BEFORE THE INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES

ICSID Case No. ARB/19/6

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In the Matter of Arbitration Between: :
ANGEL SAMUEL SEDA AND OTHERS, :
Claimants, :
and :
REPUBLIC OF COLOMBIA, :
Respondent. :
--x Volume 6

VIDEOCONFERENCE: HEARING ON JURISDICTION AND MERITS

Saturday, May 7, 2022

The World Bank Group
1225 Connecticut Avenue, N.W.
Conference Room C 3-100
Washington, D.C.

The Hearing in the above-entitled matter came on at 9:00 a.m. before:

PROF. DR. KLAUS SACHS
President of the Tribunal

PROF. HUGO PEREZCANO DÍAZ
Co-Arbitrator

DR. CHARLES PONCET,
Co-Arbitrator

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C O N T E N T S

P R O C E E D I N G S

RICHARD HERN, RESPONDENT'S WITNESS, CALLED

PRESIDENT SACHS: Good morning, Dr. Hern.

Good morning. Would you kindly read for the record the Declaration that is before you.

THE WITNESS: I solemnly declare upon my honor and conscience that my statements will be in accordance with my sincere belief.

PRESIDENT SACHS: Thank you very much. We will now invite you to deliver your presentation.

MS. BANIFATEMI: Mr. President, may I--I get the impression that the screen is blocking the view for Mr. Hern. You do see him? I just wanted to mention. Thank you.

PRESIDENT SACHS: Not in full, but--

MS. BANIFATEMI: Not in full? Well, then maybe we could push it away.

(Pause.)

DIRECT PRESENTATION

THE WITNESS: Good morning, everybody. Thank you for inviting me to be present today.

I have a set of slides that in essence

summarize the two reports that I've submitted to the Tribunal on this case and, to the extent possible, I will also use this presentation to comment on some issues that came up yesterday in the context of BRG's presentation, but also the JLL and CBRE presentation on the previous day.

I start with just a summary of background and experience. I'm a Managing Director at NERA Economic Consulting. My focus is on valuation in the context of large infrastructure assets. I've testified on more than 20 international arbitration cases, also authored a number of articles on valuation techniques.

Apologies.

(Pause.)

THE WITNESS: Sorry, I just lost the slide numbers, but I hope that's helpful by way of background.

In terms of my first slide, I thought it was useful just to summarize my conclusions on this matter. I was asked to estimate damages in the context of this case. My calculations were based, like BRG, premised on the Fair Market Value concept. Damages are never straightforward in these types of cases, but in a sense I reached the conclusion that it was fairly straightforward in this case that if there were to be any damages, that the right approach to quantify those damages was what I called the "Cost Approach" or the "Asset-Based Approach." And, in essence, that approach is based on an analysis of how much expenditure had been undertaken on the projects at the time of the valuation. And to the extent possible, that approach also takes account of what that expenditure is worth at the time of the Valuation Date. So it's an analysis of historic expenditure, we valued essentially to the Valuation Date.

Now, I don't reach that conclusion lightly, that that's the right approach. I considered other possible approaches to quantify damages, and we heard yesterday about the discounted-cash-flow methods. There's also another method that is used in these types of cases called the "Market-Based Approach." But for reasons that I explain in my report and I will elaborate on today, I don't think that they're the right approaches for this case. I think they're too speculative. I don't think we have the right data to be able to quantify damages using those approaches.

And I revert back to using an Asset-Based Approach, which I think has a lot of precedent in the context of these types of cases in the international arbitration space, too.

So, in summary, my estimate, if there are to be damages in this case, of course, I don't opine on liability, but if damages were to be awarded, then in the context of the Meritage Project, my estimates of those damages is in the region of USD 1 million plus pre-award interest of 67,000.

Now, I was also asked--for completeness, I understand it's the Respondent's case that it's only the Meritage that has been affected by the Measures, but I was asked for the purpose of completeness to also assess damages should it be found that other projects were affected by the Measures.

So, in the context of the other projects that had been put forward by the Claimants as potentially affected by the Measures--the Luxé development, the Tierra Bomba development, 450 Heights, Santa Fé--I've also examined damages using the same Asset-Based Approach or Cost Approach. And in the context of those projects and the overall set of projects that the Claimants are referring to, my estimate of damages would be in the region of 7.6 million plus 472,000 Pre-Award Interest.

Now, just to--I thought it would be useful just to take you through the steps that are involved in this Cost-Based Approach. Step 1 is, as I say, to look at the historical expenditure on the Projects. So, in the context of Meritage, the historical accounts over the period from 2012 to 2016 show expenditure of COP 69 billion, although the vast majority of that expenditure was in 2015 and '16.

The next step in this approach is to deduct how much of that expenditure has been funded by debt, and/or pre-sales, and that amount in the context of Meritage is 63 billion; that, therefore, results in net costs, if you like, excluding debts of 6 billion. I then allocate those net costs to the Shareholders that are involved in this claim, so 40 percent of the historical shares, according to the register, are held by the Claimants, so 6 billion is then allocated by 40 percent to the Claimants. That leads to 2.5.

I then--as I say, I then take account of inflation and risk over the period in which the expenditure has been made, so I roll forward that expenditure using a Risk-Free Rate, a nominal Risk-Free Rate of 5.3 percent to the Valuation Date.

And the final step I take into account is that I understand additional debt was provided by Royal Realty to the project as additional damages to be compensated. I don't believe BRG take that into account, but I do, and I increase the amount of damages by COP .4 billion, and I then convert the total amount then into U.S. dollars at the Exchange Rate at the Valuation Date.

And those series of steps then leads effectively to my calculation of damages to be COP 3 billion converted at the Exchange Rate of COP 3,000 to U.S. dollars leads to damages of 1.1 million.

And that's the step that I take for each of the projects. I've talked you through the numbers there for Meritage because that's what I focused on, but, in my report, I take essentially the same steps for each of the projects to calculate what I call the "Asset-Based Approach" for valuation of damages for each of those projects.

Now, I understand that my approach is not one that's agreed--agree with by the Claimants. I've noted a number of comments by BRG and also the counsel for the Claimants that comment on the Cost Approach, and I thought it might be useful just to respond to these comments today.

In essence, my understanding is they refer the Cost Approach as backward-looking, an approach that ignores the future and growth potential of the company and ignores intangible assets.

I acknowledge that there are comments made generally in the damage literature along these lines, and, of course, there is no single one right way to assess damages in all types of cases. So, you know, yes, I would say it's true that some of these comments have been made in the context of this approach. But I wanted to emphasize the reasons why I still think this approach is the right one.

First of all, as I say, it's one of three approaches that is almost always referred to as one of the approaches to estimate Fair Market Value. I think when we look at the precedent--and again this is slightly legal context, but when I look at the precedent legally for which approaches are used in which circumstances, I think there's a lot of precedent to use a Cost Approach for assets that are not yet going concerns, that are not profitable, that are not generating cash flows. And, of course the reasons why that's true is because, in the context of those types of case, it's actually very difficult to apply any different approach. If you haven't got assets that are generating cash flows, that are generating profits, how do you populate an approach like the DCF Model? And I'll come on to that in a minute.

But the criticism of the approach as being backward-looking is not really a fair criticism because when we think about competitive markets and underpinning an awful lot of competition policy is the premise that, in competitive markets, prices are driven down to costs. That's what happens in competitive markets. We end up with prices being driven down to costs. And what that means is when we're looking at industries that are, you know, generally quite competitive, we would expect to see the same outcome, prices being driven down to costs.

So, in that context, the future cash flows of those projects end up being driven down to the costs, to the investment costs that are put into those projects over time to generate those cash flows. So, you know, it's not strictly correct to say just because we look at historical data that means it's a backward-looking approach. No, that's not right. In competitive markets, what we expect to see is the future cash flows from those projects being driven down to the invested costs to generate those projects.

And I think in, you know, in the context that we're looking at here, the hotel and real estate market, it's a competitive market. There aren't huge barriers to entry, to buy land, to develop that land for real estate or hotels. It's generally regarded to be a competitive market. So, the merits of this particular approach, I think, are quite strong in the context of this case.

Now, I also noted in the--in counsel for the Claimants' opening that they also argued that historic costs don't account for changes in valuations over time. They gave an example of the used car markets. The prices of cars bought in historic years are not the same in future years. Well, of course, that's true, but we're not dealing with a used-car market here. We're dealing with an infrastructure investment with historic costs that have been made around bricks and mortar and land, and we wouldn't expect those costs to substantially change over time.

So, you know, I think that analogy is not really applicable to the case that we're looking at here, but I also think, in the context of this case you know, we are looking at invested costs, as I say, from Meritage that had been largely made in 2015 and '16, very close to the Valuation Date, so we're not looking at historic costs that had been spent many years ago and asking what would they be worth many years later. We're looking at costs that have been spent on land, on leases, on bricks and mortar, and we're looking at valuing those costs at a relatively recent date to when they'd been invested.

So, I think that analogy is not really relevant; and, as I say, I think this approach has a clear method of taking account of changes in valuation over time through inflation. That's how I take them into account of a change in valuation over time.

So, as I say, I think the merits of the Cost Approach in this case are actually very strong. I also considered a DCF Approach, and I think you would have seen my Second Report where I populated a DCF Model to see how that reconciles with the outcome of my Cost Approach. And, of course, you heard the evidence yesterday from BRG that also used a DCF Approach. But I think, you know, fundamentally, in the context of this case, a DCF Approach is really very difficult to apply.

We're talking about a claim that's based on five different developments--Meritage, the Luxé, Tierra Bomba, Santa Fé, and 450 Heights. In the context of the Claim, 80 percent of the damages come from the hotel components of those developments, but yet no hotel has been completed and is up and running so--but none of these developments do we have any history of cash flows associated with the hotel business, but yet 80 percent of the Claim for damages comes from the hotel operations, so we don't have any historic record of cash flows associated with the hotel operations for these activities.

Many of the projects are really in very early pre-development stage with even real estate not yet developed or sold; and, in the context of the Meritage, which is the focus of my Report in many ways, that project was supposedly phased over eight phases. Only Phase I has been--has reached equilibrium, so that was the sale of units in Phase I. But when I look at the cash flows that have been generated from Phase I, Phase I appears to be loss-making. So, even for the Meritage, where there has been some development of Phase I, we still don't have any history of positive cash flows being generated from that project.

So, I think, you know, it's very difficult to populate a DCF model in that context, and it's notable that when we look at BRG's--when I reviewed BRG's damages model, it's massively complex with literally thousands and thousands of data entries attempting to present forecasts of economic variables associated with all of these projects, but yet we really have very, almost zero operational history of these projects against which to validate those forecasts. So, in essence, the whole DCF exercise becomes highly speculative.

Notwithstanding that, I did think it was useful for the Tribunal to see what I thought a DCF approach would produce. So, in my Second Report I went further than my First Report and attempted to populate a DCF approach. I present the result on this Slide 10. In the context of Meritage, I think the DCF data suggests to me something in the region of 0 to 2 million. In the context of all the projects overall, something in the region 3 to 7 million. So the outcomes, in my view, from the most reasonable assumptions I could make for a DCF approach are actually pretty consistent with the Cost Approach, but I still don't think it's the right approach to be using. I think it's far too speculative, far too many assumptions need to be made, and we really have very little basis to validate those assumptions.

I think, just moving on a little bit to commenting on BRG's assumptions, on Slide 12, I've broken down BRG's overall claim of damages of 200 million into the different components that that claim is based on, and hopefully this is helpful because it shows you, I think, just how many different parts of this case, how many number of different projects are associated with it. You've got the hotel operations. You've got five different developments for the hotel operations. You have five different developments for the real estate operations. You have fees associated with the hotel, fees associated with the real estate. And all of these developments are also phased over time, so they have a number of different phases.

