EXHIBIT B

Counter-Memorial of the Republic of Kazakhstan

INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES

Case No. ARB/08/12

CARATUBE INTERNATIONAL OIL COMPANY LLP

Claimant

v.

THE REPUBLIC OF KAZAKHSTAN

Respondent

THE REPUBLIC'S COUNTER-MEMORIAL ON OBJECTIONS TO JURISDICTION AND THE MERITS

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TABLE OF CONTENTS

Page #

I. INTRODUCTION 1

A. Summary of Argument 1
B. Background Information Concerning the Republic of Kazakhstan 5
C. Background Information Concerning CIOC 6

II. OBJECTIONS TO THE JURISDICTION OF THE TRIBUNAL AND TO THE ADMISSIBILITY OF THE CLAIMS PRESENTED 10

A. Overview of Requirements for Jurisdiction 10
B. CIOC Has Not Made a Bona Fide Investment 11
C. Overview of Admissibility 22
D. Any Justiciable Claims Claimant Has Presented Are Inadmissible Because CIOC Waived Any Right It Might Have Had to Jurisdiction Before This Tribunal 23

1) Waivers of Treaty Rights Are Enforceable as a Matter of International Law 23
2) Scope and Nature of the Waiver in the Contract 25
3) The Waiver in the Contract Renders All of CIOC's Claims Inadmissible 28

(i) The Exclusive Jurisdiction Clause Must Be Enforced 28
(ii) CIOC's Claims Arise from the Contract 31
(iii) Even if CIOC Had Stated Treaty Claims, Such Claims Are Now Inadmissible 37

III. LIABILITY 39

A. The Umbrella Clause Does Not Cure CIOC's Jurisdiction and Admissibility Defects 39

1) Claimant Cannot Use the Umbrella Clause to Circumvent Its Contractual Obligations 39
2) The Umbrella Clause Does Not Transform Generic Contract Claims Into Treaty Claims 41

B. The Republic Terminated the Contract Due to CIOC's Material Breaches 44

1) The Caratube Oil Field 44
2) The Contract 45
3) The Minimum Work Program and the Annual Work Programs 46

4) The Monitoring of Subsoil Users Performance 48

(i) The MEMR, the Monitoring Division, TU Zapkaznedra, Other Agencies 48

(ii) The LKU Reports 49

5) CIOC's Material Breaches and the Resulting Termination of the Contract 50

6) Chronological Summary of Events and Decisions Leading to Termination of the Contract for Material Breaches 56

7) The Termination 69

8) Certain Post-Termination Events 71

9) CIOC's Excuses for Nonperformance and Other Defenses Are Meritless 72

(i) CIOC's Allegation that the Minimum Work Program Was Inadequate, Unrealistic and Artificial 73

(ii) CIOC's Allegation that the Geological Complexity of the Field Explained the Delays 75

10) The MEMR Has Not Approved of CIOC's Past Performance or Non-Performance 77

11) The 2-Year Extension of the Exploration Period Did Not Affect the MEMR's Right to Terminate the Contract 79

(i) CIOC Remained Accountable for its Failures to Perform the Minimum Work Program 80

(ii) The Extension of the Exploration Period Does Not Constitute an Approval of CIOC's Past Performance or a Waiver of the MEMR's Right to Terminate the Contract 84

12) The MEMR Validly Exercised its Right to Terminate the Contract Based on Proper Notices to CIOC 85

C. There Has Been No Harassment of CIOC, its Principals or its Employees 89

1) The Contract Was Rightfully Terminated for Material Breach and Not as Part of an Alleged Harassment Campaign 90

(i) The Record of Non-Performance Predates the Invoked Political Events 91

(ii) CIOC Was Not Subject to Biased Treatment by the MEMR 92

2) There Was No Harassment of CIOC 95

(i) The "Investigations Unrelated to CIOC" 95

(ii) The "Actions Specific to CIOC" 98

D. The Republic Has Not Expropriated any Property from CIOC 106
1) Standard for Claims of Expropriation 108
2) Analysis of CIOC's Claim Shows That It Has Not Met Its Burden 114
E. The Republic Afforded CIOC Fair and Equitable Treatment 119
1) Principles Underlying Fair and Equitable Treatment and the Proper Method of Analysis 120
2) The Obligation to Provide a Stable Legal Framework 122
3) Scope of Legitimate Expectations 125
4) Standards of Transparency, Due Process and Non-Discrimination 129
5) CIOC Has Not Met Its Burden to Prove a Breach of the Fair and Equitable Treatment Standard 130
F. The Republic Fulfilled Its Duty to Provide Full Protection and Security 135
1) Principles Underlying the Full Protection and Security Obligation 135
2) Acts Taken Within the Exercise of Legitimate State Powers Cannot Be the Basis of a Full Protection and Security Claim 140
3) The Obligation to Provide Full Protection and Security Does Not Include a Duty to Provide Legal protection 141
4) CIOC Has Not Met Its Burden to Prove a Breach of Full Protection and Security 142
G. The Republic Did Not Act in an Arbitrary or Discriminatory Manner 147

IV. DAMAGES 150
A. CIOC Is Not Entitled to Lost Profits Because It Never Made a Commercial Discovery 150
B. CIOC Is Not Entitled to Lost Profits Because Any Such Profits Are Highly Speculative and Uncertain 154
1) The Applicable Requirements for Awarding Compensation 155
2) CIOC Is Not Entitled to Future Lost Profits Calculated Using the DCF Valuation Method 158
(i) The Enterprise Must Be a Going Concern With a Record of Profits 164
(ii) There Must Be No Significant Investment to Be Made After the Date of the Alleged Taking 173

(iii) The Enterprise Must Have the Expertise and Financial Capacity Necessary to Generate Profits in the Specific Circumstances of the Case 176

(iv) The Disparity Between the Requested Compensation and the Investment Made Must Be Reasonable 182

(v) The Projection Must Be Over a Reasonable Period of Time 185

C. The Updated Investment Value Is the Appropriate Valuation Method 193

D. Even Assuming That DCF Is the Appropriate Valuation Method, CIOC's Calculation Is Erroneous 195

1. CRA's DCF Calculation Is Erroneous Because It Is Based on Flawed Information Provided in the TRACS Reserves Report 197

2. CRA's DCF Calculation Is Erroneous because it Is Based on Wrong Economic Assumptions 200

3. Appropriate DCF Calculation 201

E. CIOC Has Not Suffered Moral Damages 202

F. Interest 206

V. CONCLUSIONS 208

I. INTRODUCTION

A. Summary of Argument

1. This Counter-Memorial is submitted by the Republic of Kazakhstan (the "**Republic**") as a response to the Memorial submitted by Claimant Caratube International Oil Company LLP ("**CIOC**" or "**Claimant**") on May 14, 2009 ("**CIOC's Memorial**").

2. In this Counter-Memorial, the Republic will show that the present dispute between the Parties exclusively concerns matters of contract arising from the Contract For Exploration and Production of Hydrocarbons within Blocks XXIV-20-C (partially); XXIV-21-A (partially), including Karatube Field (oversalt) in Baiganin District of Aktobe Oblast of the Republic of Kazakhstan (the "**Contract**"). The Contract was awarded to Consolidated Contractors (Oil and Gas) Company S.A.L. ("**CCC**") on May 27, 2002. CCC assigned it to CIOC for USD 9.4 million on August 8, 2002, less than three months later. CIOC had come into existence on July 29, 2002, a week before the assignment.

3. CIOC contends that this case is about breaches by the Republic of its obligations under the Kazakhstan-US bilateral investment treaty (the "**BIT**" or the "**Treaty**"). In fact, as the Republic will show, this case is a contract dispute between the two Parties to the Contract, the Republic and CIOC, (collectively, the "**Parties**") concerning nothing more than whether the Republic's termination of the Contract for material breaches by CIOC was justified.

4. In **Section II** of the Counter-Memorial, the Republic will first show that there is no jurisdiction under the ICSID Convention over CIOC's Treaty claims, the only claims CIOC has made in this arbitration. This is because there was no qualifying

investment into the Republic of Kazakhstan as required by the Convention. Next, and independent of the above jurisdictional defect, the Republic will show that the dispute's contractual nature renders this dispute inadmissible before this Tribunal.

5. In **Section III** below, the Republic will first show that CIOC cannot invoke the umbrella clause of the BIT to artificially transform contract claims into treaty claims while at the same time circumventing the dispute settlement provisions of the Contract. The Republic will next prove via the testimony of Mr. Mirbulat Ongarbaev (the "**Mirbulat Ongarbaev Statement**"), the head of the Department for Monitoring Subsoil Use of the Ministry of Energy and Mineral Resources (the "**MEMR**"), IFM's Expert Report on the Compliance and Breaches of CIOC (the "**IFM Compliance Report**"), and documentary evidence, that CIOC was in a permanent state of material breach of the Contract from the earliest days of the Contract period until the Termination on February 1, 2008 (the "**Termination**"). For example, as will be explained and fully documented in that Section, CIOC never came close in any year to fulfilling its obligations as set out in the Contract, the contractual Minimum Work Program and the Annual Work Programs. In particular, CIOC never even began drilling the required exploratory wells in the deeper subsalt region. CIOC was notified by the Republic of its nonperformance and was threatened with termination on numerous occasions beginning in 2003. Copies of these notifications are submitted with this Counter-Memorial. These facts belie what CIOC alleges in its Memorial: namely, that CIOC was performing perfectly well and that the Termination was caused by political motivations arising in mid-2007 and not by CIOC's material breaches of the Contract. In fact, the Termination occurred as part of the Republic's ongoing review of the contractual performance of sub-soil users in

Kazakhstan. During the relevant period between late 2007 and early 2008, eighty-seven contracts were terminated for material breach, including CIOC's. Moreover, the record clearly shows that CIOC's material breaches and the Republic's repeated notices regarding those breaches occurred beginning in 2003, long before the unrelated political events referred to by CIOC.

6. The Republic will also prove through documentary evidence and the testimony of Mr. Askhat Daulbaev (the "**Askhat Daulbaev Statement**"), Deputy Prosecutor of the Republic, that the Republic did not engage in any harassment of CIOC, its principals or its employees, but rather acted at all times for legitimate purposes in accordance with applicable law and procedure. Further, the Republic will show that none of the allegedly harassing actions was in any way the cause of the Termination. Rather, CIOC lost its rights under the Contract because of its own material breaches, as confirmed by documentary evidence, the IFM Compliance Report and the Mirbulat Ongarbaev Statement.

7. Finally, the Republic will next set out the legal standards with respect to each of CIOC's purported Treaty claims and will then demonstrate that the facts referred to above also undermine each of those claims since those claims cannot prevail in the absence of proof of wrongful termination. No such proof exists because the Termination was justified.

8. In **Section IV**, the Republic will address the issue of damages. Of course, if this Tribunal concludes, as the Republic respectfully submits it should, that it has no jurisdiction over CIOC's claims or that those claims are not meritorious, there will be no need to look into the issue of damages at all. Nevertheless, for the sake of

completeness the Republic, based on documentary evidence, the IFM Expert Report on Reserves and Production Profile (the "**IFM Reserves Report**") and the Expert Report on the Value of the Project, of the economist, Mr. Vladimir Brailovsky (the "**Brailovsky Valuation Report**"), will prove that CIOC's damage claims are, to say the least, grossly inflated. This can be illustrated by one simple example. As will be fully substantiated herein, the fact is that CIOC paid USD 9.4 million to acquire the Contract, the fair market value of the asset at the time of acquisition, yet it is now claiming fair market value amounting to over a billion dollars in its Memorial, reduced for unexplained reasons from approximately two billion in its Request for Arbitration. What did CIOC do to so dramatically increase the fair market value of the asset from USD 9.4 million to over USD 1 billion? The answer is: nothing. CIOC did not discover any oil. It did not even drill into the deeper structures of the Caratube field, as it was required to do under the Contract. Rather, it merely re-entered wells drilled during Soviet times and drilled additional shallow wells into oil deposits which had already been discovered during Soviet times. Moreover, the drilling that CIOC did resulted in a downgrading of the quality of a significant portion of the previously known oil. It is thus difficult to see how the fair market value could have increased in the dramatic manner posited by CIOC.

9. More technically, the Brailovsky Valuation Report will show that the proper method for valuing CIOC's asset is a cost-based method, also known as the updated investment value method. Using this method, the Brailovsky Valuation Report concludes that the value of CIOC's asset at the time of the Termination is USD 32.2 million. The Brailovsky Valuation Report explains in detail why the Discounted Cash Flow ("**DCF**") method, proposed by CIOC, is inappropriate and would result in the

awarding of highly uncertain and speculative damages in this case. However, for the sake of comparison, he makes his own DCF analysis based upon the reserves information and production profile determined to be appropriate in the IFM Reserves Report. Mr. Brailovsky concludes that the DCF method, using what he considers to be the appropriate discount rate and other factors, would result in a value of USD 15.3 million for CIOC's asset at the time of the Termination. He also explains why the DCF analysis of CIOC's expert, which results in the over one billion dollar claim, is, in his opinion, very seriously flawed.

10. In addition, in that Section of the Counter-Memorial, the Republic will discuss the applicable legal criteria for damages in this case and will show that by applying those criteria, CIOC is not entitled to the damages it is claiming.

B. Background Information Concerning the Republic of Kazakhstan

11. In its Memorial and other submissions CIOC deliberately attempts to depict the Republic in an extremely negative light. Those blatant mischaracterizations by CIOC cannot go unanswered and, as a preliminary matter, the Republic considers it necessary to provide the following general background information.

12. The Republic of Kazakhstan has, among all of the former Soviet Republics, achieved the greatest success since the collapse of the Soviet Union. Although it was bankrupt in 1991 when it declared independence, the Republic, in just 18 years, has been successful on many fronts, including modernization, economic development, creation of a middle class and harmony among a variety of ethnic groups and religions.[1] Its ability to move swiftly away from the recent worldwide recession,

[1] *See,* **Ex. R-5**, Richard Weitz, KAZAKHSTAN AND NEW INTERNATIONAL POLITICS OF EURASIA (Central Asia and Caucasus Institute Silk Road Studies Program 2008).

thanks to competent domestic administration and without international help, was publicly noted by the IMF at the time of the recent visit to Kazakhstan by the President of the IMF.[2]

13. This successful transition from a post-Soviet, bankrupt State to a thriving developing nation is in large part due to the competent leadership provided by the Government and the President.[3] It is also due to the great efforts and dynamism of the Kazakhstani people. One example of progress is the creation of the new, modern capital city of Astana built in the steppes of central Kazakhstan.

14. This success also owes a great deal to the natural resources of Kazakhstan which are, of course, of national importance to the Republic. This importance explains the need to ensure that subsoil users are performing their contracts properly and in accordance with the law.

C. Background Information Concerning CIOC

15. As noted above, CIOC was formed on July 29, 2002, one week before it acquired the Contract from CCC, which is an affiliate of a large construction company with activities in Kazakhstan. CCC had been awarded the Contract on May 27, 2002, and assigned it to CIOC on August 8, 2002, less than three months later. Thus, CIOC at the time of the acquisition was a brand new company with no prior oil and gas experience. There is also no evidence that CIOC engaged in any oil and gas activities other than at the Caratube field.

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[2] *See,* **Ex. R-6**, International Monetary Fund Press Release dated June 15, 2009.

[3] *See,* **Ex. R-5**, Richard Weitz, KAZAKHSTAN AND NEW INTERNATIONAL POLITICS OF EURASIA (Central Asia and Caucasus Institute Silk Road Studies Program 2008).

16. Oil and gas exploration and production is a serious and complex business that requires solid managerial experience and technical skills as well as very large financial capabilities. As will be seen in this Counter-Memorial, the evidence shows that CIOC lacked both.

17. In particular, Devincci Salah Hourani ("**Devincci Hourani**"), who apparently acquired 92% of the shares of CIOC for a total price of approximately USD 6,500, had minimal oil and gas experience, all acquired at Kulandy Energy Company which, as will be demonstrated in Mirbulat Ongarbaev Statement, was a failure. In fact, the oil and gas management capability of CIOC seems to have resided in Omar Antar. However, as set out in his witness statement, his educational credentials are limited to a Masters Degree in Chemistry and to studies in petrochemical synthesis in Moscow (without mention of a diploma). These were followed by professional experience in the quality control area at Zadco Development Company, an Abu Dhabi oil company, until 2001. He was then hired by Kulandy Energy Corporation as technical manager in November 2001. As will be demonstrated later, the Kulandy project was a failure, with record low performance starting in 2002, i.e. immediately after Omar Antar's and Devincci Hourani's arrival. CIOC's lack of the required managerial experience and technical skills is discussed more fully in the IFM Compliance Report.

18. Moreover, CIOC lacked the required financial capacity to successfully carry out the Caratube project. From the beginning and continuously throughout the life of the Contract, CIOC systematically and significantly failed to meet its annual investment obligations. This is indeed one of the reasons that led to the Termination of CIOC's Contract. In addition, there is no evidence that CIOC itself or its apparent owner

and purported investor, Devincci Hourani, had the ability to finance or mobilize the financing necessary to sustain the future development of the Caratube project that CIOC predicts in its damage claim. The evidence shows that CIOC at the time of the Termination had invested less than six percent of the total investment predicted in its damage claim, and, as mentioned above, it was at all times far behind in its investment obligations. CIOC's lack of the required financial capacity is also discussed in the IFM Compliance Report.

19. Accompanying this Counter-Memorial are:[4]

- The Mirbulat Ongarbaev Statement;
- The Askhat Daulbaev Statement;
- The IFM Compliance Report;
- The IFM Reserves Report;
- The Brailovsky Valuation Report; and
- Exhibits R-5 to R-101and exhibits RL-6 to RL-82.

20. Attached to this Counter-Memorial is a consolidated index of all exhibits and authorities relied upon by the Republic since the beginning of these proceedings. Separately listed therein are the exhibits attached to the witness statements and the expert reports referred to above. References herein in the form of "**Ex. R-_**" and "**Ex. RL-_**" are to the exhibits introduced by the Republic in these proceedings. "**Ex. R-_**" is used for all exhibits except for legal authorities and "**Ex. RL-_**" is used for legal

[4] CIOC's Memorial was accompanied by two witness statements and three expert reports as follows: the witness statement of Devincci Salah Hourani (the "**Devincci Hourani Statement**"); the witness statement of Omar Antar (the "**Omar Antar Statement**"); the expert report of Sven Tiefenthal from TRACS on compliance with work programmes (the "**TRACS Compliance Report**"); the expert report of Sven Tiefenthal from TRACS on oil field reserves and resources (the "**TRACS Reserves Report**"); and the expert report of Time Giles from CRA on the quantum of damages (the "**CRA Quantum Report**").

authorities. All of the Republic's exhibits are numbered consecutively with no repeated exhibits. The witnesses and experts in their statements and reports sometimes refer to exhibits introduced with the Counter-Memorial and sometimes to exhibits attached at the end of their respective statements and reports; however, all such exhibits are numbered consecutively using "**Ex. R-_**" or "**Ex. RL-_**" as appropriate. References herein in the form of "**Ex. C-_**" and "**Ex. CA-_**" are to the exhibits introduced by CIOC and are used for their general exhibits and legal authorities, respectively.

21. Following the structure of the Republic's argument as outlined in Section I.A. above, the Republic now turns to the question of jurisdiction.

II. OBJECTIONS TO THE JURISDICTION OF THE TRIBUNAL AND TO THE ADMISSIBILITY OF THE CLAIMS PRESENTED

A. Overview of Requirements for Jurisdiction

22. When evaluating its competence to entertain a dispute submitted to it, an arbitral tribunal sitting pursuant to the ICSID Convention must first discern whether the case as presented falls within the jurisdictional requirements set out in the Convention. These requirements are contained in Article 25 of the ICSID Convention which defines the Centre's jurisdiction as follows:

> The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State ... and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre.

23. The Centre's jurisdiction is therefore circumscribed by requirements *ratione materiae*, *ratione personae* and *ratione voluntatis*. First, the dispute presented must be of a legal nature and must arise directly out of a qualifying investment (*ratione materiae*). Second, the parties to the dispute must be a Contracting State and a national of a second Contracting State (*ratione personae*) and finally, each party must have consented in writing to submit the dispute to the Centre's jurisdiction (*ratione voluntatis*).

24. These requirements are objective in nature and, although the parties may limit their consent and constrain a tribunal's competence by agreement, the parties may not extend ICSID jurisdiction, by agreement or otherwise, beyond its "outer limits."[5]

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[5] **Ex. RL-7**, Aron Broches, *The Convention on the Settlement of Investment Disputes between States and Nationals of Other States*, 136 RECUEIL DES COURS (1972) (hereinafter "Broches, *The Convention on the Settlement of Investment Disputes between States and Nationals of Other States*"), at 361. In the words of Schreuer, "there are outer limits to the Centre's jurisdiction that are not subject to the parties' disposition." **Ex. RL-8**, Christoph H. Schreuer, Loretta Malintoppi, August Reinisch and Anthony Sinclair,

Therefore, while consent is certainly a necessary requirement for ICSID jurisdiction, it is not sufficient and its breadth, regardless of how broad the parties may have wished it to be, is limited by their ability to fulfill the objective requirements of Article 25. As stated by the Report of the Executive Directors on the ICSID Convention:

> While consent of the parties is an essential prerequisite for the jurisdiction of the Centre, consent alone will not suffice to bring a dispute within its jurisdiction. In keeping with the purpose of the Convention, the jurisdiction of the Centre is further limited by reference to the nature of the dispute and the parties thereto.[6]

Therefore, the first task for an ICSID tribunal is to ascertain whether these objective requirements are met.

25. As will be discussed below, CIOC has not met its burden to show these objective requirements and this Tribunal therefore should not take jurisdiction over CIOC's claims. CIOC has failed to show that it has made a foreign investment allowing it to benefit from the provisions of the ICSID Convention or the Kazakhstan-US BIT.[7]

B. CIOC Has Not Made a Bona Fide Investment

26. In keeping with the above, this Tribunal's first duty is to determine whether CIOC is an investor who has made an investment within the meaning of Article 25 of the ICSID Convention. In order to make this determination, the Tribunal must look beyond

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THE ICSID CONVENTION – A COMMENTARY (Cambridge University Press 2009) (hereinafter "Schreuer et al, THE ICSID CONVENTION – A COMMENTARY"), ¶ 7, at 83 (internal citation omitted). *See also*, **Ex. RL-9**, *TSA Spectrum de Argentina S.A. v. Argentine Republic*, ICSID Case No. ARB/05/5, Award dated December 19, 2008 ("*TSA*"), ¶ 134. ("Article 25 of the ICSID Convention defines the ambit of ICSID's jurisdiction. In other words, it defines the extent, hence also the objective limits, of this jurisdiction (including the jurisdiction of tribunals established therein) which cannot be extended or derogated from even by agreement of the Parties.").

[6] **Ex. RL-10**, Report of the Executive Directors on the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (March 18, 1965), ¶ 25.

[7] The Republic did not request the bifurcation of these proceedings, since it concluded that the Tribunal needed factual information in order to assess these objections and that such information was best presented together with the merits of the case. This however does not mean that the Republic considers these objections to be less serious, and the Republic therefore asks the Tribunal to uphold the objections and to refrain from considering the merits of the case.

CIOC, a corporate vehicle incorporated in the Republic of Kazakhstan, who in principle is not entitled to bring a claim against its own State. Claimant relies on the exception in Article 25(2)(b) to attempt to show that it is a "national of another Contracting State" for jurisdictional purposes. This Article provides that "National of another Contracting State" means:

> (a) [...]
>
> (b) [...] any juridical person which had the nationality of the Contracting State party to the dispute on that date and which, *because of foreign control*, the parties have agreed should be treated as a national of another Contracting State for the purposes of this Convention. (emphasis added)

27. The purpose of the Convention is to allow the settlement of investment disputes between states and foreign nationals. However, Article 25(2)(b) recognizes the business model commonly employed by international investors, who often make their investments through a local investment vehicle. The purpose of this clause has been summarized as follows:

> Incorporation in the host State makes the investor technically a national of that State according to the most common test for nationality of juridical persons. This would exclude all investors that operate through local companies from the ambit of the ICSID Convention. A large and important part of foreign investment would then be outside the Convention's scope. The second clause of Art. 25(2)(b) is designed to accommodate this problem by creating an exception to the diversity of nationality requirement.[8]

28. The *ratio legis* of this provision is "the wording 'because of foreign control'. Foreign control is thus the objective factor on which turns the applicability of this

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[8] **Ex. RL-8**, Schreuer et al, THE ICSID CONVENTION – A COMMENTARY, ¶ 760, at 296 (internal citation omitted).

provision,"[9] therefore it is the justification for the extension of ICSID jurisdiction to include disputes that normally would fall outside its ambit.

29. In the present case the local investment vehicle is CIOC, and according to the Claimant, the real party in interest is Devincci Hourani, the purported "owner" of a majority of shares of CIOC. It is thus through this "ownership" that CIOC asserts a right to benefit from Devincci Hourani's US nationality to obtain the diversity needed for jurisdictional purposes. One should therefore assess "the existence and materiality of this foreign control" and this foreign control has "to be objectively proven" to establish jurisdiction.[10] This objective requirement cannot be reduced "to a mere semblance or formality."[11] As indicated by scholars, the "decisive criterion for the existence of a foreign investment is the nationality of the investor."[12] Consequently, if it is shown that Devincci Hourani has not made an investment in CIOC in accordance with Article 25 of the ICSID Convention, then this Tribunal has no competence to consider CIOC's claims.

30. Thus, before examining the actual facts of the case and the conditions under which Devincci Hourani acquired his alleged control over CIOC, we will first address the legal requirements to be met for a transaction to be considered an investment under the ICSID Convention.[13]

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[9] **Ex. RL-9**, *TSA*, ¶ 139.

[10] **Ex. RL-9**, *TSA*, ¶ 147.

[11] **Ex. RL-9**, *TSA*, Concurring Opinion of Arbitrator Georges Abi-Saab ("*TSA*, Concurring Opinion"), ¶ 12.

[12] **Ex. RL-11**, Rudolf Dolzer and Christoph Schreuer, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW (Oxford 2008) (hereinafter "Dolzer and Schreuer, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW"), at 67.

[13] Independently of whether a specific transaction could be considered an investment under the Kazakhstan-US BIT, the Tribunal needs to ascertain whether such transaction is covered by the ICSID Convention itself. This double keyhole analysis has been explained by various ICSID tribunals.

> A two-fold test must therefore be applied in determining whether this Tribunal has the competence to consider the merits of the claim: whether the dispute arises out of an investment within the meaning of the

31. The term "investment" was left undefined by the drafters of the ICSID Convention, however ICSID tribunals have established a number of objective criteria to be met before a transaction can be considered an investment. In the *Salini v. Morocco* case, the features of an investment were clearly set out and elevated to jurisdictional requirements formulating what is commonly referred to as the *Salini* test.[14] After this decision, most ICSID tribunals followed the *Salini* test in order to determine whether there was a protected investment under Article 25 of the ICSID Convention.[15] Recently tribunals have added additional criteria and proposed a more comprehensive approach that takes into account the purpose underlying the alleged investment and then seeks to determine whether that purpose is in line with the purpose of "the ICSID system."

> Convention and, if so, whether the dispute relates to an investment as defined in the Parties' consent to ICSID arbitration, in their reference to the BIT and the pertinent definitions contained in Article 1 of the BIT.

Ex. RL-12, *Československa Obchodní Banka, A.S. v. The Slovak Republic*, ICSID Case No. ARB/97/4, Decision of the Tribunal on Objections to Jurisdiction dated May 24, 1999, 14 ICSID REVIEW – FOREIGN INVESTMENT LAW JOURNAL 251 (1999), ¶ 68.

[14] **Ex. CA-10**, *Salini Costruttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco*, ICSID Case No. ARB/00/4, Decision on Jurisdiction dated July 23, 2001, 42 INTERNATIONAL LEGAL MATERIALS 609 (2003) ("*Salini*"). The test for the existence of an investment as articulated in *Salini* includes the following factors: (a) contribution of the investor; (b) certain duration of the project; (c) existence of operational risk; and (d) contribution to the host State's development. **Ex. CA-10**, *Salini*, ¶ 52.

[15] *See*, **Ex. RL-13**, *Consortium R.F.C.C. v. Kingdom of Morocco*, ICSID Case No. ARB/00/6, Decision on Jurisdiction dated July 16, 2001, ¶ 60; **Ex. RL-14**, *Joy Mining Machinery Limited v. The Arab Republic of Egypt*, ICSID Case No. ARB/03/11, Award on Jurisdiction dated August 6, 2004, 19 ICSID REVIEW – FOREIGN INVESTMENT LAW JOURNAL 486 (2004) ("*Joy Mining*"), ¶ 53; **Ex. RL-15**, *Bayindir Insaat Turizm Ticaret Ve Sanayi A.Ş. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/03/29, Decision on Jurisdiction dated November 14, 2005, ¶ 130; **Ex. RL-16**, *Helnan International Hotels A/S v. The Arab Republic of Egypt*, ICSID Case No. ARB/05/19, Decision of the Tribunal on Objection to Jurisdiction dated October 17, 2006, ¶ 77; **Ex. RL-17**, *Mr. Patrick Mitchell v. The Democratic Republic of Congo*, ICSID Case No. ARB/99/7, Decision on the Application for Annulment of the Award dated November 1, 2006, ¶ 27; **Ex. CA-1**, *Saipem S.p.A. v. The People's Republic of Bangladesh*, ICSID Case No. ARB/05/7, Decision on Jurisdiction and Recommendation on Provisional Measures dated March 21, 2007, ¶ 99; **Ex. RL-18**, *Malaysian Historical Salvors SDN, BHD v. The Government of Malaysia*, ICSID Case No. ARB/05/10, Award on Jurisdiction dated May 17, 2007, ¶¶ 73-74 ("[t]he factors considered in *Salini* are widely accepted as the starting point of an ICSID tribunal's analysis of whether there is an 'investment' within the meaning of Article 25(1)."); **Ex. RL-19**, *Romak S.A. (Switzerland) v. The Republic of Uzbekistan*, PCA Case No. AA280, Award dated November 26, 2009 ("*Romak*"), ¶ 207 (finding that the term "investment" has an "inherent" meaning regardless of the meaning ascribed to it in a BIT).

32. In keeping with the purpose of protecting only *bona fide* foreign investments, the *Phoenix* tribunal developed a comprehensive set of six factors to consider when determining the existence of an investment.[16] This method has met with quick favor.[17] The factors applied in *Phoenix* are as follows:

1. A contribution of money or assets;
2. A certain duration;
3. An element of risk;
4. An operation made in order to develop an economic activity in the host state;
5. Assets invested in accordance with the laws of the host State; and, most importantly,
6. Assets invested *bona fide*.[18]

33. Of the above-mentioned six factors, three are particularly relevant in this case: a contribution of money or assets, an element of risk and assets invested *bona fide*.

34. To satisfy the first criterion, the putative investor should show that he contributed a "significant financial resource or transfer of know-how, equipment, and personnel."[19] In *Joy Mining v. Egypt*, the tribunal noted that although the price for the contract and the money that the seller put up as a guarantee was substantial, it was only a small fraction of the entire project and therefore not substantial enough to be

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[16] **Ex. RL-20**, *Phoenix Action Ltd. v. The Czech Republic*, ICSID Case No. ARB/06/5, Award dated April 15, 2009 *("Phoenix")*, ¶ 114.

[17] *See*, **Ex. RL-21**, *Europe Cement Investment & Trade S.A. v. Republic of Turkey*, ICSID Case No. ARB(AF)/07/2, Award dated August 13, 2009, ¶¶ 173-176. **Ex. RL-22**, *Cementownia "Nowa Huta" S.A. v. Republic of Turkey*, ICSID Case No. ARB(AF)/06/2, Award dated September 17, 2009 ("*Cementownia*"), ¶¶ 154-156 (accepting the *Phoenix* factors as instructive when determining the existence of an investment).

[18] **Ex. RL-20**, *Phoenix*, ¶ 114.

[19] **Ex. RL-11**, Dolzer and Schreuer, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW, at 68.

considered an investment.[20] Further, where only a nominal price was paid for the acquisition of the asset or assets that purportedly amount to an investment, doubts are raised about the existence of a qualifying investment and an in-depth inquiry into the circumstances of the transaction at stake is required.[21]

35. Regarding the element of risk, which is intimately linked to the contribution of capital, for a transaction to be considered an investment, it must imply "an economical operation initiated and conducted by an entrepreneur using *its own financial means and at its own financial risk*, with the objective of making a profit within a given period of time."[22] It follows that for the element of risk to be present in a transaction, the alleged investor should have committed financial resources at the initial phase of the project. The importance of showing that a purported investor took some risk and actually contributed something of value to the host state was recently reiterated:

> The Arbitral Tribunal therefore considers that the term 'investments' under the BIT has an inherent meaning (irrespective of whether the investor resorts to ICSID or UNCITRAL arbitral proceedings) entailing a contribution that extends over a certain period of time and that involves some risk.[23]

36. Finally, and most importantly, this Tribunal must determine whether there was a *bona fide* transaction. The *Phoenix* tribunal noted that several factors including the timing and substance of the transaction are of utmost importance when verifying the existence of a *bona fide* investment.[24] At a minimum, it is clear that "attempts [...] to

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[20] **Ex. RL-14**, *Joy Mining*, ¶ 57.

[21] **Ex. RL-20**, *Phoenix*, ¶ 119.

[22] **Ex. RL-23**, *Toto Costruzioni Generali S.p.A v. The Republic of Lebanon*, ICSID Case No. ARB/07/12, Decision on Jurisdiction dated September 11, 2009 ("*Toto*"), ¶ 84 (emphasis added).

[23] **Ex. RL-19**, *Romak*, ¶ 207 (emphasis in original).

[24] *See*, **Ex. RL-20**, *Phoenix*, ¶¶ 136-140.

fabricate international jurisdiction"[25] are not *bona fide* transactions and such a transaction is "a party's creation of a legal fiction so as to gain access to an international arbitration procedure to which it was not entitled is an abuse which could be [a] '*détournement de procédure.*'"[26]

37. Additionally, the Tribunal must at all times remember that "the purpose of international protection is to protect legal and *bona fide* investments,"[27] and thus, as in this case, where there is any indication that there is not a qualifying investment, tribunals should employ heightened scrutiny and examine all of the circumstances surrounding the alleged investment. The *Phoenix* tribunal prescribed the following method to assess the existence of a *bona fide* investment:

> If doubts are raised with regard to the existence of a protected investment, the Tribunal has to conduct *a contextual analysis of the existence of a protected investment*, in order to decide whether or not the investment satisfies certain criteria additional to [the Salini factors], that grant it international protection through the ICSID mechanism and the BIT. In other words, in order to conclude that an economic operation, which by its nature is or looks like an investment, is indeed an investment deserving international protection, the Tribunal must also take into consideration *the purpose of the international protection of the investment*, whether it is the specific purpose of the ICSID system or the general purpose of the protection granted by international law.[28]

38. The Tribunal's duty is therefore:

> [T]o prevent an abuse of the system of international investment protection under the ICSID Convention, in ensuring that only investments that are made in compliance

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[25] **Ex. RL-22**, *Cementownia*, ¶ 117.

[26] *Id.*, ¶ 154.

[27] **Ex. RL-20**, *Phoenix*, ¶ 100.

[28] *Id.*, ¶ 79.

> with the international principle of good faith and do not attempt to misuse the system are protected.[29]

39. Further, Contracting States to the ICSID Convention such as the Republic could not have consented to and, in the case of the Republic, did not consent to ICSID jurisdiction where the transaction purporting to confer nationality on the putative claimant is marred with the absence of good faith:

> States cannot be deemed to offer access to the ICSID dispute settlement mechanism to investments not made in good faith. The protection of international investment arbitration cannot be granted if such protection would run contrary to the general principles of international law, among which the principle of good faith is of utmost importance.[30]

40. Considering the above criteria, Devincci Hourani's ownership in CIOC and by extension CIOC's purported investment in the Republic, fail to qualify as an investment for purposes of the ICSID Convention on at least three grounds: 1) Devincci Hourani made no contribution of money or assets of any significance; 2) Devincci Hourani took no risk and, finally, and most importantly; 3) the assets of Devincci Hourani (to the extent there were any) and of CIOC were not invested *bona fide*. Each of these issues will be examined in turn.

41. First, by his own admission, Devincci Hourani cannot meet the standard regarding the significant contribution of money or assets. In two transactions in May 2004 and in April 2005, he acquired 85 percent and 7 percent, respectively, of the shares of CIOC for the total sum of approximately USD 6,500.[31] This insignificant

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[29] *Id.*, ¶ 113 (emphasis in original).

[30] *Id.*, ¶ 106.

[31] **Ex. R-7**, Agreement between Fadi Jamal Hussein and Devincci Hourani dated May 17, 2004 (indicating a payment of 850,000 Tenges for a 85% share in CIOC); **Ex C-56**, Agreement between Waheeb George Antakly and Devincci Hourani dated April 8, 2005 (indicating a payment of 70,000 Tenges for an additional 7% share in CIOC). In total Devincci Hourani paid 920,000 Tenges (USD 6,500) for his alleged

payment for 92 percent of a company deserves particular scrutiny, in light of the fact that CIOC paid approximately USD 9.4 million for the assignment of the Contract.[32] Further, there is no indication that CIOC looked to Devincci Hourani as a source of operating capital, and even if it did it seems clear that Devincci Hourani was not a viable source of such capital as there is no evidence that he never contributed any of his own assets to the operating expenses of the company. In fact, a Lebanese company appears to have been the source of CIOC's operating capital.[33] Additionally, as discussed above, Devincci Hourani appears to have had no expertise to offer the company and thus he brought none of his own know-how to it.[34] Further, the circumstances of this transfer are all the more suspect because it was not reported to the proper authorities.[35] In conclusion, Devincci Hourani contributed no money or assets, no expertise or know-how, and thus nothing of legitimate value to CIOC.

92% share ownership in CIOC.

[32] *See,* CIOC's Memorial, ¶ 93; Omar Antar Statement, ¶ 39.

[33] **Ex. C-57**, Letter of Information from the Prosecutor dated September 20, 2007, in Order No. 51 of Kazakhstan Public Prosecution Office dated July 26, 2007 ("[f]or the purposes of fulfillment of the Contract obligations, CARATUBE INTERNATIONAL OIL COMPANY LLP receives funds from JOR INVESTMENT INC (Beirut, Lebanon).").

[34] Notably, during the same time period that Devincci Hourani was allegedly acquiring his expertise in the oil and gas sector in Kazakhstan, he was not only managing the Central Asian branch of a medical equipment distributor, he was also required to be resident in the United States for immigration purposes. *See,* Devincci Hourani Statement, ¶ 6 ("from 1999 until 2002 I went back to managing the Central Asian branch of a distributor of medical equipment."); *Id.*, ¶ 8 (although he had "no prior experience" in the oil and gas industry, Devincci Hourani acquired experience by working with Kulandy Energy Corporation from 1999); *see,* **Ex. C-59**, Certificate of naturalization of Devincci Hourani; Devincci Hourani Statement, ¶ 5 (Devincci Hourani acquired a certificate of US nationality on July 16, 2001 based on his marriage to a US national); **Ex. RL-24**, 8 USCS § 1430 (person seeking citizenship by marriage must be a permanent resident of the United States for at least three years and must spend at least half of the permanent residency time physically in the United States living in marital union with his citizen spouse and must have spent all of the three months immediately preceding the application in the United States).

[35] At the time Devincci Hourani acquired his interest in CIOC, the Republic held a right of first refusal in the event of a transfer of shares in a legal entity which had a right of subsoil use. However, the transfer of shares to Devincci Hourani was not in compliance with this law and the government was never offered an opportunity to exercise this right. **Ex. RL-25**, Law on Subsoil and Subsoil Use, Article 71; **Ex. R-8**, Letter from MEMR to the Ministry of Justice dated December 4, 2009 (confirming that the transfer was not properly reported); *see also, generally,* **Ex. RL-26**, *Fraport AG Frankfurt Airport Services Worldwide v. The Republic of the Philippines*, ICSID Case No. ARB/03/25, Award dated August 16, 2007.

42. Second, it seems clear that Devincci Hourani took no risk, since he did not make any financial commitments, spent only a nominal amount of money and invested nothing of significance into CIOC. Nor does it appear that Devincci Hourani had the ability to personally recoup the profits of CIOC be they legitimately or illegitimately obtained. Rather, the facts indicate that Devincci Hourani was nothing more than an employee of sorts, a strawman, acting solely at the behest of another. This is certainly not the type of activity the Convention was intended to protect and cannot serve to confer nationality on what is, at its core, a local company.

43. Under these standards, the transfer of shares to Devincci Hourani was not a *bona fide* transaction and as such cannot confer jurisdiction on this Tribunal. The substance and nature of the transaction are questionable at best. As noted above the transaction consisted of the transfer of shares in a supposedly valuable company for a nominal fee of USD 5,500 to a natural person who had no money or expertise to offer that company. However, since Devincci Hourani had no funds and no experience, it is hard to believe that he was simply given the reins of a company which, in Claimant's estimation at least, is valued at over a billion dollars. Thus it is difficult to imagine a legitimate business motive for these transactions and Claimant, itself, has steadfastly refused to put forward a legitimate explanation.

44. Next, the timing of the transaction, on May 17, 2004, is indicative of a transaction that is not *bona fide*. The company was cited for underperformance of the

Contract only five months before the share transfer took place.[36] These violations began well before the transfer and thus it was easily foreseeable to CIOC that a dispute relating to the Contract would arise. It is therefore curious that "ownership" of the company was transferred to a shareholder who had little to offer the company at a time when those in charge could foresee that the Contract could be terminated and that a dispute arising from that termination would likely ensue.[37]

45. When one considers the totality of the circumstances surrounding the transaction and the purported "investment" arising from it, it becomes apparent that the parties had no legitimate business motive for the transaction. An examination of the facts surrounding the transaction indicate that Devincci Hourani had one thing and one thing only to offer CIOC—the benefit of his US citizenship. Thus, in the face of a looming threat of a dispute arising from the Contract and with a view towards taking advantage of Treaty protections that would have otherwise not been available to CIOC, the shares were transferred for a nominal fee to a US citizen who brought nothing to the company other than that citizenship. However, this scheme does not amount to a *bona fide* transaction. Transactions undertaken to "transform a [...] dispute into an international dispute subject to ICSID arbitration under a bilateral investment treaty," are

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[36] *See,* **Ex. R-9**, Notice from TU Zapkaznedra to CIOC dated December 8, 2003. This notice predated the acquisition of 85% of CIOC's capital by Devincci Hourani. Moreover, CIOC was cited again for non-performance three months before his acquisition of an additional 7% share in CIOC. *See,* **Ex. C-56**; **Ex. R-10** (Notice of Breach from MEMR to CIOC dated January 17, 2005 stating that CIOC was in breach of its obligations under the Contract and requesting CIOC to cure); **Ex. RL-20**, *Phoenix*, ¶¶ 136-138 (noting the importance of timing and forseeability of a dispute when evaluating whether an investment is a *bona fide* investment).

[37] It is also evident that Devincci Hourani was not brought in to turn the company around. In fact, a year and half after he came to CIOC, the company was blacklisted as underperformer for having a performance rate of under 30%. **Ex. R-11**, December 11, 2006 Notice.

not *bona fide* transactions.[38] Therefore, the transfer of shares to Devincci Hourani was not a *bona fide* transaction and cannot form the basis of a *bona fide* "investment" on the part of Devincci Hourani or CIOC. This behavior is not of the sort the Convention was intended to protect, does not confer U.S. nationality on CIOC and thus does not bring this dispute into ICSID's jurisdiction.

46. In sum, Devincci Hourani has not committed financial resources to CIOC and has taken no risk. His acquisition of the shares in CIOC was evidently done in the absence of good faith for the purpose of benefiting from the protections of the ICSID Convention and the Kazakhstan-US BIT. Therefore, because of the lack of the existence of a *bona fide,* foreign investment made in accordance with the ICSID Convention, CIOC's claims are not within the jurisdiction of the Centre and thus the Tribunal should find that it does not have competence to entertain CIOC's claims.

C. Overview of Admissibility

47. The Convention itself does not distinguish between questions of jurisdiction and those of admissibility, and ICSID arbitral tribunals have taken different approaches as to the concept of "admissibility."[39] However, the effect of a finding of either a lack of jurisdiction or a lack of admissibility, regardless of the terminology used, is that the tribunal cannot evaluate the merits of the afflicted claim.

48. The tribunals and commentators that do distinguish between the concepts note that if a tribunal is without jurisdiction, it may not evaluate any claim presented to it, whereas a tribunal may find that it has jurisdiction but that for reasons unrelated to the

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[38] **Ex. RL-20**, *Phoenix*, ¶ 142.

