

**AIG Capital Partners, Inc. and CJSC Tema Real Estate Company v. Republic of Kazakhstan, ICSID Case No. ARB/01/6, Award, 7 October 2003.**

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AIG CAPITAL PARTNERS INC. AND CJSC TEMA REAL ESTATE COMPANY v.  
REPUBLIC OF KAZAKHSTAN<sup>1</sup>

(ICSID Case No. ARB/01/6)

*Award. 7 October 2003*

*(Arbitration Tribunal: Nariman, President; Bernardini and Vukmir, Members)<sup>2</sup>*

1. INTRODUCTION

1.1 On October 5, 2001, the International Centre for Settlement of Investment Disputes (“ICSID” or “the Centre”) notified to the above mentioned parties that this Arbitral Tribunal in ICSID Case No. ARB/01/6 was deemed to be constituted – whether validly or otherwise is one of the preliminary questions, amongst others, that arise for determination in this case.

This case arises out of a Request for Arbitration filed on May 3, 2001 by AIG Capital Partners Inc. (“AIG” or “the first Claimant”) and CJSC Tema Real Estate Company (“Tema” or “the second Claimant”) – (jointly referred to as “the Claimants”) – with the Centre requesting for arbitration of an “investment dispute” with the Republic of Kazakhstan (“Kazakhstan” or “the Respondent”). The claim in the Request for Arbitration arises out of the alleged expropriation of the Claimants’ investment in a Real Estate Development Project in Kazakhstan, before the construction of the Project had been completed. The Request for Arbitration was made by the Claimants pursuant to and relying upon:

- i. Article 36 of the 1965 Washington Convention on the Settlement of Investment Disputes between States and Nationals of Other States (“the Convention”).
- ii. Rules 1–4 of the Rules of Procedure for the Institution of Conciliation and Arbitration Proceedings (“Institution Rules”).
- iii. Article VI of the Treaty dated May 19, 1992 between the United States of America and the Republic of Kazakhstan Concerning the Reciprocal Encouragement and Protection of Investment (“the BIT” or “the Treaty”).

2.1 The first Claimant, AIG, is a corporation constituted under the laws of Delaware (USA) and is entirely owned and controlled by a holding company, American International Group Inc. also incorporated in Delaware (USA).<sup>1</sup> AIG, through American International Group Inc. and its subsidiaries (including AIG Silk Road Investors Inc. – a US Company), is engaged in a broad range of activities and services worldwide including financial services. The second Claimant, Tema, is a joint venture company (“the Joint Venture”) incorporated in Kazakhstan comprising (34%) LLP Tema (a Kazakhstan Real Estate Development Company) and (66%) AIG Silk Road Investment I Ltd (a Bermuda Company), a wholly owned subsidiary of AIG Silk Road Fund Ltd (a Bermuda Company).<sup>2</sup> The entire voting power and all voting rights of the AIG Silk Road Fund Ltd are vested solely and exclusively in the holders of Class A shares viz. AIG Silk Road Investors Inc. USA, and AIG (Claimant No. 1) is entitled to exercise all voting rights in respect of these Class A shares of AIG Silk Road Fund Ltd owned by AIG Silk Road Investors Inc., USA.<sup>3</sup>

The Respondent, the Republic of Kazakhstan, has been an independent sovereign State since 1991.

2.2 The BIT was signed by the parties on May 17, 1992 and on exchange of instruments of ratification it came into force on January 12, 1994.

The United States of America (hereinafter referred to as the “US” or “USA”) and the Republic of Kazakhstan are parties to the Convention – the Convention was signed by the USA on August 27, 1965, ratified on June 10, 1966 and came into force on October 14, 1966; the Convention was signed by the Republic of Kazakhstan on July 23, 1992, ratified on September 21, 2000 and came into force on October 21, 2000. The Request for Arbitration – in respect of the Claimants’ alleged investment dispute with the Respondent – was filed with the Centre on May 3, 2001 relying on the provisions both of the Convention, as well as the Bilateral Investment Treaty.

### 3. PROCEDURAL HISTORY OF THE CASE

3.1 In the Request for Arbitration (May 3, 2001) the addresses of the parties are given as follows:

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<sup>1</sup> Claimants’ Exhibit No. 83 in the arbitration proceedings.

<sup>2</sup> Claimants’ Exhibit No. 90 in the arbitration proceedings.

Claimant No. 1 (AIG) exclusively exercises all voting rights in respect of Class A shares of AIG Silk Road Fund Ltd (the Fund), a Bermuda based company, the latter is owned by AIG Silk Road Investors Inc., a Delaware company. AIG controls Silk Road Investors Inc. (a US Company) with respect to the Fund: see Claimants’ Exhibits 83 and 84.

<sup>3</sup> Claimants’ Exhibit Nos. 83, 84 and 85 in the arbitration proceedings.

a) AIG

175 Water Street,  
New York, NY 10038  
United States of America

(First Claimant)

b) CJSC Tema Real Estate Company (the Joint Venture)

Aiteke Bi Street, 62, 3rd Floor,  
480091 Almaty  
Republic of Kazakhstan

(Second Claimant)

c) Republic of Kazakhstan

Attn: Ministry of Foreign Affairs  
Minister Yerlan Idrisov  
10 Beibyshilik Street,  
473000 Astana  
Kazakhstan

(Respondent)

3.2 The facts as stated in the Request or Arbitration – and later supported by documentary evidence filed by the Claimants (and indicated in footnotes) – are as follows:

A. AIG, the first Claimant, had established AIG Silk Road Fund Limited, a private equity fund organized under the laws of Bermuda (“the Fund”) to make equity investments in projects throughout Central Asia and the Caucasus.<sup>4</sup> AIG Silk Road Fund Ltd (“the Fund”) was controlled by AIG through AIG Silk Road Investors Inc. (a US Company).<sup>5</sup> The Fund established two wholly owned subsidiaries: AIG Silk Road Investment I Limited (“the Investment Company”, a Bermuda Company) and Kazakhstan Housing Limited (“the Financing Company” – also a Bermuda Company) to invest in a real estate project in Kazakhstan (“the Project”).<sup>6</sup>

AIG directly controls AIG Silk Road Investors Inc. (a US Company), which directly controls the Fund and its two subsidiaries (viz. the Investment Company and the Financing Company). The Investment Company is the majority owner of (66%) and directly controls the Joint Venture (Claimant No. 2). Accordingly, AIG indirectly controls the Fund, the Investment Company, the Finance Company and the Joint Venture. Claimants’ control of Relevant Entities and Investments

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<sup>4</sup> Claimants’ Exhibit No. 83 in the arbitration proceedings.

<sup>5</sup> Claimants’ Exhibit No. 84 in the arbitration proceedings.

<sup>6</sup> Claimants’ Exhibit No. 88 in the arbitration proceedings: Certificate of Incorporation on Change of Name of AIG Global Securities Landing Ltd Bermuda to Kazakhstan Housing Ltd and Share Registry showing 100% ownership by

have been illustrated in the following Chart [p. 11] (part of the Request for Arbitration);

- B. that the investment was in a Project – a residential housing complex to be called “Crystal Air Village” in Almaty – expected to involve a total investment of approximately USD 16.3 million<sup>7</sup> over a three-year period;<sup>8</sup> to implement this investment the Fund, through its wholly owned subsidiary (the AIG Silk Road Investment I Limited – “the Investment Company”), entered into a joint venture with LLP Tema (a Kazakhstan Company owned and controlled by Kazakhstani principals); the majority ownership and control of this joint venture being vested in the Investment Company which was in turn controlled by the Fund (AIG Silk Road Fund Limited), and indirectly and ultimately controlled by AIG (Claimant No. 1);<sup>9</sup>
- C. that with financial assistance from the Fund, LLP Tema purchased for the Joint Venture ten hectares of land on which it was intended to construct the “Crystal Air Village”;<sup>10</sup> the land (the Project Property) was located in one of the most exclusive residential areas of Almaty, adjacent to the private residence of the President of Kazakhstan; subsequent to its purchase by LLP Tema, the property was assigned in May 1999 to the Joint Venture for the purposes of the Project;<sup>11</sup>

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AIG Silk Road Fund Ltd.

<sup>7</sup> According to the evidence the Fund’s total investment in the project would have been approximately USD 16.3 million – Scott Foushee, Transcripts of the oral hearing, Day One, pages 34 and 37.

<sup>8</sup> Under contract No. 0159-12-1999 dated December 13, 1999, Claimants’ Exhibit No. 3 – Claimant No. 2 as investor contracted to make investments as specified in paragraph 3.1 in accordance with the work programme agreed with the Agency of the Republic of Kazakhstan of Investment. Under paragraph 3.1 the object of the investment activity was the construction of a residential complex which would include investment in fixed assets to the tune of approximately USD 15,876,000.00.

<sup>9</sup> Claimants’ Exhibit Nos. 90 and 83 in the arbitration proceedings.

<sup>10</sup> Claimants’ Exhibit No. 18 in the arbitration proceedings.

<sup>11</sup> Claimants’ Exhibit Nos. 20 and 12 in the arbitration proceedings.

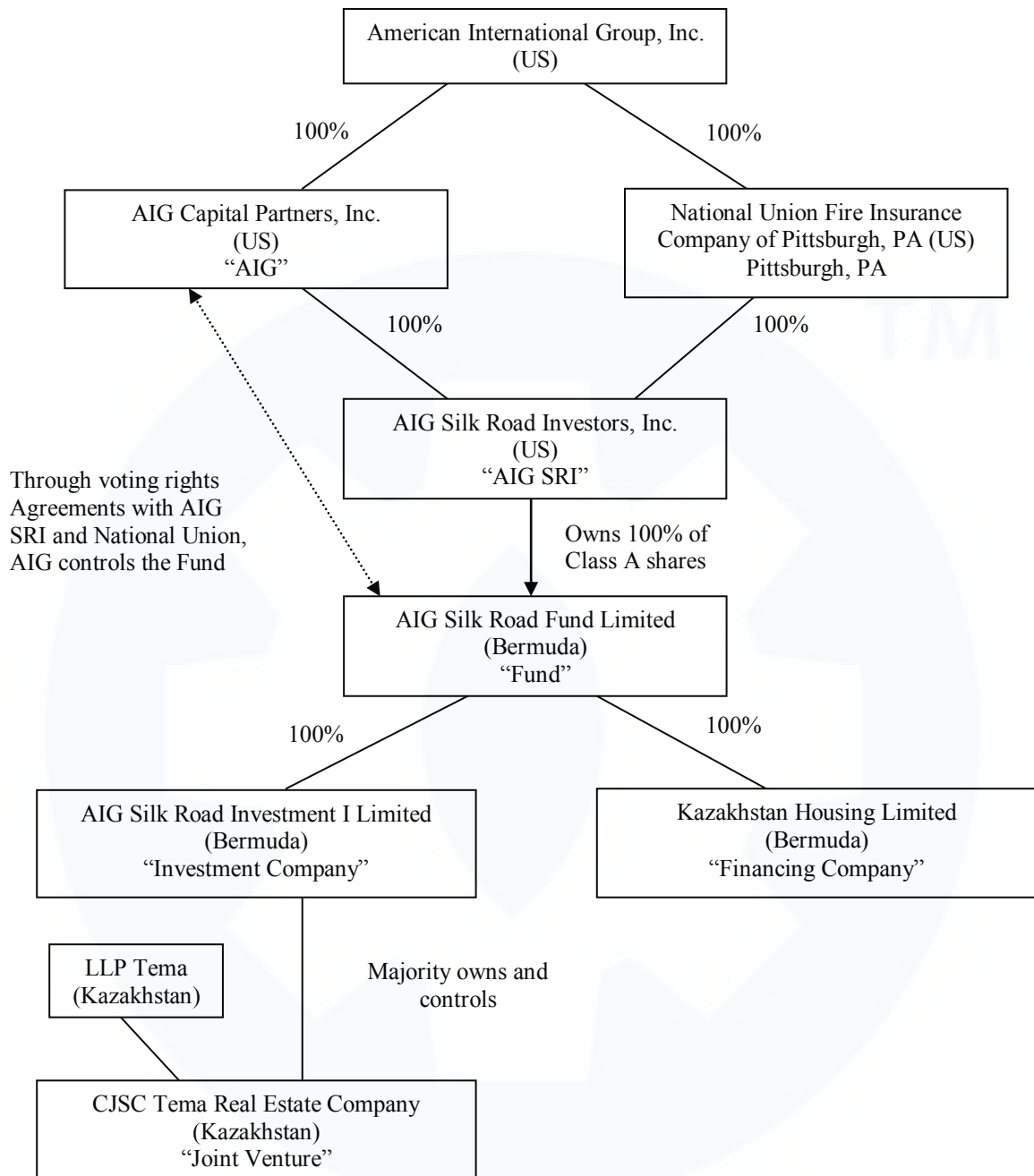


Figure 1 Claimants' Control of Relevant Entities and Investments

D. that as required by the municipal laws of Kazakhstan, the purchase of the Project Properly and its intended use as the site for the Crystal Air Village was specifically approved by local governmental authorities namely the Karasai Raion Committee on Management of Land Resources<sup>12</sup> and the

<sup>12</sup> Claimants' Exhibit No. 12 in the arbitration proceedings.

Almaty Oblast Administration<sup>13</sup> and all necessary building permits were also obtained for the Project;<sup>14</sup>

- E. that the Project itself was approved by Kazakhstan’s Agency on Investment with which the Joint Venture had entered into a written agreement on December 13, 1999<sup>15</sup> which constituted further tacit approval of the Project; the agreement dated December 13, 1999 obligated the Investment Agency to act as an advocate for the investor in the event of any dispute with other agencies or instrumentalities of the Government of Kazakhstan; the investment agreement was also registered by the Investment Agency of the Republic of Kazakhstan by means of a Certificate dated December 13, 1999,<sup>16</sup> which recognized the purpose of the Project, viz. “Construction of residential complex Crystal Air in Almaty suburb”;
- F. that after the Project Property was purchased, AIG, through affiliated companies, began the design, engineering, procurement and the financing work required to implement the Project, and retained various consultants and contractors for that purpose; it also built engineering networks and implemented other improvements on the Project Property. The Joint Venture then entered into a USD 7.3 million contract with Tuna LLP, a Kazakhstan subsidiary of the Turkish Architectural and Design Company (Tuna Insaat Sanayi ve Ticaret) for the construction of the first phase of the Project<sup>17</sup> (see Request for Arbitration page 5); the Joint Venture also retained Scott Holland Estates, a Kazakhstan company owned by UK interests, to undertake a full scale marketing and advertising campaign, and (it is stated that) Scott Holland Estates launched a marketing programme geared towards the high-end market based on a combination of direct marketing contracts and various types of advertising and made presentations to prospective clients; “all told approximately a sum of USD 3.5 million was spent in designing and implementing the Project; before the Government (of Kazakhstan) ordered the Joint Venture to permanently halt construction”;<sup>18</sup>

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<sup>13</sup> Claimants’ Exhibit No. 21 in the arbitration proceedings.

<sup>14</sup> Claimants’ Exhibit No. 23 in the arbitration proceedings.

<sup>15</sup> Claimants’ Exhibit No. 3 in the arbitration proceedings.

<sup>16</sup> Claimants’ Exhibit No. 4 in the arbitration proceedings.

<sup>17</sup> This contract is exhibited by the Claimants as part of Exhibit No. 39 in the arbitration proceedings – and is also expressly mentioned in the Appraisal Report filed by the Claimants’ Exhibit 14 (AIG Silk Road Capital Management Report, TEMA Residential Development dated December 8, 1998): it is stated in the opening paragraph of this report: “The AIG Silk Road Fund is considering an investment of USD 7 million in Tema Housing, an 81 unit western standard quality residential compound in Almaty . . . The development will be implemented in three phases over a period of two and a half years, with the first phase expected to require \$9.3 million in total investment.”

The contract (dated January 27, 2000) is also mentioned in the Release of Claims document between the Joint Venture and Construction Co. dated June 16, 2000: Claimants’ Exhibit No. 27 in the arbitration proceedings.

<sup>18</sup> Page 5 – Request for Arbitration – In the Claimants’ Memorial filed on February 15, 2002, it was stated:

On February 18, 2000, Mr Serik Tulbassov, a principal in Tema and the General Director of the Joint Venture,

- G. that on February 26, 2000, the Government of Kazakhstan verbally notified the Joint Venture that it had decided to cancel the Project for the reason that the Project Property was needed for “a national arboretum”,<sup>19</sup>
- H. that on March 1, 2000, the Joint Venture wrote to the Chairman of the Investment Agency,<sup>20</sup> explaining what had happened, requesting the Agency’s assistance pursuant to the investment agreement dated December 13, 1999. In response, the Chairman of the Agency wrote a letter to the Akim (Governor) of the Almaty Oblast stating that the rights of an Investor having been violated by the actions of the Government the Investment Agency should be informed (by the Akim) of the reasons for the decision to terminate the investment and the intentions of the Almaty Oblast management in this regard;<sup>21</sup>
- I. that on March 2, 2000, representatives of the Fund met with the Akim of the Almaty Oblast, who said that he had made “a mistake” in having the Oblast administration permit the sale of the Project Property to the Joint Venture and to issue the necessary approvals for the construction of the Crystal Air Compound on the Project Property. He (the Akim) stated that notwithstanding the authorization to purchase the site, the Joint Venture would not be permitted to construct the residential compound on the Project Property; he said that it was a decision made at the highest levels of the Government and that the only recourse available to the Joint Venture and the Fund would be to construct their residential compound on an alternate site which was offered;
- J. that on March 17, 2000, the Oblast issued a resolution (Resolution No. 3-79)<sup>22</sup> ordering the transfer of the Project Property, and also other areas, to the City of Almaty. This resolution provided for compensation to agricultural users in other areas for the taking of their property, but offered no compensation to the Joint Venture. On March 20, 2000, the Investment Agency<sup>23</sup> received a letter from the Almaty Oblast declaring invalid the construction permits issued for the Project – permits that had been previously authorized by the Oblast;

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received a telephone call from the Chairman of the Oblast Land Committee, Mr Naurzybay Taubaev, asking that a billboard advertising the Crystal Air Village Project be removed from the Project Property. The reason given by Mr Naurzybay Taubaev for this request was that the Oblast Administration was concerned that the advertising of expensive villas might cause discontent among low-income residents of Almaty. No mention was made of cancelling the Project.

<sup>19</sup> In the Claimants’ Memorial it is stated:

On February 26, however, the Chairman of the Oblast Architecture Committee, Mr Sairan Fazylov told Mr Tulbassov that the Oblast Administration had decided to take the Project Property for use as an arboretum, and that construction on the Property should cease immediately.

<sup>20</sup> Claimants’ Exhibit No. 5 in the arbitration proceedings.

<sup>21</sup> Claimants’ Exhibit No. 6 in the arbitration proceedings.

<sup>22</sup> Claimants’ Exhibit No. 7 in the arbitration proceedings.

<sup>23</sup> Claimants’ Exhibit No. 8 in the arbitration proceedings.



- K. that on April 6, 2000, the Almaty City State Architecture and Construction Inspection Agency issued an Ordinance<sup>24</sup> ordering that all work on the Project Property be stopped;<sup>25</sup>
- L. that in late February 2001, the Respondent, through the City of Almaty, physically seized the Project Property and began earthworks on it;<sup>26</sup>
- M. that these acts of the political subdivisions of Kazakhstan effectively resulted in the expropriation of the investment of AIG and the joint venture, and AIG and the Joint Venture had no choice but to accept the fact that the Respondent had terminated the Project;
- N. that in the circumstances the provisions of the BIT had been violated by the Respondent – in particular the following provisions in the Bilateral Investment Treaty viz.:

*Article II(2)*

- (a) 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.
- (b) Neither Party shall in any way impair by arbitrary or discriminatory measures the management, operation, maintenance, use, enjoyment, acquisition, expansion, or disposal of investments.

*Article III(1)*

Investments shall not be expropriated or nationalized either directly or indirectly through measures tantamount to expropriation or nationalization (“expropriation”) except: for a public purpose; in a nondiscriminatory 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): Compensation shall be equivalent to the fair market

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<sup>24</sup> Claimants’ Exhibit No. 9 in the arbitration proceedings.

<sup>25</sup> In the Claimants’ Memorial filed on February 15, 2002, it was stated:

On May 15, 2000, they attempted to resume construction and began grading the site. Oblast representatives, accompanied by Almaty police, immediately appeared and expelled the Joint Venture’s contractor from the Project Property.

At this point, it had become clear that the Government’s interference with the Claimants’ right to build and operate the Project had reached the point where that right had become useless. Accordingly, the Joint Venture and its general contractor, TISV, agreed that a situation of force majeure had arisen. On June 16, 2000, the Joint Venture and TISV implemented the force majeure provisions of the general construction contract by executing a mutual release of claims (Release of Claims dated June 16, 2000, Claimants’ Exhibit 27).

value of the expropriated investment immediately before the expropriatory action was taken or became known, whichever is earlier; be calculated in any freely usable currency on the basis of the prevailing market rate of 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.

O. that the Claimants had become entitled to invoke Article VI(4) of the Bilateral Investment Treaty which provides as follows:

4. Each Party hereby consents to the submission of any investment dispute for settlement by binding arbitration in accordance with the choice specified in the written consent of the national or company under paragraph 3. Such consent, together with the written consent of the national or company when given under paragraph 3 shall satisfy the requirement for:

- (a) written consent of the parties to the dispute for purposes of Chapter II of the ICSID Convention (Jurisdiction of the Centre) and for purposes of the Additional Facility Rules; and
- (b) an “agreement in writing” for purposes of Article II of the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, done at New York, June 10, 1958 (“New York Convention”).

P. that by ratifying the Bilateral Investment Treaty, Kazakhstan had given its written consent to submit the dispute mentioned in the Request for Arbitration to the jurisdiction of the Centre; – and the Claimants had satisfied the conditions for initiating an Arbitration under Article VI of the Bilateral Investment Treaty;

Q. that the dispute which is the subject of the Request for Arbitration is a legal dispute because it involves alleged contravention of the BIT, and of rules of customary international law; the jurisdiction of the Centre could be lawfully invoked by the Claimants by reason of the provisions of the ICSID Convention – the US and Kazakhstan having ratified the Convention: which had entered into force (in accordance with Article 68) with respect to the US on October 14, 1966, and with respect to Kazakhstan on October 21, 2000.

#### 4. NOTICE OF REGISTRATION OF THE REQUEST FOR ARBITRATION

On June 4, 2001, a formal Notice of Registration of the Request for Arbitration was issued by the Centre to the Claimants and to the Respondent (“the parties”) – the letter of June 4, 2001 to the Respondent being addressed “c/o Ministry of Foreign Affairs, 10 Beibytshilik Street, 473000 Astana, Kazakhstan”. It was

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<sup>26</sup> Claimants’ Exhibit No. 30 in the arbitration proceedings – videotape and script.

stated in the Notice of Registration that pursuant to ICSID Institution Rule 7(b) parties were notified that all communications and notices in connection with the proceedings would be sent to the addresses indicated in the Request, unless other addresses were indicated to the Centre. And in accordance with Rule 7(d) of the Institution Rules the parties were invited to proceed as soon as possible to constitute an Arbitral Tribunal in accordance with Articles 37 to 40 of the Convention.

## 5. BRIEF DESCRIPTION OF THE METHOD OF CONSTITUTION OF THE ARBITRAL TRIBUNAL<sup>27</sup>

5.1 There was apparently no response by the Republic of Kazakhstan to the Notice of Registration (of June 4, 2001), nor to the invitation to the parties made therein to proceed as soon as possible to constitute an Arbitral Tribunal in accordance with Articles 37 to 40 of the Convention.

5.2 On June 12, 2001, counsel for the Claimants acknowledged receipt of the Notice of Registration of June 4, 2001, and stated that since the parties had not agreed upon the number of arbitrators or the method of their appointment, the Claimants proposed pursuant to Rule 2(1)(a) of the Centre's Rules of Procedure for Arbitration Proceedings, also known as Arbitration Rules,<sup>28</sup> that the Tribunal consist of three Arbitrators to be appointed as follows:

- (i) the Claimants shall appoint one arbitrator not later than July 3, 2001, failing which such appointment shall be made by the Chairman of the Administrative Council;
- (ii) the Respondent shall appoint one arbitrator not later than July 3, 2001, failing which such appointment shall be made by the Chairman; and
- (iii) the third arbitrator, who shall be the president of the Tribunal, shall be appointed by agreement of the parties not later than August 3, 2001, failing which such appointment shall be made by the Chairman.

It was requested on behalf of the Claimants that this proposal for the constitution of the Tribunal be transmitted to the Respondent pursuant to Rule 2(2) of the Centre's Arbitration Rules, which was done by a

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<sup>27</sup> This is necessary in view of the Objection to Jurisdiction raised by the Respondent – as to the constitution of the Tribunal.

<sup>28</sup> *Rule 2 Method of Constituting the Tribunal in the Absence of Previous Agreement*

(1) If the parties, at the time of the registration of the request for arbitration, have not agreed upon the number of arbitrators and the method of their appointment, they shall, unless they agree otherwise, follow the following procedure: (a) the requesting party shall, within 10 days after the registration of the request, propose to the other party the appointment of a sole arbitrator or of a specified uneven number of arbitrators and specify the method proposed for their appointment.

communication from the Centre dated June 12, 2001, addressed to the Republic of Kazakhstan c/o Ministry of Foreign Affairs, Minister Yerlan Idrisov, 10 Beibytshilik Street, 473000 Astana, Kazakhstan. This letter intimated that the Centre was looking forward to receiving a response from the Republic of Kazakhstan to the Claimants' proposal. A copy of the letter of June 12, 2001, along with its enclosures (which included the Claimants' letter dated June 4, 2001) was also forwarded by the Centre to HE Ambassador Bolat K. Nurgaliyev, Embassy of the Republic of Kazakhstan, 1401 16th Street, NW Washington DC, 20036.

Since the Respondent did not respond to the Centre's letter of June 12, 2001 nor replied to the Claimants' proposal (also of June 12, 2001) and since more than 60 days had elapsed since the Request for Arbitration was registered, and since there was still no agreement on the method of constituting the Tribunal, the Claimants by a letter to the Centre dated August 6, 2001 requested that the Tribunal be constituted in accordance with Article 37(2)(b) of the Convention.<sup>29</sup>

5.3 By letter dated August 6, 2001, addressed to the parties – including to the Republic of Kazakhstan (c/o Ministry of Foreign Affairs, 10 Beibytshilik Street, 473000 Astana, Kazakhstan), the Centre intimated the fact that it had received from the Claimants a letter dated August 6, 2001, and that the Claimants had chosen the formula provided in the Article 37(2)(b) of the Convention, and that in accordance with Rule 2(3) of the Arbitration Rules, the Arbitral Tribunal was to be constituted in accordance with the Convention. By the same letter, the parties were invited by the Centre to appoint the arbitrators in accordance with Rule 3(1) of the Arbitration Rules of the Centre.<sup>30</sup>

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<sup>29</sup> *Article 37 Constitution of the Tribunal*

- (1) The Arbitral Tribunal (hereinafter called the Tribunal) shall be constituted as soon as possible after registration of a request pursuant to Article 36.
- (2) (a) The Tribunal shall consist of a sole arbitrator or any uneven number of arbitrators appointed as the parties shall agree.  
  
(b) Where the parties do not agree upon the number of arbitrators and the method of their appointment, the Tribunal shall consist of three arbitrators, one arbitrator appointed by each party and the third, who shall be the president of the Tribunal, appointed by agreement of the parties.

<sup>30</sup> *Rule 2(3)*

At any time 60 days after the registration of the request, if no agreement on another procedure is reached, either party may inform the Secretary-General that it chooses the formula provided for in Article 37(2)(b) of the Convention. The Secretary-General shall thereupon promptly inform the other party that the Tribunal is to be constituted in accordance with that Article.

*Rule 3 Appointment of Arbitrators to a Tribunal Constituted in Accordance with Convention Article 37(2)(b)*

- (1) If the Tribunal is to be constituted in accordance with Article 37(2)(b) of the Convention:
  - (a) either party shall in a communication to the other party:
    - (i) name two persons, identifying one of them, who shall not have the same nationality as nor be a national of either party, as the arbitrator appointed by it, and the other as the arbitrator proposed to be the President of the Tribunal; and

5.4 On August 7, 2001, the Claimants wrote to the Respondent, with a copy to the Centre, naming Professor Piero Bernardini as an arbitrator, proposing another person for appointment as the President of the Tribunal and inviting the Respondent to concur in that proposal and to appoint another arbitrator. A copy of this letter was also forwarded to the Respondent by the Centre under cover of a letter of August 8, 2001, in which the Centre intimated that it looked forward to hearing from the Respondent concerning the appointment by the Respondent of an arbitrator as well as the response to the Claimants' proposal for President of the Tribunal: the Centre's letter was addressed to the Republic of Kazakhstan. Ministry of Foreign Affairs, Minister Yerlan Idrisov, 10 Beibytshilik Street, 473000 Astana, Kazakhstan, with a copy to HE Ambassador Bolat K. Nurgaliyev, Embassy of the Republic of Kazakhstan, 1401 16th Street, NW Washington, DC, 20036. There was no response from the Respondent to this communication of August 8, 2001.

5.5 On August 13, 2001, the Centre informed the parties that it had received from Professor Piero Bernardini an acceptance of his appointment as arbitrator in the case, and that it was looking forward to receiving from the Respondent, pursuant to ICSID Arbitration Rule 3,<sup>31</sup> information on the arbitrator that it

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- (ii) invite the other party to concur in the appointment of the arbitrator proposed to be the President of the Tribunal and to appoint another arbitrator;
  - (b) promptly upon receipt of this communication the other party shall, in its reply:
    - (i) name a person as the arbitrator appointed by it, who shall not have the same nationality as nor be a national of either party; and
    - (ii) concur in the appointment of the arbitrator proposed to be the President of the Tribunal or name another person as the arbitrator proposed to be President;
  - (c) promptly upon receipt of the reply containing such a proposal, the initiating party shall notify the other party whether it concurs in the appointment of the arbitrator proposed by that party to be the President of the Tribunal.

<sup>31</sup> *Rule 3 Appointment of Arbitrators to a Tribunal Constituted in Accordance with Convention*

*Article 37(2)(b)*

- (1) If the Tribunal is to be constituted in accordance with Article 37(2)(b) of the Convention:
  - (a) either party shall in a communication to the other party:
    - (i) name two persons, identifying one of them, who shall not have the same nationality as nor be a national of either party, as the arbitrator appointed by it, and the other as the arbitrator proposed to be the President of the Tribunal; and
    - (ii) invite the other party to concur in the appointment of the arbitrator proposed to be the President of the Tribunal and to appoint another arbitrator.
  - (b) promptly upon receipt of this communication the other party shall, in its reply:
    - (i) name a person as the arbitrator appointed by it, who shall not have the same nationality as nor be a national of either party; and
    - (ii) concur in the appointment of the arbitrator proposed to be the President of the Tribunal or name another person as the arbitrator proposed to be President;

appoints, as well as a response to Claimants' proposed candidate for appointment as President of the Tribunal. This letter was addressed to the Republic of Kazakhstan, c/o Ministry of Foreign Affairs, 10 Beibytshilik Street, 473000 Astana, Kazakhstan, and a copy of the same was forwarded to the Embassy of the Republic of Kazakhstan, Aslan Sarimzhipov, 3rd Secretary, Trade Department, 1401 16th Street, NW Washington, DC, 20036. There was no response by the Republic of Kazakhstan to the Centre's letter of August 13, 2001.

5.6 By letter dated September 4, 2001, addressed by the Claimants to the Centre, it was stated that more than ninety days had elapsed since the Centre had registered the Request for Arbitration and the Tribunal was still not constituted. The Centre was reminded that the Respondent had not appointed an arbitrator and had neither agreed to the Claimants' proposal for appointment as President, nor proposed anyone else. In these circumstances relying on Article 38 of the Convention<sup>32</sup> and Rule 4 of the Centre's Arbitration Rules<sup>33</sup> the Claimants requested that the Chairman of the Administrative Council appoint the Arbitrators not yet appointed and designate the President of the Tribunal. A copy of this letter along with a forwarding letter of September 4, 2001 (of the Centre) was duly addressed to the parties. The last paragraph of the said letter reads as follows:

Appointments by the Chairman in compliance with this request must be made from the Panel of

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- (c) promptly upon receipt of the reply containing such a proposal, the initiating party shall notify the other party whether it concurs in the appointment of the arbitrator proposed by that party to be the President of the Tribunal.
- (2) The communication provided for in this Rule shall be made or promptly confirmed in writing and shall either be transmitted through the Secretary-General or directly [to] the parties with a copy to the Secretary-General.

<sup>32</sup> Article 38 of the Convention reads as follows:

If the Tribunal shall not have been constituted within 90 days after notice of registration of the request has been dispatched by the Secretary-General in accordance with paragraph (3) of Article 36, or such other period as the parties may agree, the Chairman shall, at the request of either party and after consulting both parties as far as possible, appoint the arbitrator or arbitrators not yet appointed. Arbitrators appointed by the Chairman pursuant to this Article shall not be nationals of the Contracting State whose national is a party to the dispute.

<sup>33</sup> *Rule 4 Appointment of Arbitrators by the Chairman of the Administrative Council*

- (1) If the Tribunal is not constituted within 90 days after the dispatch by the Secretary-General of the notice of registration, or such other period as the parties may agree, either party may, through the Secretary-General, address to the Chairman of the Administrative Council a request in writing to appoint the arbitrator or arbitrators not yet appointed and to designate an arbitrator to be the President of the Tribunal.
- (2) The provision of paragraph (1) shall apply *mutatis mutandis* in the event that the parties have agreed that the arbitrators shall elect the President of the Tribunal and they fail to do so.
- (3) The Secretary-General shall forthwith send a copy of the request to the other party.
- (4) The Chairman shall, with due regard to Articles 38 and 40(1) of the Convention, and after consulting both parties as far as possible, comply with that request within 30 days after its receipt.
- (5) The Secretary-General shall promptly notify the parties of any appointment or designation made by the Chairman.

Arbitrators of the Centre. Such appointments must be made within 30 days of our receipt of the request, i.e., no later than October 4, 2001. Before such appointments are made, the parties must as far as possible be consulted. We will shortly begin the process of consultation with the parties.

This forwarding letter of September 4, 2001 was addressed by the Centre to the Republic of Kazakhstan, c/o Ministry of Foreign Affairs, 10 Beibytshilik Street, 473000 Astana, Kazakhstan, and a copy of this letter was also forwarded by the Centre to the Embassy of the Republic of Kazakhstan, Aslan Sarimzhipov, 3rd Secretary, Trade Department, 1401 16th Street, NW Washington, DC, 20036. There was no response by the Respondent to this letter.

5.7 On September 7, 2001, the Centre addressed a letter to the parties – stating inter alia as follows:

As recalled in my letter to you of September 4, 2001, the Claimants have appointed as one of the three arbitrators Professor Piero Bernardini of Italy. As the other two arbitrators have still not been appointed, the Chairman of the Administrative Council is required to make the two appointments in order to comply, pursuant to Article 38 of the ICSID Convention and Rule 4 of the ICSID Arbitration Rules, with the request made by the Claimants in their letter of September 4, 2001.

As pointed out in my above-mentioned letter of September 4, 2001, the appointees of the Chairman of the Administrative Council must be members of the ICSID Panel of Arbitrators. They may not be nationals of the United States of America or of the Republic of Kazakhstan. As also explained in my letter of September 4, 2001, the parties must be consulted as far as possible before the Chairman of the Administrative Council makes his appointments. In this regard, I wish to inform you that we are considering recommending to the Chairman of the Administrative Council that his appointees in the present case be Dr Branko Vukmir and Mr Fali S. Nariman and that the Chairman designate Mr Nariman to be the President of the Tribunal.

Dr Vukmir is a national of Croatia and one of its designees to the ICSID Panel of Arbitrators. Mr Nariman is a national of India designated to the Panel of Arbitrators by the Chairman of the Administrative Council. Attached are copies of the curricula vitae of Dr Vukmir and Mr Nariman as on file at ICSID.

Please let me know by September 14, 2001, whether you have any objections to the appointment of Dr Vukmir or Mr Nariman.

The communication dated September 7, 2001, from the Centre was forwarded to the Republic of Kazakhstan at the following address: “Republic of Kazakhstan, Ministry of Foreign Affairs, 10 Beibytshilik Street, 473000 Astana, Kazakhstan”. A copy of this letter was also forwarded to the Embassy of the Republic of Kazakhstan, Aslan Sarimzhipov, 3rd Secretary, Trade Department, 1401 16th Street, NW Washington, DC, 20036. There was no response by the Respondent to this communication.

5.8 On September 25, 2001, the Centre informed the parties (including the Republic of Kazakhstan at c/o Ministry of Foreign Affairs, 10 Beibytshilik Street, 473000 Astana, Kazakhstan), that the Claimants by letter dated September 14, 2001, had indicated that they had no objection to the appointments of Dr Vukmir

and Mr Nariman, but that no response had been received from the Republic of Kazakhstan. It was intimated that in the absence of any objection, the Centre would recommend to the Chairman of the Administrative Council that he appoint Dr Branko Vukmir and Mr Fali S. Nariman as Arbitrators in this case and that the Chairman do designate Mr Nariman to be the President of the Tribunal. By the said letter of September 14, 2001, it was intimated that pursuant to ICSID Arbitration Rule 4(4) such appointments by the Chairman must be made within 30 days of September 4, 2001, which was the date that the Centre received the Claimants' request for the Chairman to make the appointments, i.e., by October 4, 2001. There was no response by the Respondent to this communication.

5.9 On October 1, 2001, the Centre intimated to the parties (including to the Republic of Kazakhstan at the following address: c/o Ministry of Foreign Affairs, Minister Yerlan Idrisov, 10 Beibytshilik Street, 473000 Astana, Kazakhstan, with a copy to the Embassy at the address indicated above) as follows:

In our letter of September 7, 2001, we informed you that we were considering recommending to the Chairman of the ICSID Administrative Council that he appoint Dr Branko Vukmir and Mr Fali S. Nariman as arbitrators in this case and that the Chairman designate Mr Nariman to be the President of the Tribunal. We also requested the parties to indicate whether they would have any objections to those appointments. In our letter of September 25, 2001, we informed you that, in the absence of any objection by the parties, we would be proceeding to recommend the appointment of Dr Branko Vukmir and Mr Fali S. Nariman and the designation of Mr Nariman as President of the Tribunal.

