naftohaz Ukrainy, for the Borankol, Tolkyn and Contract 302 Properties shortly after it seized them"*[371].

420 Irrespective of the utter irrelevance of this contention, Claimants have not established that an official tender initiated by the Republic has ever occurred.

421 Claimants submit as exhibit one obscure article on a Ukrainian website to support their allegations. What strikes the Republic as strange is that Claimants have not submitted any witness statement by an involved person from Naftohaz Ukrainy to credibly back up their contentions. Instead, they fail to draw any connection between the alleged tender and the Republic.

422 Whenever the Republic issues an invitation to tender, this is published on the respective Ministry's website as well as in a Kazakh newspaper. Astoundingly, Claimants have not submitted exhibits relating to these premises either. The reason is simple: there has never occurred a tender for the Borankol, Tolkyn and Contract 302 Properties initiated by the Republic.

423 Therefore, Claimants have failed to discharge their burden of proof with respect to this alleged tender.

---

370 FTI Consulting have provided tables summarising KPM and TNG gas sales to different customers from 2005 to 2010 as well as a document called "KPM and TNG's Gas Customers History", cf. FTI Consulting Supplemental Expert Report, Appendices E and F. The tables in no way indicate that the domestic market could not have absorbed KPM's and TNG's gas. Further, the "Gas Customers History" also does not indicate that this was the case.

371 Claimants' Reply on Quantum, para. 62.

VIII. Conclusion

424 As of the correct valuation date of 21 July 2010, Claimants cannot claim any damages from the Republic. According to Deloitte, as of 21 July 2010, the enterprise value of Claimants' assets amounts to USD 186 million.[372] Therefrom, the Tristan note debt in the amount of USD531.1 million, as well as other debt, has to be deducted. As a result, Claimants' suffered **no damage**.

[372] Deloitte & Touche Expert Report, para. 465.

D. The Republic's observations on Claimants' valuation as of 14 October 2008

I. Claimants disingenuously neglect all facts after their valuation date

425 The Republic has already set out above that Claimants' valuation date of 14 October 2008 is improper in the present case because it is set prior to any state conduct that could even remotely be described as expropriatory.[373] To make matters worse, in their valuation, Claimants go on to ignore all developments after the valuation date. The purpose of this approach is clear: Claimants, as ever so often in this case, try to artificially inflate their valuation.

426 The Republic submits that even if the Tribunal should decide to rely on a valuation date prior to 21 July 2010, it should in any event take account of external circumstances and Claimants' own actions up to 21 July 2010. Taking into account these developments, which would be in conformity with general international practice, the Claimants' claim shrinks considerably. In particular, the Republic refers to:[374]

(a) a sharp drop in oil and gas prices in 2008 and 2009;

(b) a sharp drop in local demand in 2009;

(c) the company's customers' conduct and the company's own business decisions;

(d) the general undercapitalization of the companies and the constant withdrawal of cash from the companies;

(e) the companies' failure to pay taxes on time as required by law;

---

373 Cf. above paras. 14 et seqq.

374 Cf. also Respondent's Rejoinder on Jurisdiction and Liability, paras. 722 et seqq.

(f) and the consequential taking out of the so-called Laren loan which was extremely risky and required the payment of very high interest rates .[375]

1. Subsequent Events

427 International legal practice and theory confirm that subsequent events may affect the extent of the damage caused by illegal state actions and must hence be reflected in the calculation.[376]

428 As stated by the second tribunal in *Amco Asia v. Indonesia* (Amco II):

> *"If the purpose of the compensation is to put Amco in the position it would have been in had it received the benefits of the Profit-Sharing-Agreement, then* ***there is no reason of logic that requires that to be done by reference only to data that would have been known to a prudent businessman in 1980*** *[…]*
>
> *if Amco is to be placed as if the contract had remained in effect, then* ***subsequent known factors bearing on that performance are to be reflected in the valuation technique*** *[…]"*[377] *(emphasis provided)*

429 Therefore, only the consequences following from the unlawful act itself must be disregarded for the hypothetical damage case:

> *"The only subsequent factors relevant to value which are not to be relied on are those attributable to the illegality itself".*[378]

430 As explained by Professor Marboe:

> ***"The fact that subsequent events and developments are included in the valuation may also reduce the amount of***

375 Respondent's Rejoinder on Jurisdiction and Liability, para. 724.

376 *Marboe*, "Compensation and Damages in International Law", 7 The Journal of World Investment & Trade (2006), p.751. (**Exhibit R-352**).

377 *Amco Asia Corporation v Indonesia* (Amco II), ICSID Case No. ARB/81/1, Award, 5 June 1990, (1993) 1 ICSID Reports 569, para. 186 (**Exhibit R-353**).

378 Ibid.

> ***damages.*** *This is simply the consequence of the principle of full reparation on the basis of the restitution approach. If subsequent events led to a diminution of value,* ***the injured party would have suffered this also in the absence of the unlawful act.*** *[…]*
>
> *The only measure of damages is the comparison of the financial situation with and without the breach."*[379] *(emphasis provided)*

431 In the present case, there is a clear correlation in time between the companies' financial troubles and certain external events, in particular

(a) a sharp drop in oil and gas prices in 2008 and 2009[380] and

(b) a sharp drop in local demand in 2009.[381]

432 Claimants themselves admit that KPM's and TNG's revenues had been under pressure since the fall of 2008 because of falling energy prices.[382] They further admit that oil and gas prices were *"severely depressed"* by December 2008 and January 2009[383] and that they were further falling sharply in spring and summer 2009, *"putting significant pressure on the companies' revenues"*.[384]

433 Further, Claimants admit that local demand dropped in the spring of 2009, leaving TNG with a shortage of demand.[385] Accordingly, not only did the companies sell their production at lower prices, they also sold much less of it.

434 The low demand was also confirmed by the Respondent's independent valuation expert:

---

379 *Marboe*, Calculation of Compensation and Damages in International Investment Law, Oxford International Arbitration Series, 2009, p.140 (**Exhibit R-324**).

380 Respondent's Rejoinder on Jurisdiction and Liability, para. 738.

381 Respondent's Rejoinder on Jurisdiction and Liability, para. 739.

382 Claimants' Reply on Jurisdiction and Liability, para. 381. See also Second Witness Statement of Mr. Stati, para. 6: "[B]etween July of 2008 […] and October 1, 2008 […] oil and gas prices had dropped fairly significantly."

383 Second Witness Statement of Mr. Stati, para. 18.

384 Second Witness Statement of Mr. Lungu, para. 7.

385 Claimants' Reply on Jurisdiction and Liability, para. 382; Second Witness Statement of Mr. Lungu, para. 8; Second Witness Statement of Mr. Stati, para. 41.

> *"The sharp fall in gas sales volumes by approximately 40% in 2009 was driven by demand and is commented in the 2009 audited financial statements of Tristan, KPM and TNG (cf. section "Management Discussion and Analysis") as follows (bold text highlighted by Deloitte):*
>
> *'The decrease in gas sales was due to a 43.2% decrease in the volumes of gas sold to 48.80 bcf for the year ended December 31, 2009 ... Gas sales volumes decreased because TNG was forced to reduce its daily production of gas by approximately 30% in March and 50% in May and June compared to the average daily production levels for the same periods in 2008* ***because of the shortage of demand for gas from MAEK and AktauGazServise.*** *In August, TNG was forced to halt its production of gas and condensate for an estimated 15-day period* ***because of an oversupply of gas by TNG*** *during the previous periods.'*[386]

435 The above mentioned external events led to a diminution of value that the Claimants would have suffered also in the absence of the alleged unlawful act. Therefore, these subsequent events and developments have to be included in the valuation and the amount of damages should be reduced accordingly. Any other approach would support Claimants in the artificial inflation of their claims.