[39] **Ex. RL-8**, Schreuer et al, THE ICSID CONVENTION – A COMMENTARY, ¶ 18, at 86-87.

merits of the case, it cannot entertain that claim.[40] Further, the effect of the inclusion of a dispute settlement clause in a contract has clearly been considered a question of admissibility.[41] Thus, where the parties have contractually agreed to bring claims in an alternate forum, those claims may be dismissed on admissibility grounds even if the tribunal properly finds jurisdiction.[42] As is set out below, to the extent that CIOC has stated any cognizable claims, CIOC has unequivocally waived any right it may have had to bring the claims in this forum rendering such claims inadmissible.[43]

D. Any Justiciable Claims Claimant Has Presented Are Inadmissible Because CIOC Waived Any Right It Might Have Had to Jurisdiction Before This Tribunal

1) Waivers of Treaty Rights Are Enforceable as a Matter of International Law

49. A party who, for whatever reason, voluntarily abandons treaty rights it otherwise may have had, has, as a matter of international law, waived those rights.[44] Waivers of treaty rights are irrevocable and completely extinguish the waived rights, thus if a party, as CIOC has done, attempts to use previously waived treaty rights,

> it cannot do so as there are no longer any rights that can be used! [...] Any conduct that does not show that the right has been abandoned is without legal force and effect. You cannot use a right and have the benefits of it after you have waived it.[45]

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[40] **Ex. RL-27**, David A. R. Williams, *Jurisdiction and Admissibility*, in THE OXFORD HANDBOOK OF INTERNATIONAL INVESTMENT LAW (Peter Muchlinski et al, eds., Oxford University Press 2008), at 919.

[41] **Ex. CA-57**, *SGS Société Générale de Surveillance S.A. v. Republic of the Philippines*, ICSID Case No. ARB/02/6, Decision of the Tribunal on Objections to Jurisdiction dated January 29, 2004 ("*SGS v. Philippines*"), ¶ 154.

[42] *See,* discussion at Section II.D below.

[43] CIOC has framed this dispute as one arising from the Treaty and concedes that this Tribunal is not sitting pursuant to the dispute resolution mechanism stated in the Contract. *See,* CIOC's Memorial, ¶ 43.

[44] As discussed at length above, the Republic strongly denies that CIOC has any rights under the BIT or the ICSID Convention, however, to the extent the Tribunal finds that it has such rights, CIOC has waived those rights and cannot assert them now.

[45] **Ex. RL-28**, E.C. Schlemmer, *Waiver in International Arbitration,* 26 SOUTH AFRICAN YEARBOOK OF

50. It is clear that treaty rights, including those arising from the ICSID Convention, are the types of rights that an individual investor may elect to waive since

> unless the bilateral investment treaty contains an explicit provision to the contrary, there is a presumption that the investor has the power to waive international arbitration.[46]

51. This presumption arises from the fact that the ICSID Convention vests rights in the private individual. In the words of Broches:

> From the legal point of view the most striking feature of the Convention is that it firmly establishes the capacity of a private individual or a corporation to proceed directly against a State in an international forum, thus contributing to the growing recognition of the individual as a subject of international law.[47]

52. Thus, these rights belong to the individual and they are the individual's to waive. Therefore,

> [g]iven that it appears clear that the Parties to an ICSID arbitration could jointly agree to a different mechanism for the resolution of their disputes other than that of ICSID, it would appear that an investor could also waive its rights to invoke the jurisdiction of ICSID.[48]

53. Parties may waive their rights under an investment treaty and consequently their right to ICSID jurisdiction as long as that waiver is explicit[49] and as

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INTERNATIONAL LAW (2001), at 206.

[46] **Ex. RL-29**, Ole Spiermann, *Individual Rights, State Interests and the Power to Waive ICSID Jurisdiction under Bilateral Investment Treaties*, 20 ARBITRATION INTERNATIONAL 2 (2004), at 208 (discussing waivers of treaty rights).

[47] **Ex. RL-7**, Broches, *The Convention on the Settlement of Investment Disputes between States and Nationals of Other States*, at 349. This sentiment is expressed in the text of the Convention itself, which clearly contemplates that the right to assert a claim before ICSID is, as far as the investor is concerned, an individual right held by that investor. *See e.g.*, Articles 25(1), 27, 28, 35, 36, and 52 of the ICSID Convention.

[48] **Ex. RL-30**, *Aguas del Tunari, S.A. v. Republic of Bolivia,* ICISD Case No. ARB/02/3, Decision on Respondent's Objections to Jurisdiction dated October 21, 2005, 20 ICSID REVIEW – FOREIGN INVESTMENT LAW JOURNAL 450 (2005), ¶ 118.

[49] **Ex. RL-31**, *Duke Energy International Peru Investments No.1, Ltd. v. Republic of Peru*, ICSID Case No. ARB/03/28, Award dated August 18, 2008, ¶182 (noting that a waiver of treaty rights could be effective

long as there is no explicit prohibition in the BIT stating otherwise.[50] This is particularly true as regards contract claims. Professor Crawford stated it succinctly: "there cannot be any doubt that [a party] can renounce the right to arbitrate contract claims in a treaty forum. An exclusive jurisdiction clause in a contract is surely intended to do just that."[51]

54. As will be shown below, by electing to include an exclusive dispute settlement clause in the Contract, CIOC irrevocably waived any rights it may have had to bring claims in connection with its investment under the Treaty.

2) Scope and Nature of the Waiver in the Contract

55. The Contract in this case clearly evinces an intent of the parties to waive any rights they might otherwise have had that arise from or relate to the Contract, i.e. the investment agreement. The Parties agreed to an exclusive forum clause and by doing so they have explicitly waived any right they may have had to bring claims arising from the investment in a treaty arbitration and have also waived any right they may otherwise have had to resort to treaty arbitration before seeking resolution of the contract disputes in the forum provided for in the Contract.

56. CIOC has waived its right to bring its claims via any other means than those stated in the Contract via Section 27.2 of the Contract. This article reads:

> **27.2 Referral to Arbitration.** In the event that any dispute cannot be resolved by amicable settlement within sixty (60) days after notice in writing of such by one Party to the other Party, the Parties agree that their exclusive means of dispute

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where such waiver is explicitly stated); **Ex. RL-32**, *Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentine Republic*, ICSID Case No. ARB/97/3, Decision on Annulment dated July 3, 2002, ("*Aguas del Aconquija*"), 19 ICSID REVIEW FOREIGN INVESTMENT LAW JOURNAL 89 (2004), ¶ 76.

[50] Not only does the Contract contain an explicit and exclusive forum clause, the Treaty does not prohibit such a waiver. Quite the opposite, the Treaty contains a provision that expressly defers to a dispute resolution provision entered into between a host state and an investor. *See*, **Ex. C-1**, Treaty, Article VI(2)(b).

[51] **Ex. RL-33**, James Crawford, *Treaty and Contract in Investment Arbitration*, 6 TRANSNATIONAL DISPUTE MANAGEMENT 1 (2009) (hereinafter "Crawford, *Treaty and Contract in Investment Arbitration*"), at 13.

> resolution shall be (a) to submit the matter to arbitration for final settlement in accordance with the then current Rules of Conciliation and Arbitration of the International Centre for Settlement of Investment Disputes ("ICSID") if the Competent Authority has become a party to the ICSID Convention at the time a proceeding is instituted, or (b) to submit the dispute for resolution according to the Arbitration (Additional Facility) Rules of ICSID if the Competent Authority has not become a party to the ICSID Convention at the time when any proceeding is instituted. Any arbitral tribunal constituted pursuant to this Contract shall consist of three arbitrators, one appointed by the Contractor and one appointed by the Competent Authority, and a third arbitrator, who shall be president of the Tribunal and shall not be a resident of Kazakhstan, appointed by agreement of the Parties, or failing such agreement, by the Chairman of the Administrative Council of ICSID. In the event that the Contractor or the Competent Authority fails to appoint an arbitrator within ninety (90) calendar days after the notice of registration of a request for arbitration has been sent, the remaining arbitrators shall be appointed in accordance with the Rules under ICSID.
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> 27.3 If for any reason the request for the arbitration proceeding is not registered by ICSID or if ICSID fails or refuses to take jurisdiction over any matter submitted by the Parties under this Section 27, such matter shall be referred to and resolved by arbitration in accordance with the United Nations Commission on International Trade Law ("UNCITRAL") Arbitration Rules in effect at the date of submission of the matter. The seat of Arbitration shall be London, England. In such event the Parties hereby consent to the jurisdiction of the London Court of International Arbitration and all the provisions of this Article 27 shall equally apply to such arbitration.[52]

57. In this Article the parties explicitly agree to the "exclusive means of dispute resolution" for all disputes arising from the investment agreement and in doing so they agree to waive any rights they may have had to any other means of dispute resolution, including those arising from the Treaty.

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[52] **Ex. C-4**, Contract, Sections 27.2-27.3 (emphasis added).

58. This provision shows that the Parties fully intended that all disputes arising from this Contract would be resolved via the means provided for in the Contract and not through the Treaty. This freely negotiated provision memorializes the agreement of the parties presently before this Tribunal and as such it is evidence of their mutual intent to be bound by an agreement to settle all disputes arising from the Contract in one of two arbitral fora. Specifically, the Contract provides that such disputes should be resolved in an ICSID arbitration or, if for some reason ICSID arbitration is not possible, in an *ad hoc* arbitration under the UNCITRAL Rules. The Parties' careful planning and clear intent to commit to settling disputes arising from the Contract pursuant to the Contract is abundantly shown by the fact that not only is ICSID arbitration included, UNCITRAL arbitration is also included as a back-up provision. The comprehensive structure of this dispute resolution mechanism proves that the Parties intended to leave nothing open to surprise and intended to provide a mechanism to resolve all disputes arising from the Contract.

59. Importantly, the parties to the Contract are identical to those present in the arbitration and as such both parties to this arbitration are bound by their commitments in the Contract, including the waiver contained therein.[53] Further, the waiver is broad and explicit and covers all disputes arising out of the investment agreement (the Contract) and thus, as CIOC itself has framed the issues, the waiver covers the issues presently before the Tribunal. As is discussed below, CIOC, as in fact it must, relates all of its so-called treaty claims to the Contract. As such those claims are *ipso facto* claims arising out of the investment agreement and thus fall within the scope of the waiver. Finally,

[53] Waiver of right to arbitration is enforceable where the dispute involved the same cause of action between the same parties. *See e.g.*, **Ex. RL-11**, Dolzer and Schreuer, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW, at 216-217.

since the contractually agreed upon forum is itself arbitration, as is the present forum, a direct effect of CIOC's refusal to follow the exclusive forum clause is to allow CIOC to seek to avoid its own liability under the Contract.[54] By attempting to bring such claims via the Treaty and not via the provisions in the Contract as it is bound to do, CIOC attempts to assert rights it has previously and expressly waived. As a matter of international law, it should not be allowed to do so.

3) The Waiver in the Contract Renders All of CIOC's Claims Inadmissible

(i) The Exclusive Jurisdiction Clause Must Be Enforced

60. In the absence of an independent Treaty claim, the Tribunal must defer to the parties agreement and therefore to the exclusive dispute resolution clause contained in that agreement:[55]

> A different solution would run roughshod over the clear text of the contract reflecting the will of the parties, in total disregard of the principles of party autonomy and *pacta sunt servanda*. It would render 'inutile' or without effect the contractual stipulation on the choice of forum, giving to a jurisdictional clause in a BIT the effect of superseding all choice of forum contractual stipulations between parties to a dispute, once one of them invokes the jurisdictional clause of the BIT. But the reverse is not true, i.e. applying the contractual clause of choice of forum does not neutralize the BIT jurisdictional clause. For, once the 'contract claim' is verified in the proper forum chosen by the contracting parties, there is room, in case of a finding of a violation, to apply the jurisdictional clause in the BIT, in order to determine whether the contract violation amounts to a treaty violation (and which one).[56]

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[54] *See,* CIOC's Memorial, ¶ 12.

[55] **Ex. RL-14**, *Joy Mining*, ¶¶ 78, 79 (finding that claimant failed to make a *prima facie* showing of treaty claims in a dispute concerning the release of bank guarantees).

[56] **Ex. RL-9**, *TSA*, Concurring Opinion, ¶ 6.

61. Such a conclusion is a necessary consequence where the agreement containing the exclusive jurisdiction clause was entered into by the parties to the dispute (as opposed to the parties to the treaty) and is particularly called for, as here, where the Contract was agreed to well after the treaty came into force.[57] This conclusion and the policy implications underlying it have long been recognized by commentators and tribunals alike:

> A specific agreement between the parties to a dispute would naturally take precedence with respect to a bilateral treaty between the investor's State and [the host state], while such a bilateral treaty would in turn prevail with respect to a multilateral treaty such as the Washington Convention. [The clause] thus reflects the maxim *generalia specialibus non derogant*...[58]

62. Therefore, even if a tribunal has jurisdiction, when presented with a competing and binding exclusive jurisdiction clause freely agreed to by the parties, that tribunal should refuse to exercise its jurisdiction on admissibility grounds. In the words of Professor Douglas:

> [A] treaty tribunal should decline jurisdiction over contractual claims in favour of a forum that has previously been chosen by the parties to resolve contractual disputes. The principles mandating this approach are the preservation of the unity of the contractual bargain (a requirement of *pacta sunt servunda*), *generalia specialibus non derogant*, and *prior tempore, potior jure*. It is important to realise that the parties' consent to investment treaty arbitration is no more 'solemn' than their consent to the submission of their contractual

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[57] The intention of Claimant to waive the dispute settlement clause in the BIT is further confirmed by the fact that the Parties to the Contract recognized that provisions in treaties signed by the State would apply when appropriate. *See,* **Ex. C-4**, Contract, Section 26.1 on applicable law: "26.1 This Contract and other agreements signed on the basis of this Contract, shall be governed by the law of the State unless stated otherwise by the international treaties to which the State is a party."

[58] **Ex. RL-34**, *Southern Pacific Properties (Middle East) Limited v. Arab Republic of Egypt,* ICSID Case No. ARB/84/3, Decision on Jurisdiction No. 2 dated April 14, 1988, 3 ICSID REPORTS 131, ¶ 83. *See also,* **Ex. CA-57**, *SGS v. Philippines*, ¶ 141; **Ex. RL-35**, Zachary Douglas, *The Hybrid Foundations of Investment Treaty Arbitration*, 74 BRITISH YEARBOOK OF INTERNATIONAL LAW (Oxford University Press 2003) (hereinafter "Douglas, *The Hybrid Foundations of Investment Treaty Arbitration*"), at 246.

> disputes to a different forum. An investment treaty tribunal has no independent interest in hearing a case that transcends the consent of the parties [...]. Moreover, the rationale of a dispute resolution clause is to create a climate of legal certainty in the contractual relations between the parties and avoid litigation over the proper forum for the resolution of disputes and thus the potential risk of multiple proceedings. By accepting jurisdiction over contractual disputes subject to a different forum, a treaty tribunal subverts this contractual certainty to the detriment of one of the parties.[59]

63. So, when a claimant attempts to enforce its rights under an agreement and at the same time refuses to comply with its obligations under the same agreement, the tribunal should intervene by refusing to entertain the claims until that claimant has fulfilled its own contractual duties. As a matter of policy and of axiomatic contract principles, a claimant "should not be able to approbate and reprobate in respect of the same contract: if it claims under the contract, it should comply with the contract in respect of the very matter which is the foundation of its claim."[60] Compliance with a contract necessarily entails compliance with its dispute resolution clause and no claimant should be allowed to present claims arising from a contract in a treaty forum before fully complying with the obligations contained in the dispute resolution provisions of the underlying contract. In short, "[t]he principle *pacta sunt servanda* is not a one-way street."[61]

64. Therefore, as is discussed in more detail below, the effect of the binding exclusive jurisdiction provisions of the Contract, is to preclude treaty jurisdiction for all of CIOC's claims because a treaty

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[59] **Ex. RL-35**, Douglas, *The Hybrid Foundations of Investment Treaty Arbitration*, at 248 (internal citation omitted).

[60] **Ex. CA-57**, *SGS v. Philippines*, ¶ 155.

[61] **Ex. RL-33**, Crawford, *Treaty and Contract in Investment Arbitration*, at 13.

> should not, unless clearly expressed to do so, override specific and exclusive dispute settlement arrangements made in the investment contract itself. On the view put forward by [claimant] it will have become impossible for investors validly to agree to an exclusive jurisdiction clause in their contracts; they will always have the hidden capacity to bring contractual claims to BIT arbitration, even in breach of the contract, and it is hard to believe that this result was contemplated by States in concluding generic investment protection agreements.[62]

65. The Kazakhstan-US BIT contains nothing to override the specific provisions of the Contract and by bringing its claims under the Treaty and by not adhering to the requirement to bring those claims in the forum provided for in the Contract, CIOC has in effect breached that Contract. This is particularly true since, as is discussed below, all of CIOC's claims are fundamentally Contract claims and are not, as CIOC argues, Treaty claims.

(ii) CIOC's Claims Arise from the Contract

66. In order for a tribunal to entertain a claim purportedly arising under a treaty, that tribunal must first find that it has ICSID jurisdiction based on that treaty.

> [I]t is no longer sufficient merely to assert that a claim is founded on the Treaty. The Tribunal must determine whether the claim truly does have an autonomous existence outside the contract.[63]

67. Further, simply labeling a claim as a "treaty" claim, is not enough to show the requisite autonomous existence:

> [W]here what is contended in the treaty claim is mainly that the contract has been violated and that this violation constitutes in turn and by another name (figuring in the treaty) a treaty violation, such a nominal trick does not

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[62] **Ex. CA-57**, *SGS v. Philippines*, ¶ 134.

[63] **Ex. RL-36**, *Pantechniki S.A. Contractors & Engineers v. The Republic of Albania*, ICSID Case No. ARB/07/21, Award dated July 30, 2009, ("*Pantechniki*"), ¶ 64.

> suffice to transform the contract claim into a treaty claim or to create a parallel treaty claim. To use the terminology of *Vivendi II*, 'where 'the fundamental basis of the claim" is the contract, however, many more layers of claims one tops it with, it remains a contract claim, which has to be settled according to the terms of the contract and in the forum chosen in that contract.[64]

68. Thus, in order to plead "self-standing" treaty claims, a claimant must state a cause of action that does not by its nature require the tribunal to rule on the contract. In order to be "self-standing," a treaty claim must be one that "does not necessarily pass by or posit a contract violation as a fundamental element or premise of its cause of action."[65] A successful claimant must do more than allege that the state party to an investment agreement breached that agreement in order to show that the state's conduct gave rise to a breach of a treaty. Rather, a claimant must show that the state's conduct has gone beyond what "an ordinary contracting partner would do" under similar circumstances.[66] Therefore,

> [i]t will only be where the host State acts in the exercise of its governmental or sovereign authority, rather than merely as a commercial party, that it can be liable for breach of treaty.[67]

69. CIOC asks this Tribunal to rely on an alleged link to a series of allegedly harassing actions taken against it to attempt to convert its otherwise wholly Contract claims into Treaty claims. Such a link does not create a Treaty claim. First, CIOC points to a series of investigations carried out against the Devincci Hourani family

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[64] **Ex. RL-9**, *TSA*, Concurring Opinion, ¶ 5.

[65] *Id.*, ¶ 4.

[66] **Ex. RL-23**, *Toto*, ¶ 104; *see also*, **Ex. RL-14**, *Joy Mining*, ¶ 72.

[67] **Ex. RL-37**, Campbell McLachlan QC, Laurence Shore and Matthew Weiniger, INTERNATIONAL INVESTMENT ARBITRATION: SUBSTANTIVE PRINCIPLES (Oxford University Press 2007) (hereinafter "McLachlan et al, INTERNATIONAL INVESTMENT ARBITRATION"), ¶ 4.73, at 103.

members for reasons unrelated to CIOC's operations under the Contract.[68] Devincci Hourani admitted to the fact that the investigators asked few if any questions regarding CIOC.[69] This in and of itself shows that the investigators were concerned with activity unrelated to the purported investment at issue in this case. Next, CIOC points to a series of alleged unfair investigations and inspections carried out with respect to CIOC.[70] What CIOC fails to mention is that all of these actions are not only contemplated by the Contract and the sub-soil use and other laws, compliance with which is required under the Contract, the Republic was also well within its contractual rights to undertake them.[71] As such, these regulatory actions were the rational reaction of a contracting party faced with on-going material breaches of the contract by the counter-party to that contract.

70. Finally, CIOC alleges that certain investigations and actions carried out by the government after the present dispute arose also have the effect of converting its Contract claims into Treaty claims. This allegation does not withstand scrutiny. The investigations fall into two categories neither of which amounts to grounds for a Treaty claim. First, there are those that are the outgrowth of legitimate criminal investigations[72] and second, those that are the logical result of CIOC's failure to perform its duties under the Contract and the Republic's consequent initiation of termination proceedings.[73]

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[68] *See,* CIOC's Memorial, ¶¶ 50-66. These activities are discussed in detail in Section III.C.2.1) below.

[69] Devincci Hourani Statement, ¶ 38.

[70] *See,* CIOC's Memorial, ¶ 68. The respective obligations and rights of the Parties under the Contract is discussed in detail in Section III.B. below.

[71] Notably, the Contract is governed by the laws of the Republic of Kazakhstan and the parties are therefore bound to comply with them. *See e.g.*, **Ex. C-4**, Contract, Sections 12.1; 12.3; 15.4; 17.1; 17.2; 18.4; 20.1 and 21.1.

[72] *See,* Askhat Daulbaev Statement, Section III.A; *See also,* section III.C.2) below.

[73] *See,* Askhat Daulbaev Statement, Section III.B.

71. A brief look both at CIOC's claims and its alleged damages belies the true, contractual nature of its claims. As will be seen, each of its claims is necessarily contingent on a finding that the Contract was wrongfully terminated. First, CIOC alleges that harassment in the form of the unrelated and legitimate criminal investigations resulted in the expropriation of its contractual rights.[74] However, if the Republic can show, as it does in Section III.B. below, that CIOC lost its contractual rights because of termination due to its own material breaches, and thus for reasons totally unrelated to the criminal investigation which CIOC characterizes as harassment, CIOC's expropriation claim necessarily fails.[75]

72. Next, CIOC argues that somehow there was a change in the legal framework such that its legitimate expectations were hindered in violation of the Treaty's fair and equitable treatment provisions.[76] Apparently, CIOC's version of stability means that a host state cannot engage in the legitimate prosecution of accused criminals where the accused and their cohorts are connected, however remotely, to an investment contract. Similarly, CIOC seems to believe that a contracting party to an investment agreement can never be held accountable for its own non-performance without at the same time violating the fair and equitable treatment provision. CIOC's assertions are not well founded and are easily overcome by a showing that the Contract was properly terminated. Yet again, CIOC's claim is defeated by a showing that due to

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[74] *See generally,* CIOC's Memorial, ¶¶ 169-182.

[75] While the Republic maintains that the question of whether or not the Contract was properly terminated is one not properly before this Tribunal, for the sake of argument, the Republic will show below that the Contract was properly terminated for reasons related to CIOC's non-performance.

[76] *See generally,* CIOC's Memorial, ¶¶ 183-202.

CIOC's own breach, the Republic legitimately exercised its termination rights. This is a question of Contract not Treaty and thus this claim too, must pass through the Contract.

73. CIOC goes on to make similar arguments with regard to the Treaty's full protection and security and non-discriminatory treatment provisions.[77] These claims can, like those discussed above, be defeated by a showing that the Contract was properly terminated. An investor, even assuming it is a legitimate one, has no treaty right to proceed *ad infinitum* in breach of its obligations under the investment agreement. To the contrary, a host state can and should, as can any party to a contract, be they private or sovereign, exercise its right to terminate an agreement in the face of material breach. Finally, CIOC makes claims under the so-called "umbrella clause" and under the "investment agreement."[78] On its face, each of these necessarily passes through the Contract, for if the Contract was properly terminated, there can be no claim that the Republic failed to live up to its obligations.

74. Therefore, CIOC's claims have none of the characteristics of a self-standing treaty claim and all of its claims as such must be treated by this Tribunal as what they are – claims arising from the Contract. CIOC makes a laundry list of purported treaty claims; however, as demonstrated above, each of these relies as a fundamental basis to the claim on an allegedly wrongful termination of the Contract. The merits, or more properly, the lack thereof of each of these claims is discussed individually below. From these discussions it will become readily apparent to the

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[77] *See generally, Id.*, ¶¶ 203-215, 223.

[78] *See generally, Id.*, ¶¶ 216-222, 224-238. As discussed in Section III.A. below, the Republic strongly rejects the notion that the umbrella clause elevates Contract claims into Treaty claims. Nonetheless, should such a claim exist, the proper forum for it is the one chosen by the parties in the Contract, because an umbrella clause does not have the effect of overriding the dispute settlement clause in the relevant contract.

Tribunal that each of these claims is in reality nothing more than a claim arising from what CIOC alleges is a wrongful termination of the Contract. However, as will also be shown below, the Republic acted as any rational actor would when confronted with a Contractor who steadily and repeatedly failed to fulfill its obligations under the Contract. After its numerous notices went unheeded and after the Contractor failed to remedy its shortcomings in any of the numerous cure periods granted to it, the Republic terminated that Contract. Put simply, if the Republic can show, and it will, that the Contract was properly terminated, all of CIOC's claims necessarily fail.

75. CIOC's own characterization of its damages further shows that the essence of its claims lies purely in Contract. Notably, CIOC values its damages as the equivalent of what it perceives to have been the value of the Contract had it actually moved into the Production phase. These are Contract damages. Admittedly, CIOC does make mention of undefined "moral damages" which are apparently based in large part on a diagnosis of depression given by a urologist to Devincci Hourani.[79] Making such a moral damages claim does not convert CIOC's Contract claims into Treaty claims.

76. In conclusion, CIOC has failed to state any stand-alone Treaty claims. Since this Tribunal's competence only extends to the scope of the consent provided by the Parties and because Claimant, for whatever reason, has decided not to bring its true Contract claims (as opposed to the claims based in contract but re-named as Treaty claims) in this arbitration all of the claims presently before the Tribunal, to the extent

[79] **Ex. C-76**, Letter from Dr. Maroun Moukarzel dated May 5, 2009 (Doctor's note presented as the sole support of Devincci Hourani's claim of depression. Curiously this was written by a urologist, rather than a mental health professional as would normally be expected).

they may have fallen within the Centre's jurisdiction, are inadmissible.[80] The contractual dispute resolution mechanism must be respected and cannot be overridden by the Treaty. Therefore this Tribunal must uphold the principle of *pacta sunt servanda* and in doing so it must refuse to entertain CIOC's claims as the parties are bound by Contract to resolve those claims in the exclusive forum provided for in that Contract.

(iii) Even if CIOC Had Stated Treaty Claims, Such Claims Are Now Inadmissible

77. Further, even if CIOC had stated an independent Treaty claim, such a claim is not now properly before the Tribunal. Such claims should not be considered before the parties complete the dispute resolution process called for in the Contract and therefore the Tribunal should deem those claims inadmissible and should grant a stay until such time as they are admissible, if ever:[81]

> [A] treaty tribunal is bound to consider the 'fundamental basis' of the causes of action relied upon [by] the claimant. If the 'fundamental basis' is determined to be contractual, then the treaty tribunal must give effect to any valid choice of forum clause in that contract. Where there is significant overlap between the claimant's causes of action based on contract and the minimum standards of protection set out in the treaty, then the treaty tribunal should exercise its discretion to stay its own proceedings to await the resolution of the contractual issues by the chosen forum.[82]

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[80] "The Tribunal is, of course, constituted pursuant to the parties' consent arising under the terms of the Kazakhstan-United States of America bilateral investment treaty." **Ex. R-12**, Letter from Counsel for CIOC to Counsel for the Republic dated October 16, 2009. *See also*, CIOC's Memorial, ¶ 43.

[81] **Ex. RL-35**, Douglas, *The Hybrid Foundations of Investment Treaty Arbitration,* at 265. "The primary test for the granting of a stay in the investment treaty context is [...] whether the 'fundamental basis of the claim[s]' is an investment contract or the treaty. If the respondent manages to discharge its burden to persuade the tribunal that the fundamental basis of the claim is a cause of action for breach of contract and that another forum with jurisdiction over such claims has been previously chosen by the parties, then the tribunal should defer to that forum and stay the proceedings."

[82] *Id.*, at 267.

78. In *SGS v. Philippines*, the tribunal, when presented with a similar scenario as that in the instant case, declared that even where a party has presented treaty claims and where those claims fall within the tribunal's jurisdiction, the tribunal should, nonetheless, refrain from exercising jurisdiction over those treaty claims where the contract disputes upon which those treaty claims rely are referred exclusively to another forum by the contract itself.[83] Put simply, a tribunal should not make an independent determination as to the propriety or impropriety of the parties' respective performance under a contract where the contract itself reserves such determinations for an exclusive forum other than the tribunal. Therefore, CIOC's Contract claims must be decided in the contractually prescribed forum before the Treaty claims can be considered, because the nature of the Treaty claims presented, to the extent any such claims have actually been presented, is such that the merits of those claims cannot be evaluated without first determining whether the Contract was terminated rightfully. Under the terms of the Contract itself, only the forum prescribed in the Contract has the authority to make such a determination and therefore, this Tribunal should stay CIOC's Treaty claims, to the extent they exist, pending determination of the underlying Contract claims in the appropriate forum.

[83] **Ex. CA-57**, *SGS v. Philippines*, ¶ 175.

III. LIABILITY

A. The Umbrella Clause Does Not Cure CIOC's Jurisdiction and Admissibility Defects

1) Claimant Cannot Use the Umbrella Clause to Circumvent Its Contractual Obligations

79. CIOC's attempts at bringing its Contract claims into this arbitration do not stop at the mischaracterization of those claims as discussed above. CIOC also argues that its Contract claims should be "elevated" to treaty claim status by virtue of the so-called umbrella clause in the Treaty which simply states:

> Each Party shall observe any obligation it may have entered into with regard to investments.[84]

80. Despite CIOC's contentions, this clause does not have a transformative effect on the Contract dispute that is the substance of the present case. The legal effect of this clause is not, as CIOC wishes the Tribunal to believe, to on the one hand elevate all claims under the Contract to Treaty claims and on the other hand to provide a means for CIOC to escape its own obligations under the Contract and specifically its obligation to adhere to the exclusive forum clause therein.

81. To the contrary, a party cannot state a claim under a contract and at the same time refuse to comply with its own obligations under that Contract. Thus, if a party intends to bring a claim under a contract it must itself comply with the binding dispute resolution mechanism and forum selection clauses stated in that contract. This point was made clear in the case heavily cited by CIOC, *SGS v. Philippines*.[85] The tribunal in that case did find that in the particular circumstances of the case, circumstances that are not present in the instant case, the umbrella clause could have

[84] **Ex. C-1**, Treaty, Section II(2)(c); CIOC's Memorial, ¶¶ 216-222.

[85] **Ex. CA-57**, *SGS v. Philippines*.

the effect of bringing some contract claims under the treaty. However, it also found that the purpose of the umbrella clause is to "help secure the rule of law in relation to investment protection" and held that even if SGS' contract claims could be stated as treaty claims via the umbrella clause, they could not be considered by a treaty tribunal because doing so would violate the binding forum selection clause in the contract.[86] Thus, the *SGS* tribunal found that the purpose of the umbrella clause was not disserved by requiring the claimant to fulfill its obligations under the contract.[87]

82. In *Toto v. Lebanon* the tribunal similarly held that a claimant cannot be allowed to escape its obligations under a contract and at the same time make a treaty claim arising from that contract via an umbrella clause in a treaty.[88] In *Toto* the claimant argued that Lebanon frustrated its ability to perform the underlying contract for the construction of a highway and that Lebanon's actions amounted to a treaty violation. The *Toto* tribunal rejected that argument and held that contract claims must be resolved in the forum set out in the contract and thus that an exclusive forum selection agreement cannot be circumvented by an appeal to an umbrella clause.[89]

83. Thus, as is discussed at length above, the exclusive forum clause in a contract is binding upon the parties and the obligations contained in it cannot be dispensed with by simply referring to an umbrella clause in a BIT. In sum, the existence or non-existence of an umbrella clause has no bearing on a party's duty to comply with a binding and exclusive choice of forum clause. It must comply with its contractual

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[86] *Id.*, ¶ 126.

[87] *Id.*, ¶ 155.

[88] **Ex. RL-23**, *Toto*, ¶¶ 201-202.

[89] *Id.*, ¶ 202.

obligations regardless of whether there is an umbrella clause in the relevant treaty or not.

2) The Umbrella Clause Does Not Transform Generic Contract Claims Into Treaty Claims

84. Additionally, CIOC's argument fails on its premise, because an umbrella clause such as the one in the Kazakhstan-US BIT does not internationalize simple contract claims and does not elevate such claims to treaty status. As Professor Crawford notes:

> The purpose of the umbrella clause is to allow enforcement without internationalization and without transforming the character and content of the underlying obligation.[90]

85. The tribunal in *Toto* also followed this line of reasoning and concluded explicitly that an umbrella clause "does not elevate pure contract claims into treaty claims."[91] Therefore, pure contract claims remain just that, contract claims, regardless of the presence of an umbrella clause in the underlying BIT.

86. Numerous tribunals have similarly recognized that there would be significant negative consequences if tribunals were to give umbrella clauses the power to transform a dispute in the manner Claimant suggests and to that end have abrogated the authorities upon which Claimant relies. In the cases of *El Paso v. Argentina* and *Pan American Energy Co. et al v. Argentina*, when confronted with an umbrella clause effectively identical to the one in the present case, the tribunals carefully surveyed the mixed precedent regarding umbrella clauses and forcefully rejected the conclusions drawn by the cases upon which Claimant's argument rests because:

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[90] **Ex. RL-33**, Crawford, *Treaty and Contract in Investment Arbitration*, at 20.

[91] **Ex. RL-23**, *Toto*, ¶¶ 200-202 (accepting Crawford's view).

> [A]n umbrella clause cannot transform any contract claim into a treaty claim, as this would necessarily imply that any commitments of the State in respect to investments, even the most minor ones, would be transformed into treaty claims.[92]

87. The *Pan Am* tribunal therefore found that "an umbrella clause cannot transform any contract claim into a treaty claim" and further noted that an interpretation as broad as that which Claimant proposes would be "quite destructive of the distinction between the national legal orders and the international legal order."[93]

88. The tribunal in *SGS v. Pakistan* also struck down the elevation argument and found that accepting it would "nullify any freely negotiated dispute settlement clause in a State contract" and make the substantive treaty violations in the treaty "superfluous."[94] Finally, the *SGS* tribunal held that only in "exceptional circumstances" such as a denial of justice could a breach of a contract give rise to a treaty violation.[95]

89. In yet another case following this reasoning, the tribunal in *Joy Mining v. Egypt*, held that only contract claims of a certain "magnitude" could trigger an umbrella clause and constitute an independent breach of a treaty obligation:

> In this context, it could not be held that an umbrella clause inserted in the Treaty, and not very prominently, could have the effect of transforming all contract disputes into investment disputes under the Treaty, unless of course there would be a clear violation of the Treaty rights and obligations or a violation of contract rights of such a magnitude as to

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[92] **Ex. RL-38**, *El Paso Energy International Company v. The Argentine Republic*, ICSID Case No. ARB/03/15, Decision on Jurisdiction dated April 27, 2006, 21 ICSID REVIEW – FOREIGN INVESTMENT LAW JOURNAL 488 (2006), ¶ 82; **Ex. RL-39**, *Pan American Energy LLC et al v. The Argentine Republic*, ICSID Case No. ARB/03/13, Decision on Preliminary Objections dated July 27, 2006 ("*Pan Am*"), ¶ 110 (expressing the same conclusion and following Crawford).

[93] **Ex. RL-39**, *Pan Am*, ¶ 110.

[94] **Ex. RL-40**, *SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/01/13, Decision of the Tribunal on Objections to Jurisdiction dated August 6, 2003, 18 ICSID REVIEW – FOREIGN INVESTMENT LAW JOURNAL 307 (2003) ("*SGS v. Pakistan*"), ¶ 168.

[95] *Id.*, ¶ 172.

> trigger the Treaty protection, which is not the case. The connection between the Contract and the Treaty is the missing link that prevents any such effect. This might be perfectly different in other cases where that link is found to exist, but certainly it is not the case here.[96]

90. Thus, arbitral authority strongly supports the conclusion that an umbrella clause cannot transform ordinary, generic contract claims such as the ones presently before this Tribunal into treaty claims.[97] The true, contractual nature of CIOC's claims is analyzed in detail above and there is no need to repeat it here. Each of the claims CIOC has brought before this Tribunal must pass by the Contract if CIOC is to succeed, CIOC's claims remain claims under the Contract and CIOC has made no showing that the Republic has violated the Contract much less that the Republic has done so to such a "magnitude" that could possibly give rise to a Treaty claim. Rather, this case is a simple Contract case and the Republic's actions vis-à-vis the Contract were those that any party to a contract would have and should have taken in the face of material breaches and non-performance of the counter-party to that contract. Without a determination that the Contract was wrongfully terminated, CIOC cannot make out a *prima facie* showing of a Treaty claim. The umbrella clause does not remedy this defect and CIOC's Contract claims are not transformed or elevated into Treaty claims by virtue of the umbrella clause. This is particularly true where, as here, those claims are referred exclusively to another forum in the contract and where the parties entered into that contract well after the treaty came into force.

91. Further, even if this Tribunal were to find that the umbrella clause internationalizes the Contract, it must then find that the parties have a mutual obligation

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[96] **Ex. RL-14**, *Joy Mining*, ¶ 81.

[97] *See,* discussion of contractual nature of CIOC's claims at Section II.D above.

to observe their obligations under the Contract. In other words, this Tribunal cannot allow CIOC to use the umbrella clause to attempt to enforce part of the Contract while ignoring those parts that it holds in disfavor, namely the dispute resolution provisions of the Contract.

92. Due to the way in which CIOC chose to submit its case, this Tribunal is bereft of the competence to judge the true issue in this dispute, whether the Contract was validly terminated. Nevertheless, for purposes of argument and should the Tribunal decide that CIOC's Contract claims are admissible, Respondent analyzes the Contract, CIOC's breach of that Contract and the Republic's subsequent rightful termination of that Contract below.

B. The Republic Terminated the Contract Due to CIOC's Material Breaches

93. CIOC's entire argument rests on its allegation that the Termination was wrongful. However, as the Republic will conclusively demonstrate, below, that Termination was rightful.

1) The Caratube Oil Field

94. The Contract Area is located near the eastern edge of the Pre-Caspian basin in Baiganin District of Aktobe Oblast of the Republic of Kazakhstan. Within its pentagonal shaped area, lies the Caratube oil field. This field is characterized by the presence of a salt domed structure around which oil can be trapped and searched for in three different layers, the shallow "supra-salt" or "post-salt" formation, the deeper "overhang" formation and the deepest "sub-salt" or "pre-salt" formation. The "supra-salt" or "post-salt" formation is located on top of the salt dome. It is a shallow formation at a depth of under approximately 1,000 meters. The "subsalt" or "presalt" formation is

located deep below the salt dome at a depth of approximately more than 4,000 meters. In between these two formations is the "overhang" formation.[98]

95. During Soviet times, the supra-salt structure of the Caratube field was extensively explored and drilled, and recoverable oil was discovered there. A key obligation of CIOC under the Contract was to conduct exploration, by drilling two prospective wells into the deep sub-salt structure, which is much more technically challenging, expensive and risky than drilling in the shallow supra-salt structure.[99]

2) The Contract

96. The Contract was originally awarded to CCC on May 27, 2002. The CCC group is a large construction group of Lebanese origin, primarily active in construction works in the Middle East.[100] CCC assigned the Contract to CIOC on August 8, 2002. CIOC is thus bound by the terms of the Contract.

97. The Contract is an "Exploration and Production" agreement. It provides for an initial exploration period of five years starting from May 27, 2002 (Section 3.2). The Contractor has a right to extend the Exploration period by two years twice (Section 9.1). Pursuant to Section 9.6, if no Commercial Discovery is made in the Contract Area by the end of the Exploration period, the Contract terminates. The Contract is thus initially in force for the Exploration period only and the existence of a Commercial Discovery operates as a condition precedent to the vesting of the Contractor's Production rights (Sections 9.6 and 10.5). However, it is contemplated that the

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[98] *See*, Mirbulat Ongarbaev Statement, ¶ 8; IFM Reserves Report, ¶ 95.

[99] *See*, Mirbulat Ongarbaev Statement, ¶ 102; IFM Reserves Report, ¶ 154.

[100] **Ex. R-13**, CCC official website.

Contractor conducts "pilot testing (trial production)" during the exploration period (Section 7.1.17).

98. CIOC was still in the Exploration period and was subject to exploration obligations at the time of the Termination. At that time, CIOC had neither declared nor made a Commercial Discovery and therefore the conditions precedent for proceeding to the commercial production phase had not been met.[101]

3) The Minimum Work Program and the Annual Work Programs

99. CIOC's minimum exploration obligations are set forth in a 5-year Minimum Work Program which is attached as Addendum 6 to the Contract (the "**Minimum Work Program**").[102] The Minimum Work Program is a fundamental document which sets out the agreed upon minimum contractual obligations of the Contractor over the relevant contract period, five years in CIOC's case. Thus, this document is of key importance because it constitutes a fundamental basis on which a contract is awarded by the host State to a contractor.[103]

100. The Minimum Work Program sets out CIOC's obligations for the first five contractual years (i.e. the initial Exploration Period) starting on May 27, 2002. The Minimum Work Program is sub-divided into annual work programs detailing CIOC's obligations over each corresponding calendar year (the "**Annual Work Programs**"). At the end of each calendar year the competent regional branch of the Geological Committee of the Republic ("**TU Zapkaznedra**") determines with CIOC the Annual Work Program for the subsequent calendar year. The Annual Work Programs take into

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[101] *See*, Mirbulat Ongarbaev Statement, Section V.1.

[102] **Ex. R-14**, Minimum Work Program.

[103] *See*, IFM Compliance Report, ¶ 27.

account the Minimum Work Program and the actual works accomplished by CIOC during the ending year. The Annual Work Programs are conceived so as to cumulatively cover all the minimum works required by the Minimum Work Program. Like the Minimum Work Program, the Annual Work Programs are contractually binding upon CIOC (Section 8.1 of the Contract).[104]

101. Pursuant to its Minimum Work Program, CIOC was required to explore the challenging and risky sub-salt formations of the Contract Area. The supra-salt part of the Contract Area was already known to contain commercially recoverable oil deposits and had already been intensively drilled, discovered and calculated by the Soviets. The 5-Year Minimum Work Program therefore required as a major minimum obligation of CIOC:

- the carrying out of a 3D seismic survey in the second contract year, i.e. to be completed by May 26, 2004 (the "**3D Survey**");
- the drilling of a first deep sub-salt well in the third contract year, i.e. to be completed by May 26, 2005 (the "**First Deep Well**");
- the drilling of a second deep sub-salt well in the fourth contract year, i.e. to be completed by May 26, 2006 (the "**Second Deep Well**", and together with the First Deep Well, the "**Two Deep Wells**").[105]

[104] *See*, Mirbulat Ongarbaev Statement, ¶¶ 19, 51.

[105] *See*, **Ex. R-14**, Minimum Work Program; Mirbulat Ongarbaev Statement, ¶ 15.

4) The Monitoring of Subsoil Users Performance

(i) The MEMR, the Monitoring Division, TU Zapkaznedra, Other Agencies

102. In Section III of his Witness Statement, Mr. Mirbulat Ongarbaev, Head of the Monitoring Division, describes the functioning of the MEMR and other State agencies with respect to the supervision and monitoring of subsoil users.

103. As explained by Mr. Ongarbaev, contractors are supervised by various competent Ministries and State agencies depending on the matter involved: subsoil use, environment, safety, hygiene and health, labor or taxes. In matters of subsoil use, it is the Monitoring Division of the MEMR (the "**Monitoring Division**") that is in charge of monitoring the performance of contractors and their compliance with subsoil and petroleum regulations as well as with their contracts and work programs.[106] In the event of breaches by a subsoil user, it is the Monitoring Division that prepares notices of breach and, if necessary, of termination. The Monitoring Division currently monitors 941 subsoil use contracts.[107]

104. TU Zapkaznedra is not responsible for this higher-level monitoring. Rather, TU Zapkaznedra supervises the work of the contractors on a regular basis, including via on-site audits; carries out scheduled audits of subsoil users; approves annual work programs; and also notifies the contractor on non-performance issues.[108] In this regard, Mr. Ongarbaev notes:

> the consultant hired by CIOC, Mr. Sven Tiefenthal of TRACS as well as Omar Antar in his Witness Statement and CIOC in its Memorial make a misleading presentation of TU

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[106] *See*, Mirbulat Ongarbaev Statement, ¶¶ 20, 23.

