

**Arbitration Institute of the Stockholm Chamber of Commerce**  
Box 16050 , SE-103 21 STOCKHOLM, Sweden

**ARBITRAL AWARD**

rendered in Stockholm on 29 March 2005

in Arbitration No. 126/2003 of the Arbitration Institute of the Stockholm Chamber of Commerce between the following parties:

**Claimant:**

Petrobart Limited, Suites 7b-8b, 50 Town Range, GIBRALTAR, represented by  
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Arsenalsgatan 6, SE-111 47 STOCKHOLM, Sweden

**Respondent:**

The Kyrgyz Republic, represented by

*Counsel:*

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**Arbitral Tribunal:**

former Justice Hans Danelius, Professor Ove Bring and Mr. Jeroen Smets, Member of the  
Brussels Bar

**Place of the arbitration:**

Stockholm, Sweden

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## **I. The Contract**

Petrobart Limited (hereinafter called "*Petrobart*") is a company registered in Gibraltar. On 23 February 1998, Petrobart as Supplier and the state joint stock company Kyrgyzgazmunaizat (hereinafter called "*KGM*") as Purchaser concluded Goods Supply Contract No. 1/98-PB (hereinafter called "*the Contract*") the subject-matter of which was defined as follows:

### **"1. SUBJECT-MATTER OF THE CONTRACT**

1.1 SUPPLIER shall supply and transfer ownership of two hundred thousand (200,000) tons of stable gas condensate (the "goods") to PURCHASER over the course of one year on a monthly basis.

1.2 PURCHASER shall accept the supplied goods and make payment under the conditions of this agreement.

1.3 The goods shall be delivered on the terms CIF Kant station. The station of destination shall be Kant station."

As regards the price of the goods, Section 4 of the Contract provided as follows:

### **"4. PRICE AND PAYMENTS**

4.1 The price of the goods shall be established in United States dollars and shall not be subject to change: one hundred forty-three US dollars and fifty cents (US\$143.50) per metric ton of gas condensate.

4.2 The price is given inclusive of VAT.

4.3 PURCHASER shall make payments according to the details pursuant to the invoice presented by SUPPLIER in relation to each separate consignment of goods, within ten days of the date of the goods' arrival at the station of destination."

Section 8 of the Contract contained the following provisions regarding the settlement of disputes between the parties and liability under the Contract:

### **"8. ARBITRATION AND LIABILITY**

8.1 Any and all disputes, differences, or demands as may arise out of this Contract or in connection herewith, or concerning the violation, termination, or invalidity hereof, shall be subject to resolution on mutually-acceptable conditions through negotiations and consultations. If an understanding cannot be reached, disputes shall be resolved by the High Arbitration Court of the Kyrgyz Republic in accordance with the rules and procedures of that court.

8.2 Decisions of the aforementioned court shall be conclusive and binding for both Parties.

8.3 The substantive law of the Kyrgyz Republic shall apply to the relations of the Parties under this Contract.

8.4 Default on obligations pertaining to payment and delivery of goods shall entail liability for the Parties in accordance with the Civil Code of the Kyrgyz Republic, including with respect to lost benefit and losses associated with failure to perform obligations under this Contract.

8.5 Breaching of the delivery schedule shall entail liability for SUPPLIER, who shall pay a penalty at the rate of 0.1% of the value of the volume of goods not delivered on time."

Section 9.2 of the Contract provided:

"Upon the signing of this Contract, all previous relations and correspondence between the Parties in relation to this matter shall be null and void."

## **II. Relevant facts**

According to Presidential Decree UP No. 30 of 29 January 1997, KGM was to be created for the purpose of rationalisation of the use of the state-owned infrastructure for oil, as well as natural and liquid gas product supply. KGM was to replace the three state-owned companies Kyrgyzgaz, Chuigazmunaizat and Kyrgyzmunaizat. KGM's charter was subsequently approved by Government Decree No. 393 of 30 June 1997.

On 12 January 1998, the Kyrgyz Government promulgated Decree No. 28 on Measures for Improving the Supply of Natural Gas to Consumers of the Kyrgyz Republic and Stabilising the Activity of the State Joint Stock Company Kyrgyzgazmunaizat, in which it was noted that the situation regarding the supply of natural gas to consumers remained difficult and that KGM's losses amounted to more than 1 million Soms per day. The Decree provided, *inter alia*, that the Ministry of Finance should find funds amounting to 50 million Soms to pay for the natural gas supply during the winter heating season of 1997-1998 and that this amount should be repaid by KGM within a year.

On 21 January 1998, Petrobart, in order to be able to fulfil its obligations under the Contract, concluded a contract with the Uzbek company GAO Uzneftegazdobicha. According to this contract, Petrobart would buy from Uzneftegazdobicha 120,000 metric tons of gas condensate from February to December 1998 with the possibility to increase the quantity. The price would be USD 95 per metric ton, and the total value of the contract was indicated as being USD 11,400,000.

After deliveries of gas condensate under the Contract, Petrobart sent the following invoices to KGM, based on the agreed price of USD 143.50 per metric ton:

(a) invoice No. 01/98-PB of 24 February 1998 regarding a delivery of 3,299.046 metric tons, the amount due being USD 473,413.10,

(b) invoice No. 02/98-PB of 2 March 1998 regarding a delivery of 3,334.936 metric tons, the amount due being USD 478,563.31,

(c) invoice No. 03/98-PB of 10 March 1998 regarding a delivery of 3,851.248 metric tons, the amount due being USD 552,654.10,

(d) invoice No. 04/98-PB of 19 March 1998 regarding a delivery of 3,506.183 metric tons, the amount due being USD 503,137.26, and

(e) invoice No. 05/98-PB of 26 March 1998 regarding a delivery of 3,213.231 metric tons, the amount due being USD 449,852.30.

Payments were made as regards the invoices under (a) and (b) but not in respect of the invoices under (c), (d) and (e).

In a letter of 2 June 1998 to Petrobart, the Deputy Director of KGM apologised for the failure to pay for delivered products which was mainly due to the fact that the company had taken measures to give assistance to the inhabitants of the Suzakski region who were suffering from the consequences of a natural disaster. The Deputy Director added that the company believed that they would be in a position to settle the debts in the near future. In a further letter of 14 July 1998 to Petrobart, the General Director of KGM again apologised for the delayed payment and stated that they envisaged that payment would be made within the next 10-15 days.

In Presidential Decree No. 282 of 23 September 1998, the President of the Kyrgyz Republic declared that it was necessary to create, on the basis of KGM's assets, a new company Kyrgyzgaz and instructed the Government to resolve the legal questions connected with the implementation of this Decree.

On 5 October 1998, the Government issued Decree No. 649. In the Decree, the Government, with reference to Presidential Decree No. 282, decided to create, on the basis of the former production company Kyrgyzgaz which was a part of KGM, a new state company Kyrgyzgaz which was to be managed by the company Kyrgyzenergo. The Government further instructed the State Property Fund to organise the transfer of assets from the former company Kyrgyzgaz to Kyrgyzenergo. It was specified that “the credit, debit and arbitration debts for natural and LP gas until 23.09.1998” were to be on the account of KGM.

On 13 October 1998, the Bishkek City Court of Arbitration (hereinafter called “*the Bishkek Court*”) granted a claim by the Central Asian Bank for Integration and Development (hereinafter called “*the Central Asian Bank*”) to recover USD 1,471,624 as well as 213,760.50 Soms in state duty from KGM.

In November 1998, Petrobart initiated proceedings before the Bishkek Court in order to recover KGM’s outstanding debt. Thereafter, the relevant bailiff reported that KGM’s account did not contain sufficient funds to satisfy Petrobart’s claim.

Thus, on 9 December 1998, the Bishkek Court, at Petrobart’s request, ordered the seizure of KGM’s account at the Mercury Bank up to an amount claimed by Petrobart.

On 15 December 1998, the Bishkek Court, at Petrobart’s request, ordered the seizure of movable and immovable property of KGM up to an amount claimed by Petrobart.

In a judgment of 25 December 1998, the Bishkek Court ruled that Petrobart was to recover from KGM USD 1,499,143.244 in principal debt and, in addition, 301,123.63 Soms in state duty.

On 4 January 1999, the Bishkek Court, in proceedings between the Central Asian Bank and KGM, ordered KGM to pay to the Bank USD 1,500,000 in principal amount, USD 273,416 in interest, USD 44,252.02 as penalty and 299,113.34 Soms as state duty.