And, therefore, what that means is, you know, when coming up with a DCF calculation, there is effectively a DCF calculation for each of these individual projects and for each of these individual phases sitting below these projects. And all of that needs to be populated, assumptions need to be made about the valuation drivers for all of these myriad of projects and forecasts; and, as I say, you know, we really have very little operational history against which to validate those assumptions.

One exercise I did in my Report was to crosscheck BRG's calculation of the DCF Approach against the prices that have been paid by the Investors in these projects into the Project Companies. In a sense, you could think of this as a Market Approach because it says, you know, what did investors pay to establish equity into the projects? And for Meritage, we see the date of the share purchases, the date of the original equity investments in May 2013, the implied value--a hundred percent of the shares were purchased at that point in time, the implied valuation of the project at that point in time was therefore 2.25 billion, but yet BRG's DCF claim for valuations in the region of 2.5 years later is

163 billion.

So, I mean, that doesn't take into account additional capital contributions that might have been made over that period, but it does say when the project was started, relatively recent to the Valuation Date, we are being led to--if BRG's DCF calculation is right, then the valuation of that project has increased by 72 times over that period, and that, to me, doesn't make sense economically because over the period from May 2013 to the end of 2016, very little has actually happened in the context of the Meritage Project. We have Phase I, yes, where there has been sales of the units, but Phase I is still only 20 percent or so constructed. We have no operational history, no sales of units for the hotel. We have a very limited number of sales for some of the other phases. But yet, if BRG's calculation is right, the valuation of the Project has increased by 72 times, so economically that doesn't really make sense, in my mind.

We asked for additional data on share purchases or acquisition of equity after that period.

I believe it's perhaps an issue of dispute as to how much of this data is on the record, but there was discussion last night of a transaction by Haystack Holdings, of a stake in the Luxé Royal Realty. My understanding is that the price that was paid for that purchase is 35.2 billion. Again, if that's right, there's a clear mismatch in the valuation that's been put forward by BRG of 155 billion against the implied valuation of the assets in 2015 of 35 billion. So, you know, again, the clear mismatch between the DCF Model that BRG are putting forward and the implied valuation in 2015.

And by the way, you know, the implied valuation of these stakes is broadly consistent with my Cost Approach, so it's very different from BRG's DCF approach. It's broadly consistent with my Cost Approach.

So, just moving on to a few comments, then, on BRG's issues of detail. Overall, as I say, I think there are exaggerated or optimistic assumptions of most of the key value drivers in the BRG model. I'm going to pick out a few, but, in essence, the valuation of these projects is driven by the profit margin. It's the EBITDA or the profit margin of the Project that really drives the valuation in the DCF Model. You know, we can dispute individual items on revenues and costs, but overall valuation is about profits; and therefore, the key assumption in their model is the profit margin, and that's what I focused on in my analysis.

When I look at the profit margin of the BRG assumptions on the various hotels and I compare that to benchmarks in Colombia but also other Emerging Markets, you know, my conclusion generally is that the profit margin appears to be in the region of two times higher than we see for relevant benchmarks. And I note that The Charlee has been discussed a number of times in the case so far; but, even if we compare these projects to The Charlee, it appears as though that these projects are around two times more profitable than The Charlee Hotel has been. So, that, in my view, is a key assumption in the BRG model that's leading to inflated estimates of damages using that approach.

The other key assumption in the model is the Cost of Capital because it's the Cost of Capital that's discounting the profits that leads to the net present value. I think, again, this is an unreasonable assumption by BRG. They appear to be assuming a Cost of Capital in the region of 8 percent nominal post-tax. I don't think that makes sense in the context of projects that haven't been yet developed, constructed, there is still a significant failure risk, construction risk associated with it. They're in Colombia, which is by no means a country of low-country risk. I think their Cost of Capital--and I've done a lot of work on Cost of Capital over many decades--is more appropriate to a Cost of Capital that we might see in a market like the U.S. A Cost of Capital around about 8 percent nominal is a typical Cost of Capital that we observe for setting rates of return for U.S. utilities, not for Colombian real estate.

I've done my own analysis. I think a more reasonable Cost of Capital is in the region of 12 to 18, but I think there's other evidence that tells us that this Cost of Capital can't be right because the projects, themselves, have taken out debt at the rates of 10 to 11 percent, and it's impossible for the Cost of Capital, which is a weighted average of equity and debt, it's impossible for that number to be below the cost of debt of the projects because the Cost of Equity is always higher than the Cost of Debt. So, the weighted average, therefore, must be higher than the Cost of Debt.

So I think that there's clear evidence on the record that Cost of Capital can't be right. I've also noted that the Claimants, themselves, appear to have offered these projects to investors at Internal Rates of Return of 25 to 28. That doesn't make sense if they think the Cost of Capital is 8 percent. Effectively, they would be giving away free money associated with these projects if they thought the true Cost of Capital was 8 percent but they're willing to offer investments at a promised or expected rates of return of 25 to 28.

So, that, in my view, is a key number that's wrong in the BRG model. But, of course, you know, all of this data also shows that actually, you know, it's quite difficult to estimate a precise Cost of Capital for this type of project in this country, and that's a key assumption in a DCF Model; and if we can't be very certain about that assumption, we can't be very certain about the outcome from a DCF Model.

I think another key issue with BRG's DCF Approach is how they take or don't take into account potential failure risk associated with the projects. This was discussed yesterday. My views on this are that, given the early stage nature of these projects, and I've talked about Meritage, only Phase I being started, being pre-sold, Phase I was not yet even fully constructed. Phase II, which is the big hotel complex was not constructed, had no pre-sales. Phases III to VIII or IV to VIII are very limited pre-sales, not yet constructed. Financing for all of the projects had not been raised. There was no clear evidence that the project was profitable. Phase I was actually loss-making.

Just intuitively as an economist, is it reasonable in that context to assume 0 percent failure risk. That's BRG's assumption--0 percent failure risk--but yet, you know, such a limited amount of the project has so far been undertaken. Yes, we can look at Charlee, and we can say Charlee--we can see that Charlee has been profitable, but Charlee is a very different business from what these projects are. These--many of these projects are multiple times bigger than Charlee. The Charlee is a hotel complex. These projects are combinations of real estate and hotels. They have many, many more units than The Charlee Hotel. They're in a very different location from The Charlee Hotel. They're outside of Medellín, sometimes in quite rural areas. It just doesn't make sense to be assuming that these projects have 0 percent failure risks.

You know, what is the right failure risk? That's the question I ask myself because I also attempted to populate a DCF Model, but the reality is, you know, we, as economists or valuation people, we have very little data to tell us what is the right failure risks for these types of investments. You know, we're looking at, you know, quite unique development plans in quite unique areas of Colombia. You know, we don't have a dataset that we can go to and say, "Oh, well there has been X number of previous attempts to develop projects in similar areas of a similar scale." That type of data just doesn't exist, and as a result of that, inevitably, if we're trying to estimate failure risk, we have to be--to essentially speculate on that, and that's very difficult to do, of course. All that makes the damages calculation inherently speculative as a result.

Moving on quickly to real estate. Real estate is a much smaller component of the damages claim. It's only 20 percent, whereas hotels are 80 percent, but I have the same concerns with BRG's assumption on real estate. At the profit margins that they appear to be assuming for key stages of the Projects at the Meritage and Tierra Bomba Project in particular, are significantly above the profit margins for other Colombian real estate developers. They're also above profit margins for other datasets that we've looked at. And I note CBRE themselves, the real estate experts, did a survey and estimated profit margins in the region of 16 to 19--sorry, 12 to 15 percent, so even lower than the 16 to 19 percent. So, you know, BRG's assumption of 47 percent or 42 percent is essentially driving their calculation of damages for real estate, but that assumption is way higher than we see in the observed data for real estate comparators.

We have the same issues with the Cost of Capital, they're actually assuming an even lower Cost of Capital for real estate of 7.7 percent nominal. You know, again that--that just doesn't make sense to me as an economist for real estate development in a country like Colombia. There must be more risks associated with that type of development than a Cost of Capital of 7.7. There's the same inconsistencies with the Cost of Debt. The Cost of Debt for these projects is higher than that number. That number, therefore, 7.7 can't be right. And we see the same inconsistencies between the offered IRR for the projects being much higher than their assumed Cost of Capital, which again doesn't make sense.

CBRE did their own surveys of the Cost of Capital for these types of projects and found numbers, you know, much higher than BRG's assumption.

I have the same issue with BRG's assumptions on failure risks for real estate. As I've talked about, you know, just like hotels, the real estate aspects of all of these projects were really in very early stage.

From what I can tell, Phase 1 of Meritage, which was a real estate phase, was the one that had really reached equilibrium in terms of the Projects the Claimants are claiming for, and as far as I can tell, that Project was actually loss-making. So, again, it doesn't seem to make sense to be assuming zero percent failure risk when we have, you know, so many potential risks associated with this Project in terms of can the Projects raise financing, can the Projects complete construction on time, are there going to be other macroeconomic risks associated with the Project that affect the profitability--you know, we simply don't know. These are very bespoke projects. It doesn't make sense to be assuming zero percent failure risk, in my view.

The other component of the damages, I've talked about hotels and real estate, the other component of the Claim for Damages is what BRG referred to as lost fees. So, these are fees that would have supposedly been paid to Royal Realty, the operator of the hotel and real estate operations. Again, in my view, these estimates of damages are--look exaggerated or inflated. And in a sense, one of the reasons for that is because they are being driven by inflated projections of revenues and profits because the fees that are generated to Royal Realty are based on the percentage of revenues and profits, and if the revenues and profits are inflated, it therefore follows that the fees are inflated.

But the other sort of crosscheck that I did was, when looking at the fees that were supposedly to be generated to Royal Realty, one would think that, because the profit margins associated with those fees were so high, in the region of 95 percent, one would think that you might then expect to see those high profit margins in the Royal Realty accounts because

Royal Realty's been operating up to the Valuation Date. So, you know, if it was true that it was a very profitable operator, we should at least expect to see those profits generated in their accounts, but we don't. We see over the period 2011 to 2015 negative profits in most of those years. So, you know, no evidence up to that point in time that the Company was profitable and, therefore, little evidence to validate these calculations of lost fees.

There's another component to damages associated with future hypothetical projects in the Claim. In my view, there's very little evidence to back up what these projects would be. I have attempted to do an almost "back of the envelope" calculation using a DCF of what they might be, but in essence, I think for this type of Claim of future hypothetical projects, I think the basis for a damage claim is very weak because it's not, in my view, been clearly established why that project has been lost, you know, why could the ideas for that project, if those ideas existed, not be sold to another investor, why could those ideas not be--not still be pursued. I haven't seen anything on the record that clearly tells me that there's a damage for these hypothetical projects.

I know BRG say they do a market crosscheck on their damage calculations, and this was discussed also in the context of JLL's presentation. I don't think what they do is the right crosscheck, and I think it leads to very misleading conclusions. And in essence, you know, what JLL appear to be doing is they appear to be saying, if we look at fully constructed hotels and the transaction prices paid for fully constructed hotels in other markets, we can compare that to the Transaction--the implied Market Value that we generate through our DCF. Yes. I mean, in theory, maybe that's, you know, something that's relevant to look at but the problem is we're not dealing with a fully constructed hotel here. We're dealing with a hotel that has not yet started construction, you know, the money hasn't been spent on any of these hotels yet. So, there's no reason to expect that the valuation of hotels that have not yet started construction should be anything like fully developed, fully operational hotels in other markets. You know, clearly, there's development construction failure risk associated with the Colombian hotels that are not present in the other markets. That's one factor they didn't take into account.