[107] *See*, *Id.*, ¶ 25.

[108] *See*, *Id.*, ¶¶ 18-19, 24.

> Zapkaznedra's role. The monitoring function is carried out primarily by the Monitoring Division. TU Zapkaznedra has no competence in matters of official approval or disapproval of the contractors' performance. This role is incumbent upon the Monitoring Division of MEMR.[109]

(ii) The LKU Reports

105. As explained by Mr. Ongarbaev, the Monitoring Division reviews the contractors' performance and compliance primarily on the basis of the 2-LKU forms (the "**LKU Reports**"). The LKU Reports are quarterly reports prepared by all sub-soil contractors. Each report presents the contractor's cumulative performance for the past calendar quarters, compared to the annual work program for the calendar year in question. The LKU Reports are prepared and filed quarterly with TU Zapkaznedra by the 25th of the month following the quarter in question. The Monitoring Division receives the LKU data by the 20th of the following calendar month.[110]

106. As discussed by Mr. Ongarbaev, the MEMR's actions regarding these reports depend in large part on the quarter in question. For instance, the Monitoring division tends not to review the first quarter LKU data as it is not significant enough to draw conclusions and take action. The Monitoring Division has developed a practice of sending end-of-the-year notices of non-performance of obligations to underperforming contractors based on the third quarter LKU data. This policy is based on practicality. The contractors' performance after nine calendar months is a reliable indicator from which to extrapolate their performance for the entire year. This is particularly true in Kazakhstan where the last quarter occurs during the extremely harsh winter months. Such conditions make it very difficult if not impossible to catch up if the contractor has

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[109] *See*, Mirbulat Ongarbaev Statement, ¶ 24.

[110] *See, Id.*, ¶ 26.

already fallen behind during the first three quarters. A prudent contractor will therefore take steps to ensure that it will be well advanced towards the completion of its Annual Work Program by the end of the third quarter. A contractor who is far behind at the end of the third quarter is in a *de facto* state of breach. The MEMR's policy in 2007 was to send out notices of non-performance to contractors, such as CIOC, whose global performance compared to the 5-Year Minimum Work Program was less than 30% after nine months. As it did for many other non-performers, the MEMR sent a notice of non-performance to CIOC on December 3, 2007.[111]

107. Mr. Ongarbaev also explains that the work of the Monitoring Division is not solely based upon the quarterly LKU Reports. The Monitoring Division also reviews the performance and compliance of contractors on an on-going and case-by-case-basis. Different situations may require different responses. For instance, the Monitoring Division shows greater tolerance for non-performance when a contract is in the early stages. This monitoring work takes place throughout the year, in parallel to and in interaction with the LKU process.[112]

5) CIOC's Material Breaches and the Resulting Termination of the Contract

108. From the beginning through to the end of the contract CIOC has been systematically and continuously in material breach of its obligations as set forth in the Contract, the Minimum Work Program and the Annual Work Programs. This as well as

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[111] **Ex. R-15**, Notice of Breach from MEMR to CIOC dated December 3, 2007; *See*, Mirbulat Ongarbaev Statement, ¶ 75.

[112] *See*, Mirbulat Ongarbaev Statement, ¶ 29.

the magnitude of CIOC's failures can be readily seen by examining the figures provided in the IFM Compliance Report and in Table No. 4 in Mr. Ongarbaev's Statement.

109. The figures provided by the expert, Mr. Chugh, in the IFM Compliance Report show CIOC's dramatic underperformance against the work programs in matters of geological exploration,[113] drilling,[114] financial obligations,[115] investment,[116] and trial production.[117]

110. Table No. 4 in Mr. Ongarbaev's Statement shows the failings of CIOC's performance from 2002 through 2007 when compared against the Minimum Work Program, the Annual Work Programs and the Contract terms.[118] The figures in Column A of this Table show CIOC's global performance compared to the Minimum Work Program. Notably, only once, in 2003, was CIOC's performance above 30%, and then it was only 34.7%, a very low figure. In 2007, this percentage was only 28.67% and CIOC's total performance over the period 2002-2007 was 23.3%, again an extremely low figure. These figures reflect a permanent state of material breach. Mr. Ongarbaev indicates that these figures are particularly relevant for notification decisions of the Monitoring Division.[119]

111. CIOC's failure to meet minimum financial obligations is indicative of CIOC's utter failure to carry out its minimum exploration works. Mr. Ongarbaev explains:

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[113] IFM Compliance Report, ¶ 99, Figure No. 3.

[114] *Id.*, Figure No. 5.

[115] *Id.*, Figure No. 2.

[116] *Id.*, Figure No. 4.

[117] *Id.*, ¶ 93, Figure No. 1.

[118] Mirbulat Ongarbaev Statement, ¶ 38.

[119] *Id.*, ¶ 40.

> Beyond the monetary figures, Table No. 4 reflects the fact that CIOC failed by large to accomplish its exploration obligations and was thus in a state of material breach. CIOC's Contract was in its exploration phase. Thus, by definition, CIOC's exploration obligations provided in the 5-Year Minimum Work Program are material obligations, and a breach of those obligations is a material breach.[120]

112. The breaches of CIOC are discussed and shown in detail in the IFM Compliance Report and are reviewed on a year-by-year basis in Section 6 of that report. This detailed yearly study shows that there has not been a single year in which CIOC has met its contractual obligations.[121] At the end of his report on compliance, Mr. Chugh summarizes CIOC's material breaches as follows:

> 125. Based on the various facts and information presented in this report, I have reached the following conclusions:
>
> 126. CIOC committed material breaches of the Contract by:
>
> a. having failed to perform its essential exploration works even though CIOC was precisely in the exploration phase of the Contract, by:
>
> (i) failing to timely perform the 3D seismic survey and, not having completed it at the time of the termination of the Contract, as required by the MWP and related AWPs; and
>
> (ii) failing to drill or even commence the drilling of the two deep Sub-Salt wells which were part of the minimum obligations of CIOC under the MWP and related AWPs;
>
> b. having failed to complete and put in commission oil collection, storage and treatment facilities and most of the equipment which is still sitting in the field unused for the last many years;
>
> c. having failed every year to meet its financial obligations as provided in the MWP and the related AWPs; and

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[120] *Id.*, ¶ 41.

[121] IFM Compliance Report, ¶¶ 26-72.

> d. having failed every year to reach the trial oil production targets.[122]

113. The most striking breaches were CIOC's failure to complete the 3D Survey and to drill the Two Deep Wells. These failures occurred in spite of numerous notices.[123] These breaches struck at the core of CIOC's obligations under the Contract. Mr. Ongarbaev explains:

> The 3D study along with the drilling of the two sub-salt wells were at the core of the exploration mission of CIOC. There is no valid reason why CIOC failed to complete this study and drill the two deep wells within this 5-year time period. CIOC had ample time to do so.[124]

114. These two major failures are discussed in detail by Mr. Chugh in Sections 7.3 and 7.4 in the IFM Compliance Report and also by Mr. Ongarbaev in Section IV.4(c) of his Witness Statement. The following summarizes these failures.

115. **Regarding the 3D Survey:** Pursuant to the Minimum Work Program, the 3D Survey should have been completed by May 26, 2004. According to CIOC, the 3D Survey was completed in the third quarter of 2007, which is more than three years overdue.[125] However, it is not correct that the 3D Survey was completed, even by then. As indicated by Mr. Ongarbaev, CIOC hired Saratovneftegeofizika OJSC to carry out the 3D seismic study. Saratovneftegeofizika OJSC and CIOC presented a 3D seismic study report at a meeting of the Scientific and Technical Council of TU Zapkaznedra in November 2007. The minutes of the meeting indicate that "the disadvantages of the work include: insufficient analysis and, accordingly, a lack of conclusions and

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[122] IFM Compliance Report, ¶¶ 125, 126.

[123] *See, Id.*, ¶¶ 68, 84; *See*, **Ex. C-4**, Contract, Section 19.

[124] Mirbulat Ongarbaev Statement, ¶ 102.

[125] Omar Antar Statement, ¶ 102.

recommendations as to mapping and evaluation of sub-cornice and sub-salt deposits within the Caratube contract area" and "the report requires correction and formatting."[126] The report was therefore insufficient, lacking and incomplete. The Scientific and Technical Council approved the report as far as it went, but this was subject to the Council's reservations indicated above. The Scientific and Technical Council also decided that "the Report shall be formatted" according to applicable instructions of the Republic and "shall be submitted for permanent storage" with competent agencies of the Republic, including TU Zapkaznedra.[127] CIOC never did either of these tasks and never cured the "insufficient analysis" or "lack of conclusions and recommendations" in the Report. Thus, when the Contract was terminated on February 1, 2008, CIOC's obligations regarding the 3D seismic study had yet to be fully performed.[128]

116. **Regarding the Drilling of the Two Deep Wells:** Pursuant to the Minimum Working Program, the Two Deep Wells were required to be completed in the third and fourth contract year, i.e. by May 26, 2005 and 2006 respectively. On February 1, 2008, when the Contract was terminated, CIOC had not even started to drill either of those two wells.

117. Mr. Chugh explains:

> 88. The drilling of the two deep Subsalt wells was the single most important exploration obligation of CIOC. It is this drilling which could have led to discoveries beyond the discoveries already made in the Soviet times and the well known and already intensely drilled reserves of the Supra-salt formations. Pursuant to the MWP and related AWPs,

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[126] **Ex. R-16**, Minutes of TU Zapkaznedra Meeting with Saratovneftegeofizika OJSC on November 1, 2007 (Minutes undated).

[127] *Id.*

[128] *See*, Mirbulat Ongarbaev Statement, ¶¶ 95, 102.

> these wells were supposed to be drilled in 2004 and 2005. CIOC never even started to drill them, in 5+ years of time.
>
> 89. The only excuse given by CIOC is the delay in the 3D seismic study. As I have said above, the delay in conducting the 3D seismic study was inexcusable. Therefore, there is no excuse to CIOC's failure to drill the two deep wells.[129]

118. CIOC seeks to hide its miserable performance by assigning the same weight to the Two Deep Wells as to shallow wells, thereby attempting to obfuscate the matter. This is particularly true of the biased presentation made by Mr. Tiefenthal which did not go unnoticed by Mr. Chugh:

> I must state that Mr. Tiefenthal provides an entirely misleading Figure No. 8, under Para. 105 of the TRACS Compliance Report. Figure 8 is a graph that compares the wells actually drilled and re-entered by CIOC versus the requirement of the MWP, simply by number of wells, without distinguishing according to the depth of the wells, i.e. shallow wells versus deep wells. By number, these two deep wells represent together merely 5.5% out of a total 36 planned wells (34 shallow wells + 2 deep wells). Thus CIOC's failure to drill these two deep wells go unnoticed in Mr. Tiefenthal's Figure No. 8. While, the total cost of these two deep wells is equivalent to that of 15 shallow wells. CIOC's most fundamental exploration obligation was to drill the two deep Sub-Salt wells. Mr. Tiefenthal's Figure No. 8 hides the magnitude of CIOC's breach.[130]

119. **Regarding the Other Material Breaches:** All along and quite systematically, CIOC committed other material breaches, such as the failure to fully and timely fund the liquidation fund,[131] that remained uncured when the Contract was

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[129] IFM Compliance Report, ¶¶ 88-89.

[130] *Id.*, ¶ 90.

[131] *See, Id.*, ¶ 73, Table No. 8; *See*, **Ex. C-4**, Contract, Section 19.

terminated.[132] As outlined by IFM, CIOC failed to complete and put in commission oil collection, storage and treatment facilities:

> CIOC built oil storage and processing facilities, but after all these years these facilities are not complete and functional. Most of the well lines were not yet connected to this system. The general intra-network of pipelines was unfinished. It took 5+ years for CIOC to build a tank battery for storage, processing, loading and metering of oil from 30+ wells but it is still not operational.[133]

120. CIOC also failed every year to meet its financial obligations as provided in the Minimum Work Program and the related Annual Work Programs. This failure is addressed, on a year-by-year basis, in Section 6 of the IFM Compliance Report.[134]

121. Furthermore, CIOC failed every year to reach the trial oil production targets. This failure is addressed, on a year-by-year basis, in Section 7.5 of the IFM Compliance Report.[135]

6) Chronological Summary of Events and Decisions Leading to Termination of the Contract for Material Breaches

122. Mr. Ongarbaev goes chronologically over the various events and notices which led to the Termination of the Contract for material breaches. It shows that CIOC received numerous notices from the MEMR concerning its nonperformance, since as early as 2003. This sequence of events and notices is summarized below. More details can be found in Section IV.2 of Mr. Ongarbaev's Statement.

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[132] As TU Zapkaznedra routinely carried forward to the next year's Annual Work Program the unfulfilled work of the prior year, CIOC, with the passage of time cured certain material breaches, though these breaches should never have occurred. Table No. 8 in the IFM Compliance Report outlines all of CIOC's breaches, as notified by the MEMR over the years in its various notices of breaches and violations to CIOC. The breaches are shown as check marks under the relevant category. *See, Id.*, ¶¶ 68, 73.

[133] *Id.*, ¶ 107.

[134] *Id.*, ¶¶ 26-72.

[135] *Id.*, ¶¶ 93-94.

123. **TU Zapkaznedra's notice dated December 8, 2003** (the "**December 8, 2003 Notice**"):[136] This letter warns CIOC that it has performed only 44.1% of its minimum obligations and is behind in the implementation of the geological survey in accordance with the approved work program.

124. **TU Zapkaznedra's meeting of December 29, 2003 concerning the 2003 performance and the approval of the 2004 Annual Work Program**:[137] When CIOC met TU Zapkaznedra on December 29, 2003 for the approval of its 2004 Annual Work Program, TU Zapkaznedra noted that, although the 3D Survey had been programmed for 2003, the "3D field seismic was not fulfilled" and it was concluded that "all outstanding obligations are carried over to 2004, and their fulfillment shall be guaranteed."[138] As explained by Mr. Ongarbaev, TU Zapkaznedra routinely carries forward unaccomplished works of contractors to the annual work program for the following year. However, such a carry forward does not constitute or imply any satisfaction with or approval of the past year's performance.[139]

125. **TU Zapkaznedra's meeting of December 21, 2004 concerning the 2004 performance and the approval of the 2005 Annual Work Program**:[140] At the end of 2004, more than two years after the start of the Contract, CIOC had still failed to commence the 3D Survey. Moreover, it had also failed to begin the drilling of the First Deep Well which had been scheduled to occur in the third contract year, i.e. starting from May 28, 2004. As it had done the previous year, TU Zapkaznedra noted these

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[136] **Ex. R-9**, December 8, 2003 Notice.

[137] **Ex. R-17**, Minutes of TU Zapkaznedra Meeting dated December 29, 2003.

[138] *Id.*, at 3.

[139] *See*, Mirbulat Ongarbaev Statement, ¶ 89, 92.

[140] **Ex. R-18**, Minutes of TU Zapkaznedra Meeting dated December 21, 2004.

failures: "CDP Seismic 3D field surveys were not performed and therefore, the construction of a deep subsalt well was not performed," and it had to carry forward the unaccomplished work to 2005: "[a]ll outstanding obligations are carried forward to 2005, and their fulfillment shall be guaranteed considering financial obligations for 2005."[141]

126. **The January 17, 2005 Notice of Breach** (the "**January 17, 2005 Notice of Breach**"):[142] By early January 2005, CIOC was more than halfway through its initial Exploration period, yet, as seen above, it had not begun its most important exploration obligations. As can be seen in Column A of Table No. 4 in Mr. Ongarbaev's Statement, CIOC had accomplished only 24.61% of its minimum obligations for the year 2004, which is an extremely low figure.[143] It was therefore clear to the Monitoring Division that CIOC was in a state of material breach. Consequently, on January 17, 2005, the MEMR sent a Notice of Breach to CIOC. This notice points out numerous breaches including non-compliance with the work program as required under Section 8.1 of the Contract.[144] CIOC did not produce or mention this Notice of Breach in its Memorial.

127. In response to this Notice of Breach, CIOC tried to justify its failures in a letter to the MEMR dated March 9, 2005.[145] Mr. Ongarbaev notes that "CIOC vaguely and briefly refers to geological complexities and the expensiveness of the 3D seismic study as excuses, without real and detailed explanations."[146] He rejects both excuses. The alleged complexities will be addressed later in this Counter-Memorial and will be

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[141] *Id.*, at 3.

[142] **Ex. R-10**, January 17, 2005 Notice of Breach.

[143] *See*, Mirbulat Ongarbaev Statement, ¶ 38, 50.

[144] **Ex. R-10**, January 17, 2005 Notice of Breach; **Ex. C-4**, Contract, Section 8.1.

[145] **Ex. R-19**, Letter from CIOC to MEMR dated March 9, 2005.

[146] Mirbulat Ongarbaev Statement, ¶ 52.

shown to be a meritless excuse. Mr. Ongarbaev explains that expensiveness is not an excuse: "[i]t is the contractor who bears the risk and responsibility of this expense."[147] He concludes: "CIOC was simply late in carrying out the necessary preparatory work for the study. The 3D seismic study could have been timely completed by the end of the second contract year, i.e. by May 27, 2004."[148]

128. However, in its letter, CIOC also guarantees that "the construction of the deep well over the sub-salt deposits will be conducted in 2005...."[149] CIOC also acknowledges that it bears the risk of full compliance with the work program: "Dear Lyazzat Ketebayevich [i.e. Vice-Minister Kiinov], our company is aware of its credibility and liability for performance of Contractual obligations in due time and to their full extent under the 2005 Work Program."[150] Thus, CIOC assured the MEMR that the drilling of the first deep sub-salt well that was scheduled to be completed in the third contract year, i.e. by May 27, 2005, would in fact be carried out in calendar year 2005. As noted by Mr. Ongarbaev, "[a]lthough this presented a potential delay of 7 months compared to the provisions of the 5-Year Minimum Work Program, this assurance was comforting"[151] to the MEMR.

129. Mr. Ongarbaev indicates that "[g]iven these assurances, and also because the Contract was only half way through the initial 5-year exploration phase and there

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[147] *Id.*, ¶ 53.

[148] *Id.*, ¶ 52.

[149] **Ex. R-19**, Letter from CIOC to MEMR dated March 9, 2005, at 2.

[150] *Id.*, at 4.

[151] Mirbulat Ongarbaev Statement, ¶ 54.

ample was time left for CIOC to fully perform all of its exploration obligations by the end of this phase, no further action was taken by the MEMR at the time."[152]

130. **TU Zapkaznedra's meeting of December 21, 2005 Concerning the 2005 Performance and the Approval of the 2006 Annual Work Program**:[153] The third quarter LKU Report for 2005 is further evidence of CIOC's chronic failure to perform. Most importantly, CIOC had again failed to conduct the 3D seismic study in spite of CIOC's guarantee, at the preceding meeting, that it would do so in 2005. Also, CIOC had not even begun drilling the First Deep Well, much less completed it, as required. Consequently, again, TU Zapkaznedra noted CIOC's failures and that found that "[a]ll outstanding obligations are carried forward to 2006, and their fulfillment shall be guaranteed considering financial obligations for 2006."[154]

131. **TU Zapkaznedra's Notice of February 28, 2006** (the "**February 28, 2006 Notice**"):[155] After the December 21, 2005 meeting discussed above, TU Zapkaznedra received CIOC's fourth quarter LKU Report for 2005. The LKU Report confirmed CIOC's failure to fulfill the 2005 work program despite all of CIOC's repeated guarantees that it would do so. TU Zapkaznedra then sent a Notice to CIOC dated February 28, 2006 calling CIOC's attention to such non-fulfillment and also complained that CIOC had filed the fourth quarter LKU Report late. TU Zapkaznedra warned that, if CIOC's failures continued, appropriate actions according to the Republic's legislation

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[152] *Id.*, ¶ 55.

[153] **Ex. R-20**, Minutes of TU Zapkaznedra Meeting dated December 21, 2005.

[154] *Id.*, at 3.

[155] **Ex. R-21**, February 28, 2006 Notice.

would be taken.[156] Mr. Ongarbaev notes that "CIOC was thus clearly warned that it had to accomplish the outstanding works in 2006. This Notice was the right thing to do. CIOC had now entered the last 18 months of its exploration period. Now, in 2006, was the time for CIOC to perform."[157] CIOC also did not produce or mention this Notice in its Memorial.

132. **TU Zapkaznedra's Notice of August 18, 2006** (the "**August 18, 2006 Notice**"):[158] Having received the second quarter LKU Report for 2006, TU Zapkaznedra noted that by mid-2006 CIOC had fulfilled its financial obligations under the 2006 Annual Work Program only up to 12.7%.[159] As noted by Mr. Ongarbaev, this is a very low figure for mid-year.[160] This persistent underperformance, in spite of TU Zapkaznedra's warning in the February 28, 2006 Notice, was troubling. Thus, yet again, TU Zapkaznedra sent a Notice to CIOC dated August 18, 2006 asking CIOC to take appropriate measures to fulfill its obligations. CIOC, again, did not produce or mention this Notice in its Memorial.

133. **TU Zapkaznedra's meeting of November 29, 2006 Concerning the 2006 Performance and the Approval of the 2007 Annual Work Program**:[161] Once again, CIOC failed to perform and failed to live up to its guarantees. Although CIOC had collected the field data in June 2006, the 3D Survey remained incomplete,

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[156] *Id.*, at 2.

[157] Mirbulat Ongarbaev Statement, ¶ 57.

[158] **Ex. R-22**, August 18, 2006 Notice.

[159] *Id.*

[160] Mirbulat Ongarbaev Statement, ¶ 58.

[161] **Ex. R-23**, Minutes of TU Zapkaznedra Meeting dated November 29, 2006.

unprocessed and un-interpreted.[162] Moreover, in 2006, CIOC again had not even started to drill the First Deep Well. Again TU Zapkaznedra noted that: "[t]he presented Work Program includes outstanding obligations of 2006 with regards to drilling works, and these obligations are carried-over to 2007."[163]

134. **TU Zapkaznedra's Notice of December 11, 2006** (the "**December 11, 2006 Notice**"):[164] Shortly after the November 29, 2006 meeting TU Zapkaznedra followed up with a letter dated December 11, 2006 informing CIOC that, given its underperformance over nine months, based on the third quarter LKU Report for 2006, "CIOC was put on the list of companies whose performance of financial obligations, percentage-wise, amounted to less than 30% (i.e. 20.9%), which constitutes a breach of Contract No. 954 of 27.05.2002".[165] TU Zapkaznedra had thus warned CIOC that it was now blacklisted as an underperformer.[166] CIOC, again, did not produce or mention this notice in its Memorial.

135. **The March 25, 2007 Notice of Breach** (the "**March 25, 2007 Notice of Breach**"):[167] The fourth quarter LKU Report showed that, as at the end of 2006, CIOC was still in material breach of its obligations. As noted by Mr. Ongarbaev, the fourth quarter LKU Report for 2006 was especially significant since the fourth Contract year ended on May 26, 2006.[168] The results as at the end of 2006 give a full picture of CIOC's under-performance over the past four contract years. This was a critical time for

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[162] CIOC's Memorial, ¶ 116.

[163] **Ex. R-23**, Minutes of TU Zapkaznedra Meeting dated November 29, 2006, at 4.

[164] **Ex. R-11**, December 11, 2006 Notice.

[165] *Id.*

[166] Mirbulat Ongarbaev Statement, ¶ 60.

[167] **Ex. R-24**, March 25, 2007 Notice of Breach.

[168] Mirbulat Ongarbaev Statement, ¶ 61.

monitoring purposes since, under the terms of the Minimum and Annual Work Programs, both the 3D Survey and the drilling of the Two Deep Wells should have been completed. The fact is that, seven months after the end of the fourth contract year, the 3D Survey remained incomplete, unprocessed and non-interpreted[169] and CIOC had still failed to drill the First Deep Well. So, on March 25, 2007, the MEMR notified CIOC of all of its breaches at the time, and asked CIOC to cure them within one month, subject to unilateral termination.[170] As outlined above, this Notice of Breach follows TU Zapkaznedra's February 28, 2006 Notice asking CIOC to remedy the situation in 2006, and its December 11, 2006 Notice warning CIOC that it had been blacklisted as an underperformer. Thus, CIOC cannot seriously declare now that this Notice of Breach was surprising or unexpected.

136. CIOC alleges however that it never received the March 25, 2007 Notice of Breach and insinuates that this notice might have been forged.[171] CIOC's obvious motive for saying so is to push the date of this notice until after the political events to which it refers for purposes of consistency with its harassment allegation. As are many of CIOC's allegations and insinuations, this is simply not true. The notice was sent by the MEMR on March 25, 2007 and then received by CIOC on March 28, 2007, as proved by CIOC's signed acknowledgement of receipt.[172] In his Witness Statement, Mr. Ongarbaev describes the circumstances in detail as follows:

> CIOC's insinuation is both shocking and incorrect. CIOC was in material breach of the Contract. This notice was

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[169] CIOC's Memorial, ¶ 116.

[170] **Ex. R-24**, March 25, 2007 Notice of Breach; *see also*, Mirbulat Ongarbaev Statement, ¶ 61.

[171] CIOC's Memorial, ¶ 126.

[172] **Ex. R-25**, CIOC's signed acknowledgment of receipt of the March 25, 2007 Notice of Breach dated March 28, 2007.

> prepared by the Monitoring Division in March 2007, signed on March 25, 2007 by Mr. Aksholakov, the Vice-Minister at the time, and then sent to CIOC.
>
> [...]
>
> I can confirm that this notice was sent to CIOC on March 25, 2007, and I have no doubt that CIOC received it since we received a signed acknowledgement of receipt thereof from CIOC dated March 28, 2007. The fact of the matter is that CIOC did not answer the March 25, 2007 Notice of Breach at the time.[173]

137. **The Second Quarter 2007 LKU Reports**: CIOC did not answer the March 25, 2007 Notice of Breach. Mr. Ongarbaev explains that, consequently, when the Monitoring Division received CIOC's second quarter LKU Report in August, both CIOC's continued underperformance and its lack of answer to the March 25, 2007 Notice of Breach were apparent.[174] He indicates that, typically, when a nonperforming contractor fails to answer a notice of breach, the next step is to send the Contractor a notice of termination.[175] This is exactly what the Monitoring Division did when it sent a Notice of Termination of Operations on October 1, 2007.[176]

138. **The September 7, 2007 Recommendation of the Aktobe Prosecutor's Office**:[177] As explained by Mr. Ongarbaev as well as by Mr. Daulbaev, Deputy Prosecutor General of the Republic, the Prosecutor's Office supervises the implementation of the laws and regulations by State agencies, including the MEMR.[178] In this case, the local Prosecutor's Office in Aktobe, in view of CIOC's performances as

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[173] Mirbulat Ongarbaev Statement, ¶¶ 62, 65.

[174] *Id.*, ¶ 66.

[175] *Id.*

[176] **Ex. R-26**, Notice of Termination of Operations dated October 1, 2007.

[177] **Ex. R-27**, Recommendation from Aktobe Oblast Prosecutor's Office to MEMR dated September 7, 2007.

[178] Mirbulat Ongarbaev Statement, ¶ 67; Askhat Daulbaev Statement, ¶ 36.

shown in its LKU Reports, issued a "Recommendation on elimination of disregard of the rule of law" from the local Prosecutor's Office in Aktobe which is dated September 7, 2007.[179]

139. Mr. Ongarbaev explains that, while the Prosecutor's Recommendation was well-founded,

> for its part, the MEMR, more specifically the Monitoring Division, had already taken appropriate monitoring and enforcement measures consisting of the January 17, 2005 Notice of Breach and the March 25, 2007 Notice of Breach which asked CIOC to cure within one month, subject to unilateral termination by the MEMR. The Monitoring Division had thus to simply pursue the normal and ordinary course of action which it had undertaken.[180]

He also recalls that TU Zapkaznedra had already sent several notices to CIOC in 2003 and 2006.

140. **The September 11-30, 2007 Prescriptive Order**:[181] Starting on September 11, 2007, TU Zapkaznedra conducted an on-site audit of CIOC at the oil field. As correctly indicated by the Prescriptive Order,[182] and as explained by Mr. Ongarbaev this audit had indeed been scheduled long before.[183] TU Zapkaznedra found numerous violations and issued and delivered to CIOC a Prescriptive Order dated September 11-30, 2007 pointing out the deficiencies requiring remedial actions (the "**Prescriptive Order**").[184]

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[179] **Ex. R-27**, Recommendation from Aktobe Oblast Prosecutor's Office to MEMR dated September 7, 2007.

[180] Mirbulat Ongarbaev Statement, ¶ 67.

[181] **Ex. R-28**, Prescriptive Order.

[182] *Id.*, at 1, "[t]he review has been carried out in accordance with the 2007 inspection schedule"'; *See* **Ex. R-29**, Schedule of Work of TU Zapkaznedra for 2007 dated January 22, 2007 at 3, item 13.

[183] Mirbulat Ongarbaev Statement, ¶ 69.

[184] **Ex. R-28**, Prescriptive Order, at 2-4.

141. **The Resending of the March 25, 2007 Notice of Breach on September 21-24, 2009[185] and the October 1, 2007 Notice of Termination of Operations**:[186] Mr. Ongarbaev further explains that as the Monitoring Division still had not received any response from CIOC to the March 25, 2007 Notice of Breach, the Monitoring Division faxed a copy of the internal copy of the notice on September 21, 2007 to TU Zapkaznedra.[187] TU Zapkaznedra resent it by fax to CIOC on September 24, 2007. Mr. Ongarbaev indicates that he was then informed by TU Zapkaznedra that CIOC, after receiving this fax, alleged to TU Zapkaznedra that it had never previously received the notice. Since CIOC was still in material breach and since Mr. Ongarbaev had the acknowledgement of receipt by CIOC of the March 25, 2007 Notice of Breach,[188] the Monitoring Division prepared and sent out the October 1, 2007 Notice of Termination of Operations, expressly mentioning that CIOC had received the March 25, 2007 Notice of Breach on March 28, 2007.[189] This notice requested the immediate termination of operations pending a decision on unilateral termination.

142. **CIOC's Response of October 1, 2007**:[190] By letter dated October 1, 2007 CIOC responded to both the Prescriptive Order and the October 1, 2007 Notice of

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[185] **Ex. R-30**, March 25, 2007 Notice of Breach (internal copy).

[186] **Ex. R-26**, October 1, 2007 Notice of Termination of Operations.

[187] **Ex. R-30**, March 25, 2007 Notice of Breach (internal copy); Mirbulat Ongarbaev Statement, ¶ 70 (i.e. the internal version that is pre-signed by the four persons in addition to the Vice-Minister in accordance with the signature procedure described in Mirbulat Ongarbaev Statement).

[188] **Ex. R-25**, CIOC's signed Acknowledgment of the receipt dated March 28, 2007.

[189] **Ex. R-26**, October 1, 2007 Notice of Termination of Operations.

[190] **Ex. R-31**, Letter from CIOC to MEMR dated October 1, 2007; Mirbulat Ongarbaev Statement, ¶ 71 (Mr. Ongarbaev notes that CIOC has produced as **Ex. C-13** this letter, bearing the same reference number: No. 21-11-534, but dated October 3 as opposed to October 1. The letter he has in his files is the letter dated October 1 and is produced by the Republic as **Ex. R-31**, Letter from CIOC to MEMR dated October 1, 2007).

Termination of Operations.[191] CIOC wrote that it had not received the March 25, 2007 Notice of Breach. Mr. Ongarbaev states "[a]s I said, I could not accept this, since we had an acknowledgement of receipt thereof dated March 28, 2007."[192]

143. CIOC's main explanation concerning its failure to perform its exploration works was that, in the meantime, the exploration period had been extended by two years and, allegedly, its performance should be judged only going forward, by reference to the new 2-year minimum work program. Mr. Ongarbaev, confirms that "[t]his is not a valid excuse for CIOC's past breaches."[193] As will be seen below, CIOC's attempt to be judged only by reference to the new work programs for the extension period is meritless.

144. **The November 27, 2007 Notice of Resumed Operations** (the "**November 27, 2007 Notice of Resumed Operations**"):[194] Although CIOC had not cured the breaches of its major exploration obligation, i.e. the drilling of the Two Deep Wells and the completion of the 3D Survey, CIOC's October 1, 2007 response indicates that certain of the other breaches had been cured since the March 25, 2007 Notice of Breach. Mr. Ongarbaev explains that, consequently, on November 27, 2007, the MEMR sent a Notice of Resumed Operations with notification of breaches. This Notice restates the on-going breaches, which include CIOC's major exploration obligations, and takes out those breaches that CIOC had apparently cured. The Notice authorized

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[191] *Id.*

[192] Mirbulat Ongarbaev Statement, ¶ 72.

[193] Mirbulat Ongarbaev Statement, ¶ 73.

[194] **Ex. R-32**, November 27, 2007 Notice of Resumed Operations.

CIOC to resume operations, but demanded cure of the on-going material breaches within one month.[195]

145. **The December 3, 2007 Notice of Breach of Obligations**:[196] Upon receipt of the third quarter LKU Reports on November 20 of each year, the Monitoring Division, identifies underperforming contractors. In 2007, the policy of the Monitoring Division was to send out notices of breach to all contractors whose overall performance compared to their respective minimum work program was below 30%. CIOC's realization was only 28.67%.[197] Thus, as for numerous other contractors at the end of 2007, the Monitoring Division sent a Notice of Breach of Obligations to CIOC on December 3, 2007.[198] Mr. Ongarbaev explains that:

> CIOC makes incorrect allegations concerning this notice. CIOC in particular finds it suspicious that we sent this notice shortly after the November 27, 2007 Notice of Resumed Operations. There is nothing peculiar here. The December 3, 2007 Notice was part of a standard action taken for non-performing contractors at this time of the year. The December 3, 2007 notice has to be understood in this context and does not affect the October 1, 2007 Notice of Termination of Operations or the November 27, 2007 Notice of Resumed Operations. Also, CIOC finds it suspicious that its performance was judged on just nine months. I already explained in Section III.4.b) above that the 3rd quarter LKU Reports constitute a significant indicator, especially given the weather conditions prevailing at the end of the year in Kazakhstan.[199]

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[195] Mirbulat Ongarbaev Statement, ¶ 74.

[196] **Ex. R-15**, Notice of Breach dated December 3, 2007.

[197] Mirbulat Ongarbaev Statement, ¶ 38, Table 4, ¶ 75.

[198] **Ex. R-15**, Notice of Breach dated December 3, 2007; Mirbulat Ongarbaev Statement, ¶ 75.

[199] Mirbulat Ongarbaev Statement, ¶ 76.

7) The Termination

146. Given CIOC's persistent and uncured material breaches, the MEMR finally ordered the termination of CIOC's Contract on January 30, 2008.[200] Then, by Notice of Termination dated February 1, 2008, the MEMR terminated the Contract (the "**Notice of Termination**").[201] In the Notice of Termination, the MEMR also requires that CIOC, *inter alia,* return the geological information of the Contract territory and rehabilitate the contract area.[202]

147. In sum, starting as early as 2003, the Republic warned and notified CIOC of its underperformance and demanded that CIOC fulfill its obligations. The list of those notices is long and continuous and it clearly shows that CIOC was simply not performing, every step of the way. CIOC's unfulfilled works were rolled over, year after year, based on CIOC's reassurances and guarantee that it would perform the following year, but it never did.

148. IMF expert Mr. Chugh, who reviewed CIOC's track record and profile, explains that CIOC lacked the fundamental qualities required to successfully operate an oil and gas exploration project. Specifically, CIOC lacked both the required expertise[203] and the required financial capabilities.[204] Moreover, the IFM Compliance Report also indicates that CIOC lacked the determination to carry out the expensive and risky exploration of the deeper zones as it was required to do under the Contract.[205] Rather

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[200] **Ex. R-33**, Order No. 20 of MEMR on Termination dated January 30, 2008.

[201] **Ex. R-34**, Notice of Termination.

[202] *Id.*

[203] IFM Compliance Report, Section 8.1.1.

[204] *Id.*, Section 8.1.2.

[205] *Id.*, Section 8.1.3.

than take such risks and costs, CIOC was content to tap into the well-known, low-risk and easier to reach supra-salt reservoirs.[206] In addition, CIOC replaced the drilling of certain shallow wells by the re-entering at lower cost of existing Soviet wells in the supra-salt area. The IFM Compliance Report describes this practice and the financial savings that CIOC was able to generate for itself by this practice.[207]

149. In fact CIOC never acted in accordance with the purpose or the terms of the Contract or its Minimum Work Program. Mr. Ongarbaev states:

> The Caratube oil field was known, from the Soviet times, to have recoverable oil in the supra-salt structure. CIOC was supposed to explore the challenging sub-salt structure. The Contract was signed for an initial 5-year exploration period (Contract, Clause 3.2). The Contract provides that it shall terminate after the exploration period in the absence of a Commercial Discovery (Contract, Clause 9.6). The 5-Year Minimum Work Program provided for the drilling of 2 prospective deep wells into the sub-salt formation in the third and fourth contract years. CIOC never drilled these wells. The drilling of those wells was a fundamental exploration obligation. CIOC concentrated on simply reopening Soviet wells and drilling new wells in the already known oil supra-salt reserves. This was easier and cheaper for CIOC than drilling into the sub-salt formations. I and the Monitoring Division consider that, by doing this, CIOC was in material breach. CIOC was warned of this issue by a notice of breach sent by the MEMR on January 17, 2005 when, for no valid reason, it was not carrying out the 3D seismic study and had not started to drill the first deep sub-salt well. Two years after, when we terminated the Contract, the 3D seismic study remained insufficient, lacking and incomplete and CIOC had still not drilled the two deep subsalt wells. Moreover, CIOC was also in breach of other obligations. Consequently, we terminated CIOC's Contract. I consider that this is a rightful termination.[208]

150. The IFM Compliance Report reaches a similar conclusion:

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[206] *Id.*, ¶ 115.

[207] *Id.*, ¶ 110.

[208] Mirbulat Ongarbaev Statement, ¶ 42.

> 127. CIOC has the profile of a very high risk corporation with a very limited amount of oil and gas experience. CIOC faced a task too big for it, and did not do it well. CIOC repeatedly, from the beginning through the end, materially breached its obligations. I have seen no valid excuse for such breaches, e.g. no force majeure or extraordinary circumstances. There was a simple and plain non compliance with the minimum work programs, notwithstanding various notices and warnings starting in December 2003, then in 2005, 2006 and 2007. CIOC failed even in spite of the carrying forward, year after year, of its unfulfilled works.
>
> 128. In my opinion, this is because CIOC was incapable of properly performing from a technical and managerial as well as from a financial standpoint. It is quite obvious that CIOC was not equipped to take the extensive deep drilling risks either financially or technically. It is also my opinion that CIOC was not determined to comply under the Contract and work programs and was content to take the cheap and easy oil from the known Supra-salt formations. CIOC also replaced the drilling obligations of new wells in the shallow zones by re-entries into old Soviet wells. In sum, CIOC failed by far to fulfill its minimum obligations under the applicable work programs.
>
> 129. My opinion is that CIOC committed numerous material breaches of the Contract.[209]

151. In sum, CIOC proved itself to be incompetent, financially incapable and unreliable. Whether CIOC was acting out of sheer incompetence and inability or whether CIOC was acting with mal-intent, the fact remains that CIOC was in a chronic state of material breach and the Republic's decision to terminate the Contract was more than justified.

8) Certain Post-Termination Events

152. After the Termination of the Contract, CIOC as well as Devincci Hourani wrote various letters contesting the Termination and asking for reconsideration of the

[209] IFM Compliance Report, ¶¶ 127-129.

Termination decision. Mr. Ongarbaev indicates that the MEMR reviewed CIOC's statements and arguments but that they did not alter the MEMR's position that the Termination was rightful and justified by the material breaches of CIOC.[210] The Executive Secretary of the MEMR confirmed this conclusion in a letter to Devincci Hourani dated May 14, 2008.[211]

153. In his witness statement, Omar Antar presents a skewed depiction of a meeting he and other representatives of CIOC held with representatives of MEMR and goes so far as to impute admissions in CIOC's favor to the MEMR.[212] Mr. Ongarbaev indicates that this depiction is "inaccurate" and the Republic rejects it.[213] Mr. Ongarbaev further states:

> CIOC tried to have us sign minutes of the meeting which CIOC had prepared (*see* Exh. C-22). We did not sign those alleged minutes that are inaccurate and convey an erroneous impression of what happened. To me, with this meeting, these minutes as well as CIOC's correspondence surrounding the termination in general, CIOC was trying to build its case against the Republic for the arbitration. CIOC knows very well that it failed to perform its obligations under the Contract.[214]

9) CIOC's Excuses for Nonperformance and Other Defenses Are Meritless

154. CIOC contends that the Termination was wrongful. To that effect CIOC gives certain excuses for the non-performance of its exploration obligations and asserts certain other defenses. As is shown below, all of these excuses and defenses are invalid.

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[210] Mirbulat Ongarbaev Statement, ¶ 79.

[211] **Ex. R-35**, Letter from MEMR to CIOC dated May 14, 2008

[212] Omar Antar Statement, Section 6.10, ¶¶ 184-190.

[213] Mirbulat Ongarbaev Statement, ¶ 83.

[214] *Id.*, ¶ 86.

(i) CIOC's Allegation that the Minimum Work Program Was Inadequate, Unrealistic and Artificial

155. CIOC tries to escape liability for its non-performance by minimizing the importance of the Minimum Work Program and its provisions[215] and by characterizing the obligations contained in the Minimum Work Program as inadequate, unrealistic, over-ambitious and artificial.[216]

156. First, this is simply inaccurate. Mr. Chugh states that "the MWP, which is part of the negotiated Contract, was not inadequate, unrealistic or artificial, and that a competent, prudent, well funded and reliable contractor would have fulfilled the obligations under the MWP."[217]

157. Second, the Minimum Work Program was defined at the time of the awarding of the Contract. CIOC was aware of these obligations when it agreed to accept the rights and obligations under the Contract. It is a basic principal of contract law, that one cannot escape from one's duties under a Contract simply by claiming that performance was burdensome. As noted by Mr. Ongarbaev:

> These allegations are not correct. CCC was awarded the Contract, which included the 5-Year Minimum Work Program. CIOC acquired the Contract from CCC on August 8, 2008, including the 5-Year Minimum Work Program. CIOC had the obligation to carry out this minimum work program, at its own risks.[218]

158. The IFM Compliance Report stresses the importance of the Minimum Work Program in the contract awarding process in the oil an gas industry:

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[215] TRACS Compliance Report, ¶¶ 35, 83.

[216] CIOC's Memorial, ¶ 115; Omar Antar Statement, ¶¶ 99, 106, 147.

[217] IFM Compliance Report, ¶ 77.

[218] Mirbulat Ongarbaev Statement, ¶ 98.

> The MWP is one of the most important documents that gets the highest scrutiny by potential contractors and host governments when competing, tendering and negotiating for an oil field. The MWP is the basis of the whole concession at the starting stage as well as during exploration and production phases. The contractor is awarded the contract based on the MWP which is an attachment to the Contract.[219]

159. Moreover, as Omar Antar recalls in his statement: "I was involved as a technical adviser in assisting [CCC] in negotiations with the Government to acquire a concession in respect of the Contract Area" and "as a result of my role for CCC, I had some involvement on behalf of CCC in the conclusion of the terms and appendices of the Contract."[220] Omar Antar was also the President of CIOC at the time of CIOC's creation as well as at the time of the assignment of the Contract by CCC to CIOC.[221] Further, Omar Antar signed both the assignment agreement with CCC and the corresponding Addendum 1 to the Contract as President of CIOC.[222] CIOC generally presents Omar Antar as its manager in technical oil and gas matters.[223] Omar Antar is thus not credible when, today in this Arbitration, he criticizes the terms of the Minimum Work Program. CIOC should not have acquired the Contract from CCC if it thought that the Minimum Work Program was unrealistic. It is not the obligations in the Minimum Work Program that are "unrealistic" or "over-ambitious" or "artificial". Rather, as shown

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[219] IFM Compliance Report, ¶ 30.

[220] Omar Antar Statement, ¶¶ 33, 35.

[221] *Id.*, ¶¶ 39, 40.