On this recommendation, the Chairman of the Administrative Council has now appointed Dr Branko Vukmir and Mr Fali S. Nariman as arbitrators in this case and has designated Mr Nariman to be the presiding arbitrator.

Pursuant to ICSID Arbitration Rule 5(2), we are now seeking the acceptance of Dr Branko Vukmir and Mr Fali S. Nariman of their appointment.

There was no response by the Respondent to this letter dated October 1, 2001.

5.9.1. Dr Branko Vukmir and Mr Fali S. Nariman having accepted their appointment, the Centre addressed a further letter dated October 5, 2001, to the parties (including to the Republic of Kazakhstan c/o Ministry of Foreign Affairs, 10 Beibytshilik Street, 473000 Astana, Kazakhstan), intimating that in accordance with Rule 6(1) of the Arbitration Rules of the Centre the Tribunal<sup>34</sup> is deemed to be constituted and the proceedings to have begun "on today's date October 5, 2001". It was further intimated that in accordance with Arbitration Rule 13(1) the Tribunal must hold its first session within 60 days after its

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<sup>34</sup> *Rule 6 Constitution of the Tribunal*

(1) The Tribunal shall be deemed to be constituted and the proceeding to have begun on the date the Secretary-General notifies the parties that all the arbitrators have accepted their appointment.



constitution, that is by December 4, 2001.<sup>35</sup>

Copies of all the letters mentioned above were, upon constitution of the Tribunal, transmitted to each of its members by the Centre.

The above factual narration describes the method of constitution of this Arbitral Tribunal in the present case.

## 6. SUMMARY OF THE SUBSEQUENT EVENTS INCLUDING A SUMMARY OF THE PROCEEDINGS BEFORE THE ARBITRAL TRIBUNAL

6.1 By letter dated October 6, 2001 addressed by Mr Erlan Idrisov Minister of Foreign Affairs, Republic of Kazakhstan to the Deputy Secretary-General of the Centre (received by the Centre on October 23, 2001) it was stated as follows:

On behalf of the Government of the Republic of Kazakhstan I would like to inform you that the Akim of Almaty Oblast (head of the Almaty Oblast Administration) has been appointed respondent from the Kazakhstan party in this case.

Also, due to internal procedures in Kazakhstan, more time is needed for appointing the arbitrator from the Kazakhstani party. Therefore, we ask you to grant a delay for conducting of all necessary procedures in Kazakhstan.

This letter was replied to by the Centre's letter dated October 25, 2001, in which it was recorded:

I have the honor to confirm our receipt on October 23, 2001 of your letter of October 6, 2001.

I understand from your letter that the Akim of Almaty Oblast will henceforth represent the Republic of Kazakhstan in this arbitration proceeding. To enable us to redirect our communications accordingly, we would be grateful if you could provide us with his full mailing address and telephone and fax numbers.

In the present case, it was established that the Arbitral Tribunal would consist of three arbitrators, one appointed by each side and the third – the President of the Tribunal – appointed by agreement of the parties. The Claimants appointed an arbitrator on August 7, 2001. The two other arbitrators, however, were not appointed within the 90-day period mentioned in Article 38 of the

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<sup>35</sup> *Rule 13 Sessions of the Tribunal*

(1) The Tribunal shall hold its first session within 60 days after its constitution or such other period as the parties may agree. The dates of that session shall be fixed by the President of the Tribunal after consultation with its members and the Secretary-General. If upon its constitution the Tribunal has no President because the parties have agreed that the President shall be elected by its members, the Secretary-General shall fix the dates of that session. In both cases, the parties shall be consulted as far as possible.

ICSID Convention. Following the expiry of that period, therefore, the Claimants requested the Chairman of the ICSID Administrative Council to appoint the two other arbitrators in accordance with Article 38 of the ICSID Convention. After we informed the parties, and received no objections from them, the Chairman of the ICSID Administrative Council appointed those arbitrators by the October 4, 2001 deadline for this under our rules. The Tribunal was officially constituted on the following day, October 5, 2001. As recalled in our letter of October 5, 2001 to the parties, the members of the Tribunal are Mr Fali S. Nariman, the President of the Tribunal; Professor Piero Bernardino; and Dr Branko Vukmir.

A first session of an ICSID Arbitral Tribunal is typically devoted to preliminary procedural matters. Under our rules, a Tribunal must hold this first session within 60 days after the official constitution of the Tribunal. As mentioned in our letter of October 18, 2001 to the parties, the President of the Tribunal in this case plans to hold the first session starting at 10:00 a.m. on Thursday, November 15, 2001, at the International Dispute Resolution Centre, 8 Breems Buildings, Chancery Lane, London, England.

We hope that the above-mentioned date and place for the first session of the Tribunal will be convenient for the Republic of Kazakhstan. Please do not hesitate to let me or my colleague Mr Ucheora O. Onwuamaegbu know if you have any questions.

Please accept, Mr Minister, the assurances of our highest consideration.

A copy of this letter was also forwarded to HE Ambassador Bolat K. Nurgaliyev, Embassy of the Republic of Kazakhstan 1401 16th Street, NW Washington, DC, 2003.

6.2 The Centre did not receive any further response from the Respondent to its letter of October 25, 2001, nor was the full mailing address, telephone and fax numbers of the Akim of Almaty Oblast communicated to the Centre by the Respondent.

6.3 The first session of the Tribunal was then held in London (as duly intimated to both parties) on November 15, 2001. Mr Robert Pietrowski of Coudert Brothers along with Mr L. Scott Foushee, Managing Director of AIG Capital Partners, Inc., attended on behalf of the Claimants. No person attended the meeting on behalf of the Respondent.

Detailed directions as required in the Rules were given and recorded in the Minutes of the first session of the Tribunal. In these Minutes it was inter alia recorded that the Respondent should file its Counter-Memorial within three months of the date of the filing of the Memorial by the Claimants.

The Claimants' Memorial is dated February 15, 2002. In the 58-page Memorial the Claimants, after narrating facts and events, have set out what according to them are the reasons why the Tribunal should adjudge and declare that:

1. The Respondent, through acts of its political subdivisions, has expropriated certain investments made

by the Claimants in the territory of Kazakhstan.

2. The fair market value of the expropriated investments immediately before the expropriatory act was \$13.5 million.
3. Under the terms of the Treaty between the United States of America and the Republic of Kazakhstan concerning the Reciprocal Encouragement and Protection of Investment, the Respondent is obligated to promptly pay the Claimants the sum of \$13.5 million, plus interest until the date of payment.
4. In addition, the Respondent shall pay to the Claimants their attorneys' fees, experts' fees and the costs of the arbitration.
5. The Claimants shall be awarded such further or other relief as may be appropriate.

6.4 By a further letter of February 27, 2002, the Claimants suggested that in view of the letter of October 6, 2001, of the Minister of Foreign Affairs of the Republic of Kazakhstan that he would be represented in this Arbitration by the Akim of Almaty Oblast, the Centre may wish to send an additional copy of the Claimants' Memorial (which was enclosed) to Mr Shalbay Kulmakhonov, the current Akim, and his mailing address was intimated.

On February 27, 2002, the Centre forwarded to the Akim of Almaty Oblast copies of the Centre's letter of October 25, 2001, minutes of the first session of the Tribunal held in London on November 15, 2001, and the letter of February 27, 2002, from the Claimants as well as the Claimants' Memorial of February 25, 2002 with annexures. The attention of the Respondent was drawn in particular to paragraph 15.1b of the minutes of the first session which recorded that the Respondent shall file its Counter-Memorial within three months of the date of the filing of the Memorial by the Claimants. The Centre in the letter dated February 25, 2002, stated that as the Claimants' Memorial was filed on February 15, 2002, "the counter-memorial must be filed by *April 15, 2002*" (later corrected by the Centre by further letter of March 4, 2002, to "*May 15, 2002*" – i.e., the date of filing of the Counter-Memorial would be May 15, 2002).

By letter dated March 27, 2002 the parties (including the Respondent) were informed by the Centre that the President of the Tribunal, after having consulted with its members and the ICSID Secretariat, planned to fix a session of the Tribunal with the parties on Sunday, June 2, 2002 in Paris, France and inquired whether the parties had any objection to this. The said letter further recorded:

Pursuant to paragraph 15(1)(b) of the minutes of the Tribunal's first session, the Respondent's Counter-Memorial is due to be filed on May 15, 2002. The purpose of the session on June 2, 2002, would be to determine further steps to be taken by the parties and the Tribunal in the arbitration, including outstanding issues under ICSID Arbitration Rule 20, as well as to deal with other preliminary matters that the parties may wish to canvass before the Tribunal. A proposed draft agenda will be sent to the parties under separate cover.

By a further letter dated March 28, 2002 the Secretary of the Tribunal informed the parties as follows:

As advised by the Embassy of the Republic of Kazakhstan in Washington, DC, I have been in correspondence with Mr Askar Batalov, President of the Kazakhstan Investment Promotion Centre (Kazinvest) – In my email to him, I again reminded the Republic of Kazakhstan of the deadline of May 15, 2002, for the filing of the Respondent's Counter-Memorial. I also informed him of the proposal by the Tribunal to hold a session with the parties on Sunday, June 2, 2002, in Paris, which was the subject of my letter to the parties of yesterday.

Please be advised that henceforth, all communications in connection with the proceeding will be sent to the above addresses unless other addresses are indicated to the Secretariat.

The said letter was addressed to the Respondent at the following addresses: viz.

Republic of Kazakhstan,  
C/o Mr Shalbay Kulmakhanov,  
Almaty Oblast Akimat,  
38, Taulsyzdyk Street,  
Republic of Kazakhstan

and

Mr Askar Batalov,  
President of the Kazakhstan  
Investment Promotion Center,  
Republic of Kazakhstan.

A copy was also sent to the Embassy of the Republic of Kazakhstan in Washington, DC.

6.5 The second meeting of the Tribunal was held on June 2, 2002 at the Offices of the World Bank, in Paris, France as previously intimated. Mr Robert Pietrowski, counsel, along with Mr Boris Evseev of AIG Capital Partners, attended on behalf of the Claimants – but no one attended on behalf of the Respondent. This was duly recorded in the minutes of the second session of the Tribunal:

The absence of the Respondent was noted. The Tribunal declared itself satisfied that both parties were duly informed of today's meeting through:

- a. Letters from the Secretary [of the Tribunal] to the parties dated: March 27, 2002, April 22, 2002, May 13, 2002 and May 15, 2002;
- b. Telephone conversation between the Tribunal's Secretary (through an interpreter) and the office of the Akim of Almaty Oblast in March 2002; as well as with the Embassy of the Republic of

Kazakhstan in Washington DC, in March 2002; and

- c. Electronic mail exchange, in March 2002, between the Tribunal's Secretary and the President of the Kazakhstan Investment Promotion Centre (Kazinvest), who had been proposed to the Centre, by the Embassy of the Republic of Kazakhstan in Washington, DC, as an addressee of correspondence in this case.

After the second session, on July 18, 2002, Mr John Barnum of McGuireWoods Kazakhstan addressed a letter to the Centre stating that McGuireWoods Kazakhstan LLP had been retained to represent the Republic of Kazakhstan with respect to the claims filed with ICSID by the Claimants. The letter went on to state:

Unfortunately, despite your apparent several efforts to bring this matter to the attention of the Government of the Republic, the Ministry of Justice has been able to locate only a few of the communications pertaining to Claimants' claims that ICSID apparently has sent to various offices in the Government.

Thanks to the courtesy of Claimants' counsel, Mr Pietrowski, however, I now have a copy of Mr Escobar's letter of June 3, 2002, and its enclosures, namely, the minutes of a June 2 hearing and procedural order No. 1. I would appreciate your sending me copies of the communications, minutes, notes of telephone conversations and e-mails referred to on pages 1 and 2 [of] those minutes, specifically the letters from ICSID dated October 16, 2001 and February 27, March 4, 27 and 28, April 22, May 13 and 15, and October 18, 2002.

We also have not been able to locate any of the correspondence from ICSID or Claimants relating to the appointment of the tribunal. I would appreciate your sending me copies of that material as well.

I would like to emphasize that I do not mean to suggest that ICSID did not act in complete good faith in its attempts to inform the Republic of Claimants' claims or of the other events that followed. The Government has indeed been aware of Claimants' claims since 2001, and it was pursuing settlement discussions until Claimants failed in January this year to deliver information concerning the specifics of their claims, but the Ministry of Justice has received very little information concerning the ICSID proceedings.

Thank you in advance for your assistance.

By a further detailed letter dated July 31, 2002 the Respondent through its Counsel contended, inter alia, that the Tribunal had been appointed without proper notice to the Government of Kazakhstan in contravention of the provisions of the Convention.<sup>36</sup>

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<sup>36</sup> In response to Mr John Barnum's letter of July 31, 2002 the Deputy Secretary-General of the Centre by his letter dated August 7, 2002 stated:

We in the ICSID Secretariat are satisfied that the request for arbitration and our subsequent communications [*sic*] regarding [these] proceedings were all notified to the Republic of Kazakhstan in full conformity with our Rules.

(Copy of the letter was forwarded by the Centre to the Claimants (Claimants' Exhibit No. 94 in the Arbitration proceedings).)

6.6 On July 31, 2002 the Respondent filed a document called “Respondent’s Objections to Jurisdiction” (attaching as Exhibit A thereto Mr John Barnum’s letter of July 31, 2002) and requested that pursuant to Rule 41(3)<sup>37</sup> the proceedings on merits be suspended including the hearing scheduled for August 28, 2002. Amongst the objections to Jurisdiction was the objection that this Tribunal was constituted without proper notice to the Respondent and the procedure followed by ICSID in constituting this Tribunal was improper and in contravention of ICSID’s own Regulations – consequently any award by this Tribunal would have to be annulled because “the Tribunal was not properly constituted”. Other objections as to jurisdiction were also raised.

On August 2, 2002 the Claimants filed with the Centre “Claimants’ Observations on the Respondent’s Objections to Jurisdiction”. The Respondent’s Reply to Claimants’ Observations on Jurisdiction was filed with the Centre on August 8, 2002.

Meanwhile, by an Order dated August 7, 2002, the Tribunal, after considering the submissions of the Parties and the facts and circumstances of the case, decided, pursuant to ICSID Arbitration Rule 41(4), to join the objections as to jurisdiction to the merits of the dispute and fixed the time limit for further procedures as follows: viz. that the Respondent be allowed a further opportunity to file its Counter-Memorial no later than August 19, 2002; and that the oral hearings in the case would take place in London on August 28–30, 2002, inclusive, as earlier scheduled.

6.7 The Respondent’s Counter-Memorial in the above case on the merits was filed on August 19, 2002 – the last extended date for filing the same. In the Counter-Memorial the Respondent reserved its objections as to jurisdiction as set forth in its letter and brief of July 31, 2002; and for the reasons stated in the said letter, it was submitted that the Claimants’ Claims should be rejected by the Tribunal.

In the Respondent’s Counter-Memorial it has set out various facts and submissions and contended:

- i. that the Claimants have brought the claim against the wrong party;
- ii. that the Claimants have brought the claim in the wrong forum;
- iii. that the Claimants have not taken appropriate measures to obtain any compensation allegedly due to them; and
- iv. that the Claimants have not made any serious or sufficient effort to mitigate [these] alleged damages

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<sup>37</sup> *Rule 41(3)*

Upon the formal raising of an objection relating to the dispute, the proceedings on the merits shall be suspended. The President of the Tribunal, after consultation with its other members, shall fix a time limit within which the parties

and that the Claimants should be denied the compensation requested or alternatively should be ordered to recalculate compensation on the basis [of] appropriate procedures that customarily apply in the Republic of Kazakhstan.

For the reasons stated in the Respondent's Counter-Memorial (filed along with 19 exhibits) it has been contended that Claimants' claim should be rejected by the Tribunal.

## 7. SUMMARY OF THE HEARINGS

7.1 The Tribunal conducted a hearing in London on August 28, 29, 30, as well as on August 31, 2002 (the scheduled dates of the hearing were extended to include August 31, 2002 by consent of the parties). Both the Claimants and Respondent appeared through their accredited Counsel and representatives. The Claimants were represented by (i) Mr Robert F. Pietrowski, Jr. Coudert Brothers; (ii) Mr Jonathan D. Cahn, Coudert Brothers; (iii) Mr Thomas C. O'Brien, Coudert Brothers; (iv) Ms Sarah M. Hall, Associate, Coudert Brothers; and (v) Ms Kulgaisha V. Mukasheva, Professor of Law, Adilet Law School, of counsel to Coudert Brothers. The Respondent was represented by (i) Mr John W. Barnum, McGuireWoods LLP (Counsel); (ii) Mr Eric E. Imashev, McGuireWoods LLP (Counsel) and (iii) Ms Dinara M. Jarmukhanova, McGuireWoods LLP (Counsel).

7.2 After a brief opening of the case by Counsel on each side, the following witnesses were examined as Claimants' witnesses viz. Mr Scott Foushee, Mr Marc Kasher, Mr Boris Evseev, Mr Ian Gomes, and Mr Phillip Pardo – each of them was cross-examined by Counsel for the Respondent. The following witnesses Mr Z. K. Zurkadilov, Mr Dolzhenkov and Mr Erlan Idrisov were called and gave evidence on behalf of the Respondent and each of them was cross-examined by Counsel for the Claimants. Some of the witnesses present were re-called and re-examined without objection by either party. Several documents, including many that had not previously been disclosed, were tendered and exhibited both by the Claimants and by the Respondent during the hearing. Detailed arguments were addressed by each side – as to the constitution of the Tribunal and other objections as to jurisdiction, as well on the merits of the case. It was agreed at the end of the hearing that a written note of submissions would be filed by and on behalf of each of the parties: The Claimants submitted a Post-hearing Memorial dated October 18, 2002, and the Respondent submitted a Post-hearing Brief also dated October 18, 2002.

The written submissions of both parties address questions as to the constitution of the Tribunal, and other objections as to the jurisdiction of the Tribunal, as well as questions arising on the merits of the case.

## 8. OBJECTION TO THE CONSTITUTION OF THIS ARBITRAL TRIBUNAL

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may file observations on the objection.

8.1 The Tribunal considers it appropriate at the outset to deal with the very first objection raised in the Respondent's Objection to Jurisdiction – viz. that the Tribunal was constituted without proper notice to the Respondent and in contravention of ICSID's own Regulations: this contention must be initially decided even before considering the other objections to jurisdiction (as well as submissions and contentions on merits) – especially since, if on a consideration of this first objection, the contention of the Respondent is upheld, the Tribunal would not be competent to go into any further question.

The objection regarding the allegedly improper constitution of the Tribunal is set out in the Respondent's Objections to Jurisdiction and is reproduced below:

Respondent's first objection is to the jurisdiction of this particular Tribunal. With all due respect to the three eminent arbitrators named by Claimants or ICSID, this Tribunal was constituted without proper notice to the Respondent. The result has been that Respondent did not participate in the Tribunal's formation, either by nominating one arbitrator or by having the opportunity to express its views concerning candidate for President. The reasons why the procedure followed by ICSID in constituting this Tribunal was improper and in contravention of ICSID's own Regulations are described in a letter to ICSID of today's date, a copy of which is attached thereto as Exhibit-A.

Suffice it to say here that, in Respondent's opinion, any award by this Tribunal would have to be annulled by ICSID pursuant to Article 52(1)(a) of the ICSID Convention because "the Tribunal was not properly constituted".

In the letter dated July 31, 2002 (Exhibit-A to the Objections to Jurisdiction) Regulation 33 of ICSID's Administrative and Financial Regulations is relied upon and quoted:

*Regulation 33 Communications with Contracting States*

Unless another channel of communications is specified by the State concerned, all communications required by the Convention or these Regulations to be sent to Contracting States shall be addressed to the State's representative on the Administrative Council.

It is contended that during the period leading up to the constitution of the Tribunal on October 5, 2001, the Republic of Kazakhstan's representative on the Administrative Council was the Kazakhstan Deputy Prime Minister Oraz Zhandosov – who was also Governor of the IBRD: and his alternate was the Minister of Economy Zhksybek Kulekeyev, and that neither Deputy Prime Minister Zhandosov nor Minister Kulekeyev were ever informed of anything pertaining to this matter. The contention is that therefore this Arbitral Tribunal has not been duly and properly constituted and consequently it does not have any authority to decide anything in this matter since it was constituted in violation of ICSID's own Regulations (i.e., Regulation 33 – of the Administrative and Financial Regulations) adopted by the Administrative Council of ICSID. It is contended that the opportunity and right to nominate an arbitrator and to participate in the selection of a Tribunal President is obviously one of the most important rights of every party to every arbitration, and ICSID's failure to follow its own Regulations has deprived the Republic of that right. Any



award made by this Tribunal (it is contended) would have to be annulled under Article 52(1) of the Convention on the ground that the Tribunal was “not properly constituted”. It is also contended that this Tribunal was constituted without any participation of the Republic of Kazakhstan and in this regard the letter of the Minister of Foreign Affairs dated October 6, 2001, has been relied upon – that letter contained a request for additional time to the Respondent to appoint an Arbitrator.<sup>38</sup>

Under Article 41 of the Convention this Arbitral Tribunal is the judge of its own competence and any objection raised by a party that the dispute is not within the jurisdiction of the Centre or for other reasons not within the competence of the Tribunal must be considered and dealt with by the Tribunal itself.

8.2 The Tribunal therefore proceeds to deal with the objection raised to its composition and constitution.

8.2.1 Under Article 6 of the Convention, the Administrative Council (the apex body of ICSID), which is composed of representatives of each Contracting State, is empowered to:

- (a) adopt Administrative and Financial Regulations of the Centre;
- (b) adopt the Rules of Procedure for the institution of Conciliation and Arbitration proceedings (for short “Institution Rules”);
- (c) adopt the rules for procedure for conciliation and arbitration proceedings (hereafter called “the Conciliation and Arbitration Rules”: for short, “Arbitration Rules” and “Conciliation Rules”).

8.2.2 As to whether the Administrative and Financial Regulations of the Centre (including Regulation 33) are applicable to ICSID Arbitration Proceedings or whether the Rules of Procedure for Institution of Conciliation and Arbitration Proceedings (briefly the Institution Rules) are applicable, must first be determined.

8.2.3 Now in Chapter IV of the Convention (Article 36) special provision is made with regard to Request for Arbitration; such request is specifically required to contain information (containing the issues in dispute, the identity of the parties and their consent to arbitration) “in accordance with the rules of procedure for the institution of arbitration and conciliation proceedings” (Article 36(2)).

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<sup>38</sup> The Tribunal notes without comment the subsequent plea on this aspect of jurisdiction as recorded in the Post-hearing brief of the Respondent (filed on October 18, 2002) which reads as follows:

With all due respect and admiration for the competence and open mindedness with which all the members of this Tribunal have addressed the witnesses and issues before them, in the event of an award to Claimants of more than Claimants’ legitimate pre-“expropriation” expenses and other damages for delaying the Project. Respondent must reserve its rights first to ask ICSID to review the procedure followed in naming this Tribunal pursuant to ICSID Convention Article 52(1)(a) and then, if necessary, to oppose any effort by Claimants to enforce the award.

The Institution Rules make special provision with regard to the address of the Respondent to an arbitration proceeding. Rule 2 of the Institution Rules provides that the Request for Arbitration shall “designate precisely each party to the dispute and *state the address of each*” (emphasis added) (Rule 2(1)(a)) and after registration of the Request under Rule 6, Rule 7 stipulates that the Notice of Registration of a Request shall “notify each party that all communication and notices in connection with the proceedings *will be sent to the address stated in the Request* unless another address is indicated to the Centre” (emphasis added).

Regulation 33 of the Administrative and Financial Regulations relied on by the Respondent stipulates that unless another channel of communication is specified by the State concerned, all communications “*required by the Convention or these Regulations* to be sent to Contracting States” shall be addressed to the State’s Representative on the Administrative Council: Regulation 33 therefore deals specifically with all communications that are required by the Convention or by the Administrative and Financial Regulations “to be sent to the Contracting States”; it does not include within its sweep all communications required by the Institution Rules to be sent to a Contracting State – which is a party to an ICSID arbitration. The communications “required by the Convention” under Regulation 33 to be sent to Contracting States would include Notices of the annual meetings of the Council under Article 7 of the Convention, and communications required by the Administrative and Financial Regulations to be sent to Contracting States (under Regulation 33) which would include: Notices of meetings (Regulation 2(1)); transmission of Agenda for meetings (Regulation 3(1)); Motions on proposed action which cannot be postponed until the next meeting of the Council (Regulation 7(3)); communication of charges for special services to be communicated to all Contracting States (Regulation 15(2)); adoption by the Administrative Council of the Budget (Regulation 17 – read with Regulation 7(3)); assessment of contributions by Contracting States which are to be promptly communicated to Contracting States (Regulation 18(1)). Communication to parties of a Request for Arbitration (even when such parties are Contracting States) [is] left to be determined by the Institution Rules under which the address stated in the Request for Arbitration determines the address [to] which all subsequent communications (including communications under the Arbitration Rules – dealing with composition of the arbitral tribunal) are to be addressed. Rule 7 of the Institution Rules makes this very clear – the Notice of Registration of the Request for Arbitration must “notify each party that all communications and notices in connection with the proceedings will be sent to the address stated in the Request for Arbitration unless another address is indicated to the Centre”.

In the Opinion of this Tribunal the specific provisions relating to communications of the Request for Arbitration, the address to which they are to be communicated and all proceedings subsequent thereto are set out in the Institution Rules – separately adopted by the Administrative Council – and they apply. Provisions relating to communications “required by the Convention or these Regulations (i.e., Administrative and Financial Regulations) to be sent to Contracting States” (Regulation 33) do not apply to

arbitration proceedings which commence with a Request for Arbitration.

8.2.4 However in this case the question regarding the validity of the composition of the Arbitral Tribunal does not merely depend upon a textual interpretation of Regulation 33 of the Administrative and Financial Regulations, and of the Convention's Article 36 (Request for Arbitration) read with Institution Rules 2(l)(a) and 7(b) quoted above. The more important and vital question – a question specifically urged by the Respondent – is whether the Respondent has been deprived of the opportunity and right to participate in the composition of the Tribunal.

8.2.5 On a careful consideration of all the facts and circumstances leading up to the constitution of the Tribunal by the Centre, the Tribunal holds that the Respondent was at all times made aware of the Request for Arbitration dated May 3, 2001 and of its right to participate in the composition of the Arbitral Tribunal as mentioned in the Arbitration Rules (Rules 2, 3 and 4). The circumstances relied on by the Tribunal for this conclusion are set out below:

- (i) Letters of the Centre addressed to the Respondent – (Letters dated May 4, 2001; May 8, 2001; May 31, 2001; June 4, 2001; June 12, 2001; August 8, 2001; August 13, 2001; September 4, 2001; September 7, 2001; September 14, 2001; September 25, 2001; October 1, 2001) – were addressed to the Respondent at the address mentioned in the Request for Arbitration (in accordance with the Institution Rules) – they were addressed to the appropriate and relevant Ministry concerned with foreign investment viz. the Ministry of Foreign Affairs: that this was the relevant Ministry is clear from the letter dated March 13, 2001 of E. Idrissov, Minister of Foreign Affairs addressed to the Deputy Prime Minister – (Claimants' Exhibit 31) – the first paragraph of which reads as follows:

The Ministry of Foreign Affairs of the Republic of Kazakhstan, having reviewed the appeal by Mr Richard G. Jones, the United States Ambassador, and the investment dispute notice received from AIG Silk Road Capital Management Ltd, informs you as follows...

In the course of his oral evidence Ambassador E. Idrissov admitted that it is the Ministry of Foreign Affairs that looks after foreign investments.<sup>39</sup> None of the witnesses called by the Respondent professed ignorance of the contents of the letters referred to above commencing with the Centre's letter of May 4, 2001; none of them stated that those letters were in fact not received by the addressee

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<sup>39</sup> See pages 13–14 of the Transcript of Day Three of the oral hearings in London: It is well settled that as a matter of international law the principal organ for regular conduct of interaction between States is the Ministry of Foreign Affairs. The Head of this Ministry is the Minister of Foreign Affairs, who directs the foreign affairs of the State. (See Oppenheim on International Law (Peace) 9th edition Vol. 1 para. 459 pp. 1045–6.) The Claimants have filed along with their Post-Hearing Memorial (as part of Claimants' Exhibit 130) copy of a regulation of the Ministry of Foreign Affairs of the Republic of Kazakhstan approved by Government Resolution No. 1578 "Issues of the Ministry of Foreign Affairs of Republic of Kazakhstan" adopted on October 21, 1999 which states that the Ministry of Foreign Affairs shall perform the following functions viz. representation of the Republic of Kazakhstan in dealings with foreign States and international organizations. It also provides that the Ministry of Foreign Affairs shall have the right to act as a party in civil-legal relations on behalf of the State.

to whom they were addressed.

- (ii) The Notices of the Centre dated June 12, 2001; and August 8, 2001 – specifically dealing with the composition of the Arbitral Tribunal (under the Arbitration Rules) were also addressed by name to HE Mr Erlan Idrissov (Minister of Foreign Affairs). Mr Idrissov was called as a witness on behalf of the Respondent and gave evidence on the merits of the case: he did not say that he was unaware of or did not receive these notices or that he was not aware of all or any of the Notices of the Centre commencing with the notice dated June 4, 2001 (intimating to the parties about the registration of the Request for Arbitration and for taking steps for constituting the Arbitral Tribunal): if it was the case of the Respondent that it was unaware of the various Notices forwarded by the Centre, the Minister of Foreign Affairs to whom at least two such notices were addressed by name would have deposed to the fact that the notices though stated to be addressed to him had not in fact been received.
- (iii) In the very first letter of July 18, 2002 addressed by Counsel for the Respondent to the Centre intimating that he had been retained to represent the Republic of Kazakhstan with respect to the claim filed by the Claimants; it was admitted that communications pertaining to the Claimants’ claim had been sent by ICSID (the Centre) “to various offices of the Government” (of Kazakhstan) – and that (one of them) the Ministry of Justice had been able to locate “only a few of the communications...” (as to which were these communications is not stated, nor have these been mentioned at any stage of the Arbitration proceedings). The relevant part of the letter dated July 18, 2002 is quoted below:

Unfortunately, despite your apparent several efforts to bring this matter to the attention of the Government of the Republic of Kazakhstan, the Ministry of Justice has been able to locate only a few of the communications pertaining to Claimants’ claim which ICSID apparently has sent to various Offices of the Government.

This letter further acknowledges that the Government of Kazakhstan had been aware of the Claimants’ claim since the year 2001 and that it was pursuing settlement discussions with the Claimants which failed in January 2002 when the Claimants did not deliver information of certain specifics of their claim.
- (iv) Besides, copies of letters addressed by the Centre informing the Respondent at each stage of its rights under the Arbitration Rules (inter alia with respect to the composition of the Tribunal) had been also sent to the Embassy of Kazakhstan in Washington – receipt of which has not been denied at any time, either in evidence or during arguments.
- (v) None of the communications addressed by the Centre to the Respondents through the Ministry of Foreign Affairs were ever responded to – and it is significant that the letter of October 6, 2001, addressed to the Centre by Mr Erlan Idrissov (the Minister of Foreign Affairs) received by the Centre on October 23, 2001, shows that the appropriate Ministry (the Ministry of Foreign Affairs) was in fact aware of the pending Arbitral proceedings – ICSID Case No. ARB 01/6 is cited in the letter.

- (vi) The Tribunal having already been duly constituted under the Rules as communicated to the parties by the Centre's letter dated October 5, 2001, the request made in the letter dated October 6, 2001, by the Minister of Foreign Affairs of Kazakhstan, received by the Centre on October 23, 2001, that further time should be granted to Kazakhstan to appoint an arbitrator, was plainly a belated request. The letters of the Centre (dated June 12, 2001, and August 8, 2001) specifically addressed to HE Mr Erlan Idrissov and specifically inviting the Respondent to participate in the composition of the Tribunal under the Arbitration Rules were ignored: the Tribunal concludes that when an opportunity is afforded to a party to appoint an arbitrator and the party chooses to do nothing and does not respond, it cannot complain that it has been deprived of the opportunity and right to participate in the composition of the Tribunal.

8.2.6 For all the above reasons the Tribunal cannot accept the contention that the Respondent had been deprived of the opportunity and right to participate in the composition of the Tribunal. The Tribunal rejects the plea of the Respondent, that this Tribunal was not validly constituted.<sup>40</sup>

## 9. WHETHER OTHER OBJECTIONS TO JURISDICTION PRECLUDED BY REASON OF RULE 41 OF THE ARBITRATION RULES

9.1 Before dealing with the other Objections to Jurisdiction raised by the Respondent, the Tribunal must first consider the plea of the Claimants that since the Respondent's Objections to Jurisdiction were not filed "as early as possible" (as required by Rule 41 of the Arbitration Rules) they cannot be and ought not to be entertained by the Tribunal: it is said that the time limit originally fixed for filing the Counter-Memorial of the Respondent was May 15, 2002;<sup>41</sup> the Respondent filed its objections to Jurisdiction only on July 31, 2002; all the facts that the Claimants rely on *to establish* the Centre's jurisdiction had been stated in the Request for Arbitration registered by the Centre as far back as June 4, 2001, and the Respondent having

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<sup>40</sup> In addition to the above, it must also be noted that even if as contended by the Respondent, Regulation 33 was applicable to arbitral proceedings (where the Contracting State is a party) the Respondent would appear to have waived its right to object: Rule 27 of the Rules of Procedure for Arbitration Proceedings (Arbitration Rules) – adopted by Administrative Council under Article 6(b) of the Convention – specifically provides for this:

Rule 27 reads:

*Rule 27 Waiver*

A party which *knows or should have known* that a provision of the Administrative and Financial Regulations, of these Rules, of any other rules or agreement applicable to the proceeding, or of an order of the Tribunal has not been complied with *and which fails to state promptly its objections thereto*, shall be deemed – subject to Article 45 of the Convention – to have waived its right to object. (Emphasis is supplied.)

However no arguments were addressed by the parties as to the application of Rule 27 of the Arbitration Rules and accordingly the Arbitral Tribunal makes no finding as to this.

<sup>41</sup> It was later extended by Order dated August 19, 2002.

been aware of these facts for fourteen months, the objections filed on July 30, 2002 to jurisdiction could not now be entertained.

9.2 In the opinion of the Tribunal this plea cannot be accepted. Objections to the jurisdiction of an adjudicatory body cannot be ignored, if raised during the arbitral proceedings – delay notwithstanding. Mere tardiness in raising a point of jurisdiction cannot preclude it being considered by the Tribunal at a later stage: so long as the same is raised during the course of the arbitral proceedings.

Rule 41 of the Arbitration Rules (Objection to Jurisdiction) cannot and does not negate the mandate of Article 41 of the Convention: the latter requires a Tribunal to determine every objection to jurisdiction.

The time limits prescribed in Rule 41(1)<sup>42</sup> and the requirement that every objection as to jurisdiction or competence of the Tribunal shall be made “as early as possible” is intended to alert the parties to bring forth their objections, basic to the dispute being adjudicated upon on merits, at the earliest possible point of time. It appears to be rationally and reasonably related only to the expeditious disposal of ICSID arbitral proceedings. It cannot be read as coercive. It could not for instance empower the Arbitral Tribunal to grant relief to a Claimant when there is apparently no jurisdiction of the Centre or the Tribunal to entertain and try the case. The plea of the Claimants based on Article 41 of the Arbitration Rules must therefore stand rejected.

9.3 *The only surviving objection to jurisdiction viz. – that Claimants do not have any right to invoke ICSID arbitration under the Bilateral Investment Treaty.*

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<sup>42</sup> *Rule 41 Objections to Jurisdiction*

(1) Any objection that the dispute or any ancillary claim is not within the jurisdiction of the Centre or, for other reasons, is not within the competence of the Tribunal shall be made as early as possible. A party shall file the objection with the Secretary-General no later than the expiration of the time limit fixed for the filing of the Counter-Memorial, or, if the objection relates to an ancillary claim, for the filing of the rejoinder – unless the facts on which the objection is based are unknown to the party at that time.

(2) The Tribunal may on its own initiative consider, at any stage of the proceeding, whether the dispute or any ancillary claim before it is within the jurisdiction of the Centre and within its own competence.

(3) Upon the formal raising of an objection relating to the dispute, the proceeding on the merits shall be suspended. The President of the Tribunal, after consultation with its other members, shall fix a time limit within which the parties may file observations on the objection.

(4) The Tribunal shall decide whether or not the further procedures relating to the objection shall be oral. It may deal with the objection as a preliminary question or join it to the merits of the dispute. If the Tribunal overrules the objection or joins it to the merits, it shall once more fix time limits for the further procedures.

(5) If the Tribunal decides that the dispute is not within the jurisdiction of the Centre or not within its own competence, it shall render an award to that effect.

9.3.1 Apart from the composition of the Tribunal, the only specific Objection to Jurisdiction that has been raised, argued and persisted in is that the Claimants do not have any right to invoke ICSID Arbitration under the Bilateral Treaty.

9.3.2 Other objections to jurisdiction that were initially made were: (i) that the Claimants' claims are based on the alleged conduct of Almaty Oblast and the City of the Almaty and not the conduct of the Republic of Kazakhstan and are therefore not subject to ICSID Arbitration jurisdiction, and (ii) that the Treaty does not subject the Republic or its Subdivisions to ICSID Arbitration Jurisdiction for claims based on land or real estate which fall under the exclusive jurisdiction of the Courts of the Republic of Kazakhstan.<sup>43</sup> But these objections were withdrawn and specifically given up as recorded in the Post-hearing Brief of the Respondent filed on October 18, 2002, in which it is stated –

The Respondent withdraws its objections to ICSID jurisdiction on the ground that the Republic is not responsible under the Treaty for the acts of the Almaty Oblast Akim. Respondent also withdraws its objection on the ground that this dispute can only be adjudicated by the courts of Kazakhstan.