In Decree No. 11 of 11 January 1999, the Government decided to implement Presidential Decree No. 282 further by giving instructions to the State Property Fund and the Ministry of Finance. The State Property Fund was, *inter alia*, “to define the creation of a new complex and volume of assets” for the new company Kyrgyzgaz on the basis of the assets of the old company Kyrgyzgaz and “to define the mechanism for conversion of shares” in KGM in connection with its reorganisation. The Ministry of Finance, *inter alia*, was to complete all accounts of KGM by 1 April 1999 and to establish and confirm that KGM was to have responsibility for “creditor and court related obligations, concerning the sale and delivery of natural gases and liquid gases prior to 1 October 1998”.

On 15 January 1999, the Supreme Arbitration Court of the Kyrgyz Republic cancelled the Bishkek Court’s decision of 13 October 1998 in the case between the Central Asian Bank and KGM and replaced it with a new decision.

On 25 January and 10 February 1999, the Bishkek Court issued Writs of Execution in favour of Petrobart in respect of the claim confirmed in the judgment of 25 December 1998. On 2 and 4 February 1999, the Court Bailiff of the Lenin Regional Court of Bishkek, in execution of the ruling of 25 January 1999, seized in favour of Petrobart assets belonging to the Tokmak and Kant branches of KGM.

On 25 January, 28 January, 29 January and 3 February 1999, the Court Bailiff of the Lenin Regional Court of Bishkek seized cars, petrol stations, rail-wagons and assets of KGM's Karabalta branch in favour of the Central Asian Bank.

According to announcements of 4 and 8 February 1999 by the Lenin Regional Court of Bishkek, two public auctions for the sale of seized goods were to take place, the first one on 15 February 1999 and the second one on 19 February 1999. According to the announcement, the value of the property exceeded 80,000,000 Soms. However, the auctions were never held.

In a letter of 9 February 1999 to the President of Petrobart, KGM's Acting General Director referred to the Bishkek Court's ruling in favour of Petrobart and asked Petrobart to postpone the enforcement of that ruling in view of KGM's financial difficulties and the ongoing efforts to elaborate a Stabilisation Programme for KGM.

On 10 February 1999, the Bishkek Court decided to allow execution of USD 1,499,143.24 and 301,123.63 Soms on KGM's property.

On 11 February 1999, the Government issued Decree No. 79 in which it approved an Individual Programme for Privatisation of KGM for the purpose of increasing the efficiency of the supply of oil products and creating a competitive environment in the oil products market. It was pointed out that, despite certain positive developments, KGM was still in a serious situation due to huge debts and losses and that, according to the results of financial and economic monitoring, KGM was an insolvent enterprise which had no chances to restore its solvency. It was added that KGM was an enterprise which was on the verge of bankruptcy.

On 11 February 1999, the Vice Prime Minister of the Kyrgyz Republic, Mr. B. Silayev, in a letter to the Chairman of the Bishkek Court, referred to court decisions in which Petrobart and the Central Asian Bank had been awarded about USD 3,000,000 from KGM and requested that, in view of the critical financial standing of KGM, the Chairman of the Court should show understanding for the current situation and assist in granting a deferral of the enforcement of the court decisions concerned. The Vice Prime Minister stated that, having regard to KGM's strategic importance, the Government was working on a Stabilisation Programme for the financial standing of KGM which would provide for actions to raise monetary resources and attract investors with the aim to repay KGM's outstanding debt.

In a decision of 16 February 1999, the Bishkek Court granted a request by KGM for a three months stay of execution, i.e. until 18 May 1999, of the judgment of 25 December 1998 and the decision of 10 February 1999. In its decision, the Court referred to the Government's letter of 11 February 1999 about the Stabilisation Programme for the financial standing of KGM.

On 4 March 1999, an extraordinary shareholders' meeting was held in KGM. The shareholders adopted the decisions necessary for the implementation of Decree No. 11 of 11 January 1999. As a result of these decisions, some of KGM's assets became the property of Kyrgyzgaz.

By Decree No. 141 of 9 March 1999, the Government decided to entrust the state company Munai with the task of organising and carrying out state policy in the petrol sector in the Kyrgyz Republic.

On 13 March 1999, a contract regarding the rent of assets was concluded between KGM and Munai. According to this contract, KGM gave Munai the right to temporary use of a large complex of assets, including land, buildings, constructions, tanks for storage of petroleum products, equipment and other property against payment of a monthly sum of 500,000 Soms. The contract was concluded for a term of three years but could be extended at Munai's request.

On 2 April 1999, KGM, in a petition to the Bishkek Court, requested that the Court should declare the company insolvent. KGM stated that it was unable to satisfy the claims of creditors in full and referred to the balance sheet which, as of 1 January 1999, showed that the liabilities amounted to 2,410,560 Soms (what is meant is presumably 2,410,560,000 Soms) and the assets to only 1,317,965 Soms (what is meant is presumably 1,317,965,000 Soms).

On 15 April 1999, a judge of the Bishkek Court ruled on this claim and found, on the basis of the testimony of an accountant and the 1998 balance, that KGM's assets amounted to 1,285 million Soms and its debts to 2,246 million Soms and decided to recognise KGM as a bankrupt and to schedule a bankruptcy procedure.

In a request of 4 June 1999 to the Special Administrator of KGM, Petrobart asked to be paid USD 1,948,375.94 and 301,123 Soms, representing its claim according to the judgment of 25 December 1998 increased with interest, penalties and state duty. On 17 March 2000, the Special Administrator informed Petrobart that the company had been included in the list of creditors to be satisfied in third priority with the principal of 64,894,258.03 Soms.

### **III. The Foreign Investment Law and proceedings regarding that law**

The Law of the Kyrgyz Republic on Foreign Investments in the Kyrgyz Republic (hereinafter called "*the Foreign Investment Law*"), which was promulgated on 24 September 1997, gives protection to foreign investors and foreign investments.

The term "foreign investments" is defined in Article 1 paragraph 2 of the Law as "investments appearing as contributions of foreign investors into objects of economic activity in the territory of the Kyrgyz Republic to derive profit". According to Article 23 paragraph 2 of the Law, a dispute between the authorised governmental organs of the Kyrgyz Republic and a foreign investor, which is not settled through consultations between the parties, shall be settled through arbitration in accordance with one of the following procedures:

"the Regulations of the Third Party Arbitration Court under the Chamber of Industry and Commerce of the Kyrgyz Republic;  
the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the ICSID Convention, signed in Washington D.C. on 19 March 1965), if applicable;  
the Additional Facility Rules of the International Centre for Settlement of Investment Disputes (ICSID), if applicable;  
the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL Rules); in this case the appointing body shall be the Secretary General of ICSID."

Paragraph 3 of Article 23 further provides that “the Kyrgyz Republic through its authorised governmental body shall consent to the transfer of the investment dispute for arbitration by virtue of this law” and that “a foreign investor’s agreement may be given at any time through a written application to the State Body effectuating the attraction of investments or at the moment of resort to the arbitration”.

In an Arbitration Notice submitted on 2 March 2000, Petrobart initiated arbitration against the Kyrgyz Republic (hereinafter called “*the UNCITRAL Arbitration*”). Petrobart relied on the Foreign Investment Law and the arbitration clauses included in Article 23 paragraphs 2 and 3 of that Law.

On 30 May 2000, a Law on the Interpretation of the Term “Foreign Investments” in Article 1 of the Law of the Kyrgyz Republic on Foreign Investments in the Kyrgyz Republic (hereinafter called “*the Foreign Investment Interpretation Law*”) was promulgated. Article 1 of that Law provides as follows:

“The term ‘foreign investments’ in Article 1 of the Law of the Kyrgyz Republic ‘on foreign investments in the Kyrgyz Republic’ should be understood to mean:

Foreign investment – a long-term tangible or intangible investment into objects of economic activity in order to realise a profit in the forms envisaged by the legislation of the Kyrgyz Republic: money, movable and immovable property, property rights, shares and other forms of participation in a legal entity, profits or revenues derived from foreign investments, [and] concessions based on the law; that is a contribution, with the aim of gaining income, into any enterprise, into socioeconomic programmes, into innovation projects, etc.

A civil law transaction between two business entities in respect of supplying goods (services), where the purchaser is obliged to pay for the supplied goods (services), does not fall under the definition of ‘foreign investment’.”