They also didn't take it into account when they looked at these other hotels, what they were looking at were, you know, very strong luxury brand hotels--Four Seasons Hotels, Sheraton, Ritz-Carlton Hotels--and trying to benchmark that against, you know, the potential valuation of the Meritage hotel, and clearly that's, you know, that's a very difficult comparison. Those hotels have extremely strong brands. They charge room rates five times or so higher in some cases than are being projected for these hotels, and therefore, you would expect their valuations to be very different. So, in a sense, what they've done as a crosscheck, in my view, actually shows that their valuation is way higher than it should be because it doesn't take account of any of these factors.

Almost, finally, I think I'm down to the issue of Pre-Award Interests. I think the right way to take account of Pre-Award Interest is using an Opportunity Cost of funds associated with the Risk-Free Rate. I think that's the--normally the standard approach to look at Pre-Award Interest because effectively what we're doing is we're saying if damages were--are calculated at a Valuation Date in 2016, how do we take account of what those damages are worth in today's money? There's no risk associated to the Claimants with rolling that money forward to the Valuation Date, and therefore, it's appropriate to use a U.S. Risk-Free Rate. Therefore, in rolling that number forwards, particularly because the calculation of damages in 2016 by both myself and BRG, are based on converting Colombian pesos to U.S. dollars in 2016, so it's a U.S. damages that's then rolled forward with the U.S. Risk-Free Rate.

In my view, the only alternative way of doing things is to calculate damages in Colombian pesos and then roll that number forward at a Colombian Risk-Free Rate. I did crosscheck it, my calculation using that alternative, and that would actually lead to a lower--a lower number to the Claimants. I didn't think that was appropriate because my understanding is that they're making a claim for damages in U.S. dollars, so I think the conversion should be done, the Valuation Date into U.S. dollars rather than at a later point in time, but I did do that--I did do that sensitivity.

Overall, this slide--this Slide 27 just summarizes the differences between my approach and BRG's, in terms of overall damages. As I say, I've been asked to focus on the Meritage because I understand it's the Respondent's case that only the Meritage was potentially affected. My valuation of damages, if there are to be damages, is in the region of 1.16 million, including interest. That contrasts with BRG's claim for damages of--in the region of 250 million.

I have a list of appendices in my Report on other matters. I didn't think I would have time to take you through that today but they deal with other assumptions in BRG's model concerning ADR and occupancy rates, the speed at which the--BRG claim they could sell real estate units, other evidence on the Royal Realty fees and why I think that's exaggerated. I'm happy to leave them in the slide pack for you to ask questions on them, if do you, but I think they're probably second order compared to the bigger assumptions about profitability margin because most of these assumptions feed into the profitability margin calculation, which I think I've shown you I think is much too high in BRG's model.

Thank you for your time.

PRESIDENT SACHS: Thank you very much, Dr. Hern. And we see that you are quite far apart, BRG and you, but we now give the floor to the Claimant for cross-examination.

Mr. Moloo, will you be in charge of the cross-examination?

MR. MOLOO: Yes, Mr. President. I do have one question from a timing perspective, I know we had said that there would be some flexibility. I don't intend to take longer than, let's say about an hour-and-a-half, but I just don't want an objection if we do end up taking, I think we have an hour and 19 minutes or something like that. Given all the interpretation issues, et cetera, I just want to make sure that we deal with that issue up front.

PRESIDENT SACHS: Yes. We may have a break after, let's say, 45 minutes or so.

MR. MOLOO: Understood.

CROSS-EXAMINATION

BY MR. MOLOO:

Q. Good morning, Mr. Hern. It's nice to meet you.

A. Good morning.

Q. My name is Rahim Moloo, and I'm counsel for Claimants in this case. And as I'm sure you expected, I have a few questions for you.

Now, in your First Report, if I understand correctly, your qualifications are set out at Appendix A, which is at Page 114; correct?

A. Yes, that's right.

Q. And you're a Managing Director in NERA UK. You're based in the United Kingdom; is that right?

A. Correct.

Q. And you've prepared testimony on a range of issues and I'm--I'll just wait for these to be given to you. Don't be scared by the number of pages. As you know, some these documents are really long, and I don't intend to take you through all of them.

So, on Page 114 of Appendix A--and you can put that up--of your First Report, in Paragraph 262, you talk about your experience, and the last sentence you talk about, you know, you've worked in the commercial investor-State disputes encompassing a wide range of industries, including energy, oil and gas, telecommunications, manufacturing, distribution, utilities, shipping, air travel and transport infrastructure. I didn't see hospitality or real estate in there. I assume that's because you have not had much experience in those industries?

A. No, that's not--that's not really true, actually. That list was--a sort of list of the bigger industries that I've worked on. I actually recent--I testified last year on a large real estate case in Serbia, which I think is listed in my detailed CV experience. Just let me try to find that.

Q. That's fine. I'll take your word for it.

A. But it's--yeah, that's right. On Page-116, it refers to a case in--it's actually in Serbia regarding a large agricultural and real estate business.

I think also, you know, fundamentally, most of the cases I testify on, they're large infrastructure investments because those are typically the types of cases that end up in investor-State disputes. Many of them have, as part of the, you know, Investment, land associated or real estate associated with those investments, so the--you know, the whole issue of the valuation of that land and real estate is often, you know, an issue that I deal with, you know, just regardless of the industry actually.

Q. So, you consider yourself a real estate expert?

A. No, I wouldn't say that. I'm an economist and valuation, you know, person. I don't specialize in one particular industry. I sp--you know, I deal typically with infrastructure generally, you know, across a wide range of industries.

Q. Do you consider yourself an expert in the hospitality industry?

A. I mean, again, it's an industry I've had quite a bit of experience on, you know, in my work.

Q. You can say "yes," that's fine. You can say--

(Overlapping speakers.)

A. I wouldn't characterize myself as a hospitality expert, but it's an industry I've worked on quite a lot in the context of, you know, consulting and dispute work.

Q. The Serbia Case?

A. The Serbia Case is one, but—you know, again--

(Overlapping speakers.)

A. I'm actually working on a hotel case right now in--again, in Serbia. I've done a lot of valuation work in the context of airports, which have hotels associated, you know, with--the air sector is a big sector that I've worked on. So, you know, this issue of valuation of hotel businesses has come up in, you know, quite a few recent cases, too.

Q. Okay. That's--then, you'll be well-placed to answer some of my questions.

You consider CBRE to be real estate experts?

A. Yes.

Q. And including Valuation Experts for real estate and hospitality assets, you consider them to be more of a specialist expert than you in that space; correct?

A. No. I think you asked, do I consider them to be real estate experts.

Q. Yes—this is a second question.

(Overlapping speakers.)

REALTIME STENOGRAPHER: I'm sorry. You're talking over each other. Try it again.

THE WITNESS: Sorry.

I thought your question was, do I consider them to be more of an expert on valuation of real estate, which I would say I don't because my understanding is that they're more experts on real estate generally, but their work is not necessarily focused on valuation, whereas my work is focused on valuation. So, I think there's a distinction there between the industry, yes, they appear to focus on real estate but, you know, I wouldn't go so far as to say that I have any particular views on whether they're an expert on the valuation or real estate.

BY MR. MOLOO

Q. You are familiar with how big CBRE is; right? You're familiar with them in the real estate sector, given the work you've done in real estate--sector

A. Yes. Yes, generally, yes.

Q. They're a pretty big company that does a lot of work in valuation of real estate assets. That's kind of one of their main streams of business?

A. Yes, I can accept.

Q. And JLL likewise?

A. Well, I know of JLL in the same context, yes.

Q. Let's go to the CBRE First Report. If you go to Page 50--can you put that up? The CBRE Report. Sorry, I wasn't expecting to have to do this.

No, they're--oh, yeah, that's the one, Page 50 of that.

You can see Mr. Chris Maugeri is the Head of Valuation and Advisory Services for Latin America.

Do you see that?

A. Yes.

Q. And I think he said yesterday they valued well over $40 billion in assets per year.

Do you see that?

A. Yes.

Q. So, you consider yourself more of an expert in valuing hotel and hospitality industry assets than CBRE? Did I understand your testimony correctly?

A. No, I didn't say--I don't think I said that I was more of an expert, but--

Q. You said that they were not an expert; right?

A. No, I didn't.

Q. Okay. You didn't--

(Overlapping speakers.)

A. I don't think I said that they were not expert. I think I said that I--my understanding of CBRE is that they certainly have a focus on real estate as an industry and are experts in that industry. I don't reach a view on whether they're more experts than me or vice versa in terms of valuation because my expertise is as a valuation economist, so I think, you know, we're not--I don't want to particularly compare those two attributes.

Q. Okay. Your instructions in your Second Report--we could go to them--turn to at Paragraph 8.

"Were to review, analyze and provide my expert views on damages calculations in BRG's Second Report, respond to BRG's critiques of the damages assessment presented in my First Report, update assessment of damages arising from measures based on info--information from BRG/Claimants."

That's roughly what you were instructed to do; is that right?

A. Yes. Yes, correct.

Q. So, you were not instructed to respond to JLL's Report; is that correct?

A. Directly, that's correct, but, of course, BRG, as part of their Report, referred to JLL in terms of some of their assumptions, so indirectly I have interpreted my instructions to respond to parts of JLL

Report--parts of the JLL Reports too.

Q. Now, you understand--I think we're all on the same page on this--that the Parties agreed that if the Tribunal finds Colombia is liable, it must compensate Claimants the Fair Market Value of their Investment as of the Valuation Date; correct?

A. Well, I think that's, in some sense, a legal issue on what they must compensate, but--so I don't reach a view on that.

Q. Okay. You talked a lot about legal precedent earlier so I thought you might have a view on that.

But you can agree, at least, that Fair Market Value is at least the price that a seller's willing to accept and a buyer's willing to pay on the open market in an arm's-length transaction; correct? That's a fairly standard definition of Fair Market Value.

A. Yes. I would say it's the price that a willing buyer would pay to a willing seller in a--in the market, in a liquid market, the--hypothetical price, yes.

Q. So, the Fair Market Value requires an assessment of what an asset would sell for on the open market; correct? That's what we're assessing here.

A. Essentially. That's right, yes.

Q. And it should be an arm's-length transaction; correct?

A. Yes.

Q. And you identified the Income Approach, the Market Approach, and the Cost Approach and, in your view, the best approach is sort of, like, a sunk-costs type approach; correct?

A. Well, I didn't characterize it as "sunk costs." I call--I think I referred to it as the Cost or the Asset-Based Approach, but I think that's right in the context of this case, that that leads to the most reliable conclusions in the context of this case.

Q. And by "sunk cost," I mean--just--what was paid for the Investments, that's what your--that's your approach to valuation; correct?

A. Well, no, not quite, because I think as I explained in one of my slides, my approach is to take account of what was paid for the Investments, but also what are those investments worth today, by--and I do that by rolling forward the historic costs of those investments with a nominal Risk-Free Rate, which includes inflation.

Q. Right.

A. Which, in my view, provides the best proxy for what those investments are worth today, so it's not just sunk costs--

(Overlapping speakers.)

Q. --sunk costs updated at a Risk-Free Rate?

A. Essentially. You know, you could think of that as a replacement--an estimate of the replacement costs of those assets, yes.

Q. So, you've taken a replacement-cost type approach?

A. Yes.

Q. And your view is that you can replace these assets by--on the--well, yes, I think you've answered that question.

And to support your approach, you appear to--you've mentioned a lot of legal precedent, and you also rely on Articles from the Global Arbitration

Review Guide on International Arbitration; correct?

A. Well, I do both, but I also--and I think I explained today--as an economist, also justify my approach based on economic principles of prices in competitive markets, generally converging to the costs of the Investments in those markets, so there's a basic economic principle that the prices that we expect to observe in markets that are competitive, that the cash flows should converge to the cost of those investments.