Respondent renews, however, its objection to ICSID jurisdiction on the ground that neither of these Claimants has standing to invoke the US–Kazakhstan Investment Treaty.

The Tribunal accordingly proceeds to deal with the Respondent's only surviving Objection to ICSID Jurisdiction viz. that neither of the Claimants have standing to invoke the BIT.

9.3.3 The jurisdictional plea is that the Claimants are not entitled to invoke the provisions of the BIT.

The BIT discloses the clear intention of the Parties thereto (the United States of America on the one hand and the Republic of Kazakhstan on the other) to place investments made by nationals of one of them in the territory of the other under the guarantee of Inter-State Relations and the protection of International Law. The jurisdiction of ICSID under Article 25 of the Convention is based directly on the BIT concluded between the host State (the Republic of Kazakhstan in the present case) and the State of the investors (USA): it being asserted that the first and second Claimants are entitled to invoke the BIT and accordingly the Jurisdiction of the Centre under Chapter II of the Convention.

It is not disputed, as it cannot be, that “the measures tantamount to expropriation” (Article III(I) of the BIT) occurred later than the date on which the BIT entered into force both in the United States and in the Republic of Kazakhstan (i.e., in January 1994), and the validity and legal consequences of these measures must be ascertained in accordance with the rules in force at the date on which they occurred (i.e., on various dates in the year 2000). The BIT which binds the parties since January 1994 is among these rules.

9.3.4 As to the Jurisdiction of the Arbitral Tribunal to adjudicate upon the Request for Arbitration the same must be determined as of the date of the filing of the Request<sup>44</sup> and its registration by the Centre<sup>45</sup> in the present case – May 3, 2001 and June 4, 2001 respectively.

9.3.5 For the purposes of the BIT, “investment” means every kind of investment in the territory of one Party *owned or controlled* directly or indirectly by nationals or companies of the other Party (Article I[1](a)); “investment” also specifically includes tangible and intangible properly including rights such as mortgages, liens and pledges and includes “a company” or interests in the assets thereof, it also includes a claim to money or a claim to performance having economic value and associated with an investment. The word “controlled” is not defined. The Treaty applies to investments existing at the time of entry into force as well as to investments made or acquired thereafter<sup>46</sup> (Article XIII).

The BIT provides that an 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 and that neither party shall in any way impair by arbitrary or discriminatory measures, the management, maintenance, use, enjoyment, acquisition, expansion or disposal of investments (Article I[1](a) & (b)).

Article III provides that investment shall not be expropriated or nationalized either directly or indirectly through “measures tantamount to expropriation or nationalisation” except for a 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).

Article VI of the BIT provides as follows:

1. For purposes of this Article, an investment dispute is a dispute between a Party and a national or company of the other Party arising out of or relating to (a) an investment agreement between that Party and such national or company; (b) an investment authorisation granted by that Party’s foreign investment authority to such national or company; or (c) an alleged breach of any right conferred or

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<sup>43</sup> See Respondent’s Objections to Jurisdiction filed on July 31, 2002.

<sup>44</sup> According to the principle established in the decision of the International Court of Justice in the case of (*Jamahiriya Libyan Arab Republic v. United States of America*) paras. 37 and 42: issues of interpretation and application of the Montreal Convention of 1971 resulting from the Lockerbie air accident: cited in *Antoine Goetz* (ICSID case) mentioned below.

<sup>45</sup> ICSID case: *Antoine Goetz or Republic of Burundi* reported in ICCA Yearbook 2001 Vol. XXVI pp. 24–46 at p. 32 (footnote 17).

<sup>46</sup> Article XIII provides that the Treaty shall enter into force thirty days after the date of exchange of instruments of ratification (i.e., January 12, 1994) and shall remain in force for a period of ten years and shall continue in force unless



created by the Treaty with respect to an investment.

2. In the event of an investment dispute, the parties to the dispute should initially seek a resolution through consultation and negotiation. If the dispute cannot be settled amicably, the national or company concerned may choose to submit the dispute for resolution:

- (a) to the courts or administrative tribunals of the Party that is a party to the dispute; or
- (b) in accordance with any applicable, previously agreed dispute-settlement procedures; or
- (c) in accordance with the terms of paragraph 3.

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

- (i) to the International Centre for the Settlement of Investment Disputes (“Centre”) established by the Convention on the Settlement of Investment Disputes between States and Nationals of other States, done at Washington, March 18, 1965 (“ICSID Convention”), provided that the Party is a party to such Convention; or
- (ii) to the Additional Facility of the Centre, if the Centre is not available; or
- (iii) in accordance with the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL); or
- (iv) to any other arbitration institution, or in accordance with any other arbitration rules, as may be mutually agreed between the parties to the dispute

(b) Once the national or company concerned has so consented, either party to the dispute may initiate arbitration in accordance with the choice so specified in the consent.

4. Each Party hereby consents to the submission of any investment dispute for settlement by binding arbitration in accordance with the choice specified in the written consent of the national or company under paragraph 3. Such consent, together with the written consent of the national or company when given under paragraph 3 shall satisfy the requirement for:

- (a) written consent of the parties to the dispute for purposes of Chapter II of the ICSID Convention (Jurisdiction of the Centre) and for purposes of the Additional Facility Rules; and
- (b) an “agreement in writing” for purposes of Article II of the United Nations Convention on the

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terminated.

Recognition and Enforcement of Foreign Arbitral Awards, done at New York, June 10, 1958 (“New York Convention”).

9.3.6 The law of the Republic of Kazakhstan on Foreign Investment of December 27, 1994 (officially published on January 20, 1995 – Claimants’ Exhibit 2) defines “foreign investments” as investments made in the form of participation in the charter capital of Kazakhstan legal entities – “with respect to which foreign investors are entitled to determine decisions being made by such legal entities”. “Foreign Investor” is defined to mean not only “foreign legal entities” (i.e., a legal entity, company, firm, enterprise, organization, association etc. established outside the Republic of Kazakhstan in accordance with the legislation of a Foreign State) but also legal entities of the Republic of Kazakhstan “with respect to which foreign investors are entitled to determine decisions made by such legal entities”. A “Joint Venture” is defined as an enterprise with foreign participation established in the territory of the Republic of Kazakhstan in accordance with the legislation of the Republic of Kazakhstan in which a part of the property (shares, interest) is owned by a foreign investor.

This law on foreign investment in the State of Kazakhstan guarantees a legal regime for foreign investment, guarantees against any change in law, guarantees against expropriation, and guarantees indemnification and reimbursement of losses of foreign investors. It also provides (sub-section (2) of Section (2) of Article 27) that investment disputes shall be resolved through negotiations and if they cannot be so resolved within a stated period, such disputes, upon choice of any of the parties, may be submitted for settlement in accordance with the agreed procedure for settling disputes, including the procedure established in the contract or any other agreement between the parties, to an arbitration body: and specifically refers to and includes the Centre if the State of the investor is a participant of the Convention (Article 27(2)(a)). Article 27(3) goes on to provide that in the event a foreign investor has chosen the procedure for dispute settlement provided for by subsection 2 of Section 2 of Article 27 (i.e., under the ICSID Convention) “the consent of the Republic of Kazakhstan shall be deemed to be obtained”. The consent of a foreign investor may be given at any time through written application to the authorized State body or at the moment of the submission to the arbitration.

9.3.7 Complementary to the December 1994 Law of Kazakhstan on foreign investment (Claimants’ Exhibit 2) there is also exhibited in this case (as Claimants’ Exhibit No. 34) the Law of Kazakhstan on State Support [of] Direct Investment of February 28, 1997, which provides guarantees of protection of interest of “approved investors”, and stipulates that the Agency of the Republic of Kazakhstan on Investment shall be the sole State Agency authorized to perform the State Support of Direct Investment in Kazakhstan (Article 14(1)). “Direct Investment” is defined in this law as meaning all types of investments made by an investor to fixed assets (fixed capital) made by a Kazakhstani legal entity excluding those investments bound by sovereign guarantees of the Republic of Kazakhstan, and the term “approved

investor” is defined to mean an investor who has entered into a contract with the Agency. Article 3(2) however provides that if an international treaty ratified by Kazakhstan establishes other Rules than those contemplated by the legislation of Kazakhstan on the State Support of Direct Investment, then the international Treaty Rules apply (Article 3(2)).

9.3.8 Apparently pursuant to the 1997 law on State Support [of] Direct Investment, a contract – being contract No. 0159-12 of December 13, 1999 (Claimants’ Exhibit No. 3) – was entered into between the Agency of the Republic of Kazakhstan for investment and Claimant No. 2 CJSC Tema Real Estate Company – the latter as “approved investor”. This contract established a certain legal framework regulating the relationship of the Agency and the Investor in accordance with the legislation of the Republic of Kazakhstan and for the purpose of providing various incentives and State Support for investment activity “in the construction sector of commercial housing”.

9.4 The relevant question that must now be addressed – as a jurisdictional issue (on this point a mixed issue of law and fact) – is whether the investment in the residential housing complex called Crystal Air Village was “owned or controlled directly or indirectly” by a US company.<sup>47</sup>

9.4.1 According to the Respondent the investment was by Claimant No. 2, which was not and is not a US entity, nor is it controlled by a US entity: it is controlled by a Bermuda based company AIG Silk Road Fund Ltd (to the extent of 66 per cent); hence there is no right to invoke the Treaty (and as a consequence no jurisdiction of the Centre under the ICSID Convention).

9.4.2 According to the Claimants, however, all of the investments in the Crystal Air Village Project in Kazakhstan were made by the Fund (AIG Silk Road Fund Ltd),<sup>48</sup> by the Investment Company (AIG Silk Road Investments I Ltd: a wholly owned 100% subsidiary of the Fund) and by the Finance Company (Kazakhstan Housing Ltd: also a wholly owned 100% subsidiary of the Fund), and by the Joint Venture<sup>49</sup> (Claimant No. 2) and these entities were “controlled indirectly” by AIG (Claimant No. 1), and therefore protected by the Treaty. Besides, the Joint Venture (Claimant No. 2) is itself a “company” (“investments” under the BIT includes a “company”) which is situated in the territory of Kazakhstan and is indirectly controlled by a US Company (Claimant No. 1). The Joint Venture (Claimant No. 2) is itself an “Investment” for purposes of the BIT and must be treated as a US national in accordance with Article

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<sup>47</sup> Article I(1) of the BIT states that for the purposes of this Treaty:

(1) investment means every kind of investment in the territory of one party owned or controlled directly or indirectly by nationals or companies of the other party...

<sup>48</sup> The Fund, the Investment Company and the Finance Company were Bermuda based.

<sup>49</sup> The Joint Venture was a Kazakhstan Company having a 66% foreign ownership and control.

25(2)(b) of the Convention (by virtue of Article VI(8) of the BIT).

9.4.3 The Respondent's detailed arguments in support of its plea of lack of jurisdiction, viz. that neither of the Claimants has standing to invoke the BIT, are set out in detail in the Post-hearing Brief filed on October 18, 2002, in which it has been asserted as follows:

- (1) That the Claimants' case for invoking ICSID jurisdiction is the BIT that allows a US private party to invoke ICSID jurisdiction in the event that it has a dispute with the Republic of Kazakhstan concerning an investment that the US party made in Kazakhstan. To qualify for Treaty jurisdiction, the investor must be "owned or controlled directly or indirectly" by a US entity.
- (2) That the investment here was the Crystal Air housing project (the Project) owned 100% by the Claimant CJSC Tema (the Joint Venture). CJSC Tema (the Joint Venture) itself is a Kazakhstani joint stock company, but it could assert Treaty jurisdiction as a US entity if it were owned or controlled by a US entity. (Reference is made to Articles I(1)(b) and (2). III and VI(1) of the Treaty.)
- (3) That CJSC Tema (the Joint Venture) is owned 34% by another Kazakhstani company, LLP Tema, which could not have given CJSC Tema any right to assert Treaty jurisdiction. The only other owner or shareholder of CJSC Tema (66% owner) is a Bermuda company, AIG Silk Road Fund, Ltd ("the Fund").
- (4) That the Fund itself does not have any right to assert Treaty jurisdiction and cannot give CJSC Tema US entity status because it is not a US entity itself.
- (5) That the question whether CJSC Tema (Claimant No. 2) was owned or controlled indirectly by the other Claimant (Claimant No. 1) – "*admittedly a US entity*" (sic) – and whether such indirect ownership or control gave the Claimants standing, must be answered in the negative because:
  - (a) the indirect owners of CJSC Tema are, in order of magnitude of their ownership interest, LLP Tema (34%), the EBRD (European Bank for Reconstruction and Development 20% of "the Fund's" 66%), various US corporate investors that are not seeking to invoke Treaty jurisdiction (even if they could), and finally Claimant No. 1 AIG Capital Partners, Inc., which it is alleged owns only 5% of the Fund's 66% or 3.3%. Such limited AIG ownership cannot be sufficient to confer US status on CJSC Tema on the basis of US ownership, or confer Treaty standing on AIG (Claimant No. 1) itself;
  - (b) there is no indirect control of AIG (Claimant No. 1) because, according to the record in this case, CJSC Tema is controlled by AIG Silk Road Investments I, Ltd, a Bermuda company that owns

66% of the common stock of, and has voting control of, CJSC Tema (Claimants' Exhibit 90).<sup>50</sup> This Bermuda company is allegedly "controlled" by the Fund, but in fact it is managed by a third Bermuda company, AIG Silk Road Capital Management, Ltd (Claimants' Exhibit 87).<sup>51</sup> The latter's management services include "the sourcing, analysis, structuring, and closing of investments, as well as active management of the investments after closing". So day-to-day "control" of both the Fund and CJSC Tema is in the hands of "another third-country entity".

- (6) That Claimant No. 1 AIG is indirectly a very minor shareholder of the third country investor, the Fund – five or even fifteen percent does not give AIG (Claimant No. 1) or its US parents, status of an "investor"; "the cases which are legion hold that such a minority ownership does not confer the right to invoke ICSID jurisdiction unless there is an express right in the treaty for related entities from third countries – which of course is not the case here".
- (7) That the present case illustrates why there is good reason to exclude third country entities from Treaty rights and to reject AIG's claim of jurisdiction in this case. If Kazakhstan purposely limited Treaty jurisdiction to genuine US investors, why should it allow an investor wholly owned by a Kazakhstani and third-country interests to qualify as a US investor?
- (8) That the tenuous and distant relationship between Claimant AIG Capital Partners, Inc. and Claimant CJSC Tema, plus the small fraction of its indirect share in CJSC Tema, bars AIG Capital Partners (Claimant No. 1) from qualifying as a legitimate claimant under the BIT.

*These are the detailed arguments set forth by the Respondent.*

9.4.4 The contentions of the Claimants in support of their plea that they have the standing to invoke the BIT have been set out initially in their Request for Arbitration and then elaborated, with reference to several documents in the course of arguments (as well as in oral evidence).

9.4.5 In the opinion of this Tribunal the Claimants have established, through documentary evidence, the following:

- (1) That AIG Capital Partners, Inc. ("AIG") is a US corporation organized and existing under the laws of Delaware, a political subdivision of the United States (as evidenced by Claimants' Exhibit No. 81); and is owned 100 per cent by AIG International Group Inc. (the holding company – a corporation organized and existing under the laws of Delaware, a US entity (as evidenced by

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<sup>50</sup> Investment Agreement dated April 10, 1999, between AIG Silk Road Investment Ltd (Bermuda Company), TEMA, two individual citizens of Kazakhstan and the Joint Venture (Claimant No. 2).

<sup>51</sup> Fund Management Agreement dated September 25, 1997, between AIG Silk Road Capital Management Ltd (Bermuda Company) and AIG Silk Road Fund Ltd (Bermuda Company).

Claimants" Exhibit No. 83)).

- (2) That AIG SRI (i.e., AIG Silk Road Investors Inc., a US Company) owns the majority of the shareholders" voting rights in the Bermuda based Company AIG Silk Road Fund, Limited (the "Fund") (as evidenced by Claimants" Exhibit Nos. 84–5). The Fund has three classes of shareholders, and AIG SRI owns 100 per cent of the Class A shares in the Fund, the remaining shareholders in Class B and C having no right to individually exercise voting rights in respect of Class B and Class C shares (as evidenced by Claimants" Exhibit No. 84).
- (3) The entire voting power and voting rights of the Fund [are] vested "solely and exclusively" in the holders of Class-A common shares (bylaw 54(2)), i.e., in AIG Silk Road Investors Inc. the US Company (Claimants" Exhibit No. 84). Under the amended and restated bylaws of AIG Silk Road Fund Ltd, effective as of June 12, 1999 (Claimants" Exhibit No. 85), the purpose and nature of business conducted and promoted by the Fund is to seek long term capital appreciation through investments in portfolio companies and the term of the company (the Fund) is to be eight years. The Board of Directors of the Fund is to consist of not less than five directors – and holders of Class-A common shares are entitled to elect the Chairman and the Deputy Chairman and all but two of the directors (bylaw No. 16). The Investment Committee of the Board is to have six members or such higher number as may be approved by the Board – and the Chairman of the Board is entitled to appoint five out of six members of the investment committee: each member of the investment committee is to hold office until death, resignation or removal (bylaw 32). The Investment Committee is responsible for making all investment decisions relating to acquisition, management and disposition of the Fund"s investments.
- (4) That AIG Silk Road Investors Inc. (AIG SRI), a US Corporation, is in turn owned ninety-five per cent (95%) by National Union Fire Insurance Co. of Pittsburgh ("National" a US Corporation) and five per cent (5%) by AIG Capital Partners Inc. ("AIG" Claimant No. 1) (as evidenced by Claimants" Exhibit No. 82) – that both National and AIG (Claimant No. 1) are wholly owned subsidiaries of American International Group Inc. US (as evidenced by Claimants" Exhibit No. 83).
- (5) "National" (the US Corporation) had agreed by memorandum dated September 29, 1997 (part of Claimants" Exhibit No. 83) that AIG (Claimant No. 1) shall exclusively exercise all voting rights in respect of Class A shares (owned by AIG Silk Road Investors Inc. US, and held in AIG Silk Road Fund Ltd); AIG (Claimant No. 1) thus controls AIG SRI with respect to the Fund (as also evidenced by Claimants" Exhibit No. 83).
- (6) AIG (Claimant No. 1) indirectly controls the Fund, having the power to appoint the Chairman of the Board of the Fund and three of the five directors of the Fund (under the Fund"s bylaws – Claimants" Exhibit No. 85). It has in fact done so (the Board"s decisions are determined by a majority vote). The Board has delegated all decisions relating to the acquisition and disposition of

investments to the Investment Committee (as evidenced by Claimants' Exhibit No. 85). Because AIG (Claimant No. 1) controls exclusively all voting rights in respect of Class A shares, it has also the power to appoint and has appointed five of the six Investment Committee members (as evidenced by Claimants' Exhibit No. 85).

- (7) That AIG Silk Road Capital Management, Ltd (a Bermuda company), which is 100 per cent owned by AIG SRI (AIG Silk Road Investors Inc., USA), provides management services to the Fund through a Management Agreement (as evidenced by Claimants' Exhibit Nos. 86 and 87). These management services include the sourcing, analysis, structuring, and closing of investments, as well as active management of the investments after closing.
- (8) That the Fund directly controls AIG Silk Road Investment I Limited ("the Investment Company") and Kazakhstan Housing Limited ("the Financing Company"), companies organized under the laws of Bermuda (Claimants' Exhibit Nos. 88 and 89). The Investment Company and the Financing Company are 100 per cent owned by the Fund (as evidenced by Claimants' Exhibit Nos. 88 and 89); and the Fund is indirectly controlled by AIG (Claimant No. 1).
- (9) That the Investment Company (AIG Silk Road Investment I Ltd) controls the Joint Venture (Claimant No. 2), and the Financing Company (Kazakhstan Housing Ltd) has provided finance for the Project to the Joint Venture (Claimant No. 2). The Investment Company entered into the Investment Agreement providing for the joint venture with LLP Tema (a Kazakhstan company owned and controlled by Kazakhstani principals), in CJPC Tema Real Estate Company (a Kazakhstan Company) (the "Joint Venture") (as evidenced by Claimants' Exhibit No. 90). The Investment Company (AIG Silk Road Investors I Ltd) owns 66 per cent of the common shares and 100 per cent of the preferred shares in the Joint Venture, and exercises voting control of the Joint Venture and appoints a majority of the Board of Directors in the Joint Venture (as evidenced by Claimants' Exhibit No. 90) – this Investment Company is a wholly owned subsidiary of the Fund. The remaining 34 per cent of the Shares of the Joint Venture (Claimant No. 2) is owned by LLP Tema (a Kazakhstan Company). Pursuant to the terms of a Bridge Loan Agreement (Claimants' Exhibit No. 35A), the Fund lent LLP Tema funds to purchase the Project Property. Pursuant to an Assignment and Assumption Agreement (Claimants' Exhibit No. 35G), LLP Tema assigned the Bridge Loan to the Joint Venture. Pursuant to a Loan Agreement (established by Claimants' Exhibit No. 91) and an Assignment Agreement (Claimants' Exhibit No. 35D), the Financing Company (Kazakhstan Housing Ltd – a wholly owned subsidiary of the Fund) (as evidenced by Claimants' Exhibit No. 88) took over the loan made by the Fund; and agreed to lend the Joint Venture further sums for the Project.
- (10) In sum, AIG (Claimant No. 1) through its control of AIG SRI, the Fund and its subsidiaries, controls the Joint Venture (Claimant No. 2), the vehicle through which AIG's investment was

committed and made.

9.4.6 Oral evidence was led by the Claimants in support of their contentions that both Claimants Nos. 1 & 2 have standing to invoke the BIT. Mr Scott Foushee gave oral evidence on August 28, 2002 before the Arbitral Tribunal (see pages 20 to 25 of the transcripts of the Oral hearing, Day One). He deposed that he is the Managing Director of AIG Capital Partners (AIG) Claimant No. 1, as well as the Managing Director of AIG Silk Road Capital Management Ltd, wholly owned by AIG Silk Road Investors Inc. a US Company in turn owned by Claimant No. 1. He is also a Director of CJSC Tema Real Estate Company (the Joint Venture) Claimant No. 2. He also deposed that he was in fact Chairman of the Board. In the course of his evidence he stated that he (Scott Foushee) is one of the four Managing Directors in AIG Capital Partners – Claimant No. 1 – (in the Headquarter Offices in New York) overseeing the operations of “the Fund” (AIG Silk Road Fund Ltd – the Bermuda company) and spending a majority of his time on working with “our individual Funds” to assess and complete investments. Mr Foushee’s oral evidence establishes the following facts:

- (i) That AIG (American Insurance Group) Inc. – a US Company – is a large Insurance and Financial Services Company founded in 1919 in Shanghai China and has over \$500 billion in assets.
- (ii) That AIG Capital Partners (Claimant No. 1) is a wholly owned subsidiary of American International Group Inc., US.
- (iii) That AIG Capital Partners (Claimant No. 1) has 100% voting control of AIG Silk Road Investors Inc., a US Company, which, in turn, controls the Fund (the AIG Silk Road Fund Ltd) which, in turn, controls the Joint Venture (Claimant No. 2) and that AIG Silk Road Capital Management Ltd is the investment manager of AIG Silk Road Fund Ltd.
- (iv) That AIG Silk Road Investors Inc., a US company, controls the Fund through control of the Class A Common Shares. The Class A Common Shares appoint the majority of the Board of Directors and appoint the majority of members of the Investment Committee which is the primary investment decision-making body within the Fund.
- (v) That AIG Silk Road Fund Ltd has two wholly owned subsidiaries which effectively control the Joint Venture as under:
  - (a) AIG Silk Road Investment I Ltd (a Bermuda Company) is the equity vehicle, and has 66% ownership of the Joint Venture. It has also voting control and right to appoint the majority of the Board; the remaining 34% of the Joint Venture is owned by LLP Tema (the Kazakhstan Company)
  - (b) Kazakhstan Housing Ltd (a Bermuda Company), which is a vehicle by which debt-financing is provided to the Joint Venture which is also a wholly-owned subsidiary of the Fund which is controlled by Claimant No. 1.

In the course of his examination in chief Mr Scott Foushee deposed as follows:



AIG Capital Partners is one of the Claimants and it has voting control of AIG Silk Road Investors which, in turn, controls the fund which, in turn, controls the joint venture.

Perhaps I will take just a couple of minutes and go through some of the details of this. AIG Silk Road Investors controls the fund through a control of the class A common shares. According to the bylaws of the fund, the class A common shares appointed the majority of the Board of directors, they employ the majority of the Investment Committee which is the primary investment decision-making body within the fund. It is the group of people which approve all investments and all sales of investments, and it also has most of the major corporate governance rights according to the bylaws of the fund.

Moving back up stream, AIG Capital Partners has 100% voting control of AIG Silk Road Investors although some of the funding for AIG Silk Road Investors comes from another wholly owned subsidiary of AIG, but that is a very typical arrangement by which AIG injects its funding into these private equity funds.

Moving below the fund level, we move to the second exhibit here.

Q. This is the second chart that has been distributed?

A. Where the fund itself, the AIG Silk Road Fund, has two wholly owned subsidiaries which effectively control the joint venture. One of these is referred to as AIG Silk Road Investments I which is the equity vehicle. It has 66% ownership of the joint venture, it has voting control and it has the right to appoint the majority of the Board.

The other entity is Kazakhstan Housing Limited, which is a vehicle by which debt financing is provided to the joint venture, and that is also a wholly owned subsidiary fund.

That is the basic chain of control.

He was then asked:

Q. So is it your testimony that AIG Capital Partners (Claimant No. 1) controls the Joint Venture (Claimant No. 2) through these relationships?

And he gave the following answer: "That is correct."<sup>52</sup>

Those Statements were not questioned in cross-examination, nor was there any refutation of the other statements about control of Claimant No. 1 over the Joint Venture through various intermediate companies. The Respondent did not lead any evidence to challenge the correctness of the documentary evidence led on behalf of the Claimants showing "indirect control" of the investments and "indirect control" of the Claimant No. 1 over Claimant No. 2. No attempt was made to contradict the evidence of Mr Scott Foushee.

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<sup>52</sup> Transcripts of the Oral hearing, Day One, pp. 22-4.

9.4.7 It is established on the oral and documentary evidence on record that Claimant No. 1 through its control of AIG SRI, the Fund and its subsidiaries controlled the Joint Venture (Claimant No. 2) which was the vehicle through which investment of Claimant No. 1 was committed and made.

9.4.8 The Arbitral Tribunal will now deal with the specific contentions of the Respondent in the Post-hearing Brief filed on October 18, 2002 (in support of its plea that the Claimants have no standing to invoke the BIT) –

(1) The assertion of the Respondents that to qualify for Treaty jurisdiction the *investor* must be owned or controlled directly or indirectly by a US entity is another way of asserting that under the Treaty the investment must be owned or controlled directly or indirectly by nationals or companies of the other Party. “Controlled . . . indirectly” is not defined in the BIT – and the interpretation of that expression must be governed by its ordinary legal meaning. In Black’s Law Dictionary, 6th Edn, page 329, the word “control” (as a noun) is defined as:

Power or authority to manage, direct, superintend, restrict, regulate, govern, administer or oversee. The ability to exercise a restraining or directing influence over something;

And as a verb the word “control” is defined as:

to exercise restraining or directing influence over; to regulate; restrain; dominate; curb; . . . Govern.

The legal meaning of the word “indirect” is (Black’s Law Dictionary, 6th Edn at page 773):

not direct in relation or connection . . . ; not related in the natural way. Circuitous, not leading to aim or result by plainest course or method or obvious means, roundabout . . . Almost always used in law in opposition to “direct”.

The upshot of all this in the context of the Treaty definition of “investment” is that investments originating from US companies and routed through a chain of other companies (whether US or non US based) would be “indirectly controlled” by “companies of the other parties” (i.e., companies established in the USA) and hence protected by the Treaty. The Law in Kazakhstan also recognizes and treats investment “with respect to which foreign investors are entitled to determine decisions being made” by legal entities established in Kazakhstan as “foreign investments”. Admittedly, and there is no dispute about this, Claimant No. 1 is a company established and incorporated in the USA and therefore entitled to invoke the Treaty.

The “investment” in the project in Kazakhstan was to be made by AIG Silk Road Fund Ltd (the Fund)<sup>53</sup> – a Bermuda based company – through its wholly owned subsidiary AIG Silk Road

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<sup>53</sup> Claimants’ Exhibit No. 14 (Appraisal Report) in the arbitration proceedings.

Investment I Ltd (also a Bermuda based company – Investment Company),<sup>54</sup> the Investment Company having a 66 per cent ownership, voting control and Board majority in Claimant No. 2. It has been established that the fund (AIG Silk Road Fund Ltd) was in turn controlled by AIG Silk Road Investors Inc., which owned the entire Class A common shares of the Fund (which carried 100 per cent voting rights); the entire voting power and voting rights of the Fund were vested (under the Bylaws of the Fund)<sup>55</sup> “solely and exclusively in the holders of Class A common shares” – the other class of shares (Class B and Class C) having no individual voting rights. And by virtue of Claimants’ Exhibit No. 83 AIG Capital Partners (Claimant No. 1) was entitled “exclusively” to exercise all voting rights in respect of Class A shares in the Fund.

Thus the chain of control of investments effectuated through the Fund and the Joint Venture has been established: by documentary and oral evidence.

- (2) The next contention of the Respondent that the investment viz. the Crystal Air Housing Project was owned 100 per cent by Claimant No. 2 Tema (the Joint Venture), which could assert Treaty jurisdiction “as a US entity if it were owned and controlled by a US entity”, is refuted by the evidence oral and documentary on record which has established that Claimant No. 2 was controlled indirectly by a US entity viz. Claimant No. 1.
- (3) The next contention – that CJSC Tema is owned 34 per cent by another Kazakhstan company LLP Tema which could not have any right to assert Treaty jurisdiction – is factually correct; the further narration that the other owner of Claimant No. 2 is a Bermuda company viz. AIG Silk Road Fund Ltd (the Fund) is also correct; and the plea that the Fund itself does not have any right to assert Treaty jurisdiction, as it is not a US entity itself, cannot also be disputed: but as explained above, the chain of control did not stop at the Fund but extended to US based corporations where the investments originated. The further contention that the invocation of Treaty jurisdiction under Kazakhstan law on foreign investments (Claimants’ Exhibit No. 2) was initially asserted by the Fund as an investor (as established by Claimants’ Exhibit No. 101 – the Notice of Investment Dispute dated July 7, 2000): and that the notice of investment dispute was given by the AIG Silk Road Fund Ltd, because it was “the investor”, is correct: it was in fact an approved investor under the Agreement dated April 10, 1999 (Claimants’ Exhibit No. 90) with the Kazakhstan Investment Agency.

But in the Notice of Investment Dispute (Claimants’ Exhibit No. 101) the chain of control is indicated and mentioned in the following words:

AIG Silk Road Fund is a private equity fund established in 1997 by American International Group Inc. (“AIG”) to make equity investments in projects throughout Central Asia and the Caucasus. AIG is one of the world’s largest financial services companies with assets of over

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<sup>54</sup> Claimants’ Exhibit 89 in the arbitration proceedings.

<sup>55</sup> Claimants’ Exhibit 85 in the arbitration proceedings.

\$260 billion and operations in more than one hundred thirty countries. The Fund's investors include the European Bank for Reconstruction and Development, AIG, and major strategic and financial investors with an interest in the region. In December 1998, the Fund approved an investment in the establishment of a 75-unit Western-style residential compound in Almaty with a total projected investment of \$18 million, called Crystal Air Village (the "Project"). The Fund designed the Project to be the premier Western residential housing complex in Kazakhstan. The Fund, to implement this investment, entered into a joint venture with a leading real estate development firm, LLP Tema, whose principals are generally recognized as the premier real estate developers in the region. The joint venture company, JSC Tema Real Estate Company (the "Joint Venture"), was the vehicle through which the Fund would construct the Project and market the residential units.

The investment made and to be made by the Fund and through the Joint Venture (as established by oral and documentary evidence on record) was controlled indirectly by AIG (Claimant No. 1) and therefore the investment is one which is protected by the BIT.

- (4) The further contention that the day to day control of the Fund and the Joint Venture is of "another third country entity" is an argument based on an erroneous hypothesis and unsupported by evidence. It is said that AIG Silk Road Investments Ltd (which owns 66 per cent of the stocks and voting control of the Joint Venture), though controlled by the Fund (AIG Silk Road Fund Ltd), is in fact managed "by the third Bermuda company AIG Silk Road Capital Management Company" – reference is then made to Claimants' Exhibit No. 87, which is the Management Agreement between AIG Silk Road Capital Management Ltd and AIG Silk Road Fund Ltd (the Fund).

But as already mentioned above the AIG Silk Road Capital Management Ltd (Bermuda based) is wholly owned by AIG Silk Road Investors Inc. (US)<sup>56</sup> through which the chain of control emanating from Claimant No. 1 has already been established.

Claimants' Exhibit No. 86 shows that 100 per cent of the shares of the Bermuda based AIG Silk Road Capital Management Ltd is owned by AIG Silk Road Investors Inc. (admittedly a US Company); and AIG Silk Road Investors Inc. US is ultimately controlled 100 per cent by Claimant No. 1, (Claimants' Exhibit No. 83); through exclusive control of voting rights in the Fund.

- (5) The assertion of the Respondent that Claimant No. 1 – "admittedly a US entity" – had only a minimal indirect ownership or control of Claimant No. 2 – "5 per cent of the Fund's 66 per cent or 3.3 per cent", which was insufficient to confer US status on Claimant No. 1, is also devoid of merit. Though AIG Silk Road Investors Inc. (a US company) is owned 95 per cent by National Union Fire Insurance Company, Pittsburgh (also a US Company) and 5 per cent by AIG Capital Partners Inc. (Claimant No. 1) (Claimants' Exhibit No. 82) it has already been established by documentary evidence (1) that National Union Fire Insurance Company, of Pittsburgh and AIG Capital Partners Inc. (Claimant No. 1) are both wholly owned subsidiaries of the American International Group Inc., the holding company of Claimant No. 1 (Claimants' Exhibit No. 83) (2) and that by a memorandum

of September 29, 1997, National Union Fire Insurance Company of Pittsburgh had agreed that AIG Capital Partners (Claimant No. 1) shall exclusively exercise all voting rights in respect of the Class-A shares of AIG Silk Road Fund Ltd (the Fund) owned by AIG Silk Road Investors Inc. US (part of Claimants" Exhibit No. 83). Although Claimant No. 1 had a minimal ownership shareholding (5%) in AIG Silk Road Investors Inc. the exclusive voting control of the entire Class A Shares of the Fund (AIG Silk Road Fund Ltd) was vested in Claimant No. 1 by virtue of the memorandum of agreement dated September 29, 1997 (part of Claimants" Exhibit No. 83).

- (6) The assertion that Kazakhstan purposely limited Treaty Jurisdiction to "genuine US Investors" and there was no reason why it would allow an investor wholly owned by Kazakhstani and third country interest to qualify as a US investor, is a tenuous plea, and the further plea that the relationship between Claimant No. 1 and Claimant No. 2 barred Claimant No. 1 from qualifying as a legitimate Claimant under the US–Kazakhstan Treaty "to protect US investments" is again only a rhetorical plea devoid of merit. All the funds invested and to be invested in the Project were routed through the AIG Silk Road Fund Ltd (Bermuda) as evidenced by the documents – Claimants" Exhibit No. 35 through 80.<sup>57</sup> AIG Silk Road Fund Ltd (Bermuda) is owned by AIG Silk Road Investors Inc. US, and AIG Silk Road Investors Inc. US is controlled solely and exclusively by the Claimant No. 1 – all voting rights in respect of Class A common Shares in the Fund being exclusively vested in and exercised by Claimant No. 1 – the Fund – through which investments were made via Claimant No. 2 – was thus entirely operated, managed and controlled by Claimant No. 1 (Claimants" Exhibit No. 85).

9.4.9 The ICSID Convention having been already signed by the USA and Kazakhstan before 1994 (when the Bilateral Investment Treaty between the USA and Kazakhstan came into force) no separate jurisdictional plea has been taken by the Respondent with respect to Article 25 of the Convention – (Jurisdiction of the Centre). Rightly so.

The prerequisites prescribed by the ICSID Convention are:

- (a) that the dispute must be a legal dispute arising directly out of an investment;
- (b) that the dispute must be between a Contracting State and a national of another Contracting State; and

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<sup>56</sup> Claimants" Exhibit No. 86 in the arbitration proceedings.

<sup>57</sup> Exhibits 36 through 79 documents are vendor payments: with funds sourced through AIG. These aggregate to USD 3,563,294.29. Some payments were made directly by AIG Silk Road Fund, Limited and Kazakhstan Housing, Limited, and some were made directly by the Joint Venture. The Joint Venture received the funds from which it made the direct payments primarily from Kazakhstan Housing Limited pursuant to funding agreements. Exhibit 80 provides further backup documentation of payments made directly by the Joint Venture. It contains the wire transfer instructions for the draw down payments made to the Joint Venture by AIG Silk Road Fund, Limited and Kazakhstan Housing Limited pursuant to these funding agreements in the aggregate USD 944,356.08. The amount of these wire transfers includes

(c) that the parties must have consented in writing to submit their dispute to the jurisdiction of the Centre.

- (i) The Claimants have alleged that the Respondent has expropriated their investment in Kazakhstan in violation of the Bilateral Treaty between the United States of America and the Republic of Kazakhstan concerning the Reciprocal Encouragement and Protection of Investment (“the Treaty”); allegations to be dealt with on the merits – if proved, they have raised a legal dispute arising directly out of an investment.
- (ii) The Republic of Kazakhstan is a “Contracting State” within the meaning of Article 25(1) of the ICSID Convention, the Republic of Kazakhstan having ratified the Convention on September 21, 2000. The Claimants are nationals of “another Contracting State” because:
  - (a) The United States is “another Contracting State”, it having ratified the ICSID Convention on June 10, 1996.
  - (b) Claimant No. 1, a US based company, is a national of the United States because it was constituted under the laws of the United States and is domiciled there under 9 USC (s) 202.<sup>58</sup>
  - (c) Claimant No. 2 (the Joint Venture), although it was constituted under the laws of Kazakhstan and domiciled there, is “a national of another Contracting State” for purposes of this arbitration, because of “foreign control” (it is indirectly owned and controlled by US companies) and the Parties have agreed (under the BIT) – Article VI(8) – to treat such a Joint Venture as a national of another Contracting State for the purposes of the Convention: Article 25(2)(b).
- (iii) The Republic of Kazakhstan has already consented in writing to submit the parties’ dispute to the jurisdiction of the Centre by virtue of Article VI(4) of the BIT, which provides that “Each Party hereby consents to the submission of any investment dispute for settlement by binding arbitration in accordance with the choice specified in the written consent of the national or company ...” The Claimants’ written consent to submit the parties’ dispute to the jurisdiction of the Centre is evidenced by Claimants’ Exhibit No. 10.