In an application dated 2 December 2000, the Government of the Kyrgyz Republic requested that the Bishkek Court should establish “Facts of Legal Value” (the case is hereinafter called “*the Show-Cause Case*”). The Government referred to the Foreign Investment Law and to the Foreign Investment Interpretation Law and asked the Court to establish that, according to these legal provisions, (i) Petrobart had no foreign investment in the Kyrgyz Republic, (ii) there was no investment dispute between Petrobart and the Government, and (iii) there was no subject-matter to be arbitrated in an arbitral tribunal between Petrobart and the Government according to the Foreign Investment Law.

Petrobart raised objections to the Government’s application to the Court and informed the Court that it did not intend to participate in the hearing in the case.

In its decision of 26 December 2000, the Bishkek Court granted the Government’s request and decided (i) that the Contract did not constitute a foreign investment in the Kyrgyz Republic, (ii) that there was no investment dispute between Petrobart and the Government, and (iii) that there was no subject-matter to be arbitrated between Petrobart and the Government in an arbitral tribunal pursuant to the Foreign Investment Law.

The UNCITRAL Arbitration initiated by Petrobart resulted in an award rendered on 13 February 2003. The arbitral tribunal found that the term “object of economic activity” in Article 1 paragraph 2 of the Foreign Investment Law means “a business and/or business activity which is carried out in an organized form, for example, as a joint stock company

(open or closed), partnership or limited liability company” and that Petrobart had not made an investment appearing as a contribution into such an object.

The arbitral tribunal also had regard to Article 9 paragraph 4 of the Kyrgyz Constitution according to which the Republic is obliged to observe the “universally recognised principles of international law” which had been relied on by Petrobart. In this respect, the arbitral tribunal concluded:

“In fact, despite the well-known formula, the actual contents of ‘the universally recognised principles of international law’ is uncertain, indeed frequently contentious. Suffice it for present purposes to note the following. ‘Foreign investment’ is mostly defined as a transfer of tangible or intangible property from one country to another for the purpose of use in that country with a view to generating profit, or at least wealth, under the control of the owner of the property. Such transfers are to be distinguished from the much more frequent export transactions where goods are sold by manufacturers, or owners, in one state to traders or users in another state. Foreign investment involves a more permanent relationship between the foreign investor and the host state than is involved in the transitory international sales transaction. [The Contract] falls unquestionably into the latter category.”

The arbitral tribunal concluded that Petrobart had not made a foreign investment within the meaning of the Foreign Investment Law and that the arbitral tribunal did not have jurisdiction to try Petrobart’s claims against the Kyrgyz Republic in that arbitration. The arbitral tribunal thus dismissed Petrobart’s claims for lack of jurisdiction.

#### **IV. The Energy Charter Treaty**

The Energy Charter Treaty (hereinafter called “*the Treaty*”) was opened for signature on 17 December 1994 and was signed on that day by a number of States, including the Kyrgyz Republic and the United Kingdom. The Treaty was ratified by the Kyrgyz Republic on 7 July 1997 and by the United Kingdom on 16 December 1997. The Treaty entered into force on 16 April 1998. It contains the following provisions:

##### “PART I DEFINITIONS AND PURPOSE

##### ARTICLE 1 DEFINITIONS

As used in this Treaty:

(1) ‘Charter’ means the European Energy Charter adopted in the Concluding Document of the Hague Conference on the European Energy Charter signed at The Hague on 17 December 1991; signature of the Concluding Document is considered to be signature of the Charter.

(2) ‘Contracting Party’ means a state or Regional Economic Integration Organization which has consented to be bound by this Treaty and for which the Treaty is in force.

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(4) ‘Energy Materials and Products’, based on the Harmonized System of the Customs Co-operation Council and the Combined Nomenclature of the European Communities, means the items included in Annex EM.

(5) ‘Economic Activity in the Energy Sector’ means an economic activity concerning the exploration, extraction, refining, production, storage, land transport, transmission, distribution, trade, marketing, or sale of Energy Materials and Products except those included in Annex NI, or concerning the distribution of heat to multiple premises.

(6) 'Investment' means every kind of asset, owned or controlled directly or indirectly by an Investor and includes:

- (a) tangible and intangible, and movable and immovable, property, and any property rights such as leases, mortgages, liens, and pledges;
- (b) a company or business enterprise, or shares, stock, or other forms of equity participation in a company or business enterprise, and bonds and other debt of a company or business enterprise;
- (c) claims to money and claims to performance pursuant to contract having an economic value and associated with an Investment;
- (d) Intellectual Property;
- (e) Returns;
- (f) any right conferred by law or contract or by virtue of any licences and permits granted pursuant to law to undertake any Economic Activity in the Energy Sector.

A change in the form in which assets are invested does not affect their character as investments and the term 'Investment' includes all investments, whether existing at or made after the later of the date of entry into force of this Treaty for the Contracting Party of the Investor making the investment and that for the Contracting Party in the Area of which the investment is made (hereinafter referred to as the 'Effective Date') provided that the Treaty shall only apply to matters affecting such investments after the Effective Date.

'Investment' refers to any investment associated with an Economic Activity in the Energy Sector and to investments or classes of investments designated by a Contracting Party in its Area as 'Charter efficiency projects' and so notified to the Secretariat.

(7) 'Investor' means:

- (a) with respect to a Contracting Party:
  - (i) a natural person having the citizenship or nationality of or who is permanently residing in that Contracting Party in accordance with its applicable law;
  - (ii) a company or other organization organized in accordance with the law applicable in that Contracting Party;
- (b) with respect to a 'third state', a natural person, company or other organization which fulfils, mutatis mutandis, the conditions specified in subparagraph (a) for a Contracting Party.

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(10) 'Area' means with respect to a state that is a Contracting Party:

- (a) the territory under its sovereignty, it being understood that territory includes land, internal waters and the territorial sea; and
- (b) subject to and in accordance with the international law of the sea: the sea, sea-bed and its subsoil with regard to which that Contracting Party exercises sovereign rights and jurisdiction.

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## ARTICLE 2 PURPOSE OF THE TREATY

This Treaty establishes a legal framework in order to promote long-term co-operation in the energy field, based on complementarities and mutual benefits, in accordance with the objectives and principles of the Charter.

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## PART III INVESTMENT PROMOTION AND PROTECTION

### ARTICLE 10 PROMOTION, PROTECTION AND TREATMENT OF INVESTMENTS

(1) Each Contracting Party shall, in accordance with the provisions of this Treaty, encourage and create stable, equitable, favourable and transparent conditions for Investors of other Contracting Parties to make Investments in its Area. Such conditions shall include a commitment to accord at all times to Investments of Investors of other Contracting Parties fair and equitable treatment. Such Investments shall also enjoy the

most constant protection and security and no Contracting Party shall in any way impair by unreasonable or discriminatory measures their management, maintenance, use, enjoyment or disposal. In no case shall such Investments be accorded treatment less favourable than that required by international law, including treaty obligations. Each Contracting Party shall observe any obligations it has entered into with an Investor or an Investment of an Investor of any other Contracting Party.

(2) Each Contracting Party shall endeavour to accord to Investors of other Contracting Parties, as regards the Making of Investments in its Area, the Treatment described in paragraph (3).

(3) For the purposes of this Article, 'Treatment' means treatment accorded by a Contracting Party which is no less favourable than that which it accords to its own Investors or to Investors of any other Contracting Party or any third state, whichever is the most favourable.

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(7) Each Contracting Party shall accord to Investments in its Area of Investors of other Contracting Parties, and their related activities including management, maintenance, use, enjoyment or disposal, treatment no less favourable than that which it accords to Investments of its own Investors or of the Investors of any other Contracting Party or any third state and their related activities including management, maintenance, use, enjoyment or disposal, whichever is the most favourable.

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(12) Each Contracting Party shall ensure that its domestic law provides effective means for the assertion of claims and the enforcement of rights with respect to Investments, investment agreements, and investment authorizations.

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#### ARTICLE 13 EXPROPRIATION

(1) Investments of Investors of a Contracting Party in the Area of any other Contracting Party shall not be nationalized, expropriated or subjected to a measure or measures having effect equivalent to nationalization or expropriation (hereinafter referred to as "Expropriation") except where such Expropriation is:

- (a) for a purpose which is in the public interest;
- (b) not discriminatory;
- (c) carried out under due process of law; and
- (d) accompanied by the payment of prompt, adequate and effective compensation.

Such compensation shall amount to the fair market value of the Investment expropriated at the time immediately before the Expropriation or impending Expropriation became known in such a way as to affect the value of the Investment (hereinafter referred to as the 'Valuation Date').