2. Conduct of Claimants

436 Further, international law also requires that Claimants' own actions be taken into account in determining compensation. This is first and foremost confirmed by Article 39 of the ILC Articles:

> *"In the determination of reparation, account shall be taken of the contribution to the injury* ***by wilful or negligent action or omission of*** *the injured State or* ***any***

[386] Deloitte & Touche Expert Report, para. 70.

person or entity in relation to whom reparation is sought."[387] *(emphasis provided)*

437 Moreover, several recent investment cases have reduced the damages otherwise due by a percentage intended to reflect the investor's role in the events leading to loss.

438 For example, the tribunal in *Azurix v. Argentina* took into account the fact that the investor paid too much to obtain the contract at issue, and reduced the award accordingly.[388] Furthermore, in *Bogdanov v. Moldova* the tribunal found the investor patrially liable for its loss because it did not ensure that the privatization contract at issue was sufficiently precise concerning compensation.[389]

439 For present purposes, the most stunning example is, however, the case of *MTD v. Chile*. Notably, the Claimants are citing this case to support their entitlement to full compensation irrespective of which ECT breach or breaches the Tribunal may find.[390] Yet, Claimants completely fail to mention that in *MTD v. Chile* the tribunal reduced damages otherwise due by 50 percent to reflect the investors's negligent conduct. The tribunal found that:

> *"Claimants […] had made decisions that increased their risks in the transaction and for which they bear responsibility, regardless of the treatment given by Chile to the Claimants. They accepted to pay a price for the land with the Project without appropriate legal protection. […]*
>
> *The Tribunal considers therefore that* ***the Claimants should bear part of the damages suffered*** *and the* ***Tribunal estimates that share to be 50%*** *after deduction of the residual value of their investment".*[391] (emphasis provided)

---

387 Art. 39 ILC Draft Articles (**Exhibit R-263**).

388 *Azurix Corp. v. The Argentine Republic*, ICSID Case No. ARB/01/12, Award, 14 July 2006, paras. 426-429 (**Exhibit C-245**).

389 *Bogdanov et al. v. Moldova*, SCC, Award, 22 September 2005, para. 5.2 (**Exhibit C-267**).

390 Claimants' Reply on Jurisdiction and Liability, para. 608.

391 *MTD v. Chile*, ICSID Case No. ARB/01/7, Award, 25 May 2004, para. 238 (**Exhibit C-258**).

440 In the present case, there is a clear correlation in time between the companies' financial troubles and Claimant's own conduct, in particular:

(a) the company's customers' conduct and the company's own business decisions;

(b) the general undercapitalization of the companies and the constant withdrawal of cash from the companies;

(c) the companies' failure to pay taxes on time as required by law;

(d) and the consequential taking out of the so-called Laren loan which was extremely risky and required the payment of very high interest rates.[392]

441 Claimants' actions lead to a rapid demise of KPM and TNG. In light of these circumstances, Claimants effectively abandoned the companies in 2009 and 2010, stripping them of as much cash as possible in the process. This fact further defeats Claimants' exaggerated valuation approach[393] and the Tribunal should be mindful of these developments in making its valuation conclusions. Ignoring Claimants' own role in the demise of the companies would help Claimants succeed in artificially inflating their claim.

II. Claimants disingenuously claim compensation for profit they have already pocketed

442 In the introduction to this submission, the Republic has already explained in general Claimants' strategy of putting together numbers without a view to economical reality but only with a view to hiding the true amounts Claimants could possibly claim.[394] One such example is Claimants' damage calculation as of 14 October 2008.

443 Undisputedly, Claimants continued to operate their assets after 14 October 2008. Undisputedly, until 21 July 2010, KPM and TNG still produced and sold oil and gas and thereby created sizable income. 2008

392 Respondent's Rejoinder on Jurisdiction and Liability, para. 724.

393 Ibid., para. 772.

394 Cf. above paras. 2 et seqq.

was in fact KPM's and TNG's best year ever.[395] Moreover, for 2009, KPM's financial statements show that KPM earned claims against Stadoil for the sale of oil in the amount of at least USD 81,235,291. These claims were assigned to Tristan Oil and Ascom by way of loan repayments and dividend payments and thus were fully forwarded to Claimants.[396]

444 Nonetheless, Claimants chose not to take account of this income, thus hugely inflating their claims for the Borankol and Tolkyn fields. Instead, they hid the income by way of "creative accounting". They simply chose an improperly early valuation date in 14 October 2008, instructed their valuation expert to value the Borankol and Tolkyn fields as of this date, without then later deducing income created between this date and 21 July 2010.

445 Such approach can obviously not be tolerated because it would lead to double counting. Even if the Tribunal should make use of Claimants' early valuation date and FTI Consulting's valuation, it should deduce the income earned until 21 July 2010. The Republic's expert Deloitte commented accordingly:

> *"The production in the 21 months and one week between 14 October 2008 (the valuation date of FTI) and the 21 July 2010 (the valuation date of Deloitte) is part of the value of the Borankol and Tolkyn fields calculated by FTI (whereas the valuation by Deloitte was done as at 21 July 2010). Therefore, the production in this period constitutes one of several causes for differences in value attributed to the Tolkyn and Borankol fields by FTI and Deloitte, respectively.*
>
> *According to the production profiles on which the valuations of the fields by FTI are based, in the 21 months and one week between the 14 October 2008 and the 21 July 2010, the Borankol field was supposed to produce 431,000 t of crude oil/gas condensate and 62.9 mln m³ of natural gas, the Tolkyn field was supposed to produce*

395 See Tristan Oil Ltd. Annual Report for the Year Ended December 31, 2008, p.2 (**Exhibit R-37.5**), providing comparisons to 2007 and 2006.

396 Tristan Oil Ltd. Annual Report for the Year Ended December 31, 2009, p. F-126 (**Exhibit R-37.6**).

526,000 t of crude oil/gas condensate and 3,724 mln m³ of natural gas.

In terms of value (based on the discounted cash flow) the production assumed by FTI during the 21 months and one week between the 14 October 2008 and the 21 July 2010 represents a value of USD 61.1 mln (i.e. 26.4% of the value of USD 231.6 mln calculated by FTI) in case of the Borankol field and USD 165.5 mln (i.e. 32.6% of the value of USD 508.4 mln calculated by FTI) in case of the Tolkyn field.

Without the production in the period between 14 October 2008 and 21 July 2010 the value of Borankol and Tolkyn fields would be 26.4% and 32.6% lower, respectively, than calculated by"[397]

446 In other words, Deloitte found that based on the FTI Consulting calculation, the production assumed by FTI Consulting for the period in between the two valuation dates represents a value of USD165.5 million for Tolkyn and USD61.1 million for Borankol.[398] If the Tribunal were to follow Claimants' valuation suggestions, USD 226.6 million would hence have to be deduced from Claimants' claims for these fields.