The jurisdiction of the Centre has been rightly invoked by the Claimants.

## 10. ON MERITS

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the sum of USD 3,563,294.29.

<sup>58</sup> “A corporation is a citizen of the United States if it is incorporated or has its principal place of business in the United States.”

### 10.1.1 *Applicable Law*

10.1.2 Article 42(1) of the Convention deals with the law applicable to an investment dispute. It provides that the Tribunal shall decide a dispute in accordance with such rules as may be agreed by the parties. In the absence of agreement it shall apply the law of the host State and “such rules of international law as may be applicable”. Historically, treaties (whether bilateral or multilateral) are an acknowledged source of international law – such treaties are often referred to as “law-making treaties”. In principle, all treaties are law-making in as much as they lay down rules of conduct which the parties are bound to observe as law.<sup>59</sup> Bilateral treaties are law-making in the narrow sense that the rights and obligations to which they give rise are legally binding on the parties to them.<sup>60</sup>

The function of international law under Article 42(1) is to close gaps in domestic law as well as to remedy any violation of international law which may arise through the application of the host State’s law.

10.1.3 The BIT itself establishes a rule of law as between the parties thereto: Article VI(1) of the BIT provides that an investment dispute (for the purposes of that Article) is a dispute between a party and a national or company of the other party that arises out of or relates to inter alia “an investment agreement between that party and such national or company” as well as “an investment authorisation granted by that Party’s foreign investment authority to such national or company”. Contract No. 0159-12-99 dated December 13, 1999 (Claimants’ Exhibit No. 3) is the Investment contract or authorization<sup>61</sup> with respect to which an investment dispute has been raised – by the Claimants in the instant case: [it] has been entered into by the Claimant No. 2 (the Joint Venture) with the Agency of the Republic of Kazakhstan for investment – the only State body invested with authority to conduct negotiations, establish conditions and sign contracts with Investors making direct investments in the Republic of Kazakhstan. The object of Contract No. 0159-12-99 is to establish a certain legal framework regulating relationships between the Agency and the Investor in accordance with the legislation of the Republic of Kazakhstan for the purpose of providing various incentives and State support of investment activity in the construction sector of commercial housing. The Investment Agreement/authorization specifically provides that the applicable law, “unless otherwise stipulated by International Treaties signed by the Republic of Kazakhstan”, shall be the law of the Republic of Kazakhstan (Clause 16.1). The law of the Republic of Kazakhstan on Foreign Investments of December 27, 1994 (Claimants’ Exhibit No. 2) and the law of Kazakhstan [on] State support of Direct Investments of February 28, 1997 (Claimants’ Exhibit No. 34) are the relevant basic laws

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<sup>59</sup> Oppenheim: International Law 9th Edition Vol. II (Peace) – page 1204.

<sup>60</sup> Oppenheim’s International Law 9th Edition Vol. II (Peace) pages 31 and 32 – para. 11.

<sup>61</sup> Contract No. 0159 12 99 is between the Agency of the Republic of Kazakhstan for investment (the Investment Agency) and CJSC Tema Real Estate Co. (the Joint Venture – Claimant No. 2) dated December 13, 1999.

of the host State.

10.1.4 In the circumstances the Tribunal holds that the applicable law in this case is the law of the Republic of Kazakhstan (State party to the dispute) – in particular that which is contained in Claimants’ Exhibit Nos. 2 and 34 – read with and controlled by the provisions contained in the BIT.

## 10.2 *Liability*

10.2.1 The elements needed to establish liability are set out in the BIT which came into force on January 12, 1994. Under the BIT, in order to establish the liability of the Respondent State the Claimants must prove:

- (1) that they owned or controlled directly or indirectly an investment in the territory of Kazakhstan as envisaged in Article I(1)(a); and
- (2) that the investment was expropriated directly or indirectly through measures tantamount to expropriation.

### 10.2.2 *Investment – Legal Position*

The BIT’s definition of investment is broad – and recognizes a wide variety of forms. It covers investments that are owned or controlled by nationals of one of the Treaty Parties made in the territory of the other: investments can be made either directly or indirectly through one or more subsidiaries including those of third countries. As to when an investment is “controlled” by nationals of one of the Treaty Parties, this is not defined in the Treaty, but for corporate entities, voting control of the stock held is generally determinative of control – whosoever may own that stock: a company of a third country that is owned or controlled by national or companies of a Party [is] covered by the BIT.

### 10.2.3 *Investment – Factual Position*

The following factual position about *investment (and its control)* emerges from the evidence oral and documentary, produced by the parties:

- (1) That AIG Silk Road Fund Ltd’s (the Fund’s) Investment Committee approved an initial investment of USD 7 million in the Crystal Air Village Project in Almaty, Kazakhstan in December 1998 – corroborated by the Appraisal Report dated December 8, 1998 (Claimants’ Exhibit No. 14). The Fund’s total investment in the Project “would have been approximately USD 16.3 million” (according to the oral evidence of Mr Scott Foushee: see transcript of oral hearing, Day One, pp. 34, 37). Mr. Foushee also stated that



the fund Sources of this investment *were to be* 7 million US Dollars from AIG; 500,000 US Dollars of hard cash investment from Tema (Claimant No. 2); in addition to their 1.2 million US Dollars of collateral. We *would have been* seeking 2.4 million US Dollars in a combination of bank financing and pre-rental revenues. Then finally 6.4 million US Dollars *would have been* re-invested cash flows from the first and second phases into the succeeding phases. (emphases added) (Transcripts of the oral hearing, Day One, p. 37)

(2) That the Fund's investment in the Crystal Air Village Project ("the Project"), including its investment in the Joint Venture, was controlled by AIG Capital Partners Inc., US Company (Claimant No. 1): oral evidence of Mr Scott Foushee, transcripts of the oral hearing August 28, 2002, pp. 23-4; corroborated by documentary evidence – Claimants' Exhibit Nos. 81 to 91 (which establish the chain of control):

- (a) Claimants' Exhibit No. 81 Certificate of Incorporation for AIG Capital Partners, Inc. (US) - Claimant No. 1: that it continues to have a legal corporate existence as of April 20, 2001
- (b) Claimants' Exhibit No. 84 Certificate of Incorporation and Share Register (dated September 1997) for AIG Silk Road Fund, Limited (Bermuda) - "the Fund" - and Subscription Agreement dated September 25, 1997 showing ownership of all Class A Common Shares by AIG Silk Road Investors, Inc. (US)
- (c) Claimants' Exhibit No. 85 Amended and Restated Bylaws of AIG Silk Road Fund Limited - effective as of June 12, 1998 - under these Bylaws:
  - (1) The entire voting power and all voting rights (in AIG Silk Road Fund Ltd) is vested solely and exclusively in the holders of record of Common Shares (Bylaw 54(2)).
  - (2) The Board of AIG Silk Road Fund shall consist of not less than 5 Directors. The holders of Class A Common Shares shall be entitled to elect the Chairman and Deputy Chairman and all but two of the Directors (Bylaw 16).
  - (3) The Investment Committee of the Board responsible for making all investment decisions shall have 6 members and the Chairman of the Board shall be entitled to appoint 5 members to the Investment Committee. Each member of the Investment Committee shall hold office until death, resignation or remov[al]. Any member of the Investment Committee may be removed by the Chairman (Bylaw 32).
- (d) Claimants' Exhibit No. 82 Secretary's Certificate dated August 9, 2002 of Ownership of Shares of AIG Silk Road Investors, Inc. (US) - SRI by National Union Fire Ins. Co. of Pittsburgh (US) - 95% and AIG Capital Partners, Inc. (US) - 5%.
- (e) Claimants' Exhibit No. 83 Control of AIG Silk Road Investors Inc. (US) - SRI by AIG Capital Partners Inc. (Claimant No. 1) is proved by letter dated August 15, 2002 from AIG Capital Partners Inc. New York to the National Union Fire Ins. Co. of Pittsburgh New York (and confirmed by the latter) to the following effect

viz.:

- (i) that each of the companies, National Union and AIGCP, are wholly owned subsidiaries of American International Group, Inc.<sup>62</sup>
  - (ii) that as contemplated in a memorandum sent by Thomas Haughey on September 29, 1997 (attached as Exhibit A), National Union had agreed that AIGCP shall exclusively exercise all voting rights in respect of the Class A shares of AIG Silk Road Fund, Limited (the "Fund") owned by SRI.
  - (iii) that AIGCP (Claimant No. 1) controls SRI with respect to the Fund.
- (f) Claimants' Exhibit No. 86 Secretary's Certificate dated August 9, 2002 and Share Register of AIG Silk Road Capital Management, Ltd (Bermuda) showing ownership of 100% of shares by AIG Silk Road Investors, Inc.
- (g) Claimants' Exhibit No. 87 Fund Management Agreement between AIG Silk Road Capital Management, Ltd (Fund Manager) and AIG Silk Road Fund Ltd (the Fund) dated September 25, 1997:
- (i) Subject to the supervision of the Investment Committee the Fund Manager agrees to provide Fund Managing Services to the Fund.
  - (ii) Managing Director of the Fund is Mr L. Scott Foushee.
- (h) Claimants' Exhibit No. 88 Certificate of Incorporation on Change of Name of Kazakhstan Housing, Ltd (Bermuda) - Share Registry showing 100% ownership by AIG Silk Road Fund, Limited, and Share Transfer Form, dated February 10, 1999.
- (i) Claimants' Exhibit No. 89 Certificate of Incorporation of AIG Silk Road Investment I, Ltd (Bermuda) and Share Register showing 100% ownership by AIG Silk Road Fund, Limited (December 18, 1999).
- (j) Claimants' Exhibit No. 90 Investment Agreement between AIG Silk Road Investment I, Ltd. LLP Tema, Serik Tulbassov, Serzhan Zhumashev and CJSC Tema Real Estate Company, dated 10 April 1999, with annexes: recites that the Joint Venture Claimant No. 2 has been caused to be registered on the basis of the Foundation Agreement dated February 16, 1999 (part of Exhibit No. 90) under which AIG Silk Road Investment I Ltd would purchase 66% of shares of the Joint Venture (Claimant No. 2).
- (k) Claimants' Exhibit No. 91 Example of Share Certificate of CJSC Tema Real Estate Company held by AIG Silk Road Investment I, Ltd.

(3) That on December 18, 1998, LLP Tema (34% owner of Joint Venture Claimant No. 2), using a

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<sup>62</sup> Holding Company of Claimant No. 1.

bridge loan from the AIG Silk Road Fund (the Fund), purchased the Project Property at Ahmaty suburb from LLP Talap (a limited liability partnership) for a price of USD 1.5 million.

(Evidence of Mr Scott Foushee – transcripts of the oral hearing. Day One, at p. 35, corroborated by Claimants’ Exhibit 18): the Land Purchase Contract dated December 18, 1998 (Claimants’ Exhibit No. 18) stated that the land plot (the Project Property) would contain not less than 10 hectares and would be used for purpose of building residential units.

- (4) On December 23, 1998, the Karasai District Land Resources Management Committee issued an Act of Ownership confirming Tema’s ownership of the Project Property (area: 10 hectares) and stating that the designated use of the Property was “constructing and servicing a property – a residential compound” (Claimants’ Exhibit No. 19).
- (5) An Investment Agreement (as between the investors) was entered into on April 10, 1999, between AIG Silk Road Investors I Ltd and LLP Tema (along with two individual citizens of the Republic of Kazakhstan) and the Joint Venture Company (Claimant No. 2) represented by its Chairman L. Scott Foushee (Claimants’ Exhibit No. 90). This investment agreement recited that the parties had caused the Joint Venture (Claimant No. 2) to be registered on the basis of the Foundation Agreement dated February 16, 1999, under which AIG Silk Road Investment Ltd would purchase 66 per cent of the registered shares of the Joint Venture (Claimant No. 2) – LLP Tema the other shareholder of Claimant No. 2 holding 34 per cent. It was recorded in this Investment Agreement that the company (i.e., Joint Venture – Claimant No. 2) would directly or indirectly through one or more subsidiaries undertake and implement the project (i.e., residential real estate project) described in Annexure I which contemplated a construction of 81 units (later reduced to 76 units) within a housing development in a three-phased development plan.
- (6) On the same day – April 10, 1999 – LLP Tema transferred the Project Property to the Joint Venture for a price of USD 1.5 million – the same price that LLP Tema had paid LLP Talap for the property in December 1998 (see Claimants’ Exhibit No. 20); this is also corroborated by Claimants’ Exhibit No. 35, an invoice showing payment of USD 1.5 million to LLP Talap by LLP Tema from the Fund emanating from AIG Silk Road Fund Ltd.
- (7) On May 10, 1999, the Akim of the Almaty Oblast, Mr Zamenbek Nurkadilov, having considered the application of the Joint Venture, signed a decree (Claimants’ Exhibit No. 21) authorizing the Joint Venture to carry out the Crystal Air Project on the land plot with total area of 10 hectares (Claimants’ Exhibit No. 21); this particular land plot had been allocated in accordance with Decision No. 2-4 of the Akim of Almaty Oblast dated February 18, 1999 (Claimants’ Exhibit No. 145).
- (8) On May 13, 1999, the Karasai District Land Resources Management Committee issued an Act of

Ownership in favour of the Joint Venture (Claimant No. 2) which earmarked the Project Property (land plot of 10 hectares) for construction and servicing of a housing complex (Claimants' Exhibit No. 12).

- (9) On December 3, 1999, the Joint Venture's design contractor, TISV, completed the detailed design for the project, including full application drawings upon which the construction contract was then tendered: the Joint Venture paid TISV USD 325,000 for this design as evidenced by Claimants' Exhibit No. 38.
- (10) That on December 13, 1999, a contract (on the provision of incentives on and State support [of] investment activities in the Republic of Kazakhstan) was entered into by and between the Agency of the Republic of Kazakhstan for Investment (the Agency) represented by the Chairman of the Agency of the Republic of Kazakhstan for Investment and the Joint Venture – viz. Claimant No. 2 – as “approved investor”. The object of the Investment Activity was stated to be the construction of a residential complex. It was provided in this contract – contract No. 0159-12-99 – that unless otherwise stipulated by International Treaty signed by the Republic of Kazakhstan, the laws of the Republic of Kazakhstan shall apply to the contract and other agreement[s] signed on the basis of this contract. The contract provided that the “approved investor” would conduct its investment activity in accordance with the work programme agreed with the Agency (Claimants' Exhibit No. 3).

The Work Programme (attachment 1 to Contract No. 0159-12-1999 dated December 13, 1999) identifies the plot on which the investment project is to be constructed – “construction of Crystal Air Residential Compound in Almaty suburb”.

- (11) That on January 18, 2000, after receiving bids from six companies in a competitive tender, the Claimants selected TISV as the general contractor for the Project based on the application design which was the final design provided to the Claimants by TISV. As required by the tender, each cost item was priced according to the scope of work described in the application design, and was based on TISV's record of completing premium quality construction within the budget and within the time period allotted. On January 27, 2000, the Joint Venture and TISV signed a Turnkey Contract for USD 7.29 million (inclusive of VAT) for the construction of the first phase of the project (Claimants' Exhibit No. 39 contains this contract) – evidence to corroborate this was given during the oral hearing on August 28, 2002 by Mr M. Kasher Senior Associate of Claimant No. 1 and Investment officer in AIG Silk Road Fund Ltd (transcripts of the oral hearing, Day One, at pp. 128 and 130).

The evidence of Mr Mark Kasher establishes the source and extent of the expenses actually incurred in designing and implementing the Project before the Government ordered the Joint Venture to permanently halt construction. The expenses together with all the relevant receipts

(proved by Claimants' Exhibits No. 35 through Exhibit 79) aggregated in all to USD 3,563,294.29 – which funds were wire transferred through the AIG Silk Road Fund Ltd, Bermuda.<sup>63</sup>

- (12) That on January 26, 2000, the State Architecture and Construction Inspectorate for the Almaty Oblast after making an assessment of the project (Act No. 7-19/99 dated October 14, 1999) issued a Permit authorizing the Joint Venture to begin construction „at the residential complex CRYSTAL AIR” (Claimants' Exhibit No. 23).
- (13) According to the uncontradicted testimony of Mr Foushee and Mr Evseev (Claimants' witnesses), by mid-February of 2000, the Joint Venture had completed certain infrastructure work on the Project Property, including installation of water lines, electrical cabling and a temporary fence, and its contractor (TISV) had mobilized its construction crew on the site to commence general construction of the Project. (See Evidence of Mr Scott Foushee, transcripts of the oral hearing, Day One, at p. 93 and Evidence of Mr Boris Evseev, at p. 164 and p. 169.)

10.2.4 On a consideration of the entire evidence, oral and documentary, the Tribunal holds that it is established that the Claimants owned or controlled indirectly an investment in the territory of Kazakhstan as contemplated in Article 1(a) of the BIT.

### 10.3 *Expropriation*

#### 10.3.1 *Legal Position*

Article III of the BIT reflects a balance between the legitimate interests of the Contracting State where the investment is made and the need to protect from arbitrary action by that State those who provide foreign capital – particularly since such capital is essential to the full development of natural resources of any State and would not be forthcoming unless assured of reasonable protection.<sup>64</sup>

Article III incorporates into the BIT international law standards for “expropriation” and “nationalisation”. Paragraph 1 describes the general rights of investors and the obligation of the parties with

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<sup>63</sup> The entire totality of wire transfers up to 2001 aggregating to USD 944,356.08 from AIG Silk Road Fund Ltd, and Kazakhstan Housing Ltd. to Claimant No. 2 include the sum of USD 3,563,294.29 (payments made to Vendor). See Claimants' Exhibit 80.

<sup>64</sup> See Oppenheim's International Law 9th Edition Vol. II – pp. 912–15 under the heading “Property of Aliens: Expropriation”:

Some states have regarded foreign investment capital used in the development of a state's natural resources as threatening that state's sovereignty over them, and have wanted to assert those sovereign rights as justifying the seizure without compensation of the foreign investments concerned. Nevertheless, a balance has to be struck between the legitimate interests of the territorial state and the need to protect from arbitrary action by that state those who provide the foreign capital, particularly since such capital is essential to the full development of the natural resources

respect to expropriation and nationalization: they apply to direct and indirect measures (of the State) tantamount to expropriation or nationalization – i.e., to what are known as “creeping expropriations” which result in substantial deprivation of the benefit of an investment without taking away of the title to the investment. Expropriation (in relation to investments) conveys in a general sense the deprivation of an owner of his investment and its equivalent – i.e., to a “taking” of that investment. Expropriations (“or measures tantamount to expropriation”)<sup>65</sup> include not only open deliberate and acknowledged takings of property (such as outright seizure or formal or obligatory transfer of title in favour of the Host State) but also covert or incidental interference with the use of property which has the effect of depriving the owner in whole or in significant part of the use or reasonably to be expected benefit of property even if not necessarily to the obvious benefit of the Host State.

### 10.3.2 *Factual Position: Expropriation of Claimants’ Investment*

The following factual position regarding “expropriation” or “measures tantamount to expropriation”<sup>66</sup> emerges from the evidence oral and documentary produced by the parties:

- (a) That on February 18, 2000, the Joint Venture received an oral request (telephone call) from the Chairman of the Oblast Land Committee. Mr Naurzybay Taubaev, to the effect that a billboard which had been put up three months back advertising the Crystal Air Village Project be removed from the Project Property. Mr Taubaev said that the billboard was offensive to low-income residents of Almaty who could not afford the advertised project. Accordingly, the Joint Venture removed the billboard, “for fear of the billboard being taken down forcibly and damaged”: evidence of Boris Evseev, Country Director of AIG Silk Road Capital Management Ltd, given at the oral hearing, Day

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of many states and will not be forthcoming unless assured of reasonable protection.

<sup>65</sup> This concept of a “creeping expropriation” is best illustrated in the words of the Iran–US Tribunal in the *Starrett Housing Corporation Case* (Interlocutory Award dated December 19, 1983). The Tribunal (Judge [Lagergren], Mr [Kashani] and Judge Holtzmann) concluded in its Interlocutory Award as follows:

It is undisputed in this case that the Government of Iran did not issue any law or decree according to which the Zomorod Project or Shah Goli expressly was nationalized or expropriated. However, it is recognized in international law that measures taken by a State can interfere with property rights to such an extent that these rights are rendered so useless that they must be deemed to have been expropriated, even though the State does not purport to have expropriated them and the legal title to the property formally remains with the original owner . . . It has therefore been proved in the case that at least by the end of January 1980, the Government of Iran had interfered with the Claimants’ property rights in the Project to an extent that rendered these rights so useless that they must be deemed to have been taken. (Reported in 4 Iran–US CTR 122(1983).)

<sup>66</sup> Article II(2)(b) read with Article III(1) of the BIT – relevant portion reads as under:

II(b) Neither Party shall in any way impair by arbitrary or discriminatory measures the management, operation, maintenance, use, enjoyment, acquisition, expansion, or disposal of investment . . .

III(1) Investments shall not be expropriated or nationalised either directly or indirectly through measures tantamount to expropriation or nationalisation (“expropriation”) except: for a public purpose: in a nondiscriminatory 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).

One, at page 165.<sup>67</sup>

This part of the evidence was not contradicted by the Respondent; Mr N. Taubaev Chairman of the Oblast Land Committee did not attend the hearings or give any oral evidence on behalf of the Respondent. His absence is the more significant since Mr Nurkadirov (at the relevant time the Akim of Almaty Oblast) who did give evidence for the Respondent deposed that the Land Committee did not have information and was not aware of “the fact” that according to the general plan of the City the land which was given to Talap to build the residential compound was to be developed as a green area for Almaty and the Land Committee made a “mistake” when it gave its consent: “According to that same general plan, they were supposed to develop a Green Area for Almaty. The Land Committee did not have the information or it was not aware of this . . . “ (Oral Evidence of Mr Nurkadirov – transcripts of the oral hearing, Day Two, pages 144–5): there is no independent evidence to corroborate this assertion viz. that the Land Committee made a mistake and/or was unaware of building construction being not permitted on the Project Site Property, and the person who could have deposed to this as a fact was Mr N. Taubaev, Chairman of the Oblast Land Committee, whose non-availability to give evidence for the Respondent is neither explained nor accounted for.

- (b) That on February 26, 2000, the Joint Venture received a telephone call from the Chairman of the Oblast Architectural Committee, Mr Sairan Fazylov, who said that the Joint Venture must stop construction of the Crystal Air Village project because the Project Property was to be taken for use “as an arboretum”. After the Joint Venture was told to stop construction Mr Nurkadirov, Akim of Almaty Oblast, was contacted and he confirmed this (evidence of Mr Boris Evseev – transcripts of the oral hearing, August 28, 2002, pages 166–8).<sup>68</sup> Mr Boris Evseev was then asked:

Q. And did you stop construction?

A. Yes, we had to comply with the order. The people who ordered the Joint Venture to stop construction were the same people who had issued prior approvals and construction apartments [*sic*], so we had to comply and complied with this order, and halted construction on the Project Property.

(Evidence of Mr Boris Evseev on August 28, pp. 166–8.)

- (c) That in response to the telephone calls from Mr Taubaev and Mr Fazylov, the Claimants requested a meeting with Mr Nurkadirov, the Akim of the Almaty Oblast. (See Evidence of Boris Evseev, transcripts of the oral hearing, August 28, p. 169.) Mr Fazylov, Chairman of the Oblast Architectural Committee did not give oral evidence nor is the telephone call of February 26, 2000 –

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<sup>67</sup> He went on to say that “Later in our discussions – in our meeting with the Akim of the Almaty Oblast. Mr Nurkadirov, we learned that the real reason was that President Nazarbayev did not want the Billboard to be there.” Evidence of August 28, 2002, of Mr Boris Evseev, page 165.

deposed to by Boris Evseev – denied.

- (d) That the Claimants’ representatives met with Mr Nurkadilov on 2 March 2000. At this meeting, Mr Nurkadilov confirmed to the Claimants that their property was being taken for use as an arboretum and that they must therefore stop construction of the Crystal Air Village Project. (Evidence of Boris Evseev, transcripts of oral hearing, August 28, pp. 169–70.)
- (e) That following the meeting with Mr Nurkadilov, the Claimants “strongly persuaded for nearly four months” (i.e., persuaded governmental authorities) to reverse the Government’s decision to cancel the Crystal Air Village Project.<sup>69</sup> The Claimants even sought and obtained the intervention of US Ambassador to Kazakhstan, Richard Jones. The Claimants and Ambassador Jones both wrote to President Nazarbayev’s advisor, Mr Bolat Utemuratov, seeking to have Mr Nurkadilov’s decision to cancel the Project overturned.<sup>70</sup> The Claimants also met repeatedly with Mr Dulat Kuanyshiev, the Chairman of the Agency for Investment, which represents the Republic of Kazakhstan in its dealing with foreign investors. At the Claimants’ request Mr Kuanyshiev wrote Mr Nurkadilov warning him of the legal implications of his decision to cancel the Project and asking for an explanation of that decision. The letter is on record – Claimants’ Exhibit No. 6 – March 2, 2000.<sup>71</sup> The Claimants also met with the Mayor of the City of Almaty, Mr Victor Khrapunov, because they were told that their property was being transferred to the City and it was the City that would build the arboretum. (Evidence of Mr Boris Evseev, transcripts of the oral hearing, August 28, at pp. 174–81.) By letter dated March 21, 2000, Mr Scott Foushee, a Managing Director of Claimant No. 1 and the Managing Director of Claimant No. 2, wrote the Advisor to the President of Kazakhstan informing him of the Akim’s intimation to confiscate the Project Property in order to construct a National Arboretum (a

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<sup>68</sup> Mr Nurkadilov, Akim of Almaty Oblast, who gave evidence did not deny this.

<sup>69</sup> This was not disputed by the Respondent. In the opening statement of its Counsel at the oral hearing, it was stated: “. . . After the project property was taken which was in March 2000, Claimant persisted: they tried to get the decision reversed.” (Transcript – Day One page 14.) Besides, the evidence on record (documentary and oral) does establish that the Claimants made several efforts to reverse the Government’s decision to cancel the Property viz: (i) The Claimants requested the Chairman of the Agency for Investment to intervene on their behalf (Claimants’ Exhibit 5); (ii) The Claimants requested the United States Ambassador to Kazakhstan to intervene on their behalf and he did so (transcripts of oral hearing, Day 1, p. 177; Claimants’ Exhibit 26); (iii) The Claimants wrote to Mr Bolat Utemuratov, Advisor to President Nazarbayev, asking that the decision to cancel the Project be reversed (Claimants’ Exhibit 25); (iv) The Claimants met repeatedly with the Chairman of the Agency for Investment and representatives of the Almaty Oblast and Almaty City administrations seeking a reversal of the decision to cancel the Project (Testimony of Mr Evseev, transcripts of oral hearing, Day 1, p. 155; and Statement of Mr B. Evseev, pp. 3–4); (v) The Claimants attempted to resume construction on the Project Property in May 2000 when they were prevented from doing so by authorities of the City of Almaty, accompanied by police (transcripts of oral hearing, Day One, p. 186).

<sup>70</sup> Claimants’ Exhibit No. 26 – letter dated March 24, 2000 from the US Ambassador Richard Jones to Mr Bolat Utemuratov.

<sup>71</sup> In reply (March 20, 2000) the Deputy Akim of Almaty informed Mr D. Kuanyshiev, Chairman of the Investment Agency, that the Act of Ownership which had authorized construction of the Project was unacceptable and that the prior decision of the Akim (No. 5-142) as well as Ordinance of the Oblast Architectural and Construction Inspectorate authorizing the project were “deemed invalid”. This letter was communicated to the Claimant by the Chairman of the Agency for Investment (Evidence of Boris Evseev, transcripts of oral hearing, Day One, pages 175–6).



copy of this was forwarded to the Prime Minister of Kazakhstan): this document is also on record (Claimants' Exhibit No. 25).

- (f) That on April 6, 2000, the Architecture and Construction Department of the City of Almaty issued a Resolution ordering the Joint Venture to suspend all works of construction of the Project (Claimants' Exhibit No. 95).
- (g) That on May 15, 2000, when the Joint Venture attempted to resume construction on the Project Property, the City authorities, accompanied by police, expelled the Joint Venture's contractor from the site. (Evidence of Mr Boris Evseev, transcripts of oral hearing, Day One, pp. 186-7) – Material part of his evidence reads as follows:

Q. After meeting with the city Akim, did you try to recommence the construction at the site?

A. Yes, we did. There was a period of time after that meeting when, despite the communications that we have received from the city and the Oblast prior to that, nothing happened. The authorities did not actually move in and start construction of the arboretum on that site.

We were about three months late in to the construction season and our crew was still in a stand by mode, so in mid May we decided to recommence construction.

We sent a contractor with some equipment to the site, with a bulldozer.

Q. What happened when you did that?

A. Shortly after our contractor showed up at the site, the representatives of the city authorities appeared on the property, accompanied by the police, and expelled our contractor from the site.

Q. What do you mean when you say "expelled"?

A. They requested that the contractor leave the property, leave the land and suggested that they would apply physical force if the contractor did not apply.

Q. When you say "apply physical force" what are we talking about?

A. The representatives that were on the property were accompanied by police, and the police is equipped with the necessary tools to apply physical force. The contractor would be forcibly expelled.

Q. Were you physically present when this took place?

A. No, I was not.

Q. How do you know it took place?

A. The contractor contacted me and said that indeed took place.

Q. As of May 15 or thereabouts therefore you had been prevented from constructing on the property. So what did you next do?

A. At that point, it had become clear to us that we would not be allowed to continue with the project. We consulted with AIG Capital Partners in New York, myself, Mr Foushee and others, and made a decision that the project had been essentially cancelled and that we could no longer continue with it. We had to mitigate our damages.

(h) That the Fund's Investment Committee decided not to proceed further with the Project, to mitigate their mounting losses, and to release the construction contractor. Accordingly, the Joint Venture invoked force majeure, and terminated the construction contract on June 16, 2000, paying \$182,000 in furtherance of a mutual release of claims. (Oral evidence of [Mr] Scott Foushee, transcripts of oral hearing, August 28, 2002, pp. 112–15.) Evidence of Mr Boris Evseev, August 28, 2002, p. 188:

Q. When you say “mitigating” your damage, what do you mean?

A. It means reducing our losses as a result of this.

Q. What did you do?

A. Specifically, first, we invoked the force majeure provision in our construction contract, and both the joint venture and the contractor decided that performance was no longer possible under the contract. The contract was therefore terminated and the joint venture paid compensation to the contractor for the costs involved. Second, we, being the joint venture management, terminated most of the staff of the joint venture, most of the eleven people, reducing our costs, operating costs, therefore.

We also tried to sell some of the project property. We were not successful in doing that, but electrical cables, water pipes, simply, there was no demand for those assets because they were configured for this larger project that was not going to happen.

All this is further corroborated by Claimants' Exhibit No. 27, a letter dated June 16, 2000 from Boris Evseev (for and on behalf of Claimant No. 2) to the Contractor (TUNA):

As you are aware, Closed Joint Stock Company Tema Real Estate Company (“TREC”) having entered into that Contract for Works of Civil Engineering Construction with Tuna Insaat Sanayi ve Ticaret Ltd, St. (“TUNA”) dated January 27, 2000 (the “Contract”), as Employer under the Contract, has been unable to continue with construction of the project as contemplated in the Contract due to the Government of Kazakhstan's apparent decision to use the site as part of a national arboretum. Although it remains possible that the project will continue in some form, the parties to the Contract have been blocked from making progress on the project in accordance with the Contract for over three months without any indication from the Government that it will permit the use of the site for the project.

In light of these intervening circumstances, the Parties agree that both are prevented and discharged from performing the Contract pursuant to Clauses 66.1 and 65.8 of the Contract. In satisfaction of all amounts due from TREC and TUNA pursuant to the Contract, as well as in satisfaction of losses, costs, and expenses incurred by TUNA as may be due under the Contract, TUNA has confirmed that its costs associated with performance of the Contract amount to \$182,179 (the “Settlement Amount”) and TREC has agreed to pay such Settlement Amount in consideration for this release (the “Release”).

(i) The Claimants treated the date of expropriation as June 16, 2000 and on July 17, 2000 a Notice of Investment Dispute was submitted by AIG Silk Road Fund<sup>72</sup> pursuant to Article VI of the BIT and Article 27 of the Law of Kazakhstan on Foreign Investments dated December 27, 1994 (Claimants' Exhibit 101): further explained by oral evidence of Boris Evseev (transcripts of oral hearing, Day

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<sup>72</sup> The Notice of Investment Dispute was signed by L. Scott Foushee, Managing Director AIG Capital Partners as well as Managing Director AIG Silk Road Capital Management (which manage and control the AIG Silk Road Fund Ltd) – L. Scott Foushee was also a Director of Claimant No. 2.

One, p. 190).

Q. Did you reach a point in time when you decided to file a formal claim related to the taking of the property?

A. Yes. In the summer of 2000, on July 17, after a continuous series of attempts to bring this issue to a resolution through negotiations with the Government officials that were involved in this, we filed a Notice of Investment Dispute.

(j) That on August 2, 2000, the Chairman of the Agency for Investment, Mr Dulat Kuanyshev,<sup>73</sup> wrote to the First Deputy Prime Minister, Mr Alexander Pavlov, concerning the Notice of Investment Dispute filed by AIG Silk Road Fund, Ltd on July 17, 2000. In this letter, the Chairman stated:

An analysis of the notice submitted and the preceding correspondence points to violation of a series of legal procedures concerning the seizure of the land plot owned by CJSC Tema Real Estate Company.

Given all of the above, with the aim of preventing the dispute from going to international arbitration, which could prove very expensive for the government of the Republic of Kazakhstan, we think it acceptable to seek a path to constructively resolve this conflict in an out-of-court settlement. (Claimants' Exhibit 118)

(k) That to consider the notice of Investment Dispute on September 2000, an ad hoc Working Group (Protocol of Inter-Ministry Working Group) was set up consisting of representatives of the Foreign Ministry, the Ministry of Finance, the Ministry of Justice, the Agency for Investment, the Almaty Oblast and the City of Almaty: these representatives concluded that the cancellation of the Project was "in violation of [applicable] legislation". The Working Group recommended that the Akim's order to stop construction of the Project be invalidated and the Project Property be returned to the Joint Venture, or if this was not possible, that the Joint Venture be compensated for the taking of the Property. (Claimants' Exhibit 28) – the conclusion is reproduced verbatim below:

Having reviewed the available materials the Working Group considers that:

- (1) the decision of the local executive body that impedes the implementation of construction by the investor was adopted in violation of the procedures established by the current legislation;<sup>74</sup>
- (2) with view to avoid the involvement of the Government of the Republic of Kazakhstan in the litigation process in the framework of international arbitration, bearing of judicial costs by the state, lowering of the credit rating and deterioration of the investment image of the Republic of Kazakhstan and to reimburse the economic damages concerned with the compensation of the

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<sup>73</sup> Mr Kuanyshev, Chairman of the Agency for Investments, was not called as a witness and gave no oral evidence.

<sup>74</sup> What were these procedures and how they were violated is not brought out in evidence - neither in the evidence in chief of the Respondent's witnesses nor in their cross-examination and questioning on behalf of the Claimants: neither the oral nor written arguments of either Party have addressed this question: it appears to have been accepted by the Respondent that the decision to cancel the project was in fact in violation of "the procedures established by current legislation".

investor's expenses to recommend the following to the Government of the Republic of Kazakhstan:

1. In accordance with Article 16 of the Constitutional Law of the Republic of Kazakhstan "On the Government of the Republic of Kazakhstan", for the Government of the Republic of Kazakhstan to cancel the decision of the local executive authority with regard to the land plot owned by Tema Real Estate Company.
2. In case it is impossible for the investor to maintain ownership of the land plot (10 hectares), for the Akim of the Almaty Oblast jointly with Tema Real Estate Company to coordinate a more precise amount of compensation in the order established by law.

The Minutes (of the Working Group September 5, 2000 – Exhibit No. 28) show that the Group consisted of the Director of the Department for Regulation of Investment Activity in priority sectors of the economy (Agency on Investment of the Republic of Kazakhstan) who chaired the Working Group, as well as eight other representatives<sup>75</sup> from various departments of Government. The fate of this unanimous recommendation of the Working Group (recorded in Claimants' Exhibit No. 28) later endorsed by Mr Idrisov, Minister of Foreign Affairs in his letter dated March 13, 2001 to the Deputy Prime Minister, is not known: it was (apparently) not further pursued;<sup>76</sup> the decision to cancel the project was at no time revoked nor were the Claimants informed of the same. On the contrary – on February 14, 2001, contractors for the City of Almaty, accompanied by police, began construction on the Project site, and expelled the Claimants' representatives from the site. (Claimants' Exhibit 30 and 128 – video tape and written transcript recording construction by Almaty Oblast's Contractors on the Project Property.)

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<sup>75</sup> Kaimsultanov Gabidin, Head of Construction Department of Almaty City Akim Office; Parsegove Boris Anatolievich, Deputy Director of Department of Legal Service, Agency on Investments of the Republic of Kazakhstan; Umbetalieva Dana Shekerbekovna, Head of Division of Department of Legal Provision and Work with Investor Applications, Agency on Investments of the Republic of Kazakhstan; Tashibayev Murat Seitghanovich, Head of Administration of Department of International Economic Co-operation of the Ministry of Foreign Affairs of the Republic of Kazakhstan; Saparov Abai Esbolovich, Chairman of Almaty City Committee on Land Resources Management; Krasnik Victor Kondratievich, Deputy Chairman of Almaty Oblast Committee on Land Resources Management; Rakhimov Dauketkhan Zhanbatovich, Chief Specialist of the Land Use Department, Agency on Land Resources Management of the Republic of Kazakhstan; and Kasymbekova Aigerim Zhaksybayevna, Lead Specialist of the Legislative Department of the Ministry of Justice of the Republic of Kazakhstan.