So, yeah, that's the basis for why I think that's the right approach. And then, I think, yes, there are legal and economic precedents to support that view as well, yes.

Q. Mr. Hern, we're the--you and I are what stand between everybody going home, so I would prefer if you can just listen the question very carefully and just answer the question, and this will proceed much more quickly.

A. Well, I thought I did, sir. I mean, you asked me why I preferred the Cost Approach--

(Overlapping speakers.)

Q. No, I did not ask that. I said, did you rely on the Global Arbitration Guide to Damages on International Arbitration--

A. But my answer to that question is no, sir. I did not rely on that, and I explained my answer because I said I start with an economic justification for using that approach, and then the precedent and the GAR Articles and the other precedent I've referred to, you know, supports, in my view, in my choice of that approach. But I, you know, I'm not just relying on the GAR--on the GAR Article.

Q. Understood. You're just not relying on them. That's completely fine, Mr. Hern.

Let's go to Hern--your First Report at Paragraph 76, which is page 34.

So in B and D, you referred to the Damodaran Guide to Damages in International Arbitration, and you referred to few articles, even in Footnote 45 from this book. I assume you're quite familiar with this book; is that fair?

A. Yes.

Q. And now, did you look at this book just for quotes that supported your position, or did you, as an independent expert, also look for quotes that suggested another approach might be appropriate here?

A. I thought I--my interpretation of what was written in this book was that it supported my choice of approach, and I referred to paragraphs that I thought were particularly relevant to highlight that.

Q. So, you think overall the position expressed in this book supports your view?

A. Yes.

Q. I think one of the articles you cite is at Page 205 of the GAR book, which is RH-004, if you want to go to it. It's in one of your binders as well. But we will put it up on the screen, if that's easier. Page 205.

And at Paragraph 76(b) of your First Report, you cite this last paragraph of the page; correct? You cite this paragraph saying: "In the case of startups, it may, therefore, not be appropriate to use the DCF method as there may not be much evidence on which an expert could conclude that any forecasts are reasonable, and there are examples of tribunals rejecting the DCF valuation methodology based on lack of historical data."

And you quote that paragraph; correct?

A. Yes.

Q. But you don't quote the very next sentence, which says: "However, a lack of historical data does not necessarily preclude the use of a DCF method. It is necessary to assess the Company involved or project in question."

Correct?

A. Well, I don't quote that because, if you look at the next sentence on that paragraph, it then talks about industries, for example resource industries, mining, oil and gas where start-up companies may actually have quite good--quite a good basis to forecast cash flows because, the cash flows generated by those industries are essentially driven by the prices of those commodities, so that paragraph didn't seem relevant to me to quote because those are not the type of industries that we're dealing with here.

Q. So, you accept, though, that in certain instances, in the start-up context, it is acceptable to use the DCF valuation, just not in this particular industry?

A. That's--that is my view, yes, that's right. In some circumstances, for start-ups or newer types of industries, I think you could apply a DCF with much less speculation than this context, and a DCF could be appropriate.

Q. Okay. So, your concern is primarily with the hospitality industry and real estate sector; correct?

A. No, not just the industry--not just the industry. The nature of these projects. I mean, it's the hospitality and real estate industry in the stage of development or lack of development that we're dealing with here. The Projects haven't been constructed. They haven't--we don't have a historical set of data to tell us about the cash flows for these projects. We don't have other projects that are existing that, I think, are comparable to these projects. So, there's a myriad of factors I think why the DCF in this particular case, hospitality but also early stage in Colombia, lack of comparators, makes it very speculative.

Q. You're aware that some of the criteria that were identified here are whether or not the forecasts are supported by other closely related entities with relevant experience. Do you see that? That's one of the criteria that you would look at?

A. Yes, absolutely, that's right.

Q. And you're aware that Mr. Maugeri yesterday said that for completely undeveloped properties, he has used the DCF method before--correct?--with the hospitality industry?

A. I'm aware--I'm aware that's CBRE's statement, yes.

Q. But you disagree with it, that that is a reasonable approach for purposes of the hospitality industry?

A. I disagree with the use of this approach, DCF approach, in this context. I don't know what context he was talking about. I understand it to be land in California or somewhere. You know, I haven't reviewed what he's done in that particular case.

I disagree--

Q. He didn't refer to land in California, but maybe you're familiar with the study that I'm not?

A. So. Perhaps you could tell me what the study did concern.

Q. There was no study. I can take you to the testimony. It seems like you may have access to information I don't, but I can--if we go to the testimony from--I had it here--from yesterday. If we go to Page 154 of Day 5. Of Day 5, yes. Losing track of days.

REALTIME STENOGRAPHER: Page 154 you said?

BY MR. MOLOO:

Q. Yes, it's Page 154. I'll just read it into the record. The question was: "Have you ever done a DCF for an undeveloped project, Mr. Maugeri? Undeveloped, not in development."

And Mr. Maugeri's answer was: "Yes."

So do you disagree with that as an approach to valuing undeveloped real estate projects?

A. Not as a matter of principle. I don't know what he was talking about. I did have a conversation that he had done some work in California but apologies, if that's not on the record.

As a matter of principle, would I disagree with the use of a DCF for undeveloped projects? Not necessarily because I think there are some circumstances where one could get quite comfortable with, you know, how that project would evolve, based on, for example, a history of that developer developing a number of very similar projects in similar locations.

And I think as a valuer, you could get quite comfortable, taking California as an example, that if, if a developer bought a plot of land in one part of California and had developed that plot of land in very close locations and had a very high success rate of doing that over a number of years, I think one could get quite comfortable that the DCF assumptions in that circumstance, you know, might be quite--quite reliable because you could get, you know, for example, good data on Failure Rates. That developer had done a lot of similar projects.

So, I think you have to take each case on its own. As I said, I don't know what he was talking about, but my view is, in the context of this case, it's too much--way too much speculation about the valuation drivers for these projects, so it's in the context of this case that I reached my view.

Q. So, you would be okay with completely undeveloped Project using DCF but not in the context where you have construction underway, Construction Contracts, pre-sales of 150 units, in the Luxé context, 70 percent constructed hotel. You wouldn't be comfortable with using a DCF in that context. But undeveloped potentially yes?

A. As I say, each case has to be on its own merits. You've described a few of the features of these projects that have happened, but I think what you haven't described is that the vast majority of the valuation that is supposedly coming from these projects, 80 percent is coming from the hotel component of these projects. And the hotel has not started in any of these developments, so we don't have a track record of hotel operations in any of these developments. We don't have comparator data for similar hotels that we can benchmark against for any of these developments. These are much bigger scale hotels than The Charlee Hotel that has been put on record as a supposed comparator.

So, in the context of this case, with the limited amount of data that we have, with the very early stage nature of all of these projects, yes, I don't think you can get comfortable with a DCF Approach. Now, that may be very different for other cases where you have better data, more reliable data on the--you know, whether that developer has successfully developed similar projects in very similar locations. A DCF could be more appropriate in those cases. I just don't think so here.

Q. Okay.

MR. DAOUD: Mr. Chairman, I'm sorry, we need to clarify something for the record. Mr. Moloo suggested that Dr. Hern has information, has access to information that is not on the record. That information is at C-434, Claimants' exhibit.

MR. MOLOO: Well that's the study. I didn't realize that was the study he was referring to.

Yeah, I believe that study relates to a project in Mexico, not in California, actually. So, I actually don't know what you're--

MR. DAOUD: Baja California in Mexico. It relates to a study in Baja California in Mexico.

MR. MOLOO: Right, it's a state in Mexico; right? Not California. Just to confirm.

MR. DAOUD: Correct.

MR. MOLOO: So, it's in Mexico, not in California. I have no idea what California study was being referred to there.

THE WITNESS: I think he said Baja California, I think, to me. I understood that as a British person as being California, so apologies.

BY MR. MOLOO:

Q. I completely understand that a British person may not be familiar with Latin American real estate or terms or other things like that. Totally understand.

Let's look at, so I think, in your view, it's your position that--actually let's go to the Mexico study since we're talking about it. Let's go to C-434. 434.

And I can see the source of confusion here, so this is the valuation of property in Mexico, and you can see that on Page 3--it's by CBRE--and Mr. Maugeri is one of the valuation experts who valued this property. And since you've had a conversation about this with Mr. Maugeri, I assume you know this is an undeveloped piece of land?

A. I have to say I had a 10-second conversation. I haven't read this Report. I know very little about what's in this Report. This was a conversation I very briefly had yesterday, but I'm sure you will tell me what it's about.

Q. Well, let's go to Page 49. And it talks about appraisal methodology. And if you look at the last one, this is the appraisal methodology that's ultimately adopted in here, it talks about the Subdivision Development Method. Are you familiar with that method?

A. I mean, I think that's a real estate terminology, but I presume it means they've divided the land into subdivisions.

Q. So, are you familiar with this approach--

A. Generally speaking but I would have to look at how he's defined it precisely.

Q. Are you familiar with this approach to valuation?

A. As I say, generally speaking, but I would have to--I don't think it's a common term. I would have to look at exactly what he's done here.

Q. Let's look at it. It says: "The Subdivision Development Method is used to value land when subdivision and development represent the highest and best use of the appraiser's parcel. In this method, an Appraiser determines the number and size of lots that can be created from the appraised land physically, legally, and economically. The value of the underlying land is then estimated through a discounted-cash-flow analysis with revenues based on the achievable sale price on the finished product and expenses based on all costs required to complete and sell the finished product."

Have you ever done this Subdivision Development Method before?

A. Yes. I have looked at this actually in other cases.

You understand what's happening here; right? The value--

Q. I understand what's happening. I'm just asking you if you've used this approach to value other assets before.

A. Yes.

Q. Okay. You have.

All right. Let's go to your Second Report. And before we go to any particular paragraphs, my understanding--tell me if I'm correct on this--is that you believe that, in a perfectly competitive market, the Cost and the Income Approach to calculating damages converge; is that right?

A. Generally, that's right, yes.

Q. And so, in a perfectly competitive market, the NPV of any particular investment is zero.

A. Tends towards zero, correct.

Q. "Tends toward zero." So, any investment in a competitive market is zero.

A. In a perfectly competitive market, that's right.

Q. And you've said that in this particular situation, you were reassured in your valuation because you felt that the Colombian market, hospitality market, was a competitive market where the NPV should tend towards zero; is that right?

A. Yes, as an industry, I think real estate and hospitality is generally regarded as a competitive industry. It's easy to enter. There is no particular IP associated with the activities of those industries. It's easy to buy land, it's easy to develop land. It's easily available, so we would expect, as economists, the Net Present Value of those types of projects to tend towards zero.

Q. So, any hotel in the world, NPV should be--should tend towards zero?

A. No, I didn't say that. I said as an industry you would expect to see that. Of course, there are examples in situations where you would--you know, you would also expect to see out-performance. Some hotels do better than the average, and in those situations you would expect to see those hotels have positive NPVs. Some hotels do worse and get negative NPVs. But on average, because it's a competitive industry, on average we would expect to see NPVs, you know, around zero.

Q. All right. And I think at Page 38 of your Second Report, you say at Paragraph 74, because of that, there is therefore no reason to assume that the Claimants' project would be able to generate excess returns because you would expect the NPV to tend towards zero because you think that the hospitality industry is perfectly competitive, in Colombia is a perfectly competitive market; is that right?

A. As an industry, yes, but I also do say that I've seen no evidence why these particular projects should be expected to generate excess returns. Right? So, I haven't seen any evidence about why these particular projects should be different from what one would expect to see for that type of industry as a whole.

So, that leads me to the conclusion I have seen no evidence to suggest they should be higher than zero.