Such fair market value shall at the request of the Investor be expressed in a Freely Convertible Currency on the basis of the market rate of exchange existing for that currency on the Valuation Date. Compensation shall also include interest at a commercial rate established on a market basis from the date of Expropriation until the date of payment.

(2) The Investor affected shall have a right to prompt review, under the law of the Contracting Party making the Expropriation, by a judicial or other competent and independent authority of that Contracting Party, of its case, of the valuation of its Investment, and of the payment of compensation, in accordance with the principles set out in paragraph (1).

(3) For the avoidance of doubt, Expropriation shall include situations where a Contracting Party expropriates the assets of a company or enterprise in its Area in which an Investor of any other Contracting Party has an Investment, including through the ownership of shares.

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#### ARTICLE 17 NON-APPLICATION OF PART III IN CERTAIN CIRCUMSTANCES

Each Contracting Party reserves the right to deny the advantages of this Part to:

- (1) a legal entity if citizens or nationals of a third state own or control such entity and if that entity has no substantial business activities in the Area of the Contracting Party in which it is organized; or
- (2) an Investment, if the denying Contracting Party establishes that such Investment is an Investment of an Investor of a third state with or as to which the denying Contracting Party:
  - (a) does not maintain a diplomatic relationship; or
  - (b) adopts or maintains measures that:
    - (i) prohibit transactions with Investors of that state; or
    - (ii) would be violated or circumvented if the benefits of this Part were accorded to Investors of that state or to their Investments.

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#### PART IV MISCELLANEOUS PROVISIONS

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#### ARTICLE 22 STATE AND PRIVILEGED ENTERPRISES

- (1) Each Contracting Party shall ensure that any state enterprise which it maintains or establishes shall conduct its activities in relation to the sale or provision of goods and services in its Area in a manner consistent with the Contracting Party's obligations under Part III of this Treaty.

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#### PART V DISPUTE SETTLEMENT

#### ARTICLE 26 SETTLEMENT OF DISPUTES BETWEEN AN INVESTOR AND A CONTRACTING PARTY

- (1) Disputes between a Contracting Party and an Investor of another Contracting Party relating to an Investment of the latter in the Area of the former, which concern an alleged breach of an obligation of the former under Part III shall, if possible, be settled amicably.
- (2) If such disputes can not be settled according to the provisions of paragraph (1) within a period of three months from the date on which either party to the dispute requested amicable settlement, the Investor party to the dispute may choose to submit it for resolution:
  - (a) to the courts or administrative tribunals of the Contracting Party party to the dispute;
  - (b) in accordance with any applicable, previously agreed dispute settlement procedure; or
  - (c) in accordance with the following paragraphs of this Article.
- (3) (a) Subject only to subparagraphs (b) and (c), each Contracting Party hereby gives its unconditional consent to the submission of a dispute to international arbitration or conciliation in accordance with the provisions of this Article.
  - (b) (i) The Contracting Parties listed in Annex ID do not give such unconditional consent where the Investor has previously submitted the dispute under subparagraph (2)(a) or (b).
  - (ii) For the sake of transparency, each Contracting Party that is listed in Annex ID shall provide a written statement of its policies, practices and conditions in this regard to the Secretariat no later than the date of the deposit of its instrument of ratification, acceptance or approval in accordance with Article 39 or the deposit of its instrument of accession in accordance with Article 41.
  - (c) A Contracting Party listed in Annex IA does not give such unconditional consent with respect to a dispute arising under the last sentence of Article 10(1).
- (4) In the event that an Investor chooses to submit the dispute for resolution under subparagraph (2)(c), the Investor shall further provide its consent in writing for the dispute to be submitted to:
  - (a) (i) The International Centre for Settlement of Investment Disputes, established pursuant to the Convention on the Settlement of Investment Disputes between States and Nationals of other States opened

for signature at Washington, 18 March 1965 (hereinafter referred to as the 'ICSID Convention'), if the Contracting Party of the Investor and the Contracting Party party to the dispute are both parties to the ICSID Convention; or

(ii) The International Centre for Settlement of Investment Disputes, established pursuant to the Convention referred to in subparagraph (a)(i), under the rules governing the Additional Facility for the Administration of Proceedings by the Secretariat of the Centre (hereinafter referred to as the 'Additional Facility Rules'), if the Contracting Party of the Investor or the Contracting Party party to the dispute, but not both, is a party to the ICSID Convention;

(b) a sole arbitrator or ad hoc arbitration tribunal established under the Arbitration Rules of the United Nations Commission on International Trade Law (hereinafter referred to as 'UNCITRAL'); or

(c) an arbitral proceeding under the Arbitration Institute of the Stockholm Chamber of Commerce.

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(6) A tribunal established under paragraph (4) shall decide the issues in dispute in accordance with this Treaty and applicable rules and principles of international law.

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(8) The awards of arbitration, which may include an award of interest, shall be final and binding upon the parties to the dispute. An award of arbitration concerning a measure of a sub-national government or authority of the disputing Contracting Party shall provide that the Contracting Party may pay monetary damages in lieu of any other remedy granted. Each Contracting Party shall carry out without delay any such award and shall make provision for the effective enforcement in its Area of such awards.

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## PART VIII FINAL PROVISIONS

### ARTICLE 38 SIGNATURE

This Treaty shall be open for signature at Lisbon from 17 December 1994 to 16 June 1995 by the states and Regional Economic Integration Organizations which have signed the Charter.

### ARTICLE 39 RATIFICATION, ACCEPTANCE OR APPROVAL

This Treaty shall be subject to ratification, acceptance or approval by signatories. Instruments of ratification, acceptance or approval shall be deposited with the Depository.

### ARTICLE 40 APPLICATION TO TERRITORIES

(1) Any state or Regional Economic Integration Organization may at the time of signature, ratification, acceptance, approval or accession, by a declaration deposited with the Depository, declare that the Treaty shall be binding upon it with respect to all the territories for the international relations of which it is responsible, or to one or more of them. Such declaration shall take effect at the time the Treaty enters into force for that Contracting Party.

(2) Any Contracting Party may at a later date, by a declaration deposited with the Depository, bind itself under this Treaty with respect to other territory specified in the declaration. In respect of such territory the Treaty shall enter into force on the ninetieth day following the receipt by the Depository of such declaration.

(3) Any declaration made under the two preceding paragraphs may, in respect of any territory specified in such declaration, be withdrawn by a notification to the Depository. The withdrawal shall, subject to the applicability of Article 47(3), become effective upon the expiry of one year after the date of receipt of such notification by the Depository.

(4) The definition of 'Area' in Article 1(10) shall be construed having regard to any declaration deposited under this Article.

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ARTICLE 44  
ENTRY INTO FORCE

(1) This Treaty shall enter into force on the ninetieth day after the date of deposit of the thirtieth instrument of ratification, acceptance or approval thereof, or of accession thereto, by a state or a Regional Economic Integration Organization which is a signatory to the Charter as of 16 June 1995.

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ARTICLE 45  
PROVISIONAL APPLICATION

(1) Each signatory agrees to apply this Treaty provisionally pending its entry into force for such signatory in accordance with Article 44, to the extent that such provisional application is not inconsistent with its constitution, laws or regulations.

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(3)(a) Any signatory may terminate its provisional application of this Treaty by written notification to the Depository of its intention not to become a Contracting Party to the Treaty. Termination of provisional application for any signatory shall take effect upon the expiration of 60 days from the date on which such signatory's written notification is received by the Depository.

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As regards the Annexes referred to in some of the quoted provisions, the following may be noted.

Annex EM, to which reference is made in Article 1(4), contains an enumeration of energy material and products which includes liquified petroleum gases and other gaseous hydrocarbons such as natural gas, propane, butanes, ethylene, propylene, butylene and butadiene.

Annex NI, to which reference is made in Article 1(5), contains a list of non-applicable energy materials and products which is of no relevance in the present case.

Annex ID, to which reference is made in Article 26(3)(b), contains a list of Contracting Parties not allowing an investor to resubmit the same dispute to international arbitration. The Kyrgyz Republic is not included in this list.

Annex IA, to which reference is made in Article 26(3)(c), contains a list of Contracting Parties not allowing an investor or a Contracting Party to submit certain disputes to international arbitration. The Kyrgyz Republic is not included in this list.