III. The 2008 indicative offers during the first phase of Project Zenith

447 In their pleadings, Claimants try to create the impression as if the indicative, non-binding offers made during the first phase of Project Zenith in Autumn 2008 somehow were an indication of fair market value for Claimants' improper October 2008 valuation date.[399] Apparently, Claimants want the Tribunal to use the indicative offers as a guide for the Tribunal's damage calculation. The Republic strongly rejects this proposition. To some extent, this has already been addressed in the

397 Deloitte & Touche Expert Report, paras. 193 et seqq.

398 Deloitte & Touche Expert Report, para. 195.

399 Claimants' Statement of Claim, para. 73.

Republic's Rejoinder Memorial on Jurisdiction and Liability.[400] A few additional points will be made in the following:

1. Lack of information in the information memorandum and the vendor due diligence distributed to the bidders

448 Prior to making their indicative bids for KPM and TNG, the bidders had been provided with an information memorandum[401] and a vendor due diligence[402] by Claimants' bank Renaissance Capital. At the hearing in October, Claimants repeatedly referred to these documents. It should be pointed out that these documents were not a proper basis for valuing KPM and TNG.

449 First of all, the information memorandum itself does not purport to be a proper basis for a valuation. It clearly states that it "does not purport to be comprehensive" and that it "has not been independently verified".[403] Further, it mentions that it was based in part on unaudited financial statements.[404] This clearly shows that the information contained in the information memorandum is not sufficient to come to a proper fair market valuation.

450 Second, when questioned at the October hearing, the representatives of KNOC, Total E&P and KMG EP all confirmed that the information contained in the information memorandum was not sufficient to make a fair market valuation.[405] Moreover, already in their indicative offers in September 2008, some of the bidders stated themselves that the information memorandum contained only limited information. In particular, KNOC[406]

---

400 Respondent's Rejoinder on Jurisdiction and Liabiity, paras. 778 et seqq.

401 Project Zenith – Information Memorandum by Renaissance Capital (**Exhibit C-70**).

402 Project Zenith – Vendor Due Diligence by KPMG (**Exhibit C-69**).

403 Project Zenith – Information Memorandum by Renaissance Capital, p.1 (**Exhibit C-70**).

404 Project Zenith – Information Memorandum by Renaissance Capital, p.4 (**Exhibit C-70**).

405 Cf. Testimony of Dr. Kim, Transcript Day 6, p.6, line 9 - p.7, line 5; Testimony of Mr. Chagnoux, Transcript Day 4, p.4, lines 4-15; Testimony of Mr. Suleimenov of KMG EP, Transcript Day 4, p.127, line 16 - p.128, line 5.

406 Indicative Offer for Project Zenith from Korea National Oil Corporation dated 26 September 2008, p.3 (**Exhibit C-18**) (*"As the Confidential Information Memorandum provides limited information […]"*).

and Total E&P[407] explicitly made such clarification. Further, Mr. Seitinger of OMV states:

> *"[…] it should be pointed out that OMV E&P GmbH did not prepare a detailed business plan for the purchase and did not rigidly calculate the value based on such plan. Such approach was not feasible because there was only limited information contained in Renaissance Capital's information memorandum. A more detailed and reliable calculation could have been made only based on further information obtained during a due diligence."*[408]

451 Third, Claimants' suggestion is belied by the offers that were made based on the information memorandum and the vendor due diligence. These offers varied wildly, ranging from USD 0.55 billion[409] to USD1.55 billion.[410] In other words, the highest offer was three times as high as the lowest one. Regarding the individual assets, the offers varied even further, coming in between

(a) USD 90 mn[411] and USD 248 mn[412] for Borankol;

(b) USD 367 mn[413] and USD 1.067 bn[414] for Tolkyn; and

(c) USD 70[415] and USD 280[416] for the LPG Plant.

452 This fact alone shows that the information memorandum and the vendor due diligence did not allow for a fair market valuation. Several proper fair market valuations conducted at the same time could not lead to such

---

407 Indicative Offer for Project Zenith from Total E&P dated 26 September 2008, p.2 (**Exhibit C-75**) ("This Purchase Price is based on the limited information contained in the 'Project Zenith – Confidential Information Memorandum' dated August 2008 […]").

408 First Witness Statement of Mr. Seitinger, para. 2.4.

409 Indicative Offer for Project Zenith from Meridian Petroleum dated 1 October 2008 (**Exhibit C-71**).

410 Indicative Offer for Project Zenith from Korea National Oil Corporation dated 26 September 2008 (**Exhibit C-18**).

411 Indicative Offer for Project Zenith from Meridian Petroleum dated 1 October 2008 (**Exhibit C-71**).

412 Indicative Offer for Project Zenith from OMV dated 26 September 2008 (**Exhibit C-76**).

413 Indicative Offer for Project Zenith from China National Petroleum Corporation dated September 2008 (**Exhibit C-72**).

414 Indicative Offer for Project Zenith from Korea National Oil Corporation dated 26 September 2008 (**Exhibit C-18**).

415 Indicative Offer for Project Zenith from Meridian Petroleum dated 1 October 2008 (**Exhibit C-71**).

416 Indicative Offer for Project Zenith from Korea National Oil Corporation dated 26 September 2008 (**Exhibit C-18**).

extremely diverging results. Experienced valuation experts applying a scientific approach based on sufficient information should usually get to results which are at least in the same range and one valuation should not lead to thrice the amount of another valuation.

453 Such variation as in the present case can only be explained by the fact that the individual bidders each made a whole number of assumptions filling in the gaps left by information missing in the memorandum and the vendor due diligence. For this reason alone, these indicative bids can not be taken as a representation of fair market value.

2. If anything, the indicative offers show that Claimants strongly exaggerate the value of the assets

454 Claimants rely very broadly on those indicative bids which seem most favourable to them, ignoring all circumstances that show that these bids were far above the fair market value and ignoring all other, much lower indicative bids. Such cherry picking exercise by Claimants should not be accepted. Instead, if one should indeed take account of the indicative bids, they and the circumstances surrounding them have to be properly assessed. Taking this approach, the indicative bids can in fact only lead to one conclusion, namely that the amounts claimed by Claimants in this arbitration (for their improper valuation date of 14 October 2008) are hugely exaggerated.

a) Numerous circumstances led to the indicative offers being far higher than the fair market value at the time

455 There are numerous circumstances which had the effect that the indicative bids far exceeded the fair market value. The Republic addressed some of these already in its Rejoinder Memorial on Jurisdiction and Liability. The Republic, *inter alia*, demonstrated that

(a) strategic considerations led the bidders to increase their offers beyond what the markets were reasonably prepared to pay;[417] and

[417] Respondent's Rejoinder on Jurisdiction and Liabiity, para. 780.

(b) the bids were pushed up by Renaissance Capital which asked for increases in the bids as a condition for potential buyers to get access to the data room.[418]

456 The following is to explain further and to add to these points:

aa) Claimants ramped up production in 2008

457 All statistics submitted in this arbitration show that Claimants strongly increased production in the Tolkyn field in 2008, just before putting their assets on the market. In fact, production nearly doubled from 2007 to 2008, only to go back to the level of 2007 in 2009.[419] Claimants apparently increased production in 2008 specifically in order to convince potential buyers to make higher offers based on the strong production numbers.

458 In order to make sure that the bidders would notice, Claimants had Renaissance Capital include the increase in production in the 2008 information memorandum distributed to the bidders. The memorandum impressively depicted how TNG's production of gas for only the *first half* of 2008 equalled the production for the *whole* of 2007.[420] Further, the memorandum contained a forecast according to which the high production level would have been maintained and even increased slightly until 2010 to only then drop gradually.[421] It is now known that due to production constraints and a drop in demand, this never happened.