None of the eleven persons mentioned in these Minutes gave evidence or denied the correctness of the contents recorded in the Minutes of September 5, 2000. In fact as stated in the oral evidence of Mr Idrisov (transcripts of oral hearing, Day Two – page 6) the findings and recommendations of this Working Group coincided with the findings recorded in Exhibit 31: Letter dated March 13, 2001, from Mr Idrisov, to the Deputy Prime Minister of the Republic of Kazakhstan.

<sup>76</sup> Exhibit 97–98, Respondent's Counsel (Mr Barnum) was asked by the Tribunal (during cross-examination of Boris Evseev) as to why the decision to revoke the cancellation was not pursued (Transcripts of the oral hearing, Day One, pages 256–7). There was no relevant response – either at that time or later during oral arguments or the Post-Hearing Brief filed on behalf of the Respondent.

*The video tape shows a Site Visit by representatives of Claimants and their US attorney's firm to the plot*

It is in evidence that the Claimants received notification from their security guard at the Project Property on February 14, 2001 that a construction crew had entered upon the property accompanied by local militia and had started site work for the arboretum. The next day AIG personnel accompanied by lawyers from Coudert Brothers visited the Project Property to view and document the seizure of the land plot.<sup>77</sup>

(l) That, inexplicably, and despite what was stated in the letter of Mr Idrissov (March 13, 2001) to the Deputy Prime Minister (Claimants' Exhibit 31) – recommending that the prior decision of the Local Executive Body which was “in breach of certain procedures” be cancelled<sup>78</sup> – on April 2, 2001, transfer of Project Property from Almaty Oblast to City of Almaty was decreed (Claimants' Exhibit No. 13).

(m) On April 2, 2001, a decree of the President of [the] Republic of Kazakhstan recorded:

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<sup>77</sup> Relevant extract of transcript of the video-tape reads as follows:

Claimants' "Attorney representative"

Oleg Shvander: “Before going to court we’d like to know on what basis the work is being conducted.”

The Contractor: “We are, let’s say, the general contractor for the City.”

Oleg Shvander: “Has the City given you the assignment to do the construction?”

The Contractor: “Absolutely! [unclear]. I have a contract with City to build this park.”

Voice of Aliya

Suleymonova of Coudert: “Can we have a look at ...”

The Contractor: “Yes, you can, but who are you? You understand, I don’t like this ... when somebody films sneakily ... I speak to you openly...”

Then the Contractor says: “It is prohibited to be on the construction site.”

Side conversation as to videotaping.

The tape ends.

The tape, identified as Exhibit 30, was made by Yerken Kaliyev, video cameraman for AIG. The time stamp of “15.02.2001” is shown throughout the entire length of the tape.

<sup>78</sup> About this letter Mr Idrissov – who gave oral evidence on behalf of the Respondent (transcripts of oral hearing, Day Two, page 6) – deposed:

It clearly shows that the Government has tried looking into the matter and they have made their recommendations and I have informed the Deputy Prime Minister of those recommendations which were valid, and never changed.

Q. How is this letter related to the Claimants' Exhibit 28, the protocol of the working group, please?

A. There is a clear relation between both exhibits because it is clearly seen that the findings and recommendations of the working group almost completely coincide with the recommendations I have made in my letter.

DECREE OF THE PRESIDENT OF THE REPUBLIC OF KAZAKHSTAN

REGARDING DEMARCATION OF THE BOUNDARIES OF THE ALMATY CITY

In compliance with submission of the Government of the Republic of Kazakhstan prepared in accordance with Article 9 of the Law of the Republic of Kazakhstan “On Administrative–Territorial Structure of the Republic of Kazakhstan”, dated December 8, 1993 and considering the opinions of representative and executive bodies of the Almaty city and the Almaty oblast I hereby DECREE:

1. To demarcate the boundaries of the Almaty city and include certain part of lands of Karasai district of the Almaty oblast with the total area of 158. 4 [*sic*] hectares in the territory of the city.
2. This Decree shall become effective from the date of publication.

The President of the Republic of Kazakhstan N. Nazarbayev. Astana. April 2, 2001 No. 579

- (n) All this meant that the cancellation of the Project was irrevocably affirmed and the Project Property was transferred out of the jurisdiction of the Almaty Oblast to the City of Almaty.
- (o) The case suggested to the Claimants’ witnesses on behalf of the Respondent, and also mentioned in the arguments of the Respondent, that the Akim Oblast had no authority at all to grant the construction permits on the Project Property or that there had been a mistake in granting them – because of some lack of authority – has not been established by reference to any law of Kazakhstan. On the contrary what is established on the evidence is that the cancellation of the construction permits and continuous course of impediments to the Project being proceeded with on the Project site, were contrary to procedures established by Kazakhstan law.

10.3.3 In the circumstances aforesaid the Tribunal holds:

- (a) That it has been proved that the investment<sup>79</sup> of the Claimants was expropriated, directly or indirectly through “measures tantamount to expropriation” (Article III( 1) of the BIT); the date of taking was treated according to the Claimants as June 16, 2001 [*sic*],<sup>80</sup> shortly after the date on which the Claimants were physically and forcibly dispossessed from the project site (May 15, 2000) – making their ownership rights to the plot allocated practically useless. By May–June 2000 the practical and economic use of the Project Property by the Claimants was irretrievably lost – and could not thereafter be used for development purposes.
- (b) The later recommendation of the Working Group to revoke the “expropriation” (even though it was

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<sup>79</sup> The quantum of investment expropriated will be dealt with when considering the claim for compensation.

<sup>80</sup> In the Claimant Post-hearing Memorial dated October 18, 2002 it is stated:

For purposes of estimating fair market value, the Claimants have taken mid-June of 2000, when the Claimants invoked force majeure under the construction contract, as the date of the taking because that is when it became

at a very belated stage) was never finally accepted by the Government: in any event the Claimants were never informed of the same, and

- (c) The Tribunal also holds that the expropriation of the Project Property was not in accordance with “procedures established by current (Kazakhstan) legislation” (as admitted in the Minutes of the Working Group September 5, 2000 – Claimants’ Exhibit No. 28).<sup>81</sup>

The same is also acknowledged in the Post-Hearing Brief of the Respondent (filed on October 18, 2002) in which under the heading “Facts not contested by the Respondent” it is stated:

Respondent acknowledges that the Akim of Almaty Oblast did not follow Kazakhstani law when he stopped the Project and for six months prevented CJSC Tema (Claimant No. 2) from building the Project at the Site.<sup>82</sup>

#### 10.4 *Was the Expropriation for a Public Purpose? Was there any Direct Intervention by the President of Kazakhstan in the Taking as Suggested in the Evidence?*

10.4.1 Under Article III(1) of the BIT investments shall not be expropriated or nationalized either directly or indirectly through measures tantamount to expropriation or nationalization “except for a public purpose ...”. This is only a reiteration of one of the essential elements of State sovereignty viz. the right to take by compulsory acquisition private property for public purposes: the fact-situation in this case is that there is no dispute whatever between the parties that the “taking” was for an arboretum or public park,<sup>83</sup>

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apparent that the various measures taken by the government had become irreversible.

<sup>81</sup> The Ministry of Foreign Affairs of the Republic of Kazakhstan, having reviewed the Appeal of the US Ambassador Mr Richard Jones and the Investment Dispute Notice, informed the Deputy Prime Minister of the Republic of Kazakhstan that the Working Group had reviewed all available material and concluded that the earlier decision that had been made by the local executive body was in breach of “certain procedures established by existing legislature [*sic*]” and recommended that the Government of [the] Republic of Kazakhstan should cancel it. It appears from this letter (Claimants’ Exhibit No. 31) that the Government of [the] Republic of Kazakhstan agreed with the opinion expressed by the Working Group and had instructed the Almaty Oblast to take all necessary steps to settle the issue and inform the Government of the Republic of Kazakhstan of the results thereof – but also further records that “the dispute has not been settled yet” (letter of Mr Idrissov dated March 13, 2001, to the Deputy Prime Minister – Claimants’ Exhibit No. 31).

<sup>82</sup> Page 17, para. 30 B of the Post-Hearing Brief of the Respondent.

<sup>83</sup> (1) Claimants’ Request of Arbitration dt. May 3, 2000 page 9: “On February 26, 2000, the Government verbally notified the Joint Venture that it had decided to cancel the Project for the purported reason that the Project Property was needed for a „national arboretum“.”

(2) Claimants’ Exhibit No. 25 letter of Mr Scott Foushee dt. March 21, 2000 to the Advisor to the President of Kazakhstan: “Late last month, we were notified by the Almaty Oblast Akim that our land, which had been purchased in full compliance with Kazakhstan Law, would be confiscated in order to construct a „National Arboretum“ on it and surrounding property.”

(3) Claimants’ Exhibit No. 30 Transcript of video tapes:

Oleg Shvander: “Has the City given you the assignment to do the construction?”

which is manifestly a “public purpose”. The Tribunal holds that the taking was for a public purpose.

10.4.2 However, in the course of the evidence of Boris Evseev, it was alleged that the President of Kazakhstan was involved and implicated in the decision to cancel the project. This assertion must now be dealt with.

10.4.3 In the Request for Arbitration the Claimants stated as follows:

On 26 February 2000, the Government verbally notified the Joint Venture that it had decided to cancel the Project for the purported reason that the Project Property was needed for a “national arboretum”. This notice was given despite the prior approval by governmental authorities of the land purchase, the zoning and the construction plan for the Project.

10.4.4 In the Request for Arbitration, the only mention of the President of Kazakhstan is in the context that the Project Property was located in one of the most exclusive residential areas of Almaty, “adjacent to the private residence of the president of the Republic of Kazakhstan” (page 3 of the Request for Arbitration). [The] verbal intimation to the Joint Venture that the Government had decided to cancel the project (February 26, 2000) was “for the purported reason that it was needed for a national arboretum”; this is further amplified by the statement (in the Request for Arbitration) that on March 2, 2000, the Representatives of the Fund and the Joint Venture met with the Akim of the Almaty Oblast, who said he had made a “mistake” [in] having the Oblast Administration permit the sale of the Project Property to the Joint Venture. There is no mention in the Request for Arbitration that it was at the express instance and request of the President of the Republic of Kazakhstan that the project was cancelled. In the Claimants’ Memorial (page 22) it is once again mentioned that on February 26, the Chairman of the Oblast Architectural Committee (Mr Sairan Fazylov) stated that the Oblast Administration had decided to take the Project Property for use as an arboretum and that the construction on the property should cease. No mention of the President is made. It is however stated that the mistake of the Akim was that he had failed to

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The Contractor: “Absolutely (unclear) I have a contract with city to build this park.”

(4) Evidence of Boris Evseev (Transcripts of the oral hearing, Day One. p. 184).

“(The arboretum) for the most part was completed. As you can see they are still building something there but the walkways are there, the trees have been planted [and] the irrigation system is there.”

(5) Evidence of Nurkadilov (Transcripts of the oral hearing. Day Two, at p. 154 – Mayor of Almaty):

“Every Saturday, the population of Almaty, including the children come to this arboretum and plant the trees there.”

(6) Evidence of Dolzhenkov (Transcripts of the oral hearing, Day Three, at page 54):

Q. The purpose of that transfer was so that the city could build the park?

A. We just gave the land, or transferred the land, to the city territory, both for the arboretum and the golf club, or golf course, together with all the land users documents.



obtain the permission of the President before authorizing commercial authorization of the project.<sup>84</sup>

10.4.5 It is in the oral evidence (of the Claimants' witness Boris Evseev)<sup>85</sup> that it is sought to directly implicate the President with regard to cancellation of the project:

- (a) In his examination-in-chief Boris Evseev says that he learned from his meeting with the Akim of Almaty that the real reason why the billboard advertising the project had to be removed was:

we learnt that the real reason was that President Nazarbayev did not want the billboard to be there (transcripts of the oral hearing, page 165).

The witness does not say who told him this.

- (b) He went on to further depose in his examination-in-chief as follows:

Q. What did the Oblast Akim tell you when you met with him?

A. The Oblast Akim told us that, indeed, President Nazarbayev was opposed to the Project and that we had to stop construction. There was no choice otherwise.

He said that the Project property indeed would be taken and an arboretum would be constructed on it.

Q. Did he give you any hope that this decision was reversible?

A. No, he made it very clear that this was a final decision and there was nothing we could do about it (transcripts of oral hearing, Day One, pages 169–70).

Mr Nurkadilov has in the course of his evidence vehemently rejected the suggested involvement of the President in the cancellation of the project (transcripts of oral hearing, Day Two, pages 153–4).

- (c) Boris Evseev was asked about his conversation with US Ambassador Richard Jones, and he once again attempted to implicate the President (transcripts of oral hearing, Day One, page 178):

Q. Did the (US) Ambassador (Jones) investigate the situation any further?

A. Yes, he did. He later informed us that, based on his information, there had indeed been presidential interference into this project, and the reason was that the President did not want this development in the vicinity of his Almaty residence.

Boris Evseev then went on to state in cross-examination (transcripts of oral hearing, Day One, page 234):

I was told by the officials that I mentioned, including Mr Nurkadilov, which was later supported by US Ambassador Jones that the President himself indeed interfered with this project and it did not appear as a reasonable proposition to us to go and seek presidential blessing for the new site (i.e., the alternative site).

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<sup>84</sup> There is no law of Kazakhstan which is pointed out or relied on to show that the President's permission was needed.

<sup>85</sup> Oral evidence of Boris Evseev, Country Director AIG Silk Road Investment Ltd, given on August 28, 2002.

This evidence is again unsubstantiated. Ambassador Jones did not give evidence and his only letter on record (Claimants' Exhibit No. 26) makes no mention of Presidential interference.

(d) About the meeting with the Mayor of the City of Almaty, in April Boris Evseev deposes as follows (transcripts of oral hearing, Day One, page 180):

Q. Can you tell us what happened at that meeting?

A. Yes, Mr Khrapunov told us that the project property was indeed being taken by the Government and that we could not construct our project on it. He further told us that an arboretum and a golf course would be built on that land. *He also suggested that the Oblast authorities had made a grave mistake in not consulting with President Nazarbayev when they issued for us with the permits to go ahead with the project* (emphasis added).

He also issued what we interpreted as a thinly-veiled threat by invoking a prior example of dealing with a US Ambassador. He did not specify who it was but apparently the situation was when the city wanted the Embassy to move to another location and the Ambassador was reluctant to do that. Soon thereafter they found themselves without power and water. The message was very clear that "this is my City, I make the rules here. Don't mess with me."

Again the alleged involvement of the President is unsubstantiated.

The [italicized] portion is not foreshadowed at any prior stage of documentation (nor mentioned or relied on in the written arguments of the Claimants).

10.4.6 In the Claimants' Post-hearing Memorial filed on October 18, 2002 there is no mention of the direct intervention of the President of Kazakhstan – and what is more significant, no reliance is placed on the oral evidence of [Mr] Boris Evseev given in that behalf. In fact when dealing with Respondent's liability under the BIT there is no reference to Mr Boris Evseev's evidence that the billboard advertising the Crystal Air Village be removed since it was offensive to the President. And even with regard to the meeting of March 2, 2000 with Mr Nurkadilov, it is stated that Mr Nurkadilov confirmed that the property was being taken to build an arboretum and therefore construction must stop (no mention of the President). The relevant portion from the Claimants' Post-hearing Memorial is extracted in the footnote.<sup>86</sup>

10.4.7 The Tribunal finds the invocation of the name of the President of the Republic of Kazakhstan and his alleged involvement with the cancellation of the project (mentioned in the oral evidence of Mr Boris Evseev) not proven.

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<sup>86</sup> As to the expropriation of the Claimants' investment:

On 18th February, 2000, the Joint Venture received a telephone call from the Chairman of the Oblast Land Committee. Mr Taubaev, asking that a billboard advertising the Crystal Air Village Project be removed from the Project Property. Mr Taubaev said that the billboard was offensive to low-income residents of Almaty. Accordingly, the Joint Venture removed the billboard. (Testimony of Mr Boris Evseev, *ibid.*, p. 165.) The Claimants' representatives met with Mr Nurkadilov on March 2, 2000. At this meeting, Mr Nurkadilov confirmed to the Claimants that their property was being taken for use as an arboretum and that they must therefore stop construction of the Crystal Air Village Project. (*Ibid.*, Testimony by Mr Boris Evseev pp. 169–70.)

In the opinion of the Tribunal, clear refutation of the plea of direct Presidential interference is to be found in contemporaneous documentary evidence viz. the Working Group's conclusion (Claimants' Exhibit No. 28) – and minutes of Working Group dated September 5, 2000, and by the endorsement of this conclusion in the letter dated March 13, 2001 of Mr E. Idrissov, Minister of Foreign Affairs, to the Deputy Prime Minister (Claimants' Exhibit No. 31): the recommendation there made was that a revocation of the prior cancellation of the Project should be effectuated. Obviously this would not have been so recommended if the entire initiation of the cancellation of the Project and revocation of building permits at the Project site was at the personal insistence of the Head of the State.

#### 10.5 *Was the Expropriation Arbitrary?*

10.5.1 Expropriation of alien property is not itself contrary to international law provided certain conditions are met, and perhaps the most clearly established condition is that expropriation must not be arbitrary (i.e., must not be contrary to “the due process of law”) and must be based on the application of duly adopted laws.<sup>87</sup> The requirement that expropriation should be in a non-discriminatory manner (i.e., as between alien and national) and in accordance with due process is also widely accepted, and is relevant to the assessment whether the expropriation was or was not arbitrary and in furtherance of the public interest. In the case concerning *Elettronica Sicula (USA v. Italy)*,<sup>88</sup> the International Court of Justice noted that:

Arbitrariness is not so much something opposed to a rule of law as something opposed to *the* rule of law. This idea was expressed by the Court in the *Asylum* case when it spoke of “arbitrary action” being “substituted for the rule of law” (*Asylum Judgement ICJ Report 1950* p. 284). It is a wilful disregard of due process of law, an act which shocks or at least surprises a sense of juridical propriety (para. 128 at p. 76).

10.5.2 In the facts and circumstances of the case – particularly the events that occurred between February [and] May 2000 (already set out in detail – para. 10.3.2 above)<sup>89</sup> – and in the light of the findings recorded in the Minutes of the high-powered Working Group (of September 5, 2000)<sup>90</sup> to the effect that the decision of the local executive body impeding implementation of construction by the investor on the Project Property was adopted “in violation of the procedures established by the current legislation”, this Tribunal records a finding that the taking (by measures tantamount to expropriation) was arbitrary, in wilful disregard of due process of law and the series of acts from February 26, 2000 and culminating in the events

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<sup>87</sup> Oppenheim's International Law, 9th Edition Vol. 1 Peace pages 919–20.

<sup>88</sup> ICJ Rep. (1989) page 15 at pages 73 to 77.

<sup>89</sup> The last straw was when the Joint Venture (Claimants' Exhibit No. 2) attempted on May 15, 2000 to resume construction on the Project Property – the City authorities accompanied by the police expelled the Contractor from the project site: an event not disputed or contradicted by or on behalf of the Respondent State.

<sup>90</sup> Claimants' Exhibit No. 28 in the Arbitration proceedings.

of May 15, 2000 were shocking to “all sense of juridical propriety”.

#### 10.6 *Mitigation of Damages: Offer of Alternative Site and its Refusal*

10.6.1 At this stage it is necessary to deal with the contention foreshadowed in the Respondent’s Counter-Memorial filed on August 19, 2002, and developed later during the examination of witnesses and during arguments: although this contention has been raised by the Respondent as a substantive plea in defence of the Claim for compensation, it is dealt with here as a separate topic.

10.6.2 In the Request for Arbitration it has been stated that on March 2, 2000, when Representatives of the Fund and of the Joint Venture met with the Akim of Almaty Oblast, he insisted that notwithstanding the Joint Venture’s authorized purchase of the site to construct the Crystal Air Village the Joint Venture would not be permitted to construct a residential compound on the project site and that this was an irrevocable decision; that the only recourse available to the Joint Venture and the Fund would be to construct their residential compound on an alternate site (“which was an unacceptable solution from the Claimants’ point of view for commercial reasons which will be explained at the appropriate stage of the arbitral proceedings”).<sup>91</sup>

In the Claimants’ Memorial of February 15, 2002, the events of March 2, 2001, are recorded thus:

Then, on March 2, 2000, the Akim (governor) of the Almaty Oblast formally notified the Claimants that the authorization to construct the Project was being rescinded. The Akim said that he had “made a mistake” when he authorized construction on the Project Property, because he had failed to obtain prior authorization from the President, Nazarbayev. The Akim said that the Project Property and other contiguous property were to be used to create a public park adjacent to the President’s home. In exchange for the Project Property, the Akim offered the Claimants an alternative but inferior site on which to build the Project. The Claimants explained that the Project Property was an integral part of the Project and that moving the Project to a different site would in effect involve a new and different project which would require new feasibility studies, re-design of the Project, a new construction contract and de novo approval of the Project by the Fund’s Investment Committee. The Akim replied that construction of the Project on the Project Property was simply not an option.

The Respondent’s Counter-Memorial does not dispute the fact that an alternative site was offered on March 2, 2001, orally by the Akim of the Almaty Oblast, and was not accepted by the Claimants. Apart from relying on Kazakhstan law about Claimants “not taking reasonable measures to mitigate losses” (reliance is placed on Article 364 of the Civil Code of the Republic of Kazakhstan), it is concluded that “Claimants have not made any serious or sufficient efforts to mitigate the alleged losses” and that the Claimants should be denied the compensation claimed.

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<sup>91</sup> Request for Arbitration pages 9 and 10.

10.6.3 At the oral hearing, Counsel for the Respondent (in his opening statement) said that the Government of Kazakhstan had offered both “compensation” in the form of alternate land a kilometre away and offered to do some of the same work that had been done already by Tema on their project to save them the expense of having to do that over again. The transcript shows that Respondent’s counsel then went on to say:

So in other words, Kazakhstan offered an alternative site and we offered to undertake *some of the expenses* so that they would not be duplicated, and for reasons, that will [have] to be explained, at least to me, Claimants rejected that offer (emphasis supplied). (See transcripts of the oral hearing, Day One, page 13.)

In the oral evidence led by the parties the offer (orally made) of an “Alternative Site” is an undisputed and admitted position.<sup>92</sup> Based on this, in the Post-Hearing Brief filed by the Respondent (October 18, 2000) reliance is placed on a passage in paragraph 172 of the ICSID Award in the *Pyramids Case*.<sup>93</sup> It is suggested that whilst in the *Pyramids Case* the substituted site was inappropriate for the project (of the Claimants) in that case, in the present case, the alternate site was virtually identical and only 170 metres away from the project site: whilst the Claimants do not admit that the alternate site was “virtually identical” its location is not disputed by the Claimants in evidence. See Mr Foushee’s Evidence – transcripts of oral hearing, Day One, page 53.

10.6.4 As to the competing pleas of the parties with regard to the offer of an alternative site and the “duty to mitigate”, the findings and conclusions of this Tribunal are as follows:

- (1) Mitigation of damages, as a principle, is applicable in a wide range of situations. It has been adopted in common law and in civil law countries, as well as in International Conventions and other international instruments – as for instance in Article 77 of the Vienna Convention and Article 7.4.8 of the UNIDROIT Principles for International Commercial Contracts. It is frequently applied by international arbitral tribunals when dealing with issues of international law. In commercial trade

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<sup>92</sup> See Transcripts of the oral hearing, Day 1, Mr Foushee pp. 53 to 63, Mr Boris Evseev pp. 170 to 178; Day 2 (August 29, 2002), Mr Z. Nurkadirov at pp. 145 to 155; Day 4 (August 31, 2002) at pp. 89 to 95 (Arguments).

<sup>93</sup> Vol. 106 ILR 50 (*SPP(ME) Ltd v. Egypt*) – Award of ICSID Arbitral Tribunal dated May 20, 1992, para. 630: the entire paragraph reads as follows:

72. Finally, as to the substitute site at the Sixth of October City, the Claimants’ witnesses gave convincing testimony that the site was totally unsuitable for tourist development. In any event, it is clear that the Prices agreement provided for development of the Pyramids site, not a substitute site. The Claimants made a substantial investment pursuant to those agreements, and the investment was in effect expropriated as a result of the Respondent’s cancellation of the Pyramids Oasis Project. Furthermore, the same commercial and financial considerations which suggest that financing could not have been raised for the Ras El Hekma site after the cancellation of the Pyramids Oasis Project apply to development at the Sixth of October City site. While the Claimants may have been under an obligation to mitigate the damages incurred as a result of the cancellation of the Pyramids Oasis Project, such an obligation is not so broad and all encompassing as to require the Claimants to accept an unsuitable alternative site that was never contemplated by the Parties’ agreement.

relations, it is said that a purchaser "... must take measures that are reasonable in the circumstances to mitigate the loss..." (Vienna Convention, Article 77): as when for example a seller fails to deliver materials contracted to be sold, and the buyer neglects to purchase substitute materials available in the market, the shutdown losses that the purchaser could have prevented would not be recoverable.<sup>94</sup> More recently a Panel of the UN Compensation Commission has noted in a cryptic passage its opinion that:

under the general principles of international law relating to mitigation of damages, which have also been recognised by the Governing Council of the UN Compensation Commission (resolutions are quoted) the Claimant was not only permitted but indeed obligated to take reasonable steps to fight the oil fires in order to mitigate the loss, damage or injury being caused by those fires to the property of Kuwaiti Oil Sector Company and the State of Kuwait.<sup>95</sup>

- (2) The law of Kazakhstan spells out the consequences of not taking reasonable measures to mitigate losses – particularly in paragraph 20 of Resolution No. 5 dated July 21, 1954 of the Plenum of the Supreme Arbitration Tribunal of the Republic of Kazakhstan (“concerning practices of solving Claims for compensation or damages”)<sup>96</sup> – in the latter it is stated that “in seeking recovery of damages in form of lost profits, arbitration tribunals should note that a creditor may not claim compensation or damages that it would have avoided had it taken necessary measures to reduce them”.

This is no different from the rule as to mitigation stated in a leading judgment of the Privy Council: “It is undoubted law that the plaintiff who sues for damages owes the duty of taking all reasonable steps to mitigate the loss consequent upon the breach and cannot claim as damages any sum that is due to his own neglect.”<sup>97</sup> The principal meaning of this is that a claimant cannot recover for “avoidable loss”.

- (3) Though the duty to mitigate damages is recognized in international law, it can never justify a wrongful act. In the *Case Concerning Gabčíkovo–Nagymaros*, it was held by the International Court of Justice that whilst the principle of mitigation might provide a basis for the calculation of damages it could not “on the other hand justify a wrongful act” (paras. 80 to 86 at page 54). In that case the ICJ concluded that the “duty to mitigate” was not a legal obligation which itself gives rise to responsibility – it was rather that a failure to mitigate by the injured party precluded recovery to that extent. Since the party State (in that case), which had pleaded a duty on the part of the other State to mitigate losses, had itself committed an intentional wrongful act, the International Court concluded

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<sup>94</sup> Honnold, J., *Uniform Law for International Sales*, cd., 1982, p. 418.

<sup>95</sup> *Well Blowout Control Claim* – UN Compensation Commission (Tribunal consisting of Allan Philip, Chairman; Bola A. Ajibola, and Antoine Antoun. Members) dated November 15, 1996 – reported in Vol. 109 *International Law Reports* 479 at pages 502–3 para. 54.

<sup>96</sup> Enclosure No. 3 to the Post Hearing Brief of the Respondent of 18-10-2002.

that the duty on the part of the other party State to mitigate damages “does not need to be exercised further.”<sup>98</sup>

- (4) The onus of proof on the issue of mitigation is always on the person pleading it – if he fails to show that the Claimant or Plaintiff ought reasonably to have taken certain mitigating steps, then the normal measure of damages will apply.

The question of mitigation of damages is always a question of fact: as to whether the loss was avoidable by reasonable action that could have been taken by a Claimant is also a question of fact, not of law.<sup>99</sup> In the present case the taking of the Project Property was in no way due to the “neglect” of the Claimants; and there was no contractual obligation to accept an offer of an alternative site. The project site had been deliberately chosen as a strongly preferred site;<sup>100</sup> it had been duly fixed and determined by necessary certificates and permits (Claimants’ Exhibits Nos. 4, 11, 12, 21, 23)<sup>101</sup> and as was set out in the letter of March 2, 2000 (Claimants’ Exhibit No. 6) by the Chairman of the Investment Agency of Kazakhstan to the Akim of Almaty Oblast “the acquisition of the land plot for USD 1.5 million by the Joint Venture Company served as a principal pre-condition for the implementation of the investment project” (emphasis supplied). The unilateral and unjustified cancellation of all these permits could not possibly result in imposing any

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<sup>97</sup> *Jamal v. Mulla Daud* [1916] 1 AC 175 PC at page 129.

<sup>98</sup> In the case concerning the *Gabčíkovo–Nagyymaros Project* (Hungary/Slovakia) – 1997 ICJ Reports page 7 at paras. 79 and 80 (page 55).

<sup>99</sup> *The Soholt* 1983 (1) Lloyds Reports 605 CA – also see Macgregor on Damages 16th Edition paragraphs 299–300.

<sup>100</sup> In the Claimants’ Memorial (filed in February, 2002), the reason for selection of the Project site has been stated as follows:

In September of 1998, after carefully evaluating a number of potential sites, the Fund and Tema selected a 10 hectare site in the Karasai District of the Almaty Oblast as the location for the Project. The site was selected for a number of reasons. It was convenient to the City of Almaty; it was in a prestigious neighbourhood near the President’s residence and a planned international school (a significant marketing benefit for the Project); it is a physically attractive site with good views of the mountains; and it was generally flat so it would have required very little grading. This site was certainly not the only site on which the Project could have been built, but it was the strongly preferred site. It was part of a 240 hectare tract that was being offered for sale by the Almaty Oblast. At the time, this property was zoned for agricultural use. The Oblast agreed to re-zone the site to allow construction of the Project in the event that the Fund and Tema elected to purchase it.

<sup>101</sup> Exhibit 4: Certificate of Registration of the Investment Agreement by the Investment Agency, dated 13 December 1999

Exhibit 11: Resolution No. 10-289 of the Akim of the Almaty Oblast, dated October 6, 1998

Exhibit 12: Act of Ownership No. 0025673, issued to CJSC Tema Real Estate Company (the “Joint Venture”) by Karasai District Land Resources Management Committee, dated May 13, 1999

Exhibit 21: Decision No. 5-142 of the Akim of the Almaty Oblast authorizing the Joint Venture to Construct the Project on the Project Property, dated May 10, 1999

Exhibit 23: Ordinance No. 23 of State Architecture and Construction Inspectorate for Almaty Oblast, dated January 26, 2000.

obligation on the Claimants to accept an alternative site – even if it was not unsuitable.<sup>102</sup>

(5) Apart from the position set out above, the rule as to mitigating avoidable loss in an action for damages<sup>103</sup> is not at all applicable, in principle or in law, to a foreign investor in a host State, especially where their relationship [is] governed by a bilateral investment treaty:

(a) When it comes to taking of the property of a foreign investor and to offers of an “alternative solution” more favourable to the host State, this Tribunal is of the view that once the host State decides to expropriate or to take measures tantamount to expropriation of property, it would be wrong in principle to impose on the injured party (the creditor or foreign investor) a “duty” to examine (and if reasonable, to accept) an alternative solution. Such an imposition would only encourage Governments to breach with impunity solemn provisions of an international treaty and weaken the protection of foreign investors – which such a treaty is expressly designed to safeguard. In the present case counsel for the Respondent expressly disclaimed that there was any legal obligation on the part of the Claimants to accept the alternate site. When specifically asked whether AIG or the Joint Venture had any obligation to accept the alternate site or was it only a matter of judgment – Respondent Counsel’s response was:

Mr Barnum: I think it is the latter. I do not claim that there is any legal obligation to accept the alternate site. I do not claim that, as a matter of law, Tema was obliged to take the alternate site.<sup>104</sup>

(b) Whilst the offer of a substituted mode of performance may be relevant to consider whether the investment of the project was in fact expropriated, once the conclusion is reached that there was an “expropriation” (or “measures tantamount to expropriation”), the offer of an alternative site to an agreed project site becomes irrelevant under the applicable law: under Article III of the BIT, expropriation of the investment is permitted inter alia only “upon payment” of compensation: in “free usable currency”.

(6) Paragraph 172 of the Award in the Pyramids Case,<sup>105</sup> relied on by the Respondent, is misplaced – the passage relied on in this paragraph was in response to the specific plea taken by the Respondent party in that case (Egypt) that, while the contractual rights of the Claimants (in that case) may have been diminished in their value, they were not expropriated; the Respondent (Egypt) then contended

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<sup>102</sup> The decisions to cancel the permit were reached by the local authorities in breach of Kazakhstan’s laws and in fact it was so decided at the highest level after consideration of the recommendation of a high powered working group appointed by the Government for that purpose: it recommended to the Government of the Republic of Kazakhstan that the permit should be restored (Claimants’ Exhibit 31) – the letter dated March 13, 2001 from Mr Erlan Idrissov, Minister of Foreign Affairs, to Deputy Prime Minister Mr Uraz Dzhandosov also recommended this to the Government.

<sup>103</sup> See the common law principles of “mitigation” as stated in Chitty on Contracts 28th Ed Vol. I pp. 1316 to 1325.

<sup>104</sup> Transcripts of oral hearing, Day Four, page 65.



that the Ras El Hekma Project was never cancelled and that the Claimants were offered a substitute site for it on the Plateau close to the Sixth of October City. This substitute site, according to the Respondent (Egypt), “offered views and other features similar to those of the Plateau area” (paragraph 160). This contention was answered by the ICSID Tribunal in the *Pyramids Case* in paragraph 172 of the Award. After holding that the agreement in that case was “for development of the Pyramids site and not a substituted site” and after holding that the Claimants in that case had made a substantial investment pursuant to the agreement and that the investment was in effect expropriated as a result of Egypt’s cancellation of the Pyramids Oasis Project, the ICSID Tribunal then went [on] to add:

While the Claimants may have been under an obligation to mitigate the damages incurred as a result of the cancellation of the Pyramids Oasis Project, such an obligation is not so broad and all encompassing as to require the Claimants to accept an unsuitable alternative site that was never contemplated by the Parties’ agreement, (paragraph 172)

The quoted portion is in the nature of an aside – an additional argument, quite unnecessary for the real decision (or ratio) in that case, which was (1) that the agreement provided for the development of the Pyramids site, not a substituted site; and (2) that substantial investment pursuant to that agreement had been made by the Claimant and the investment expropriated was as a result of Egypt’s cancellation of the Pyramids Oasis Project. The observation that “whilst the Claimant may have been under an obligation to mitigate the damages incurred as a result of the cancellation of the Pyramids Oasis Project... “does not, in the opinion of this Tribunal, state any legal principle viz. that upon expropriation of a particular project there is an obligation on the party who has suffered a loss “to mitigate the damages by accepting a suitable alternative site”. It only ventures an assumption – restricted and applicable to the facts of the case on hand: it does not declare any law.

- (7) The Respondent has not discharged the onus of showing that the Claimants acted “unreasonably” in refusing to accept the alternative site – the offer of an alternative site was admittedly an oral one, made by the same person (Akim of Almaty Oblast) who had in fact expressly authorized in writing (under decision No. 5-142 dated May 10, 1999) the Claimant No. 2 to construct the project on the allocated land plot with total area 10 hectares, an allocation made by the Akim in writing, decision No. 2-29 dated February 18, 1999. One could not expect the Claimants to place much reliance on an oral offer made by the same authority (Akim of Almaty Oblast) who had breached written commitments.<sup>106</sup>

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<sup>105</sup> Vol. 106 ILR 501 – *SPP(ME)Ltd. v. Egypt* – Award of ICSID Arbitral Tribunal dated May 20, 1992.

<sup>106</sup> The reluctance on the part of the Claimants to accept the alternative site was summed up in the closing arguments of Mr Pietrowski:

Mr Pietrowski: So Mr Nurkadilov said that the guarantee, if these people went ahead and took the alternative site, and risked their money, they had his signature and he said he had never gone back on his signature and, as I said, that is just what he did. This is why we are here today: because Mr Nurkadilov went back on his signature...

Besides there was no authoritative statement issued on behalf of the Government of the Republic of Kazakhstan or its Agency (and addressed to the Claimants) that all expenses of and incidental to the refusal to permit construction on the project site would be met by the Government, much less was there any evidence of tender of any amount in respect thereof – no attempt was made to arrive at an agreed figure to be paid as additional expenses that would have to be incurred. As a matter of fact Counsel for the Respondent during arguments (transcripts of the oral hearing, Day Four, at page 89) went on record to say:

The question was, did the Oblast offer to put the substitute site in the same condition for construction as Claimants had already prepared the site for the Project? Apparently, no enquiry was made as to whether or not that would be done or paid for by the Oblast.

Mr Nurkadilov (Akim at the relevant time of Almaty Oblast), who gave evidence on behalf of the Respondent, was asked about the additional help that he offered to the Claimants with regard to the alternative site – but his answers were not very reassuring.<sup>107</sup>

Q. Have you ever offered the company, Tema Real Estate, any additional help with regard to compensation of their expenses in connection with the transfer of land?

A. Naturally. We offered to build a road, we offered to establish the infrastructure and to... Well, actually we offered an additional size, a hectare and a half more of land. This work that we offered to do for them would actually exceed all their assumed expenses that they claimed they would incur.

Your Honour, in order to receive all those permits to provide the energy, the electrical energy, to connect the water pipe infrastructure and all such other infrastructural benefits, it is necessary to invest millions of dollars into the economy of Almaty. These are just mandatory expenses, like necessary expenses. These are expenses that investors necessarily incur when building for any city, New York, London or other... like New Delhi (transcripts of the oral hearing, Day Two, at pp. 150–1).