Q. And have you done any research into the competitiveness of the hospitality industry in Colombia?

A. Oh, yes. Through this project. We've looked at these appendices and tables that show the number of hotel operators, or real estate developers, operators in Colombia. That's all--that's the type of evidence that one needs to look at to see, you know, are there other operators in the market as a whole, developing real estate, developing hotels, are there other five star hotels in Colombia.

From what we've seen, from what I've seen, there is a lot of different operators in that market. By definition, that makes that market reasonably competitive.

Q. Mr. Hern--Dr. Hern, you are an economist. You understand when we're talking about competition, we're talking about a competition analysis is not I look at the market and see if there is more than one player; right? When you're talking about a perfectly competitive market, that is a term of art. That is an economic assessment. Have you made that assessment, whether or not it's a perfectly competitive market?

A. No, I haven't made the assessment. Did you ask me whether it's perfectly competitive?

Q. Well that's when it tends toward zero; right? That's what you said.

A. No. When it's perfectly competitive, that's a hypothetical. Nothing is perfectly competitive; right?

Q. Right. Right. That's right.

A. Perfectly competitive means everyone produces the same product, and the price of the product is absolutely the marginal cost of production. I think you asked me is the industry competitive to which my answer is yes, I think there is a lot of evidence to show the industry in Colombia is competitive because there's a lot of operators of both hotel and real estate operations.

Q. Are you aware that Mr. Seda went to Colombia because the market was far from saturated? That's in his First Witness Statement.

A. I've read his Witness Statement, yes.

Q. And it's the position of the Respondent that, in fact, he was entering into markets where nobody else was there, and you would have no idea if it was successful, so you think those are competitive markets? Or perfect--or close to perfectly competitive markets where NPVs would tend towards zero?

A. As I say, I think in my Reports--I can take you to the tables if you would like--but there is a lot of operators of hotels, there's a lot of five star supposedly luxury hotels in Colombia. There's a lot of operators on real estate in Colombia.

But generally speaking, it's regarded to be a competitive market because the barriers to entry to do real estate, to construct infrastructure are generally regarded to be relatively low.

Q. Are you aware that you agree that The Charlee outperforms the market; correct? The Charlee Hotel?

A. Not--not necessarily. It depends on how you define "out-performance." But certainly in terms of profitability, it looks to me to be broadly in line with the profitability of luxury market, and I think there is a slide that I present that shows that, actually. So, on Slide 17 of my presentation, I show out-performance should be measured in terms of profitability, in my view. And if we look at profitability of The Charlee Hotel--and this is over 2014 to 2016--the profitability is, you know, very similar to the Colombian luxury market which is the other five star hotels in Colombia and very similar to other emerging markets.

So, I think any statement about out-performance is, certainly in terms of profitability, it doesn't appear to be particularly strong.

Q. And you, I think, on Page 17, you accept that from a room perspective, it does out-perform the market; correct? I mean—Let's put a—let's put a—

A. No, no, that's not correct. That's not correct. If you were to look at the room, the profitability of rooms excluding F&B, you would have to compare that to the profitability of the other hotel operators excluding F&B. All this shows you here is that the Colombian luxury market as a whole has profitability around 20 percent. The F&B would typically be lower, and the rooms would typically be higher, so that's—that's an important distinction.

Q. Would you, so is your position that The Charlee Hotel, the NPV is worth roughly zero?

A. I haven't done an NPV analysis of The Charlee Hotel, but it looks to be in line with the market as a whole.

Q. So, all of these hotels are worth roughly zero, their Net Present Value?

A. Well—

Q. Is that your position?

A. The Net Present Value of the overall investment is roughly zero. That doesn't mean that if you sell the hotel today that you would get zero, that's not what I'm saying. It's the overall investment is zero.

Q. So, the overall NPV—if The Charlee Hotel was expropriated, you would be sitting here saying the Net Present Value is zero?

A. No, of course not, because The Charlee Hotel has already been developed—right?—the costs have already been spent.

Q. Right but it's in a competitive market.

A. Of course. So, the cash flows from The Charlee Hotel in a competitive market would expect--you would expect those cash flows to tend towards what has been spent on the hotel, so the valuation of the hotel because you have already done the expenditure.

Q. I understand that.

A. The valuation of the hotel would then be the expected cash flows generated by the hotel.

Q. So, the overall value based on the expenses, et cetera, so why would anybody invest in a hotel if the NPV--if you're not making--if the NPV is zero?

A. Well, I didn't say it was zero. I said, as an industry, you would expect the returns to tend towards competitive returns. Why would anyone invest? Possibly because they think they have got something better than the industry--right?--they think they've got a better product than the industry.

But you know, also, by definition, you don't need excess returns to do the Investment. You just need a normal return. Right?

Q. So…

A. So, as an investor, I need my Cost of Capital. Then I will make the Investment. That still gives me a Net Present Value of zero because it's the Cost of Capital that I need. You're talking about should these hotels--

Q. I understand—I understand--

(Overlapping speakers.)

A. get excess returns—I think, you know, you don't necessarily need that as an investor.

Q. Let's look at what you do rely on. You rely on--you say that the historical cost approach is frequently used in setting fair rates of return in the context of economic regulation of natural monopolies. That's one example that you use. We look at Hern 2, Paragraph 81.

A. Yeah, absolutely, that's correct.

Q. And you say that historical costs in Paragraph 82 are often used as the best available proxy for replacement costs in a range of economic contexts. Again, you rely on the example of the economic regulation of natural monopolies; correct?

A. Yes, correct.

Q. And the particular study you rely on in supporting the costs approach is the example of the European electricity market, I think; correct?

A. Yes.

Q. And that Report is--this Report that you cite at Footnote 66, RH-032, "Report on Regulatory Frameworks for European Energy Networks."

We're not dealing with regulated natural monopolies here, are we? The hospitality industry.

A. No, you're not. Correct.

Q. This Report doesn't talk about the real estate industry at all; does it? It talks about the electricity sector that's heavily regulated in Europe; correct?

A. That's correct, yes.

Q. And by definition, a regulated market is not a free market; correct?

A. But define, if you don't mind, what you mean by a "free market."

Q. Well, you have one electricity provider to everybody, so it's a natural monopoly, and so it needs to be regulated and that's why you get the rates you do; right? It's not the same thing as a free market where rates are set by supply and demand?

A. No, no. That's—that's right. Obviously in a regulated market you have conditions that are not competitive, they're monopoly conditions typically, but the point of the example is still, you know, a very poignant one, because what do regulators do in those circumstances where you have a monopoly? What they do is they set returns that are equal to the Cost of Capital.

Q. That's what regulators do? Right.

A. They give, therefore, the Investors a Net Present Value of zero for those investments, and that's the context that I'm referring to--because--

Q. Understood.

A. Those companies still make those investments, the electricity companies, they still make those investments, they're getting their returns on the Cost of Capital. And I'm using that as an example here to say what they're trying to do in regulation is to set conditions akin to competitive markets. I think we're dealing with a competitive market here, and the returns should therefore also tend towards the Cost of Capital here.

Q. So, that analogy works if we're dealing--the assumption is that this reflects a perfectly competitive market in Colombia, the hospitality industry; correct?

A. If it reflects a broadly competitive market, yes.

Q. Okay. Mr. President, I think this is an appropriate time for a break.

PRESIDENT SACHS: I was just going to suggest this, fine.

Let's say 10 minutes, 10:45? Is that ok?

MR. MOLOO: That works.

(Brief recess.)

PRESIDENT SACHS: So, we can resume.

Mr. Moloo, please proceed.

MR. MOLOO: Thank you, Mr. President.

BY MR. MOLOO:

Q. Dr. Hern, turning to some of the--little bit of the echo maybe because that door is open.

Dr. Hern, turning to some of the inputs into the DCF, you agree that the construction costs are, in the BRG model are reasonable; correct?

A. Apologies. Generally speaking? That's the question?

Q. Yes.

A. Because there are obviously many, many thousands of construction cost assumptions.

I mean, based on the evidence that I've seen from CBRE. I have no reason to think that they are excessively different from what one would expect. But there's still, I think, a lot of subjectivity into what those numbers really are, but I see no real evidence to dispute them, that's right.

Q. Now, in talking about the Meritage in particular, you say that the occupancy rates are higher than the market, and that to you is surprising; correct?

A. Sorry, could you take me to my report where I say this?

Q. If we go to Hern 2, Page 71. Hern 2,

Page 71.

A. Yes, correct, Figure 5.3, you can see the projections in the BRG model on Meritage occupancy of 85 percent, and that looked surprising to me given the evidence for Charlee Hotel which in Medellín and the Colombian luxury market as a whole, both of them showing lower occupancy rates.

Q. You agree that The Charlee Hotel outperformed the market with respect to occupancy; correct?

A. Over this period, that's what the evidence shows, yes.

Q. And did you take into account that the Meritage had a number of apartasuites, which are long-term rentals which is less susceptible to fluctuation and occupancy? Did you take that into account in your assessment?

A. Well—ye, yes, I mean in a sense, yes, but I have seen no evidence Corrected by the Respondent, Claimants to agree. the occupancy rate for apart hotels should be 85 percent so it's still surprising to me that that occupancy rate forecast is the—is the, you know, is the most reasonable forecast.

Q. In your Second Report, you conducted a corrected DCF valuation, I believe, and you offered an alternative WACC calculation. And in coming up with your WACC calculation--and it's at RH-035, which is a spreadsheet, so I will put it up on the screen for you. If we go to Cell H-29.

You specified that, for the low scenario, the asset's beta source is average of unlevered and total unlevered beta estimates by Professor Damodaran for emerging markets, hotel gaming and real estate development industry; correct?

A. Yes.

Q. And if we go to H-25 for the debt:equity ratio, your source is again an estimate from Professor Damodaran's "Emerging Markets, Hotel/Gaming and Real Estate (Development) Industry"; correct?

A. Correct.

Q. So, the dataset for both of these metrics includes gaming sector investments; correct?

A. That's how the data is cut, yes.

Q. And you criticize JLL's hotel comparator set for originally including hotels with gaming segments; correct?

A. I did, yes.

Q. But you've not extracted the gaming businesses from your own analysis of WACC; correct?

A. The criticisms are different. I mean, here it's--the WACC calculation is attempting to get a measure of a risk, generally speaking.

Q. And so you say--

A. And that's the way the data is cut in that dataset. This is the best data I've got for calculating a WACC, in my view. The data is not cut in any more detail.

But I think when you're looking at comparator data for benchmarking of occupancy rates and margins, there is data that exists that allows you to cut the data in a better way because you can just simply look at comparators that are only focused on hotels or real estate, not gaming comparators. So it was really just a drawback of the way this particular data was cut on Cost of Capital. That was--that was the issue here.

Q. Right.

So, in assessing risk, you've included risk in the gaming industry in your WACC calculations; correct?

A. Implicitly, yes.

Q. You also calculate the average EBITDA margins for real estate developers at around 16 percent, and this is how you select Colombia's real estate comparators. You--you've--I think seeing--if we go to Hern 2, Paragraph 285, which is at Page 126, I think, I can show you what I'm talking about.

So, in establishing comparators for the purposes of real estate developer EBITDA margins, you first downloaded the "Superintendencia's annual 1,000 largest companies by revenue" report, and then you selected companies classified as operating in real estate or activities with owned or leased properties or construction of residential buildings. Then you calculated each of the building's total revenue for the period of 2015 to 2019, and so on and so forth; correct?

A. Correct. Yes.

Q. And I suspect you've seen JLL's presentation of this issue that these developers' portfolios consisted of anywhere from 35 to 90 percent social housing; correct? Have you seen that presentation?

A. Yes, I did. I did see that, yes.

Q. And social housing margins are much smaller than those for luxury hotels; correct? Or luxury housing--

A. No, not--I didn't see any evidence in that report to show that, which I'm happy if you want to take me to that.

Q. So you think the social housing market is comparable to the projects that we're valuing here?

A. Well, I didn't say that, exactly, but I think you said that social housing would have lower margins than luxury hotels, and I haven't seen--I haven't seen any evidence in the JLL report to show that, with respect to that.