459 The practice of increasing production just prior to selling oil and gas assets is not uncommon and such trick is used by some sellers to increase bids. Mr. Ongarbayev, who has extensive experience in the Kazakh oil and gas industry, even concluded that Claimants tricked the authorities into allowing the increase in production in the development projects for precisely that reason – so as to be able to sell the assets for a higher price:

> *"The fact is that development projects are developed by project companies. The project itself was not prepared by TNG. In this case the designer may not have the entire*

418 Respondent's Rejoinder on Jurisdiction and Liabiity, para. 781.

419 Cf. Minutes on the results of the extraordinary verification of the fulfillment of the contractual and licensing obligations by TOO Tolkynneftegaz, para. 5, Table 5 (**Exhibit C-599**).

420 Project Zenith – Information Memorandum by Renaissance Capital, p.49, Chart 25 (**Exhibit C-70**).

421 Ibid., p.50, Chart 26.

information of the field, and he prepares a project proceeding from the technical specifications provided by the soil user. On the basis of such specifications, the designer prepares the project.

After this project is reviewed by the subsoil user, it is submitted for review by the Central Commission for Development. ***The commission itself reviews the project as such, as it is, with regards to its technical elements, and not more than that. The members of the Central Commission may not have the entire information concerning the field and its status, geological status.***

So I think that in this case ***TNG is confusing everyone by not providing the exhaustive information.*** *And the situation of 2008 now becomes more clear to me because 2008 was the year of high prices for hydrocarbons and the company for a number of years has made attempts to sell the field, and in this case* ***the high yield, the high production with high prices, is a good, attractive moment for potential buyers reviewing acquisition of the assets.*** *"*[422] (emphasis provided)

460 Under such circumstances, with increased production volumes pushing up the bids, bids made for the fields can simply not be taken at face value or even seriously at all.

bb) Oil and gas prices were very high in 2008 but dropped decisively thereafter

461 A further aspect leading to high bids were the high energy prices during the first phase of Project Zenith. The bidders had naturally made certain assumptions about oil and gas prices and due to the markets deteriorating quite strongly in the following, these assumptions turned out not to be correct.[423] To that end, Mr. Seitinger of OMV explains that at the end of November 2008

422 Testimony of Mr. Ongarbayev, Transcript Day 6, p.75, lines 11-17.

423 For example, Mr. Suleimenov of KMG EP specifically mentions that "the price forecasts for oil and gas were at higher levels" than what the prices turned out to be in October 2008 and beyond, cf. Witness Statement of Mr. Suleimenov, para. 2.11.

> *"the oil price was rapidly dropping to levels far below our expectations at the time of the indicative bid at the end of September. Further, the financial crisis was making it increasingly difficult to finance any kind of large capital investment."*[424]

462 The Republic has already demonstrated that such later developments must be taken into account in a valuation for the purposes of international law.[425] This is a further reason why the indicative bids cannot be taken as an indication for a potential award against the Republic.

cc) A Tripartite Agreement with KazAzot and KMG NC was never concluded

463 In the information memorandum, the bidders were also informed about the then ongoing negotiation of a tripartite agreement under negotiation between TNG, KazAzot and KMG NC.[426] The memorandum stated:

> *"TNG has had a series of negotiations with KazTransGas and KazAzot, which could result in a binding agreement, allowing TNG to export 7 bcm of gas starting in 2009 through 2018 and realize netbacks significantly higher than those available domestically"*[427]

464 The bidders, when making their indicative bids, relied on this information. For example, KMG EP even expressly stated that one of the key assumptions for their indicative bid was that TNG would be able to export "7 bcm of gas starting from 2009 pursuant to negotiations currently underway between the Company and KazTransGas and KazAzot."[428]

465 KNOC also expected a tripartite agreement to be concluded. As Dr. Kim from KNOC explained:

> *"Around the time we submitted the indicative offer in September 2008 we had some anticipation with regard to the conclusion of gas sales contracts because according*

---

424 First Witness Statement of Mr. Seitinger, para. 3.2.

425 Cf. above paras. 425 et seqq.

426 For the details cf. above paras. 269 et seqq.

427 Project Zenith – Information Memorandum by Renaissance Capital, p.10 (**Exhibit C-70**). See also p.24.

to the material and information submitted to us by Renaissance Capital with regard to the Tolkyn gasfields, it said that negotiations for these sales agreements on those gas products are underway. So we naturally expected that agreement to come into existence pretty soon."[429]

466 However, the "Tripartite Agreement" was never concluded and for the reasons set out above, it was never reasonable to expect the tripartite agreement to be concluded.[430] Hence, the indicative bids made were based on far too high gas sales prices. The logical conclusion is that the bids were placed far above fair market value. This again shows that the indicative bids do not support Claimants' blown up approach to valuation.

467 This also addresses Claimants' contention that the "magnitude" of the bidders' offers indicates that the bidders must have assumed export prices as basis for their bids.[431] KNOC and KMG EP explicitly stated that they made their assessment based on the tripartite agreement and the same may be true for other bidders. These and possibly other bidders thus did assume high prices, but only because Claimants had specifically advertised the tripartite agreement in their information memorandum.

dd) Renaissance Capital tried to push up indicative bids

468 A further reason why indicative bids ended up much higher than the fair market value were demands by Claimants' bank Renaissance Capital to the bidders for increases in their bids.

469 The Republic has already set out in its Rejoinder Memorial on Jurisdiction and Liability how Renaissance Capital tried to push up Total E&P's bid by demanding a higher bid from Total E&P as condition for access to the data room.[432] When cross-examined at the October hearing, Mr. Chagnoux of

---

428 Ibid., p.4.

429 Testimony of Dr. Kim, Transcript Day 6, p.21, line 22 - p.22, line 5. Upon further questions, Dr. Kim confirmed that he was referring to the mentioning of the tripartite agreement on p.10 of the information memorandum (**Exhibit C-70**), cf. ibid., p.23, lines 12-20.

430 Cf. above paras. 269 et seqq.

431 Claimants' Reply on Quantum, para. 10; FTI Consulting Supplemental Expert Report, para. 6.10.

432 Respondent's Rejoinder on Jurisdiction and Liabiity, paras. 781 et seq.

Total E&P added some further details to these disingenuous attempts by Renaissance Capital:

> *"And in September 2008 we sent a non-binding offer with a amount of $900 million. That was basically based on the information we had in the info memo of Renaissance Capital, because otherwise we knew very little about these assets.*
>
> *And then I remember that the negotiator in charge, Louis Caillard, had a hard time with Renaissance Capital because he was told that $900 million would not be sufficient for us to be allowed to have access to the data room, and that Total had to redo another non-binding offer or to be out of the process.*
>
> *So vis-à-vis our management it was very unpleasant, and I remember that Louis Caillard was very upset at Mr Rusinov. There has been a very unpleasant telephone discussion. And eventually, early October, we have replaced our first letter with $900 million by another letter with USD1,000 million, $1 billion altogether."*[433]

470 During cross-examination, Claimants tried to insinuate that the actual reason for the increase of the initial indicative bid by USD100 million was that this earlier bid had not included a valuation of the LPG Plant.[434] However, Mr. Chagnoux clearly explained that the increase was nothing but a face saving exercise necessary to stay in the bidding process:

> *"I just remember very well Louis Caillard being very angry at the situation because after getting management approval to send a non-binding offer with a high amount of 900, it was difficult to go back to the management telling people: it was a high figure but it's not considered as sufficient, and we have to send a higher figure or to stop the process. […]*

---

433 Testimony of Mr. Chagnoux, Transcript Day 4, p.3, line 11 - p.4, line 3.

434 Testimony of Mr. Chagnoux, Transcript Day 4, p.17 et seqq.

> *You know, when you say to somebody, "Following your communication of last Friday", for me it means very simply that you have asked for something and you get it, and you get it because we want to have access to the data room. We are the serious buyer, we want to continue to assess this opportunity, and although you make things more difficult, we are trying to continue in this process."*[435]

471 This indicates that Renaissance Capital may have contacted other bidders and asked them to increase their bids as well. One must therefore take the indicative bids with more than just one grain of salt and must assume that these indicative bids were set too high in order to comply with demands by Renaissance Capital.

b) Even taking the indicative bids at face value, Claimants' claims in this arbitration exceed what the bidders were offering

472 Even if one disregards all of these factors – all of which show that the indicative bids were set too high –, the indicative bids made during the first phase of Project Zenith do largely not support Claimants' valuation results in this arbitration. This applies in particular to the LPG Plant and the Borankol field.