## **V. Proceedings**

Petrobart's Request for Arbitration, directed against the Kyrgyz Republic, was submitted to the Arbitration Institute of the Stockholm Chamber of Commerce (hereinafter called "*the SCC Institute*") on 1 September 2003. The Kyrgyz Republic submitted its Reply to the Request for Arbitration in a letter dated 15 October 2003 which was received by the SCC Institute on 16 October 2003. In further submissions dated 31 October 2003, Petrobart commented on the Kyrgyz Republic's Reply.

In its Request for Arbitration, Petrobart appointed as arbitrator Professor Ove Bring, Stockholm. In its Reply to the Request for Arbitration, the Kyrgyz Republic nominated as arbitrator Mr. Jeroen Smets, Member of the Brussels Bar.

On 28 November 2003, the SCC Institute appointed Mr. Hans Danelius, former Justice of the Supreme Court of Sweden, to be chairman of the Arbitral Tribunal.

After Petrobart had provided the entire advance on costs, the SCC Institute, on 23 January 2004, referred the case to the Arbitral Tribunal and decided that the award should be rendered not later than 23 July 2004. This time-limit was extended by the SCC Institute, on 17 June 2004 until 31 December 2004, on 26 November 2004 until 31 January 2005 and on 22 December 2004 until 29 April 2005.

Petrobart submitted its Statement of Claim on 20 February 2004. The Kyrgyz Republic submitted its Statement of Defence on 24 March 2004.

In the Statement of Defence, the Kyrgyz Republic requested that the Arbitral Tribunal, pursuant to Article 31 of the Rules of the SCC Institute, should order Petrobart to pay a certain amount of money, based on the award in the UNCITRAL Arbitration, to the Kyrgyz Republic or, alternatively, to an escrowee, as a condition precedent to the present arbitration going forward. On 7 April 2004, Petrobart commented on this request and submitted that it should be dismissed. On 15 April 2004, the Arbitral Tribunal, in a Procedural Decision, dismissed the Kyrgyz Republic's request for an order on interim measures under Article 31 of the Rules of the SCC Institute.

On 28 May 2004, Petrobart submitted a Response to the Statement of Defence. On 26 July 2004, the Kyrgyz Republic submitted a Rejoinder. On 11 October 2004, Petrobart submitted a First Rejoinder and Final Statement of Evidence.

After consulting the parties, the Arbitral Tribunal decided that the final hearing should be held in Stockholm from 2 to 5 November 2004. However, on 12 October 2004, the Kyrgyz Republic proposed that the case should be submitted to the Arbitral Tribunal in written form only and that the parties should be permitted and required to answer the Arbitral Tribunal's questions in written form only.

On 14 October 2004, Petrobart accepted that the Arbitral Tribunal should render an award based solely upon the respective parties' written briefs, including attached exhibits and legal opinions, subject to certain conditions. These conditions, which were accepted by the Kyrgyz Republic on 16 October 2004, were:

- (a) that the parties should refrain from submitting further briefs, with the exceptions outlined below;
- (b) that Petrobart should be allowed to submit a particular envisaged legal opinion;
- (c) that the parties should refrain from submitting further witness statements;
- (d) that the Arbitral Tribunal should be allowed, at its discretion, to ask written questions to the parties;
- (e) that each party should submit written answers to the Arbitral Tribunal's questions;
- (f) that each party should be given one opportunity to comment upon the other party's answers to the other party's written answers;
- (g) that the Arbitral Tribunal should draft and submit to the parties a recital to the award, including the undisputed facts of the case and the parties' argumentation;

- (h) that each party should be given one opportunity to comment in writing on the recital; and
- (i) that the Arbitral Tribunal should set final deadlines for the submissions, it being understood that a party's non-compliance with a deadline should be acknowledged as a waiver to make the relevant submission and that such non-compliance should not prevent the Arbitral Tribunal from rendering the award.

Having regard to the agreement reached by the parties in this respect, the Arbitral Tribunal decided, on 18 October 2004, to cancel the hearing planned for 2-5 November 2004.

On 3 November 2004, the Arbitral Tribunal addressed a number of questions, in the form of a questionnaire, to the parties. The Arbitral Tribunal also referred to an expert report, submitted by Petrobart a few days earlier, and invited the Kyrgyz Republic, if it considered that the report contained any new element, to comment on it. Replies were submitted by Petrobart on 24 November 2004 and by the Kyrgyz Republic on 7 December 2004. The parties submitted comments on each other's replies, the Kyrgyz Republic in its brief of 7 December 2004 and Petrobart in a brief of 25 January 2005.

On 4 November 2004, the Arbitral Tribunal sent the parties a draft summary of undisputed facts and the parties' arguments. On 11 February 2005, the Arbitral Tribunal sent the parties an updated version of this summary. Both parties submitted comments on the draft summary on 21 February 2005.

In its replies of 7 December 2004, to the Arbitral Tribunal's questionnaire, the Kyrgyz Republic raised certain issues regarding the applicability of the Treaty to Gibraltar and to Petrobart's status as a Gibraltar company. The Republic also requested the Arbitral Tribunal to ask Petrobart to submit certain documents relating to Petrobart's registration and status in Gibraltar and suggested that the Arbitral Tribunal should make an inquiry as to the status of Gibraltar under the Treaty in the Legal Affairs Department of the Energy Charter Secretariat and possibly ask a supplementary question to an expert on whose opinion Petrobart had relied. The Republic also argued that there were reasons to stay the present proceedings until the conclusion of certain proceedings in a Swedish court.

The Arbitral Tribunal decided on 20 December 2004 not to stay the proceedings and on 31 January 2005 not to ask for further documents, not to make an inquiry in the Energy Charter Secretariat and not to ask a supplementary question to the expert.

On 14 December 2004, Petrobart requested that the Arbitral Tribunal should reject as having been raised too late certain arguments regarding Petrobart's status in Gibraltar and the applicability of the Treaty to Gibraltar. On 31 January 2005, the Arbitral Tribunal decided to examine this request in connection with the final award.

Cost claims were submitted on 8 March 2005 by Petrobart and on 10 and 17 March 2005 by the Republic. The parties were given the opportunity to comment on each other's cost claims.

On 18 March 2005, the SCC Institute finally determined the arbitration costs in accordance with Article 39 of the Rules of the Institute.

## **VI. Claims**

Petrobart requests the Arbitral Tribunal

- (a) to declare that it has jurisdiction to entertain the claim as submitted by Petrobart;
- (b) to order the Kyrgyz Republic to pay compensatory damages to Petrobart in the amount of USD 1,507,812.60 and interest thereon, at an annual rate determined in accordance with Article 7.4.9 of the UNIDROIT Principles of International Commercial Contracts, from 25 December 1998 until payment has been made;
- (c) to order the Kyrgyz Republic to pay compensation for lost profits to Petrobart in the amount of USD 2,376,339.60 and interest thereon, at an annual rate determined in accordance with Article 7.4.9 of the UNIDROIT Principles of International Commercial Contracts, from 4 March 1999 until payment has been made;
- (d) to order the Kyrgyz Republic to pay to Petrobart an amount of USD 200,500.00 for outlays and related expenses together with interest thereon, at an annual rate determined in accordance with Article 7.4.9 of the UNIDROIT Principles of International Commercial Contracts, from 1 September 2003 until payment has been made;
- (e) to declare that all costs, as between the parties, of this arbitral proceeding, including legal fees, are to be borne by the Kyrgyz Republic; and
- (f) to grant Petrobart such other relief as the Arbitral Tribunal may deem appropriate.

The Kyrgyz Republic contests these claims and requests that the costs of the arbitration be borne by Petrobart and that the Kyrgyz Republic be awarded compensation from Petrobart for its costs in the arbitration, including legal fees.

## **VII. Grounds and arguments**

### ***1. Petrobart:***

#### ***A. Background***

The Kyrgyz Republic is a state that is currently in transition from a formerly communist regime to a democratic country. In attempting to implement degrees of political and institutional pluralism, the Republic has to grapple with the establishment and implementation of democratic institutions such as the separation of powers and legal concepts like property and contractual rights. Even though some positive steps have been taken in this direction, reform in general has been painstakingly slow. Much of the ex-Soviet style of governance remains in place, and the Republic is in many ways a microcosm reproduction of the former Soviet model in which political authority, business and corruption still overlap comprehensively.