(Overlapping speakers.)

Q. Well, this is--but you're relying on it, so have you presented any evidence to suggest that this is a valid comparator?

A. Well--
Q. You think--my question is--
A. Yeah.
Q. --EBITDA margins, you think you can rely on EBITDA margins of social housing projects and compare that to the types of projects we're looking at here.
A. Actually, if you look at the JLL data--and I'm happy to go to that if you've got the exhibit--but the JLL data has cut these companies into the proportions that they--supposedly undertaken to private-sector investments and the proportions into social investments, and actually there is no real trend.
I mean, if your--if the assumption is right that private-sector investments have a higher return, then we would expect to see these operators that do more of their activities into the private-sector market having higher returns. And I'm happy to take you to their report--
(Overlapping speakers.)
Q. Well, let's go to--
A. But we don't see that, I think.

Q. Well, I'll show you the slide that I'm talking about, Slide 40 of the JLL presentation from yesterday.

(Pause.)

MR. MOLOO: No, their presentation from yesterday, if you have it.

That's fine. If we can't put it up, that's fine.

BY MR. MOLOO:

Q. I think you also used a sample of real estate developers from emerging markets sourced from Professor Damodaran's database; is that correct?

A. Yes, I do.

Q. And were you aware that, in the underlying dataset, only 9 out of the 776 companies are from Latin America?

A. Yes, I was aware of that, yes.

Q. And did you know that the sample includes businesses with diversified portfolios, not just in real estate?

A. Yes.

Q. So, if we go to BRG-150, for example, which is an Excel spreadsheet, so it will come up on the screen in a minute. And if we go to Row 426, this is an example of ACME Holdings.

And if we go to the description on the right-hand side.

So, if you can read it there, it says: "An investment Holding Company engages in the housing and property development business in Malaysia, Brunei, Singapore and internationally. It operates through manufacturing property development, and other segments. The company also manufactures and sells various plastic wear products."

Scroll over a little bit more.

"The Company was formally known as Supportive International Holdings," and I think you can see it's plastic wear products and it's cut off, but I think it's kitchenware and toys.

And if you go up a couple--if you just go up one actually to the Brown company, it's a real estate business in the Philippines, engages in agriculture, power and utilities, holding segments.

If you look at 429 on this page, it's

business, real estate and construction in India. It also operates cold-storage facilities that provide storing, trading, dealing in the distribution of vegetables, fruits, et cetera. So, this is your comparator database for EBITDA--correct?--assessment.

A. Well, I mean, look, this is a database that's put forward by Damodaran, who I thought--

(Overlapping speakers.)

Q. But you've chosen to use it for this purpose.

My question is--I'm not asking if Damodaran is an expert--we share an alma mater--but my question is your use of this particular database to tell us that it's relevant to assess EBITDA margins in the real estate industry.

A. Yes, and--

Q. Which is what you've used; right?

(Overlapping speakers.)

A. Yes, Damodaran is an expert in putting data together. First of all, he's widely sourced for this type of comparator dataset. This is a dataset that he's published as real estate developers. Of course, you know--

(Overlapping speakers.)

Q. Of companies that do real estate business--

A. Yes.

Q. --as part of many other things.

A. Of course, of course. We don't have--we're not living in a perfect world where we have thousands of companies that only do real estate in Colombia, exactly what this developer is doing. We have to look at what data exists to help us. And the reality is, of course, some of these--some of these companies that he's included in his dataset, of course, do some percentage of activities in other things. That's the real world; right?

But he's--but when they put--when he puts this dataset together, there are normally clear criteria around which a particular company would be judged to be a real estate developer such as you have more than 50 percent of profits from real estate. And what it means is that you've got a database of, you know, companies that-

(Overlapping speakers.)

Q. (Unclear.)

A. --and a majority do real estate development. Of course the data is a bit mixed because they do some other things. Some might be more risky, some might be less risky, but you've got a dataset that you can benchmark.

And I'm sorry, but BRG didn't do this; I did this, and, to me, it's a benchmark that has to be relevant for a projected EBITDA margin, even if it's not perfect, and no one is saying it's perfect, but it has to still be relevant.

Q. And BRG--you're right--did not look at EBITDA multiples. They look at the actual costs, et cetera, and sales and the actual data that's in the Business Plans as opposed to looking at EBITDA multiples as you have; correct?

A. That's right. They take a business plan and they assume that that's reasonable. I take their business plan and I crosscheck the business plan margins against margins for other real estate developers in Colombia. Again that data is not perfect. Some of them do social housing, too, but it has to be a relevant crosscheck even if the data is not relevant--not perfect. I crosscheck it against emerging markets, classified it as real estate developers. Again, there has to be a relevant crosscheck.

Q. And BRG compares their valuation to JLL's data of the Colombian real estate market specifically, instead of taking this approach. That's what BRG does; correct?

A. I can't recall, actually. You have to take me to that.

Q. Well, that's fine if you can't recall.

A. But I--just to be clear. I take the Colombian real estate markets in Table E-1 so that--I take the Colombian real estate markets. I don't recall that JLL did that.

Q. You say that Luxé hotel is only 45 percent constructed in your First Report. Do you correct that or do you stand by that?

A. Can you take me to the paragraph?

Q. In your First Report, Paragraph 18(B).

A. Yeah, I think there's evidence subsequently on the record that suggests it's higher than that, but I can't recall the precise number. I think maybe--I'm sure you'll tell me.

Q. It's about 72 percent.

A. Yeah.

Q. Do you accept that?

A. Yes.

Q. Now, you say that the Luxé hotel ADRs, the average daily rates, were higher than the Colombian luxury market. We saw that graph earlier. And you criticized the Luxé ADRs on this basis; is that correct?

A. Sorry, can you just take me to the--to where we--where I say that? Lots of--

(Overlapping speakers.)

Q. Sure, page 70 of Hern 2.

A. Page 70.

Yes. You can see in Figure 5.2 that the projections for the ADR for the Luxé are 709, which is quite a bit higher than the ADRs for the Colombian luxury market as a whole.

Q. And you don't take into account the room rates for the cabañas; right? You were instructed not to consider the revenues from the cabañas; correct?

A. Sorry, in the calculation of the ADRs?

Q. Yes.

A. I think that's right because the cabañas are already built, correct.

Q. But the cabañas, you accept, would achieve a higher ADR than a regular hotel room; correct?

A. No, I don't--I don't know that, that that's the case, no.

Q. In fact, they would achieve an ADR of about 2.6 times the ADR of a regular room. Would you think that's about reasonable?

A. Can you show me where that number comes from?

Q. It's comes from BRG 2 at Paragraph 134.

Based on the operations model, the Luxé includes a conversion factor of 2.6 to account for the difference in size and value of the cabañas.

A. Well, as I think we established, I don't take that into account; but, from what you just said, that's what in the Business Plan model, so I have no reason to think that that's the right assumption anyway, but I haven't done analysis to tell me what that assumption should be.

Q. Well, let's go to C-265.

So, these are some pictures of the cabañas.

Go down. These are actually constructed.

So, would you consider that's a picture of one? Would you consider that to be--to get a higher room rate than a normal hotel in Colombia?

A. I mean--I mean, I--you know, I'm not in a position to make that judgment. It will depend on what room rate you were--what type of room you were comparing to, how close the cabañas were to other amenities at the hotel. You know, honestly, I can't make a judgment on whether that's higher or lower than something hypothetical.

Q. Okay. Now, you say that the hotel comparators used by BRG are not comparable when they're doing the comparable market analysis; correct?

A. Yes. I think that's right. Can you take me to the paragraph where--where I say that?

Q. Sure.

Hern 2—I thought this, you would recall this, but Page 44 to 46 of Hern 2.

A. You have to appreciate sir, there's many developments here over many stages of developments and many (unclear), I've tried to--

Q. It's a--it's a--I don't deny that this is a complex business.

(Overlapping speakers.)

Q. I know you mentioned it, and you are right that this is a complex real estate development business. But the job here is still to value that business. And you say that the hotel comparators used by BRG are not comparable; correct?

A. Which paragraph? Are you referring to Paragraph 90 here?

Q. I think you covered over the course--I mean it's the heading: "BRG's hotel comparators are not comparable to the Claimants' hotels in any case." That's the sentence.

A. Yeah, but the details of your question are important because what--here we're talking about what BRG do in undertaking what they call a market crosscheck.

Q. Just confirm your heading. I'm asking you if this is--do you confirm that BRG--this is your view.

A. Yes, of course I confirmed that that heading is accurate but I--

(Overlapping speakers.)

Q. If we can, just wait for the question, and then you will have an opportunity, I promise you. And if you are not, you can tell me that there's further clarification or, of course, counsel for Respondent can seek clarification.

And you understand that BRG relied on JLL for hotel data; correct?

A. Correct.

Q. And JLL in turn, relied on a particular industry database; correct?

A. That's my understanding, yes.

Q. And you accept, of course, that JLL is a expert in the hospitality industry; correct?

A. As a company, yes.

Q. So, you looked at room rates for what you thought are comparator hotels--sorry, the comparator hotels identified by JLL, and I think that's on Page 90 of Hern-1. Table 6.2; right?

A. Yes.

Q. And this is what you--these are the--you look at these hotels that are in the JLL comparator database, and to assess whether or not they're actually comparators, you looked at nightly rates for one weekday and one weekend night in the year; correct?

A. I picked one—one--it was--obviously, I had to pick one date, and I picked one weekday and one weekend, yes.

Q. Well, it's not obvious that you had to pick one date, but we can differ on that.

And so, you went--you did this on October 28th, 2020, and you went to Booking.com; is that right?

A. Yes.

Q. I also use that website.

And you forecast out, you put in the date June 16th. Why did you pick June 16th, just out of curiosity? Did you try other dates or you just, you know, you thought June 16 is a nice date, let's pick that date?

A. Pretty much. I picked a date sig--you know, well in advance of the day that I was doing the work so that the future date wasn't distorted by, you know, capacity, last minute deals, capacity constraints at the time that I was looking at. So, it wouldn't have been appropriate, for example, to look next week, so I picked a date, you know, in advance that I thought was, you know, normalized for any of those in a particular--particular booking issues.

Q. Right. So, you didn't look at dates over the year, averages, you just--okay. So, you picked June 16, one weekday of the year, and then you looked up the hotel rates on Booking.com for those hotels, and you compared those, and that's what you've presented in the table; correct?

A. Correct.

Q. And you say that that's representative of the rates of those hotels for all weeknights of the years? That's your position?

A. Not necessarily, but it was certainly the, you know, representative of the rates that were available in the period that I looked at. It would have been a--you know, an extremely data intensive exercise. You know, I'm sure, as you've used Booking.com. You have to put in the date that you're trying to book for and get a quote for that date--

(Overlapping speakers.)

Q. Yes, if you're using Booking.com, it would be.

A. Exactly. I didn't, you know, I didn't have the time to put in every single date and then average all the data, so the--but it seemed to be representative of the differences in prices charged across--a reasonable representation of the differences in prices charged by the different hotels.

Q. And you didn't have access to the database that JLL--you know, JLL's proprietary database; right?

A. Correct.

Q. So, we'll look at what Booking.com says.

You compared the nightly rates, and you get this table. Did you consider the school year calendar, for example, in Mexico as compared to Colombia? They have different school year calendars.

A. Not--not--not specifically, but there's a, you know, there's a weekend night and there's a weekday night. They don't look very different between the two, so it wasn't that obvious that they were differentiating based on the particular time at that point.