473 In their Reply Memorial on Quantum, Claimants have increased their estimate of the LPG Plants' prospective value to USD408.3 million.[436] The absurdity of that number becomes clearly apparent if one looks at the indicative bids made during the first phase of Project Zenith. As Claimants themselves noted, the average of bids for the LPG Plant amounted to USD 150 million,[437] or only about 37% of what Claimants are claiming now. Even the highest bid made in that phase estimated the LPG Plant only at USD 280 million[438] and thus at about two thirds of Claimants overblown claim in this arbitration. Claimants' claim for the LPG Plant is thus outright

---

435 Testimony of Mr. Chagnoux, Transcript Day 4, p.19, line 24 - p.20, line 5, and p.21, lines 5-12.

436 Claimants' Reply on Quantum, para. 73.

437 Claimants' Reply on Quantum, para. 66.

438 Indicative Offer for Project Zenith from Korea National Oil Corporation dated 26 September 2008 (**Exhibit C-18**).

contradicted by the indicative offers made in the first phase of Project Zenith.[439]

474 Moreover, the above does not even take account of what Mr. Chagnoux of Total E&P explained to the Tribunal at the hearing in October. Mr. Chagnoux was very firm that Total E&P in fact considered the LPG Plant to be worthless:

> ***Mr. Mohr:*** *"So the process letter instructed the bidders to provide a value for each of the assets, and in the first bid you do not provide a value for the LPG plant, right?"*
>
> ***Mr. Chagnoux:*** *"Yes. The LPG has a negative value in our estimates."*[440]

If one takes account of this fact, Claimants' calculation, as compared to the average of the indicative bids, becomes even more ridiculous.[441]

475 With regard to the Borankol field, Claimants' valuation also largely exceeds the average of the indicative bids. While Claimants now claim USD 231.5 million,[442] the average of those indicative bids which provided specific numbers for Borankol was much less, namely USD 151.8 million. Only the offer by OMV was in the same range as the amount now demanded by Claimants,[443] all other bids very substantially lower.

---

439 Claimants might argue that their valuation of the LPG Plant is higher because they based their calculation on the assumption that also gas from the Contract 302 Properties would be delivered to the LPG Plant. The bidders in the first phase of Project Zenith did not make such assumption because Contract No. 302 was not up for sale at that time. However, such arguement does clearly not resolve the huge disconnect between Claimants' calculation and the indicative offers. As already set out above in paras. 87 et seqq., chances of success for the Contract 302 Properties are marginal and no reasonable business person would have ever tried to start production there. The Contract 302 Properties were thus never to contribute to the LPG Plant's production in the first place, cf. paras. 149 et seqq.

440 Testimony of Mr. Chagnoux, Transcript Day 4, p.18, lines 14-17. Upon further questioning by Claimants, Mr. Chagnoux reaffirmed this statement, cf. p.21, lines 13-15.

441 As Mr. Chagnoux also explained, the only reason why TOTAL E&P in the end put a value on the LPG Plant with its second indicative bid was to increase their overall bid as requested by Renaissance Capital: *"Another way to say that was that we would have found it outrageous to increase the figure on the other elements. So the only face-saving solution was to put value on the LPG plant."*, Testimony of Mr. Chagnoux, Transcript Day 4, p.21, lines 20-23.

442 Claimants' Reply on Quantum, para. 79.

443 Indicative Offer for Project Zenith from OMV dated 26 September 2008 (**Exhibit C-76**).

E. The Republic's observations on Claimants' further damage claims

I. The Republic's observations on the appropriate interest calculation

476 Claimants' case on interest is prototypical of their whole case on damages: It lacks the necessary differentiations and overbroadly assumes higher losses than could have ever existed. In the following, the Republic will address in detail and with the necessary care the issues of

(a) the applicable interest rate and

(b) the non-applicability of interest to Claimants' "loss of opportunity" claim.

a) Interest rate

477 Claimants suggest applying an interest rate of up to the 10.5% rate of the Tristan notes; at the very least, Claimants request interest in the amount of Kazakhstan's borrowing rate.[444] The Republic strongly refutes these suggestions which are in contradiction to Claimants' own reasoning for the awarding of interest, Claimants' own damages claim as well as arbitral practice.

aa) Claimants' own reasoning for the awarding of interest does not support claiming interest at a commercial loan or at a sovereign debt rate

478 Claimants claim that interest should be based on "the cost of debt for commercial loans for investments in the Kazakh market during the relevant time period". They suggest that the 10.5% interest rate of the Tristan notes would be an appropriate example thereof.[445] Further, they suggest that at a

444 Claimants' Reply on Quantum, para. 86.

445 Ibid.

minimum, the interest rate of the award should be based on "Kazakhstan's borrowing rate".[446]

479 To begin with, the Republic denies that the Tristan note rate would be an example of the typical interest rate of a commercial loan in Kazakhstan at the time. Claimants have not provided any evidence for this allegation.

480 More importantly, however, the Republic denies that commercial loan rates or the Kazakh sovereign debt rate play any role in determining interest rates for a potential damages award in the first place. That is because the principle behind the awarding of interest does not support such approach.

481 As Claimants themselves argue, and as the Republic agrees, the claim for interest arises from the principle of "full compensation". According to Claimants, payment of interest is necessary because "between the date of the illegal act and the date of actual payment, the injured party cannot use or invest the amounts of money due."[447]

482 Naturally, under this premise, interest calculation has to be based on what Claimants could have earned by investing the amounts due under the award. Full compensation thus requires a closer look at what Claimants would have done with the money due – what the Republic did or could have done with the money in the meantime is completely irrelevant. As the Tribunal in *Chevron v. Ecuador* stated:

> *"The guiding principle in the determination of pre-award interest is that what should be charged is not the amount of the Respondent's enrichment as a result of its non-payment, nor the actual cost incurred by the Claimant as a result of non-payment, but rather the lost investment income the Claimants otherwise could have realized had the claim been paid in a timely manner."*[448]

483 It is for this reason that Claimants' interest demand is completely flawed:

---

446 Ibid.

447 Claimants' Reply on Quantum, para. 80, citing *LG&E Energy Corp. v. Argentine Republic*, ICSID Case No. ARB/02/1, Award, 25 July 2007, para. 55 (**Exhibit C-314**).

448 *Chevron Corporation (U.S.A.) and Texaco Petroleum Corporation (U.S.A.) v. Republic of Ecuador*, PCA Case No. AA 277, Partial Award on the Merits, 30 March 2010, para. 555 (**Exhibit C-285**).