The Tribunal is also not unmindful of the fact that (as explained by Mr Scott Foushee, Managing Director of Claimant No. 1 in the course of his evidence) the actions of the Government in unilaterally cancelling the allocated project site appeared wanting in bona fides and appeared to the Claimants as “capricious”. The following extract of the evidence of Mr Scott Foushee (transcripts of

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I want to ask each one of you to imagine that you are the individual who is responsible for making the decision on this substitute site. You are the one who has to say: Yes. I accept it. I am going to accept it with all the economic risks I know are involved, or: No, I am just going to reject it and find some place else. You are not just talking about your money; you are talking about the money of other people. You are talking about \$18 million of other people’s money, your investors’ money.

I just put it to you: would you entrust that money to Mr Nurkadilov on his assurance that you can rely on his signature? That is exactly the position [that] Mr Foushee and the three other members of the Investment Committee faced in June 2000. That is what they were looking at.

You have seen what they had to deal with and I am not going to say any more on the subject. (Transcripts of oral hearing, Day Four, pages 13–14).

<sup>107</sup> The further evidence of Mr Nurkadilov, that the US Ambassador Jones actually approved of his offer to give alternative land (Transcripts of the oral hearing, Day Two, page 154) appears to be directly contrary to the documentary

the oral hearing, Day One, pages 123–4) is relevant:

Q. But did anything happen between February and June to make you feel that, well, there is no point in going in for an alternative site? I mean, apart from the risk factor, which I appreciate, apart from that, I am just asking you, is there any overt act on anybody's part?

A. Well, in addition to the costs and the things I described...

Q. Yes, apart from that?

A. The thing that added to that concern during that time period was the mixed messages we got from the Government and there was a tremendous amount of confusion and mixed messages as to whether our land had been taken, was it not, what was the nature of the Government interference in our project, and what that did is lowered our confidence that contracts would be honoured and the quality of the investment environment.

Mr Scott Foushee was asked in his cross-examination as to what were the considerations relevant to Claimants' decision not to move to the alternate site. And he responded as follows:

The final consideration we had in our mind when we took this difficult decision was that the Government had taken what we viewed as a capricious action in just coming in one day and saying, "Sorry, this business you have built, it is no longer there. You have to go build a different business elsewhere."

When you accede to those requests, those demands, those demands keep coming, and the next thing you know, you have moved it, you are beginning construction and you get a call from a senior government minister who says, "You know, I need a house there and, by the way, it needs to be X hundred metres or X metres away from the next house" and those demands do not *quit*.

It was a combination of those factors which (said) [*sic*] showed the Government's action had killed the project for us, economically, the market and in terms of government interaction, and (we) said that we could not accept the alternate site and that we would seek to negotiate a settlement (emphasis added) (transcripts of the oral hearing, Day One, p. 57).

#### 10.6.5 Conclusion

In the Opinion of this Tribunal the offer of an alternative site – though "not unsuitable"<sup>108</sup> – cannot be urged as a valid defence to the Claimants' claim for compensation nor in mitigation thereof because:

- (1) There was no "obligation" on the part of the Claimants – either in contract or in principle or in law – to accept an alternative site in place of the agreed and allocated Project site; not only was the offer of an alternate site in breach of contract and wrongful; the taking itself was also wrongful and

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evidence placed on record and cannot be accepted.

<sup>108</sup> See the evidence of Boris Evseev, Country Director of AIG Silk Road Capital Management –

Q. What was your view of the alternative piece of land?

A. The alternative property was of a different configuration. I cannot say that it was materially inferior to the original plot of land that we had for the property, but our decision to terminate the project had little to do with the attributes of the alternative piece of land. The reason[s] to terminate the project were purely economic.

arbitrary i.e., not in accordance “with procedures established by (current) Kazakhstan legislation” as admitted in the [minutes] of the high powered Working Group (of September 5, 2000) and hence the alleged duty to mitigate damage under international law did not need to be exercised any further.

- (2) The project site was inextricably linked with the project itself (especially after all the necessary permits were duly applied for and obtained) and served as a principal pre-condition for the implementation of the investment project.
- (3) There was no “neglect” or “unreasonableness” on the part of the Claimants in not accepting the oral offer of an alternative site: its suitability was not the sole criteria for its acceptability; a substantial sum had already been expended for preparation towards construction at the Project site without any firm commitment on the part of the Respondent that the costs thrown away would be reimbursed.
- (4) In any case on a true interpretation of Article III(1) of the BIT, the legal consequences of expropriation (or measures tantamount to expropriation) of an investment had necessarily to be “compensation” in the shape of currency, not an offer of a mode of performance different from that already agreed.

#### 11. SUBSIDIARY POINT – CONCERNING MR TULBASSOV

11.1 One disquieting feature of this arbitration has been the non-appearance of Mr Serik Tulbassov (General Director of the Joint Venture – Claimant No. 2 and a principal in LLP Tema – which had a 34% share in the Joint Venture). Claimants apparently intended to call Mr Tulbassov as their witness and forwarded to the other side his Witness Statement. But on the very first day of the hearing in London, the Tribunal was informed by Counsel for the Claimants as follows:

We also had another witness who was not able to come to London today, Mr Serik Tulbassov, who was going to provide testimony as to the market situation in Kazakhstan. That goes to support the assumptions in the KPMG report. Mr Tulbassov is not able to be here so we had to get another witness.<sup>109</sup>

11.2 When the witnesses of the Claimants (Mr Scott Foushee and Mr Boris Evseev) were examined on the first day of the hearing in London, it was suggested to them by Counsel for the Respondent – based on certain documents then brought on record (Respondent’s Exhibits 11, 12 and 1.3)<sup>110</sup> that Mr Tulbassov had

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Transcripts of the oral hearing, Day One, pages 220-1.

<sup>109</sup> Transcripts of the oral hearing, Day One, page 5.

<sup>110</sup> Respondent Exhibit No. 11: Letter of Tulbassov to Nurkadilov Akim of Almaty Oblast dt. June 13, 2000 requesting permit to purchase the alternative site. Respondent Exhibit No. 12: Letter from Mr Scott Foushee to Mr Nurkadilov. Akim dt. June 12, 2000 rejecting the alternative site. Respondent Exhibit No. 13: Act of Determination of the Assessed Value of Land Parcel dt. September 8, 2000.

purchased the alternative site (which had been offered) for his own personal benefit; also that Mr Tulbassov had himself made a profit on the sale and re-sale of the Project Property through another entity (Talap LLP).

11.3 Later – also during the first day of hearing – the reason[s] why Mr Tulbassov could not be present in London were stated “off the record” to the Tribunal and to Counsel for the Respondent.<sup>111</sup> But then on the fourth day of the hearing in London, after all the oral evidence was concluded. Counsel for the Respondent addressed the Tribunal as follows:

This story, I believe, is relevant to another side-show. Why is Mr Tulbassov not here? You were given an explanation by counsel for Claimants. I suggest to you that that explanation is largely, if not wholly, a fabrication. I am not saying that counsel did not repeat to you what they were told by Mr Tulbassov. What I do say is that the reason Mr Tulbassov is not here is more likely than anything to have to do with the fact that he had made a profit himself on the sale and resale of the Project property in the first instance, and did not want to have to answer questions as to how and where that money went. He knew that he had bought the alternate site and he probably also believed that AIG did not know that, and he was not at all interested in coming before you, in the presence of AIG, to explain why he had bought the alternate site for his personal benefit without telling them.

We were very anxious to have Mr Tulbassov here as a witness. We had many questions to ask him and I have described some of them.

So the idea that the Government of Kazakhstan has intimidated Mr Tulbassov to the point where he was scared to come, I suggest, is a fabrication. We wanted him here.

We had no fear of his coming. AIG was going to be able to present its own case without him and Mr Tulbassov may or may not have been a vital witness from AIG’s point of view, but it is inconceivable that the Government would have leapt to the conclusion that if Tulbassov goes to London to testify, he is a bad boy. The fact is the only person who would have been embarrassed by Mr Tulbassov’s coming here was Mr Tulbassov himself.<sup>112</sup>

11.4 The response of Claimants’ counsel to the suggestion that Tulbassov deliberately absented himself from the hearings in London was as follows:

Mr Pietrowski: Finally, as to the fact that Mr Tulbassov could not be here today, I ask that this be kept off the record.

The Chairman: He has brought it on the record.

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<sup>111</sup> Transcripts of the oral hearing, Day One, page 79:

The Chairman: Where is Mr Tulbassov?

Mr Barnum: He is not coming.

The Chairman: No, but where is he?

Mr Cahn: I do think we need to address this issue.

Mr Pietrowski: Could we go off the record and we will explain why Mr Tulbassov is not here./ (Off the record at 11.58 a.m. and back on the record at 12.09 p.m.).

<sup>112</sup> Transcripts of the oral hearing, Day Four, page 73.

Mr Pietrowski: I know he has brought it on the record, so I just want the record to show Mr Tulbassov was intimidated and there is no evidence to the contrary. That is all I have (to say).<sup>113</sup>

From the oral assertions made by Counsel on either side it is not possible for the Tribunal to come to any firm conclusion as to why Mr Tulbassov did not travel to London to give oral testimony.

11.5 During the hearings in London it was sought to be made out on behalf of the Respondent: first, that Mr Tulbassov profited through Talap's purchase of the Project Property from the Oblast at a price of KZT 4,140,000 (approximately USD 50,000)<sup>114</sup> and by the resale of the project property by Talap to the Joint Venture at a price of USD 1.5 million; and second, he had also profited by the purchase by a firm called Tansu of the alternate site from the Oblast for a price of KZT 3,875,000 (approximately USD 40,000) and that he had effected a resale of it for an alleged but unspecified profit.<sup>115</sup> Apart from the fact that none of these allegations find any place in the Respondent's Counter-Memorial (filed on August 19, 2002) and were brought out for the first time at the hearings in London, the same are only relevant (if at all) to the concluding submission made by Counsel for the Respondent (and recorded in the proceedings).

Mr Barnum: Not at all. I was just going to say that if the Tribunal decides, for whatever reasons, to make an award in this case, it should remember that Mr Tulbassov has already made a profit of at least \$1 million, and probably closer to \$1,400,000...

The Chairman: Where is that evidence?

Mr Barnum: It is the subtraction of the price at which he sold the project land to the Project for 1.5 million.

The Chairman: Yes.

Mr Barnum: And the price at which he bought it for \$50,000. This is not an extraordinary event, I am sorry to say, in venture capital fund investments. We know, I believe – I know – that often someone putting together a venture capital fund will say, “We have a terrific project. We are going to invest in this project”, and you find out only later that, yes, it is a terrific project, they bought great land but they overpaid for it, and somewhere in the process of their acquiring that land somebody connected with the proponent of the venture capital had made a profit in selling the property to the investment.

If that is what happened here, whether there was some agreement between AIG and Tulbassov. “I am splitting the profit that was made by putting the property into the joint venture for 1.5 million”, if Mr Tulbassov pocketed the full difference, fine for Mr Tulbassov; if AIG participated in that, that was their business too. But when you come to award damages, I do not think that you can award Mr Tulbassov that 1.5 million again. He has already made that profit once.<sup>116</sup>

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<sup>113</sup> Transcripts of the oral hearing, Day Four, pages 113–14.

<sup>114</sup> Respondent's Exhibit 4 – Transcripts of the oral hearing, Day One, page 75.

<sup>115</sup> Respondent's Exhibit 13 – Transcripts of the oral hearing, Day One, pages 74–5 and Day Four, page 72.

<sup>116</sup> Transcripts of the oral hearing, Day Four, pages 71–2.

11.6 In his closing arguments Counsel of the Claimants responded to these submissions – as follows (also part of the record of proceedings):

Mr Cahn: Mr Barnum also stated this morning that 34% of the properties of the Project would flow through to Mr Tulbassov and Tema Real Estate. Mr Barnum apparently did not look at the deal documents which appear in Claimants’ Exhibit 90. They show very clearly that Mr Tulbassov and Tema get virtually nothing from this Project until AIG and its investors have recovered approximately \$8 million. It is only after then, with respect to the balance, that they participate in the profits.

Mr Cahn: If you look at the deal documents. Exhibit 90, what you will see is that Mr Tulbassov, or Tema, is not entitled to any return on money until after AIG receives a 30% rate of return, OK. There is some small cash flow distributions which will go to him as a result of financing, but really quite limited and certainly it would not be applicable here. So until, in fact, there is a 30% rate of return hit, an annual rate of return which is hit, none of those profits would he be entitled to share.<sup>117</sup>

The Tribunal is of the opinion that the latter submission is a correct one.

11.7 The Investment Agreement (Claimants’ Exhibit No. 90) dated April 10, 1999 – the Joint Venture Agreement between AIG and Tema to construct a residential compound and to sell and lease housing units as described in the Project Implementation Summary attached to the Agreement – shows quite clearly that AIG had an obligation to fund the entire cost of the project (then estimated at over USD 10 million) and that the ownership interests or shares in the Joint Venture (Claimant No. 2) was to be AIG 66 per cent and Tema 34 per cent (Tulbassov owned 50 per cent of Tema); but Tema was not to receive any dividend on its shares until AIG received an internal rate of return of 30 per cent (Article III Clause 3.8 read with Article V Clause 5.3).<sup>118</sup> If the Crystal Air Project had generated cash flows as anticipated and once the Claimants had exited the project at the end of the fifth year Tema would have begun to share in the cash flows to the extent of its Joint Venture interest (34 per cent) after the fund had earned a 30 per cent internal rate of return: in which latter event Mr Tulbassov would have received 50 per cent of Tema’s share.

Accordingly, in the opinion of this Tribunal the conduct of Tulbassov or LLP Tema in allegedly making a profit from the land transactions has no relevance to the Claim in the present proceedings or award to be made in respect thereof – so long as it is not established that AIG had any connection or role in these

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<sup>117</sup> Transcripts of the oral hearing, Day Four, pages 113 and 119.

<sup>118</sup> Claimants’ Exhibit No. 142 (Assignment Agreement dated September 27, 2002 between CJSC Tema Real Estate Company and AIG Silk Road Fund Ltd, and Assignment Agreement between AIG Capital Partners and AIG Silk Road Fund Ltd), and Claimants’ Exhibit No. 143 (Waiver dated September 26, 2002 between LLP Tema [and] AIG Silk Road Fund Ltd) were filed after the London hearings. In these documents the Joint Venture (Claimant No. 2) has irrevocably and unconditionally as of September 27, 2002, assigned and transferred to the Fund all right, interest (and title) to the proceeds of monetary or any other form of compensation from any award resulting from ICSID Case No. ARB/01/06 (i.e., the present case) and LLP Tema have also waived and relinquished their rights to all proceeds from any award to be made by the Arbitral Tribunal including rights, titles and interests from payments of any stock or distribution of funds available from the proceeds of any such award. But this ex post facto documentation has been

transactions: and this has not been established.

11.8 The document relied upon by the Respondent in support of the allegation that Tulbassov wrongly profited from the sale of the project property to Talap and its resale from Talap to Tema, is a letter dated July 28, 1998 (Respondent's Exhibit 2 – attached to the Claimants' Counter-Memorial). By this letter one Yuri Nosof, Director of Talap Construction Company LLP, sought permission of the Akim of Almaty to sell ten hectares of land (which later became the Project Property) for the construction of a Housing Estate: there is no mention in this letter either of Tulbassov or of AIG. Mr Scott Foushee, Managing Director of Claimant No. 1 and Director of Claimant No. 2, was asked in evidence about the origin of the Crystal Air Village and he deposed as follows:

Q. Can you tell us about the Crystal Air Project which came to be known as the project that the joint venture was launching?

A. Crystal Air, as I mentioned, was designed to be a very prestigious high-end *gated* residential community that sought to provide its residents with not only residence of very high quality international construction, but reliable utilities and a high level of security, all elements that were unavailable at the time in the Almaty Housing market.

Q. Where did this idea come from?

A. The idea was originally brought to US by Serik Tulbassov who later became our Partner, who had seen this market opportunity and was developing a business plan around it.<sup>119</sup>

Mr Foushee was then asked how this site was selected and the relevant evidence reads as follows:<sup>120</sup>

Q. How did you select this site? Was there a process you went through?

A. There was, Our Partner, Mr Tulbassov, scouted the various available plots at the time and he presented four land plots to us for evaluation.

The Chairman: Showed four?

A. Yes, which were viewed by AIG Capital Management staff and by myself and by Dr John Doede who was the Chairman of the fund. The site that we ended up selecting was viewed as the superior site on just about every dimension, and we selected this out of the four.

Mr Cahn: How much did the joint venture pay for this property?

A. We paid \$1.5 million for this property.

Q. How did you reach the conclusion that this was the value that you were to pay?

A. That was, essentially, a market valuation. That represented, based on our comparable research, what land was going for in this very prestigious area close to the city. Land comparables in Kazakhstan are very hard to obtain, but the ones that we were able to identify showed pricing anywhere from \$13 to \$16 per metre and we ended up purchasing this land for \$15.

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ignored by the Tribunal in these proceedings.

<sup>119</sup> Transcripts of the oral hearing, Day One, pages 25–6.

<sup>120</sup> Transcripts of the oral hearing, Day One, pages 33–5.



The price we paid for this was also within the range of the pricing for the other three [sites] that Mr Tulbassov showed. As a footnote, all land south of Alfarabi Avenue, which is effectively one of the borders of our property, is considered very prestigious as it is on the mountain side, as you can see here.

Q. Who was the seller of this property?

A. The seller was LLP Talap.

Q. Is there a time when you came to understand that Talap, although they had asked for this price, did not own this property?

A. There was, and that was in December 1998. As we were selecting the site and reviewing the alternatives, it was represented to us that Talap owned the land, and it was only in December, I believe it was a week before we actually closed, so it would have been December 11, when we asked for a copy of Talap's contract under which they had purchased the land which we got, a document which showed that they only had an option at that time and they had not fully closed their transaction.

Tribunal: Who is Talap?

A. Talap is the entity from who we purchased the land.

The Chairman: "Entity" meaning a government entity, a private entity?

A. No, it is a private company.

Mr Cahn: Do you know what business Talap was in?

A. It was represented to us that they were a real estate company, and nothing more.

Q. Can you tell us the way in which this land was purchased from Talap, the process that you went through?

A. The land was purchased by our partners, Tema, under a bridge loan provided by us of \$1.4 million. Tema funded the additional 100,000 and it was purchased by Tema because the joint venture was not set up yet, and all the joint venture documents were not finalised, but the bridge loan agreement that we negotiated with them was a very tight one and one in which we had additional collateral on top of the land plot itself.

Mr Tulbassov's Business Plan which is on record (Claimants' Exhibit No. 133) is of the year 1998 and it appears that he approached AIG some time in August 1998 and the site that was selected as the project site was in September 1998.<sup>121</sup>

11.9 During the London hearings, Counsel for the Claimants requested the Respondent to produce Constitutive Documents relating to Talap – but they were not produced.<sup>122</sup> After the conclusion of the hearings in London, in order to disprove the suggestion that Tulbassov was involved in the ownership, organization or management of Talap, the Claimants wrote a letter dated October 7, 2002 (Claimants'

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<sup>121</sup> Claimants' Memorial at page 16 – Mr Scott Foushee states in his evidence (Transcripts of the oral hearing, Day One, page 28) that Mr Tulbassov and his partner Serzhan Zhumashev were broadly recognized as the most competent real estate developers in Kazakhstan when they brought [the] business plan to them.

Exhibit 137), requesting the Department of Justice of Almaty City to provide them with a copy of the Charter of the LLP Talap as well as copies of any documents which the Department of Justice could provide regarding the legal status of the partnership, composition of its founder partners, as well as the changes in the composition of the partnership participation. These documents were furnished by the Department of Justice by its letter dated October 11, 2002. The genuineness of these documents [has] not been disputed by the Respondent. The LLP Foundation documents (Claimants' Exhibits Nos. 135 and 136) do not show that Tulbassov was involved in the ownership, organization or management of Talap – there are various names of participants in Talap, and Tulbassov is not one of them.<sup>123</sup>

11.10 In support of its allegations that Tulbassov profited from the purchase of the substitute (alternative) site by a firm with the name of "Tansu", the Respondent put in evidence the following:

- (i) a letter written by Mr Tulbassov stating that AIG is "a main investment partner" and asking permission for his company Tansu to purchase the substitute site;<sup>124</sup>
- (ii) a sales agreement which purports to show that Tansu paid \$40,000 for the substitute site;<sup>125</sup> and
- (iii) sales contracts which show that Tansu sold 6.52 hectares (54 per cent) of the substitute site for KZT 3,616,634 or approximately \$23,000.

11.11 The letter dated June 13, 2000 written by Tulbassov was shown to the witness Boris Evseev (on behalf of the Plaintiffs) and he denied that either he or Claimant No. 2 had authorized Tulbassov to refer to Tansu as a partner.<sup>126</sup> Mr Scott Foushee, when shown Claimants' Exhibit No. 11 – letter dated June 13, 2000 – deposed that neither AIG nor any of its affiliates had any relationship with Tansu and stated that he was prepared to provide a certification letter to that effect.<sup>127</sup>

11.12 The Claimants then filed various documents (Claimants' Exhibit Nos. 102, 122 and 124) to refute the contention of the Respondent regarding Tansu – Exhibit 102 is a faxed letter from Mr Tulbassov stating that Tansu did not and does not have any relationship with AIG Silk Road Capital Management and AIG or any other affiliated companies or employees of AIG: but since it is not satisfactorily established as to why Tulbassov was not present or could not be present at the London hearings as a witness, the Tribunal has

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<sup>122</sup> Transcripts of the oral hearing, Day Four, page 110.

<sup>123</sup> When Talap purchased the Project Property from the Oblast and resold it to LLP Tema the General Director of Talap was Yuri Nosof (Claimants' Exhibit Nos. 16 and 18).

<sup>124</sup> Respondent's Exhibit 11 (letter dated June 13, 2000).

<sup>125</sup> Transcripts of the oral hearing, Day 4, page 69.

<sup>126</sup> Transcripts of the oral hearing, Day One, pages 217 –18.

chosen to ignore this self-serving letter from him. However Claimants' Exhibit Nos. 123 and 124 are certifications of AIG Capital Partners Inc., certifying that neither AIG Silk Road Management nor any other affiliates of American International Group or their representatives has any ownership or interest [or] beneficial relationship with Tansu [which] are relevant. These documents were taken on record and after copies had been supplied to the other side, Respondent's Counsel in the course of arguments accepted the position that Tulbassov was "not acting with AIG".<sup>128</sup>

11.13 Since the refusal to accept the substituted site is in the opinion of the Tribunal irrelevant and cannot be taken into account in mitigation of damages, the circumstances under which the alternate site was taken or purchased are also irrelevant – so long as it is clear that those who funded the Project (and who were obliged to fund the Project) had no interest in nor [were] concerned with that alternate site.

The Tribunal finds no evidence (documentary or oral) to suggest that AIG or its subsidiaries had any interest whatever in the alternate site or were at all concerned with the activity carried on at the alternate site (substitute site).

## 12. REMEDIES – COMPENSATION, INTEREST, COSTS

### 12.1 *Jurisdiction to Determine Compensation*

Having regard to the Tribunal's finding (in para. 10.3.3 above) that the investment of the Claimants was expropriated indirectly through measures tantamount to expropriation, the question that must now be addressed is as to remedies.

First, as to compensation. It is settled law that where a Court or a Tribunal has jurisdiction to determine a dispute, it also has jurisdiction to determine reparation or compensation.<sup>129</sup>

#### 12.1.1 *Compensation*

##### *International Law and Principles derived from International Law and Arbitral Practice*

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<sup>127</sup> Transcripts of the oral hearing, Day Two, pages 4-5.

<sup>128</sup> The entire part of Respondent's counsel's statement reads: "We have no reason to believe or disbelieve that he was or [was] not acting with AIG. I accept the representations of AIG that he was not, but the fact is Mr Tulbassov saw there was an opportunity to acquire a piece of land that the Oblast was clearly disposed to sell for development of housing. Undoubtedly, he did not tell AIG that he was going to buy it if they did not, but he did buy it." – Transcripts of the oral hearing, Day Four, page 67.

<sup>129</sup> See *[Military] and Paramilitary Activities Case*, ICJ Reports (1986) at page 146.

State responsibility for breach of a treaty obligation depends upon the precise terms of the treaty provision alleged to have been infringed, which raises a question of construction of the words used: if the treaty provision is breached, responsibility follows.<sup>130</sup>

In the 1928 judgment of the Permanent Court of International Justice in the *Chorzów Factory Case* – a decision traditionally resorted to as a source of wisdom on the legal remedy for a taking<sup>131</sup> of property – it was held to be a “principle of International Law, and even a general conception of law, that any breach of an engagement involves an obligation to make reparation”: and that reparation must so far as possible wipe out the consequences of the illegal act and re-establish the situation that would have existed had the illegality not occurred.<sup>132</sup> The case arose from the seizure by Poland of a factory controlled by German nationals in Upper Silesia. The Polish Government had no right of expropriation under the German–Polish Convention of May 15, 1922, whereunder property could not be expropriated even against payment of compensation; the seizure was held to be an “international wrong”, hence “unlawful”; therefore “reparation” or “restitution in kind”. This is the context in which the following oft-quoted passage (from the judgment in the *Chorzów Factory Case*) must be read:

The essential principle contained in the actual notion of an illegal act – a principle which seems to be established by international practice and in particular by the decisions of arbitral tribunals – is that reparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed. Restitution in kind, or, if this is not possible, payment of a sum corresponding to the value which a restitution in kind would bear; the award, if need be, of damages for loss sustained which would not be covered by restitution in kind or payment in place of it – such are the principles which should serve to determine the amount of compensation due for an act contrary to international law.

This conclusion particularly applies as regards the Geneva Convention, the object of which is to provide for the maintenance of economic life in Upper Silesia on the basis of respect for the status quo. The dispossession of an industrial undertaking – the expropriation of which is prohibited by the Geneva Convention – then involves the obligation to restore the undertaking and, if this be not possible, to pay its value at the time of the indemnification, which value is designed to take the place of restitution which has become impossible. To this obligation, in virtue of the general principles of international law, must be added that of compensating loss, sustained as the result of the seizure. The impossibility, on which the Parties are agreed, of restoring the *Chorzów* factory could therefore have no other effect but that of substituting payment of the value of the undertaking for restitution: it would not be in conformity either with the principles of law or with the wish of the Parties to infer from that agreement that the question of compensation must henceforth be dealt with as though an expropriation properly so called was involved. (Pages 47–8.)

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<sup>130</sup> Starke’s International Law 11th Edition 1994 page 269.

<sup>131</sup> The word “taking” is wider than “espropriazione” (or expropriation): a “taking” is generally recognized as including not merely an outright expropriation of property but also unreasonable interference with its use, enjoyment or disposal. (See *Case Concerning Elettronica Sicula – USA v. Italy*) – Judgement of the ICJ dated 20.7.1989 at p. 68.

<sup>132</sup> *Case concerning the Factory at Chorzów* Judgment No. 13 (September 1928) – PCI.I – Ser A. No. 17 – page 29.

This authoritative exposition of the measure of damages in international law was rendered at a time when the taking by the State of private property of aliens was regarded in international law as a clear basis for an international claim for restitution.<sup>133</sup>

But after the end of the Second World War, with ever-increasing control by Nation States over their own national economy and over major aspects of private enterprise, it became impossible to treat as necessarily contrary to international law an “expropriation” or taking of foreign private property. A series of UN General Assembly Resolutions confirmed the rights of States to manage their own national resources subject to payment of appropriate compensation. In Resolution 1803 (XVII) 1962, the UN General Assembly declared that:

Nationalisation, expropriation or requisitioning shall be based on grounds or reasons of public utility, security or the national interest which are recognised as overriding purely individual or private interests, both domestic and foreign. In such cases the owner shall be paid appropriate compensation in accordance with the rules in force in the state taking such measures in the exercise of its sovereignty and in accordance with international law...

An alien whose property was taken by the host State had no longer any claim to reparation or restitution in kind, in the absence of special requirements under Treaty or Municipal Law: the nature of the wrong done was not the taking itself, but the failure to pay for the property taken at whatever standard of compensation was appropriate under the circumstances.<sup>134</sup>

There is considerable unanimity in arbitral practice and scholarly opinion that UN Resolution 1803 reflects the current slate of customary international law.<sup>135</sup> what is lacking is however the precision as to the amount required to be paid. There is no universally-accepted word, phrase or concept that describes the standard of “appropriate compensation” due under international law.

The vocabulary in which the standard of compensation has been expressed differs from treaty to treaty: “prompt, adequate and effective” is the expression used in most bilateral treaties to which the USA is a

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<sup>133</sup> For an insightful modern analysis of the *Chorzów Factory Case* see the observations of Judge Brower in *Amoco International Finance Corporation v. Iran*: (1987) 15 Iran–US Claims Tribunal Reports page 189 at pages 300–1.

<sup>134</sup> It is now accepted that, subject to any international engagements to the contrary, expropriation of alien property is not in itself contrary to international law, provided that certain conditions are met; including payment of “appropriate compensation” (which is no different from “full compensation”). Article 31 of the Draft Articles on Responsibility of States for Internationally Wrongful Acts prepared by the International Law Commission – and which were adopted by the UN General Assembly Resolution 56/83 on December 12, 2001 sets forth as a general rule that the responsible State is under an obligation to make full reparation for any injury caused by the internationally wrongful act.

<sup>135</sup> The standard set in Resolution 1803 came to represent “*opinio juris communis*” according to Professor Dupuy: see award in *Texaco Overseas Petroleum Co. v. Government of the Libyan Arab Republic* – 17 ILM 329 (1978), 53 ILR 389 (1979).

party;<sup>136</sup> like words, such as “equivalent”, “fair”, “just”, “reasonable” and “genuine”, are also used in other international instruments. But “the battle of the rhetoric on compensation standards”<sup>137</sup> is not won or lost in the choice of words or phrases used: but in the comprehension of their true meaning. Despite the diversity of vague and indefinite terms, there is a growing agreement on a standard of compensation that more closely approximates to a “fair market value” (or its equivalent) of the property taken. “Fair market value” is the method most generally used to determine the capital value of property taken and this is what is mandated in Article III(1) of the BIT.

But “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”. If the investment occurs under the protection of a bilateral treaty, there is the expectation that the compensation standard would be such that would reduce the real risks that foreign investors are concerned to forestall;<sup>138</sup> foreign investors expect to be compensated for the opportunities that they would be denied by deprivative action of the State. Accordingly, if foreign investment is to be encouraged (which is the avowed object of all bilateral investment treaties), the compensation-standard must be such as to ensure that investors receive at least the present value to them of the expected future earnings that they would derive from their investment.

The standard for compensation adopted in cases of expropriation of investments and enterprises has been the restoration of the Claimant to the position it would have enjoyed but for the taking: this has now ripened into and has been recognized as a principle of customary international law.<sup>139</sup> It has been reiterated in many of the more recent awards by international tribunals.<sup>140</sup> It is also a standard reflected in

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<sup>136</sup> Based on the classic Hull doctrine, Secretary of State Cordell Hull’s famous letter to the Mexican Government in 1938, demanding “prompt, adequate and effective” compensation for the expropriation of a US national’s property. See R. Dolzer, *New Foundations of the Law of Expropriation of Alien Property*, 45 *Am. J. Int’l L.* 553, 558 (1981).

<sup>137</sup> So described by Professor Rosalyn Higgins (later to be Judge of the International Court of Justice) in her 1982 Hague Academy Lectures: *Taking of Property by the State: Recent Developments in International Law*, Vol. 1976 *Recueil des Cours* 1982 p. 267 at p. 294.

<sup>138</sup> It has been pointed out by the International Court of Justice in the *Barcelona Traction Case* ICJ (1970) – page 3 (at para. 87 of the judgment) – that the investment-receiving State, though not an insurer of the investment made, is bound to extend some protection in law to the investment.

<sup>139</sup> See the Award of Damages (dated June 30, 1990) of the Arbitration Tribunal consisting of Judge Schwebel, President, Mr Wallace and Mr Leigh, Arbitrators, in the UNCITRAL Arbitration *Biloune v. Ghana Investment Centre*, Vol. 95 *ILR* 183 at page 228.

<sup>140</sup> See for instance *Texaco Overseas Petroleum v. Libya (“TOPCO”)*, 53 *ILR* 389 (1977); *Sedro Inc. v. The National*

innumerable bilateral investment treaties.

12.1.2 But the modes or methods in which appropriate compensation (or fair market value) is arrived at for expropriated investments and property do not follow any uniform pattern. They consist of varied schemes adapted to suit the circumstances of the case at hand, and are seldom referable to any common guiding principle – “If one wants to know what the law is, one should look at real life”, is the homely advice given in the Foreword to a collection of articles – in four volumes – by academics headed “The Valuation of Nationalised Property in International Law”!<sup>141</sup> Each of the essays in these four volumes make plain that general principles, whilst affording general guidance, offer little else: “the actual issues in real life are too complex, the cases to be decided and the precedents of decision, too disparate and unique for easy, simple principles”, (sic)

That “precedents of decision” are “disparate” is obvious on a cursory glance at arbitral jurisprudence. For instance:

- In one of the Iran–US Tribunal cases (in 1963) the measure of damages for breach of a Concession Agreement for oil exploration between a State Corporation and a foreign company was taken to be the “loss suffered” (*damnum emergens*): e.g. the expenses incurred in performing the contract; and “lost profit” (*lucrum cessans*), e.g. the net profit which the contract would have produced; but as the amount of compensation could not be “established exactly”, the Arbitrator (Swiss Federal Judge Cavin) held that his task was “to decide *ex aequo et bono*” by considering “all the circumstances”. Five million US dollars was claimed for loss of profit, and the arbitrator concluded that “it is reasonable and equitable to fix the amount of compensation for loss of profit at USD 2 million”.<sup>142</sup>
- In another case<sup>143</sup> (1983) the claim arose out of the nationalization of the Iran America International Insurance Company (“Iran–America”) by the Government of Iran in 1979. The claimants maintained that Iran–America should be valued as a going concern including such elements as goodwill and likely future profitability, and the respondent Government contended that the assessment should be made exclusively on the basis of the net book value or break-up value of the company. The Arbitral Tribunal (Chamber Three: Judge Mangård, Mr Mosk and Mr Moin) took a different path. It held that the appropriate method was to value the company as a “going concern”, but since the company had

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*Iranian Oil Co.*, 84 ILR 483 (1986) and separate opinion of Judge Brower; and the award in *Amoco International Finance Corp. v. Islamic Republic of Iran* (“*Khemco*”), 83 ILR 500 (1987).

<sup>141</sup> Volumes 1 to 4 published in different years from 1972 to 1987 by the University Press of Virginia, Charlottesville; Editor Mr Richard Lillich.

<sup>142</sup> *Sapphire International Petroleum Ltd v. National Iranian Oil Company* – Arbitral Award dated March 15, 1963 of Sole Arbitrator M. P. Cavin, Federal Judge, Lausanne, Switzerland (ILR Vol. 35, page 136(1963)).

<sup>143</sup> *American International Group, Inc. v. The Islamic Republic of Iran* (Chamber Three: Mangard, Mosk and Moin: award dated December 19, 1983) 4 Iran–US CTR 96 (1985).

been conducting its business for little more than four and a half years it also held that “such a short period must be deemed to provide an insufficient basis for projecting future profits”. It said that the fair market value of Iran–America at the date of nationalization was “significantly less than even the lowest figure arrived at by the experts of the Claimants”. The Tribunal then concluded as follows:

The next issue to be considered is therefore what conclusions can be drawn from the evidence before the Tribunal concerning the going concern or fair market value of Claimants’ interest in Iran America.

From what has been stated above, it might be possible to draw some conclusions regarding the higher and the lower limits of range within which the value of the company could reasonably be assumed to lie. But the limits are widely apart. In order to determine the value within those limits, to which value the compensation should be related, the Tribunal will therefore have to make an approximation of that value, taking into account all relevant circumstances in the case.

The claimants had assessed the value of Iran–America as a “going concern” on the date of nationalization at USD 111.4 million, and in accordance with their 35% interest (in Iran–America) claimed compensation in the sum of USD 39.01 million. But the Tribunal fixed the value of all the shares for which the claimants should be compensated at only USD 10 million, making “an approximation of that value” between the “higher and the lower limits of the range”.

- And in yet another case<sup>144</sup> decided two years later (1985) (Iran–US Tribunal: Chamber One: Judge Lagergren, Mr Ameli and Judge Holtzmann) it was held that the words “full equivalent” of the property taken in the applicable Treaty of Amity<sup>145</sup> entitled the Claimant to be granted compensation equal to the fair market value of its shares in the nationalized concern assessed as at the date of nationalization – but concerning levels of compensation in the field of nationalization, separate opinions were written. Swedish Judge Lagergren wrote that in a case of lawful large scale nationalization in a State undergoing a process of radical economical restructuring the “fair market value” standard needed to be discounted, taking into account “all circumstances” – such discounting of course, could never be such as to bring the compensation below a point which would lead to unjust enrichment of the expropriating State: the discounting being greater in a situation where the investor had enjoyed the profits of its capital outlay over a long period of time, but less or none in the case of a recent investment. On the other hand, the American Judge Howard Holtzmann, differing from the views expressed by Judge Lagergren about a “discounted” compensation standard, wrote (in

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<sup>144</sup> *INA Corporation v. The Government of the Islamic Republic of Iran* (Chamber One: Lagergren, Ameli and Holtzmann – Award dated August 12, 1985) 8 Iran–US CTR 373 (1985).

<sup>145</sup> Article IV paragraph 2 of the Treaty of Amity reads:

Property of nationals and companies of either High Contracting Party, including interests in property, shall receive the most constant protection and security within the territories of the other High Contracting Party, in no case less than that required by international law. Such property shall not be taken except for a public purpose, nor shall it be taken without the prompt payment of just compensation. Such compensation shall be in an effectively realizable form and shall represent the full equivalent of the property taken: and adequate provision shall have been made at or prior



his separate opinion): “justice demands, as it always has, that a party who has been deprived of his property should be made whole: and in an economically interdependent world the law should encourage investment, not discourage it by increasing its risks”.