Q. On that day, right. You're aware that the public school calendar year in Colombia, for example, is January to November, as opposed to Mexico it's mid-August to July, so, you know--

A. Right. I mean, of course you can have--

(Overlapping speakers.)

Q. Vacation dates might be different and things like that; right?

A. Of course. This could change of course a little bit as a result of seasonal factors, yes.

Q. Right.

And then, on the next page, Page 91, you went to Booking.com as well. And I assume you just fill--you know, I think Booking.com has that five-star filter. Is that the filter you used to identify these hotels?

A. I think that's right. I can't recall exactly how I--how we put it, but I think that's right.

Q. Okay. So, you used the five-star--let's assume you used the five-star filter on Booking.com, and these are the hotels that showed up as five-star hotels in Medellín; is that right?

A. Yes.

Q. Have you been to any of these hotels? Have you been to the Sites Hotel, for example, at the bottom. The one that is $69 a night?

A. No.

Q. Have you been to The Charlee Hotel?

A. No.

Q. Have you been to Colombia?

A. No.

Q. And then, you say this is a better comparator set rather than the comparator set that JLL used. Is that your--based on your review of the Booking.com rates for June 16, 2021, and June 19, 2021?

A. That is my view, yes. I think that the JLL dataset you can see here, consists of very strong branded hotels: The Four Seasons, the Ritz-Carlton, the Hilton, the Sheraton, the Fairmont. Everybody knows that those are super strong hotel brands. The rates that are being charged are, you know, astronomically high in some cases. It's my view that this is not a good dataset to benchmark hotels that are not even constructed, but it's also my view that when I crosschecked that dataset against the dataset in Colombia, you can see that The Charlee Hotel, the number--the room rates at The Charlee Hotel, you know, are pretty much in the middle of the range of room rates for other Colombian hotels. Very different from the JLL dataset.

So, it is my view that the data--that the Colombian market is the better market.

Q. Because you would say they're in different class? Is that what you're saying? These hotels--

A. Well, implicitly, but they're in a different country; right? They're in a--they're in a--they have a different brand. So, you know, Costa Rica, Barbados, you know, these are international tourism markets.

Q. And you're a hospitality expert.

A. Well, I've been to some--not--no, but I've been to some. And I think you would agree that these are some of the, you know, the strongest hotel names in the market, located in some of the most desirable countries in the world for holidays, like Barbados. But that just doesn't seem to be the right dataset to be benchmarking against Colombian hotels when you've got Colombian hotel data that tells you what that market is pricing at.

Q. But in your view, comparing data from social housing construction projects is fine; right? You can compare it against social housing projects though; right?

A. No. I'm sorry, but you're misrepresenting that. The social housing developers--you're talking about real estate now. That's not--nothing to do with hotels.

Q. No, I'm just trying to assess how you determine comparators.

A. Again, I focus on Colombia because that's the market that we're foc--that we're dealing with, and I think anybody that does this type of exercise in valuation that I've seen, starts the comparator set by looking at other operators in that geographical market in Colombia, and that's what I do, both for hotels and real estate.

Yeah, it's not perfect. Some of these hotels and real estate operators do other things, maybe it's not a perfect comparison, but in my view, it must be a better starting point than going to an international dataset of branded hotels that are very different from what we're looking at here.

Q. And what we're looking at here is something that you've never actually looked at because you've never been to Colombia?

A. Well, with respect, sir. What we're looking at here is hotels that are not yet constructed. So, even if I had been to Colombia--I've spent quite a bit of time in South America in Ecuador and other places, so I know that—I know the--the geography pretty well, but these hotels that we're talking about here are not even constructed.

So, if I had been to Colombia, I wouldn't be in a better place to say, you know, whether--I wouldn't be in a very good place to appraise them anyway because they're not constructed.

Q. Yeah, that's not what we're talking about. We're talking about comparators but let's move on.

Mr. Hern, you've also looked at implied value of stock sales and you've looked at two particular transactions at Paragraph 108 of Hern 2; correct?

A. Yes.

Q. And these were the only two transactions that you were given data for; is that correct?

A. Well, that's been supplemented by the slide that I presented today.

Q. Right. And you--

(Overlapping speakers.)

A. The presentation where I've found more data on transactions, but yes, this--at the time of writing this Second Report--

Q. That's what you had been given.

A. I looked at data from the Royal Realty accounts that gave me prices for transactions, yes.

Q. And you supplemented this Report today, it's for the first time we're seeing that information, too, because you were not given data about other transactions before yesterday; correct?

A. Yes. We asked--I asked for data on all transactions into these project companies over the period since they've existed, and I wasn't given that data. I had to find it for myself in the Royal Realty accounts, but that still didn't give me the precise Transaction Data, actually.

Q. So, let's go to the two that you were given. Let's go to RHO-033.

So, this is one of the implied value of stock sales that you have used, and it's an unsigned letter to Roger Khafif, dealing with a capital call; correct?

Are you aware of whether or not this capital call even actually happened?

A. This is--so, this is the Meritage Purchase

Option; that's right?

Q. Yes.

A. Yep.

So, that's right. So, I'm not aware of whether this happened or not. I'm aware the Mr. Seda, subsequent to my Second Report, has put another Witness Statement on record, his third Witness Statement, I think that says this didn't happen. I haven't been able to establish whether it did or didn't. The evidence that he referred to didn't clearly tell me that it didn't happen.

Q. All right. And the next agreement that you reference is--you looked at the Financial Statements, and you say that they referred to two transactions of Luxé Shares in 2015. And you've also seen Mr. Seda's explanation of this, that this was not an arm's-length transaction, it was him restructuring his shareholding; correct?

A. I've seen his Witness Statement that says that, but it's actually not obvious, it's not clear to me that he has provided data that clearly shows that.

Q. Right. I'm not asking whether you believe him or not. I'm just asking, you know, that you understand now that Mr. Test--Mr. Seda's testimony is that that was not an arm's-length transaction; correct?

A. I understand that's what he says.

Q. And aside from those two, you were not provided any other information about other transactions until yesterday, and based on that analysis, I think if we look at Page 14 of your slide deck, you say--if you look at that, so you've gone from 26 times higher than applied valuation to November 27, 2015, of a four-times increase in valuation. And you haven't looked at whether or not there are other transactions that are more recent than November 2015? You haven't been provided about information on that; right?

A. Correct. I haven't been provided with any further information on transactions.

Q. All right. Let's talk about lost fees.

Royal Realty had a right to fees for managing the Projects; correct?

A. That's my understanding, yes.

Q. And you say that the calculations of lost fees should also account for costs that Royal Realty would have incurred; is that right?

A. Yes.

Q. Now, let's go to BRG-048. And if we go to Page 3--6--right?--if we go to the next page, Page 6--oh, no--that's the one, yeah.

At bottom, you see the managing member intends to contact Royal Realty S.A.S. for one or more of its affiliate companies in order to execute the Project and make the decision to do so without the approval of the Shareholders. And then, it talks about on the next page, a number of different things for which it might engage others--sales, project development, management, general construction, wellness center, rentals, et cetera.

Do you see that?

A. Yes.

Q. And then, if you go to 3.08, which is on Page 10, it says: "Each member acknowledges it has been advised in the Deal Memo provided to Shareholders that the Company Agreement for Project Owner provides for the payment of various fees and reimbursement of expenses to the Managing Member and its affiliates for services provided."

Do you see that?

A. Yes.

Q. And then, midway through, it says: "In addition, Royal Realty has contracted their real estate sales and brokerage services for the project sales at 4 percent, sold directly by those individuals, plus the individual sales, agent salaries who will primarily reside on-site or affiliate sale sites designated for the sale of the Project, and the 4 percent sales commission includes all commissions including for external brokers."

Do you see that?

A. Yes.

Q. And then, the last sentence says. Oh, sorry, the next sentence I should say: "Each of the Shareholders consents to the payment of such fees and reimbursement of expenses and acknowledges that the Shareholders shall not be entitled to any portion of such fees and reimbursed expenses." And then, the last sentence says: "The Shareholders also acknowledge the possibility of additional fees paid to Royal Realty or its affiliate companies in accordance with Section 3.03."

So, you can see that all of the fees and costs were going to be reimbursed.

Do you see that?

A. All of the fees and costs associated with what, though? Right? It doesn't clearly say that all of the fees--sorry, all of the costs associated with Royal Reality would be reimbursed. It's a fairly general description of reimbursed expenses. That doesn't--to me, that doesn't mean all costs associated with Royal Realty.

Q. And you can see it's a pretty exhaustive list of 3.03, sales, project management, project development and management, general construction, the wellness center, rentals.

And then if you look at (f), it says: "Any other goods or services that any of the managing member's affiliates and/or subsidiary now in existence or incorporated in the future may provide to the

Company while carrying out the primary business of the Company as described in the Deal Memo." Pretty much everything; isn't it?

A. Sorry, can you take me up to--that's (f) of? Can you take me to--

Q. 3.03. The relevant sentence is actually 3.08, the last sentence. It says: "The Shareholder also acknowledges the possibility of additional fees paid to Royal Realty or its affiliate companies in accordance with Section 3.03." 3.03 is what—so that's the relevant provision. But I do understand you're not a lawyer, so it's okay--

A. That's right. This is a legal document, but as an economist, what I'm asked to look at here is what damages has Royal Realty suffered from not doing these services?

Q. Right.

A. It seems to me BRG has taken account of the revenues that it wouldn't get, potentially, from doing these services, but has ignored--

Q. The costs?

A. --the potential costs associated with doing those services. This agreement refers to reimbursed expenses. But expenses are often very different from the Operating Costs of running the business.

Q. Right. So, that's your--your position is that there might be additional costs that are not accounted for in this Agreement that are not taken into account. That's your position?

A. Correct, yes.

Q. Okay. Understood.

Now, you say you have not seen any evidence that Claimants' ability to provide hotel and real estate operations has been impacted due to the Measures; is that right?

A. Sorry, can you take me to the paragraph where I say this?

Q. Paragraph 77 of Hern 2.

A. Yes.

So, you're talking here about the Royal Realty services, yes.

Q. Actually, let's go to Paragraph 220--well, let's start at 119, actually.

MS. BANIFATEMI: I do not mean to interrupt, Mr. Moloo. I just--I'm noting that we are now at one hour-and-a-half, and with the flexibility allowed by the Tribunal, I just wanted to know whether there is still a lot more to go?

MR. MOLOO: I think I have probably about 15 minutes to go.

MS. BANIFATEMI: But that would be way beyond your time.

PRESIDENT SACHS: Try to shorten it, please.

MR. MOLOO: Okay. This is my last line.

PRESIDENT SACHS: Okay.

BY MR. MOLOO:

Q. I think your general position, 119, for example, it says (reading) I understand that Claimants argue that they were unable to develop the other projects. This argument doesn't make any sense. And you talk about the fact that you don't think that they were prevented from being able to develop the other projects; is that right? That's your general position?

A. Well, as a matter of economic logic, if the other projects had, you know, such a significant positive Net Present Value, than the loss associated with those projects is not clear because either they continue to operate those projects--

Q. I know your position--

A. --or they could sell the Projects to another investor, so that's essentially my position. I haven't--I haven't been able to establish that either of those two possibilities is not an option for them.

Q. And you're aware that this entire case is about doing business with someone who might be tainted and not being able to buy a property from them; correct?

A. Well, I'm aware that that's the Claimants' case, yes.

Q. And, well actually I think that's Respondent's case, but you're aware of the implication and the reputational impact of being tainted with an Asset Forfeiture Proceeding, I assume?

A. Yes.

Well, broadly speaking, yes, but I'm not--I don't know the specifics of exactly what--how every investor could potentially concerns themselves with that.

Q. And that you have to know your client when you're doing business with someone else; correct?

A. Well, I mean, not necessarily.

Q. Okay. You're saying that, in a real estate transaction, you wouldn't necessarily do a "know your client" analysis on your--on your counter-party?