[222] *Id.*

[223] Devincci Hourani Statement, ¶¶ 11-12.

in the IFM Compliance Report, the problem is that CIOC lacked the competence, financial resources or determination to successfully perform the Contract.[224]

(ii) CIOC's Allegation that the Geological Complexity of the Field Explained the Delays

160. Antar states that "[t]he geological complexity of the field explained our delay in completing the sub-salt wells during the first five years of the Contract."[225] CIOC, of course, had not even started to drill the Two Deep Wells. Thus the delay was not in "completing" these wells, but rather in commencing to drill them and in turn, it is the delay in carrying out the 3D seismic study that delayed the commencement of the deep drilling.[226] There is simply no excuse whatsoever for CIOC's failure to duly conduct this survey. As Mr. Ongarbaev states:

> From my experience as head of the Monitoring Division since its creation and as mining engineer-geologist, I cannot see any valid reason why the conduct of such a study, which is a common operation in the oil exploration industry, took so long.[227]

161. In contrast, and without stating any reasons for his conclusion, Mr. Tiefenthal writes: "The completion of a 3D seismic survey as complex as the one required within a year of commencing operations was not in my experience, a realistic aim."[228] It is apparent that Mr. Tiefenthal limits his tolerant view to a lack of completion of the 3D Survey within one year. Significantly, he does not opine on a lack of completion of the 3D Survey in five years, i.e. the entire duration of the Minimum Work

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[224] IFM Compliance Report, ¶ 101.

[225] Omar Antar Statement, ¶ 103.

[226] Mirbulat Ongarbaev Statement, ¶ 52.

[227] *Id.*, ¶ 100.

[228] TRACS Compliance Report, ¶ 111.

Program, but even Mr. Tiefenthal's one-year tolerance is unwarranted. Mr. Chugh finds Mr. Tiefenthal's commentary "highly inaccurate" particularly because the Caratube field had been extensively studied and drilled during the Soviet era and abundant related geological and technical data was available to and used by CIOC.[229] Mr. Chugh explains what a performing contractor would have done under similar circumstances:

> Any prudent operator would have reviewed the existing well data, geological maps, and all other logs and well test data from the existing wells and used this information to promptly design an appropriate 3D survey...
>
> The determination of the specification for this 3D seismic survey should have taken a few days or at most, just a few weeks. Once you have 2D seismic data, acquisition and processing parameters along with available well log, then normally it should not take more than one to two weeks (5-10 days) of professional time to design a good 3D survey. For an oil field like this, it is unheard of that a technically sound and experienced oil company will take more than just a few weeks to design such a 3D survey. Salt dome geology and 3D survey technology have been known for a long time and to claim that it takes years to plan this survey is simply inaccurate. I do not see any circumstances justifying that such a determination took over three years. Any one who knows about 3D survey will confirm that it does not take months and years to design and get ready for the 3D seismic survey. This is now old, tested and routine technology and oil companies are spending billions of dollars every year on 3D surveys in every part of the world including not very far from CIOC's Contract Area.[230]

162. He concludes:

> In my opinion, CIOC's failure to duly and timely complete the 3D survey is rather explained by CIOC's lack of competence and financial means as well as its lack of determination to undertake the costly and risky drilling of the deep wells. [231]

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[229] TRACS Reserves Report, ¶ 96, Table No. 2.

[230] IFM Compliance Report, ¶¶ 84-85.

[231] *Id.*, ¶ 87.

163. Therefore, it is clear that the 3D survey is something that could have been performed by a competent Contractor in 2003. Yet CIOC proved to be so incompetent that by 2007, it still had not managed to complete this task. Incompetence does not excuse non-performance.

164. In sum, therefore CIOC has not demonstrated anything that, legally, could constitute an excuse for its non-performance.

10) The MEMR Has Not Approved of CIOC's Past Performance or Non-Performance

165. In its submissions, CIOC states that the approval of an Annual Work Program for a new calendar year by TU Zapkaznedra constitutes approval of the performance of CIOC over the past year.[232] CIOC thereby tries to give the impression that the MEMR was satisfied with and in fact approved CIOC's performance, or rather its non-performance, on an on-going basis. These allegations are incorrect.

166. CIOC has failed to point to any documentary or other evidence that would show that the MEMR "approved" CIOC's performance, or rather nonperformance. CIOC is thus left with the argument that there was an implicit approval of its non-performance. However, this argument is repeatedly contradicted by the continuous series of notices sent by the MEMR to CIOC recited above. These documents evidence that the MEMR was at all times wholly dissatisfied with and never approved of CIOC's performance, or more aptly put, CIOC's non-performance.

167. As explained by Mr. Ongarbaev:

> CIOC pretends that the approval of an annual work program for a new calendar year by TU Zapkaznedra means that we

[232] Omar Antar Statement, ¶¶ 65, 73.

> approved of the performance of CIOC over the past year. This is not correct.
>
> If a contractor did not perform works that were planned in a given annual work program, these works must be carried forward to the next year's annual work program. An oil concession involves on-going works that must be planned. Therefore, generally in December, while only the LKU Reports for the 3rd quarter are available, TU Zapkaznedra meets with the subsoil users to plan for next year's work. The unaccomplished works is rolled over into the next year's annual work program. Such rolling over is for planning purposes. One has to know what the next year's annual work program is. This is a technical carry forward which does not mean satisfaction with or approval of the non-performance of the contractor over the last year.
>
> This carrying forward also reiterates the contractor's obligation to carry out the unaccomplished works and contains the contractor's guarantee that it will perform the unfulfilled work the following year. It is on the basis of this guarantee that TU Zapkaznedra carries the unfulfilled work forward, and not because it approves the contractor's past performance.[233]

168. Indeed, the minutes of TU Zapkaznedra concerning the Annual Work Programs contain no approval of the past year's performance. To the contrary, those minutes typically require that " [a]ll outstanding obligations are carried forward to [the next year], and their fulfillment shall be guaranteed".[234] Moreover, the numerous notices regarding nonperformance sent to CIOC, many of which came soon after the annual meetings in which CIOC contends its annual performance was approved, negate any alleged approval.

169. Further, the fact that the MEMR did not instantly terminate the Contract when it first became aware of CIOC's material breaches does not imply any approval on

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[233] Mirbulat Ongarbaev Statement, ¶¶ 88-90.

[234] *See*, Minutes for the approval of the 2004 Annual Work Program: **Ex. R-17**, for the 2005 Annual Work Program: **Ex. R-18**, for the 2006 Annual Work Program: **Ex. R-20**, and for the 2007 Annual Work Program: **Ex. R-23**.

the MEMR's part. As Mr. Ongarbaev explained, "the Monitoring division tends to be more tolerant with respect to non-performance when the Contract is at its early stage".[235] The MEMR simply gave CIOC ample opportunity to remedy its breaches. As time passed by and CIOC proved not to be performing in spite of its repeated guarantees that it would perform, the matter escalated and the Monitoring Division served CIOC with the January 17, 2005 Notice of Breach.[236] Thereafter, the matter continued to escalate until it became clear that CIOC was simply not ever going to perform in spite of the opportunities to cure, and thus the MEMR was led to decide the Termination.

170. In sum, the MEMR, neither explicitly nor implicitly, approved of CIOC's past performance and at all times retained its right to terminate the Contract for CIOC's material breaches.

11) The 2-Year Extension of the Exploration Period Did Not Affect the MEMR's Right to Terminate the Contract

171. CIOC knows all too well that it was in material breach of its exploration obligation and that it has no serious excuse for its non-performance. Consequently, CIOC constructs a defense based on the fact that the initial 5-year exploration period had been extended by two years prior to the time of the Termination.[237] This is not a valid defense. Section 9.1 of the Contract provides: "the Contractor shall have the right to extend the period of Exploration twice with a duration of each period of up to two years in accordance with the Legislation on Subsoil Use." CIOC had simply exercised

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[235] Mirbulat Ongarbaev Statement, ¶ 29.

[236] **Ex. R-10**, January 17, 2005 Notice of Breach.

[237] CIOC's Memorial, ¶ 118.

its right to an extension. This in no way means that the MEMR has relinquished its own termination rights.

172. In the context of this extension three new work programs were created: a minimum program for the next two years (the **"2-Year Extended Minimum Work Program"**); an Annual Work Program for the rest of 2007, i.e. from May 27 to December 31, 2007 (the **"Extended 2007 Annual Work Program"**); and a 2008 Annual Work Program (the **"2008 Annual Work Program"**). It should be noted that none of these new Work Programs can be considered "revised" work programs as CIOC contends.[238] The new programs simply started (on May 27, 2007) where the prior ones stopped (May 26, 2007). CIOC's failures under the prior work programs remained failures as did CIOC's accountability for its non-compliance with them.

173. CIOC's defense is twofold: first, CIOC argues that its performance should be measured against the extended work programs without regard to the prior work programs. Second, CIOC argues that the extension constitutes approval of its past performance by the MEMR or a waiver of its right to terminate the Contract. Neither is correct.

(i) CIOC Remained Accountable for its Failures to Perform the Minimum Work Program

174. The contractual Minimum Work Program as agreed to by the Parties at the outset of the Contract is a key measuring stick by which to judge compliance. The existence of new extended work programs for future years does not erase or moot CIOC's failure to perform the Annual Work Programs or the Minimum Work Program.

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[238] CIOC's Memorial, ¶ 105.

Likewise, it does not cancel or moot the MEMR's right to act on CIOC's material breaches, particularly when, as in this case, CIOC was already under notices to cure at the time of the extension.

175. Thus, CIOC tries to hide its failure to carry out its obligations under the Minimum Work Program by comparing its performance at the time of the Termination only against the new extended programs and not against the contractual Minimum Work Program. To that effect, CIOC states that the extended work programs "replaced the previous framework."[239] As indicated by Mr. Ongarbaev, this is also not correct. The extended work programs for the 2-year period started when the Minimum Work Program and corresponding 2007 Annual Work Program ended. In support of its allegation, CIOC claims that the Minutes of the June 6, 2007 meeting of the Work Group of the MEMR stated that there was such a replacement. This is again incorrect. CIOC simply misread and misquoted these Minutes, the alleged source of this "replacement." In footnote No. 133 of the Memorial, CIOC quotes these Minutes as stating "*the work* **[sic]** *agreement shall be replaced with Addendum #3.*" The translation of the Minutes produced by CIOC states: "*'Agreement' shall be changed to 'Addendum #3'*", meaning the word (not the "work") "*Agreement*" is to be replaced by the word "*Addendum #3.*"[240]

176. On the Termination date, i.e. February 1, 2008, CIOC was only one month into the year 2008. Needless to say, if one were to review CIOC's 2008 performance of only one month as at the Termination date against the 2008 Annual Work Program, one would not be in a position to judge CIOC's performance in 2008. However, this is exactly what Mr. Tiefenthal has done, following the approach adopted by CIOC and

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[239] CIOC's Memorial, ¶ 100.

[240] CIOC's Memorial, ¶ 100, footnote 113.

Omar Antar. In spite of the blatant breach by CIOC of its exploration obligation, Mr. Tiefenthal is able to conclude: "I could not identify any significant shortfalls in CIOC's performance against the programmes applicable at the date of termination."[241] Mr. Tiefenthal goes on with the following statement: "...there is every reason to believe that CIOC would have completed the drilling of the wells by the end of the two-year extension period".[242]

177. With all due respect to Mr. Tiefenthal, the opposite is true. Quite obviously, Mr. Tiefenthal is able to conclude that CIOC was not in breach and, consequently, to believe that CIOC would have drilled the deep wells in the next two years, only because he closed his eyes to CIOC's entire past performance prior to the date of the Termination. Given CIOC's lack of managerial abilities, technical know-how and financial capacity combined with its consistent record of serious non-performance there is every reason to believe that CIOC would not have been able to complete the drilling of the wells. Mr. Chugh's in the IFM Compliance Report strongly disagrees with any suggestion that CIOC could have successfully performed during the extended work programs:

> I cannot agree with this statement. There is really no basis to claim that "*CIOC would have been in a position to execute the agreed work streams*" going forward. All the indicators, CIOC's profile and track record point to the opposite direction. I find Mr. Tiefenthal's view quite astonishing, abstract and theoretical given CIOC's record as a consistently unreliable and systematically underperforming contractor. Year after year, as TU Zapkaznedra kept rolling CIOC's unfulfilled works to the next AWP for planning purposes, CIOC systematically breached its obligations, again and again, to the point that it became an almost

[241] TRACS Compliance Report, ¶ 123.

[242] *Id.*, ¶ 118.

> certainty that CIOC would be in breach in the future. CIOC was still in breach, as at the end of 2007, of its Extended AWP for 2007. Whenever, in the past, CIOC was put "*in a position to execute*" future streams of work, CIOC failed to do so. I cannot see any reason to believe the opposite today, judging the situation as it was in early 2008. As shown in this report, CIOC has never lived up to its obligations.[243]

178. CIOC also attempts to revise its obligations in these extended work programs downward. Thus, with the help of its expert, CIOC subtracts the budget for the Two Deep Wells, i.e. USD 10.4 million, from the amount of the Minimum Work Program, i.e. USD 36.58 million, to arrive at USD 26.18 million, on the grounds that the drilling of these wells had to be carried forward to the 2-year extended exploration period. Then, Mr. Tiefenthal compares CIOC's past performance against this unilaterally downsized Minimum Work Program and expresses his appreciation.[244] This operation is flawed. Mr. Tiefenthal cannot validly revise, unilaterally, CIOC's minimal contractual obligations, especially after the fact.

179. The numerous notices discussed above show that the MEMR considered CIOC in breach of its obligations of the Minimum Work Program. However, it should be noted that, as at the Termination, CIOC was also in breach of its obligations under the 2007 Extended Annual Work Program. Over the 8-month period from May 27 to December 31, 2007, CIOC, as usual, was in breach. As set out in the IFM Compliance Report, CIOC's performance percentages "are way below the minimum obligation,

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[243] IFM Compliance Report, ¶ 123.

[244] TRACS Compliance Report, ¶ 122.

except for Drilling Work; but this is because the drilling of the two deep wells was not included."[245] Mr. Chugh also indicates:

> If one considers CIOC's real obligation in 2007, i.e. by comparing (A) CIOC's actual performance over 12 months, on December 31, 2007, against (B) what CIOC should have accomplished under the initial AWP for 2007 which ended on May 26, 2007 and thus covered only a 5 months period, CIOC's fulfillment percentage was only 32%.[246]

(ii) The Extension of the Exploration Period Does Not Constitute an Approval of CIOC's Past Performance or a Waiver of the MEMR's Right to Terminate the Contract

180. CIOC argues that, in the context of the 2-year extension of the exploration period: "the MEMR *necessarily* approved (or waived any concern about) CIOC's performance under the Contract to that date."[247] This is erroneous. There was no such waiver or approval. When CIOC initiated the extension process by exercising its right to a 2-year extension on November 27, 2006,[248] CIOC was under the request of the February 28, 2006 Notice to cure in 2006. In addition, in the course of the processing of CIOC's extension right, the MEMR sent the March 25, 2007 Notice of Breach to CIOC. Thus there has been no approval or waiver on the MEMR's part as alleged by CIOC.

181. As explained by Mr. Ongarbaev, the extension did not immunize CIOC from termination based on its existing material breaches. CIOC had a contractual right to this 2-year extension which it exercised (Section 9.1 of the Contract). Mr. Ongarbaev explains that:

> The extension does not mean that the MEMR approved CIOC's past performance or waived concern in this respect.

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[245] IFM Compliance Report, ¶ 70.

[246] *Id.*, ¶ 71.

[247] CIOC's Memorial, ¶ 106.

[248] **Ex. R-36**, Letter from CIOC to MEMR dated November 27, 2006.

> The MEMR did not express any such approval. The MEMR still had the right to terminate CIOC's Contract for existing material breaches. CIOC's right to an extension and the MEMR's right to terminate existed in parallel.
>
> The extension procedure focused primarily on the content of the minimum work program for the next two years and the related revision of the contract. Independently and in parallel, the MEMR had sent out the March 25, 2007 Notice of Breach. CIOC had failed to answer this notice. The Monitoring Division pursued the termination of the Contract based on the persistent material breaches of CIOC following the March 25, 2007 Notice of Breach.[249]

182. As Mr. Ongarbaev states:

> In sum, CIOC was in a state of material breach. On January 17, 2005 and more recently on March 25, 2007, CIOC had been formally notified of the material breaches of its exploration obligations and requested to cure them. At the end of the 5-year exploration period, and even 7 months thereafter, CIOC had not even started to drill the two deep wells and the 3D seismic study was not finalized. The extension does not protect CIOC from non-performance and the legitimate termination of its Contract for such breaches. I can firmly state that the MEMR legitimately and validly terminated CIOC's Contract.

183. In conclusion, the facts show that the extension did not prevent the MEMR from pursuing the termination procedure that it had previously initiated, prior to CIOC's exercise of its right to extension, and specifically pursued during the processing of the extension.

12) The MEMR Validly Exercised its Right to Terminate the Contract Based on Proper Notices to CIOC

184. With reference to the stabilization provision in Clause 28 of the Contract, CIOC alleges that the Republic's notices related to the Termination are flawed in that they were not made in accordance with the version of the Subsoil Law that was in force

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[249] Mirbulat Ongarbaev Statement, ¶ 95.

at the date of signature of the Contract.[250] CIOC concludes that "any failure to respond to them did not form the basis of a ground for termination of the Contract."[251] Irrespective of this argument, the Republic recalls that the Termination was made for material breaches of the Contract by CIOC and that Section 29.6 of the Contract contains provisions regarding termination for breach. As will be seen below, the Republic's notices complied with these provisions. CIOC's failure to respond to these notices and to cure the material breaches cited in them constitutes appropriate grounds for termination under the Contract.

185. Pursuant to the first part of Section 29.6 of the Contract which concerns notices:

> If either Party to the Contract commits a material breach of the Contract, the other Party to the Contract shall have the right to demand that such breach be remedied within a reasonable specified period of time. If such breach is not remedied within such period of time, the complaining Party shall have the right to terminate this Contract by giving ninety (90) days' written notice to the defaulting Party...

186. CIOC contends that the Republic failed to comply with these provisions "by both failing to give a reasonable specified time in which a breach should be remedied and by failing to give CIOC ninety day's written notice of termination."[252] As shown by the chronology set out at length above, this is contradicted by the record. CIOC was in a constant state of material breach of its obligations. CIOC's most critical breach was that CIOC was not carrying out its major exploration obligations: the 3D

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[250] CIOC's Memorial, ¶ 141-142.

[251] *Id.*, ¶ 142.

[252] CIOC's Memorial, ¶ 226.

Survey and the drilling of the First Deep Well. As we have seen, CIOC received numerous notices covering those breaches, which rose crescendo until the Termination.

187. The January 17, 2005 Notice of Breach covered both these failures and others. It requested CIOC to cure. So, as early as January 17, 2005, CIOC was on notice that it should cure and perform these obligations.[253]

188. At the end of 2005, CIOC had still not performed these obligations. The end-of-the-year Minutes of the meeting with TU Zapkaznedra provides that their fulfillment in 2006 were guaranteed by CIOC.[254] Two weeks after this meeting, TU Zapkaznedra followed up with the February 28, 2006 Notice to CIOC specifically requesting fulfillment of all outstanding works in 2006 and warning CIOC that, otherwise, appropriate actions according to the Republic's legislation shall be taken.[255] This Notice thus granted CIOC ten months to remedy. This constitutes a specified reasonable period of time to remedy, in compliance with Section 29.6 of the Contract and well exceeds the ninety days provided for in the Contract.

189. Six months later, TU Zapkaznedra followed up with the August 18, 2006 Notice. The Notice points to CIOC's underperformance as at mid-2006 and reiterates that CIOC should take appropriate measures to fulfill its obligations.[256]

190. Since CIOC had still not fulfilled these obligations after the third quarter of 2006, TU Zapkaznedra sent the December 11, 2006 Notice informing CIOC that it was now on the blacklist of underperformers below 30%.[257]

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[253] **Ex. R-10**, January 17, 2005 Notice of Breach.

[254] **Ex. R-20**, Minutes of TU Zapkaznedra Meeting dated December 21, 2005.

[255] **Ex. R-21**, February 28, 2006 Notice; *see also*, Mirbulat Ongarbaev Statement, ¶ 57 (As noted by Mr. Ongarbaev "CIOC was thus clearly warned that it had to accomplish the outstanding works in 2006.").

[256] **Ex. R-22**, August 18, 2006 Notice.

191. Then the MEMR sent the March 25, 2007 Notice of Breach, asking CIOC to cure within one month the same breaches that had first been noticed in 2005, subject to unilateral termination of the Contract.[258] Since CIOC had not remedied its breaches, the MEMR sent the October 1, 2007 Notice of Termination of Operations.[259]

192. Section 29.6 of the Contract does provide for a 90-day cure period while the March 25, 2007 Notice of Breach asked CIOC to cure within one month. The Republic respectfully submits that since CIOC was first notified of these breaches as early as 2005 and that the MEMR at all times was clear via notices that CIOC at all times remained in breach of its obligations to complete the said obligations, the cure period began in 2005. Thus, the Republic granted a cure period that greatly exceeded what was required under the Contract, and the Republic validly exercised its right to terminate the Contract based on its notices.

193. Further, even if one assumes that the March 25, 2007 Notice of Breach itself begins the cure period, despite the fact that the notice cited a one month cure period, the Republic did not actually terminate the operations until six months later, and the Contract until ten months later. Thus CIOC cannot now claim that it was not given the cure period required under the Contract. As at the date of the October 1, 2007 Notice of Termination of Operations, CIOC had six months to cure since the March 25, 2007 Notice of Breach, 33 months since the January 17, 2005 Notice of Breach and 20 months since the February 28, 2006 Notice. Therefore, there is no question that CIOC

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[257] **Ex. R-11**, December 11, 2006 Notice.

[258] **Ex. R-24**, March 25, 2007 Notice of Breach.

[259] **Ex. R-26**, Notice of Termination of Operations dated October 1, 2007.

was granted ample time to remedy its breaches and was given far more time than that required by Section 29.6 of the Contract.

194. In conclusion, the MEMR rightfully terminated the Contract for material breach. CIOC was given ample notice and ample time in which to cure that breach and failed to do so. Therefore, it is clear that Termination was justified and that the Republic properly exercised its termination right under the Contract.

C. There Has Been No Harassment of CIOC, its Principals or its Employees

195. Being well aware of its miserable performance, CIOC correctly predicted: "The Tribunal is likely to read and hear a great deal about CIOC's performance of its obligations under the Contract during the course of this proceeding," but wrongly asserted that "this case is not about CIOC's contractual performance, which in any event provided no reason for complaint let alone termination."[260]

196. In the face of CIOC's long history of nonperformance and the related notices by the MEMR, CIOC offers the following story:

> For five years CIOC had successfully, and without any controversy, pursued its investment. New oil wells were drilled and Soviet-era ones were re-opened, extensive geological testing and exploration work was carried out, infrastructure was installed at the field and pilot production commenced. Suddenly in mid 2007, the political landscape changed...[261]

197. CIOC points to a political feud between the President of the Republic and "his powerful son in law, Rakhat Aliyev"[262] and then to family ties between Rakhat Aliyev

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[260] CIOC's Memorial, ¶ 12.

[261] *Id.*, ¶ 9.

[262] *Id.*

and Issam Hourani, the elder brother of Devincci Hourani. According to CIOC, simply and only because of these ties:

> Kazakh officials concocted unsubstantiated allegations that CIOC was in breach of its contractual obligations as a pretext for what was no more than a politically-motivated campaign against the company and its owner.[263]

198. CIOC is simply wrong for the following reasons:

- First, as fully demonstrated above and the Mirbulat Ongarbaev Statement, the Contract was rightfully terminated for material breach and not as part of a politically-motivated campaign against CIOC and its apparent owner; and
- Second, as will be shown below and through the Askhat Daulbaev Statement, there was no harassment as alleged by CIOC.

1) The Contract Was Rightfully Terminated for Material Breach and Not as Part of an Alleged Harassment Campaign

199. As shown in the preceding Section, the record abundantly demonstrates that the MEMR rightfully terminated the Contract for material breaches. This, alone, is sufficient to contradict CIOC's contention that the Contract was terminated for political reasons. CIOC lost its Contract because of its own material breaches.

200. Mr. Ongarbaev, the head of the Monitoring Division, confirms in no unclear terms:

> Finally, I have noted that CIOC alleges that the contract was terminated for political reasons and not because of the material breaches of CIOC. I know that that is not true. I was responsible for the monitoring and termination process of the CIOC contract and carried out the termination of the Contract because of the persistent material breaches of

[263] *Id.*, ¶ 11.

CIOC and for no other reason. CIOC simply was a non-performing and unreliable subsoil user.[264]

201. This lack of causation between the Termination and the political events referred to by CIOC is easily seen from a number of facts and circumstances.

(i) The Record of Non-Performance Predates the Invoked Political Events

202. CIOC's political argument does not stand when one considers the long history of notices of breach, starting in 2003, that predate the said political events:

- the December 8, 2003 Notice of non-compliance; [265]
- the January 17, 2005 Notice of Breach;[266]
- the February 28, 2006 Notice of non-performance;[267]
- the August 18, 2006 Notice on non-fulfillment;[268]
- the December 11, 2006 Notice blacklisting CIOC as an underperformer;[269]
- the March 25, 2007 Notice of Breach. [270]

203. CIOC simply did not produce the first five notices and pretends not to have received the sixth. This approach enables CIOC to pretend that the story of this case starts after the mid-2007 political events, on October 1, 2007, when CIOC was allegedly surprised to receive a Notice of Termination of Operations. The Republic maintains that the Termination stems from CIOC's track of record non-performance, officially

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[264] Mirbulat Ongarbaev Statement, ¶ 105.

[265] **Ex. R-9**, December 8, 2003 Notice.

[266] **Ex. R-10**, January 17, 2005 Notice of Breach.

[267] **Ex. R-21**, February 28, 2006 Notice.

[268] **Ex. R-22**, August 18, 2006 Notice.

[269] **Ex. R-11**, December 11, 2006 Notice.

[270] **Ex. R-24**, March 25, 2007 Notice of Breach.

registered as early as in December 2003. Surely, Kazakhstani officials cannot have "concocted" CIOC's own and verifiable past breaches as well as this record of six prior notices, including CIOC's own written correspondence in this regard.[271]

204. Thus, since it as a matter of basic logic that something which occurred in the future (the political dispute) cannot be the cause of something that pre-dates it (the long line of notices regarding material breach), CIOC's argument is missing the necessary causal link. Further, as is shown below, this argument also lacks a factual basis.

(ii) CIOC Was Not Subject to Biased Treatment by the MEMR

205. CIOC alleges that it was the victim of biased treatment by the MEMR because of the political events referred to by CIOC. But the arguments and elements submitted by CIOC do not support and even at times contradict this allegation.

206. CIOC contends that the on-site audit conducted by TU Zapkaznedra in September 2007 was in fact "unscheduled"[272] in spite of the indication in the September 11-30, 2007 Prescriptive Order that the audit was scheduled.[273] CIOC alleges that this audit was politically motivated. This is simply wrong. As shown by TU Zapkaznedra's planning of audits for 2007,[274] and as explained by Mr. Ongarbaev,[275] this on-site audit had been scheduled for September 2007 months in advance of the said political events.

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[271] **Ex. R-19**, Letter from CIOC to MEMR dated March 9, 2005.

[272] Omar Antar Statement, ¶ 137.

[273] **Ex. R-28**, Prescriptive Order, "[t]he review has been carried out in accordance with the 2007 inspection schedule."

[274] **Ex. R-29,** Schedule of Work of TU Zapkaznedra for 2007 dated January 22, 2007, at 3, item 13.

[275] Mirbulat Ongarbaev Statement, ¶ 69.

207. CIOC similarly raises suspicion regarding the December 3, 2007 Notice of Breach of Obligations on the grounds that it was sent shortly after the November 27, 2007 Notice of Resumed Operations, that it was allegedly an unusual notice, and that it was based on the third quarter LKU Reports, it being allegedly inappropriate to judge CIOC's performance after only nine months.[276] CIOC infers from these points that this notice was causally linked to the political situation. But none of CIOC's points are valid. First, as explained by Mr. Ongarbaev, the Monitoring Division developed a practice of sending notices of breach warning underperforming contractors at the end of the year, based on the third quarter LKU data. Second, this is because the data over nine months is a significant indicator of performance since nine months of the year have gone by and the remaining three months lead into harsh winter conditions, during which it is very hard to catch up.[277]

208. Finally, in an effort to show a bias of the MEMR against Devincci Hourani, CIOC alleges that another oil and gas company which he owned, Kulandy Energy Corporation, was confiscated through the termination of its oil exploration and production contract on 31 July 2007 by notification from the MEMR.[278] This, again, is not correct. As the head of the Monitoring Division, Mr. Ongarbaev was also responsible for monitoring of the Kulandy contract. He states: "there has been no confiscation at all, just the expiration of the contract term". [279] In fact, the Kulandy contract simply expired on June 18, 2007. He observes that the Kulandy project was a complete failure. In terms of financial obligations, Kulandy Energy Corporation recorded

[276] CIOC's Memorial ¶ 134; Omar Antar Statement, ¶ 164.

[277] Mirbulat Ongarbaev Statement, ¶¶ 27, 75-76.

[278] Devincci Hourani Statement, ¶ 8.

[279] Mirbulat Ongarbaev Statement, ¶ 138.

a dismal performance of less than 2% from 2003 to 2006, and even 0% in 2007, compared to the minimum work program.[280] The pattern that can be observed here is not one of harassment by the MEMR. Rather, it is the pattern of incompetence and financial incapacity of Devincci Hourani and Omar Antar. In fact, the collapse of Kulandy Energy Corporation occurred in 2002, precisely when Devincci Hourani took over the company and Omar Antar became its technical management.[281] Mr. Ongarbaev concludes "In Kulandy's case, the contract simply expired in June 2007. Like CIOC, Kulandy Energy Corporation was an underperforming, incompetent and unreliable subsoil user."[282]

209. In sum, none of CIOC's allegations lend any credit to the contention that the MEMR terminated the Contract because of the political events referred to by CIOC. On the contrary, they point again to CIOC's incompetence and unreliability.

210. In Section III.4(b) of his Statement, Mr. Ongarbaev provides an overview, complete with statistics, of the monitoring of subsoil users by the MEMR. This overview further shows that the Termination occurred as part of the Republic's ongoing review of the contractual performance of sub-soil users in Kazakhstan.[283] During the period from late 2007 through early 2008, i.e. after the political events refer to by CIOC, eighty-seven contracts were terminated for material breach, and CIOC's was simply one of them.[284] Mr. Ongarbaev states:

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[280] *Id.*, ¶¶ 136-137, 140.

[281] *Id.*, ¶ 134, 137, Table No. 7.

[282] *Id.*, ¶ 138, 140.

[283] *Id.*, ¶ 35.

[284] *Id.*

> CIOC's termination was processed pursuant to our normal termination procedures. This termination was justified and legitimate based on CIOC's poor performance under the Contract. It was definitely not part of a harassment campaign or a political feud as contended by CIOC.[285]

211. The evidence shows that the Contract was rightfully terminated for material breach and not as part of an alleged harassment campaign. Thus, there is no causal link between the alleged harassment and the damages claimed by CIOC.

2) There Was No Harassment of CIOC

212. Moreover, the Republic in fact did not engage in any harassment of CIOC, its principals or its employees, but rather acted at all times for legitimate purposes in accordance with applicable law and procedure. This is confirmed by the Witness Statement of Mr. Daulbaev, Deputy Prosecutor General of the Republic, the government official responsible for the management of the operation of the Department for the Supervision of Legality in the Social and Economic Sphere.

213. CIOC has wrongly put into one single category different investigations and actions of State agencies which, Mr. Daulbaev explains, should be distinguished as follows.

(i) The "Investigations Unrelated to CIOC"

214. These are criminal investigations and actions concerning Mr. Rakhat Aliyev and members of his entourage. These investigations are not related to CIOC, to Devincci Hourani as shareholder of CIOC or to Hussam Hourani as manager of CIOC.[286]

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[285] *Id.*, ¶ 36.

[286] Askhat Daulbaev Statement, ¶ 10.

215. Mr. Rakhat Aliyev used to be an influential figure in Kazakhstan. He held top positions in the Financial Police and the KNB in 1996-2001 and gained control and dominance over a number of Kazakhstani companies and business activities. Mr. Daulbaev explains that Rakhat Aliyev is currently being investigated for using criminal means to rise to a preeminent business position, including abuse of influence, racketeering and extortion, as well as money laundering, in particular via Lebanon.[287]

216. These investigations, which are on-going, are being carried out in close cooperation with the authorities of various foreign countries and via the Interpol. These investigations were precipitated in 2007 by the kidnapping by Rakhat Aliyev of two top managers of Nurbank, a bank which he controlled.[288]

217. Mr. Daulbaev indicates that Rakhat Aliyev's deeds and actions involve members of the entourage of Rakhat Aliyev, and that Mr. Issam Hourani, the elder brother of three Hourani brothers, is one of the persons closest to Rakhat Aliyev. He gives examples showing this proximity. They include possible money laundering via Lebanon, the suspicious death of the purported mistress of Rakhat Aliyev on premises of Issam Hourani in Beirut, and the alleged extortion by Issam Hourani in association with Rakhat Aliyev of the Kazakhstani subsidiary of Ruby Rose Agrikol from its founder.[289]

218. Mr. Daulbaev states:

> The Republic's law enforcement authorities and judicial system are properly functioning and playing their role when investigating the alleged crimes of Rakhat Aliyev and associated persons, and sanctioning them when established.

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[287] *Id.*, ¶¶ 11-12.

[288] *Id.*, ¶¶ 13-14.

[289] *Id.*, ¶¶ 16-17, 20.

> It is the contrary that could be criticized. Indeed, the Republic's and its President's reputation would be harmed if such alleged crimes could go uninvestigated. What can be observed in this matter is not, as CIOC would have it, a misuse of the public authorities of the Republic to harass CIOC and related persons. We are observing the proper functioning of the Republic's institutions which are duly investigating and bringing law, justice and order into the unfortunate situation related to Rakhat Aliyev and his entourage.[290]

219. As explained by Mr. Daulbaev, it is in this context that, mid-2007, the Republic investigated the businesses and activities connected to Issam Hourani and that, in particular, on June 27, 2007, the Almaty Police investigated the Hourani headquarters at 92a Palezhayeva Street in Almaty, where CIOC along with other Hourani companies is located. Mr. Daulbaev observes that this police operation was not a "raid", as alleged by CIOC, but a legitimate and legal operation.[291]

220. In sum, all these investigations are unrelated to CIOC, to Devincci Hourani as shareholder of CIOC or to Hussam Hourani as manager of CIOC. To the extent that these persons have been interviewed, it has nothing to do with them in particular but is related to the investigations concerning Issam Hourani as the associate of Rakhat Aliyev. This in effect is confirmed by Devincci Hourani itself. He writes that during his interview by the Financial Police on June 28, 2007:

> The questions concentrated upon my relationship with my brother Issam, his whereabouts, how he had met his wife Gulshat Aliyev, how he had developed a relationship with

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[290] Askhat Daulbaev Statement, ¶ 15.

[291] Askhat Daulbaev Statement, ¶¶ 23-24; Devincci Hourani Statement ¶ 33; CIOC's Memorial ¶ 52. Mr. Daulbaev also corrects the misleading impression given by Devincci Hourani of his interview on June 28, 2007 by the Almaty Police. Devincci, like Omar Antar, have omitted to mention that they were interviewed as witness by the Almaty Police concerning also a deposition of Mr. Sami Sabsabee, a former engineer of Ruby Rose Agrikol, who accuses Issam Hourani with others of having physical assaulted him and extorted certain payments in cash and in kind from him, because he would have misappropriated funds of Ruby Rose Agrikol. Mr. Daulbaev observes that physical assault being a very serious matter, as is normal, the Almaty Police investigated these accusations (Askhat Daulbaev Statement, ¶ 28).

> Rakhat Aliyev, and the nature of that relationship. There were very few questions about CIOC or any of our other businesses.[292]

221. Devincci Hourani also confirms that the questions asked by the KNB on September 1, 2007 "concentrated on the nature and details of my relationship with Mr Aliyev and also Issam's relationship with Mr Aliyev" and also his whereabouts, and his businesses and homes around the world.[293]

222. In no unclear terms, Mr. Daulbaev writes:

> I can state that the June 27, 2007 Police operation and investigations, the interviews of Devincci Hourani and others as witnesses, as well as the other investigations conducted, in particular during the second half of 2007, concerning the Houranis as well as other persons or businesses related to them, were all legitimate and appropriate, were lawfully and correctly conducted by the competent authorities of the Republic and were unrelated to CIOC. In particular, no persons were harmed, intimidated or maltreated, and every person's right has been fully respected, in compliance with the law.[294]

(ii) The "Actions Specific to CIOC"

223. Certain other investigations and actions that are referred to by CIOC indeed concerned CIOC and its activities. Such investigations and actions, however, were all legitimate actions and were conducted in accordance with applicable law and procedure. As explained by Mr. Daulbaev, they can be categorized as follows.

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[292] Devincci Hourani Statement, ¶ 38.

[293] *Id.*, ¶ 58.

[294] Askhat Daulbaev Statement, ¶ 25-31.

(a) The "MEMR's Monitoring Actions"

224. Mr. Daulbaev confirms that the MEMR was the competent authority to monitor CIOC's performance and to terminate the Contract.[295] As shown in this Counter-Memorial and in Mr. Ongarbaev's Statement, the Termination was a rightful termination for material breaches and was unrelated to the political events referred to by CIOC.[296] Mr. Daulbaev also confirms:

> I can further state that the termination of CIOC's Contract has been decided and carried out by the MEMR based only on its monitoring of CIOC's performance and breaches and not for any other reason, including the reasons alleged by CIOC. Notifications of breaches and violations had been sent out to CIOC and CIOC had been warned of its non-performance and invited to cure long before the criminal investigations related to Rakhat Aliyev to which CIOC refers. The termination of CIOC's Contract followed a normal and ordinary course.[297]

(b) The "Unlicensed Sales of Oil Actions"

225. These are the actions of the Financial Police concerning CIOC's continued production and sale of oil after the Termination, when CIOC no longer had a valid license to do so (the "**Criminal Action No. 0815005100091**"). As stressed by Mr. Daulbaev, after the Termination, CIOC could only stay in the Contract Area for the purpose of carrying out the handover of the oil field to the Republic and related liquidation operations.[298] He also notes that certain actions taken later by the Republic are in fact developments of Criminal Action No. 0815005100091. An example of that is the visit by the Financial Police at CIOC's headquarters in Almaty on July 5, 2009 that is

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[295] *Id.*, ¶ 33.

[296] *Id.*, ¶¶ 33-34.

[297] *Id.*, ¶ 39.

[298] *Id.*, ¶¶ 40-41.

referred to, "in inaccurate terms", in the letter dated July 6, 2009 from CIOC's Counsel to the Tribunal.[299]

226. Mr. Daulbaev confirms that "Criminal Action No. 0815005100091 and its developments are related only to the illegal production and sale of oil by CIOC, without proper authorization, after the termination of the Contract, and in no way constituted a form of harassment of CIOC, its shareholders or related persons".[300]

227. In this Arbitration, the Republic submits that the MEMR had the right to terminate the Agreement as it did. There is no reason why the Financial Police should have second-guessed the decision of the MEMR. The Financial Police acted in its legitimate and legal role when it prosecuted unlicensed production and sales of oil. There can be no harassment here.

228. Mr. Daulbaev's Statement also shows that CIOC, after the Termination and by deception, led both the Financial Police and the Aktobe local authorities to believe that the shutdown of the wells caused a threat to the environment due to high pressure and blowout risks. CIOC was thus able to obtain approval to operate the six most productive wells, i.e. to occasionally let oil flow to release the pressure built up, if any. According to the depositions of a former geologist of CIOC and of the prophylactics engineer of "Ak-Beren"[301] who regularly inspects the wells, there in fact was no such risk to the environment.[302] Indeed, since the definitive shutdown of those

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[299] *Id.*, ¶ 42.

[300] *Id.*, ¶ 43.

[301] The "Ak-Beren" is the Kazakhstani unit which is specialized in oil and gas risks, like firemen (*Id.*, ¶ 49).

[302] *Id.*, ¶¶ 47-52.

six wells in April 2009, no environmental problem has been reported by "Ak-Beren."[303] Moreover, according to the geologist, instead of just periodically releasing the excess pressure from the wells, if any, which was the only thing that CIOC had been authorized to do, CIOC seems to have let the valves of the relevant wells remain open and kept selling the oil output.[304]

229. Thanks to this environmental pretense, CIOC was able to continue producing and selling oil throughout 2008 and until April 2009, when the KNB found about the deceit. In fact, CIOC's production in 2008, i.e. after the Termination, was in line with that of the prior years.[305] Moreover, CIOC seems to have circumvented the freezing of its bank accounts by lodging the profits of these sales of oil with affiliated companies instead of crediting them to the frozen accounts.[306]

230. Thus, in fact, CIOC tranquilly stayed at the oil field and, during one and a half years following the invoked political events, continued to sell oil under this environmental pretense instead of proceeding to the liquidation of the operation and the handover as demanded by the MEMR. The above goes to show that the Kazakhstani authorities, in fact, were rather lenient towards CIOC and that CIOC was not, as it alleges, subject to constant adverse attention and persecution of the State authorities. CIOC's fearless attitude of defiance towards the State authorities shows that, in fact, CIOC did not expect or fear bad treatment. Indeed CIOC had no reason to fear

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[303] *Id.*, ¶ 52.

[304] *Id.*, ¶ 50.

[305] IFM Compliance Report, ¶ 93, Figure No. 1.

[306] Askhat Daulbaev Statement, ¶¶ 46, 50-51.

anything for, as confirmed by Mr. Daulbaev, CIOC's management and personnel and related persons were at all times correctly treated by the State.[307]

(c) The "Miscellaneous Regulatory Actions"

231. CIOC also complains of certain inspections and actions by State agencies in various areas such as environment, customs, tax and safety.[308] CIOC has wrongly confused these actions with the Investigations Unrelated to CIOC.[309]

232. Mr. Daulbaev explains that State agencies closely scrutinize subsoil users' compliance with the applicable Kazakhstani regulations. In particular, he emphasizes Kazakhstan's concern regarding environmental compliance. Mr. Daulbaev observes that CIOC had already been subjected to environmental inspections and actions in 2006, before the said political events. He confirms that, contrary to what CIOC has alleged,[310] it is not abnormal for environmental inspections to be carried two years in a row. In fact, there is a tendency to re-inspect subsoil users that, as CIOC, have previously been found to violate regulations.[311]

233. Mr. Daulbaev confirms that all these inspections and actions have been carried out on legitimate and legal bases and were pursued in strict compliance with the laws. He observes that these inspections and actions gave rise to sanctions only when legally justified. This was the case for instance with respect to certain repeated

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[307] *Id.*, ¶ 56.

[308] *See*, Omar Antar Statement, ¶¶ 126-127.

[309] Askhat Daulbaev Statement, ¶ 53.

[310] Omar Antar Statement, ¶ 126.

[311] Askhat Daulbaev Statement, ¶ 54.

breaches by CIOC of environmental land re-cultivation obligations. He confirms that when there was no ground for sanction, no sanction was taken.[312]

234. Mr. Daulbaev also disproves yet another allegation that CIOC uses in this Arbitration to artificially keep alive its fictitious story of harassment. CIOC has alleged on various occasions that certain Palestinian employees of CIOC who remained in Kazakhstan, namely Mr. Rashid Mahmud Badran, Mr. Mussa Adbul Gani and Mr. Nadir Zib Hourani were the subject of hardship and illegitimate inquiries. This is incorrect.

235. In its Response to CIOC's Amended Request for Provisional Measures,[313] the Republic has already shown that CIOC's allegations that Mr. Rashid Mahmud Badran and Mr. Nadir Zib Hourani had been victimized, put under house arrest and deprived of their travel and identity documents are incorrect. The Republic showed that the documents of these persons were legitimately reviewed as they had invalid work or residency status and that these persons were treated well and were free to move.

236. Recently, by letter of its Counsel dated November 24, 2009, CIOC made again an incorrect presentation of the situation of Rashid Mahmud Badran, Nadir Zib Hourani and Mussa Adbul Gani in Kazakhstan.

237. First, CIOC failed to report to the Tribunal that one of these three persons, Mr. Nadir Zib Hourani, a member of the Hourani family, had already left Kazakhstan.

238. Second, CIOC alleges that, today, the two other employees, Rashid Mahmud Badran and Mussa Adbul Gani, are deprived of financial means to survive due to the freezing of CIOC's bank accounts. This sudden predicament does not ring true.

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[312] *Id.*, ¶ 55.