Accordingly, the Kyrgyz Republic's economy still remains under the complete control of the central government. In such environment, most reforms towards market economy have faltered. The main problem which has plagued the Republic since its independence is the continuing high level of corruption. It is evident that corruption in the Republic's governmental and public institutions, including the judiciary, is not merely present but chronic. According to the International Business Council Report on the Promotion of Investment in Business in Kyrgyzstan, "many officials in most or all ministries and

government departments at all levels request monetary inducements to do their jobs or approve investments and so on”.

In general, the energy sector in the Kyrgyz Republic is government-controlled and still highly centralised. The Government controls, *inter alia*, the granting and transfer of property rights and title to energy resources, any exploitation of energy resources, the conditions for attracting investments in the energy sector, the general price policies in the energy sector, the granting of licence to sell natural gas, the setting of tariffs, and the resolving of disputes between consumers and energy selling companies. Despite the fact that the Republic is endowed with huge energy resources, it has encountered serious problems in meeting its own inhabitants’ demand for energy. As a result, nearly the entire domestic demand of the Republic for energy is met through imports.

In January 1997, the Kyrgyz Republic formed KGM for the purpose of rationalising the use of the state-owned infrastructure for the supply of oil and natural and liquid gas products within the Republic. The creation of KGM was formalised by Presidential Decree UP No. 30 dated 29 January 1997, in which the Republic was to arrange for the transferral of the assets and property of three state companies to KGM prior to 1 March 1997.

According to KGM’s charter, the company’s basic activities were, *inter alia*, to supply all types of oil products as well as natural and liquid gas to the Kyrgyz Republic and to facilitate the distribution of said products. According to section 3.2.2 of the charter an additional explicit purpose of KGM was to supply the national economy and the people of the Republic with petroleum products as well as natural and liquid petroleum gas.

It is clear from section 3.2.2 of the charter that KGM was set up as an organ or an entity of the Government, acting for and on behalf of the Kyrgyz Republic. It is to be noted that at the time of KGM’s formation, the Republic (through the governmental body of the State Property Fund) owned 100 per cent of the shares of KGM. At the time of Petrobart’s investment, the Republic owned 98.5 per cent of the shares in KGM.

In February 1998, both Petrobart and KGM arranged to enter into agreements with the aim of supplying KGM with raw materials. In line with this arrangement, Petrobart and KGM concluded the Contract. It was agreed in the Contract that Petrobart would supply KGM with 200,000 tons of gas condensate over a period of twelve months. The Contract also provided that further contracts for additional supply of gas condensate would follow.

From the Contract it appears that the supply of gas condensate was transacted in an open account and that Petrobart was to invoice KGM subsequent to each delivery, with the invoices being due 10 days after the arrival of the goods at the place of delivery. The Contract also stipulated a fixed price for the gas condensate in order to enable KGM to avoid the risks of price fluctuations in the gas market. The Contract was designed to allow KGM to receive pre-payments from its customers first and only afterwards to make payments to Petrobart for the delivered quantity of goods.

Due to the absence of payment for deliveries according to three invoices, Petrobart postponed further deliveries under the Contract and had no alternative but to seek redress in local courts. In the proceedings, the Bishkek Court issued a freezing order against KGM’s current account in the Mercury Bank and an order for the seizure of KGM’s movable and immovable property. On 25 December 1998, the Court also rendered a judgment in favour of Petrobart. It is to be noted that the Court did not rule on the

termination of the Contract. However, the Contract was later expropriated or completely frustrated with the Republic's transfer of assets which eventually led to the dissolution of KGM.

Since the bank funds of KGM were insufficient to cover Petrobart's claim, the Bishkek Court, upon the request of Petrobart, also rendered a decision that allowed Petrobart to execute the judgment against the property of KGM.

Arrangements for the realisation of KGM property took place in early February 1999. The Court Executive of the Lenin Regional Court of Bishkek sent letters to the editor of the "Slovo Kirghizstana" newspaper outlining the KGM assets to be sold at public auction. These letters make it clear that the starting price for the listed assets was over 80,000,000 Soms. Based on the exchange rate of 16 February 1999 (USD 1.00 = 30.56 Soms), the accumulated value of KGM's property and assets was more than USD 2,600,000. In addition, several vehicles for which the starting prices had not been assessed were also listed for the auctions.

KGM's property was to be sold for the benefit of Petrobart and the Central Asian Bank. The available assets were more than sufficient to cover the claims of both Petrobart and the Central Asian Bank. It should be noted that Petrobart at this time was in the process of securing further valuable KGM assets, such as petrol terminals and petrol wagons.

The Vice Prime Minister's letter of 11 February 1999 was clearly a direct reaction to the execution decisions of the Bishkek Court in favour of Petrobart and the Central Asian Bank. The alleged intent of the Vice Prime Minister's letter was to permit KGM to begin a "stabilisation programme". However, the true intention of the Republic and its officials was to bankrupt KGM by stripping it of all its assets. This was done by establishing two new state-owned companies, i.e. Munai and Kyrgyzgaz, both of which were to resume the same business as was originally conducted by KGM.

In the Bishkek Court's decision of 16 February 1999 granting a three-month stay of execution, a clear reference is made to the Vice Prime Minister's letter as ground for granting the stay of execution. The relevant part of the decision reads as follows:

"The court deems it possible to give a stay of execution, hence a letter came from the Government of the Kyrgyz Republic of 11 February 1999 [...]."

Following the court order, the scheduled auctions were cancelled. It should be noted that the potential bidders had already assembled for the first auction which was to take place on the same day that the stay of execution was effected.

During the stay of execution, the Kyrgyz Republic transferred the assets of KGM to the two new state-owned companies Kyrgyzgaz and Munai, without transferring its liabilities. As a result, KGM became insolvent and was declared bankrupt by the Bishkek Court in a ruling which was rendered within the period of the stay of execution. Since Petrobart recovered no assets whatsoever in the bankruptcy proceedings against KGM, the actions of the Republic deprived Petrobart directly of the ability to recover its claim against KGM.

It is nowhere to be found that the Contract was terminated *per se*. Its performance, however, was frustrated by the Kyrgyz Republic's various interventions which, under the applicable law, clearly amount to expropriation in breach of Article 13 of the Treaty. It was the failure of payment that prompted Petrobart to initiate legal proceedings and to suspend

further deliveries of the gas in order to minimise its credit losses. Furthermore, the decision to suspend any further deliveries has in fact served to mitigate Petrobart's loss following the frustrated Contract with KGM.

From 1997 until 2000, the transmission, distribution and sale of oil and natural gas in the Kyrgyz Republic were all carried out by KGM, which existed as a vertically integrated natural monopoly in the Republic, owned and totally controlled by the Government. However, both the manner of KGM's establishment (by transferring to KGM the assets of three other state-owned companies) and the Special Administrator's handling of KGM's subsequent bankruptcy were regarded by the Kyrgyz local media as a huge political scandal. For instance, an article in the local Kyrgyz news-magazine *Rinok kapitala* stated that the appointed general director of KGM had been granted a ministerial position with wide ranging powers throughout the Republic. The article continued by reviewing the activities of the Kyrgyz Parliamentary Commission that had conducted a financial investigation of KGM and had concluded that KGM was used for an unprecedented and large specifically planned financial and credit set-up with the direct involvement of very high ranking people within the Government of the Republic.

The alleged subsequent "restructuring" of KGM involved taking of huge amounts of credit in several banks with only the word of the general director for security. Indeed, the President of KGM's Board was also the President of the Republic's National Bank, which in itself explains why commercial banks gave KGM excessive amounts of credits without security and reinforces the earlier point regarding corruption and intransparent political and business practices. The Parliamentary Commission made critical remarks on the use of these credits.

Presidential Decree No. 282 was promulgated during the time when KGM was already in default with its payments to Petrobart. It stated that the new company Kyrgyzgaz would be created on the basis of KGM's assets. KGM however was to remain, according to the Presidential Decree, liable for its accrued debts. The Decree expressly stated its aim as being "to create in juridical procedure on the basis of the assets of GAK Kyrgyzgazmunaizat the new stock company Kyrgyzgaz". Concerning KGM's debts until 23 September 1998, the responsibility should remain with KGM.

According to Government Decree No. 649, the gas-related assets of KGM were to be transferred to yet another new company called Kyrgyzenergo, the task of which was supposedly to "manage" Kyrgyzgaz. Decree No. 11 of 11 January 1999, which replaced Decree No. 649, explicitly stipulated that KGM was to remain liable for debts arising from the sale and delivery of natural gas prior to 1 October 1998 (i.e., *inter alia*, the debts arising out of the Contract with Petrobart).