A. What do you mean by that precisely?

Q. Would you Google-search them?

A. Are you talking about the sale of assets to another person?

Q. Yeah.

A. So--well, I'm sure you--of course, you would do due diligence on the assets, yes, and the person.

Q. What about on the counter-party?

A. Sure, yes. I would expect you to do that, yes.

Q. And so, if you were looking up your counter-party, would you expect for Royal Property Group--let's go to C-42, for example, if you looked up Royal Property Group--it's in your binder, if we're having trouble pulling it up, you can get it in your binder, C-42. Go to the next page. Page 9 and 10.

You can see that it says: "According to the investigation, that Lot, worth more than COP 60,000 million and located in one of the most valued sectors of the metroCorrected by the Respondent, Claimants to agree. politan area, would really belong to a capital of the dreaded Envigado Office, which a decade ago tried to sneak into demobilization of self-defense groups." That's what the press is reporting about the Meritage Project. And if you look on the next page, it talks about "El Tiempo communicated this Wednesday with the sales room of the luxury project and was sent to the sales management of Royal Property Group Colombia, which sells the condominium."

So, if this is the kind of news that you're getting, you might be hesitant to do business with that counter-party; would that be fair?

A. I can't put myself in the shoes of every investor, but the news reports that you just referred to, appear to be quite specific about the Meritage land and property; right? Whereas the paragraph that you took me to in my Report is concerned with the other projects, how investors would look at the Luxé project or the Tierra Bomba project or the 450 project. And obviously, those are very different projects.

So, I would expect--and again, you're perhaps asking me a question that's a little bit outside my scope of what would an investor do, but I would expect the Investor for those types of projects to be looking at the specifics of those projects.

Q. The Royal Property Group is the one that's developing all of these projects; correct? The one that's named in this Article.

A. That's my understanding, yes.

Q. And you're aware that with the Luxé Project, Colpatria informed them that they would no longer continue to finance development of the Project after the--after this Asset Forfeiture Proceeding with respect to the Meritage Project. You're aware of that; correct?

A. I'm aware that that's what the Claimants say.

Q. And you're aware that there were investors like Paladin that said we can't move forward with our investment in the Meritage Project until the--sorry, in the Luxé Project until the Meritage issue is resolved. You're aware of that?

A. Again, I'm aware that that's what the Claimants say, but I haven't—

Q. You haven't seen the evidence--

(Overlapping speakers.)

A. I haven't--

Q. You weren't shown the evidence?

A. I haven't looked at the evidence behind those.

Q. Okay, so, you weren't shown, for example, C-379 which is the--

MS. BANIFATEMI: I'm sorry, I think the Court Reporter did not get the previous exchange.

BY MR. MOLOO:

Q. You haven't been shown the evidence that underlies those statements by the Claimants?

A. Correct. Not to say whether those statements--not the evidence for me to say whether those statements are true or not.

Q. Okay. And with respect to Tierra Bomba, have you seen the Cancellation Agreements with respect to the Purchase Contract and the reason given for why they were going to cancel that project? Have you seen those underlying documents?

A. Can you refer to what documents you're--

Q. For example, C-186. We can put it up, and you can tell me if you've seen it or not.

Do you recall seeing this Agreement? There are several others like it, but I won't take you to them all.

A. I can't recall, honestly, whether I have seen that particular agreement.

Q. Have you seen statements from Government representatives acknowledging that Mr. Seda, his reputation, had been impacted and it would be difficult for him to borrow money, for example?

A. Again, can you take me to the statements you're referring to?

Q. Yeah.

Let's go to C-322. Page 10.

A. I have not seen this document.

Q. Okay. You haven't seen the exchanges with the government officials where Mr. Seda says every financial institution thinks we are criminals, and the Head of the Asset Forfeiture Unit says, yes, of course, of course. Those kinds of exchanges? You're not aware of that?

A. I haven't seen this document.

Q. Did you ask for evidence of the impact on the other projects?

A. Yes.

Q. And you weren't given any of this evidence that I've just shown you?

A. I wasn't given that document that you referred to, but as far as I can see, that's Mr. Seda's statements of how he thinks he's impacted as opposed to evidence to show that he's impacted.

Q. And have you seen the documentation or exchanges with the banks that called the loan? Have you seen any of that documentation?

A. Yes, I have seen--I have seen documentation in relating--relating to the banks, yes.

Q. And it's still your position that the asset forfeiture proceeding with respect to the Meritage did not impact any of the other measures--investments; is that your position? It did not impact the Luxé?

A. No. That's not my position. That's not my position. My position in Paragraph 119 is concerning the other investments, but it clearly says, if the Claimants were unable to undertake these projects themselves (overlapping speakers)—

Q. They could sell it.

A. -due to lack of financing, they should have been able to sell the projects to other investors.

So, my comment is in relation to—I'm not—I'm not in a position really to make a judgment on the facts of the case.

Q. Right.

A. But I'm trying to make my judgment as an economist to take into account of, well, there's two scenarios here, really. Either he can continue to develop the Projects because he's not impacted on these projects, or if he can't do it on these projects, he should be able to economically, they're worth the Net Present Value that the Claimants say they are, he should be able to sell the projects to another investor, and I haven't seen evidence that that's not a possibility, that either of those two scenarios are not a possibility.

Q. So, your assumption, though, is that someone would be able to buy from him, that someone would transact with Mr. Seda's company?

A. Implicit in that is the assumption that, either yes, that someone--that he should have been able to sell them.

Q. Yes.

And if he was prevented from being able to sell them, if nobody would buy from or transact with the Royal Property Group, then you'd take a different view; correct?

A. Yes, logically if he is impacted and he can't develop them and he can't also sell them, then I would take a different view that economically those projects must have been impacted, then.

MR. MOLOO: I have no further questions, Mr. President.

PRESIDENT SACHS: Thank you very much.

Will there be redirect?

MR. DAOUD: Short one, Mr. Chairman.

PRESIDENT SACHS: Please go ahead.

REDIRECT EXAMINATION

BY MR. DAOUD:

Q. Dr. Hern, counsel for Claimants took you to Exhibit C-434. If we can show it on the screen.

Sorry, 434, C-434.

MS. BANIFATEMI: I want to make sure that someone is trying to show the document on screen. Thank you.

(Pause.)

MR. DAOUD: Perhaps, while the document is being opened, I can take Dr. Hern to a different point and then get back to this.

PRESIDENT SACHS: We have it now.

MR. DAOUD: Okay.

BY MR. DAOUD:

Q. So, it's Page 51, which is, I think, Page 63 of the PDF that you were shown. 51, which is Page 63 of the PDF. And it's the third paragraph. You were shown the third paragraph.

Now, you, when answering, you were saying--you said you understand what is happening here, and then you were not given an opportunity to explain. Do you wish to explain?

A. Yes. I mean, my understanding from this paragraph is what CBRE are doing is they're trying to value what the land is worth of--for this development, and they're using a DCF Model to forecast the cash flows that might come from developing this land, and then discounting it back with a Cost of Capital to derive the economic value of the land.

And you know I think that's exactly what I'm doing, actually, which is I'm deriving the value of the Investment by looking at what is invested, and that should be equivalent to a Discounted Cash Flow of the cash flows discounted at the Cost of Capital, which is actually what I find.

So, CBRE's use of a DCF Model in this context is actually pretty much what I'm doing in my valuation.

Q. And here, CBRE, were they valuing a project or land?

A. No, they were--they appear to be valuing the underlying land.

Q. Yes.

Thank you.

Now, counsel for Claimants also asked you if Royal Realty had a right for fees for managing the Projects, and he showed you Exhibit BRG 48, which relates to the Meritage Project.

A. Um-hmm.

Q. Are you aware of any--so that's BRG 48 is a contract relating to the Meritage Project. Have you seen any contracts, similar contracts for Tierra Bomba, 450 Heights, or Sante Fé?

A. I don't recall, actually.

Q. Thank you, Dr. Hern.

MR. DAOUD: Thank you, Mr. Chairman, that will be all.

PRESIDENT SACHS: We have no further questions. Thank you, Dr. Hern.

THE WITNESS: Thank you, sir.

PRESIDENT SACHS: Your expert testimony is now terminated. You're released.

(Witness steps down.)

PRESIDENT SACHS: All right. Shall we have a five-minute break, and then discuss the further proceedings or shall we immediately continue?

MR. MOLOO: I don't think we will take that long because there seems to be, I think aside from the specific dates, agreement.

PRESIDENT SACHS: Okay, good. Then you are now released.

(Witness steps down.)

PRESIDENT SACHS: David, we do not need the discussion on the record. Once we have agreed, hopefully, on what is to happen, then we will go back to the record.

(Discussion off the record.)

PRESIDENT SACHS: Okay, yes. I think we have now identified dates for in-person closing hearing, namely October 1 and 2, and possibly as an alternative and preference, October 2 and 3, depending on Mr. Poncet's availability to come to Paris on October 2.

(Tribunal confers.)

Alright. Now, we do reverse-engineering. What would be the deadlines for your first round, plus the limited rebuttal if we understood correctly?

MS. BANIFATEMI: Is that all right if we consult internally and coordinate—

PRESIDENT SACHS: Yes.

MS. BANIFATEMI: --among Parties and come back to the Tribunal with this?

PRESIDENT SACHS: Yes.

Maybe with respect to the other items with the deadlines that you mentioned with respect to the closing of the record, 31 May, and also your agreement as regards the documents which are still outstanding and deleted documents which--on which you're still conferring, if we could all this have in writing and confirmed by you both, then we would put this in a Procedural Order that would--

MS. BANIFATEMI: With pleasure.

PRESIDENT SACHS: --that would be good.

All right, on the principle we agree, namely one round of submissions, and with the possibility of a limited rebuttal on the security, essential security defense only, and that is what we understood.

250 pages we understood?

MS. BANIFATEMI: 150.

PRESIDENT SACHS: Sorry, 150 pages, okay.

MS. BANIFATEMI: And one round of consecutives.

PRESIDENT SACHS: And one round on consecutive briefs, yes. And we may send you a list of questions after this Hearing next week or so, and for you to consider in particular.

All right.

Any further?

MR. MOLOO: Nothing from us, just to thank you gentlemen for your time and attention this week.

PRESIDENT SACHS: Respondent, any?

MS. BANIFATEMI: And likewise, with our thanks to the Tribunal for its patience and its diligence in this matter. Thank you very much.

PRESIDENT SACHS: So it's our turn, then, to thank counsel for an--the efficient conduct of the proceedings. With few exceptions, this was, as it should be--the exceptions I mean it is quite natural that from time to time there are procedural incidents, but we were very pleased about the quality of your legal work and presentation of the case, and thank you very much.

I also want, of course, to thank the Interpreters who did a great job. Our thanks go, of course, to Leandro and David. It was not easy, always, and we know the usual quality of David's Transcripts. Unfortunately, I didn't look into Leandro's Transcripts, but I would assume that they are of equal quality.

And last but not least, I want to thank Sara and ICSID for having hosted us and having organized all this so efficiently.

And, with that, I close this evidentiary hearing, and wish you well for a safe journey back, as the case may be, to Latin America or Paris. Thank you very much.

(Whereupon, at 12:27 p.m., the Hearing was concluded.)

CERTIFICATE OF REPORTER

I, David A. Kasdan, RDR-CRR, Court Reporter, do hereby certify that the foregoing proceedings were stenographically recorded by me and thereafter reduced to typewritten form by computer-assisted transcription under my direction and supervision; and that the foregoing transcript is a true and accurate record of the proceedings.

I further certify that I am neither counsel for, related to, nor employed by any of the parties to this action in this proceeding, nor financially or otherwise interested in the outcome of this litigation.

DAVID A. KASDAN