### 12.1.3 *Standard of Compensation*

Although there is much disagreement as to the appropriate standard of compensation, customary international law has consistently recognized that the expropriation of a foreign investor’s property, including contract rights, must be accompanied by “compensation” – the traditional standard being that such compensation be adequate in amount, be paid promptly, and be effective in the manner and form of its payment to recompense the owner for the loss of the property or investment: each element of this standard allows a considerable margin of appreciation in the light of the circumstances of the case. It is nevertheless an open question whether those elements constitute a separate and necessary part of the standard of compensation required by international law, or whether they are merely considerations to be taken into account (perhaps along with others) in assessing whether compensation satisfies some much broader standard as that it be “just”, “equitable”, or “appropriate”.<sup>146</sup>

In the Preface to the first volume of “The Valuation of Nationalised Property in International Law” (published in the year 1972), the editor (Mr Richard B. Lillich) had warned that “future settlement of many of the difficult problems raised by takings of property in the modern world must be solved eventually by working out agreed methods of valuation of the property”. But even when the fourth volume of the series was published in the year 1987, it became apparent on a reading of the essays and articles contained in it, that “agreement as to methods of valuation” had still not been reached: perhaps one must hark back to an earlier formulation: that a determination of the amount of “appropriate” compensation is best arrived at “by means of an enquiry into all the circumstances relevant to the particular concrete case than through abstract theoretical discussion”.<sup>147</sup>

### 12.1.4 *World Bank Guidelines*

But the quest for agreement as to “methods of valuation” is an ever ongoing one. Writing in the early 1980s Dr Rudolf Dolzer (of the University of Heidelberg)<sup>148</sup> stressed the need from a conceptual point of

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to the time of taking for the determination and payment thereof.

<sup>146</sup> Oppenheim’s International Law Vol. I – 9th Edition pages 920–1.

<sup>147</sup> So stated in the Award dated March 24, 1982 by the Arbitral Tribunal (consisting of Mr Reuter, President and Mr Hameed Sultan and Sir Gerald Fitzmaurice, Members) in *Government of Kuwait v. American Independent Oil Co.* (1982) ILR 66, pages 518, 602 (para. 144).

<sup>148</sup> “New Foundations of the Law of Expropriations of Aliens Property” by Rudolf Dolzer – printed in Vol. 75 – American Journal of International Law (1981) page 553 at page 573.

view of what he described as “the missing link”: a set of standards derived from criteria that would directly or indirectly guide present practice and opinions. In the early nineties this “missing link” was helpfully provided by the efforts of International Financial Institutions.

In April 1991, a Joint Ministerial Committee (known as the Development Committee) of the Boards of Governors of the International Monetary Fund and the World Bank requested the Multilateral Investment Guarantee Agency (MIGA) to prepare a “legal framework” to promote foreign direct investment. Realizing that this was a matter of interest to all World Bank Group institutions, the President of these institutions assigned the project to a small working group consisting of their respective General Counsel.

The approach followed by this Task Force was described in a Progress Report submitted to the April 1992 meeting of the Development Committee and published in Volume I of the Legal Framework for the Treatment of Foreign Investment. The Report explained that the World Bank Group could not issue binding rules to govern the conduct of member States in this or other fields. A draft convention could of course have been prepared and opened for signature by interested countries, but the working group found it more advisable at that stage to prepare a set of guidelines embodying commendable approaches which would not be legally binding as such, but which could greatly influence the development of international law in this area in view of their preparation by organizations of universal membership after broad consultations, and their eventual issuance by no less an authority than the Development Committee.

First drafts of the guidelines and of their accompanying explanatory report were circulated to the Executive Directors of the World Bank, IFC and MIGA in May 1992. Extensive consultations followed with the Executive Directors, as well as with other representatives of interested member countries, intergovernmental organizations, business groups and international legal associations. In the consultations, it became clear that certain clarifications and modifications were necessary or desirable. These were incorporated into the text but did not fundamentally change its basic balance.

The resulting Guidelines cover each of the four main areas usually dealt with in investment treaties, namely the admission, treatment, and expropriation of foreign investments and the settlement of disputes between governments and foreign investors. Although they are based on general trends distilled from detailed surveys of existing legal instruments (published in Volume I of the Legal Framework for the Treatment of Foreign Investment), the guidelines are formulated in such a manner as also to incorporate policies that the World Bank Group institutions have been advocating in recent years. This approach, aimed at progressively developing, rather than merely codifying, applicable rules in the field, has made possible the formulation of progressive standards which are open, fair and consistent both with emerging rules of customary international law and with commendable practices identified by the World Bank Group.

The guidelines and accompanying report were submitted to the Development Committee for consideration at its September 1992 meeting. The Committee reviewed the Guidelines and called them to the attention of member countries. In so doing, the Committee noted, in the words of the communiqué of its meeting, that the guidelines should “serve as an important step in the progressive development of international practice in this area”.

The Guidelines on the Treatment of Foreign Direct Investment – first published in 1992 – popularly known as “the World Bank Guidelines”, encapsulate what are described as “essential principles meant to promote foreign direct investment”. They set out generally acceptable international standards, and complement provisions made in Bilateral Investment Treaties.<sup>149</sup>

Part IV of the World Bank Guidelines (Expropriation and Unilateral Alteration or Termination of Contracts) sets out some useful criteria for determining “fair market value” in the facts and circumstances of a particular case. Sections 4, 5 and 6 in Part IV read as follows:

4. Determination of the “fair market value” will be acceptable if conducted according to a method agreed by the State and the foreign investor (hereinafter referred to as the parties) or by a tribunal or another body designated by the parties.

5. In the absence of a determination agreed by, or based on the agreement of, the parties, the fair market value will be acceptable if determined by the State according to reasonable criteria related to the market value of the investment, i.e., in an amount that a willing buyer would normally pay to a willing seller after taking into account the nature of the investment, the circumstances in which it would operate in the future and its specific characteristics, including the period in which it has been in existence, the proportion of tangible assets in the total investment and other relevant factors pertinent to the specific circumstances of each case.

6. Without implying the exclusive validity of a single standard for the fairness by which compensation is to be determined 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*;
- (ii) for an enterprise which, not being a proven going concern, demonstrates lack of profitability, on the basis of the *liquidation value*;
- (iii) for other assets, on the basis of (a) the replacement value or (b) the *book value* in case such value has been recently assessed or has been determined as of the date of the taking and can therefore be deemed to represent a reasonable *replacement value*.<sup>150</sup> (emphases added)

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<sup>149</sup> The World Bank Guidelines have been noted in the recent UN Report of the International Law Commission, 53rd Session (2001) – at page 255 in the commentary under Article 36.

In August 2001 the International Law Commission adopted draft Articles on Responsibility of States for internationally wrongful acts and on December 12, 2001, the United Nations General Assembly adopted Resolution 56/83 which commended the Articles to the attention of Governments “without prejudice of their future adoption”.

<sup>150</sup> Each of the [italicized] expressions [is] also defined in the purposes of greater clarity. For the above purposes:

It is important to note that to arrive at a “fair market value” of the property taken the measure of compensation (under Section 6 of the Guidelines) is made to depend not necessarily upon whether the expropriation is lawful or unlawful;<sup>151</sup> but upon the actual investment or stage at which the enterprise has progressed – if it is “a going concern with a proven record of profitability” it is to be valued on a discounted cash flow basis (the DCF method): which would then reflect its fair market value. On the other hand if the investment or enterprise at the time of its taking is not a proven “going concern”, and demonstrates lack of proof of profitability, the basis of compensation to arrive at a fair market value is different: perhaps more appropriately its “liquidation value” (the Asset Valuation Method). But this again is only illustrative: as is emphasized in the opening words of Section 6: “without implying the exclusive validity of a single standard for the fairness by which compensation is to be determined ...”.

In the Report to the Development Committee on the legal framework for the treatment of foreign direct investment (para. 42) it is stated:

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- 1) “going concern” means 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;
  - 2) “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. Such discount rate may be measured by examining the rate of return available in the same market on alternative investments of comparable risk on the basis of their present value;
  - 3) “liquidation value” means the amounts at which individual assets comprising the enterprise or the entire assets of the enterprise could be sold under conditions of liquidation to a willing buyer less any liabilities which the enterprise has to meet;
  - 4) “replacement value” means the cash amount required to replace the individual assets of the enterprise in their actual state as of the date of the taking; and
  - 5) “book value” has been defined as the difference between the enterprise’s assets and liabilities as recorded on its financial statements or the amount at which the taken tangible assets appear on the balance sheet of the enterprise, representing their cost after deducting accumulated depreciation in accordance with generally accepted accounting principles.

<sup>151</sup> Controversy has persisted in relation to expropriation cases, particularly over standards of compensation applicable in light of the distinction between lawful expropriation of property by the State on the one hand, and unlawful takings on the other, a distinction clearly drawn by the Permanent Court in *Factory at Chorzów*, Merits, 1928, PCIJ, Series A, No. 17 page 47. In a number of cases tribunals have employed the distinction [to] rule in favour of compensation for lost profits in cases of unlawful takings (see e.g. the observations of the arbitrator in *Libyan American Oil Company (LLAMCO) v. Government of Libya* (1982) ILR vol. 62, p. 141 at pp. 202–3; and also the *Aminoil* arbitration: *Government of Kuwait v. American Independent Oil Company* (1982) ILR vol. 66, p. 529, at p. 600, para. 138; and *Amoco International Finance Corporation v. Government of Islamic Republic of Iran* (1987) 15 Iran–US CTR 189, at page 246, para. 192). Not all cases, however, have drawn a distinction between the applicable compensation principles based on the lawfulness or unlawfulness of the taking. See, e.g., the decision of the Iran–United States Tribunal in *Phillips Petroleum Co. Iran v. Government of the Islamic Republic of Iran* (1989) 21 Iran–US CTR 79, at page 122, para. 110. See also *Starrett Housing Corp. v. Government of Islamic Republic of Iran* (1987) 16 Iran–US CTR 79, where the Tribunal made no distinction in terms of the lawfulness of the taking and its award included compensation for lost profits.

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.<sup>152</sup>

#### 12.1.5 *Treaty Law and the Law of Kazakhstan – and Nature and Extent of Protection of Investments*

Before considering what should be the appropriate measure of compensation in the facts and circumstances of the present case it is first necessary to analyse the applicable treaty provisions and the appropriate Kazakhstan law.

Paragraph 1 of Article III of the BIT describes the general rights of investors and the obligations of the parties with respect [to] expropriation and nationalization: these rights also apply to direct or indirect State measures “tantamount to expropriation or nationalization”: viz. even to “creeping expropriations” that result in a substantial deprivation of the benefit of an investment, without necessarily taking of the title to the investment. The standard set out in Article III of the BIT guarantees fair and equitable treatment and prohibits the arbitrary and discriminatory impairment of the investment in its broadest sense. When

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<sup>152</sup> The “caution” to be observed in applying the DCF method and in considering claims for lost profits is also reflected in the recent Report of the International Law Commission (2001) published by the United Nations, New York. Under Article 36 paragraph 2 (Draft Article on State Responsibility) the ILC provided that “compensation shall cover any financially assessable damage, including loss of profit in so far as it is established”. The commentary on this draft article reads as follows:

27 Paragraph 2 of article 36 recognizes that in certain cases compensation for loss of profits may be appropriate. International tribunals have included an award for loss of profits in assessing compensation: for example the decisions in the *Cape Horn Pigeon Case (USA v. Russia)* UNRIAA Vol. IX p. 63, 1902) and *Sapphire International Petroleum Ltd v. National Iranian Oil Company* (1963 ILR Vol. 35 p. 136 at pp. 187, 189). Loss of profits played a role in the *Factory at Chorzów* case itself, the Permanent Court deciding that the injured party should receive the value of property by way of damages not as it stood at the time of expropriation but at the time of indemnification (1928 PCIJ Series A No. 17 pp. 47–8, 53). Awards for loss of profits have also been made in respect of contract-based lost profits in *Libyan American Oil Company (LIAMCO) v. Libya* (1977 ILR Vol. 62 p. 40) and in some ICSID arbitrations (e.g. *Amco Asia and Others v. Republic of Indonesia* 1984 and Resubmitted Case 1990 (1) ICSID Reports 377. *AGIP v. Government of Republic of Congo* 1979 (1) ICSID Reports 306). Nevertheless, lost 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 (and intangible assets which are income-based) profits 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 of dealings. According to Whiteman: “in order to be allowable prospective profits must not be too speculative, contingent, uncertain and the like. There must be proof that they were reasonably anticipated and that the profits anticipated were probable and not merely possible”: Whiteman, *Damages* Vol. III page 1837.

investments are expropriated directly or indirectly through measures tantamount to expropriation there is a resultant obligation on the State to pay “prompt, adequate and effective compensation”: which is clarified to mean the equivalent of the fair market value of the expropriated investment immediately after the expropriatory action was taken or became known; it must also be paid without delay and include interest at a commercially reasonable rate from the date of expropriation.

The obligation of the Respondent State under the BIT (that governs the present case) is not substantially different from the law of Kazakhstan on Foreign Investment of December 27, 1994 (Claimants’ Exhibit No. 2). This law determines the fundamental, legal and economic basis for attracting foreign investments into the economy of the Republic of Kazakhstan; it also defines the procedure for settling disputes involving foreign investors: “foreign investor” is defined to include “legal entities of the Republic of Kazakhstan with respect to which foreign investors are entitled to determine decisions made by such legal entities”. The law contemplates investment by a joint venture – an enterprise with foreign participation established in the territory of the Republic of Kazakhstan “in accordance with the legislation of [the] Republic of Kazakhstan” in which part of the property (Shares, Interest) is owned by a foreign investor.

Article 7 of the Law provides for *Guarantees against Expropriation*:

1. Foreign investments may not be nationalized, expropriated or subjected to any other measures with the same consequences as nationalization and expropriation (hereinafter referred to as “expropriation”) with the exception of cases when such expropriation is implemented in the public interests and in compliance with the appropriate legal procedure, and such expropriation is implemented without discrimination and with the immediate payment of adequate and effective compensation.

2. The indemnification shall be equal to the fair market value of the expropriated investments at the moment when the investor becomes aware of the expropriation.

3. The indemnification shall include payment for the use of money subject to repayment, for the period from the date of expropriation to the date of repayment of compensation at the rate being determined by the National Bank of the Republic of Kazakhstan.

Article 27 provides for the settlement of the investment disputes which cannot be resolved through negotiations, through ICSID – if the State of the investor is “a participant of” the ICSID Convention.

In the circumstances set out above, applicable State law is no different from the applicable Treaty Law – the law of the BIT.

The protection under the Treaty and under Kazakhstan law is to every kind of investment in the territory of one party owned or controlled, directly or indirectly, by a national or a company of the other party and includes tangible and intangible properties including rights (as well as any right conferred by law or contract). The “investment” covered by the Treaty and by the Kazakhstan law on Foreign Investments is an investment that has been agreed to be brought into the territory of the State Party. It does not merely include a sum or sums actually laid out in the territory of the party State at the date of expropriation or measures tantamount to expropriation. It certainly extends to and includes “committed” investment. That is why under Article II(3) of the BIT nationals of either party must be permitted to enter and remain in the territory of the other party for the purpose of establishing, developing, administering or advising on the operation of an investment “to which they or a company of a first party [which] had employed them have *committed* or *are in the process of committing* a substantial amount of capital or other resources” (emphasis added).

Even under the local Kazakhstan law on Foreign Investment the expression “investing” is defined to mean something ongoing, “an *activity* connected with the implementation of foreign investment in the object of entrepreneurial activity for the purpose of obtaining profit (Income)” (emphasis added).

#### 12.1.6 *The Investment – Committed Contracted and Actually Invested and Brought In: the Factual Position*

In light of the above, the first question for consideration is what was the investment of Claimant No. 2 (a legal entity of the Republic of Kazakhstan “with respect to which foreign investors were entitled to determine decisions made by such legal entity”).

In the Appraisal Report [of] December 1998 (Claimants’ Exhibit No. 14) – which has been proved through witnesses of the Claimants – the total fund costs of the project are stated to be of the order of USD 16.3 million;<sup>153</sup> this was the contemplated investment in Kazakhstan. A year later – after some initial expense – the remaining amount to be actually invested in fixed assets was agreed to with the State Agency as USD 15.876 million. This is evidenced by Contract No. 0159-12-99 dated December 13, 1999 (Claimants’ Exhibit No. 3 – “The Investment Agreement”), which established the legal framework regulating the relationship between the Agency of the Republic of Kazakhstan for investment (The Agency), the only State body having the authority to represent the Republic of Kazakhstan “before the

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<sup>153</sup> It is stated in the Appraisal Report (at p. 25): “The total funding cost for the project is \$16.3 MM of which \$9.9 MM will be external funding made up of a \$1.5 MM straight equity and \$8.4 MM debt. The latter will come as \$1.2 MM SRF subordinated secured loan, \$4.8 SRF subordinated unsecured loan and \$2.4 as senior secured bank debt. The balance of the required funding of \$6.4 MM will be re-invested from internally generated cash.”

investors making direct investments in the Republic of Kazakhstan”.<sup>154</sup> Under this Contract No. 0159-12-99 (Claimants’ Exhibit No. 3) the object of the “investment activity” (defined as the “entrepreneurial activity connected with the *process of making investments*” (emphasis added)) was to be of investment in fixed assets (as mentioned in paragraph 3.1). The Investor (Claimant No. 2) had contracted to make investments as specified in paragraph 3.1 “in accordance with the work programme” (paragraph 6.2); and under Clause 20.1 the investor was required to conduct its investment activity “in accordance with the Work Programme agreed with the Agency”. The Work Programme (Attachment 1 to Contract No. 0159-12-99) set out the details of the works to be done from the year 1999 up to the year 2003 – when the entire construction of the Crystal Air Residential Compound in the Almaty Suburb was expected to be completed.

Contract No. 0159-12-99 dated December 13, 1999 (Claimants’ Exhibit No. 3) contains mutual obligations enforceable by each of the parties – on the part of the Claimant No. 2 a firm obligation to make further investment of USD 15,876,000.00 in fixed assets as provided in para 3.1 – in accordance with the work programme set out in the annexure thereto.

It appears from the documentary evidence that over time amounts aggregating in all to USD 9.44 million from Claimant No. 1 and its subsidiaries had been sent to Claimant No. 2 in Kazakhstan – as shown in Claimants’ Exhibit No. 80: but the amount actually and directly spent on the project up to June 16, 2000 was a sum of only USD 3.56 million (as evidenced in Claimants’ Exhibit Nos. 35 to 79).

#### 12.1.7 *Claim made for Compensation and the Reply thereto*

It is in this background – of law, contract, treaty obligation, and fact – that the claim for compensation in the present case must now be considered.

In the Request for Arbitration (May 3, 2001) (after referring to the BIT and the Kazakhstan law of foreign investment) it is stated:

Accordingly, the Claimants claim both *damnum emergens* and *lucrum cessans* for the damages caused by the Respondent’s expropriation of the Project Property and other breaches of the Bilateral Investment Treaty, customary international law and Kazakhstan’s Law of Foreign Investment. These damages will be quantified and proven at an appropriate stage of these arbitral proceedings.

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<sup>154</sup> It has been held in an ICSID Arbitral Award that the legal relation arising from a request for an investment licence and from a decision granting it can be deemed to be a *sui generis* relationship comparable to a contract. (See *AMCO Asia Corporation v. Republic of Indonesia* (1984) 24 International Legal Materials (1985) page 1030, ICCA Yearbook Vol. XIV 1989 p. 92 noted in a later ICSID award in *Antoine Goetz, et al. (Belgium) v. The Republic of Burundi* ICCA Yearbook – 2001 Vol. XXVI p. 24 at pp. 32–3, where the Claimants did not allege any contractual relationship and the relationship was held to be strictly unilateral in character.)



In the Claimants' Memorial of February 15, 2002, fair market value of the expropriated property has been assessed at USD 13.5 million exclusive of interest – with the date of taking as of June 16, 2000. The Claimants' Memorial deals with the three principal elements of its investment and claims arising therefrom viz.

- (1) tangible assets: the Project Property: purchased at a cost of USD 1.5 million – described as a fundamental element of the Claimants' investment;
- (2) intangible assets: actual expenditure, reduced project risks and goodwill – further expenditures of USD 2.0 million to retain consultants, invite tenders for the design and construction of the project; complete the design work and sign the construction contract and install certain infrastructure: because the design and construction contract[s] were specific to the project property most of the additional expenses [were] rendered useless by the taking: it is stated that the expenditure of USD 2.0 million added value to the Claimants' investment because it significantly reduced the project risk and in addition AIG's sponsorship of the project and that of its parent company American International Group added further value in the form of goodwill; and
- (3) rights conferred by law and contract: opportunity to make a commercial success of the project (the most important part of the claim) – this right was cancelled by the Almaty Oblast which (it is [said]) deprived the Claimants of their right to build the project and attempt to “derive economic benefit from it”.

The fair market value has been assessed on the “discounted cash flow” method (at the original discount rate of 30%) at USD 10.4 million, and at what is stated to be a more appropriate discount rate at the time of expropriation, viz. of 24%, at USD 13.5 million.

In the Counter-Memorial of the Respondent filed on August 19, 2002 it has been stated that the calculations given in the Claimants' Memorial are speculative and uncorroborated by proper documentation other than “a self-serving expert report”; it is also submitted that under the terms of the Treaty fair market value should be calculated in accordance with the laws of the Republic of Kazakhstan and that according to the laws and Courts of the Republic of Kazakhstan only proven lost profits can, if at all, be recovered. It has also been argued that the DCF method is inapplicable since the project was not an ongoing one and no proven record of profitability could be established. It has also been stated as a matter of fact that the capital of Kazakhstan was moved from Almaty to the Northern City of Astana for political, economic and security reasons and that although the move predates the contemplated transaction, the move impacted the real estate market more than anyone expected.<sup>155</sup>

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<sup>155</sup> No evidence has been led by the Respondents in support of this statement.

### 12.1.8 Evidence of the Claim – Documentary and Oral Evidence

The documentary evidence produced by the Claimants in support of their claim for compensation consist[s] of the following:

- (1) The Appraisal Report dated December 8, 1998 (Claimants' Exhibit 14):<sup>156</sup> it was prepared as a result of a "very detailed due diligence process" (see Evidence of Mr Scott Foushee – Transcripts of the oral hearing, Day One, at page 30): details are given in the Appraisal Report about the project which was proposed to be designed: a material part of the Executive Summary reads as follows:

#### *Investment Overview*

The AIG Silk Road Fund ("SRF") is considering an investment of \$7.0 MM in Tema Housing, an 81-unit Western-standard quality residential compound in Almaty. The investment objective is to develop a premier residential compound targeting expatriate employees of large multinational companies and affluent Kazakh customers. The compound, centrally located within a 12–15 minute drive from the center of Almaty, is expected to address a significant market vacuum for quality, secure housing in the city. To this end, it will have autonomous utilities, reliable security, and desirable recreation facilities. The development will be implemented in three phases over a period of two and half years, with the first phase expected to require \$9.3 MM in total investment.

The local partner in this transaction is Tema Ltd. a company owned by the principles [sic] of Capital Real Estate Company ("CREC"), a well-regarded and experienced Kazakh real estate developer. Our investments will be made via a Netherlands Antilles company 66% owned by SRF and 34% by Tema. The transaction provides for SRF to receive 100% of all cash flows generated by rental or sale of individual properties until it achieves an IRR of 30% and will split subsequent cash flows on a 66/34 basis with Tema. Our initial investment of \$7.0 MM will consist of \$1.0 MM straight equity, and two 4-year 14% term loan[s], one of which is \$4.8 MM unsecured facility, with the other a \$1.2 MM note fully secured by collateral owned by Tema principles [sic].

In the Appraisal Report it is also recorded as follows:

The agreed upon deal structure provides for SRF to receive 100% of any rental, sale, or fee generated cash flow (after operating costs and debt service) in this development until it has achieved a minimum 30% cash-on-cash IRR on its total investment.

Scott Holland Estates and others suggest that demand for single-family up-scale housing has more than doubled over the last year, a trend primarily driven by multinational[s] that are progressing beyond the business development phase and are moving into a meaningful operational or production stage. This transition is accompanied by the arrival of more seasoned expatriate management personnel with higher living standard expectations for themselves, their spouses and children. We note that this demand for a quality compound has been strongly articulated by corporate customers leasing office space at CREC's commercial properties.

Our base case projections are founded on rental pricing of \$35/sq. meter and sale pricing of \$1,500/sq. meter, prices that are 17% and 20% higher than that achieved by the Reiz

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<sup>156</sup> AIG Silk Road Capital Management Appraisal Report – Tema Residential Development.

compound, respectively. Several factors underlie this assumption of achieving a price premium.

We note that our market feedback to date from Almaty real estate agents suggests that a quality residential compound a short drive from central Almaty can achieve rents in the \$35–40 sq. meter range and sale values of \$1,500/sq. meter.

The total funding cost for the project is \$16.3 MM of which \$9.9 MM will be external funding made up of a \$1.5 MM straight equity and \$8.4 MM debt. The latter will come as \$1.2 MM SRF subordinated secured loan, \$4.8 SRF subordinated unsecured loan and \$2.4 as senior secured bank debt. The balance of the required funding of \$6.4 MM will be reinvested from internally generated cash.

- (2) The next document relied on in support of the Claim for compensation is a statement annexed as Exhibit A to the Claimants’ Memorial filed on February 15, 2002: it was prepared by the Claimants’ Valuation Expert Mr Philip Haberman of KPMG who valued Claimants’ investment in the project from the perspective of a “hypothetical purchaser” of the investment and of a “hypothetical seller” on the basis of “historic and future cash flows”. This valuation statement (Report) dated February 14, 2002, is referred to (on pages 52 to 55) in the Claimants’ Memorial. Mr Haberman – author of the statement Exhibit A to the Claimants’ Memorial – was not called to give evidence and it was stated at the hearing in London that “he was not available to give testimony today” (sic).
- (3) A third document is the “Report to the Tribunal on the quantum of loss” (Claimants’ Exhibit Nos. 105 and 106) [which] has been prepared by Ian Gomes, a Partner in KPMG (Report of 8 pages dated August 24, 2002). The opening paragraph of the Report gives the reason why it had to be prepared:

1.1.2 In January 2002, one of my fellow partners (at that time) in the London office of KPMG, Mr Philip Haberman, was instructed by the Claimants to prepare an expert report into the quantum of loss suffered by the Claimants as [the] result of an alleged expropriation of the housing development project known as "Crystal Air".

1.1.3 Mr Haberman issued his report on 14 February 2002. Mr Haberman, subsequently, at his own request, resigned from KPMG. Mr Haberman has advised KPMG that, due to prior personal commitments during the dates proposed for the Tribunal hearings in August 2002, he would be unable to appear as an expert in this arbitration.

1.1.4 The Claimants have therefore appointed me to consider carefully the report of Mr Haberman and consider whether I can adopt Mr Haberman's report as my own.

In his report Mr Gomes states that he has reviewed Mr Haberman’s Report and the “underlying documents on which Mr Haberman relied”. He then states:

2.1.1 I have reviewed Mr Haberman’s report and the underlying documents on which Mr

Haberman relied. I have discussed Mr Haberman's report with him. Mr Haberman referred in his report to occasions where he had spoken either to other KPMG colleagues (such as those in KPMG Moscow) or to employees of the Claimants. I have not contacted these individuals but rely instead on the documented discussions of Mr Haberman.

2.1.2 I note that, as stated by Mr Haberman at section 4.3 of his report, several of the assumptions contained in his calculations are based on information and best estimates supplied by Claimants' personnel (and business associates) and have not been independently verified by Mr Haberman. Similarly, I have not independently verified certain assumptions.

2.1.3 I also note in passing that Mr Haberman's report does not address the issue of costs flowing directly from the expropriation (such as costs associated with this claim). These costs are similarly outside the scope of this report but should be considered when quantifying the total amount lost by the Claimants.

In his report Mr Ian Gomes states that he has made modifications to Mr Haberman's calculations taking into account information contained in another Report – prepared by the Rice Group Central Asia LLP (The Rice Group Report) (Claimants' Exhibit No. 132).

The conclusion in the Report of Mr Gomes reads as follows:

### 3.1 Conclusion

3.1.1 Due to circumstances outside my control and outside the control of the Claimants, the author of the original report on quantum, Mr Haberman, is unable to give evidence at the scheduled hearing of the Tribunal.

3.1.2 I have therefore been instructed by the Claimants in the place of Mr Haberman.

3.1.3 I have adopted and agree with Mr Haberman's report, but have amended Mr Haberman's calculations and re-estimated the quantum of loss as \$13.1 million (before interest and excluding costs incurred as a result of expropriation).

- (4) The next document produced is the Report containing an Analysis with respect to KPMG of Crystal Air Village of June 16, 2000, prepared by Mr Philip Pardo of the Rice Group Central Asia LLP (for AIG Silk Road Capital Management, August 19, 2002). The purpose of the Rice Group Report is stated in the letter of the Claimants' witness Mr Philip D. Pardo (Director, Rice Group Central Asia – part of Claimants' Exhibit No. 132). It records as follows:

In response to your request and authorization letter dated July 23, 2002, the Rice Group, Central Asia LLP has conducted the required investigation, gathered the necessary data, and made certain analyses of the assumptions and methodology contained in the valuation report prepared by KPMG London dated February 14, 2002 with regard to the development project named "Crystal Air" which is located in the Karasai District of Almaty Oblast. You have

asked whether, in light of the data available to us, the assumptions and methodology contained in the KPMG Report are reasonable.

Your attention is directed to the data and discussions in the report that follows, upon which, in part, we have based our conclusions. The value estimates, rental estimates and other opinions and conclusions should be considered in the context of the entire report and are subject to the contingent and limiting conditions included in the report.

The report has been completed in conformity without interpretation under International Valuation Standards 2000 of the Uniform Standards of Professional Appraisal Practice and Code of Ethics of the American Society of Appraisers. The reporting format is complete-summary as defined in the Uniform Standards of Appraisal Practice. The use of the analyses, opinions and conclusions [is] limited by the contingent and limiting condition set forth in the report.

The narrative report that follows sets forth the identification of the property, the assumptions and limiting conditions, pertinent facts about the area and the subject property, comparable data, the results of the investigation and analyses, and the reasoning leading to the conclusions.

The conclusion in the Rice Group Report was principally based upon a Sales Price Analysis and a Rental Analysis. With regard to the Sales Price Analysis it was stated that on the basis of “available market data” the USD 2,000 per sq. mtr. (Sale Price in the KPMG Report) was a reasonable one – Sale Prices in 1998, 1999, 2000 and 2001 ranged from USD 1,352 to 1,719. It was opined that the “brief downward trend” in the Kazakhstan Real Estate market in 2000 was temporary and would not affect planned sales of 9 units of Crystal Air in 2000–2001. Similarly with regard to the rental rate analysis the conclusion was that a range was from a low of USD 39 per sq. mtr. in 2000 to a high of USD 50 per sq. mtr. in 2005 (the chart showing a summary analysis of “actual rental rates” based on comparables of USD 39 to USD 42 between 1998 to 2001).

It was stated in the Rice Group Report under the heading “Investment Specific Risk” as follows:

#### 4.4.6 *Investment Specific Risk*

The Crystal Air Village project was sponsored and effectively controlled by a subsidiary of AIG, a major international financial institution with a wealth of experience in private equity investments around the globe. AIG put that experience, as well as skills and time of several of its professional staff to service in the design and implementation of the Crystal Air Village project. This undoubtedly significantly increased the chance that the project would be a commercial success and thereby reduced its risk. In addition, by the time of the taking of the Crystal Air Village property, the project was well underway: the land had been acquired, all necessary permits obtained, design completed, contractor appointed, construction contract signed, marketing effort in full swing. This further reduced the risk of the project, and as a result a reasonable discount rate appears to be 23% to 25% per annum. This estimate considers that the terminal value of the Crystal Air Village investment will encompass the expansion of the Kazakhstan economy in which Crystal Air Village project should likely high return.

The conclusion reached was that the discount rate of 24% derived by KPMG (Mr Haberman) “is suitable for the determination of the fair market value of the Crystal Air Village”.

Mr Ian Gomes and Philip Pardo were called and gave oral evidence. Mr Ian Gomes deposed to

his qualifications to give expert evidence – he frankly stated that he was not personally involved in the preparation of Mr Haberman’s Report of February 2002 (Exhibit A to the Claimants’ Memorial), but that he had reviewed the Report along with the Rice Group Report. He was then asked several questions and gave the following answers (Transcripts of the oral hearing, Day Two, pages 50–1):

Q. Why is Mr Haberman not here to testify?

A. Mr Haberman resigned from KPMG and has accepted an appointment at Ernst and Young. He told us that he would have been willing to testify if he had been given advance notice of the dates for this hearing. He only became aware of the dates in July, last month, and he had some family commitments.

Q. Have you reviewed Mr Haberman’s report?

A. I have reviewed Mr Haberman’s report and I have also discussed his report and conclusions with him.

Q. Have you formally adopted Mr Haberman’s report as your own?

A. Subject to some modifications I have made, which I have explained in my supplemental report, I have adopted his methodology and conclusions.

He was then asked what were the modifications he had set out in his supplemental Report of the Haberman Report and his answer was (Transcripts of the oral hearing, Day Two, pages 51–2):

A. They fall into two categories, really. Since the Haberman report, the Rice Group of Central Asia produced a report which commented on the reasonableness of several of the assumptions which supported Haberman’s calculations. I noted that with regard to the rental rate assumption, the Haberman calculations were overly conservative; so I adjusted the rental rate assumption so that the bottom of the range now, in my report, coincides with the bottom of the range in the Rice report.

The other calculation – the other amendment that I have made relates to the timing of the cash flows to investors. I have assumed that the cash flows to investors, free cash flows to investors, would be returned to them on a monthly basis which accords with the order documents which are part of the exhibits.

He was then asked:

Have you also received any information regarding financing, availability of financing?

His answer was (Transcripts of the oral hearing, Day Two, page 53):

A. My understanding is that the equity financing was going to be put in place by the Claimants, AIG, and that they were, at the point of valuation, in discussion with bankers who would provide their financing facilities, but that no agreements were signed at that point.

Mr Gomes was asked whether he had taken into consideration in his valuation (on a DCF basis) the fact that the Claimants had not earned any profits at that stage – i.e., June 2000.

And his answer was:

I have said to you that my methodology assumes that the valuation of any business, at any point in time, is the sum total of future cash flow. So in my methodology I am always looking at the future. So the fact that it had not earned any money at that point in time is irrelevant (Transcripts of the oral hearing, Day Two, page 68).

He also stated in examination-in-chief that what made the project worthwhile for the Claimants were two or three components, the principal one of which was that: “they were getting free financing by way of advance rental from the renters. The market in Almaty I am told that people pay six months in advance and so on and so forth and that was a huge source of free funding to the Claimants [*sic*]” (Transcripts of the oral hearing, Day Two, page 70).

He then stated that “free funding through customer pre-payment makes a material impact to financing costs and so on” (Transcripts of the oral hearing, Day Two, page 71). He also stated that based on “all the financing arrangements” the Claimants would try and replace equity financing with Bank financing which was a cheaper form of financing and that assumption was built into his cash flow assumption (Transcripts of the oral hearing, Day Two, page 74).

Following a question from a Member of the Tribunal as to the risk involved, Mr Ian Gomes stated as follows (Transcripts of the oral hearing, Day Two, pages 87 to 88):

Tribunal: May I ask you, considering the Haberman report, and I draw your attention to paragraph 4.5.13 where Mr Haberman lists a number of risks not eliminated, one of which, tinder (b), he has referred to the fact “despite positive reaction from marketing, future rental and sale price to be achieved remains uncertain”, which would seem to suggest quite a significant area of risk, because these are the key elements for future profits and cash flow.

A. Yes.

Q. Do you still share the conclusion under paragraph 4.5.14 that in the light also of the remaining risks as just mentioned ...

A. Yes.

Q. ...a reasonable discount rate would be approximately midway between 18 and 30?

A. Yes, I do because I have approached it slightly differently when I explained it as being two buckets; the first bucket being build/construct and, although all the risks connected with phases II and III in respect of construction have not been eliminated, you have got a pretty good base construction contract which, I think, would probably hold for phases II and III.

Q. The significant risk at that point was rental income achievement or sales income achievement.

A. Yes.

Q. The way I rationalized (that is the Rice Group report) – is that people in the Rice Group have knowledge of the local conditions, they have come back to say, well, it is reasonable.

Now to me, the 24% rate is still six percentage points above what a commercial bank would lend on a completed project, so I think that takes care of the risk.

Mr Philip Pardo, who prepared the Report (Claimants' Exhibit No. 132), deposed that actual recorded sales value[s] were not available (Transcripts of the oral hearing, Day Two, page 98) and that "usually sales are recorded at much lower prices". He deposed that the kind of buyers in the "target market" of this Crystal Air Project [were] "mostly expatriate[s] from large companies and some local people who had a particular wish to affiliate themselves with those same people" (Transcripts of the oral hearing, Day Two, page 102). He deposed that rental rates were easy to get "because rentals are usually handled by brokers and usually are more centralised in terms of the information". He stated that this was the main source of his data.

No report or documentary evidence was filed by the Respondent and no oral evidence was led on behalf of the Respondent in answer to the Claim for compensation: except with regard to the plea of "mitigation" by the offer of an alternative site. However arguments were addressed on behalf of the Respondent disputing the claim of the Claimants and the figures.

#### *12.1.9 Conclusions derived from the Evidence presented by the Claimants as to Compensation*

The yardstick of fair market value is not a mechanical or arithmetical one, based on a series of hypothetical calculations. Ultimately, howsoever calculated and arrived at, the fair market value to be paid as adequate compensation for an expropriation must square with the realities of the situation in a given case.

The figure of USD 13.1 million (the amount claimed on the DCF method of calculation as fair market value on the basis of lost profits) is worked out on the assumption that the fund costs of the project (USD 16.3 million) had been expended. But at the date of the taking they were not – only USD 3.56 million had been spent by June 16, 2000. 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. This is particularly significant because the Claimants after terminating the construction contract with their contractor in June 2000 and settling with them on the basis that the work on the project would have to be abandoned, were freed from their contractual obligations under the Investment Agreement with the State Investment Agency to bring in the balance monies committed to be invested in the project. No evidence is forthcoming that this large sum of about USD 12.74 million could not be or was not profitably invested by the Claimants as a consequence of the premature expropriation of the project. Money has no earmark, and when freed from the contractual obligation to invest the remaining USD 12.74 million of the projected or committed investment, it would be natural to assume that the same or a substantial part of it was obviously employed in some other profitable activity: no account of this has been



taken in the DCF calculation: either when computing the discount rate or otherwise.<sup>157</sup> 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. True, the opportunity to make a commercial success of the project (the third head of claim in the Claimants' Memorial) must be compensated for since it is included in the wide definition of "investment" in the BIT: but the DCF method of valuation does not, in the opinion of this Tribunal, constitute in the present case a fair measure of compensation to be awarded.