(a) Claimants have never stated that they wanted and less even that they would have been able to give out to anyone a loan at a rate typical "for commercial loans for investments in the Kazakh market during the relevant time period". Claimants are not a bank operating in Kazakhstan. They do not need to be "fully compensated" with regard to the interest a bank in Kazakhstan could have achieved with a commercial loan.

(b) Likewise, there is no reason to assume that Claimants would have invested any sum under a potential damages award into Kazakh state bonds. Given what Claimants themselves claim to have been their experience with the Kazakh government, this seems in fact very unlikely.

484 These findings are also supported by arbitral practice. For example, the tribunal in *Siemens v. Argentina* expressly declined to apply a commercial borrowing rate because this would not have been the "interest rate the amount of compensation would have earned had it been paid after the expropriation."[449] In *LG&E v. Argentina*, the tribunal denied the "proposal to use Argentina's borrowing rate as speculative and extemporaneous".[450]

485 Likewise, the tribunal in *Chevron v. Ecuador* declined to award interest based on the Ecuador's sovereign debt rates, arguing that

> *"Ecuador's sovereign cost of debt includes compensation for certain investment risks that were not and are not being taken by the Claimants on the sum of any award."*[451]

486 In the same vein, the tribunal in *CSOB v. Slovak Republic* rejected applying Slovak sovereign debt rates because it had not been proven that the investor would have invested the amounts due under the award in Slovak state bonds, had the money been available.[452]

---

449 *Siemens A.G. v. The Argentine Republic*, ICSID Case No. ARB/02/8, Award, 6 February 2007, para. 396 (**Exhibit C-232**).

450 *LG&E Energy Corp., LG&E Capital Corp., and LG&E International, Inc .v. Argentine Republic*, ICSID Case No. ARB/02/1, Award, 25 July 2007, para. 102 (**Exhibit C-314**).

451 *Chevron Corporation (U.S.A.) and Texaco Petroleum Corporation (U.S.A.) v. Republic of Ecuador*, PCA Case No. AA 277, Partial Award on the Merits, 30 March 2010, para. 555 (**Exhibit C-285**).

452 *Ceskoslovenska Obchodni Banka, A.S. v. The Slovak Republic*, ICSID Case No. ARB/97/4, Award, 29 December 2004, para. 332 (**Exhibit R-354**).

bb) Arbitral practice dictates that interest rates should be based on usual interest rates for conservative investments

487 Instead of relying on interest rates for commercial loans or the Republic's sovereign debt rate, the Republic submits that in accordance with usual arbitral practice, interest rates for typical conservative and risk-adverse investments should be applied.

488 Tribunals frequently determine interest based on a "prudent", "risk-free", "low risk", "highly secure" or "conservative" hypothetical re-investment practice. Examples of such decisions include the awards in *Occidental v. Ecuador*,[453] *BG Group v. Argentina*,[454] and *Unglaube v. Costa Rica*.[455] Professor Marboe, who has studied the topic intensively in her treatise on damages in international investment law, also points out that tribunals frequently refer to the lowest available interest on investment.[456]

489 Applying interest rates of risk adverse investments is also in line with the purpose of "full compensation" set out above. That is because when estimating what profits the investor could have made with the amounts due under the award, risky investments are much harder to use for calculations. If a tribunal were to base its interest findings on possible risky investments, it would have to decrease the return rates of that investment with view to the increased risks connected to it. For this reason, it is much more advisable to rely on conservative risk-free investments which reflect more clearly possible returns.

cc) The interest rates of US treasury bills should be applied

490 In the present case, the Republic submits that the low-risk re-investment that the Tribunal should look at for guidance in determining the applicable interest rate are 6 months US treasury bills.

---

453 *Occidental Petroleum Corporation and Occidental Exploration and Production Company v. Republic of Ecuador*, ICSID Case No. ARB/06/11, Award, 5 October 2012, para. 842 (**Exhibit R-355**).

454 *BG Group Plc. v. The Republic of Argentina*, UNCITRAL, Final Award, 24 December 2007, para. 455 (**Exhibit C-268**). The award was vacated by the US Court of Appeals for the District of Columbia on unrelated grounds in 2012.

455 *Reinhard Hans Unglaube v. Republic of Costa Rica*, ICSID Case No. ARB/09/20 and *Marion Unglaube v. Republic of Costa Rica*, ICSID Case No. ARB/08/1, Award, 16 May 2012, para. 319 (**Exhibit R-276**).

456 *Marboe*, Calculation of Compensation and Damages in International Investment Law, Oxford International Arbitration Series, 2009, para. 6.120 (**Exhibit R-324**).

491 Tribunals have been adamant that the interest rate should be determined with a view to the currency in which damages are awarded.[457] This makes perfect sense because one of the most important factors determining the interest rate for any kind of debt is the currency of a debt. Different currencies have different inflation rates which strongly influence available interest.[458] Further, the standard rates determined by a national bank supervising a currency are an important factor for determining typical available interest rates.[459]

492 Interest under a debt arising from an arbitral award must hence primarily be tied to the typical interest rates of risk-adverse investments under the applicable currency. Presently, Claimants claim damages in USD. Should the Tribunal decide to award such damages, it should hence turn to typical USD interest rates for a risk-adverse investment. Such approach would also be in line with several tribunal decisions in cases which had nothing to do with the USA apart from damages being awarded in US currency. In these cases, the tribunals turned to typical US interest rates nonetheless.[460]

493 The Republic suggests that the rates of *6 months US Treasury bills* over the relevant period of time best match the description of a risk-adverse investment in US currency. Such choice would also be supported by previous tribunal practice, in particular in the cases of *LG&E v. Argentina*,[461] *CMS v. Argentina*[462] and *BG Group v. Argentina*.[463]

---

457 *Siemens A.G. v. The Argentine Republic*, ICSID Case No. ARB/02/8, Award, 6 February 2007, para. 396 (**Exhibit C-232**); *S.D. Myers, Inc. v. Government of Canada*, UNCITRAL, Second Partial Award, 21 October 2002, para. 304 (**Exhibit R-356**); *Archer Daniels Midland Company and Tate & Lyle Ingredients Americas, Inc. v. United Mexican States*, ICSID Case No. ARB(AF)/04/5, Award, 21 November 2007, para. 300 (**Exhibit R-280**).

458 Claimants' Reply on Quantum, para. 86.

459 Claimants' Reply on Quantum, para. 86.

460 Cf. *Reinhard Hans Unglaube v. Republic of Costa Rica*, ICSID Case No. ARB/09/20 and *Marion Unglaube v. Republic of Costa Rica*, ICSID Case No. ARB/08/1, Award, 16 May 2012, para. 324 (**Exhibit R-276**); *BG Group Plc. v. The Republic of Argentina*, UNCITRAL, Final Award, 24 December 2007, para. 455 (**Exhibit C-268**) (the award was vacated by the US Court of Appeals for the District of Columbia on unrelated grounds in 2012); *Siemens A.G. v. The Argentine Republic*, ICSID Case No. ARB/02/8, Award, 6 February 2007, para. 396 (**Exhibit C-232**).

461 *LG&E Energy Corp., LG&E Capital Corp., and LG&E International, Inc .v. Argentine Republic*, ICSID Case No. ARB/02/1, Award, 25 July 2007, paras. 102, 104 (**Exhibit C-314**).