[313] The Republic's Response to CIOC Amended Request for Provisional Measures dated June 15, 2009, ¶ 17.

CIOC's bank accounts were frozen in June 2008, a year and a half ago.[314] Also, it is hard to believe that CIOC which has the financial means to support these costly arbitration proceedings cannot find a way to send money to these persons in Kazakhstan. In fact, CIOC showed greater creativity when it circumvented the freezing of its bank account to avoid the seizure of the proceeds of its unlicensed sales of oil after the Termination.[315]

239. Mr. Daulbaev writes:

> I can also state that all the investigations and actions taken by the State authorities concerning various CIOC employees with respect to, in particular, their status under the immigration or labor laws, were legitimate and appropriate, and were lawfully and correctly conducted. In particular, no persons were harmed, intimidated or maltreated, and every person's right have been fully respected, in compliance with the law. This is true, in particular, concerning Mr. Rashid Mahmud Badran, Mr. Nadir Zib Hourani and Mussa Adbul Gani.[316]

(d) The "2009 KNB Investigations"

240. Mr. Daulbaev explains that the investigations and actions of the KNB which, primarily, have consisted in the seizures of documents and other material of CIOC in April 2009, are part of investigations regarding illegal awarding of contracts in Kazakhstan. He indicates that these investigations are on-going

241. In this regard, Mr. Daulbaev points to the circumstances of the awarding of the Contract to CCC followed by its immediate assignment to CIOC and subsequent acquisition of 85% of CIOC's capital by Devincci Hourani.

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[314] **Ex. R-37**, Order on the Arrest of Funds in CIOC's Bank Account dated June 20, 2008.

[315] Askhat Daulbaev Statement, ¶ 46.

[316] *Id.*, ¶ 56.

242. Mr. Daulbaev also corrects the inaccurate and wrong depiction of the KNB intervention by CIOC. He also indicates that the KNB agents did not carry weapons during these interventions, but that the Caratube oil field is guarded by armed gunmen hired by CIOC.

243. Mr. Daulbaev states that these investigations by the KNB, including the seizures and the related interviews of witnesses were legitimate and appropriate, and were lawfully conducted by the KNB. He confirms that no one was maltreated and that everyone's rights were fully respected.

244. It is entirely legitimate for the competent State authorities to investigate the circumstances surrounding the awarding and assignment of the Contract. Moreover, when the KNB seized CIOC's documents, the Contract had already been terminated for a year and a half. It thus cannot be said the KNB seizures form part of an alleged harassment campaign that led to the Termination.

245. Daulbaev concludes:

> I wish to personally state to the ICSID Tribunal that CIOC, its shareholders and related persons have not been subject to any harassment. I can further state that the Prosecutor's Office, including me, has not received any instructions from anyone to conduct any investigations or take any actions against CIOC, its shareholders or related persons. All the actions and investigations that have been conducted, directed or ordered by the Prosecutor's Office or by other State agencies (which are all supervised by the Prosecutor's Office in matters of law enforcement) with respect to CIOC, its shareholders or related persons have been exclusively motivated by legitimate and lawful law enforcement concerns.[317]

[317] *Id.*, ¶ 61.

D. The Republic Has Not Expropriated any Property from CIOC

246. Despite the weight of the evidence set out above proving that the Termination was rightful, CIOC argues that a "wrongful" termination of the Contract resulted in the expropriation of its investment and specifically of "the package of long-term rights which it enjoyed under the Contract to explore for and commercially develop hydrocarbons."[318] In order to properly examine a claim of expropriation it is necessary first examine what the legal standard of such a claim is and consequently what the burden of a successful claimant is.[319] Next, the facts of the case must be analyzed in order to determine whether the claimant has met that burden. When applied to the circumstances of this case, this analysis shows that CIOC has not discharged its burden and cannot prevail on its expropriation claim.

247. CIOC alleges that its rights have been expropriated in violation of Article III of the BIT. This Article provides:

> Investments shall not be expropriated or nationalized either directly or indirectly through measures tantamount to expropriation or nationalization ("expropriation") except: for public purpose; in a non-discriminatory manner; upon payment of prompt, adequate and effective compensation; and in accordance with due process of law and the general principles of treatment provided for in Article II(2).[320]

248. Both the BIT and international law recognize two categories of expropriation, direct (*de jure)* and indirect (*de facto).* "The difference between a direct or formal expropriation and an indirect expropriation turns on whether the legal title of

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[318] CIOC's Memorial, ¶ 170.

[319] **Ex. RL-41**, *Tokios Tokelės v. Ukraine*, ICSID Case No. ARB/02/18, Award dated July 26, 2007, ¶ 121 (finding that the burden of demonstrating the impact of the State action indisputably rests on the claimant (*probandi actori incumbit*)).

[320] **Ex. C-1**, Treaty, Article III.

the owner is affected by the measure in question."[321] Direct expropriation occurs when a state seizes physical assets or deprives an investor of its legal rights or claims. Also referred to as "*de facto* expropriation" or acts that are "tantamount to" or "equivalent to" expropriation, indirect expropriation

> may take place through State measures other than direct taking of tangible property, such as taxation. When such interference occurs, the legal title to the property remains in the owner but, as a result of the host State measure, the investor's rights to use of the property are rendered nugatory, or lack the economic value they previously had.[322]

249. CIOC, in its filings, does not clearly state which of these types of expropriation it has allegedly suffered.[323] CIOC's only mention of the distinction comes in a footnote in its Memorial where it refers to an argument in the alternative of indirect expropriation.[324] Presumably, if this is an argument in the "alternative," then CIOC's primary argument must be one of direct expropriation. However, in this case there cannot be a direct expropriation because there has been no sovereign act, *iure imperi*, which deprived CIOC of any legal right. This case, as shown above, relates to a contract termination by a contracting party under the terms of the underlying contract. This is, however, merely an academic question, since CIOC cannot plead a successful claim of either direct or indirect expropriation.

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[321] **Ex. RL-11**, Dolzer and Schreuer, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW, at 92.

[322] **Ex. RL-42**, *Archer Daniels Midland Company et al v. The United Mexican States,* ICSID Case No. ARB(AF)/04/5, Award dated November 21, 2007 ("*ADM*"), ¶ 238.

[323] A claim of expropriation should be stated as one of indirect or direct expropriation not both: "In fact, if a given measure qualifies as a form of direct expropriation it cannot at the same time qualify as an indirect expropriation, as their nature and extent are different. The converse is also true." **Ex. RL-43**, *Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic*, ICSID Case No. ARB/01/3, Award dated May 22, 2007, ¶ 250.

[324] CIOC's Memorial, fn. [206], at 58.

1) Standard for Claims of Expropriation

250. A claimant has a burden to prove the elements of expropriation in order to prevail on its claim. In summary, those elements are an 1) unreasonable substantial deprivation of existing rights; 2) of a certain duration; and 3) caused by a sovereign act of the host state.

251. Therefore, to state a successful claim of expropriation a claimant must first show that it actually held the rights it alleges were expropriated.[325] Since rights can only be taken from one who "owns" them, the rights or claims subject to the deprivation must exist under the law that creates them.[326] Further,

> [t]he property rights that are the subject of protection under the international law of expropriation are created by the host State law. Thus, it is for the host State law to define the nature and extent of property rights that a foreign investor can acquire.[327]

252. Finally, only rights that are vested at the time of the expropriatory act can be the object of an expropriation and thus when evaluating whether an expropriation has occurred, the tribunal must identify "the Claimant's investment in the form it existed at the time" of the allegedly expropriatory act.[328] The facts in the *Generation Ukraine*

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[325] **Ex. RL-44**, *Bayindir Insaat Turizm Ticaret Ve Sanayi A.Ş. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/03/29, Award dated August 27, 2009 ("*Bayindir*"), ¶ 442 (the first step in the expropriation analysis is to "identify the assets allegedly expropriated").

[326] **Ex. RL-45**, *EnCana Corporation v. Republic of Ecuador*, LCIA Case No. UN3481, Award dated February 3, 2006, 12 ICSID REPORTS 427 (2007), ¶ 184.

[327] **Ex. RL-37**, McLachlan et al, INTERNATIONAL INVESTMENT ARBITRATION, ¶ 8.65, at 289.

[328] **Ex. RL-46**, *Generation Ukraine Inc. v. Ukraine*, ICSID Case No. ARB/00/9, Award dated September 16, 2003, 10 ICSID REPORTS 240 (2006) ("*Generation Ukraine*"), ¶ 20.26 (finding claimant's argument "seriously flawed" where claimant assumed it had a vested right in the completed project). Notably, in the cases relied on by CIOC, there was no dispute that the claimants in those cases held vested contract rights. *See,* **Ex. CA-31**, *Southern Pacific Properties (Middle East) Limited v. Arab Republic of Egypt*, ICSID Case No. ARB/84/3, Award on the Merits dated May 20, 1992, 8 ICSID Review – Foreign Investment Law Journal 328 (1993) ("*SPP ICSID*"), ¶ 164; **Ex. CA-35**, *Middle East Cement Shipping and Handling Co. S.A. v. Arab Republic of Egypt*, ICISD Case No. ARB/99/6, Award dated April 12, 2002, ¶ 107.

case are illustrative. In that case the claimant argued that certain of its prospective, contingent rights had been expropriated.[329] The tribunal found that such arguments were "seriously flawed" and held that only vested rights and not those contingent on future events could be expropriated.[330]

253. Once a claimant has shown that it actually owns and has a vested interest in the rights it alleges have been expropriated, it must then show that it has been the victim of a "substantial" deprivation of those rights. In determining whether an interference amounts to an expropriation, "the test is whether that interference is sufficiently restrictive to support a conclusion that the property has been 'taken' from the owner."[331] In a recent award, an ICSID tribunal surveyed cases in which expropriation had been alleged and noted that the

> level of interference with rights has been variously described as '*unreasonable*'; 'an interference that renders rights so *useless* that they must be deemed to have been expropriated'; 'an *interference that deprives* the investor of the *fundamental rights of ownership*'; 'an interference that makes rights *practically useless*'; 'an interference *sufficiently restrictive* to warrant a conclusion that the property has been 'taken''; 'an interference that makes *any form of exploitation* of the property disappear'; [and] 'an interference such that the property *can no longer be put to reasonable use*'.[332]

254. To support an expropriation claim, the deprivation must not only be substantial and relate to an existing right, it must also be lasting. There is no clear test as to how long a deprivation must continue before it can amount to expropriation;

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[329] **Ex. RL-46**, *Generation Ukraine*, ¶ 20.27.

[330] *Id.*, ¶ 20.26.

[331] **Ex. RL-47**, *Pope & Talbot Inc. v. Government of Canada*, NAFTA, Interim Award dated June 26, 2000, 7 ICSID REPORTS 69 (2005), ¶ 102.

[332] **Ex. RL-48**, *Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania*, ICSID Case No. ARB/05/22, Award dated July 24, 2008 ("*Biwater*"), ¶ 463 (emphasis added) (internal citation omitted).

however, it is well recognized that the deprivation cannot be fleeting and in at least one instance a tribunal has held that it must be permanent.[333]

255. Finally, the deprivation must arise from a sovereign act and thus from the occurrence of a State using its sovereign powers rather than incident to a state acting in a private manner. Certainly, where, as here, a private actor's rights were lost because of its own misdeeds and not because of sovereign interference by the state, there can be no expropriation. Rather, the claimant must show that each of the sub-factors of this element is met. Specifically, the successful claimant must both be able to show that there was a sovereign act and also that the sovereign act, and not some other event or non-sovereign act, caused the loss of rights at issue.

256. Thus, expropriation can only occur where the state actor engages in behavior, such as withholding tax refunds, denying access to courts or enacting laws, that is not available to an ordinary private party to a contract.

> [T]he critical distinction is between situations in which a State acts merely as a contractual partner, and cases in which it acts '*iure imperi*', exercising elements of its governmental authority.[334]

257. The weight of authority is conclusive and the breach of a contract, much less the exercise of legitimate termination rights under a contract, by a state actor, even when proved, does not amount to expropriation as a matter of international law.[335] A

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[333] **Ex. RL-42**, *ADM*, ¶ 240 (duration is of key importance); **Ex. RL-49**, *LG&E Energy Corp. et al v. Argentine Republic*, ICSID Case No. ARB/02/1, Decision on Liability dated October 3, 2006, 21 ICSID REVIEW – FOREIGN INVESTMENT LAW JOURNAL 203 (2007), ¶ 193 (holding that deprivation must be permanent absent special circumstances).

[334] **Ex. RL-48**, *Biwater*, ¶ 458.

[335] *See, e.g.*, **Ex. RL-50**, *Impregilo S.p.A. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/03/3, Decision on Jurisdiction dated April 22, 2005 ("*Impregilo*"), ¶ 281; **Ex. CA-49**, *Waste Management, Inc. v. United Mexican States*, ICSID Case No. ARB/(AF)/00/3, Award dated April 30, 2004 ("*Waste Management*"), ¶ 174; **Ex. RL-51**, *Parkerings–Compagniet AS v. Republic of Lithuania*, ICSID Case No.

state cannot be deemed to have expropriated an investor's property simply by exercising its own rights under an investment agreement:

> it is the Tribunal's view that only measures taken by [the State] in the exercise of its sovereign power ("*puissance publique*"), and not decisions taken in the implementation or performance of the Contracts, may be considered as measures having an effect equivalent to expropriation.[336]

258. Further, not only is there no expropriation where a state acts pursuant to a contract, there can also be no expropriation where a loss of the rights occurs in the framework of a contract even if the state failed to perform that contract:

> In the present case, the Claimant has suggested that a breach of the Contract as a result of governmental directives would suffice for a finding of expropriation. The Tribunal disagrees. First, not every contract breach deprives an investor of the substance of its investment. Second, even where it does and the breach stems from a governmental directive, it would not necessarily follow that the contractual breach is the result of a sovereign act, as a directive of the State may be given in the framework of the contract.[337]

259. This principle is also set out in the oft-cited *Waste Management* decision:

> The mere non-performance of a contractual obligation is not to be equated with a taking of property, nor (unless accompanied by other elements) is it tantamount to expropriation. Any private party can fail to perform its contracts, whereas nationalization and expropriation are inherently governmental acts.[338]

260. To the contrary, to support a claim of expropriation a breach of contract must be perpetuated by sovereign means:

ARB/05/8, Award dated September 11, 2007 ("*Parkerings*"), ¶ 443; **Ex. RL-44**, *Bayindir*, ¶ 445; **Ex. CA-65**, *Siemens A.G. v. The Argentine Republic*, ICSID Case No. ARB/02/8, Award dated February 6, 2007 ("*Siemens*"), ¶ 253.

[336] **Ex. RL-50**, *Impregilo*, ¶ 281; *see also*, **Ex. RL-11**, Dolzer and Schreuer, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW, at 117.

[337] **Ex. RL-44**, *Bayindir*, ¶ 445.

[338] **Ex. CA-49**, *Waste Management*, ¶ 174.

> Not every failure by a government to perform a contract amounts to an expropriation even if the violation leads to a loss of rights under the contract. A simple breach of contract at the hands of the state is not an expropriation. Tribunals have found that the determining factor is whether the state has acted in an official, governmental capacity.[339]

261. Therefore, in order to be liable for expropriation of contractual rights a host state

> must use its public authority. The actions of the State have to be based on its 'superior governmental power'. It is not a matter of being disappointed in the performance of the State in the execution of a contract but rather of interference in the contract execution through governmental action.[340]

262. Further, in order to prove that an expropriation has occurred, a claimant must show not only that the host state has exercised sovereign authority, it must also show that it was the exercise of that sovereign authority that led to the loss of rights for which it seeks redress. Thus, the existence or non-existence of an expropriation must be "assessed on the basis of the effect of the measure in dispute on the investor."[341] Therefore if the measure did not have the effect of causing a loss of the investor's rights, then there can be no expropriation. Put conversely, if the sovereign act is not the cause of a loss, there is no expropriation. As one tribunal recently summarized:

> [A] breach of an agreement will amount to an expropriation only if the State acted not only in its capacity of party to the agreement, but also in its capacity of sovereign authority, that is to say using its *sovereign power*. The breach should be the result of this action. A State or its instrumentalities which simply breach an agreement, even grossly, acting as any other contracting party might have done, possibly wrongfully, is therefore not expropriating the other party.[342]

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[339] **Ex. RL-11**, Dolzer and Schreuer, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW, at 117.

[340] **Ex. CA-65**, *Siemens*, ¶ 253.

[341] **Ex. RL-37**, McLachlan et al, INTERNATIONAL INVESTMENT ARBITRATION, ¶ 8.85, at 296.

[342] **Ex. RL-51**, *Parkerings*, ¶ 443 (italic emphasis in original) (underline emphasis added).

263. Finally, in the specific circumstance of the present case, the situation where a state exercises its contractual right to terminate a contract, that act must be examined within the framework of the contract and not as a sovereign act where it can be shown that the contractor did not fulfill its performance obligations under that contract:

> [I]f the expulsion [of Bayindir] was lawful under the Contract, then there would be no taking of or interference with Bayindir's rights. Moreover, even if the expulsion was conducted in breach of the Contract, that would not as such be enough for a finding of expropriation under the Treaty.
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> [...]
>
> [E]ven if the expulsion violated the Contract and deprived Bayindir of the economic substance of its contract rights, a finding of expropriation would only be founded if the acts at issue were sovereign acts. The evidence ... shows that Pakistan can reasonably justify the expulsion by Bayindir's poor performance ... with the consequence that the expulsion must be seen in the framework of the contractual relationship, not as an exercise of sovereign power.[343]

264. In summary, where, as in the present case, the claimant's loss arose because of its own material breaches of the contract, no claim of expropriation can survive. This is so, in large part because the claimant cannot show a causal link between its loss and a state action. In such cases a tribunal cannot find that an expropriation has occurred:

> Accordingly, where the loss to the investor can be said to arise out of a bad investment decision, it will not be allowed to rely on any regulatory act that apparently takes away its property rights, as this is not the major cause of the loss. Only where a regulatory act is unforeseeable, and is the

[343] **Ex. RL-44**, *Bayindir*, ¶¶ 458, 461.

> primary, or at least a contributory, cause of the loss to the investor, will it be able to claim compensation.[344]

2) Analysis of CIOC's Claim Shows That It Has Not Met Its Burden

265. When the facts of this case are measured against the above legal standards, it is readily apparent that CIOC's expropriation claim is groundless. First, most if not all of the rights that CIOC alleges have been expropriated do not and have never existed. Second, to the extent CIOC actually had rights to lose and has now lost those rights, this loss was not caused by a sovereign act of the Republic. Finally, the acts of "harassment" that underpin all of CIOC's claims, even if they could be considered sovereign actions, are not a cause of, much less the cause of the termination of CIOC's contractual rights. Rather, any loss CIOC has suffered is a result of its own failure to perform the Contract and not the result of some alleged political plot. Each of these points is discussed below.

266. As the *Bayindir* tribunal noted, the first step in an expropriation analysis is to determine what rights or interests are alleged to have been expropriated.[345] The next step is to determine whether the Claimant actually possessed a vested interest in those rights.[346] CIOC goes to great lengths to argue that contract rights as a general matter can be expropriated, but nowhere does it define with clarity what rights it actually held, as opposed to those it hoped to hold at some unknown time in the future.[347]

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[344] **Ex. RL-52**, Peter Muchlinski, MULTINATIONAL ENTERPRISES & THE LAW (Oxford University Press 2007) (hereinafter "Muchlinski, MULTINATIONAL ENTERPRISES"), at 592; *see also*, **Ex.RL-46**, *Generation Ukraine*, ¶ 20.30 ("The fact that an investment has become worthless obviously does not mean that there was an act of expropriation; investment always entails risk. Nor is it sufficient for the disappointed investor to point to some government initiative, or inaction, which might have contributed to his ill fortune.").

[345] **Ex. RL-44**, *Bayindir*, ¶ 442.

[346] **Ex. RL-46**, *Generation Ukraine*, ¶ 20.26.

[347] CIOC's Memorial, ¶¶ 172-178 (Claimant spends its entire legal argument regarding expropriation discussing the uncontested point that contract rights can, in theory, be expropriated).

CIOC's only statement on this point is that "the package of long-term rights which it enjoyed under the Contract to explore for and commercially develop hydrocarbons" constitute the "rights" that have been subject to expropriation.[348] However, it is apparent from CIOC's damage requests that it defines the rights expropriated as all the rights that would have arisen had it sufficiently performed the Contract and fulfilled all the conditions precedent to move into the Production phase of the Contract. In doing so, CIOC confuses the notion of a vested right with that of an opportunity. CIOC had no automatic right to move to the Production phase under the Contract.[349] Rather, it had an exclusive opportunity to do so only upon the fulfillment of certain conditions precedent specified in the Contract.[350]

267. At the time of the Termination of the Contract, CIOC had failed to fulfill any of these conditions precedent. Thus, as more fully discussed in Section IV.A below no Commercial Discovery had been made. Further, even if such a Discovery had been made, CIOC never completed the administrative and reporting requirements required under the Contract before the Contractor can move to the Production Phase. As Mr. Ongarbaev states:

> In any event, CIOC did not make a Commercial Discovery. This is not a surprise since CIOC had failed to duly explore the Contract Area. A discovery presupposes the drilling of one or more prospective wells to demonstrate the presence of commercially recoverable oil not previously discovered. CIOC precisely failed to drill the 2 sub-salt prospective wells and did not discover anything.[351]

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[348] *Id.*, ¶ 170.

[349] Mirbulat Ongarbaev Statement, ¶¶ 119, 125-126.

[350] *See,* **Ex. C-4**, Contract No. 954, Sections 10.1, 10.3, 11.3 and 21.5.

[351] Mirbulat Ongarbaev Statement, ¶ 111.

268. In addition, to preserve the rights that it did actually hold, including the opportunity to vest the purely contingent rights, CIOC was obligated to perform its obligations under the Contract. Namely, it was required to comply with the Minimum Work Program. This is an obligation that CIOC never properly met. Thus, not only was CIOC still in the Exploration phase, it failed to fulfill its contractual commitments to progress from Exploration to Production:

> CIOC's Contract was in its exploration phase. Thus, by definition, CIOC's exploration obligations provided in the 5-Year Minimum Work Program are material obligations, and a breach of those obligations is a material breach.[352]

269. Moreover, the approval of a Development Plan by the Central Commission on Development of Oil and Gas of the MEMR was required before CIOC could start commercial production.[353] Mr. Ongarbaev states:

> Also, the preparation of a field development plan, assuming a proper one was effectively prepared, is not enough. The development plan must be approved by the Central Commission on Development (Section 11.3 of the Contract). Given CIOC's poor past performance, in particular CIOC's underperformance in trial production, one cannot assume that CIOC would have been able to present an adequate plan that could be approved.[354]

270. Therefore, CIOC had no vested interest in the Production of hydrocarbons from the Contract Area and therefore had no rights relating to those interests that could have been expropriated. The only rights that CIOC held at the time of the Termination were those granted to it under the Exploration Phase and a continuing opportunity to fulfill the requirements needed to move to the Production Phase. Those are the only

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[352] *Id.*, ¶ 41.

[353] **Ex. C-4**, Contract, Section 11.3.

[354] Mirbulat Ongarbaev Statement, ¶ 125.

rights CIOC held and thus the only ones it could have lost. It has now lost them. However, this loss was the result not of a sovereign act, but rather resulted from the exercise of termination rights by a State party to a contract faced with continued non-performance and material breach by its contractual counter-party.[355]

271. Just as it fails to explain what rights it alleges to have been expropriated, CIOC also fails to show what sovereign act caused the loss of the limited contractual rights it actually held. Instead, CIOC makes allegations of "harassment" that it claims amounted to the alleged expropriation. However, the loss of rights, instigated by CIOC's own non-performance, was carried out via the exercise of the Republic's termination rights under the Contract. As the long-line of authority discussed above shows, an exercise of rights under a Contract is not a sovereign act and thus cannot be a method of expropriation.

272. As seen above and in Mr. Daulbaev's Witness Statement, there is no causal link between the criminal investigations and the Termination. Therefore, to the extent that CIOC has identified any actual sovereign acts, those acts concern criminal investigations that have no causal relationship to CIOC's loss of its contractual rights. A quick analysis of CIOC's own characterization of that harassment underscores this point.[356] The criminal investigations that took place before the Termination were in fact unrelated to CIOC. The only other investigations that took place at that time were the various regulatory actions mentioned above, such as environmental and safety compliance, which were all legitimate actions. As to the post-Termination actions, it is a

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[355] The extent of Claimant's material breach is discussed at length in the Mirbulat Ongarbaev Statement and in Section III.B above.

[356] For a more through discussion of these points see Section III.B.

simple matter of logic that an act cannot be the cause of something that temporally precedes it. A future event cannot cause a past event.

273. CIOC's own characterization of the facts in this case proves that there is no causal link between the criminal investigations and the Termination of the Contract. CIOC states repeatedly that the investigators' questions focused not on CIOC, but on a criminal investigation of Devincci Hourani's brother, Issam, who notably, is not and apparently never has been an employee of CIOC much less one of its owners or directors.[357] This is but one example of a chronic problem in CIOC's arguments. Namely, CIOC fails to recognize that actions taken concerning Hourani family members, unnamed Hourani family companies and even Devincci Hourani in his personal capacity, are not actions taken against CIOC, who is the only Claimant in this matter. In reality, there is no causal link between actions taken concerning these persons and entities and CIOC's loss of rights. Thus even if one were to incorrectly assume that all of these actions took place as CIOC described and that they are in fact sovereign actions, the causal link necessary to prove expropriation is, nonetheless, missing.

274. It is difficult to imagine how "harassment" can lead to expropriation, but at a minimum, in order to prove such a claim a claimant would have to show that the harassment was of such a degree that it was forced to abandon its investment. Such a scenario is not what occurred here. To the contrary, CIOC's rights in the Contract were terminated because of CIOC's own material breach. The cause of CIOC's loss of its rights in the Contract is, simply put, its own behavior. Had CIOC actually performed its

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[357] *See,* CIOC's Memorial, ¶¶ 53, 56; Devincci Hourani Statement, ¶ 38.

obligations under the Contract in good faith, there would be no dispute between the Parties today.

275. Therefore, CIOC lost its rights under the Contract not because of any sovereign act. It lost those rights because it failed to perform its obligations and was thus in material breach of the Contract and consequently triggered the Republic's termination rights under that Contract. That the Republic has now exercised those termination rights does not mean that CIOC's assets have been expropriated. They have not. They have been lost due to nonperformance and the Tribunal should therefore not give credence to CIOC's expropriation claims.

E. The Republic Afforded CIOC Fair and Equitable Treatment

276. CIOC next alleges that the Republic breached its duty to treat CIOC fairly and equitably.[358] As is the case with all of CIOC's claims, it bases this claim on unsupported alleged facts and an incomplete characterization of arbitral precedent. Article II(2)(a) of the Treaty provides as follows:

> Investment shall at all times be accorded fair and equitable treatment (...).[359]

277. CIOC asserts that the duty to afford fair and equitable treatment obligates host states:

> (1) to provide a stable legal and business framework for investments made by foreign investors;
> (2) to act in good faith in respecting the legitimate expectations of foreign investors;
> (3) to act in a consistent, transparent and non-discriminatory manner; and
> (4) to act in accordance with due process and procedural propriety.[360]

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[358] *See,* CIOC's Memorial, ¶ 183.

[359] **Ex. C-1,** Treaty, Article II(2)(a).

[360] *See,* CIOC's Memorial, ¶¶ 195-196.

278. Where CIOC's analysis falters, however, is in its failure to properly define the scope of these factors. As a result, the fair and equitable treatment standard CIOC proposes is overly broad and must be rejected by the Tribunal. Further, CIOC fails to recognize that to properly analyze a claim of fair and equitable treatment one must take into account the totality of the circumstances and should not critique the state's behavior in the abstract. Nonetheless, even if one were to give this standard the expansive meaning CIOC proposes, CIOC has failed to present evidence sufficient to support its claim and that claim must be rejected by this Tribunal.

1) Principles Underlying Fair and Equitable Treatment and the Proper Method of Analysis

279. To violate the duty of fair and equitable treatment, measures taken by the host state should show "a wilful neglect of duty, an insufficiency of action falling far below international standards, or even subjective bad faith."[361] Thus, the burden on a claimant who seeks to recover under such a claim is high.

280. The principle is, as its name suggests, an equitable principle and thus rather than apply rigid rules a tribunal should undertake a case-by-case analysis:

> [T]he standard is case specific and requires a flexible approach given that it offers a general point of departure in formulating an argument that the foreign investor has not been well treated by reason of discriminatory or other unfair measures that have been taken against its interests. Such case-specific flexibility may require an examination not only of governmental but also of investor conduct in a given case.[362]

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[361] **Ex. RL-53**, *Alex Genin et al v. The Republic of Estonia*, ICSID Case No. ARB/99/2, Award dated June 25, 2001, 17 ICSID REVIEW – FOREIGN INVESTMENT LAW JOURNAL 1 (2002) ("*Genin*"), ¶ 367.

[362] **Ex. RL-52**, Muchlinski, MULTINATIONAL ENTERPRISES, at 639 (internal citation omitted); *see*, **Ex. RL-54**, *Mondev International Ltd. v. United States of America*, ICSID Case No. ARB(AF)/99/2, Award dated October 11, 2002, 6 ICSID REPORTS 192 (2004) ("*Mondev*"), ¶ 118 ("A judgment of what is fair and equitable cannot be reached in the abstract; it must depend on the facts of the particular case.").

281. Thus when considering such a claim, the tribunal should not look at the state's conduct in the abstract, but rather should evaluate that conduct in light of the investor's own conduct:

> Investor conduct should be considered not only because it may break the chain of causation between the governmental act and the loss to the investor, but as a matter of principle and duty, so as to balance out the emergent duties of the host country to act with proper regard to good regulatory practice.[363]
>
> [...]
>
> Where unconscionable conduct is found, this may have serious consequences for any claim made by the investor. Evidence of such conduct may vitiate any right to a claim, especially if the regulatory response that is being challenged arises out of the application, by the host country, of its powers to punish the conduct through an interference with the investment.[364]

Tribunals have also followed this approach.[365] In doing so tribunals have emphasized that the state's actions should be evaluated in light of the conduct of the investor and thus tribunals must analyze whether those actions are a justifiable reaction to that conduct. Further, where it can be shown that the state's actions were a justifiable response to the investor's conduct, there can be no violation of the state's obligation to provide fair and equitable treatment.[366]

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[363] **Ex. RL-52**, Muchlinski, MULTINATIONAL ENTERPRISES, at 639 (internal citation omitted).

[364] *Id.*, at 640.

[365] **Ex. CA-58**, *Noble Ventures, Inc. v. Romania*, ICSID Case No. ARB/01/11, Award dated October 12, 2005 ("*Noble Ventures*"), ¶ 182; **Ex. RL-53**, *Genin*, ¶ 367.

[366] **Ex. RL-53**, *Genin*, ¶¶ 366-367.

2) The Obligation to Provide a Stable Legal Framework

282. The obligation to provide a stable legal framework is not, as CIOC presumes, insurance against enforcement of a law, regulation or termination provision to the detriment of an investor. This is particularly true, as noted above, when the enforcement of that provision was instigated by the investor's own behavior.

283. Further, a state does not incur international responsibility for issuing legislation or administrative decrees in good faith, directed towards a public interest. For example, the tribunal in *Saluka*, a case relied on by CIOC,[367] recognized that a state would not be liable for the issuance and implementation of a regulatory measure aimed at the general welfare:

> It is now established in international law that States are not liable to pay compensation to a foreign investor when, in the normal exercise of their regulatory powers, they adopt in a non-discriminatory manner *bona fide* regulations that are aimed at the general welfare.[368]

284. Thus, a tribunal should not evaluate the investor's subjective expectation of how the investment will proceed and the profit it hopes to reap from it, but rather the tribunal should consider the objective expectations a rational actor would have under the circumstances:

> [T]he scope of the Treaty's protection of foreign investment against unfair and inequitable treatment cannot exclusively be determined by foreign investors' subjective motivations and considerations. Their expectations, in order for them to be protected, must rise to the level of legitimacy and reasonableness *in light of the circumstances*.
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> 305. No investor may reasonably expect that the circumstances prevailing at the time the investment is made

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[367] *See,* CIOC's Memorial, ¶ 194.

[368] **Ex. CA-50**, *Saluka Investments BV v. The Czech Republic*, UNCITRAL, Partial Award dated 16 March 16, 2006 ("*Saluka*"), ¶ 255.

> remain totally unchanged. In order to determine whether frustration of the foreign investor's expectations was justified and reasonable, the host State's legitimate right subsequently to regulate domestic matters in the public interest must be taken into consideration as well.[369]

285. Therefore, the tribunal must first consider the "context in which the Claimants knowingly chose to invest" including, where relevant, the youth of the host state and "the emergence of state institutions responsible for overseeing and regulating areas of activities perhaps previously unknown."[370]

286. The tribunal in *EDF Limited* recently re-iterated that the scope of an investor's legitimate expectations to a stable legal framework is limited by the regulatory activities of the state. In doing so the tribunal emphasized that an investor cannot have a *legitimate* expectation that it is insulated from changes in the legal and economic climate in the host state:

> The idea that legitimate expectations, and therefore FET, imply the stability of the legal and business framework, may not be correct if stated in an overly-broad and unqualified formulation. The FET might then mean the virtual freezing of the legal regulation of economic activities, in contrast with the State's normal regulatory power and the evolutionary character of economic life. Except where specific promises or representations are made by the State to the investor, the latter may not rely on a bilateral investment treaty as a kind of insurance policy against the risk of any changes in the host State's legal and economic framework. Such expectation would be neither legitimate nor reasonable.[371]

287. Moreover, the standard applicable to violations of the stability of the legal framework, and therefore to fair and equitable treatment, in the context of alleged

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[369] *Id.*, ¶¶ 304-305 (emphasis in original).

[370] **Ex. RL-53**, *Genin*, ¶ 348.

[371] **Ex. RL-55**, *EDF (Services) Limited v. Romania*, ICSID Case No. ARB/05/13, Award dated October 8, 2009 ("*EDF*"), ¶ 217 (emphasis added).

contractual breaches is heightened. In this sense, several tribunals have clearly stated that a contractual breach, since it is properly a non-sovereign act, does not imply a breach of an investment treaty. In a recent decision, the tribunal in *Bayindir*, relying on a long line of authority emphasized this point:

> Furthermore, because a treaty breach is different from a contract violation, the Tribunal considers that the Claimant must establish a breach different in nature from a simple contract violation, in other words one which the State commits in the exercise of its sovereign power.[372]

288. Claimant relies solely on the award in *CME* to support its expansive view of the legitimate expectations doctrine.[373] However, the facts and reasoning underlying the *CME* award are easily distinguishable from the present case and CIOC's reliance on it is misplaced. Specifically, the tribunal found that the claimant in that case was injured by a regulatory change and implementation of a new regulation, which resulted in the termination of the investment agreement.[374] Further, the claimant's complaint was aimed at the regulatory authority and the regulation and not at the counter-party to the investment agreement.[375] In the present case, CIOC's complaints result from the termination of a contract by the counter-party to that contract. Further, that termination arose not because of a new law or regulation, in fact CIOC points to no such administrative or legislative change, but rather it came about because of the Republic's exercise of its termination rights under the investment agreement. In conclusion, as opposed to Claimant's unfounded assertion that a contractual breach by itself would

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[372] **Ex. RL-44**, *Bayindir*, ¶ 180 (internal citations omitted). *See also,* Sections III.D and III F herein fully discussing the non-sovereign nature of contractual acts.

[373] CIOC's Memorial, ¶ 189; **Ex. CA-46**, *CME Czech Republic B.V. (The Netherlands) v. The Czech Republic*, UNCITRAL, Partial Award dated September 13, 2001 ("*CME Partial*"), ¶ 611.

[374] **Ex. CA-46**, *CME Partial*, ¶¶ 133-136.

[375] *Id.*, ¶¶ 133-136.

constitute a "reversal" of the assurances made to an investor, the duty to provide a stable legal framework, does not insure an investor against risk and concerns matters of law, not contract.

3) Scope of Legitimate Expectations

289. The concept of legitimate expectations is closely tied to that of legal stability and legal commentators often consider them together. However, as CIOC apparently considers them as two, distinct obligations, they are so treated here. CIOC apparently infers from the general duty to respect the legitimate expectations of an investor, a duty to protect the investor from any alteration of its contractual rights. Authority and practice do no support such a conclusion.

290. The *Parkerings* tribunal stated that the expectations of contractual performance of a party are not necessarily expectations protected under an investment treaty:

> The expectation a party to an agreement may have of the regular fulfilment of the obligation by the other party is not necessarily an expectation protected by international law. In other words, contracts involve intrinsic expectations from each party that do not amount to expectations as understood in international law.[376]

291. Moreover, the tribunal in *Bayindir* also set clear limits on the extent and nature of legitimate expectations that can arise with respect to a contractual relationship. Specifically, the tribunal stated that it must take into account the terms of the contract as a factual element indicative of the legitimate expectations of the claimant. Thus, where a respondent acted in accordance with its contractual rights

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[376] **Ex. RL-51**, *Parkerings*, ¶ 344.

(including the right to terminate the contract), there is no violation of the fair and equitable treatment standard:

> [I]n the present context of a contractual relationship between Bayindir and the NHA, as the Respondent rightly stresses, the expectations of the Claimant are largely shaped by the contractual relationship between the Claimant and NHA. In this connection, there was no basis for the Claimant to expect that NHA would not avail itself of its contractual rights.[377]

292. The tribunal in *Pakerings* also confirmed that expectations are legitimate only if they arise from explicit commitments made by the state at the time of the investment:

> The expectation is legitimate if the investor received an explicit promise or guaranty from the host-State, or if implicitly, the host-State made assurances or representation that the investor took into account in making the investment. Finally, in the situation where the host-State made no assurance or representation, the circumstances surrounding the conclusion of the agreement are decisive to determine if the expectation of the investor was legitimate.[378]

293. These explicit commitments, in order to be considered legitimate for purposes of evaluating fair and equitable treatment, should not only be made by the state, they should also be made at the time that the investment decision was made and not afterwards.[379] In this sense, the tribunal in *Duke Energy v. Ecuador* held the following:

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[377] **Ex. RL-44**, *Bayindir*, ¶ 197.

[378] **Ex. RL-51**, *Parkerings*, ¶ 331 (internal citation omitted).

[379] *See*, **Ex. RL-56**, *Jan de Nul N.V. et al v. Arab Republic of Egypt*, ICSID Case No. ARB/04/13, Award dated November 6, 2008, ¶ 265 (finding that "the legitimate expectations that are protected are the ones at the time of the making of the investment."). The tribunal in *Bayindir* also noted that:

> Several awards have stressed that the expectations to be taken into account are those existing at the time when the investor made the decision to invest. [...] There is no reason not to follow this view here.

> [T]he legitimate expectations which are protected are those on which the foreign party relied when deciding to invest. [Agreements] concluded more than two years later [] can thus in no event give rise to expectations protected under the fair and equitable treatment standard.[380]

294. More recently, the tribunal in *EDF* confirmed this holding:

> Legitimate expectations cannot be solely the subjective expectations of the investor. They must be examined as the expectations at the time the investment is made, as they may be deduced from all the circumstances of the case, due regard being paid to the host State's power to regulate its economic life in the public interest.[381]

295. In sum, in the context of a contractual relationship, an investor's legitimate expectations are framed by the express commitments made by the state at the time the investment was made. Further, tribunals and commentators alike have repeatedly recognized that investment decisions do not take place in a vacuum and therefore, the risks faced by the investor should also be taken into account when evaluating what the legitimate expectations of an investor are.

> [I]n a market economy, a degree of independent judgment as to the scope of an investment risk will be expected of the investor. Not all investment risks can, or should, be protected against. This may prove inimical to the efficient functioning of a market economy, where the freedom of economic actors to make informed business judgments lies at the heart of the market mechanism. It is up to the firm to determine the risks and to develop an appropriate strategy to deal with them.[382]

296. The *Waste Management* tribunal, in an award cited by CIOC to define the fair and equitable treatment standard, concluded that international law did not have "the

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Ex. RL-44, *Bayindir,* ¶¶ 190-191 (internal citations omitted).

[380] **Ex. RL-57**, *Duke Energy Electroquil Partners & Electroquil S.A. v. Republic of Ecuador*, ICSID Case No. ARB/04/19, Award dated August 18, 2008 ("*Duke Energy*"), ¶ 365 (internal citation omitted).

[381] **Ex. RL-55**, *EDF*, ¶ 219.

[382] **Ex. RL-52**, Muchlinski, MULTINATIONAL ENTERPRISES, at 639.

function [...] to eliminate the normal commercial risks of a foreign investor, or to place on [the host State] the burden of compensating for the failure of a business plan."[383]

297. The role of the investor also affects the legitimacy of its expectations:

> The recent case-law on the scope of protection offered by [international investment agreements] appears to be developing a principle that the investor is bound to assess the extent of the investment risk before entering the investment, to have realistic expectations as to its profitability and to be on notice of both the prospects and pitfalls of an investment undertaken in a high risk-high return location. Any losses that subsequently arise out of an inaccurate risk assessment will be borne by the investor. They will not be recoverable under the terms of the investment treaty [...]. The development of such a principle is justified by the view that [international investment agreements], 'are not insurance policies against bad business judgments'.[384]

298. In support of its expansive interpretation of legitimate expectations, Claimant relies on two awards that are inapplicable here, *Tecmed* and *Eureko*.[385] Neither does anything to advance CIOC's argument. The issue in *Tecmed* arose from the state's unjustified refusal to renew a license needed by *Tecmed* to operate its business, not from a termination of the underlying contract.[386]

299. CIOC's reliance on *Eureko* is similarly misplaced. In particular, CIOC relies on the tribunal's statement that Poland violated the fair and equitable treatment standard by "consciously and overtly" breaching the investor's basic expectations by

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[383] **Ex. CA-49**, *Waste Management*, ¶ 177 (internal citation omitted).

[384] **Ex. RL-58**, Peter Muchlinski, *'Caveat Investor'? The Relevance of the Conduct of the Investor Under the Fair and Equitable Treatment Standard*, 55 INTERNATIONAL & COMPARATIVE LAW QUARTERLY 527 (2006), at 542 (internal citation omitted).

[385] CIOC's Memorial, ¶¶ 190-191; **Ex. CA-44**, *Técnicas Medioambientales Tecmed S.A. v. The United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award dated May 29, 2003, ("*Tecmed*"); **Ex. CA-43**, *Eureko B.V. v. Republic of Poland, Ad Hoc* Arbitration, Partial Award dated August 19, 2005 ("*Eureko*").

[386] Further, recently, the *Tecmed* case appears to have met with disfavor. *See*, **Ex. RL-44**, *Bayindir*, ¶ 179 ("The Tribunal also agrees with the Respondent that the *Tecmed* case lays out a broad conception of the FET standard.").

changing its privatization policy and rebuking its prior commitments. In the present case, there has been no evidence that there was such a system-wide change in government policy or a rebuke of commitments. To the contrary, this case involves nothing more than the state's legitimate exercise of its termination rights under an investment agreement.

4) Standards of Transparency, Due Process and Non-Discrimination

300. CIOC next relies on the *Waste Management* Award which noted that a breach of fair and equitable treatment can involve "*a lack of due process* leading to an outcome which offends judicial propriety – as might be the case with a manifest failure of natural justice in judicial proceedings or a complete *lack of transparency and candour in an administrative process*."[387] However, the *Waste Management* tribunal further clarified that in the context of an alleged fair and equitable treatment violation arising from a contractual relationship, contractual breaches could not amount to a violation of the fair and equitable treatment requirement unless the state's conduct was "wholly arbitrary" or "grossly unfair."[388] Thus the tribunal set a high bar for a claimant to prove a violation of the fair and equitable treatment obligation in the contractual context. In addition, the tribunal went on to note that if "some remedy" is available, even an aggrieved investor cannot prevail on a fair and equitable treatment claim.[389]

301. The hurdle is even higher where, as here, the state action was taken in response to the failures of the investor, itself. This was the scenario in the *Genin* case.

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[387] *See,* CIOC's Memorial, ¶ 193 (emphasis in original); citing **Ex. CA-49**, *Waste Management*, ¶ 98.

[388] **Ex. CA-49**, *Waste Management*, ¶ 115.