Besides, the Tribunal cannot contemplate the possibility of a "hypothetical buyer" paying a sum as high as USD 13.1 million which is assessed as the fair market value of the yet unstarted Crystal Air Project which till June 15, 2000, had proceeded up to the stage of acquisition of the plot, preparation of construction design etc. with a proven disbursement and expense of only USD 3.56 million. The hypothetical buyer would obviously have to spend nearly USD 13 million more on the construction and completion of the project!

In the opinion of this Tribunal the fair market value assessed by the Claimants at USD 13.1 million immediately prior to the taking is wholly unrealistic, by whatever method that figure is arrived at. It is stated that the figure is based on the "DCF method of valuation": if so, it only demonstrates that an otherwise acceptable method of computation could not possibly be the right method in the facts and circumstances of the instant case.<sup>158</sup>

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<sup>157</sup> In *Sapphire International Petroleum Ltd v. National Iranian Oil Company* – Award of Sole Arbitrator Federal Judge M. Pierre Cavin (March 15, 1963) – the fact that the party was released from the contract (by reason of the expropriation) was stated to be a relevant consideration that had to go to diminish any damages [that] must be awarded:

Another plausible consideration is that, now that they are released from the present contract, the plaintiff company can employ its resources, its organization and its strength in other profitable activities which it could probably not have kept on hand at the same time as the prospecting and exploration of the concession areas, which required investments and important personal obligations.

<sup>158</sup> The DCF method and the difficulties arising in its application have been succinctly summarized by the International Law Commission in its Report of 53rd Session (2001) in its commentary on Draft Article 36 (on Compensation). It reads (para. 26):

(26) Since 1945, valuation techniques have been developed to factor in different elements of risk and probability. 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. Although developed as a tool for assessing commercial value, it can also be useful in the context of calculating value for compensation purposes. But difficulties can arise in the application of the DCF method to establish capital value in the compensation context. 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) suggesting a cautious approach to use the method. Hence although income-based methods have been accepted in principle, there has been a decided preference for asset-based methods. A particular concern is the risk of double-counting which arises from the relationship between the capital value of an enterprise and its contractually based profits.

#### 12.1.10 *The Appropriateness of the DCF Method of Valuation in the Present Case*

The Claimants and their experts have propounded the DCF method of valuation and have based their entire claim of lost profits on calculations in accordance with that method. This is stated to be justified – on the assumption that the investment or enterprise taken was a “going concern”.<sup>159</sup> The definition of “going concern” given by the World Bank in its publication *Legal Framework for the Treatment of Foreign Investments* (Volume II – Guidelines, item 42. p. 26) is the following:

*For a going concern, i.e., enterprise consisting of income producing assets and already in existence for a sufficient period of time to generate the data necessary for proving its profitability and calculation, with reasonable certainty, of its income in future years (on the assumption that taking did not occur). Section 6 of the Guidelines suggests that discounted cash flow may represent an acceptable method of valuation.*<sup>160</sup>

In the present case, the enterprise did not exist as an income generating entity at all, and since it did not exist for a sufficient period of time, it could not generate business data necessary for proving its profitability with reasonable certainty.<sup>161</sup>

The finding of the Tribunal on the basis of the evidence, oral and documentary, is that the Crystal Air Village project on which no part of any construction had even commenced could not be described as an ongoing project. At the time of the Project suspension and ultimate stoppage (“effective expropriation”), the Project remained virtually unstarted, inoperative and generated no revenue at all (still less profit) leaving no basis whatever to calculate loss of profits. The forecast of costs and revenues distributed in time – particularly the latter – have no foundation at all to support a credible DCF valuation claim.

It had been stated in the Appraisal Report (Claimants’ Exhibit No. 14) that “our market feedback to date from Almaty real estate agents suggests that a quality residential compound a short drive from central

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It is stated in the UN Report (2001) that “in the context of claims for the lost profits there is corresponding preference for claims to be based on past performance rather than forecasts”. For example, the United Nations Compensation Commission Guidelines on valuation of business losses in Decision 9 (S/AC.26/1992/9. para. 19) state: “the method of a valuation should therefore be one that focuses on past performance rather than on forecasts and projections into the future”.

<sup>159</sup> See evidence of Scott Foushee (Transcripts of the oral hearing, Day One, page 48) and evidence of Mark Kasher (Day Two, page 68).

<sup>160</sup> [Emphasis] supplied.

<sup>161</sup> In considering claims for future profits, the UNCC Panel dealing with the fourth instalment of “E3” claims expressed the view that in order for such claims to warrant a recommendation, “it is necessary to demonstrate by sufficient documentary and other appropriate evidence a history of successful (i.e., profitable) operation, and a state of affairs which warrants the conclusion that the hypothesis that there would have been future profitable contracts is well founded” (see Report and Recommendations made by the Panel of Commissioners concerning the Fourth Instalment of “E3” Claims, 30 September 1999 (S/AC.26/1999/14), para. 140 (quoted in footnote (600) of the UN Report of the

Almaty can achieve rents in the \$35–40 [per] sq. meter range and sales value of \$1,500 per sq. meter”. There is no evidence to support the “market feedback”. It was also stated in the Rice Group Report (Claimants’ Exhibit No. 132) that on the basis of “available market data” sales price was estimated at USD 2,000 per sq. metre and was “reasonable” and that sales prices in 1998–2001 ranged from USD 1,352 to 1,719. Similarly with regard to rental rate analysis it was noted that the range was from a low of USD 39 per sq. metre in 2000 to a high of USD 50 in 2005 (with a chart showing summary analysis of “actual rental rates” based on [comparisons] of USD 39 to 42 between 1995 to 2001). There is no supporting evidence of real estate agents or other “available market data” as stated in the Rice Group Report.

The burden of establishing by reliable evidence the quantum of damages or compensation for the expropriation was and is on the Claimants. The Claimants did not lead evidence of any representative of Scott Holland Estates, who had been engaged to initiate marketing efforts in December 1999 – three months before the property was taken. Except for a “sense of excitement” about the project in the market (so stated by Mr Foushee) which gave Claimants the confidence that “this was going to be a very successful joint venture”, there is no evidence whatever of offers of sale of units proposed to be constructed nor of any offers of rent for letting of any of the units proposed to be constructed (see Transcripts of the oral hearing, Day One, pages 65 and 139). There is also a complete absence of any evidence of Bank negotiations for the loans which were proposed to be taken for the second and third phase of the project (see Transcripts of the oral hearing, Day One, page 37). “Have you received any confirmed commitments for your project?”<sup>162</sup> Mr Scott Foushee was asked in cross-examination, and his answer was: “we have not received firm commitments, merely indications of strong interest” – of which no particulars are given.

Mr Mark Kasher, Investment Officer, based in Almaty, of the AIG Silk Road Fund, who also gave evidence, admitted that prior to construction starting they did not “feel it was prudent to take advance orders at that time” – it was only when there would [be] a “model home” (by August 2000) when people would come and see (Transcripts of the oral hearing, Day One, page 139). The relevance of this is that if there had been a “model home” and offers for sale or letting of units were received, it could perhaps be said that the Project had “taken [off]” even though no construction work had started. The parameters of the DCF formula require that projected revenues (a vital element in the DCF computation) have to be based on some actual revenues earned. Not only is there no evidence of any revenues earned or profits derived from the project but there is not a single instance of an advance taken or order registered for any unit proposed to be built. The Haberman Report lists a number of risks not eliminated, one of which was “future rental and sale price” (despite so called “positive reaction from marketing”) – this was stated to remain “uncertain”: they were and are key elements for determining future profits and cash flow. Mr Ian Gomes admitted in the course of his evidence that “rental income achievements” and “sales income achievements” were and still

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International Law Commission (2001) at p. 260).

remained significant risk factors. At no stage therefore has there been any attempt to establish by any reliable evidence either rental income or sale income in respect of any of the units in the Crystal Air Village project.

In the circumstances aforesaid the Tribunal is convinced that there is no basis whatever on which a DCF valuation could be justified in the proved or admitted facts of this case.

### 12.2 *International Arbitration Practice as to “a Realistic Proof of Future Profits”*

International arbitral practice over the years (in the form of published awards) has uniformly rejected the adoption of the DCF valuation method – a method intended to determine the present value of future earnings expected to be generated by the investment during a prolonged projected period – where the enterprise or project has not been an “ongoing” one. Thus, for instance:

- (a) In the *Pyramids Case*<sup>163</sup> (1992) the implementation of a development project of two international tourist complexes (covered by Agreements entered into [in] September 1974) was cancelled by Presidential decree in 1978 and the Arbitral Tribunal (consisting of Dr Edurado Jimenez de Arechaga, Dr Mohamed Amin El Mahdi and Mr Robert F. Pietrowski) observed:

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 per cent 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 (at para. 188 at page 634).

- (b) In *Phelps Dodge Corporation v. Iran*<sup>164</sup> (1986) the factual situation was that the Iranian company (SICAB) was established for the purpose of manufacturing in Iran and selling various wire and cable products, that Phelps Dodge Corporation was one of the initial investors and had contributed USD 2.4 million for its share in SICAB. The construction of SICAB Factory had begun in August 1976 and would have been completed in May 1979 had the revolution not occurred. But in October 1980 the SICAB management was transferred by Governmental decree to an agency of the Government, and Phelps Dodge argued that its 19.36% interest in SICAB should be valued as a “going concern” at the time of taking and when so valued its shares (it was claimed) would have fetched USD 7.5 million. The Tribunal (consisting of R. Briner Chairman, and Messrs Aldrich and Bahrani members) stated (last [sic] para. 30 at pages 132–3) that it could not agree that “SICAB had

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<sup>162</sup> Transcripts of the oral hearing, Day One, page 139.

<sup>163</sup> *Southern Pacific Properties (Middle East Ltd) v. Arab Republic of Egypt* (1992) (ILR Vol. 106 p. 501) – (ICSID Case No. ARB/84/3).

become a going concern” prior to the date of taking so that such elements of value as future profits and good will could confidently be valued: “In the case of SICAB any conclusions on these matters would be highly speculative” (the Tribunal opined). Taking into account all relevant evidence the Tribunal valued Phelps Dodge’s ownership interest in SICAB on the date of taking as equal to its actual investment, viz. USD 2.4 million dollars, and awarded compensation in that amount (para. 31, page 138).

- (c) In an UNCITRAL Arbitration Case<sup>165</sup> (1993) the dispute arose out of certain investments made by the claimant, Antoine Biloune, a Syrian national, involving the development of a hotel resort complex on Marine Drive in the city of Accra, Ghana – these investments were made under a framework agreement with a government entity charged with the encouragement of foreign investment in Ghana. Mr Biloune formed a joint venture with another governmental entity for the development of the Marine Drive resort complex. Remodelling and construction work had proceeded substantially to completion when government officials issued an order to stop work, citing lack of a building permit – no further work on the project was permitted. Mr Biloune and the Marine Drive Complex Ltd commenced arbitration proceedings under the UNCITRAL Rules against the Government of Ghana, claiming damages for expropriation.

The Arbitral Tribunal (consisting of Judge Schwebel, Mr Wallace and Mr Leigh) stated the true basis for calculating damages as follows (pages 228–9 of Vol. 95 ILR 183):

Normally, in cases of expropriation of a going concern, the most accurate measure of the value of the expropriated property is its fair market value, which in its nature takes into account future profits. The discounted cash flow method of valuation is often used to calculate the worth of the enterprise at the time of taking. (*Starrett Housing Corp. v. Islamic Republic of Iran* – 16 Iran–US Claims Tribunal Reports 112, paragraphs 279–80 (1987))

The Claimants have made a compensation claim based on the future lost profits of MDCL. While the Tribunal accepts the validity of the principle that lost profits should be compensated it is not possible to make an award on that basis in this case. The Claimants have not provided any realistic proof of the future profits of the company. The Lambrisi Report purports to project profits but the Tribunal agrees with the Respondents that this report was not an economic forecast of the profits, but a projection intended to encourage potential investors. Moreover, at the time of the project’s suspension and effective expropriation, the project remained uncompleted and inoperative. It was generating no revenue, still less profits. Thus, with no basis on which to calculate future profits, the Tribunal is required to consider an alternative methodology.

The Claimants have also requested that Mr Biloune be awarded the historical investment value of the project. Given the nature of the project, and its early interruption by the Respondents, the Tribunal has concluded that the most appropriate method for valuing the damages to be paid will be to return to Mr Biloune the amounts he invested in MDCL, i.e., restitution.

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<sup>164</sup> 10 Iran–US Claims Tribunal Reports 121.

<sup>165</sup> (1993) 95 ILR 183 – *Biloune and Marine Drive Complex Ltd v. Ghana Investments Centre*.

- (d) In a NAFTA arbitration – *Metalclad Corporation v. The United Mexican States*<sup>166</sup> (2000) – dispute arose out of the activities of the Claimant, Metalclad Corporation in the Mexican Municipality of Guadalupe located in the Mexican State of San Luis Potosi: the activity was the development of, and the operation of, a hazardous waste landfill. Metalclad proposed two alternative methods for calculating damages: the first one was a discounted cash flow analysis of future profits to establish the fair market value of the investment of approximately USD 19 million; and the second was to value Metalclad’s actual investment in the landfill (approximately USD 20–5 million). The arbitration was under the North American Free Trade Agreement (NAFTA). The relevant parts of the award of the Tribunal (which consisted of Prof. Sir Elihu Lauterpacht as President, and Mr Benjamin Civiletti and Mr Jose Luis Sequeiro as members) read as follows:

118. NAFTA, Article 1135(1)(a), provides for the award of monetary damages and applicable interest where a Party is found to have violated a Chapter Eleven provision. With respect to expropriation, NAFTA, Article 1110(2), specifically requires compensation to be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place. This paragraph further states that “the valuation criteria shall include going concern value, asset value including declared tax value of tangible property, and other criteria, as appropriate, to determine fair market value”.

119. 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; *Benvenuti and Bonfant Srl v. The Government of the People’s Republic of Congo*, 1 ICSID Reports 330; 21 ILM 758; *AGIP SPA v. The Government of the People’s Republic of Congo*, 1 ICSID Reports 306; 21 ILM 737.

120. However, where the enterprise has not operated for a sufficiently long time to establish a performance record or where it has failed to make any profit, future profits cannot be used to determine going concern or fair market value.<sup>167</sup> In *Sola Tiles, Inc. v. Iran* (1987) (14 Iran–US CTR 224, 240–2; 83 ILR 460, 480–1), the Iran–US Claims Tribunal pointed to the importance in relation to a company’s value of “its business reputation and the relationship it has established with its suppliers and customers”. Similarly, in *Asian Agricultural Products v. Sri Lanka* (4 ICSID Reports 246 (1990) at 292), another ICSID Tribunal observed, in dealing with the comparable problem of the assessment of the value of good will, that its ascertainment “requires the prior presence on the market for at least two or three years, which is the

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<sup>166</sup> Arbitral Award dated August 30, 2000 – (ICSID Case No. ARB (AF)/97/1). In an action to set aside the *Metalclad* Award, the Supreme Court of British Columbia had partially set aside the award of interest, on the ground that the original tribunal had erred in fixing the date of appropriation; the Court did not, however, question the compounding of interest nor the principles on which the award was founded.

<sup>167</sup> *Biloune v. Ghana Investment Centre* 95 ILR 183, 207–10 (1993) – Judge Schwebel, Mr Wallace and Mr Leigh.

minimum period needed in order to establish continuing business connections”.

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.

122. Rather, the Tribunal agrees with the parties that fair market value is best arrived at in this case by reference to Metalclad’s actual investment in the project. Thus, in *Phelps Dodge Corp v. Iran* (10 Iran–US CTR 121 (1986)), the Iran–US Claims Tribunal concluded that the value of the expropriated property was the value of Claimants’ investment in that property. In reaching this conclusion, the Tribunal considered that the property’s future profits were so dependent on as yet unobtained preferential treatment from the government that any prediction of them would be entirely speculative (id. at 132–3). Similarly, in the *Biloune* case (see above), the Tribunal concluded that the value of the expropriated property was the value of the Claimants’ investment in that property. While the Tribunal recognized the validity of the principle that lost profits should be considered in the valuation of expropriated property, the Tribunal did not award lost profits because the claimants could not provide any realistic estimate of them. In that case, as in the present one, the expropriation occurred when the project was not yet in operation and had yet to generate revenue. (*Biloune*, 95 ILR at 228–9.) The award to Metalclad of the cost of its investment in the landfill is consistent with the principles set forth in *Chorzów Factory (Claim for Indemnity) (Merits), Germany v. Poland*, PCIJ Series A, No. 17 (1928) at p. 47, namely, that where the state has acted contrary to its obligations, any award to the claimant should, as far as is possible, wipe out all the consequences of the illegal act and re-establish the situation which would in all probability have existed if that act had not been committed (the status quo ante).

- (e) In *Starrett Housing Corporation v. Govt. of Islamic Republic of Iran*<sup>168</sup> (1987) the DCF method of valuation was indeed accepted and adopted: the facts show why: that case concerned the development of a large housing complex in Iran commencing from 1974 (6,000 apartment units over 1,500 hectares of land); Starrett Housing undertook to construct a total of 6,000 apartment units in three phases of which only Phase I was at issue: this phase comprised 1,600 such apartment units grouped in eight tall buildings. As on the date of taking (January 31, 1980) 1,538 apartments had been completed and 1,235 apartments had been sold. As a consequence of a large number of people leaving Iran prematurely because of the Revolution, it was estimated by the Expert that 600 apartments out of the already sold apartments would be expected to be resold:

97. The Expert assumed that all apartments available for sale would have been sold in October 1980, the month in which he expected construction work on the Project to

recommence. He based this conclusion on the premises that inflation and the price level of luxury apartments would increase after 31 January 1980, and that by October 1980 conditions in Iran could have been expected to return to normal. Thus, the Expert concluded that Shah Goli<sup>169</sup> could expect to recognize revenue from the sales of apartments by October 1980.

On this basis, the Expert proceeded to establish the fair market value of the project applying the Discounted Cash Flow method – according to which the expected cash flow for the remaining lifetime of the project was determined (on the basis of data generated from implementation of the project itself) and then discounted back to its present value. The projection of “future revenues” – one of the most crucial individual factors in arriving at fair market value – and the manner in which the expert drew up a forecast of “future revenues and remaining costs” is set out in paras. 77, 78 and 79 of the decision (in the *Starrett Housing Case*), [the] material part of which reads as follows:

In order to establish the net cash flow of the Project, the Expert drew up a forecast of future revenues and remaining costs. This Section deals with his estimate of future revenues.

One factor concerning future revenues, namely the price level for unsold/resold apartments, is described by the Expert in his sensitivity analysis as “the most crucial individual factor...where a slight alteration is of considerable importance to the value of the Project, given the number of free apartments as presupposed in the valuation”, i.e., apartments that had not yet been sold or are available for resale. In the Respondents’ view, the Expert’s estimate of future revenues constituted by far the most important part of his Report, and, in particular, Coopers & Lybrand identified the expected future price of apartments that had not yet been sold on 31 January 1980 and those that were assumed to be available for resale on that date as one of two factors that had the greatest effect on the final valuation (the issue of the total number of apartments is discussed in the following Section).

In order to estimate the Project’s future revenues from the proceeds of apartment sales, the Expert first calculated the remaining proceeds from apartments sold before 31 January 1980. He then determined how many apartments remained to be sold on the valuation date, how many of the apartments sold before that date would become available for resale after that date, the time at which they would be sold, and their price. In addition, he estimated sales proceeds from extra parking spaces and heavy duty construction equipment.

The Tribunal (consisting of Judge Lagergren, Mr Ameli and Judge Holtzmann) broadly accepted the valuation made by the Expert: since prices likely to be realized for apartments to be constructed in future were taken on the basis of actual Apartment Purchase Agreements for apartments sold. The Tribunal concluded that the valuation method adopted was “professional and reasonable” – but it modified the valuation by making some adjustments. The Starrett Housing Project was an ongoing project with a proven record of profitability.

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<sup>168</sup> (1987) 4 Iran–US Claims Tribunal Reports 122.

<sup>169</sup> Shah Goli Apartment Company was the Iranian subsidiary to which Starrett had assigned the Project Agreement. Starrett Housing owned 79.7% of Shah Goli.



- (f) Again in *Philips Petroleum v. Iran*<sup>170</sup> compensation was claimed for taking of Claimants' rights under a 1965 Contract for exploration and exploitation of Petroleum resources of a certain area in the Persian Gulf (Joint Structure Agreement or JSA). The property right taken was to exploit natural resources previously discovered pursuant to the contract. In the circumstances the Tribunal (consisting of Mr Briner, Mr Khalilian and Mr Aldrich) considered the use of the DCF method "a relevant contribution to the evidence of the value of the Claimants' contract rights which have been taken by the Respondents" – though "not [an] exclusive method of analysis". The Tribunal added that "all relevant considerations" must also be taken into account.

In para. 116 the Tribunal held (copy at page 125):

With respect to the method of valuation, the Tribunal has used methods it considers appropriate in light of all the issues and evidence in this Case, including the nature of the contractual arrangements represented by the JSA, and the Tribunal makes no finding with respect to the valuation of other types of contracts or other types of property.

### 12.3 *How Appropriate Compensation and Fair Market Value should be Determined in the Instant Case*

12.3.1 The Claimants have to be placed in the position they would have been [in] if the expropriation had not taken place. Since 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. But that is not the end of the matter. In the Claimants' Memorial there is the claim for tangible assets: purchase cost of USD 1.5 million, and claim for intangible assets viz. further expenditures of USD 2 million "on retaining

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<sup>170</sup> (1989) 21 Iran-US Claims Tribunal Reports 79 (award dated 29/06/1989 Chamber Two: Mr Briner, Mr Khalilian and Mr Aldrich) – Relevant parts of paras. 111 and 112 of the Award read as follows:

111. The Tribunal recognizes that the determination of the fair market value of any asset inevitably requires the consideration of all relevant factors and the exercise of judgement. In the absence of an active and free market for comparable assets at the date of taking, a tribunal must, of necessity, resort to various analytical methods to assist it in deciding the price a reasonable buyer could be expected to have been willing to pay for the asset in a free market transaction, had such a transaction been possible at the date [the] property was taken ...

112. One such method of analysis, and the method used by the Claimant, is the Discounted Cash Flow ("DCF") analysis, which calculates the Claimants' prospective net earnings over the term of the JSA and discounts them to give their value at the date of taking, using a discount rate that takes into account the perceived risks. In that connection, the Tribunal does not understand the Claimants' calculations of anticipated revenues from the JSA as a request to be awarded lost future profits, but rather as a relevant factor to be considered in the determination of the fair market value of its property interest at the date of taking. The Tribunal recognizes that a prospective buyer of the asset would almost certainly undertake such DCF analysis to help it determine the price it would be willing to pay and that DCF calculations are, therefore, evidence the Tribunal is justified in considering in reaching its decision on value. In *Starrett*, supra, the Tribunal based its Award on an expert's report that utilized the DCF method, but the Tribunal made various adjustments to the conclusions and the resulting amounts. The need for some adjustments is understandable, as the determination of value by a tribunal must take into account all relevant circumstances, including equitable considerations. While a DCF analysis can, and often should, be an essential and even central component in that determination of value, it must not exclude other relevant considerations. In this connection, the Tribunal notes that in *Amco International Finance*, supra, Chamber Three considered the DCF method inadequate and distinguished between the assets of a going concern, including good will and commercial prospects, which it noted are closely linked to the profitability of the concern, and what it described as the "financial capitalization of the revenues which might be generated by such a concern ..."

consultants, inviting tenders for design and construction, completing design work, installing infrastructure” for which the Claimants have necessarily to be compensated as if the expropriation had not taken place. The expenses incurred are of the aggregate order of USD 3.56 million as projected in items (1) and (2) of the claim set out in the Memorial. Apart from these claims in respect of tangible claims and claims for intangible assets including expenditure, there is a separate and distinct head of claim viz. “opportunity to make a commercial success of the project”. Having rejected the DCF method of computation (valuation) the question is in what manner are the Claimants to be compensated for the termination of the “opportunity to make a commercial success of the project”.

The right of the Claimants to be compensated for the expropriation in the instant case is unquestionable. That compensation must necessarily consist of *damnum emergens* as well as *lucrum cessans*: even if *lucrum cessans* depends on various factors including the possible illegality or unlawfulness of the taking. Although the taking of the Project Property was within the framework of the BIT because it was for a public purpose (Arboretum), it was not a lawful taking under Kazakhstan Law. The repeated admissions by officials in Kazakhstan at the highest level<sup>171</sup> (including the Foreign Minister himself)<sup>172</sup> that the cancellation of the project was in violation of (applicable) legislation constitutes an admission of the illegality of the taking under local law.

This has been admitted in the course of closing arguments made on behalf of the Respondent – in the following passage:<sup>173</sup>

Tribunal: We have seen in several documents admissions, or implied admissions, that Kazakhstan procedures were violated or were not, in taking away of this property.

I would like to know what is your opinion on the process of taking away or seizing this property by Akim. Was this in accordance with the Kazakh law [or was it not]?

Mr Barnum (for the Respondent): The short answer is no. Do you want a detailed answer?

Tribunal: The short answer, it was not?

Mr Barnum (for the Respondent): Correct. We can give you the longer answer, but I think that is – if we said “yes”, [then] you would want to know how, but since the answer is “no”. [I] think that meets your purpose.

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<sup>171</sup> Claimants’ Exhibit No. 28 – Protocol of Inter Ministry Working Group dated September 5, 2000: the Working Group considers that:

1) the decision of the local executive body that impedes the implementation of construction by the investor was adopted in violation of the procedures established by the current legislation.

<sup>172</sup> Claimants’ Exhibit No. 31 – letter dated March 17, 2001 of Foreign Minister Yerlan Idrissov to Deputy Prime Minister.

<sup>173</sup> Transcripts of the oral hearing. Day four, pages 58–9.

Tribunal: That is right.

Tribunal: That is the end of it.

Mr Barnum (for the Respondent): That is, indeed, what the working group found which was one of the predicates for the working group's recommendation that you undo this illegal or improperly-activated taking, if you will.

Tribunal: Very well.

Besides, the circumstances attending the stoppage of work and high handedness of officials in ousting the Claimants' contractors from the Project Property (in May 2000) was obviously without regard to due process and was arbitrary – contrary to the Claimants' clear title on the land and their right to build the entire Project Property (at an estimated cost of USD 16.3 million) which constituted an obligation on the part of the Claimants vis-à-vis the State agency, as evidenced in Contract No. 0159-12-99 dated December 13, 1999: they were freed from this only [on] June 16, 2000.

The Claimants were also not accorded the right, though they were entitled under Article III(2) of the BIT, to a prompt administrative review of their case (though recommended by the Ministerial level meeting).<sup>174</sup>

12.3.2 In the circumstances aforesaid in the opinion of the Tribunal the Claimants are entitled to be compensated for the loss of opportunity on the total amount they were entitled to invest, i.e., on the amount of USD 16.3 million afforded by the projected investment. Whilst the Reports (Claimants' Exhibit Nos. 105, 106 and 132) were prepared for the purposes of proving the case of the Claimants in the Arbitration and may therefore be regarded as self-serving, the earlier Appraisal Report dated December 8, 1998 (Claimants' Exhibit No. 14) affords contemporaneous evidence as to why the Claimants were interested in investing in Kazakhstan –i.e., for constructing in the aggregate in all three phases a total of 82 units (later reduced to 76)<sup>175</sup> of residential quarters to be known as the Crystal Air Village at the project site. The Appraisal Report records that there was a market vacuum for premium quality western standard housing in Kazakhstan and that according to Almaty City Statistics there were then in excess of 9,000 registered expatriates residing in Almaty with Westerners making up more than 60% of this figure: and that at least sixty multinational companies had a significant presence there: the investment objective was therefore to develop a premier residential compound targeting expatriate employees of large multinational companies

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<sup>174</sup> Article III(2) reads as follows:

A national or company of either Party that asserts that all or part of its investment has been expropriated shall have a right to prompt review by the appropriate judicial or administrative authorities of the other Party to determine whether any such expropriation has occurred and, if so, whether such expropriation, and any associated compensation, conforms to the principles of international law.

<sup>175</sup> See Claimants' Memorial dated February 15, 2002, p. 19.

and affluent Kazakh customers at the conveniently located project site. The Appraisal Report mentions an expected return of 30% on the total investment.<sup>176</sup> In the circumstances the Tribunal considers that the appropriate compensation for the loss of opportunity would be and should be the expected return as foreshadowed in the Appraisal Report: because it was only by reason of the acts of the Respondent and its agents and officials, that the Claimants were undoubtedly deprived of making the contemplated investment, and earning the anticipated return: a return by no means exaggerated or chimerical as contemplated at the time (i.e., in December 1998). But after June 16, 2000, the date of termination, the Claimants no longer remained committed to invest in the project and therefore had at their disposal an aggregate amount of USD 12,740,000 (the difference between USD 16.3 million and USD 3.56 million actually invested up to June 2000) on which amount interest could and would have been ordinarily earned until the date of the award: hence interest on the said amount (USD 12.740 million) at the rate of 6% p.a.<sup>177</sup> has been offset against the figure of compensation.

In addition, the entire sum of USD 3.56 million which was actually spent up to June 2000 and was a totally lost investment has to be compensated for in the opinion of the Tribunal. Therefore the Claimants would be entitled to interest on *this* amount at the rate 18%, a rate mentioned in Claimants' Exhibit No. 125, where it is stated that in the year 2001 the Almaty Merchant Bank provided loans to corporate clients in foreign currency at rates between 18%–20%.<sup>178</sup> The Tribunal reckons that the amount of USD 3.56 million actually spent (infructuously, as it ultimately turned out) is more in the nature of a business loan and has therefore applied the lowest of the rates mentioned in Claimants' Exhibit No. 125 to the said amount of USD 3.56 million actually expended by the Claimants, for a project that never took off due entirely to the fault of the Respondent and its agents and officials.

### 13. INTEREST

Simple interest tends to be awarded more frequently than compound interest, compounding being justified only as an aspect of "full reparation".

At the time of concluding arguments the case of the Respondent was that the claim for compound interest would be valid only where the Claimants had invested the money and wanted to get it back; for the

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<sup>176</sup> The Appraisal Report mentions that investment would be made through a company owned by AIG Silk Road Fund and that AIG Silk Road Fund would receive 100% of all cash flows generated by rental or sale of individual properties until it achieves an IRR of 30% – subsequent cash flows would be split with TEMA on a 66%/34% basis.

<sup>177</sup> Interest on deposits in the World market were of the order of about 6% p.a. at the time.

<sup>178</sup> Claimants' Exhibit 125: "In response to your letter, we hereby inform you that JSC „Almaty Merchant Bank" in 2001 provided loans to corporate clients with the following interest rates: in foreign currency – 18%–20% and in the national currency (tenge) – 22%–24% per annum."

rest, simple interest (it was argued) would be more than adequate.<sup>179</sup> The following are relevant excerpts from the record of proceedings.

Tribunal: What should be the rate of interest and whether it should be simple or compound, that is the main point?

Mr Barnum: It should be 8% simple interest.

Tribunal: Why 8%?

Mr Barnum: That is the rate of interest payable on judgments under the law of Kazakhstan which governs this dispute. That is statutory National Bank of Kazakhstan refinancing rate, and that is 8% now.

With respect to whether compound or simple, the argument for compound interest is valid, if at all, when the complainant has invest[ed] the money it now wants to get back.

If, in the year 2000, AIG had invested the \$13 million it is asking for now and had not had that \$13.5 million in these intervening years, then there is an argument that they should have compound interest on that 13.5 million, but that is not in this case. The vast bulk of that claim, \$10 million of it, is not for the money that they invested; it is for the money that they did not get paid then.

Tribunal: Yes.

Mr Barnum: And for that, simple interest is more than adequate.

Tribunal: On that same argument, for the expenditure they would be entitled to compound interest?

Mr Barnum: Yes, sir, because that is what they laid out, that capital had a cost for the intervening period, and I would accept as logical, applying compound interest to monies laid out but not for hypothetical lost profits which were never a cash cost to the complainant. That is my distinction between simple and compound, sir.

The award of compound interest is not unknown or excluded in international law. The UN Report of the International Law Commission, 53rd Session (2001) in its commentary under Article 38 (Interest) states at page 273 that:

... given the present state of International law it cannot be said that an injured State (party) has any entitlement to compound interest, in the absence of special circumstances which justify some element of compounding as an aspect of full reparation ... There is no uniform approach, internationally, to questions of quantification and assessment of amounts of interest payable. In practice the circumstances of each case and the conduct of the parties strongly affect the outcome.

It appears to the Tribunal that as a matter of law where the owner of the property or an investment has at some earlier point of time lost part of the value of his assets or investment, and has not received the monetary equivalent which then became due to him, the amount of compensation to be awarded must reflect the additional sum that his money would have earned had it (and the income generated by it) been

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<sup>179</sup> Transcripts of the oral hearing, Day Four, pages 101–2.

reinvested each year at available rates of interest.<sup>180</sup>

In the present case the quantum actually expended on the project by the Claimants up to June 16, 2000, has not been disputed at all – and was not even offered and much less paid during the subsequent negotiations between the parties.

Accordingly, compound interest has been awarded only in respect of the claim for USD 3.56 million – the amount actually expended on the project up to June 2000. Compound interest awarded on this sum is not as a punitive measure – to punish the Respondent for the undoubted delay in payment of this admitted expense. It is only intended to ensure that the compensation awarded to the Claimants ensures “full reparation”. It is on this basis, viz. restoring the Claimants to a reasonable approximation of the position they would have been [in] if the wrongful act had not taken place, that compound interest was awarded in *Metalclad v. United Mexican States* – Award dated August 30, 2000 in ICSID Case No. ARB/(AF)97/1.

As for the remaining amount to which the Claimants are entitled simple interest has been awarded since the amount of the sum due has been fixed and the obligation to pay has been established by this award itself: this was the principle on which the Permanent Court of International Justice awarded simple interest as from the date of judgment in the *SS Wimbledon Case*: 1923, PCIJ Series A, No. 1 page 32.

#### 14. COSTS

The claim was resisted in the arbitral proceedings by the Respondent not only on ground of the incompetence of the Tribunal to entertain and adjudicate the claim, but also on other grounds of jurisdiction. The liability on merits – both in law and on facts – was also disputed: arbitration was therefore inevitable. The Respondent has failed to convince the Tribunal on its pleas of jurisdiction (including the plea regarding the constitution of the Tribunal), and on various defences raised disputing liability. It is only on the quantum of compensation awarded that the claim of the Claimants has stood reduced. In the circumstances the Tribunal has decided that a sum of USD 1.25 million (in words: one million two hundred and fifty thousand US dollars) should be paid by the Respondent as and by way of compensation for expenses incurred by the Claimants in connection with the arbitral proceedings. This includes the legal fees and expenses of the Claimants, as well as the fees and expenses of the arbitrators and charges of the Centre.

#### 15. FINAL AWARD

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<sup>180</sup> It was on this basis that in the *Santa Elena* case: 15 ICSID Review Foreign Investment Law Journal 169 (as rectified in 15 ICSID Review Foreign Investment Law Journal 205 (2000)) 39 ILM 1317 (2000) that compound interest was awarded.

In the circumstances, and for the reasons stated above, the award of this Tribunal is as follows:

- 1 The Centre has jurisdiction and the Tribunal is competent to decide the present dispute.
- 2 The acts of the Respondent's political subdivisions constitute measures tantamount to expropriation of the Claimants' investment in the Republic of Kazakhstan for which Respondent is liable to pay compensation.
- 3(a) The Respondent is obligated to pay and must pay the Claimants, in the manner in which the Claimants will jointly instruct the Respondent, the sum of USD 3,560,000.00 (in words: three million five hundred and sixty thousand US dollars) together with compounded interest (with semi-annual rests) at the rate of 18% (in words: eighteen per cent) from the date of taking of the investment, i.e., from June 16, 2000, until the date of the award.
- 3(b) Should the amount due under sub-clause (a) of this clause (clause 3) remain unpaid for more than 30 days (in words: thirty days) after receipt of the Claimants' payment instructions, then the Respondent must also pay further interest on the sum awarded under sub-clause (a) of this clause with simple interest at the rate of 6% per annum (in words: six per cent) from the date of the award until payment.
- 4(a) It is declared that a sum of USD 4,890,000.00 (in words: four million and eight hundred and ninety thousand US dollars) represents the estimated return of 30% on the planned investment of USD 16,300,000.00 (in words: sixteen million three hundred thousand US dollars) that Claimants intended to invest.
- 4(b) It is further declared that this sum of USD 4,890,000.00 would stand reduced by an amount USD 2,490,670.00 representing the accumulated simple interest of 6% per annum that could have been earned in the period from the taking (June 16, 2000) until the date of this award on the amount of USD 12,740,000.00 (in words: twelve million and seven hundred and forty thousand US dollars) that the Claimants were no longer committed to invest in the Project, and therefore had at their disposal.
- 4(c) Accordingly, the Respondent is also obligated to pay and must pay to the Claimants, in the manner in which the Claimants will jointly instruct the Respondent (in addition to the sums mentioned in Clause 3), the net sum of USD 2,399,330.00 (in words: two million three hundred and ninety nine thousand three hundred and thirty US dollars) – that is the difference between USD 4,890,000.00 and USD 2,490,670.00 – with simple interest at the rate of 8 per cent per annum (in words: eight per cent) from the date of the award until payment.
- 5 The Respondent is obligated to pay and must pay to the Claimants, in the manner in which the Claimants will jointly instruct the Respondent, the sum of USD 1.25 million, which represents

compensation for the Claimants' reasonable costs and expenses in connection with this arbitration, including the fees and expenses of the arbitrators and the administrative charges of the Centre.