462 *CMS Gas Transmission Company v. Republic of Argentina*, ICSID Case No. ARB/01/8, Award, 12 May 2005, para. 471 (**Exhibit C-65**).

463 *BG Group Plc. v. The Republic of Argentina*, UNCITRAL, Final Award, 24 December 2007, para. 455 (**Exhibit C-268**). The award was vacated by the US Court of Appeals for the District of Columbia on unrelated grounds in 2012.

494 US treasury bills do not yield compound interest.[464] However, had the Claimants invested the money due under the award in 6 months US Treasury bills, they could have reinvested their interest gains every six months. Thus, interest has to be compounded semi-annually.[465]

b) Non-application of interest to Claimants' "loss of opportunity claim"

495 Further, no interest of any kind can be awarded for Claimants "loss of opportunity claim" regarding the Contract 302 properties.

496 The Republic has already set out above that this claim has no chance of success and should be dismissed.[466] However, even if the Tribunal should award any amount of money under this claim, it should not award interest on it. This, again, follows from the principle that there may not be double compensation.

497 The awarding of damages for loss of opportunity – equal to the awarding of damages for lost profits – is based on the presumption that capital had been invested and that this investment would have created future profits. However, capital invested in a way to create future profits cannot create an additional amount of interest at the same time. Or in other words: the future profits claimed are already the "interest" on the investment. Additional interest is not possible.[467]

498 For this reason, the Tribunal should in any event not award interest for Claimants' loss of opportunity claim regarding Contract No. 302.

---

464 Cf. Investopedia – Treasury Bill / T-Bill, http://www.investopedia.com/terms/t/treasurybill.asp (visited 22 November 2012) (**Exhibit R-357**).

465 Should the Tribunal award interest and not rely on US Treasury Bills or other short-term bonds that yield interest at their date of maturity, the Republic maintains its position established in the Statement of Defence that compound interest should not be awarded, cf. Respondent's Statement of Defence, paras. 56.1 et seqq.

466 See above paras. 47 et seqq.

467 Cf. *Marboe*, Calculation of Compensation and Damages in International Investment Law, Oxford International Arbitration Series, 2009, para. 6.19 (**Exhibit R-324**), referring to negotiations in the ILC regarding the ILC Draft Articles on State Responsibility.

II. Claimants are not entitled to moral damages

499 The Republic respectfully submits that the Tribunal should not give in to Claimants' disingenuous request for moral damages.

500 Claimants suggest that the Republic is liable for moral damages mainly because of the allegedly unfounded imprisonment of Mr. Cornegruta. The imprisonment purportedly served to intimidate Claimants' personnel and allegedly caused them grave concern for Mr. Cornegruta's health.[468] Further, Claimants also complain about the search of KPM's and TNG's premises on 6 May 2009.[469]

501 The Republic has set out in its previous submissions in detail that the Republic's actions were legal and proper. This fact alone bars any claim for moral damages. Instead of going into these issues again, the Republic will now focus on other aspects, namely that the Claimants in this arbitration did not suffer any moral harm and in particular not the kind of moral harm that would warrant an award for moral damages in the amount claimed by Claimants.[470]

1. No exceptional circumstances warranting an award for moral damages

502 It is common ground between the parties that moral damages can only be granted in exceptional circumstances.[471] This understanding is reflected in the practice of investment tribunals which, on numerous occasions, have rejected investor requests for compensation of such non-pecuniary damages.[472]

503 The Republic, in its Statement of Defence, has already explained that such exceptional circumstances do not exist in the present case and that in particular, the requirements set out in the *Lemire* case are not fulfilled.[473] In

---

468 Claimants' Statement of Claim, paras. 453 et seq.; Claimants' Reply on Quantum, para. 95.

469 Claimants' Statement of Claim, para 455.

470 In that regard, see already the Republic's response to Claimants' moral damages claim in the Republic's Statement of Defence, paras. 55.1 et seqq.

471 Claimants' Statement of Claim, para. 453, Respondent's Statement of Defence, para. 55.2 (b).

472 Cf. e.g. *Técnicas Medioambientales Tecmed S.A. v. The United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003, para. 198 (**Exhibit C-209**); *Biwater Gauff v. Tanzania*, ICSID Case No. ARB/05/22, Award, 24 July 2008, para. 808 (**Exhibit C-270**); *Lemire v Ukraine*, ICSID Case No. ARB/06/18, Award, 28 March 2011, paras. 344 et seq. (**Exhibit C-61**).

473 Respondent's Statement of Defence, para. 55.2 (b).

its Statement of Defence, the Republic has also explained how the present case is distinguishable from the *Desert Line* case, the only case cited by Claimants in which moral damages were awarded.[474] Since submitting the Statement of Defence, further facts have been.

504 To begin with, the Republic reiterates that the search of 6 May 2009 was clearly not as burdensome as Claimants would like the Tribunal to believe. As Mr. Rakhimov explained in his written testimony:

> *"I recall that the number of KPM's and TNG's security services members was greater than the number of the Financial olice officers. Moreover,* ***I and my officers were not armed*** *while KPM's and TNG's security personnel were armed. […]*
>
> *I am surprised that Mr. Stejar now claims that the search was carried out in a bullying and intimidating manner. To the contrary, the search was conducted in a proper manner. I recall hat Mr. Stejar and employees of KPM and TNG co-operated with us.* ***We appreciated their cooperation and likewise tried, to the extent possible, not to create inconveniences and difficulties****.*
>
> *[…] I respectfully asked everyone to remain calm, showed my identification and explained what the purpose of the search was. I recall that Mr. Stejar agreed that our proposal to inform the employees and calm them down was reasonable. And later on, to the extent possible, we tried not to disrupt the companies' operation.*
>
> *[…]* ***Then I identified those employees who lived locally and who had families and children waiting for them at home so that we could search their offices first and let them go home.***
>
> *[…] It is correct that while waiting for their offices to be searched, employees had to wait outside their offices with the doors closed and an officer of the Financial Police*

474 Ibid. para. 55.2 (c).

> *was placed in each corridor. However, all employees were provided with chairs so they were not forced to stand. This is a standard procedure the purpose of which is to ensure that documents are not destroyed or concealed. This procedure is generally accepted and it is not intended to cause suffering, discomfort or harm to anybody."*[475]

505 These statements clearly show that the search on 6 May 2009 was in no way comparable to anything that led the *Desert Line* tribunal to award moral damages. In the present case, unarmed officers took utmost care to carry out a search without creating more disturbance than necessary. In the *Desert Line* case, armed tribes attacked the investor's premises[476] and Yemeni military put the premises under "siege", as one Yemeni military official called it himself.[477] The cases are hence easily distinguishable.

506 Interestingly, at the October hearing, Claimants chose not to challenge Mr. Rakhimov on this part of his witness statement.[478] In fact, Mr. Rakhimov further explained at the October hearing how he took every precaution so as not to distract KPM's and TNG's employees unnecessarily. According to his testimony, the search was conducted only in the afternoon and by two teams, so as to ensure that it could be done quickly:

> *"[…] the investigative action was planned by myself for the afternoon of the day, in order not to distract the staff from their current duties. […] I knew for certain hat the office of KPM and TNG are not small by Aktau standards, and therefore I decided to have two teams searching the premises."*[479]

507 A search conducted with such consideration and caution can clearly not be the basis for any claim of moral damages.

---

475 Second Witness Statement of Mr. Rakhimov, paras. 4.11 et seqq.

476 *Desert Line Projects LLC v. Republic of Yemen*, ICSID Case No. ARB/05/17, Award, 6 February 2008, para. 185, 286.