[389] *Id.*

In that case, the tribunal first concluded that the state's actions were justified and then held that:

> in order to amount to a violation of the BIT, any procedural irregularity that may have been present would have to amount to bad faith, a wilful disregard of due process of law or an extreme insufficiency of action.[390]

302. As is shown by the discussion above, CIOC misstates the scope and nature of the duty of fair and equitable treatment. However, as is shown by the analysis below, CIOC has not stated a successful claim under the fair and equitable provision of the BIT regardless of whether one gives it the scope afforded to it under arbitral precedent or whether one gives it the wider breadth advocated by CIOC and unsupported by precedent or commentary.[391]

5) CIOC Has Not Met Its Burden to Prove a Breach of the Fair and Equitable Treatment Standard

303. In accordance with the precedent outlined above, before considering whether the fair and equitable treatment standard has been breached, one must first examine the context in which the investment was made and also the context in which the allegedly violative state actions were taken. In this case, CIOC made its purported investment at a time when Kazakhstan was a fledgling nation with a rapidly evolving legal and regulatory regime.[392] Further, as is discussed at length herein and in the attached witness statements, the actions CIOC complained of were taken in reaction to CIOC's on-going material breaches of the Contract. Each of CIOC's complaints will be examined against this backdrop.

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[390] **Ex. RL-53**, *Genin,* at ¶ 371.

[391] Since they are largely duplicative of CIOC's arguments under Art. II(2)(b), CIOC's arguments regarding discrimination under Art. II(2)(a) are considered with those arguments below.

[392] Mirbulat Ongarbaev Statement, ¶ 31.

304. First, CIOC complains that Kazakhstan failed to provide a stable legal framework by subjecting it to inspections and investigations.[393] However, CIOC points to no change in implementation or application of the existing laws or regulations, much less to an actual change in the laws and regulations. CIOC presents no argument as to how the state measures it complains of violate the Republic's duty to provide a stable legal framework, however, one can only assume that CIOC equates the duty to provide a "stable" framework with a duty to refrain from enforcing legitimate and pre-existing laws and regulations against it. This of course is not what the Treaty is meant to do. The Treaty simply requires that the Republic enforce its laws and exercise its Contract rights fairly. It has fulfilled that duty.[394]

305. Next, CIOC argues that the Republic breached the duty of fair and equitable treatment by terminating the Contract and refusing to "respond" to its protestations that the termination was not warranted. Even if one ignores precedent and finds that the simple termination of a contract could give rise to a breach of fair and equitable treatment, CIOC has failed to provide any evidence to support its claim. As is set out above, the witness statement provided by Mr. Ongarbaev and the expert witness statement provided by Mr. Chugh, in the IFM Compliance Report, the Ministry was justified in its termination of the Contract. Further, as stated by Mr. Ongarbaev, Ministry officials did review the arguments and evidence presented by CIOC in support of its appeal to the Ministry not to terminate the Contract. The MEMR even accepted to participate in an unscheduled meeting with CIOC's representatives in March 2008.

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[393] CIOC's Memorial, ¶ 197.

[394] Askhat Daulbaev Statement, ¶ 61.

However, what CIOC refuses to admit is that the evidence it presented to Ministry officials was wholly unpersuasive:

> CIOC's representatives did not convince us at all that CIOC was right. We had terminated CIOC's Contract for material breaches and CIOC presented us with no new elements. We thus had no reason to reconsider the termination decision.[395]

More generally, as reported by Mr. Ongarbaev:

> After the termination of the Contract, CIOC as well as Mr. Devincci Salah Hourani, wrote various letters contesting the termination of the Contract. The MEMR reviewed their statements and arguments. However, these statements and arguments did not alter the MEMR's position that the termination was rightful and justified by the material breaches of CIOC.[396]

For the reasons discussed at length in Mr. Ongarbaev's statement and confirmed in the expert report of Mr. Chugh, the Ministry was rightfully un-persuaded by CIOC's arguments.

306. CIOC's next argument is that the Republic violated its legitimate expectations by apparently causing it to expect, despite its chronic nonperformance, that it would be allowed to continue operating under the Contract and would be given a production license. As support for this, CIOC argues that these expectations were "created" when CIOC was permitted to exercise its right to a two-year extension of the Exploration phase of the Contract and by the local authorities' approval of the 2008 Work Program. CIOC's argument fails from the start. As the precedent clearly shows, legitimate expectations are created at the time of the investment and thus cannot be created by subsequent acts. Further, even if one could properly consider the measures

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[395] Mirbulat Ongarbaev Statement, ¶ 81.

[396] *Id.*, ¶ 79.

CIOC points to as the basis of a legitimate expectation, one cannot infer from them any expectation that CIOC would be allowed to continue the Contract, much less that it would be allowed to enter the Production phase. This is so because one must consider the totality of the circumstances when evaluating whether the expectations held by a claimant are in fact legitimate. Where a contracting party is in a permanent state of breach, there can be no expectation, much less a legitimate one, that the counter-party to that contract will not exercise its termination rights. Moreover, when CIOC exercised its extension right in November 2006, CIOC was still under the request of the February 28, 2006 Notice, to remedy its breaches in 2006. What is more, the MEMR sent the March 25, 2007 Notice of Breach in the middle of the extension process.

307. CIOC's argument also fails because the evidence provided for it is wholly insufficient. First, as is noted by Mr. Ongarbaev in his statement, the extension cannot be considered an acceptance of CIOC's past performance.[397] Rather, CIOC had an express contractual right to that extension. Further, the approval of the 2008 Work Program most certainly does not indicate that CIOC would be allowed to move to the Production phase. To the contrary, even if the Contract had not been terminated, CIOC would have actually had to among other things, fulfill that Work Program and make a Commercial Discovery in order to move into the Production phase. Given its failure to perform to date, there can be no expectation, much less a legitimate one, that it would have done so.

308. CIOC next argues, based on the same evidence as it presented for its legitimate expectations argument, that the Republic failed to act in a transparent,

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[397] Mirbulat Ongarbaev Statement, ¶¶ 91-95.

consistent or non-discriminatory manner. CIOC does not elucidate how this evidence supports such a claim. Perhaps it fails to do so because the evidence provides no such support for the same reasons it does not support any of the other of CIOC's litany of claims. This point is discussed more fully below, however suffice it to say, that, as demonstrated by the conclusive evidence and witness statements submitted along with this Counter-Memorial, it is CIOC who has failed to present a "cogent" explanation for its actions (or more properly, inactions) regarding the Contract. The Republic, on the other hand, was well-justified in its decision to terminate the Contract.

309. Finally, CIOC argues that its due process rights were violated by the Republic's alleged failure to provide reasons for the Termination, for the Republic's "unsubstantiated allegations of wrongdoing" and alleged threats against CIOC's management and employees. CIOC presents no evidence in this regard and thus, it is CIOC's claim, and not the Republic's termination of the Contract that is unsubstantiated. Mr. Ongarbaev's statement confirms that the Termination was anything but unsubstantiated.[398] Moreover, it is supported by a long history of notices of breach. Further, Mr. Daulbaev similarly confirms that all investigations of CIOC, its employees, its managers and even the wholly unrelated investigations of the Hourani family and its purported companies were carried out in accordance with Kazakhstani law and thus did not violate CIOC's right to due process.[399]

310. In conclusion, the Republic did not breach its duty of fair and equitable treatment. When considering such a claim a tribunal must take into account the purported investor's own behavior. In the present case, CIOC refused and/or was

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[398] *See generally*, Mirbulat Ongarbaev Statement.

[399] Askhat Daulbaev Statement, ¶¶ 15, 25, 43, 55-56, 59, 61.

unable to perform its obligations under the Contract. The Republic had every reason to exercise its right to terminate the Contract and its exercise of that right does not give rise to liability under the Treaty.

F. The Republic Fulfilled Its Duty to Provide Full Protection and Security

1) Principles Underlying the Full Protection and Security Obligation

311. CIOC alleges that the Respondent is in breach of the full protection and security obligations of the U.S.-Kazakhstan BIT by failing to safeguard the physical integrity and legal security of its purported investment.[400] In doing so, CIOC not only greatly overstates the scope of the Republic's obligation to provide full protection and security, it also fails to present facts to show a breach of that standard even if one assumes for the purposes of argument that the scope is as expansive as CIOC suggests.

312. Article II(2)(a) of the U.S.-Kazakhstan BIT provides:

> Investment shall at all times be accorded fair and equitable treatment, shall enjoy full protection and security and shall in no case be accorded treatment less than that required by international law.[401]

313. Claimant misconstrues this obligation when it asserts that it encompasses an obligation to provide both physical and legal security to its investment.[402] One only needs to look at the well-established principles of international law, to realize that this obligation is much narrower than CIOC contends. The historical and accepted interpretation of this obligation holds that it is an obligation of due diligence that must be

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[400] CIOC's Memorial, ¶¶ 205, 207.

[401] **Ex. C-1**, Treaty, Article II2(a). The obligation to provide fair and equitable treatment is discussed separately in Section III.E above.

[402] CIOC's Memorial, ¶¶ 205,207.

analyzed according to the circumstances under which the purportedly infringing actions were taken and not under a strict liability standard.[403] As such, as is discussed further below, when evaluating a claim of breach of full protection and security, a tribunal must compare the state actions at issue to those that any other state would have taken when confronted with similar circumstances. Finally, as is outlined below and contrary to what CIOC contends, as a matter of customary international law, the obligation does not include a duty to provide legal protection. Thus, given the legal standards concerned, a claim of violation of the full protection and security obligation is "not easily to be established" and it is therefore not surprising that CIOC has failed to do so in this case.[404]

314. The duty of full protection and security is a due diligence obligation that requires host states to take measures that are reasonable in the specific circumstances of the case:

> Although the host state is required to exercise an objective minimum standard of due diligence, the standard of due diligence is that of a host state in the circumstances and with the resources of the state in question. This suggests that due diligence is a modified objective standard – the host state must exercise the level of due diligence of a host state in its particular circumstances. In practice, tribunals will likely consider the state's level of development and stability as relevant circumstances in determining whether there has been due diligence. An investor investing in an area with endemic civil strife and poor governance cannot have the same expectation of physical security as one investing in London, New York or Tokyo.[405]

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[403] **Ex. CA-58**, *Noble Ventures*, ¶ 164; *see also* **Ex. RL-36**, *Pantechniki*, ¶ 81 (following Newcombe and Paradell and recognizing due diligence standard and objective nature thereof); **Ex. CA-47**, *Ronald S. Lauder v. The Czech Republic*, UNCITRAL Case, Final Award dated September 3, 2001("*Lauder*"), ¶ 308 (also finding that the duty to provide full protection and security imposes a duty to exercise reasonable due diligence).

[404] **Ex. CA-58**, *Noble Ventures*, ¶ 165.

[405] **Ex. RL-59**, Andrew Newcombe and Lluís Paradell, LAW AND PRACTICE OF INVESTMENT TREATIES:

315. Rudolph Dolzer and Christoph Schreuer explain the obligation and its objective nature in similar terms:

> In terms of the law of state responsibility, the host state is not placed under an obligation of strict liability to prevent such violations. Rather, it is generally accepted that the host state will have to exercise 'due diligence' and will have to take such measures protecting the foreign investment as are reasonable under the circumstances.[406]

316. ICSID tribunals have also repeatedly confirmed that the obligation to provide full protection and security imposes a duty on the State to act with due diligence towards investments. The duty therefore requires a state to provide only the level of protection that is objectively reasonable under the circumstances.[407]

317. The terms "full" and "enjoy" when used in a BIT such as the Kazakhstan-U.S. BIT, should not be construed as a guarantee against all types of loss that could be suffered by an investor and do not convert the standard to one of strict liability.[408] Thus, in rejecting the argument that strict liability should apply, the *AAPL* tribunal described the appropriate method of analysis as follows:

> For sustaining said construction introducing a new type of objective absolute responsibility called 'without fault', the Claimant's main argument relies on the existence in the text of the Treaty of two terms: 'enjoy' and 'full', a combination which sustains, according to the Claimant, that the Parties intended to provide the investor with a 'guarantee' against all losses suffered due to the destruction of the investment for whatever reason and without any need to establish who was

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STANDARD OF TREATMENT, (Kluwer Law International 2009) (hereinafter "Newcombe and Paradell, LAW AND PRACTICE OF INVESTMENT TREATIES"), ¶ 6.44, at 310.

[406] **Ex. RL-11**, Dolzer and Schreuer, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW, at 149-150.

[407] *See*, **Ex. RL-36**, *Pantechniki*, ¶ 81 (following Newcombe and Paradell and recognizing due diligence standard and objective nature thereof); **Ex. CA-58**, *Noble Ventures,* ¶ 164 (noting that the full protection and security obligation is one of due diligence); **Ex. CA-47**, *Lauder*, ¶ 308 (also finding that the duty to provide full protection and security imposes a duty to exercise reasonable due diligence).

[408] **Ex. RL-60**, *Asian Agricultural Products Ltd. (AAPL) v. Republic of Sri Lanka*, ICSID Case No. ARB/87/3, Final Award dated June 27, 1990, 4 ICSID REPORTS 250 (1997) ("*AAPL*"), ¶¶ 45-46.

> the person that caused said damage. In other words, the Parties substituted the 'due diligence' standard of general international law by a new obligation creating an obligation to achieve a result ('obligation de résultat') providing the foreign investor with a sort of 'insurance' against the risk of having his investment destroyed under whatever circumstances.
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> 46. The Tribunal is of the opinion that the Claimant's construction of [the full protection and security provision] as explained herein-above cannot be justified....[409]

318. Therefore, before finding a violation of this obligation a tribunal must examine the identity of the perpetuator of the allegedly offensive action and then must examine the reason for the state action or inaction. Only by performing this analysis can a tribunal determine whether the state's actions or inactions were reasonable under the circumstances.

319. Thus, in order to determine whether there has been a violation of the full protection and security standard, a tribunal must compare the actions taken or not taken by a state with those that any other state would have taken or refrained from taking in the same situation. Such a comparison is necessary since, as stated above, the full protection and security obligation requires a state to take the "reasonable measures of prevention which a well-administered government could be expected to exercise under similar circumstances."[410] Thus, it is clear, that a host state cannot be considered to be "an insurer or a guarantor of [] security ... [a state] does not, and could hardly be asked to, accept an absolute liability for all injuries to foreigners."[411]

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[409] *Id.*

[410] **Ex. RL-61**, Alwyn V. Freeman, *Responsibility of States for Unlawful Acts of their Armed Forces*, RECUEIL DES COURS DE L' ACADEMIE DE DROIT INTERNATIONAL DE LA HAYE (1957), at 15-16.

[411] *Id.*, at 14.

320. Moreover, as noted above, the burden to show a violation of the full protection and security standard is a high one.[412] The *AAPL* tribunal noted that as a matter of international law: "international responsibility of the State is not to be presumed" and as such a "party alleging a violation of international law giving rise to international responsibility has the burden of proving the assertion."[413] Thus, as that tribunal expressly stated, the investor who invokes a violation of the full protection and security standard "assumes a heavy burden of proof."[414]

321. Professor Paulsson similarly criticized claimants who, as CIOC has done, make unsubstantiated claims. In the words of Paulsson:

> [A] claim before an international tribunal simply cannot be made good by casual references to general perception. Specific conduct must be alleged and *proved*. So must its purported effect. [415]

322. It is also not enough to presume or even prove the participation of state officials in the offending action. The claimant must show that that state action or inaction "prejudiced [it] to a material degree" and must "prove that its alleged injuries and losses could have been prevented had the [state] exercised due diligence."[416]

323. In effect, in order to prove the liability of a state, a claimant must show that the whole state system has failed to afford the investor with the reasonable protection required by the obligation. Thus, before presenting a claim to an international tribunal, a claimant must give the state an opportunity, through its judicial and administrative

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[412] **Ex. RL-36**, *Pantechniki*, ¶ 83; **Ex. CA-58**, *Noble Ventures*, ¶ 165.

[413] **Ex. RL-60**, *AAPL*, ¶ 56.

[414] *Id.*, ¶ 58.

[415] **Ex. RL-36**, *Pantechniki*, ¶ 83 (emphasis added).

[416] **Ex. CA-58**, *Noble Ventures*, ¶ 166.

organs, to remedy the situation.[417] If the state does correct the situation or finds that state officials acted in accordance with the law, and in doing so finds that there was no problem in need of correction, then no violation of the standard can be found.[418] This was recognized by the *Lauder* tribunal:

> The Respondent's only duty under the Treaty was to keep its judicial system available for the Claimant and any entities he controls to bring their claims, and for such claims to be properly examined and decided in accordance with domestic and international law.[419]

324. The *Lauder* tribunal further found that an investor had effectively acquiesced to the allegedly offensive state action when the investor failed to bring a claim of redress before the proper forum.[420]

2) Acts Taken Within the Exercise of Legitimate State Powers Cannot Be the Basis of a Full Protection and Security Claim

325. Acts taken according to normal and lawful administrative, judicial or prosecutorial proceedings do not run afoul of the full protection and security obligation. In cases where a breach of this obligation has been proved, third parties or state entities acted outside the scope of their legal powers or acted outside the normal legal

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[417] In the words of Ian Brownlie:

> Where the state authorities cause injury to the alien visitor, for example in the form of brutality by police officials, then the legal position is clear. The host state is responsible, but, as a condition for the presentation of the claim by the state of the alien, the latter is required to exhaust the remedies available (where this is so) in the local courts. The reasons for this particular condition of admissibility are practical: small claims by individuals are handled better in municipal courts.

Ex. RL-62, Ian Brownlie, PRINCIPLES OF PUBLIC INTERNATIONAL LAW (Oxford University Press, 7th ed. 2008), at 523 (internal citation omitted).

[418] *Id.*, **Ex. CA-43**, *Eureko*, ¶¶ 236-237.

[419] **Ex. CA-47**, *Lauder*, ¶ 314 (finding no violation of full protection and security obligation where host state's judicial system was readily available to entertain investor's complaints).

[420] **Ex. CA-47**, *Lauder* ¶¶ 271-273.

framework.[421] Thus, it can be presumed that where a state and its organs act in accordance with national legislation and in doing so respects the investor's due process rights, there can be no breach of full protection and security.

326. The *Lauder* tribunal discussed this point at length. In that case the tribunal was asked to determine whether a state entity acting within the scope of its legal powers could violate the state's duty to provide full protection and security. The tribunal found that such action did not violate the duty where

> administrative proceedings were initiated because there were objective grounds for suspecting a breach of the law, especially when similar proceedings were commenced against others in a similar situation.[422]

3) The Obligation to Provide Full Protection and Security Does Not Include a Duty to Provide Legal protection

327. As CIOC itself recognizes, legal protection is not part of the customary international law standard of full protection and security.[423] In rare cases tribunals have discussed the legal protection issue when analyzing whether intangible assets, and thus assets not capable of being physically harmed, could be deprived of full protection and security.[424] However, those cases are largely limited to cases in which the BIT at issue included more expansive wording, and thus a more expansive obligation than that in the present case.[425]

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[421] *See e.g.*, **Ex. CA-46**, *CME Partial*, ¶ 613.

[422] **Ex. CA-47**, *Lauder*, ¶¶ 238, 248-249. It should be noted that the tribunal found that this holding applied equally to the finding that there was not a discriminatory measure as well as to the standard of full protection and security. *Id.*, ¶ 310.

[423] Claimant recognized this when it stated that "[t]he obligation to ensure *'full protection and security'* primarily creates an obligation upon the host State to protect investments from physical harm or violations." CIOC's Memorial, ¶ 204 (emphasis in original).

[424] **Ex. CA-65**, *Siemens*, ¶ 303; **Ex. CA-45**, *Azurix Corp. v. The Argentine Republic*, ICISD Case No. ARB/01/12, Award dated July 14, 2006, ¶¶ 406-408.

[425] For example, in the Siemens case the tribunal employed this approach because "the Treaty refers to

328. Not only does the Kazakhstan-US BIT not include wording that would allow the Tribunal to expand the obligation, the Letter of Transmittal from the U.S. Department of State to the U.S. Senate regarding the BIT also expressly limits the standard to its traditional concept and thus limits it to the physical protection provided for in customary international law. When describing the purpose of the full protection and security clause in the BIT, the Transmittal Letter states: "[t]his paragraph sets out a minimum standard of treatment based on customary international law."[426]

329. Moreover, in those exceptional situations in which legal protection was included as part of the obligation, the offense at issue related to the enactment and implementation of a law or regulation which was allegedly in breach of the full protection and security standard. This is the case in the *CME* Award, the only legal authority cited by Claimant in support of its allegation that the full protection and security obligation includes a duty to provide legal security.[427] However, as CIOC has neither alleged that the enactment of a law targeted its investment, nor that the Republic's judicial or administrative bodies failed to comply with due process, that case is inapplicable here.

4) CIOC Has Not Met Its Burden to Prove a Breach of Full Protection and Security

330. Learned tribunals have repeatedly acknowledged that the burden to prove a breach of a treaty's full protection and security obligation is a high one that must be

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'legal security.'" **Ex. CA-65**, *Siemens*, ¶ 301. The exact terms used in Article 4(1) of the Argentina-Germany BIT are "*las inversiones de nacionales o sociedades de una de las Partes Contratantes gozarán de plena protección y seguridad jurídica en el territorio de la otra Parte Contratante.*" (*Investments from a national or companies from a Contracting Party shall enjoy full protection and legal security in the territory of the other Contracting Party*); **Ex. RL-63**, Bilateral Investment Treaty celebrated between the Argentine Republic and the Federal Republic of Germany, Article 4(1).

[426] **Ex. C-1**, Treaty, Letter of Transmittal.

[427] CIOC's Memorial, ¶ 206; **Ex. CA-46**, *CME Partial*, ¶ 613.

supported by conclusive evidence.[428] Further, not only must the putative claimant show that the acts it claims occurred actually did occur, it must also show that they are indicative of the state's failure to act with due diligence to protect the integrity of the claimant's investment. CIOC in this case has failed to meet this burden. This failure comes to light when one examines the acts CIOC alleges violated its right to full protection and security, the evidence presented to support those allegations and finally the level of due diligence required by a state in the Republic's position.

331. To support its full protection claim, CIOC makes the same vague and unsubstantiated allegations of harassment that it makes with regard to all of its claims. Specifically CIOC points to the following: (i) "harassment" in various administrative proceedings; (ii) "illegal detentions and interrogation" by judicial and administrative officers; (iii) "repeated and abusive raids, searches, and audits by multiple and overlapping agencies;" (iv) "false allegations of criminal conduct and attempted extortions;" and (v) "threats to the personal safety and well-being" by means of telephone calls from supposed Kazakhstani agents.[429]

332. In reality the actions of the authorities of the Republic were legal, were not abusive, had a legitimate purpose and most certainly did not amount to a scheme of harassment.[430] As has been set out repeatedly in the Republic's response to CIOC's duplicative claims, the acts CIOC finds offensive can be divided into two categories. First are those aimed at preventing illegal activities within Kazakhstani borders that have nothing to do with CIOC, the Contract or the performance thereof. The second

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[428] **Ex. CA-58**, *Noble Ventures,* ¶ 165; **Ex. RL-36**, *Pantechniki*, ¶ 83.

[429] CIOC's Memorial, ¶ 205.

[430] *See generally*, Askhat Daulbaev Statement.

actions do concern CIOC, but as explained in detail above and in the Askhat Daulbaev Statement, did not involve any harassment of CIOC, its principals and its employees.

333. The paucity of the evidence CIOC offers to support its claims underscores this point. Its sole source of support comes from two witness statements provided by Mr. Hourani and Mr. Antar of CIOC. Even if these statements are taken at face value, they cannot be considered evidence of the sort that would support a full protection and security claim. A quick examination of these statements reveals that they are replete with hearsay and assumption and are wholly lacking in documentary support.

334. In fact, CIOC begins its substantiation of the harassment claims by pointing to "rumours" of government interest in Hourani family members and businesses.[431] CIOC's attempts at substantiation continue in this vein and largely rely on hearsay from "trusted sources" without either naming those sources or presenting evidence to corroborate the hearsay CIOC claims is true.[432]

335. Further, even if one exempts CIOC from meeting its evidentiary burden and assumes for purposes of argument that the events unfolded as CIOC describes, CIOC has nonetheless failed to show that the Republic did not act with the level of due diligence required under the circumstances. To the contrary, when a state, in its role as a sovereign state, becomes aware of possible illegal activity and, when a state, in its role as a co-contracting party becomes aware of breaches by the other party to the Contract, that state must take appropriate actions. With regard to the first problem, any

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[431] CIOC's Memorial, ¶ 50.

[432] *See e.g.*, CIOC's Memorial, ¶ 51 (referring to unnamed sources), ¶ 57 (Hourani heard of threat from an unnamed "contact"), ¶ 59 (an unidentified caller threatened Hourani on an unverified call), ¶ 60 (unnamed secretary who did not present a witness statement was harassed), and ¶ 64 (a mysterious informant called "Malek" informed Hourani of a threat). *See also*, Devincci Hourani Statement, ¶¶ 30, 53 (relying on hearsay from unnamed CIOC employee).

state would investigate such activity as needed. With regard to the second problem, any state confronted with on-going material breach by a contractual counter-party would exercise its termination rights under that contract.

336. In its attempt to create a claim where none exists, CIOC repeatedly alleges, without any proof, that the two are causally linked. They are not. The Republic could have and would have terminated CIOC's Contract regardless of whether the company's primary shareholder's family was involved in a criminal investigation. Conversely, the Republic would have continued to investigate illegal activity regardless of whether family members of those involved in the activity held shares in a locally incorporated company.

337. CIOC's only response to this is that the criminal investigations are unfounded. However, this argument does nothing to remedy CIOC's failure to show a causal link between the "harassment" and the Termination. As has been stated repeatedly herein the administrative and regulatory inspections conducted regarding CIOC itself, as opposed to Issam Hourani (who, notably has no legal relationship with CIOC, the Claimant in this case), are not acts of harassment. They are an exercise of inspection rights explicitly provided for in the Contract and in the law.[433] Further, even if CIOC could show that the investigation of Issam Hourani was unfounded, and it cannot, that investigation caused no injury to CIOC itself and it is CIOC, and only CIOC, who is the Claimant in this Arbitration.

338. Similarly, CIOC has presented no proof of extraordinary involvement of the State as a whole. The audits and visits to its premises were all conducted according

[433] Askhat Daulbaev Statement, ¶ 55.

to Kazakhstani law.[434] These officials had a right according to Kazakhstani law to initiate proceedings against the company and, notably, CIOC has never argued otherwise. Lawful audits and investigations do not give rise to physical damages.

339. Finally, CIOC never alleges, much less proves, that it was somehow foreclosed from seeking redress for its alleged injuries in the relevant Kazakhstani courts. According to Hourani's own statement, CIOC had the awareness and resources to do so since it had the constant advice of attorneys and legal personnel.[435] Indeed, Mr. Hourani's statement shows that he had the wherewithal to initiate legal proceedings: "[w]hen Mr. Omran told me what had happened I called my family's solicitors in Kazakhstan and they helped Mr. Omran make a signed statement.... This statement was sent to the Prosecutor General's Office in the form of a complaint."[436]

340. Nevertheless and despite the ability to do so, Hourani never submitted a formal complaint on behalf of himself or, more importantly, CIOC. This unwillingness to work within normal judicial and administrative channels, while at the same time feigning disbelief that it was not given special treatment further undermines CIOC's claim. A normal investor who had a grievance regarding security with a state would go to the relevant authority, file a complaint and seek relief. Hourani, on the other hand, first sought the help of the daughter of the President.[437] This seems a curious attempt at obtaining relief since she holds no position of governmental authority whatsoever.

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[434] *Id.*, ¶ 25.

[435] Devincci Hourani repeatedly indicates that he had full access to legal counsel. *See e.g.*, Devincci Hourani Statement, ¶¶ 37, 55.

[436] Devincci Hourani Statement, ¶ 55. Notably, Mr. Omran "did not include all the details of his interrogation in the signed statement." *Id.*

[437] CIOC's Memorial, ¶¶ 55-56, 58.

When that proved unsuccessful Hourani sought private counsel with the President himself while the President was on an important diplomatic mission.[438]

341. It seems that Hourani, and by extension CIOC, has missed the point of the full protection and security standard. This standard simply obliges the state to keep its courts open so that a party who feels its rights to protection and security have been violated can seek redress via normal judicial processes. It does not mean that an investor should receive special dispensation from the President or his family. Nor does it mean that an "investor" and his extended family and associates are insulated from legitimate criminal investigation and prosecution simply by virtue of his ownership of an investment.[439] Finally, it does not mean that an investor is immune from the inspections and audits that are contemplated in the investment agreement itself. The Republic has fulfilled its duty to provide full protection and security to CIOC and, accordingly, this Tribunal should dismiss CIOC's claim.

G. The Republic Did Not Act in an Arbitrary or Discriminatory Manner

342. CIOC's final claim is that the Republic failed in its duty not to treat it arbitrarily and not to discriminate against it. This duty is set out in Article II(2)(b) of the Kazakhstan-US BIT:

> Neither party shall in any way impair by arbitrary or discriminatory measures the management, operation, maintenance, use, enjoyment, acquisition, expansion, or disposal of investments.[440]

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[438] **Ex. C-64**, Letter from Devincci Hourani to the president of the Republic dated September 24, 2007 (interestingly, in this letter, Hourani claims to own 100% of the shares of CIOC); CIOC's Memorial, ¶ 63; Devincci Hourani Statement, ¶ 61. *Id.*

[439] Of course, as set out at length herein, the Republic strongly disagrees with the notion that Devincci Hourani is an investor within the meaning of the ICSID Convention.

[440] **Ex. C-1**, Treaty, Article II(2)(b).

343. In this context the word "arbitrary" should be given its literal, dictionary meaning and thus an act can be considered arbitrary when it is based on "prejudice or preference rather than on reason or fact."[441] Conversely, an act cannot be considered arbitrary where it is a reasoned response serving a legitimate government purpose.[442]

344. In order to be discriminatory a measure must be directed at a certain investor because of an immutable attribute that investor holds. In the typical case, in international investment arbitration, that attribute is nationality.[443] Thus, "the Claimant has to demonstrate that a certain measure was directed specifically against a certain investor by reason of his, her or its nationality."[444] In determining whether a measure is discriminatory, "[t]he basis of comparison is a crucial question."[445] Further, actions that are "well founded" cannot be deemed discriminatory actions in violation of a BIT.[446]

345. CIOC alleges, that the Republic's actions "were not based on rational decision-making or the rule of law, but were motivated by political purpose."[447] However, as is demonstrated repeatedly above, the only rational response to CIOC's on-going material breach of the Contract, was the one undertaken by the Republic to

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[441] **Ex. CA-47**, *Lauder,* ¶ 221 (applying definition contained in Black's Law Dictionary).

[442] **Ex. CA-58**, *Noble Ventures*, ¶ 178 (finding no arbitrariness where government proceedings were a reasonable response given the status of the investor and where those proceedings are ordinary proceedings found in most legal systems); **Ex. RL-53**, *Genin*, ¶ 370 (finding government's action not arbitrary where it was justified given the totality of the circumstances).

[443] **Ex. RL-11**, Dolzer and Schreuer, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW, at 176.

[444] **Ex. CA-58**, *Noble Ventures*, ¶ 180.

[445] **Ex. RL-11**, Dolzer and Schreuer, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW, at 177.

[446] **Ex. CA-58**, *Noble Ventures*, ¶ 180; **Ex. RL-53**, *Genin*, ¶¶ 363, 369-370.

[447] CIOC's Memorial, ¶ 213.

terminate the Contract. The termination was a justified response to the material breaches of CIOC and as such it cannot be considered arbitrary.[448]

346. Next CIOC argues that it is the victim of a discriminatory measure, not on the basis of its nationality but because Devincci Hourani has family ties to the President's "rival."[449] CIOC provides no further elaboration on this claim and it is thus difficult to understand exactly what it is arguing. Regardless it is clear that CIOC misconstrues the duty of non-discrimination and in doing so stretches it beyond its meaning as CIOC does not even allege, much less prove, that it was discriminated against on the basis of its nationality. Further, CIOC presents no basis of comparison by which to determine whether it was treated in a manner that can be considered derogatory when compared with the treatment of comparable parties.

347. However, as Mr. Ongarbaev attests, the Termination did not result from a discriminatory measure. Much to the contrary, it was the result of a normal termination procedure for material breaches. In fact, the MEMR terminated the contracts of 87 subsoil users between late 2007 and early 2008, including CIOC. Thus, there is no way that CIOC can now argue that it was the victim of discriminatory measures for it was subjected to the same measures as other similarly situated companies operating within the Republic of Kazakhstan. This claim must, as must all those that have come before it, be rejected by this Tribunal.

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[448] The evidence showing the propriety of the Termination is set out at length in this Counter-Memorial, in the attached witness statements and in the attached expert reports. For the sake of brevity, it need not be repeated here.

[449] CIOC's Memorial, ¶ 215.

IV. DAMAGES

348. Before discussing the issue of damages, the Republic wishes to point out that if the Tribunal finds that it does not have jurisdiction over CIOC's claims or if the Tribunal finds that the Republic was justified in its termination of the Contract, as the Republic respectfully submits it should, there will be no need to consider damages at all. Thus, the following discussion is made on a purely subsidiary basis.

349. In its Memorial, CIOC claims that the Republic is under an obligation to compensate CIOC for the damages it has allegedly caused, and that such compensation should cover all assessable damages, including lost profits.[450] The Republic will demonstrate below that there are two independent reasons for rejecting CIOC's claim for lost profits. Thereafter, the Republic, with reference to the Brailovsky Valuation Report and the IFM Reserves Report, (i) will set out the appropriate compensation to which CIOC could be entitled, if it is entitled to any compensation at all; and (ii) will provide a critique of the valuation proposed by CIOC and its experts. Finally, the Republic will address the questions of moral damages and interest.

A. CIOC Is Not Entitled to Lost Profits Because It Never Made a Commercial Discovery

350. In its Memorial, CIOC claims that it was "contractually entitled to a commercial production license of at least 25 years' duration."[451] However, as will be seen below, this entitlement only vests after CIOC has made and declared a Commercial Discovery, as defined in the Contract. For the reasons discussed below, it

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[450] CIOC's Memorial, ¶ 243.

[451] *Id.*, ¶ 271.

is clear that CIOC never made a Commercial Discovery and thus had no vested interest in future profits. As a result, it cannot claim lost profits.

351. The Contract is an "Exploration and Production" agreement that conditions entitlement to commercial production on the prior making of a commercial discovery during the exploration phase. This is reflected in the following clauses of the Contract:

- Clause 10.5: "A Commercial Discovery gives the exclusive right to the Contractor to proceed to the Production stage;"
- Clause 9.6: "This Contract shall terminate after the expiration of the period of Exploration, and any extension, if no Commercial Discovery is made in the Contract Area or if the Contractor decides not to shift to the Production stage...;"
- Clause 10.7: "If, as a result of Exploration, there is no Commercial Discovery, the Contractor shall have no right to reimbursement of its expenses incurred by the Contractor during Exploration...."

352. Thus, CIOC's entitlement to commercial production is conditioned upon the making of a Commercial Discovery during the exploration phase. The purpose of the exploration phase is thus to try to make a Commercial Discovery. Absent such a discovery, the Contract terminates and CIOC is not even entitled to the reimbursement of its expenses.

353. Clause 9.1 of the Contract provides CIOC with a right to extend the Exploration phase if it has failed to make a Commercial Discovery during the first five years of the Contract:

> The period for Exploration shall consist of five consecutive years as agreed in this Contract and the Contractor shall

> have the right to extend the period of Exploration twice with a duration of each period of up to two years in accordance with the Legislation on the Subsoil Use.[452]

354. The initial five-year exploration period expired on May 27, 2007 and CIOC exercised its right to the first two-year extension. Consequently, on July 27, 2007, the exploration period was extended by two years, until May 27, 2009.

355. The Contract further provides in Clause 10.1:

> In the event that the Contractor discovers a Hydrocarbon Deposit which in its sole opinion is economically and technically suitable for Production, it shall immediately inform the Competent Authority and shall within 120 days prepare a report for an estimation of its reserves for submission to the authorized State Agency for confirmation of the reserves of the Deposit.[453]

356. The Republic is not aware of the filing of any such declaration of Commercial Discovery by CIOC with the Competent Authority, the MEMR. The department of the MEMR which deals with these declarations is the Department of Direct Investments. Neither the MEMR, its Department of Direct Investments nor any other department or subdivision of the MEMR has any record of such a declaration from CIOC.

357. In any event, independent of this lack of declaration, CIOC did not make a Commercial Discovery. This is confirmed in the Mirbulat Ongarbaev Statement.[454] The absence of a Commercial Discovery is not surprising since, as seen above, CIOC failed to properly explore the Contract Area, and this is one of the reasons why the Contract was terminated.

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[452] **Ex. C-4**, Contract, Section 9.1.

[453] *Id.*, Section 10.1 (emphasis added).

[454] Mirbulat Ongarbaev Statement, ¶¶ 108, 119.

358. After the Termination, in the letters of Claimant's Counsel threatening the Republic with arbitration,[455] then in its Request for Arbitration[456] and more recently in its Memorial,[457] Claimant asserts that it has made a Commercial Discovery. However, Claimant fails to produce a corresponding declaration of Commercial Discovery although, pursuant to Clause 10.1 of the Contract, CIOC had the obligation to inform the MEMR "immediately" of a Commercial Discovery. Also, Claimant fails to indicate what precise Commercial Discovery it alleges it has made.

359. Claimant suggests that by obtaining a certificate of reserves on February 29, 2008 from the State Committee on Reserves (the "**February 29, 2008 Expert Opinion on Reserves**") it made a Commercial Discovery.[458] This is not correct. The State Committee on Reserves is distinct from the Department of Subsoil Direct Investments which is the competent authority with regard to declarations of Commercial Discovery. The State Committee on Reserves has competence to issue expert opinions on reserves. Such opinions do not constitute evidence of a Commercial Discovery.[459]

360. Moreover, as explained in the Mirbulat Ongarbaev Statement, the February 29, 2008 Expert Opinion on Reserves[460] actually does not show any Commercial Discovery. This certificate of reserves indicates a tonnage of 4,248 million tons of recoverable reserves in category C1. Annexed to the Contract as Addendum 10, is an Expert Opinion on reserves which is based on the discoveries already made in

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[455] **Ex. C-24**, Letter from Counsel for CIOC to MEMR dated May 8, 2008; **Ex. C-25**, Letter from Counsel for CIOC to the President of the Republic dated May 19, 2008.

[456] Request for Arbitration, ¶ 25.

[457] CIOC's Memorial, ¶ 120; *see also,* Omar Antar Statement, ¶ 107.

[458] Request for Arbitration, ¶¶ 25-26.

[459] Mirbulat Ongarbaev Statement, ¶ 115.

[460] **Ex. R-38**, Expert Opinion on Reserves dated February 29, 2008.

1969 by the Soviets.[461] It shows 7,319 million tons of reserves in category C1. There are more recoverable reserves in category C2 in the February 29, 2008 Expert Opinion than in the in the Expert Opinion in Addendum 10 to the Contract. However, C1 reserves are proved but undeveloped reserves, while C2 are unproved reserves.[462] This shows that CIOC's work resulted in a significant downgrading in the overall quality of the reserves when compared to Soviet times. Therefore, the Expert Opinion on Reserves does not constitute a Commercial Discovery and CIOC made no Commercial Discovery.

361. Consequently, pursuant to Clauses 10.5 and 9.6, CIOC was not entitled to commercial production and CIOC's damage claim for lost profits should be rejected entirely.

B. CIOC Is Not Entitled to Lost Profits Because Any Such Profits Are Highly Speculative and Uncertain

362. Independent of the issue of Commercial Discovery, CIOC is not entitled to lost profits because, as will be seen below, any such profits are too speculative and uncertain.

363. In its Memorial, CIOC claims compensation for an alleged expropriation of its investment.[463] In addition, if its investment is not found to have been expropriated, CIOC claims compensation for certain alleged breaches of the BIT, other than expropriation.[464]

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[461] **Ex. R-39**, Addendum 10 to Contract, Expert Opinion on Reserves based on the Soviet-era calculation.

[462] IFM Reserves Report, Figure 13, at 31.

[463] CIOC's Memorial, ¶¶ 244-247.

[464] *Id.*, ¶ 248.

364. CIOC argues that "fair market value" is the standard of compensation to be applied in the case of expropriation[465] and seems to argue that it is also the standard to be applied in the event of breaches of the BIT other than expropriation.[466] According to CIOC, the appropriate valuation methodology to determine fair market value in this case for either the alleged expropriation or breaches of the BIT is the DCF method.[467]

365. CIOC's damage claim is mainly comprised of future lost profits calculated using the DCF method. The Republic will first review the requirements for awarding compensation under applicable law and then will consider whether the award of future lost profits using the DCF method is appropriate under the specific circumstances of this case.

1) The Applicable Requirements for Awarding Compensation

366. To be awarded, damages must be reasonably certain and must not be speculative. This basic principle of international law has been stated by numerous tribunals, including the *Amoco* tribunal as follows:

> One of the best settled rules of the law of international responsibility of States is that no reparation for speculative or uncertain damage can be awarded. This holds true for the existence of the damage and of its effect as well. Such a rule, therefore, applies in the case of unlawful expropriation. *A fortiori*, the reasoning on which it rests must also apply in the case of compensation for a lawful expropriation. It does not permit the use of a method which yields uncertain figures for the valuation of damages, even if the existence of the damages is certain.[468]

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[465] *Id.*, ¶ 264.

[466] *Id.*, ¶ 270.

[467] *Id.*, ¶¶ 265, 270.

[468] **Ex. CA-32**, *Amoco International Finance Corporation v. The Government of the Islamic Republic of Iran et al*, Iran-US Claims Tribunal Case No. 56, Chamber Three, Award No. 310-56-3 dated July 14, 1987 ("*Amoco*"), ¶ 238; *see also*, **Ex. CA-64**, *Case Concerning the Factory at Chorzów (Claim for*

In *BG*, the tribunal made a similar statement in the following terms:

> 428. The damage, nonetheless, must be the consequence or proximate cause of the wrongful act. Damages that are '*too indirect, remote, and uncertain to be appraised*' are to be excluded. In line with this principle, the Tribunal would add that an award for damages which are speculative would equally run afoul of 'full reparation' under the ILC Draft Articles.
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> 429. The Tribunal will be guided by these principles. Provided that the damage is not speculative, indirect, remote or uncertain, the Arbitral Tribunal may have recourse to such methodology as it deems appropriate in order to achieve the full reparation for the injury caused to BG by Respondent....[469]

367. This requirement applies to lost profits. According to Article 36.2 of the International Law Commission's Articles on State Responsibility (the "ILC Articles"), "compensation shall cover any financially assessable damage including loss of profits insofar as it is established."[470] Lost profits cannot thus be awarded if they are remote, uncertain or speculative. The existence and amount of lost profits must be established with a sufficient degree of certainty.[471] In keeping with this reasoning the tribunal in *Autopista* refused to award compensation for lost profits where these were uncertain:

Indemnity) (Merits), Permanent Court of International Justice, Series A-No. 17, Judgment No. 13 dated September 13, 1928, at 56-57 ("The Court must however observe that it has not before it the data necessary to enable it to decide as to the existence and extent of damage resulting from alleged competition at the Chorzów factory with the Bayerische factories [...] In these circumstances, the Court can only observe that the damage alleged to have resulted from competition is insufficiently proved. Moreover, it would come under the heading of possible but contingent and indeterminate damage which, in accordance with the jurisprudence of arbitral tribunals, cannot be taken into account.").

[469] **Ex. RL-64**, *BG Group Plc. v. The Republic of Argentina*, UNCITRAL, Final Award dated December 24, 2007, ¶¶ 428-429 (emphasis added) (internal citations omitted).

[470] **Ex. CA-29**, James Crawford, *The International Law Commission's Articles on State Responsibility: Introduction, Text and Commentaries* (Cambridge University Press 2002) (hereinafter "Crawford, *ILC Articles on State Responsibility, Commentary*"), Article 36, at 218 (emphasis added).

[471] *See*, **Ex. RL-65**, *Autopista Concesionada de Venezuela, C.A. v. Bolivarian Republic of Venezuela*, ICISD Case No. ARB/00/5, Award dated September 23, 2003 ("*Autopista*"), ¶¶ 351-352 ("Again, the Tribunal notes that the requirement of Venezuelan law pursuant to which lost profits must be established with sufficient certainty and cannot be awarded on the basis of speculative assessments is consistent with the practice of international tribunals. Decisions issued by ICSID tribunals and by the Iran-US Claims

> [T]he Arbitral Tribunal is disinclined to award lost profits in the circumstances of this case. It reaches the conclusion that Aucoven has not made a showing of future lost profits with a sufficient degree of certainty....[472]

368. Moreover, any valuation method that is used to determine compensation must lead to results that are reasonably certain and are not speculative.[473] The *Amoco* tribunal refused to use the DCF method of valuation because it would have led to results that were speculative. The tribunal further held that the principle according to which no reparation for speculative or uncertain damage can be awarded "does not permit the use of a method which yields uncertain figures for the valuation of damages, even if the existence of damages is certain."[474]

369. As will be seen below, CIOC is not entitled to damages that are based on future lost profits calculated using the DCF valuation method. CIOC's alleged future lost profits are uncertain and speculative and using the DCF valuation method to calculate CIOC's compensation would result, in the case at hand, in the awarding of speculative and uncertain damages.