On 4 March 1999, Government Decree No. 11 was "executed" by the shareholders of KGM in an extraordinary shareholders' meeting. The minutes which emerged from the extraordinary shareholders' meeting confirmed both the clear separation of Kyrgyzgaz from KGM and the balance sheets and the new share capital allocated directly to Kyrgyzgaz.

Presidential Decree No. 62 created the new state-owned company Munai. The charter of Munai was approved by the Government on 9 March 1999 (Decree no. 141). Four days later, on 13 March 1999, a lease agreement was entered into between Munai and KGM. Under the lease agreement, all of KGM's remaining oil-related assets were transferred to

Munai for the wholly unrealistic and inappropriate amount of 500,000 Soms per month (approximately USD 16,000 based on the exchange rate on 13 March 1999 of USD 1 = 31.20 Soms).

By establishing Munai and by transferring to it the remaining assets of KGM, the Kyrgyz Government deprived Petrobart of its final opportunity to enforce its claims against KGM in a very comprehensive fashion. Since KGM had been stripped of its assets and left with its debts, Petrobart was not surprised to learn that KGM applied for bankruptcy, and was consequently declared bankrupt on 15 April 1999. In fact, following the stay of execution of the Bishkek Court's judgment of 25 December 1998, Petrobart had been advised by its then local counsel that it had no possibility to protect its interests other than by applying for the bankruptcy of KGM and by monitoring its claim in such bankruptcy proceeding. Adhering to this advice, Petrobart filed a petition in the Bishkek Court by which Petrobart sought to have KGM declared bankrupt. However, the Bishkek Court refused to deal with Petrobart's application which was subsequently returned to Petrobart. In the meantime, KGM's assets were transferred to Kyrgyzgaz and Munai and KGM was declared bankrupt on 15 April 1999 following its own application.

Petrobart suffered severely as a direct result of continued government involvement in KGM affairs. It is apparent that KGM was a para-statal entity which was set up and directly controlled by the Government for all intents and purposes, and indeed regarded as a constituent part of the Republic. It is evident from the facts that the activities of the Republic and its officials have not only systematically frustrated the Contract, but have also dispossessed Petrobart of both the value of its established claim and the ability to recover its claim under the judgment rendered in its favour against KGM.

### *B. The Treaty*

The Treaty was signed and applied provisionally on 17 December 1994. It entered into force on 16 April 1998 after having received the required thirty ratifications. As of February 2004, 52 states (as well as the European Communities) had signed and/or ratified the Treaty, including the Kyrgyz Republic and the United Kingdom.

The Contract benefits from the investment protection provisions of the Treaty. It is true that the Contract was concluded on 23 February 1998, i.e. over two months before the Treaty entered into force, but according to the penultimate paragraph of Article 1(6) of the Treaty, an investment that existed before the Treaty entered into force is still covered by the provisions of the Treaty "provided that the Treaty shall only apply to matters affecting such investments after the Effective Date". It is clear from the facts of this case that each one of the Republic's incriminating acts was committed after the date of the entry into force of the Treaty, which was 16 April 1998. Moreover, pursuant to its Article 45, the Treaty was already in effect upon its signature on 17 December 1994 by virtue of it being applied provisionally. Therefore, there is no doubt that the Contract is an asset constituting an investment protected by the provisions of the Treaty.

Petrobart has initiated this arbitration in the exercise of a right granted to it by the Treaty. Pursuant to Article 26(1) of the Treaty, the causes of action under which the present claim has been submitted are based on the Kyrgyz Republic's breach of its various obligations under Part III of the Treaty. Therefore, the present case is in its entirety a claim under international law and more specifically a Treaty claim.

The Treaty is explicit on the issue of applicable law. Article 26(6) provides that an arbitral tribunal (such as the present one) that has been seized pursuant to paragraph (4) of Article 26 of the Treaty is to decide the issues at hand by applying (a) the Treaty provisions, and (b) the applicable rules and principles of public international law.

However, a point of clarification is warranted concerning procedural law. Under paragraph (4) of Article 26, the Treaty offers the investor a choice of four venues, including among others the SCC Institute. The investor's choice of one of the four available venues also determines which particular procedural rules will apply to the dispute at hand. In the instant case, for example, procedural questions which have not been determined by the Treaty will be decided both in accordance with the institutional Rules of the SCC Institute and in accordance with the law of the seat of arbitration, namely Swedish arbitration law.

Since this dispute has arisen in connection with the Treaty, the interpretation of any of its provisions should be ascertained in accordance with the generally accepted rules of treaty interpretation. The general principles of treaty interpretation are set out in Articles 31-33 of the Vienna Convention on the Law of Treaties of 1969. It follows from Article 31 that the determination of the common intention of the parties to the treaty in their choice of certain terms must be undertaken "in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose". It is to be noted that one of the central objectives of the Treaty is to provide a high level of protection to the investments of investors in the energy sector.

Having established that the present claim is an international law claim and that the applicable law to this dispute is the Treaty and the rules and principles of international law, the question remains as to the relation between such applicable law and the Kyrgyz Republic's own domestic law. In this context, two fundamental principles are important. The first principle is that for the purposes of an international law claim, domestic law and governmental measures are essentially matters of fact or evidence. The second fundamental principle concerning the relationship between international law and domestic law is that a state cannot invoke its municipal law as a reason for not fulfilling its international obligations.

Accordingly, the question as to whether the Kyrgyz Republic is in breach of any of its Treaty and international obligations (and if so what consequences follow from any such breach) is to be determined by reference to the applicable law, i.e. the Treaty and rules and principles of international law, and not by reference to the Republic's domestic law. It should of course be borne in mind that domestic law will be relevant as a question of evidence and fact.

According to Article 2, the purpose of the Treaty is to promote long-term co-operation between its Contracting Parties in the energy field, based on complementarities and mutual benefits in accordance with the principles of the European Energy Charter. These principles include the creation of a climate favourable to foreign investors and the flow of investments by implementing market principles in the field of energy.

Part III of the Treaty expressly provides for the promotion and protection of investments (Articles 10-17). Its provisions grant extensive rights to the investments of foreign investors in the Area of a Contracting Party.

The dispute settlement provisions of the Treaty are set out in Part V and include both direct investor-state arbitration (Article 26) and state-to-state arbitration (Article 27). Relevant to the present arbitration is Article 26 which gives investors of a Contracting Party the right to bring a claim against another Contracting Party for breach of certain Treaty obligations. Article 26 makes it clear that the present claim falls within the Arbitral Tribunal's jurisdiction.

According to Article 1(7)(a)(ii) of the Treaty, an investor is a company organised in accordance with the law applicable in a state that is a Contracting Party. Petrobart is a joint stock company incorporated in Gibraltar. Petrobart is thus an investor as defined in Article 1(7) of the Treaty. The dispute requiring resolution relates to investments made by Petrobart as an investor in the Kyrgyz Republic. It concerns the Kyrgyz Republic as a Contracting Party to the Treaty, and its breach of obligations owed to Petrobart as an investor under the Treaty.

Pursuant to Article 1(6) of the Treaty, the term "Investment" means "every kind of asset owned or controlled directly or indirectly by an Investor". The following enumeration is not exhaustive. Reference is made in subparagraph (c) to "claims to money and claims to performance pursuant to contract having an economic value and associated with an Investment" and in subparagraph (f) to "any right conferred by law or contract". Further, Article 1(6) of the Treaty stipulates that the term "Investment" in the Treaty refers to any investment associated with an "Economic Activity in the Energy Sector" which under Article 1(5) includes an economic activity concerning the production, distribution, trade, marketing or sale of Energy Materials and Products. The definition of "Energy Materials and Products" in Article 1(4) includes gas and hydrocarbons.

On the basis of the Contract, the Bishkek Court ruled in favour of Petrobart in December 1998. Furthermore, KGM has in letters to Petrobart dated 2 June 1998 and 14 July 1998 acknowledged KGM's outstanding debt to Petrobart under the Contract. Hence, Petrobart holds a right which has been conferred by law as well as by contract.

### *C. The Republic's breaches of the Treaty*

The Contract, Petrobart's claim for money and indeed the Bishkek Court's judgment in favour of Petrobart all represent investments pursuant to Article 1(6) of the Treaty.

The relevant general principle of international law has been stated clearly in Article 12 of the International Law Commission's Draft Articles on Responsibility of States for Internationally Wrongful Acts which provides that "[t]here is a breach of an international obligation by a State when an act of that State is not in conformity with what is required of it by that obligation, regardless of its origin or character".