477 *Desert Line Projects LLC v. Republic of Yemen*, ICSID Case No. ARB/05/17, Award, 6 February 2008, para. 167.

478 Testimony of Mr. Rakhimov, Transcript Day 5, p.1 et seqq.

479 Testimony of Mr. Rakhimov, Transcript Day 5, p.5, line 21 - p.6, line 3.

508 Further, there is another reason undermining Claimants' moral damages claim: any award for moral damages would benefit only Gabriel and Anatoli Stati. However, both of these men have clearly not suffered any moral harm in the present case.

509 Claimants in this arbitration are Anatoli Stati, Gabriel Stati, Ascom and Terra Raf. Ascom is 100% owned by Anatoli Stati whereas 50% of Terra Raf are owned by Anatoli Stati with the other 50% being owned by Gabriel Stati. It is thus safe to say that ultimately, any award for moral damages in these proceedings would benefit Anatoli and Gabriel Stati only.

510 Yet, Claimants have not demonstrated how either of these two alleged investors would have suffered moral harm from the Republic's actions. In fact, it appears that Gabriel Stati has not taken part in this case at all. From all evidence on record, he has not been involved in any of the events that gave rise to this case. Gabriel Stati can hence not have suffered any moral harm whatsoever. Awarding moral damages for his benefit would thus be manifestly improper.

511 Ultimately, the same conclusion must be drawn with regard to Anatoli Stati. While Anatoli Stati was indeed involved in the case and supervised the events in Kazakhstan from his office in Moldova, he also cannot claim moral harm. With regard to the search of KPM's and TNG's premises on 6 May 2009, this follows from the following facts:

(a) Mr. Stati was not present at the search;

(b) as explained above, the conduct of the search was perfectly proper

(c) as explained above, the effects were not of such a grave nature as Claimants want to have it appear.

512 Moreover, with regard to the imprisonment of Mr. Cornegruta, Mr. Stati cannot claim compensation for moral suffering either. This became patently clear at the October hearing:

> ***Dr. Nacimiento:*** *"You mention Mr Cornegruta in both your witness statements. Are you still in contact with him?"*

> ***Mr. Stati:*** *"Unfortunately not. He is aware that we are now in the arbitration, involved in arbitration proceedings, and as he is not a person well versed in these matters, he does not go into this process."*
>
> ***Dr. Nacimiento:*** *"Did he help you with information to prepare this arbitration?"*
>
> ***Mr. Stati:*** *"No. I didn't need it."*
>
> ***Dr. Nacimiento:*** *"Did you inform him about the arbitration?"*
>
> ***Mr. Stati:*** *"No, but this is no secret. Everyone is aware of this, including Mr Nazarbayev himself."*
>
> ***Dr. Nacimiento:*** *"When were you last in contact with Mr Cornegruta?"*
>
> ***Mr. Stati:*** *"I don't remember. I don't remember."*
>
> ***Dr. Nacimiento:*** *"This year?"*
>
> ***Mr. Stati:*** *"No."*[480]

513 Mr. Cornegruta escaped from prison and returned to Moldova in August 2010.[481] From Mr. Stati's testimony, we can see that for most of the time since Mr. Cornegruta's return, Mr. Cornegruta and Mr. Stati have apparently not been on speaking terms. Mr. Stati is in fact not even informing Mr. Cornegruta about this arbitration even though Mr. Cornegruta is supposedly the person whose suffering is the basis of Mr. Stati's moral damages claim. This manifestly undermines any claim for moral damages by Claimants.

---

480 Testimony of Mr. Stati, Transcript Day 2, p.57, line 15 - p.58, line 5.

481 Note on the criminal prosecution of the heads of the prison connected to the escape of Mr. Cornegruta from prison dated 16 September 2011 (**Exhibit R-169**).

2. Claimants' claim for moral damages is unprecedented and far out of proportion

514 In their Reply Memorial on Quantum, Claimants boldly suggested that "the Tribunal should award, as moral damages, a sum equivalent to at least 10% of the total compensatory damages awarded to Claimants."[482] Irrespective of the fact that moral damages should not be awarded in this case in the first place, some comment is warranted with regard to this extraordinary amount demanded by Claimants.

515 Claimants claim is quite unprecedented, both with a view to Claimants' calculation method for moral damages and with a view to the potential results such calculation method could lead to.

516 As to the first point, Claimants cite no case which would establish that moral damages need to be calculated as a percentage of the compensatory damages awarded. This does not surprise since no such case exists. The reason for this is simple: there is no necessary connection between the tangible and the moral harm suffered. Or, to apply this to the case at hand, there is no connection between the financial losses following from the assets being taken into trust management and the alleged stress and anxiety supposedly following from the May 2009 search or the imprisonment of Mr. Cornegruta. The Tribunal should not fall for Claimants' flawed logic and their percentage based approach.

517 As to the second point, the potential results of applying such approach are patently absurd. With their Rejoinder Memorial on Quantum, Claimants claimed USD 2,728.2 million in compensatory damages for the Borankol and Tolkyn fields, the Contract 302 Properties and the LPG Plant.[483] Applying their own calculation method, Claimants thus claimed at least USD 272.82 million in moral damages. Needless to say that no investment arbitration award for moral damages ever came close to such amount.[484]

518 From the above, it in fact appears as if Claimants want to introduce US-style punitive damages into the investment arbitration context. However,

---

482 Claimants' Reply on Quantum, para. 97.

483 Claimants' Reply on Quantum, para. 79.

484 In fact, the only case cited by Claimants in which moral damages were actually awarded was the *Desert Line* case, in which moral damages amounted to USD1 million, cf. *Desert Line Projects LLC v. Republic of Yemen*, ICSID Case No. ARB/05/17, Award, 6 February 2008, para. 291 (**Exhibit C-136**).

there is no basis in international law for doing so and tribunals have been firm in rejecting claims for punitive damages in the past.[485] The Republic respectfully submits that the Tribunal should do likewise in the present case and not follow Claimants' flawed calculation approach.

III. The Republic is entitled to a full award on costs

519 The Republic further respectfully requests the Tribunal to order Claimants to reimburse the Republic for, *inter alia*, the fees and expenses of the experts, consultants, witnesses, and legal counsel. Details of this cost claim will be set out in later cost submissions.[486]

---

485 Cf. *Waguih Elie George Siag & Clorinda Vecchi v. Arab Republic of Egypt*, ICSID Case No. ARB/05/15, Award, 1 June 2009, paras. 544 et seqq. (**Exhibit C-217**).

486 Cf. Sections 1.10 and 1.11 of the Tribunal's Procedural Order No. 6 dated 15 October 2012.

F. Requests for Relief

The Republic requests the Arbitral Tribunal to issue:

(a) an order from the Arbitral Tribunal that dismisses all of Claimants' claims;

(b) an order from the Arbitral Tribunal of all of its costs incurred and to be incurred as a result of this arbitration. The Republic thus requests that the Claimants be ordered to reimburse the Republic for, *inter alia*, the fees and expenses of the experts, consultants, witnesses, and legal counsel. The Republic hereby reserves the right to detail and document its claim for such foregoing costs, which by their very nature are continuing, at the appropriate future time as directed by the Arbitral Tribunal.

Respectfully submitted on behalf of Respondent,

Patricia Nacimiento

Norton Rose LLP
Dr. Patricia Nacimiento

Winston & Strawn LLP
Joseph Tirado