Tribunal have often dismissed claims for lost profits in cases of breach of contract on the ground that they were speculative and that the claimant had not proven with a sufficient degree of certainty that the project would have resulted in a profit.... The Tribunal will now turn to reviewing whether Aucoven has established the existence and amount of lost profits for which it seeks compensation with a sufficient degree of certainty." (internal citations omitted)).

[472] *Id.*, ¶ 353; *see also,* **Ex. CA-41**, *Wena Hotels Limited v. Arab Republic of Egypt*, ICSID Case No. ARB/98/4, Award dated December 8, 2000 ("*Wena*"), ¶ 123 ("Wena's claims for lost profits (using a discounted cash flow analysis), lost opportunities and reinstatement costs are inappropriate – because an award based on such claims would be too speculative.").

[473] **Ex. CA-32**, *Amoco*, ¶ 238.

[474] *Id.*; *see also,* **Ex. RL-66**, *Metalclad Corporation v. The United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award dated August 30, 2000, 16 ICSID Review – FOREIGN INVESTMENT LAW JOURNAL 1 (2001) ("*Metalclad*"), ¶ 121 ("[A] discounted cash flow analysis is inappropriate in the present case because the landfill was never operative and any award based on future profits would be wholly speculative."); **Ex. RL-67**, *Compañia de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentine Republic*, ICSID Case No. ARB/97/3, Award dated August 20, 2007 ("*Vivendi II*"), ¶ 8.3.3 ("[T]he net present value provided by a DCF analysis is not always appropriate and becomes less so as the assumptions and projections become increasingly speculative.").

2) CIOC Is Not Entitled to Future Lost Profits Calculated Using the DCF Valuation Method

370. In its Memorial, CIOC argues that "fair market value" is the standard of compensation to be applied in case of expropriation,[475] and seems to argue that it is also the standard to be applied for breaches of the BIT other than expropriation.[476]

371. Pursuant to Article III of the BIT, the standard of compensation in the case of expropriation is as follows:

> Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriatory action was taken or became known, whichever is earlier; be calculated in a freely usable currency on the basis of prevailing market rate exchange at that time; be paid without delay; include interest at a commercially reasonable rate from the date of expropriation; be fully realizable; and be freely transferable.[477]

The BIT does not provide for a standard of compensation for breaches of the BIT, other than expropriation.

372. The BIT also does not define fair market value. In the *Starrett Housing* case, the Iran-US Claims tribunal defined fair market value as:

> the price that a willing buyer would pay to a willing seller in circumstances in which each had good information, each desired to maximize his financial gain, and neither was under duress or threat. [The Expert] appropriately assumed that the willing buyer was a reasonable businessman.[478]

373. In addition, the BIT does not provide a methodology for evaluating the fair market value of an expropriated investment. As recognized by the *AIG* tribunal:

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[475] CIOC's Memorial, ¶ 264.

[476] *Id.*, ¶ 270.

[477] **Ex. C-1**, Treaty, Article III(1).

[478] **Ex. CA-72**, *Starrett Housing Corporation et al v. The Government of the Republic of Iran et al*, Iran-U.S. Claims Tribunal, Award No. 314-24-1 dated August 14, 1987 ("*Starrett Housing*"), ¶ 277.

> 'fair market value' can be determined in diverse ways to yield varied and different results: either with reference to net book value, or to liquidation or dissolution value or with reference to the discounted cash flow method (which includes lost profits): or even an amalgam of several methods. Which then is the most 'appropriate' method for determining fair market value? There is no international judicial precedent of universal application; but as a practical matter the nature and circumstances in which the foreign investment is originally made affords some guide as to what is included in the phrase 'fair market value'.[479]

CIOC submits in its Memorial that the appropriate valuation methodology to determine the fair market value of its investment, both in cases of expropriation and other breaches of the BIT, is the DCF method of valuation.[480] CIOC claims future lost profits calculated using the DCF method because:

> there is sufficient information on which to base the calculations involved in the DCF valuation in that the Reserves Report provides an independent estimation of oil reserves, and the successful completion of the Pilot Production Programme, confirmed the appropriate future production levels that CIOC could expect. CIOC was also contractually entitled to a commercial production license of at least 25 years' duration.[481]

374. The Republic will review each of the legal criteria for the award of lost profits and the application of the DCF method and will apply each one to the specific circumstances of this case to show that the DCF method is not the appropriate method to determine CIOC's fair market value.

375. DCF is defined in the World Bank Guidelines on the Treatment of Foreign Direct Investment (the "World Bank Guidelines") as follows:

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[479] **Ex. RL-68**, *AIG Capital Partners Inc. et al v. Republic of Kazakhstan*, ICSID Case No. ARB/01/6, Award dated October 7, 2003, 11 ICSID REPORTS 3 (2007) ("*AIG*"), at 85.

[480] CIOC's Memorial, ¶¶ 264, 270.

[481] *Id.*, ¶ 271 (internal citation omitted).

> *'discounted cash flow value'* means the cash receipts realistically expected from the enterprise in each future year of its economic life as reasonably projected minus that year's expected cash expenditure, after discounting this net cash flow for each year by a factor which reflects the time value of money, expected inflation, and the risk associated with such cash flow under realistic circumstances.[482]

Thus, the DCF method follows an income-based valuation approach which allows tribunals to award an amount that reflects the net present value of both the physical assets that have been lost (*damnum emergens*) and lost profits (*lucrum cessans*).[483] This method involves a complex analysis. It is based on future expectations and requires an assessment of various forward-looking factors such as projected cash flows, projected future effects of inflation on the future income stream, etc.[484] In the words of Thomas Wälde and Borzu Sabahi:

> The difficulty with this method–as compared to the historic-cost method–is that while it may look objective and scientific when presented by experts using spread-sheet models, it does not provide objective and predictable outcomes. The DCF method is in essence a speculation about the future dressed up in the appearance of mathematical equations. The inherent subjectivity present in most of the assumptions of the financial model explains why rational bankers and

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[482] **Ex. RL-69**, The World Bank Group, *Legal Framework for the Treatment of Foreign Investment: Volume II, Report to the Development Committee and Guidelines on the Treatment of Foreign Direct Investment*, September 21, 1992 (hereinafter "World Bank Guidelines"), Guideline IV: *Expropriation and Unilateral Alterations or termination of Contracts* (hereinafter "Guideline IV"), ¶ 6, at 42.

[483] **Ex. RL-70**, Henry Weisburg and Christopher Ryan, *Means to be made whole: Damages in the context of international investment arbitration*, in EVALUATION OF DAMAGES IN INTERNATIONAL ARBITRATION (Yves Derains and Richard Kreindler ed., ICC Publication 2006) (hereinafter "Weisburg and Ryan, *Means to be made whole: Damages in the context of international investment arbitration*"), at 174 (internal citation omitted).

[484] **Ex. RL-59**, Newcombe and Paradell, LAW AND PRACTICE OF INVESTMENT TREATIES, ¶ 7.42, at 389 ("The inherent difficulty with the DCF method is that it requires an assessment of various forward looking factors. These include: (i) the projected future revenue of the enterprise; (ii) the projected future expenses of the enterprise; (iii) the opportunity cost of keeping funds tied up in the given enterprise and not reinvesting them elsewhere, i.e. a comparative assessment of other available investment opportunities; (iv) the projected future effects of inflation on the future income stream, as inflation over time lowers the net present value of such an income stream; and (v) the probability that the projected revenue in fact will be realized. Such analysis requires assessments about the future – and in some circumstances, those assessments can be difficult to make reliably; while in others they can be made reasonably well.").

> business executives put highly different values on the same asset.[485]

The DCF method seeks to adjust for its inherent uncertainties by "risk-adjusting" the discount rate used to calculate the present value of the future stream of projected earnings.[486] However, this is not always enough to adjust these uncertainties and the application of the DCF method can, and does produce, as in the case at hand, remarkably disparate results depending on who is performing the analysis.[487]

376. As will be shown below, tribunals have refused to use the DCF method and award lost profits when profits were not reasonably anticipated and when the profits anticipated were not probable[488] or sufficiently certain.[489] In the Report to the

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[485] **Ex. RL-71**, Thomas W. Wälde and Borzu Sabahi, *Compensation, Damages, and Valuation*, in THE OXFORD HANDBOOK OF INTERNATIONAL INVESTMENT LAW (Peter Muchlinski et al, eds., Oxford University Press 2008) (hereinafter "Wälde and Sabahi, *Compensation, Damages, and Valuation*"), at 1074 (emphasis added) (internal citation omitted); *see also,* **Ex. CA-70**, Manuel A. Abdala and Pablo T. Spiller, *Damage Valuation of Indirect Expropriation in International Arbitration Cases*, 14(4) American Review of International Arbitration (2003), at 458 ("It is key to avoid entering into large speculations about cash flow projections.").

[486] **Ex. RL-72**, Mark Kantor, VALUATION FOR ARBITRATION: COMPENSATION STANDARDS, VALUATION METHODS AND EXPERT EVIDENCE (Kluwer Law International 2008) (hereinafter "Kantor, VALUATION FOR ARBITRATION"), at 79.

[487] *See,* Brailovsky Valuation Report, ¶ 90 (which concludes that a proper application of the DCF method, with a discount rate of 26.1% pa, would yield a value of USD 15.3 million); CRA Quantum Report, ¶¶ 3.33, 4.7 (which concludes that a proper application of the DCF method, with a discount rate of 8.9%, would yield a value of USD 1,005.7 million); *see also,* **Ex. CA-44**, *Tecmed*, ¶ 186 ("The Arbitral Tribunal has noted both the remarkable disparity between the estimates of the two expert witnesses...."); **Ex. RL-73**, *Waguih Elie George Siag et al v. Arab Republic of Egypt*, ICSID Case No. ARB/05/15, Award dated June 1, 2009 ("*Siag*"), ¶ 569 ("It is not necessary to attempt the impossible exercise of determining which figure is 'right' to realize that the DCF analysis in such a case is attended by considerable uncertainty."); **Ex. CA-41**, *Wena*, ¶ 122 ("Although experts presented by each party adopted variations of the well-known discounted cash flow ('DCF') method of calculating the amount of the damages sustained by Wena, the experts reached widely varying results from their calculations.").

[488] **Ex. RL-60**, *AAPL*, ¶ 104 ("[A]ccording to a well established rule of international law, the assessment of prospective profits requires the proof that: 'they were *reasonably* anticipated; and that the profits anticipated were probably and not merely possible'...." (internal citation omitted) (emphasis in original)); *see also,* **Ex. RL-74**, *William J. Levitt v. The Government of the Islamic Republic of Iran et al*, Iran-U.S. Claims Tribunal Case No. 209, Chamber One, Award No. 297-209-1 dated April 22, 1987 ("*Levitt*"), ¶ 58 ("[T]he Tribunal finds that the Claimant has not established with a sufficient degree of certainty that the project would have resulted in a profit.").

[489] **Ex. RL-67**, *Vivendi II*, ¶ 8.3.10. ("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

Development Committee on the legal framework for the treatment of foreign direct investment, which was submitted for consideration along with the guidelines to the Development Committee, it is stated that:

> Section 6 of Guideline IV suggests that *discounted cash flow* may represent an acceptable method of valuation. This method values an income-producing asset by estimating the *net* cash flow which the asset could be realistically expected to generate over the course of its life, and then discounting that net cash flow by a factor that reflects the time value of money, expected inflation and the risk associated with the cash flow. This method is regarded as appropriate for valuing enterprises with a firmly established income-producing capacity because it recognizes that the economic value of such an enterprise to its owner is a function of the cash that the enterprise can be expected to produce in future. However, particular caution should be observed in applying this method as experience shows that investors tend to greatly exaggerate their claims of compensation for lost future profits. Compensation under this method is not appropriate for speculative or indeterminate damage, or for alleged profits which cannot legitimately accrue under the laws and regulations of the host country.[490]

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probabilities it would have produced profits from the concession in question in the face of the particular risks involved...."); *see also,* **Ex. RL-75**, George Joffé, Paul Stevens, Tony George, Jonathan Lux, and Carol Searle, *Expropriation of oil and gas investments: Historical, legal and economic perspectives in a new age of resource nationalism*, 2 Journal of World Energy Law & Business (2009) (hereinafter "Joffé, Stevens, Gorge, Lux, and Searle, *Expropriation of oil and gas investments: Historical, legal and economic perspectives in a new age of resource nationalism*"), at 17 ("There is, indeed, wide acceptance that a DCF exercise is appropriate only in relation to the expropriation of the assets of a profitable going concern and, in the absence of a genuinely profitable going concern, a claimant investor will face a heavy burden in seeking to prove lost profits, applying the DCF method." (internal citations omitted)).

[490] **Ex. RL-69**, World Bank Guidelines, ¶ 42, at 26 (internal citation omitted) (italic in original) (underlining added); *see also,* **Ex. RL-75**, Joffé, Stevens, George, Lux, and Searle, *Expropriation of oil and gas investments: Historical, legal and economic perspectives in a new age of resource nationalism*, at 17 ("A major problem with the DCF approach is that projected cash flows are inevitably speculative and uncertain. DCF is 'affected by uncertainties: uncertainty in the comparable data available; uncertainty in the current and future market conditions and uncertainty in the specific inputs for the subject property'. As we have seen, tribunals are wary of speculation: '. . . the net present value provided by a DCF analysis is not always appropriate and becomes less so as the assumptions and projections become increasingly speculative'." (internal citations omitted)); **Ex. RL-72**, Kantor, VALUATION FOR ARBITRATION, at 79 ("If such risks create too much uncertainty, though, some tribunals may decide to reject such an Income-Based method computation as insufficiently certain to sustain a damage award for lost future earnings.").

This "caution" to be observed in applying the DCF method and in considering claims for lost profits is also reflected in the following statement of Professor Crawford, in his commentary on Article 36 of the ILC Articles:

> The discounted cash flow (DCF) method has gained some favour, especially in the context of calculations involving income over a limited duration, as in the case of wasting assets.... The method analyses a wide range of inherently speculative elements, some of which have a significant impact upon the outcome (e.g. discount rates, currency fluctuations, inflation figures, commodity prices, interest rates and other commercial risks). This has led tribunals to adopt a cautious approach to the use of the method. Hence although income-based methods have been accepted in principle, there has been a decided preference for asset-based methods.[491]
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> [...]
>
> [L]ost profits have not been as commonly awarded in practice as compensation for accrued losses. Tribunals have been reluctant to provide compensation for claims with inherently speculative elements. When compared with tangible assets, profits (and intangible assets which are income-based) are relatively vulnerable to commercial and political risks, and increasingly so the further into the future projections are made. 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 on dealings.[492]
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> According to Whiteman, 'in order to be allowable, prospective profits must not be too speculative, contingent,

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[491] **Ex. CA-29**, Crawford, *ILC Articles on State Responsibility*, *Commentary,* Article 36, at 227 (internal citation omitted) (emphasis added); *see also,* **Ex. CA-32**, *Amoco*, ¶ 230 ("The Tribunal can also perceive the advantages of such a method for a claimant seeking substantial compensation. The calculation of the revenues expected to accrue over a long period of time in the future, which opens a large field of speculation due to the uncertainty inherent in any such projection, will probably yield higher results than any other method. For this reason, however, such a method cannot easily be accepted by a tribunal, and the reluctance of all tribunals ... to make use of it is easy to understand.").

[492] **Ex. CA-29**, Crawford, *ILC Articles on State Responsibility*, *Commentary,* Article 36, at 228 (internal citations omitted) (emphasis added).

> uncertain, and the like. There must be proof that they were *reasonably* anticipated; and that the profits anticipated were probable and not merely possible'....[493]

377. Taking the above into account, tribunals, as will be seen in detail below, have applied the following criteria in order to determine whether the profitability of an enterprise was sufficiently established (i.e. not too uncertain or speculative) and whether to apply the DCF method:

(i) the enterprise must be a going concern with a record of profits,

(ii) there must be no significant investment to be made after the date of the alleged taking,

(iii) the enterprise must have the expertise and financial capacity necessary to be profitable under the circumstances,

(iv) the disparity between the compensation requested and the investment made must be reasonable and

(v) the cash-flow projection must be over a reasonable period of time.

378. The Republic will discuss each of these criteria and will apply them to the specific circumstances of this case to determine whether CIOC's fair market value should include future lost profits and be determined using the DCF method. As will be shown below, none of these criteria is met and CIOC's future profitability is highly uncertain and speculative.

(i) The Enterprise Must Be a Going Concern With a Record of Profits

379. The World Bank Guidelines provide that:

> Without implying the exclusive validity of a single standard for the fairness by which compensation is to be determined

[493] *Id.*, fn. [601] (emphasis added).

> and as an illustration of the reasonable determination by a State of the market value of the investment under Section 5 above, such determination will be deemed reasonable if conducted as follows: (i) for a going concern with a proven record of profitability, on the basis of the discounted cash flow value....[494]

A going concern is defined in the World Bank Guidelines as:

> an enterprise consisting of income-producing assets which has been in operation for a sufficient period of time to generate the data required for the calculation of future income and which could have been expected with reasonable certainty, if the taking had not occurred, to continue producing legitimate income over the course of its economic life in the general circumstances following the taking by the State....[495]

380. Tribunals have held that the DCF method was appropriate to determine compensation, including lost profits, only when the enterprise was a going concern with a record of profits. The *AIG* tribunal refused to apply the DCF method on the basis that the project for the construction of a complex housing project in Kazakhstan was not a profitable going concern,

> [s]ince the Project was not a 'going-concern' immediately prior to the taking and there was no proven record of profitability, the DCF method of valuation was and is inappropriate.[496]

As stated by the tribunal in *Siemens*:

> [T]he DCF method is applied to ongoing concerns based on the historical data of their revenues and profits; otherwise it

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[494] **Ex. RL-69**, World Bank Guidelines, Guideline IV, ¶ 6, at 42 (emphasis added).

[495] *Id.*; *see also*, **Ex. RL-67**, *Vivendi II*, ¶ 8.3.6 ("A 'going concern' is generally understood to be a business enterprise with demonstrable future earning power.").

[496] **Ex. RL-68**, *AIG*, at 111; *see also*, **Ex. RL-71**, Wälde and Sabahi, *Compensation, Damages, and Valuation*, at 1076 ("The widespread principle that [...] DCF methodology should only be used for well-established projects with a solid record of commercial performance again reflects a justified reluctance on the part of tribunals to get involved in what are essentially competing prophecies of often equal plausibility." (internal citations omitted)).

> is considered that the data is too speculative to calculate future profits.[497]

Similarly, the *National Grid* tribunal stated that:

> The DCF method, while not without its drawbacks, has the advantage of realistically assessing the economic value of a going concern by relying on the stream of value that it can generate over its operative life. In order to function properly, the DCF approach requires that the concern in question must have a history of profitable operation. This does not appear to be a major issue in this case, since Transener has a history of almost nine years of successful operation.[498]

The tribunal in *Vivendi II*, which refused to award future lost profits calculated using the DCF method because the claimant had failed to establish with a sufficient degree of certainty that the water concession in question would have been profitable,[499] held that:

> [T]he net present value provided by a DCF analysis is not always appropriate and becomes less so as the assumptions and projections become increasingly speculative. And, as Respondent points out, many international tribunals have stated that an award based on future profits is not appropriate unless the relevant enterprise is profitable and has operated for a sufficient period to establish its performance record.[500]

Thus, for the DCF method to be appropriate, there must be both a going concern and a record of profits. The Republic will discuss each in greater depth below.

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[497] **Ex. CA-65**, *Siemens*, ¶ 355; *see also*, **Ex. RL-65**, *Autopista*, ¶ 360 ("These decisions show that ICSID Tribunals are reluctant to award lost profits for a beginning industry and unperformed work. This reluctance of ICSID tribunals is confirmed by the practice of the Iran-U.S. Claims Tribunal."); **Ex. RL-76**, *Phelps Dodge Corp. et al v. The Islamic Republic of Iran*, Iran-U.S. Claims Tribunal, Case No. 99, Chamber 2, Award No. 212-99-2 dated March 19, 1986, 25 INTERNATIONAL LEGAL MATERIALS 1 (1986), ¶ 30 ("The Tribunal cannot agree that SICAB had become a 'going concern' prior to November 1980 so that such elements of value as future profits and goodwill could confidently be valued. In the case of SICAB, any conclusions on these matters would be highly speculative.").

[498] **Ex. CA-76**, *National Grid P.L.C. v. Argentine Republic*, UNCITRAL, Award dated November 3, 2008, ¶ 276 (internal citation omitted).

[499] **Ex. RL-67**, *Vivendi II*, ¶ 8.3.5.

[500] *Id.*, ¶ 8.3.3 (internal citations omitted) (emphasis added).

381. First, the enterprise must be a going concern. A clear example of the application of this criterion can be found in the *Southern Pacific Properties* case, where the tribunal refused to apply the DCF method because the tourist project in the Giza Pyramids Plateau Area at issue was in its infancy and could not generate reliable data on which to base projected revenues.[501] As stated by the *SPP* tribunal:

> 188. In the Tribunal's view, the DCF method is not appropriate for determining the fair compensation in this case because the project was not in existence for a sufficient period of time to generate the data necessary for a meaningful DCF calculation. At the time the project was cancelled, only 386 lots–or about 6 percent of the total–had been sold. All of the other lot sales underlying the revenue projections in the Claimants' DCF calculations are hypothetical. The project was in its infancy and there is very little history on which to base projected revenues.
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> 189. In these circumstances, the application of the DCF method would, in the Tribunal's view, result in awarding 'possible but contingent and undermine damage which, in accordance with the jurisprudence of arbitral tribunals, cannot be taken into account.'[502]

Similarly, the *Iran America* tribunal acknowledging that the expropriated insurance company had been conducting its business for little more than four and a half years held

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[501] **Ex. CA-31**, *SPP ICSID*, ¶ 188.

[502] *Id.*, ¶¶ 188-189 (internal citation omitted) (emphasis added); *see also,* **Ex. RL-66**, *Metalclad*, ¶ 121 ("The Tribunal agrees with Mexico that a discounted cash flow analysis is inappropriate in the present case because the landfill was never operative and any award based on future profits would be wholly speculative."); **Ex. RL-73**, *Siag*, ¶ 570 ("Points such as those just mentioned tend to reinforce the wisdom in the established reluctance of tribunals such as this one to utilise DCF analyses for 'young' businesses lacking a long track record of established trading. In all probability that reluctance ought to be even more pronounced in cases such as the present where the business is still in its relatively early development phase and has no trading history at all."); **Ex. RL-70**, Weisburg and Ryan, *Means to be made whole: Damages in the context of international investment arbitration*, at 174 ("it is often difficult to obtain the objective data necessary to allow a tribunal to calculate a company's future revenue stream. In the absence of such data, some tribunals have been reluctant to award lost profits and, therefore, have declined to apply the DCF method." (internal citation omitted)).

that "such a short period must be deemed to provide an insufficient basis for projecting future profits."[503]

382. Second, the enterprise must have a record of profits. The tribunal in Metaclad relied, *inter alia*, on the absence of a proven record of profitability of the landfill in question to reject the application of the DCF method:

> Normally, the fair market value of a going concern which has a history of profitable operation may be based on an estimate of future profits subject to a discounted cash flow analysis.... However, where the enterprise has not operated for a sufficiently long time to establish a performance record or where it has failed to make a profit, future profits cannot be used to determine going concern or fair market value.[504]

Similarly, the tribunal in *Sola Tiles* rejected the claim for compensation for the claimant's lost profits because the claimant's subsidiary, Simat, an Iranian corporation dedicated to the import and resale of high quality ceramic tiles, was not a "going concern."[505] The tribunal found that Simat was not a going concern because, *inter alia*:

> Simat had the briefest past record of profitability, having shown a loss in 1976, its first year of trading, and a small profit the next year.[506]

The *Aucoven* tribunal also denied the claimant's claim for lost profits on the basis that *inter alia* "Aucoven had no record of profits...."[507]

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[503] **Ex. RL-77**, *American International Group, Inc. et al v. The Islamic Republic of Iran et al*, Iran-U.S. Claims Tribunal Case No. 2 (93-2-3), Award dated December 19, 1983, 23 INTERNATIONAL LEGAL MATERIAL 1 (1994), at 10 (internal citation omitted).

[504] **Ex. RL-66**, *Metalclad*, ¶¶ 119-120 (internal citation omitted) (emphasis added); *see also*, **Ex. RL-60**, *AAPL*, ¶ 107 ("The assumptions upon which the claimant's projection were based in the present case (were) insufficient in evidencing that Serendib was effectively by 27 January 1987, a 'going concern' that acquired a valuable 'goodwill' and enjoying a proven 'future profitability', particularly in the light of the fact that Serendib had no previous record in conducting business for even one year of production.").

[505] **Ex. RL-78**, *Sola Tiles, Inc. v. The Government of the Islamic Republic of Iran*, Iran-U.S. Claims Tribunal Case No. 317, Chamber One, Award No. 298-317-1 dated April 22, 1987, ¶ 64.

[506] *Id.*

[507] **Ex. RL-65**, *Autopista*, ¶ 362.

(a) CIOC Was Not a Going Concern

383. CIOC was not a going concern. As in SPP, which refused to apply the DCF method, CIOC's project was in its infancy.[508] CIOC, itself, had been in existence for only approximately 6 years. At the time of the alleged taking, CIOC was still in the Exploration phase and had not even commenced the required drilling of the Two Deep Wells. It had never entered into any commercial production. In *Phillips Petroleum*, which did apply the DCF method, the operator had been in commercial production for more than eight years and consequently Phillips' contractual rights were viewed as part of a going concern.[509] There can be no parallel to CIOC's situation.

384. Consequently, there is simply no data available for a meaningful DCF calculation based on commercial production. CIOC's cash-flow calculation is based on future income that CIOC alleges it would receive during the 25 year Production phase. However, CIOC has no history of commercial production on which to base a calculation of future income.

385. The most important data CIOC uses to make its calculation are the history of production during the Exploration phase and TRACS' reserves re-calculation.[510] This data is not a sufficient basis for projecting future income over 37 years.[511] As stated by IFM in its Reserves Report:

> The value of a petroleum property is neither fixed nor guaranteed, and it is certainly not determined by geology and commodity prices alone. Value also depends upon the

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[508] **Ex. CA-31**, *SPP ICSID*, ¶ 188.

[509] **Ex. CA-38**, *Phillips Petroleum Company Iran v. The Islamic Republic of Iran et al*, Iran-U.S. Claims Tribunal Case No. 39, Chamber 2, Award No. 425-39-2 dated June 29, 1989 ("*Phillips Petroleum*"), ¶¶ 111-113.

[510] CIOC's Memorial, ¶ 271.

[511] CRA Quantum Report, ¶¶ 2.15, 4.4.

> skills and experience of management and management's willingness and ability to identify exploration strategies. Value further depends upon alternative development concepts and production strategies, financial strength, i.e. quick and relatively easy access to efficient capital markets.[512]

386. First, the history of production during the Exploration phase was very limited and production was well below the quantities set in the Annual Work Programs.[513]

387. Second, TRACS' reserves re-calculation, as well as any of the estimates of the Caratube field reserves available, provide only an estimation of the reserves, but cannot provide a guarantee that CIOC would or could have been able to extract the reserves or that CIOC would have in fact found the amount of reserves estimated in these reports.

388. Further, it is the opinion of IFM that TRACS' oil field development plan was completely unrealistic and "impossible to achieve by any prudent company, which CIOC was not, with limited financial and human resources."[514] IFM is also of the opinion that "given CIOC's track record and risk profile, it is highly likely that CIOC would not have been able to carry [CER] development plan."[515]

389. In addition, the extent of the reserves estimate in TRACS reserves re-calculation, which include as reserves contingent and prospective resources, is highly uncertain.[516] According to the IFM Reserves Report:

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[512] IFM Reserves Report, ¶ 20.

[513] IFM Compliance Report, ¶ 93.

[514] IFM Reserves Report, ¶ 174.

[515] *Id.*, ¶ 181.

[516] *Id.*, ¶ 123 ("As a general matter, TRACS achieves its inflation of reserves by recognizing as reserves 'Contingent' or 'Prospective' resources." (internal citation omitted)).

> Generally Accepted Valuation Practice for oil and gas property transactions considers only the 'reserves' of the property/field and does not consider 'resources.' As a matter of fact, even the SEC does not require reporting contingent and prospective resources in a company's filing. These are 'speculative' quantities by nature. In our combined 85 plus years of experience in the Oil and Gas industry and financial sector we have not seen any commercial lender who is willing to lend using Contingent and Prospective resources on a stand alone basis. Prospective resources are yet to be discovered and need to be proven as economically producible.[517]

390. This is particularly true given CIOC's failure to explore the Contract Area. Only the proper completion of a 3D seismic study and the drilling of wells in the sub-salt structure of the Caratube field would have allowed CIOC to determine the extent of the reserves in the deeper horizons of the reservoir.[518] As stated in the IFM Reserves Report: "[e]ven today, however, drilling is still the only way of definitely establishing the presence or absence of hydrocarbons in a given subsurface formation."[519] Based, *inter alia*, on CIOC's failure to drill the wells in the sub-salt structure of the Caratube field, IFM considered that it is not correct to assign reserves to the sub-salt structure of the Caratube field:

> IFM is of the opinion that the resources within the 'Subsalt' deposits in the Contract Area are not a viable candidate for commercial development unless proven otherwise through drilling and testing of additional wells, which was CIOC's obligations under the Contract. TRACS has included significant quantities of oil and gas (Risked volume of approximately 18 million barrels or 2.6 mln tons) in the production profile based on positive tests in one well (#G36) out of the 11 wells in the area and seismic data. Mr. Giles

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[517] *Id.*, ¶ 126.

[518] *Id.*, ¶¶ 139, 154.

[519] *Id.*, ¶ 41.

> has consequently included this volume for valuation of the quantum of damages in the CRA Damages Report.[520]

IFM concludes that TRACS' re-calculation of reserves "is fundamentally flawed [...] and should be disregarded."[521]

391. In sum, neither CIOC's very limited, low and disappointing history of production during the Exploration phase nor TRACS completely flawed re-calculation of reserves constitute reliable and sufficient data for a meaningful DCF calculation based on commercial production.

392. Finally, there is no reasonable certainty that CIOC would have been able to generate income in the future. Contrary to what CIOC argues in its Memorial, CIOC was not contractually entitled to a commercial production license of at least 25 years' duration.[522] CIOC would have been entitled to the 25 year commercial production license only if it made a Commercial Discovery. As was shown in Section IV.A above, CIOC did not make a Commercial Discovery and there is no guarantee that CIOC would have made a Commercial Discovery in the future. Also, proceeding with commercial production requires the approval of a Development Plan by the Central Commission on Development of Oil and Gas Deposits of the MEMR.[523] Mr. Ongarbaev explains:

> Also, the preparation of a field development plan, assuming a proper one was effectively prepared, is not enough. The development plan must be approved by the Central Commission on Development (Section 11.3 of the Contract). Given CIOC's poor past performance, in particular CIOC's underperformance in trial production, one cannot assume

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[520] *Id.*, ¶ 154.

[521] *Id.*, ¶ 155.

[522] CIOC's Memorial, ¶ 271.

[523] **Ex. C-4**, Contract, Section 11.3.

> that CIOC would have been able to present an adequate plan that could be approved.[524]

393. Given all of the above, it is self-evident that CIOC was not a going concern. As in the *SPP* case, the project was in its infancy, key exploration of the deep formations remained to be accomplished and the project never had any commercial production and was not in operation for a sufficient period of time to generate reliable data for calculating future income based on commercial production. Likewise, the Brailovsky Valuation Report finds that "the conclusion of the historical performance of the project must be that CIOC is not a going concern."[525]

(b) CIOC Had No Record of Profits

394. During the entire Contract period prior to termination, CIOC generated no profits whatsoever.[526] As stated in the Brailovsky Valuation Report, CIOC's expenditures, which amounted to approximately USD 44.9 million, were larger than CIOC's revenues, which amounted to approximately USD 15.9 million.[527]

395. It is thus self-evident that CIOC had no record of profits.

(ii) There Must Be No Significant Investment to Be Made After the Date of the Alleged Taking

396. Tribunals have also refused to apply the DCF method or award lost profits when a significant part of the investment remains to be made after the alleged taking occurred, because this would lead to damages that are too uncertain or speculative. In *Tecmed*, the tribunal rejected the DCF method because, *inter alia*, the future cash flow

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[524] Mirbulat Ongarbaev Statement, ¶ 125.

[525] Brailovsky Valuation Report, ¶ 21.

[526] *Id.*, ¶ 18.

[527] *Id.*, ¶¶ 17-18.

was dependent upon investments that were to be made in the future.[528] As stated by the *Tecmed* tribunal:

> The non-relevance of the brief history of operation of the Landfill by Cytrar –a little more than two years– and the difficulties in obtaining objective data allowing for application of the discounted cash flow method on the basis of estimates for a protracted future, not less than 15 years, together with the fact that such future cash flow also depends upon investments to be made –building of seven additional cells– in the long term, lead the Arbitral Tribunal to disregard such methodology to determine the relief to be awarded to the Claimant.[529]

397. In *SPP*, the ICSID tribunal rejected the DCF method because, *inter alia*, "[a]t the time the project was cancelled, only 386 lots–or about 6 percent of the total– had been sold" and all "of the other lot sales underlying the revenue projections in the Claimants' DCF calculations [were] hypothetical."[530] The ICC tribunal also rejected the claimant's estimate of the value of its investment based on the DCF method because inter alia "[b]y the date of cancellation the great majority of the work had still to be done."[531]

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[528] **Ex. CA-44**, *Tecmed*, ¶ 186.

[529] *Id.* (internal citation omitted) (emphasis added); *see also,* **Ex. RL-79**, *Aram Sabet et al v. The Islamic Republic of Iran*, Iran-U.S. Claims Tribunal Cases No. 815, 816, and 817, Chamber Two, Award No. 598-815,816,817-2 dated November 28, 2000 ("*Sabet*"), ¶ 136 ("During the period in which the projections were made, the Zamzam Bottling Companies were engaged in a substantial expansion program. The Companies were in the process of building at least two new bottling plants and were modernizing and expanding existing bottling plants to allow for significantly higher production. This expansion program not only rendered less certain any projections that were made before and during the expansion, its cost diminished the likelihood that the Zamzam Companies would earn short-term profits. For valuation purposes, the more distant the expected cash flows, the more unreliable the use of the DCF method: Specifically, distant cash flows are more difficult to predict accurately, and their present value is more dependent on the chosen discount rate, a necessarily subjective feature in any DCF analysis." (emphasis added)).

[530] **Ex. CA-31**, *SPP ICSID*, ¶ 188.

[531] **Ex. RL-80**, *SPP (Middle East) Limited and Southern Pacific Properties Limited v. Arab Republic of Egypt and Egyptian General Company for Tourism and Hotels*, ICC Arbitration No. YD/AS No. 3493, Award dated March 11, 1983, 22 INTERNATIONAL LEGAL MATERIALS 1 (1983) ("*SPP ICC*"), ¶ 66.

398. Similarly, the tribunal in *Aucoven*, in refusing to award lost profits, took into account the fact that part of the investment had not yet been made and held that:

> The main purpose of the Agreement was the construction of the Bridge.... As a matter of contractual interpretation, one cannot rely exclusively on the figures set forth in the original [Financial Plan] without taking into account that the Bridge was never built. Otherwise, Aucoven would obtain the same compensation that it would have received had it built the Bridge and, for that purpose, invested the amounts forecast. The Tribunal is of the opinion that such result cannot be deemed to correspond to the intent of the parties.[532]

The *Aucoven* tribunal concluded that:

> In the present case, the fact remains that Aucoven had no record of profits and that it never made the investments in the project nor built the Bridge required by the Concession Agreement. In these circumstances, the Tribunal considers that Aucoven's claim for future profits does not rest on sufficiently certain economic projections and thus appears speculative.[533]

(a) The Overwhelming Majority of CIOC's Investment Was to Be Made After the Date of the Alleged Taking

399. At the time of the alleged taking, CIOC had completed less than 6% of the total investment it predicts in its damage claim. CIOC projected an investment of an additional USD 473.6 million and had only invested approximately USD 30 million as of 2008.[534] Thus, by CIOC's own admission, over 94% of the total investment remained to be made.[535]

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[532] **Ex. RL-65**, *Autopista*, ¶ 357 (emphasis added).

[533] *Id.*, ¶ 362 (emphasis added).

[534] Brailovsky Valuation Report, ¶ 18, Table 3; Appendix 1, at 39; *see also* CRA Quantum Report, ¶ 3.19, Table 1. These estimated capital expenditures comprised the installation of 6 deep rigs to drill wells into the sub-salt formation of the field, one medium rig to drill wells into the over-hang formation of the field, and two shallow rigs to drill wells into the supra-salt formation of the field.

[535] *See also*, Brailovsky Valuation Report, ¶ 59.

400. CIOC had thus only barely begun to make its investment at the time of the alleged taking. As in *Sabet*, the fact that CIOC's projected cash-flows are based on CIOC's future substantial investment to develop and expand the project renders the projection less accurate and uncertain, and thus the DCF method unreliable.[536] The Republic contends that, as in the *Aucoven case*, in which the tribunal rejected Aucoven's claim for lost profits, the fact that CIOC made such a small part of the total investment cumulated with the absence of a record of profits shows that CIOC's claim for future lost profits "does not rest on sufficiently certain economic projections and thus appears speculative."[537]

401. It is thus clear that the overwhelming majority of CIOC's investment, including 100% of the production stage investment, was to be made in the future and that its projected cash flow was dependent upon such an investment.

(iii) The Enterprise Must Have the Expertise and Financial Capacity Necessary to Generate Profits in the Specific Circumstances of the Case

402. The enterprise must have the expertise and financial capacity necessary to be profitable or expand its investment in the future. Examples of the application of this criterion can be found in the *Vivendi II, Levitt* and *Wena* cases.[538] In *Vivendi II*, the tribunal examined the expertise of the claimant to determine whether it would likely have been profitable under the circumstances of the case.[539] As stated by the tribunal in *Vivendi II*:

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[536] **Ex. RL-79**, *Sabet*, ¶ 136.

[537] **Ex. RL-65**, *Autopista* ¶ 362.

[538] **Ex. RL-67**, *Vivendi II*, ¶ 8.3.4; **Ex. RL-74**, *Levitt*, ¶¶ 56-58; **Ex. CA-41**, *Wena*, ¶ 124.

[539] **Ex. RL-67**, *Vivendi II*, ¶ 8.3.4.

> A claimant might be able to establish clearly that an investment, such as a concession, would have been profitable by presenting *sufficient* evidence of its expertise and proven record of profitability of concessions it (or indeed others) had operated in similar circumstances.[540]

The tribunal acknowledged the evident expertise of the claimants (Compagnie Générale des Eaux/Vivendi Universal), but rejected the claimants' damage claim that included future lost profits calculated using the DCF method because the claimants did not present convincing evidence of their ability to produce profits in the particular circumstances they faced.[541]

403. Similarly, the tribunal in *Levitt* rejected claimant's claim for lost profits resulting from the breach of a contract for the construction of a housing development in Iran because it did not establish "with a sufficient degree of certainty that the project would have resulted in a profit."[542] To make this determination, the tribunal took into account, *inter alia*, the fact that the claimant "would have experienced considerable difficulties in proceeding with the major phases of the construction under the prevalent conditions of disruption and unrest, particularly in view of the fact that it was the first such project Mr. Levitt had undertaken in Iran."[543]

404. In *Wena*, the tribunal, which was ruling on the seizure by the Arab Republic of Egypt of two hotels operated by the claimant, rejected "Wena's claims for lost profits (using a discounted cash flow analysis), lost opportunities and

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[540] *Id.* (italic in original) (underlining added).

[541] *Id.*, ¶ 8.3.8.

[542] **Ex. RL-74**, *Levitt*, ¶ 58.

[543] *Id.*, ¶¶ 56-57 (emphasis added).

reinstatements costs,"[544] because inter alia there was some doubt as to the financial capacity of the claimant to expand and operate its investment.[545] The tribunal held that:

> Like the *Metaclad* and *SPP* disputes, here, there [was] insufficiently 'solid base on which to found any profit... or for predicting growth or expansion of the investment made' by Wena. Wena had operated the Luxor Hotel for less than eighteen months, and had not even completed its renovations on the Nile Hotel, before they were seized on April 1, 1991. In addition, there is some question whether Wena had sufficient finances to fund its renovation and operation of the hotels.[546]

(a) CIOC Did Not Have the Expertise or Financial Capacity to Operate and Expand the Project

405. CIOC did not have the expertise or financial capacity to operate and expand the project at the time of the alleged taking. Solid oil and gas technical and managerial competence as well as solid financial capabilities are inherent requirements associated with petroleum exploration and production operation.[547] In its Compliance Report IFM describes these requirements as follows:

> Petroleum exploration and production is a serious business that requires solid oil and gas technical and managerial competence. This is in particular true for deep well drilling which is technically very challenging. Technical issues increase considerably with the depth of the drilling.
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> [...]
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> Likewise, petroleum exploration and production requires very solid financial capabilities. The oil industry is capital intensive. Oil exploration is financially risky. Millions can be spent without a commercial discovery and may have to be written off. Events can cause exploration budgets to soar.

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[544] **Ex. CA-41**, *Wena*, ¶ 123.

[545] *Id*, ¶ 124.

[546] *Id.* (internal citations omitted) (emphasis added).

[547] IFM Reserves Report, Section 5.1; IFM Compliance Report, Sections 8.1.1 and 8.1.2.

> This is all the more true with deep well drilling which is financially very risky. Financial skills are also important.[548]

406. As shown above and in IFM Compliance Report, CIOC lacks both. CIOC alleges that it would have been able to make an investment of an additional USD 473.6 million.[549] These estimated capital expenditures comprised the installation of six deep rigs, one medium rig and two shallow rigs to drill wells into, respectively, the sub-salt, over-hang, and supra-salt formations of the field.[550] There can only be very serious doubt as to whether CIOC would have had the ability to carry out such a program and to make such an investment in light of CIOC's obvious lack of financial capacity and expertise.[551]

407. First, at the time of the alleged taking, and unlike the claimants in the *Vivendi II* case, CIOC did not have the level of expertise and management skills necessary to operate and develop the project they alleged they would carry out in the future.[552] As in the *Levitt* case, the Caratube project was the first and only project ever undertaken by CIOC in its young and short business life.[553] CIOC is a company with no previous experience of the oil and gas industry.[554] Thirty-eight year old Devincci

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[548] IFM Compliance Report, ¶¶ 102, 110.

[549] CRA Quantum Report, ¶ 3.19, Table 1; Brailovsky Valuation Report, Appendix 1, at 39.

[550] IFM Reserves Report, ¶ 174.

[551] *Id.*; Mirbulat Ongarbaev Statement, ¶ 103 ("To me, the reasons for [CIOC's failure to perform its obligations] are to be found in other places: incompetence or insufficient financial means or lack of real intent to exploration and drill the deeper formations.").

[552] **Ex. RL-67**, *Vivendi II*, ¶ 8.3.8.

[553] **Ex. RL-74**, *Levitt*, ¶¶ 56-57; *see also,* IFM Compliance Report, ¶ 122.

[554] IFM Compliance Report, ¶ 102, 122.

Hourani, CIOC's majority shareholder, has "virtually no or certainly no successful oil and gas experience."[555]

408. Moreover, and most significantly, as shown above, CIOC was in a permanent state of material breach of its obligations under the Contract. Between 2002 and 2008, CIOC systematically and continuously failed to perform its obligations under the Contract.[556] CIOC failed to comply with any of the Annual Work Programs or with the Minimum Work Program by an enormous margin.[557] CIOC failed to act as a prudent operator and failed to accomplish its key exploration obligations, i.e. to duly and timely complete the 3D seismic study and the drilling of the two deep wells into the sub-salt formation of the field.

409. This is clear evidence of a lack of the requisite expertise and management skills. The IFM Compliance Report provides additional examples and further discussion concerning CIOC's lack of expertise and management skills.[558]

410. Second, as in *Wena*, CIOC has presented no evidence of its ability to obtain the necessary financing to fund the operation and to make the remaining substantial investment required for the successfully completion of the project. Devincci Hourani acquired 92% of CIOC's capital for USD 6,500.[559] Moreover, the historical data reviewed shows that CIOC had used the income from the sale of oil extracted from the

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[555] *Id.*, ¶ 102.

[556] *Id.*, ¶ 73; Mirbulat Ongarbaev Statement, ¶ 40.

[557] IFM Compliance Report, Section 6; Mirbulat Ongarbaev Statement, ¶ 38, Table 4.

[558] IFM Compliance Report, Sections 8.1.1 and 8.2.

[559] **Ex. R-7**, Agreement between Fadi Jamal Hussein and Devincci Hourani dated May 17, 2004 (indicating a payment of 850,000 Tenges for a 85% share in CIOC); **Ex C-56**, Agreement between Waheeb George Antakly and Devincci Hourani dated April 8, 2005 (indicating a payment of 70,000 Tenges for an additional 7% share in CIOC). In total Devincci Hourani paid 920,000 Tenges (USD 6,500) for his alleged 92% share ownership in CIOC.

known reserves to finance its very limited investment.[560] The limited income was obtained by exploiting existing wells and drilling in well-known areas.[561] As stated by IFM in its Compliance Report:

> The arbitrage that CIOC made in favor of easy access of oil in the Suprasalt formation to make quick money and in the cheapest possible manner financially (see my above review concerning the 2003 performance, when CIOC re-entered Soviet wells instead of drilling new ones at greater expense and in accordance with the 2003 AWP) is telling concerning its need for immediate cash and potentially lack of financial capabilities.[562]

411. Most importantly, as shown above, CIOC failed to comply with its financial obligations and to make the required investments under the Annual Work Programs.[563] Most of the failures listed above with respect to CIOC's lack of expertise were also caused by CIOC's poor financial capacities.

412. This is clear evidence of a lack of financial capacities. The IFM Compliance Report provides other examples and further discussion concerning CIOC's lack of financial capacities.[564]

413. In sum, as stated in IFM Compliance Report:

> 127. CIOC has the profile of a very high risk corporation with a very limited amount of oil and gas experience. CIOC faced a task too big for it, and did not do it well. CIOC repeatedly, from the beginning through the end, materially breached its obligations. I have seen no valid excuse for such breaches....
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> 128. In my opinion, this is because CIOC was incapable of properly performing from a technical and managerial as well

[560] IFM Compliance Report, ¶ 110; Brailovsky Valuation Report, ¶ 19.

[561] IFM Compliance Report, ¶ 110; Brailovsky Valuation Report, ¶ 20.

[562] IFM Compliance Report, ¶ 110.

[563] *Id.*, ¶¶ 99, 110.

[564] *Id.*, Sections 8.1.2 and 8.2.

> as from a financial standpoint. It is quite obvious that CIOC was not equipped to take the extensive deep drilling risks either financially or technically. It is also my opinion that CIOC was not determined to comply under the Contract and work programs and was content to take the cheap and easy oil from the known Supra-salt formations.[565]

Given the above, it is clear that CIOC did not have the solid oil and gas technical and managerial competence or the very solid financial capabilities necessary to carry out petroleum operation and production and to be profitable in the future.

(iv) The Disparity Between the Requested Compensation and the Investment Made Must Be Reasonable

414. Tribunals have also looked at the disparity between the requested amount and the investment actually made to determine whether the DCF method was appropriate. The greater the disparity between the investment made and the alleged investment value, the less likely that the DCF method will be appropriate in the circumstances of the case. The reasoning behind this requirement is that an unreasonable disparity is strong evidence of an unrealistic evaluation of the damages.

415. In *Wena*, the tribunal stated that it was "disinclined to grant Wena's request for lost profits and lost opportunities given the large disparity between the requested amount (GB£ 45.7 million) and Wena's stated investment in two hotels (US$8,819,466.93)."[566] Similarly the AIG tribunal stated that:

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[565] IFM Compliance Report, ¶¶ 127-128.

[566] **Ex. CA-41**, *Wena*, ¶ 124 (internal citation omitted); *see also,* **Ex. CA-44**, *Tecmed*, ¶ 186 ("The Arbitral Tribunal has noted ... the considerable difference in the amount paid under the tender offer for the assets related to the Landfill –US$ 4,028,788– and the relief sought by the Claimant, amounting to US$ 52,000,000, likely to be inconsistent with the legitimate and genuine estimates on return on the Claimant's investment at the time of making the investment." (internal citation omitted)); **Ex. RL-80**, *SPP ICC*, ¶¶ 64-65 (Another reason that the Tribunal took into account in rejecting claimant's estimate of the value of the investment based on the DCF method was the disparity between the USD 42,500,000 claimed by claimants and the USD 5,062,657 invested by claimants: "The calculation put forward by the Claimants produces a disparity between the amount of the investment made by the Claimants and its

> In the opinion of this Tribunal loss of profit of an order of USD 13.1 million (as claimed) on an assumed total projected investment of USD 16.3 million cannot possibly reflect a 'fair market value' of the investment taken when the actual amount spent on the date of taking was only USD 3.56 million.
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> [...]
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> Any basis of calculation that results in a claim of loss of profit of USD 13.1 million for what was at the time of expropriation an actual investment of only USD 3.56 million (without accounting for the interest or profit earned on the balance of USD 12.74 million remaining to be invested) would, in the opinion of this Tribunal, be highly speculative: whether on the DCF method or any other method of computation.[567]

(a) The Disparity Between CIOC's Claimed Compensation and CIOC's Investment Is Extreme

416. In this case, there is an extreme disparity between the compensation claimed by CIOC and the amount of investment it has made. CIOC is claiming compensation of approximately USD 1.005 billion (without interest) but had only invested USD 30 million at the time of the alleged taking. CIOC is thus requesting compensation that is more than 33 times greater than its total investment.[568] The Republic notes in passing that in its Request for Arbitration, CIOC claimed that its lost profits would have exceeded USD 2 billion.[569] CIOC never explained why its claim dropped by almost one half.

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supposed value at the material date.").

[567] **Ex. RL-68**, *AIG*, at 102-103.

[568] This ratio would be 22.5 if CIOC's total expenditures, i.e., USD 44.5 million, were compared to CIOC's claimed compensation.

[569] CIOC's Request for Arbitration, ¶ 85.

417. Tribunals have rejected claims for lost profits using the DCF method in cases where the ratio was lower by far. In *Wena*, the ratio was 8.5.[570] In SPP, the ratio was 8.4.[571] In *AIG*, the ratio was only 3.6.[572] CIOC's ratio of twenty-two is 2.5 times the *Wena* and *SPP* ratios and six times greater than the *AIG* ratio.

418. Moreover, CIOC's ratio is far higher if, as in the *Tecmed* case, the tribunal uses the ratio between the amount paid by CIOC to acquire the Contract and the amount of CIOC's claimed compensation. CIOC paid CCC USD 9.4 million to acquire the Contract but it now requests compensation of USD 1.005 billion (without interest), i.e., a ratio of almost 107 times. In Tecmed, the tribunal, in rejecting the DCF method, noted the "considerable difference in the amount paid under the tender offer for the assets related to the Landfill –US$ 4,028,788– and the relief sought by the Claimant, amounting to US$ 52,000,000,"[573] i.e., a ratio of approximately 13 times. If a ratio of 13 times is a "considerable difference," how should one qualify a ratio of 107 times?

419. Given the above, it is clear that such extreme disparities are strong evidence of an unrealistic and inappropriate evaluation of the damages. To rephrase the *AIG* tribunal, the Republic contends that the extreme disparity between the compensation CIOC claims and its investment shows that "an otherwise acceptable method of computation could not possibly be the right method in the facts and circumstances of the instant case."[574]

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[570] **Ex. CA-41**, *Wena*, ¶ 124. Wena requested GBP 45.7 million out of an investment of USD 8,819,466.93.

[571] **Ex. RL-80**, *SPP ICC*, ¶ 64. SPP requested USD 42,500,000 out of an investment of USD 5,062,657.

[572] **Ex. RL-68**, *AIG*, at 103. AIG requested USD 13.1 million (without interest) out of an investment of USD 3.56 million.

[573] **Ex. CA-44**, *Tecmed*, ¶ 186 (internal citation omitted).

[574] **Ex. RL-68**, *AIG*, at 103.

(v) The Projection Must Be Over a Reasonable Period of Time

420. The projection of the cash-flow of the enterprise must be computed over a reasonable period of time. If the projection is over a too long period of time, especially in the oil industry where oil prices are highly volatile,[575] tribunals have found that the application of the DCF method would result in a compensation that is speculative and uncertain. In particular, the *Amoco* tribunal held that a projection of over 18 years was speculative and ultimately refused to use the DCF method to calculate the market value of a going concern with a record of profitability:

> The element of speculation in a short-term projection is rather limited, although unexpected events can make it turn out to be wrong. The speculative element rapidly increases with the number of years to which a projection relates. It is well known, and certainly taken into account by investors, that if it applies to a rather distant future a projection is almost purely speculative, even if it is done by the most serious and experienced forecasting firms, especially if it relates to such a volatile factor as oil prices. Such projections can be useful indications for a prospective investor, who understands how far it can rely on them and accepts the risks associated with them; they certainly cannot be used by a tribunal as the measure of a fair compensation.[576]

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[575] **Ex. CA-32**, *Amoco*, ¶ 237 ("Actually, it is well known that oil prices have demonstrated a great instability.... The difficulties and risks of error inherent in every price forecast are therefore considerably aggravated. A clear illustration of this situation is provided by the discrepancies which can be observed between the oil price forecasts used in the Claimant's expert study and the actual evolution of prices from 1979 to 1987.").

[576] *Id.*, ¶ 239 (emphasis added); *see also*, **Ex. RL-81**, Louis Wells, *Double Dipping in Arbitration Awards? An economist Questions Damages Awarded to Karaha Bodas Company in Indonesia*, 19 ARBITRATION INTERNATIONAL 471 (2003) (hereinafter "Wells, *Double Dipping in Arbitration Awards*"), at 474 ("Projecting the stream of earnings for 30 years requires some heroic assumptions, especially for a project that has not yet been completed and thus has no track record....").

Similarly, the *Tecmed* tribunal also took into account in rejecting the DCF method that the projection was based on estimates "for a protracted future, not less than 15 years."[577]

(a) CIOC's Projection Is Over a Period of Time That Is Too Long

421. The Republic contends that CIOC's cash-flow projection is too speculative because it is calculated over too long a period of time. Specifically, CIOC's DCF calculation depends on forecasting cash flows based on the sale of oil over 37 years into the future. Oil prices are unstable and oil price forecasting is notoriously imprecise.[578] The risks of error of an oil price forecast over 37 years are tremendous. A cash-flow projection based on oil prices over 37 years is highly speculative.[579]

422. Given the above, it is clear that CIOC's projection of over 37 years, based on volatile oil prices, will lead to speculative and uncertain results.

423. In conclusion, the Republic contends that there is no sufficient basis to allow the Tribunal to reasonably calculate future revenues and to justify the award of lost profits based on the DCF method. In particular, the Republic maintains that the awarding of lost profits calculated using the DCF method is not appropriate in the circumstances of the case because, as shown above:

- CIOC was not a going concern with a record of profit, i.e. CIOC's project was in its infancy, key exploration in the deep formations remained to be accomplished and the project never had any commercial production and

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[577] **Ex. CA-44**, *Tecmed*, ¶ 186.

[578] Brailovsky Valuation Report, ¶ 63; *see also,* **Ex. CA-32**, *Amoco*, ¶ 237.

[579] **Ex. CA-32**, *Amoco*, ¶ 237.

was not in operation for a sufficient period to generate reliable data for calculating future income based on commercial production. In fact CIOC never made any profits at all;

- The overwhelming majority of CIOC's investment (over 94%), including 100% of its production stage investment, was to be made in the future and CIOC's projected cash flow was dependent upon such an investment;

- CIOC did not have the solid oil and gas technical and managerial competence or the solid financial capabilities necessary to carry out petroleum operation and production and be profitable in the future;

- The disparity between CIOC's claimed compensation and CIOC's investment is extreme (the claimed compensation is 33 times greater);

- CIOC's 37 year projection is too speculative because it is based on volatile and unstable oil prices and over too long a period of time.

CIOC's projected future earnings are simply too uncertain and too speculative to permit the award of lost profits calculated using the DCF method.

424. Before proceeding further with the analysis of the valuation method that the Republic considers appropriate in the case at hand, the investment value, the Republic wishes to briefly discuss the cases relied on by CIOC to argue that the DCF method is the most appropriate method to determine the fair market value of CIOC's investment in this case.[580] CIOC relied on four cases, i.e. *Phillips Petroleum,*[581] *Starrett*

[580] CIOC's Memorial, ¶¶ 265-270.

Housing,[582] *ADC*,[583] and *CME*.[584] In each of these cases, the tribunals have applied or relied on the DCF method to determine the amount of compensation to be awarded, however, as will be shown below, the facts of these cases are easily distinguishable from the facts at hand.

425. In *Phillips Petroleum*, the tribunal found that, on September 19, 1979, Phillips was deprived, by conduct attributable to the Government of Iran, of its rights under a contract, for the exploration and exploitation of the petroleum resources of a certain area offshore in the Persian Gulf, executed among Phillips, AGIP, the Oil and Natural Gas Commission of India as well as the National Iranian Oil Company and effective on February 13, 1965.[585] The tribunal held that Phillips' contractual rights were part of a profitable going concern.[586] As stated by the *Phillips Petroleum* tribunal:

> [T]he Parties formed IMINOCO soon after the JSA entered into force and conducted all their operations through IMINOCO. IMINOCO began a seismic survey in the spring of 1965, and further surveys and exploratory drilling from 1965 to 1969 led to the relinquishment of three of the four blocks covered by the JSA and to the discovery of two fields in the remaining block, called block 'R'. The discoveries were named the Rostam field and the Rakhsh field. The Second Party submitted the required commerciality report on Rostam in 1967 and on Rakhsh in 1969. NIOC reviewed the reports

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[581] **Ex. CA-38**, *Phillips Petroleum*.

[582] **Ex. CA-72**, *Starrett Housing*.

[583] **Ex. CA-74**, *ADC Affiliate Limited et al v. The Republic of Hungary*, ICSID Case No. ARB/03/16, Award of the Tribunal dated October 2, 2006 ("*ADC*").

[584] **Ex. CA-75**, *CME Czech Republic B.V. (The Netherlands) v. The Czech Republic*, UNCITRAL, Final Award dated March 14, 2003 ("*CME Final*").

[585] **Ex. CA-38**, *Phillips Petroleum*, ¶¶ 100-102.

[586] *Id.*, ¶¶ 106, 111-113 ("106. [...] That the Claimant's JSA contract rights, which the Tribunal has found continued to exist until they were taken by the Respondents in September 1979, were part of a 'going concern' is demonstrated by the history described above and, in particular, by the fact that the wells, platforms, pipelines, and storage facilities covered by the JSA produced petroleum from the JSA fields both before and after the taking in 1979, except for a few months in late 1978 and early 1979 when they were shut down as a result of strikes and violence related to the culmination of the Islamic Revolution.").

> and declared the fields commercial, Rostam on 11 March 1968 and Rakhsh on 14 December 1969. An active development phase followed for each of the two fields, during which platforms were constructed, wells drilled, and pipelines laid. Commercial production began in Rostam on 19 September 1969 and in Rakhsh in February 1971.[587]

Thus, the two fields had been in commercial production for 10 years and eight-and-a-half years, respectively. The tribunal thus applied the DCF method to determine the fair market value of Phillips' property interest at the date of the taking.[588]

426. Contrary to Phillips, CIOC has never even begun commercial production and not even completed exploration, let alone has a track record of eight to ten years of commercial production as in *Phillips Petroleum*.[589] Moreover, unlike in *Phillips Petroleum*, the vast majority of CIOC's investment and work remained to be done. There thus can be no parallel possible between Phillips and CIOC.

427. In *Starrett Housing*, the tribunal found that the Government of Iran expropriated Starrett Housing's property interest in a large housing project, which comprised the physical property as well as the right to manage the project, to complete its construction and collect the proceeds from the sales of approximately 1,500 apartments.[590] By the time of the expropriation, almost all the apartments had been sold, and according to Starrett Housing, the project was 75% complete.[591] The tribunal appointed an expert to value Starrett Housing's Iranian subsidiary as of the date of

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[587] *Id.*, ¶ 23.

[588] *Id.*, ¶¶ 112-113.

[589] *Id.*, ¶ 27 ("Each field had reached its peak production rate within the first few years of production and then declined significantly.").

[590] **Ex. CA-37**, *Starrett Housing Corporation et al v. The Government of the Islamic Republic of Iran et al*, Iran-U.S. Claims Tribunal Case No. 24, Interlocutory Award No. ITL 32-24-1 dated December 19, 1983, at 156-157.

[591] *Id.*, at 128, 130.

expropriation and directed the expert to consider "as he deems appropriate the discounted cash flow method of valuation."[592] The expert used the DCF method, and such method was accepted by all of the parties, including the Government of Iran, and was applied by the tribunal.[593]

428. Contrary to *Starrett Housing*, CIOC's cash flow calculation is not based on the sale of apartments that had already occurred by the time of the expropriation, but on the sale of oil during the production phase that had not even commenced at the time of the alleged taking. In addition, according to CIOC's own admission, its projected investment was less than 6% complete in January 2008, as opposed to the 75% allegedly made by the claimants in *Starrett Housing*. Finally, in *Starrett Housing*, the Government of Iran agreed to the application of the DCF method. In this case, the Republic, for all the reasons stated above and in the Brailovsky Valuation Report does not agree to the application of the DCF method.

429. In *ADC*, the tribunal found that the claimants' interests in the renovation of the Budapest international airport, construction of an additional terminal for the airport and their right to participate in the airport's ongoing operations had been unlawfully taken by the Republic of Hungary.[594] At the time of the taking, the claimants, and a project company, had completed the renovation of the airport and the construction of

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[592] *Id.*, at 157; *see also,* Concurring Opinion of Howard M. Holtzmann, at 176-177 ("I think, however, that it would have been better not to have suggested any particular theory. In stating this I note that no party in this case has proposed use of the discounted cash-flow method. The Tribunal has no knowledge as to whether this method, which is typically used to value going concerns with a long future expectancy of continuing business, is equally appropriate when valuing a short-term construction project to build and sell condominium apartments, in which the owner would have no further participation in the project – particularly when substantially all of the apartments had been sold before the expropriation.").

[593] **Ex. CA-72**, *Starrett Housing*, ¶¶ 32, 36-37, 277-280. The Tribunal, however, reduced its own expert calculation of the net revenue of the Starrett Housing's Iranian subsidiary by some 90% (reducing gross profit by 350 million Rials, from 377 million Rials to 27 million Rials) (¶¶ 337, 342).

[594] **Ex. CA-74**, *ADC*, ¶¶ 109, 476.

the terminal, had participated in the airport's ongoing operations for approximately three years, and the project company had been profitable.[595] The tribunal rejected the Republic of Hungary's contention that the renovation of the existing terminal and the construction of the additional terminal were poorly performed by the claimants.[596] The project company was a profitable going concern. The tribunal used the DCF method, without much justification, to calculate the market value of the expropriated investments as of the date of the award.[597]

430. Unlike the claimants and the project company in *ADC*, CIOC has never been profitable, did not complete its projected investment and has never begun any commercial production. CIOC was not a profitable going concern at the time of the alleged taking. Unlike the claimants in *ADC* who professionally performed the renovation of the terminal and the construction of the airport, CIOC had not even finished the exploration phase of the Contract which required drilling two wells in the sub-salt structure of the field.

431. In *CME*, the tribunal found that the Czech Republic destroyed CME's investment in a television services company, CNTS, which operated a broadcasting license through a broadcasting station, in breach of several provisions of the applicable BIT.[598] At the time of the destruction of CME's investment, the broadcasting station was, according to CME, the:

> Czech Republic's most popular and successful television station with an audience share of more than 50%, with USD109 million revenues and USD 30 million net income in

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[595] *Id.*, ¶¶ 153-154, 162-164.

[596] *Id.*, ¶¶ 262-263, 275-276.

[597] *Id.*, ¶¶ 499, 502, 514.

[598] **Ex. CA-75**, *CME Final*, ¶¶ 8-12, 52.

> 1998. CME claims to have invested totally an amount of USD140 million, including the afore-mentioned share purchase transactions for the acquisition of the 99 % shareholding in ČNTS, by 1997.[599]

CNTS was a profitable going concern. The parties agreed that the DCF method was an appropriate valuation method in this case,[600] but the tribunal held, however, that

> the adjusted DCF calculation due to its dependence on disputed assumptions can serve only as a confirmation of the Tribunal's findings in assessment of the SBS offer, which as described above provided a firm value for CNTS at the amount of USD 400 million. The Tribunal does not see any need to review this finding in the light of the parties' DCF valuations, which contain a rather high element of uncertainty and speculation.[601]

Thus, the *CME* tribunal, contrary to CIOC's allegations,[602] relied on a sales transaction entered into between CME and a third party purchaser in 1999 to determine the fair market value of CNTS.[603]

432. Contrary to CNTS in the *CME* case, CIOC's situation cannot be compared to that of a successful oil and gas business, with USD 109 million revenues and USD 30 million net income in 2007. Unlike CNTS, CIOC never generated any net income at all. Moreover while CNTS was already a highly successful and popular TV station with a large audience, CIOC's project was in its infancy with less than 6% of CIOC's total projected investment having been made, and with a meager and disappointing trial production record, well below the target of the Annual Work Programs.

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[599] *Id.*, ¶ 14.

[600] *Id.*, ¶ 564.

[601] *Id.*, ¶ 604.

[602] CIOC's Memorial, ¶ 270 ("In *CME* v. *Czech Republic* the Tribunal found that there was no expropriation but that the claimant was still entitled to the fair market value of its investment valued according to the DCF method as a result of the Tribunal's finding that other standards of the BIT had been breached." (internal citation omitted) (emphasis in original)).

[603] **Ex. CA-75**, *CME Final*, ¶¶ 514-562.

C. The Updated Investment Value Is the Appropriate Valuation Method

433. As demonstrated above, since CIOC is not entitled to lost profits, the DCF method is not appropriate to determine CIOC's fair market value. The Republic contends that the proper method of valuation of CIOC's fair market value is not an income-based valuation but, as stated in the Brailovsky Valuation Report, is a cost-based valuation, namely the updated investment value.[604]

434. This method values "the amount actually invested prior to the injurious acts"[605] and updates it "to take into consideration two factors: inflation and depreciation."[606] Tribunals have relied on this method when the investment was made recently or was still in the process of being made.[607] As stated by Louis Well:

> [w]hen the investment is very recent, or still in the process of being made, there is an obvious and often easier alternative to using NVP of future cash flow to determine [fair market value]. If the project was expected to generate 'normal' rates of return for the business, then the amount of investment itself provides a reasonable starting point for determining [fair market value]. In most cases, the [fair market value] of recently acquired assets is unlikely to be substantially different from the cost of those assets. Cost of investment will approximate what a buyer might pay; moreover, the investor who receives his investment back can invest the sum in another project, earn normal returns, and be equally well off. For most unfinished projects, this should end the calculations.[608]

435. The tribunal in *Wena* found that the proper calculation of the fair market value of Wena's investment prior to the expropriation was "best arrived at, in this case,

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[604] Brailovsky Valuation Report, ¶¶ 23-24.

[605] **Ex. RL–67**, *Vivendi II*, ¶ 8.3.12.

[606] Brailovsky Valuation Report, ¶ 23.

[607] **Ex. RL–67**, *Vivendi II*, ¶ 8.3.13; **Ex. CA-41**, *Wena*, ¶ 125; **Ex. RL–66**, *Metalclad*, ¶ 122.

[608] **Ex. RL-81**, Wells, *Double Dipping in Arbitration Awards?*, at 475 (internal citations omitted).

by reference to Wena's actual investments in the two hotels."[609] The *Wena* tribunal rejected Wena's claim for lost profits using the DCF method on the grounds that:

> [l]ike the *Metaclad* and *SPP* disputes, here there [was an] insufficiently 'solid base on which to found any profit ... or for predicting growth or expansion of the investment made' by Wena. Wena had operated the Luxor Hotel for less than eighteen months, and had not even completed its renovations on the Nile Hotel, before they were seized on April 1, 1991. In addition, there is some question whether Wena had sufficient finances to fund its renovation and operation of the hotels.[610]

The grounds on which the *Wena* tribunal rejected Wena's claims for lost profits using the DCF method and applied the investment value are the same, i.e., at the time of the expropriation the project was in its infancy and had incurred only losses, parts of the projected investment had not been made, and there were uncertainties as to the financial capacity of the investor to carry out the remaining investment and operate the project.

436. Similarly, the *Metaclad* tribunal rejected the use of a DCF analysis of future profits to establish the fair market value of Metaclad's investment because the business, a landfill, had never been operative.[611] For the same reason, the *Metaclad* Tribunal used Metaclad's actual investment to determine Metaclad's fair market value.[612]

437. As shown above, CIOC's investment was recent and had just begun (by its own admission CIOC has made only 6% of its total projected investment, and not even started prospective drilling of the deep zones). Moreover, at the time of the

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[609] **Ex. CA-41**, *Wena*, ¶ 125 (internal citations omitted).

[610] *Id.*, ¶ 124.

[611] **Ex. RL–66**, *Metalclad*, ¶ 121; *see also* **Ex. RL–67**, *Vivendi II*, ¶¶ 8.3.8-8.3.13.

[612] **Ex. RL–66**, *Metalclad*, ¶ 122.

alleged taking, CIOC had no record of profits and, as it was only in the Exploration phase, it never had any commercial production. The Republic contends that under these circumstances, like in the *Wena* and *Metaclad* cases, the updated investment value is the appropriate valuation method of CIOC's fair market value.

438. Using this valuation method, the Brailovsky Valuation Report determines that the fair market value of CIOC's asset as of the date of the alleged taking is USD 31.8 million.[613] As summarized in the Brailovsky Valuation Report:

> [T]his report has determined that the appropriate approach to valuation is the type of cost-based method known as the updated investment value. This method yields a value of US$31.8 million. Such amount, if granted as compensation, would allow CIOC to recover its investment over the last 5 years and make some profits....[614]

In the words of Mr. Brailovsky, "[t]his is a reasonable reward for a project in the exploration phase consisting in trial production of oil that had already been discovered and partly drilled."[615]

D. Even Assuming That DCF Is the Appropriate Valuation Method, CIOC's Calculation Is Erroneous

439. Before discussing CIOC's DCF calculation, the Republic wishes to point out that if the Tribunal considers that CIOC is not entitled to lost profits or that the DCF method is not appropriate under the circumstances, as the Republic respectfully submits it should, there will be no need to consider CIOC's erroneous DCF calculation at all. Thus the following discussion is made on a subsidiary basis only.

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[613] Brailovsky Valuation Report, ¶ 31.

[614] *Id.*, ¶ 89.

[615] *Id.*, ¶ 32.

440. CIOC requested CRA to determine the value of its investment.[616] CRA determined that the DCF method was the appropriate method to assess the fair market value of CIOC's investment.[617] It estimated that value, at the time of the alleged taking, at USD 1.005 billion.[618]

441. CRA based its calculation on the TRACS Reserves Report. For DCF valuation purposes, CIOC requested TRACS to provide an estimate of the reserves of the Caratube field as well as a production and costs profile.[619] TRACS' reserves re-calculation gives an estimate of the reserves that is considerably higher than the one that CIOC itself had presented with the assistance of its expert consultant, Caspian Energy Research ("**CER**"), to the Republic's State Committee on Reserves of the Republic in February 2008 (the "**CIOC/CER 2008 Reserves Estimate**").[620] It also produced a risked full field production profile (the "**TRACS Risked Full Field Production Profile**") based on a very ambitious future development plan for the Caratube field.[621] To provide its Risked Full Field Production Profile, TRACS assumed that CIOC would be able to carry out TRACS' oil field development plan.[622]

442. The Republic contends that CRA's DCF calculation based on the flawed TRACS Reserves Report is erroneous. As shown in the Brailovsky Valuation Report, CRA's DCF calculation is based on wrong assumptions, such as the flawed information provided in the TRACS Reserves Report, exaggerated export prices and inflation rate

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[616] CRA Quantum Report, ¶ 1.2.

[617] *Id.*, ¶¶ 1.8-1.10.

[618] *Id.*, ¶ 1.14.

[619] TRACS Reserves Report, ¶¶ 2, 4.

[620] IFM Reserves Report, ¶ 121.

[621] TRACS Reserves Report, ¶ 316.

[622] *Id.*, ¶ 343.

and a low discount rate, which fails to take into account the country and the company specific risks.

443. The Republic maintains that a proper DCF calculation would be based on a liquidation production profile, realistic oil price and inflation forecasts, and a discount rate of 26.1% pa, which takes into account the country and the company specific risks.

1. CRA's DCF Calculation Is Erroneous Because It Is Based on Flawed Information Provided in the TRACS Reserves Report

444. First, CRA's DCF calculation is entirely based on the flawed information provided in the TRACS Reserves Report, i.e. TRACS' reserves re-calculation and the TRACS Risked Full Field Production Profile.

445. In its reserves re-calculation, even though TRACS concurred with most aspects of the CER/CIOC 2008 Reserves Estimate, which was presented by CIOC itself to the State Committee on Reserves, TRACS greatly departed from these estimations.[623]

446. As shown in the IFM Reserves Report, TRACS illegitimately included in its reserves re-calculation probable reserves in the supra-salt zones as well as contingent and probable resources in the overhang and sub-salt zones.[624] The contingent and probable resources located in these deeper zones, into which CIOC never drilled despite its contractual obligations to do so, are speculative resources with a very high

[623] Mirbulat Ongarbaev Statement, ¶¶ 120-121.

[624] IFM Reserves Report, ¶¶ 120, 123.

degree of uncertainty.[625] They, according to IFM, should be excluded from the estimation of CIOC's reserves for financial valuation purposes.[626]

447. Based *inter alia* on the above, IFM concludes that:

> IFM is of the opinion that TRACS Reserves Re-Calculation is fundamentally flawed for the purpose of which it was done and should be disregarded.[627]

Likewise, Mr. Ongarbaev explains that:

> It is apparent from Table No. 6 [in Mirbulat Ongarbaev Statement] that TRACS' Reserves Re-Calculation is contradicted by both the CIOC/CER 2008 Reserves Estimate and the February 29, 2008 Expert Opinion on Reserves. For the purpose of the calculation of its damages in the arbitration, CIOC, with the help of TRACS, pretends that there exist much more reserves than CIOC itself, CER and the State Committee on Reserves, assisted by the three independent experts, had calculated in February 2008, before the arbitration. I thus consider that the objectivity of TRACS' Reserves Re-Calculation is highly questionable and that it should be disregarded.[628]

Thus, the Republic contends that the TRACS' reserves re-calculation should be entirely disregarded by the Tribunal.

448. Moreover, the TRACS Risked Full Field Production Profile should also be disregarded by the Tribunal. Not only is it based on a fundamentally flawed reserves re-calculation discussed above but it also relies on an unrealistic development plan and erroneous rate of production and decline rate per well. TRACS' oil field development plan envisions the simultaneous running of six deep drilling rigs in a remote area of a

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[625] *Id.*, ("123. As a general matter, TRACS achieves its inflation of reserves by recognizing as reserves 'Contingent' or 'Prospective' resources, mistakenly, we believe.").

[626] *Id.*, ¶¶ 123-126.

[627] IFM Reserves Report, ¶ 155; *see also, Id.*, ¶ 121 ("Mr. Tiefenthal's recalculation is unfounded and fails to demonstrate any basis for departing so greatly from the existing and certified reserves calculations.").

[628] Mirbulat Ongarbaev Statement, ¶ 123.

developing country and assumes that all wells will be drilled immediately and simultaneously, and that they will all have a high production rate.[629] As shown in the IFM Reserves Report, TRACS' development plan is unrealistic because, *inter alia*, it is so ambitious that it would be "virtually impossible to achieve by any prudent company, which CIOC was not, with limited financial and human resources."[630] IFM further states that:

> Not even large international oil companies like Chevron, Exxon or B.P. with their know how, technical expertise, financial strengths and human resources are known to have run six deep drilling rigs simultaneously in one field. Resource requirements and supply logistics for running six deep drilling rigs throughout the year, including during harsh winter conditions, are enormous. The drilling of deep wells involves costs, technical issues and risks far greater than those of shallow wells.[631]

As stated by Mr. Ongarbaev:

> To my knowledge, no commercial oil companies operating in Kazakhstan, including the largest ones, have ever operated in parallel so many deep drilling rigs at the same time. I believe that this would be much too complex, expensive and risky.[632]

Thus, TRACS' development plan does not even correspond to the industry standards of major oil companies. In his Valuation Report, Mr. Brailovsky adds that:

> the drilling plan proposed in the Tiefenthal Reserves Report seems out of proportion to what has been happening since 1966.... This seems even more awkward when one sees that the proposed drilling plan is mainly concentrated in the

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[629] *See*, IFM Reserves Report, ¶ 174.

[630] *Id.*

[631] *Id.*

[632] Mirbulat Ongarbaev Statement, ¶ 131.

> sub-salt horizon of the reservoir, which CIOC so far has not attempted to explore, let alone exploit.[633]

449. IFM determined that in the circumstances of the case the appropriate profile to serve as a basis for a meaningful DCF calculation is the liquidation profile. Such a profile assumes that "the production starts to decline from the existing level of production, at a natural decline rate, and without taking into account any potential future capital expenditures in the field."[634] As stated in the Brailovsky Valuation Report:

> [a]ssuming additional capital expenditures in a discounted cash flow analysis is tantamount to rewarding the present assets of the project with profits of a *different* project, *i.e.* an expansion project, the investment of which has not been undertaken nor the concomitant risks confronted.[635]

450. The Republic thus contends that, in light of CIOC's track record, risk profile and lack of expertise and financial capabilities the liquidation profile is the appropriate one for DCF valuation purposes.

2. CRA's DCF Calculation Is Erroneous because it Is Based on Wrong Economic Assumptions

451. Second, CRA's DCF calculation is based on wrong economic assumptions. The Brailovsky Valuation Report criticizes CRA's high inflation rate, oil high price scenarios and very low discount rate of 8.9% pa, which does not take into account country and the company specific risks.[636] In particular, the Brailovsky Valuation Report states that:

> [t]he expert reports pose [...] a high price scenario that no analysts were expecting at the time of the termination; and a

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[633] Brailovsky Valuation Report, ¶ 62.

[634] IFM Reserves Report, ¶ 177.

[635] Brailovsky Valuation Report, ¶ 27 (emphasis in original).

[636] *Id.*, Section VI.

> discount rate so low that it would not even apply to a safe oil project in the United States.[637]

3. Appropriate DCF Calculation

452. Based upon the IFM Reserves Report, the Brailovsky Valuation Report and the Mirbulat Ongarbaev Statement, the Republic contends that the Tribunal should disregard entirely the TRACS Reserves Report and the CRA Quantum Report for DCF valuation purposes. An appropriate DCF calculation, using a liquidation profile, is provided in the Brailovsky Valuation Report.

453. This production profile is based on realistic oil prices, realistic inflation forecasts, and a discount rate of 26.1% pa. This discount rate was calculated using the average result of the two following valuation models, which both include consideration of the country-risk: the Capital Asset Pricing Model adapted to the particular case of an international project in the oil sector of Kazakhstan, and the country risk-rating model, which considers surveys among international lenders that measure investors' perception of risks associated with Kazakhstan.[638] The average result of the two models is 21.1%.[639] To this, the Brailovsky Valuation Report determined that it was necessary to add a 5% company-specific risk for the following reasons:

> CIOC is a single asset company (Caratube field) which cannot benefit from the advantages of diversification. This single resource has not yet been developed. It is also a relatively small company, and as such it tends to be subject to higher uncertainty than one of larger size. It is located in a remote area which lacks infrastructure. Access to the financial markets at a reasonable cost is questionable. The company's performance over the period 2002–2007 has

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[637] *Id.*, ¶ 91.

[638] *Id.*, ¶¶ 34-37.

[639] *Id.*, ¶ 57.

> been meagre. Depth of management and technical and professional staff expertise appears to be limited.[640]

Thus, with application of the factors described above and fully described in the Brailovsky Valuation Report, the appropriate discount rate is 26.1% pa.[641]

454. With application of the above assumptions, the net present value of the project, as calculated using the DCF method in the Brailovsky Valuation Report, is USD 15.3 million.[642] As stated by Mr. Brailovsky in his Valuation Report: "[t]his is a significant figure when one recalls that, during the period 2002 to January 2008, CIOC's cash flow was *negative* in the amount of US$29.0 million."[643] Mr. Brailovsky concludes that:

> The expert reports presented by Claimant, which concluded that the quantum of compensation should be about one billion dollars, are fundamentally flawed because they seek to reward CIOC for an expansion project that does not exist —an undertaking that the company has done little to achieve. Apart from this basic error of approach, the expert reports pose an extremely optimistic and premature enlargement of production and drilling, which bears no relationship with the history of the project in the past 40 years; a high price scenario that no analysts were expecting at the time of termination; and a discount rate so low that it would not even apply to a safe oil project in the United States.[644]

E. CIOC Has Not Suffered Moral Damages

455. CIOC also requests extraordinary relief in the form of moral damages in order to compensate it for the "substantial harm" allegedly suffered by CIOC, its

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[640] *Id.*, ¶ 55.

[641] *Id.*, ¶ 57.

[642] *Id.*, ¶ 90.

[643] *Id.*, ¶ 30.

[644] *Id.*, ¶ 91.

employees, directors and shareholders "as a result of the harassment."[645] However, as is discussed below, CIOC has not alleged much less proven the type of extraordinary injury that warrants moral relief.

456. Moral damages are distinct from contract, treaty or other material damages. Professor Crawford describes the concept of moral damage as follows:

> 'Moral' damage includes such things as individual pain and suffering, loss of loved ones or personal affront associated with an intrusion on one's home or private life.[646]

457. The award of moral damages is, in international law, extraordinary and as such it is reserved for instances of "extreme cases of egregious behaviour."[647] In order to obtain such damages a party must show that the alleged injury actually occurred and that the state actions complained of were the cause of that injury. In refusing to grant moral damages the *Tecmed* tribunal noted:

> The Arbitral Tribunal finds no reason to award compensation for moral dammage (*sic*), as requested by the Claimant, due to the absence of evidence proving that the actions attributable to the Respondent that the Arbitral Tribunal has found to be in violation of the Agreement have also affected the Claimant's reputation and therefore caused the loss of business opportunities for the Claimant.[648]

458. The availability of moral damages is further limited where the claimant has itself engaged in actions lacking in good faith. In refusing to award moral damages where, among other things, the claimant's documents had been taken and its executives were forced to leave the country, the *Biwater* tribunal noted that "the

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[645] CIOC's Memorial, ¶ 280.

[646] **Ex. CA-29,** Crawford, *ILC Articles on State Responsibility, Commentary*, Article 31, at 202.

[647] **Ex. RL-73,** *Siag*, ¶ 545.

[648] **Ex. CA-44,** *Tecmed*, ¶ 198 (internal citation omitted).

circumstances of this case, and in particular [claimant's] own conduct, would render any such award inappropriate."[649]

459. In the case heavily relied on by CIOC, *Desert Line v. Yemen*, the tribunal similarly recognized the "exceptional" nature of moral damages.[650] In that case, heavily armed members of Yemen's military occupied the claimant's business. Not only did these armed forces descend on the claimant's premises, they repeatedly discharged automatic weapons, arrested several managers of the claimant and detained the claimant's chairman's son.[651] Importantly, the respondent provided no defense or explanation regarding these actions.[652] Thus, the facts alleged and, in fact, substantiated in *Desert Line* stand in stark contrast to those in the present case.

460. CIOC also argues that it suffered moral damages because it was forced to hand over documents and was thus unable to continue its business and because its "shareholders, directors and employees [] have also been subjected to unwarranted harassment and intimidation."[653] These harms, even if the tribunal finds that they have actually occurred, and Respondent respectfully submits that it should not, do not amount to the "egregious" acts which can give rise to moral damages.

461. First, in contrast to the facts in the *Desert Line case*, the Republic has presented ample evidence to show that the acts CIOC complains of are legitimate

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[649] **Ex. RL-48**, *Biwater*, ¶ 808.

[650] **Ex. CA-68**, *Desert Line Projects LLC v. The Republic of Yemen*, ICSID Case No. ARB/05/17, Award dated February 6, 2008 ("*Desert Line*"), ¶ 289.

[651] *Id.*, ¶ 185.

[652] *Id.*, ¶¶ 159, 167.

[653] CIOC's Memorial, ¶ 280.

actions taken in accordance with the law and with due process.[654] Second, while it has made unsubstantiated allegations, CIOC has submitted no evidence to prove that its principals or employees were subjected to physical threats. To the contrary, as indicated by Mr. Daulbaev, KNB agents did not carry weapons during their interventions, while the Caratube oil field is guarded by armed gunmen hired by CIOC.[655] In fact, not only does CIOC fail to present evidence of a physical threat, but the Republic has demonstrated that in fact none of CIOC's principals or employees have been maltreated.

462. Further, the only physical manifestation of harm that CIOC presents in relation to its claim for moral damages is the depression allegedly suffered by Devincci Hourani himself. However, this claim is quite suspicious as the only support provided for it other than Devincci Hourani's own characterization of his mental health is a doctor's note from a urologist.[656] However, it would seem that if a person were truly suffering from "severe depression" he would seek treatment from a mental health professional with skills to treat this condition rather than a doctor concerned with the treatment of urinary tracts and reproductive organs. Such evidence is insufficient to support any claim much less one as serious in nature as a charge of moral damage.

463. Finally, given the Tribunal's intervening Decision on Preliminary Measures, the Republic considers CIOC's argument with regard to the seizure of its documents and other materials moot. However, it should be noted that, as was stated during the provisional measures hearing those documents and materials have at all

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[654] Askhat Daulbaev Statement, ¶ 61.

[655] *Id.*, ¶ 60.

[656] **Ex. C-76**, Letter from Dr. Maroun Moukarzel dated May 5, 2009.

times been accessible to CIOC representatives. Given CIOC's right of access to these materials, there is little argument that CIOC has been morally damaged.

464. In sum, CIOC has not substantiated a case of moral damages.

F. Interest

465. With regard to interest, the Republic considers that simple, not compound interest should be applied in this case. Arbitral precedent and commentators have repeatedly found that simple interest provides appropriate compensation.[657] In the commentary to the ILC Articles, Professor Crawford notes:

> The general view of courts and tribunals has been against the award of compound interest, and this is true even of those tribunals which hold claimants to be normally entitled to compensatory interest.
>
> [...]
>
> But given the present state of international law it cannot be said that an injured State has any entitlement to compound interest, in the absence of special circumstances which justify some element of compounding as an aspect of full reparation.[658]

The tribunal in *Desert Line v. Yemen*, a case upon which CIOC heavily relies in its damages argument also concluded, as did Professor Crawford, that simple interest provides appropriate compensation in treaty cases.

466. Beyond the issue of simple versus compound interest, the Republic believes it premature to discuss the appropriate rate of interest at this stage of these proceedings, as it will be less speculative to determine an appropriate rate of interest

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[657] *See e.g.*, **Ex. RL-57**, *Duke Energy*, ¶¶ 457-458; **Ex. CA-31**, *SPP ICSID*, ¶ 236; **Ex. CA-68**, *Desert Line*, ¶ 295.

[658] **Ex. CA-29**, Crawford, *ILC Articles on State Responsibility*, *Commentary*, Article 38, at 237-238.

closer to the date of the rendering of an award when the interest rates existing in the interim period will be known.

467. Of course, the Republic considers that the Tribunal will not need to concern itself with interest rates since, for all of the reasons developed above, be they jurisdictional or on the merits, no damages at all should be awarded to CIOC.

V. CONCLUSIONS

468. For the reasons set forth above and to be developed further during the course of these proceedings, CIOC's claims should be rejected in their entirety for lack of jurisdiction or for inadmissibility. In the event that the Tribunal were to find jurisdiction and admissibility with respect to any of the claims asserted, those claims should nevertheless be dismissed for the substantive reasons set forth above. In addition, CIOC should be ordered to reimburse the Republic for all reasonable costs and expenses relating to this Arbitration including without limitation legal fees and expert fees.

RESERVATION OF RIGHTS

469. The Republic hereby expressly reserves the right to submit such additional defenses, evidence, arguments and counter-claims as it may deem appropriate to supplement or augment this Counter-Memorial, to respond to any allegations made by CIOC in connection with this Arbitration and to define any relief or remedies in connection with this dispute.

Respectfully Submitted,

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