The crucial issue in this case is whether there has been a violation of the Treaty. The argument that the Kyrgyz Republic's incriminating acts were part of a "stabilisation programme" functionally in compliance with Kyrgyz bankruptcy law (which Petrobart denies) cannot be a justification under the Treaty. The assertion that it will be necessary to examine Kyrgyz law to determine, *inter alia*, the size of Petrobart's alleged investment and the propriety or impropriety of the Republic's alleged conduct is also an erroneous statement of the law. Instead, the propriety or impropriety of the Republic's alleged conduct is to be determined in accordance with the Treaty and applicable rules and principles of international law. It is therefore futile to argue that the Republic's

incriminating acts were in compliance with its domestic law. It does not follow from this that these acts were in conformity with the Republic's Treaty and other international law obligations.

The above notwithstanding, Petrobart submits that the acts of the Kyrgyz Republic, particularly its conduct in the bankruptcy proceedings, directly contravened the substance of its own domestic law as well. It should be noted that KGM as a state-owned energy company of the Republic cannot be legitimately made insolvent by an order from its owner, namely a sovereign state. This is particularly the case if the insolvency in question has been brought about by the direct involvement of the Republic itself through activities such as ordering KGM to supply other state-owned companies with petroleum products without receiving payment for the same.

The Kyrgyz Republic is in breach of its obligations under Articles 10(1), 10(12), 13(1) and 22(1) of the Treaty. Consequently, Petrobart has the right to be compensated by the Republic in accordance with both the provisions of the Treaty and the applicable rules and principles of international law. In respect of each of the breaches, Petrobart makes the following comments:

*(a) The Republic has failed to create stable, equitable, favourable and transparent conditions for Petrobart's investment (Article 10(1) of the Treaty)*

The Kyrgyz Republic is under an obligation under Article 10(1) of the Treaty to provide Petrobart with stable, equitable, favourable and transparent conditions. The Republic has failed to provide such conditions for Petrobart's investment. Petrobart has been constantly subjected to haphazard and opaque decisions taken by the Government and its authorities, and the Republic itself, through its own deliberate acts and repeated interventions, created unstable, inequitable, unfavourable and intransparent conditions for Petrobart's investment. Petrobart has been a victim of these same chronic features of unpredictability and inconsistency. Presidential Decree No 282 dated 23 September 1998 and its implementing Government Decrees Nos. 649 and 11 had the effect of creating unstable and inequitable conditions for Petrobart. Further, these Decrees ultimately caused the total frustration or expropriation of the Contract.

In addition, the intervention by the Vice Prime Minister in judicial proceedings coupled with the willingness of the Bishkek Court to grant the requested stay of execution created wholly unfavourable and intransparent conditions for Petrobart as an investor.

Even if KGM should have been insolvent before the Kyrgyz Republic's incriminating acts took place or even before the Contract was entered into, which Petrobart denies, this is of no legal significance for finding the Republic responsible under international law. This is so for the following reasons.

First, the Kyrgyz Republic, as the owner of the para-statal entity KGM, was under an obligation to act in good faith and to bring the fact that KGM was insolvent to the attention of Petrobart at the time when the Contract was concluded. Failing to do so, the Republic has assumed the responsibility for the performance of the Contract. Second, even if one were to assume for the sake of argument that a total separation existed between KGM and the Republic, the facts make this case a classical one in which the principle of "lifting the corporate veil" must apply.

The Kyrgyz Republic is therefore under international law in clear breach of the obligation it owed to Petrobart under this heading.

*(b) The Republic has failed to accord Petrobart's investment a fair and equitable treatment and most constant protection for Petrobart's investment (Article 10(1) of the Treaty)*

The Kyrgyz Republic must, pursuant to Article 10(1) of the Treaty, accord fair and equitable treatment to investments of investors, and such investments must enjoy the most constant protection and security.

First the obligation to accord investments a fair and equitable treatment is a common feature in the majority of investment treaties. It is also accepted that this standard of treatment is designed to provide a basic and general standard which is detached from the host state's domestic law. Second, there is no specific definition of this obligation under international law. Its meaning therefore should be determined by applying the applicable rules of interpretation in light of the circumstances of the present case. However, it is clear from the plain meaning of the provisions regarding fair and equitable treatment that a Contracting Party to the Treaty must not only accord such treatment, but must also assist in establishing and maintaining the conditions of its application. The Kyrgyz Republic has utterly failed to comply with this on both accounts.

During the time that KGM was in breach of its contractual obligations, the President issued Decree No. 282 dated 23 September 1998 indicating that KGM would be dismantled. This Decree represents a form of direct intervention enacted by the highest authority of the Kyrgyz Republic, and led to a series of direct interventions by the Government with Petrobart's investment.

Petrobart secured its partial contractual claim against KGM in a judicial ruling from the Bishkek Court of 25 December 1998. Already before that judgment Petrobart had been granted a freezing order dated 9 December 1998 against KGM's account in the Mercury Bank and, since the funds of that account did not suffice to cover Petrobart's claim, another interim security measure, i.e. a decision dated 15 December 1998 for the seizure of movable and immovable property, was obtained. However, since these were only interim measures, Petrobart had to obtain another decision after the judgment of 25 December 1998 in order to have KGM's property levied for execution of the judgment. Thus, on 10 February 1999, the Bishkek Court authorised Petrobart to execute its judgment against KGM's property. Prior to the execution of the judgment, the Vice Prime Minister of the Kyrgyz Republic sent a letter to the Bishkek Court requesting a postponement of the execution of the judgment. In response to the Vice Prime Minister's order, the Bishkek Court postponed the execution of the judgment on 16 February 1999. During the postponement period, the Republic transferred all KGM's assets to other state-owned companies for only nominal consideration, leaving KGM with only its debts. KGM was subsequently declared bankrupt on 15 April 1999.

The Vice Prime Minister's blatant interference with the judicial powers of the Bishkek Court, the Court's decision to act in accordance with the Vice Prime Minister's request, the Republic's transfer of KGM assets during the stay of execution and the decision to place KGM in bankruptcy constitute acts which, separately and collectively, amount to wholly unfair and inequitable treatment that in no way represents the constant protection and security owed by the Kyrgyz Republic to Petrobart's investment according to the Treaty.

Additionally, the various Presidential and Government Decrees stripping KGM of its assets and leaving it with its liabilities, and the consequent dubious bankruptcy procedures have not only deprived Petrobart of its ability to enforce the very rights granted to it by a court order, but also frustrated and/or expropriated the performance of a legal contract for the supply of 200,000 tons of gas condensate.

These measures separately and jointly constitute a clear breach by the Kyrgyz Republic of its obligation to treat the investment of an investor in a fair and equitable manner.

*(c) The Republic is in breach of its obligation not to accord unreasonable impairment of use and enjoyment of Petrobart's investment (Article 10(1) of the Treaty)*

The Kyrgyz Republic is obliged, pursuant to Article 10(1) of the Treaty, to not in any way impair by unreasonable or discriminatory measures the use, enjoyment or disposal of investments under the Treaty.

The refusal of KGM as an entity established by the Kyrgyz Republic and acting under its direct control to honour the Contract along with the Vice Prime Minister's blatant interference with the judicial powers of domestic courts, the Bishkek Court's decision to act in accordance with the Vice Prime Minister's request, the Republic's transfer of KGM assets during the stay of execution and the decision to place KGM in bankruptcy clearly constitute unreasonable or discriminatory measures which have visibly and directly impaired Petrobart's use, enjoyment and disposal of the Contract.

There is no doubt that Presidential Decree No. 282 and the subsequent Government Decrees promulgated to implement said Presidential Decree constituted unreasonable measures which in effect impaired Petrobart's use and enjoyment of its investment. The Kyrgyz Republic's direct intervention in transferring KGM's assets before it was declared bankrupt had the direct effect of depriving Petrobart of its acquired rights under the Court judgment. Moreover, the Republic's enactment of the Foreign Investment Interpretation Law restricting the interpretation of what constitutes an investment in its Foreign Investment Law and the Court's confirmation of that same legislation must also be regarded as measures impairing Petrobart's use and enjoyment of its investment.

The Kyrgyz Republic is thus in breach of its obligation not to impair by unreasonable or discriminatory measures the management, maintenance, use, enjoyment or disposal of Petrobart's investment.

*(d) The Republic is in breach of its obligation to observe the obligation it has entered into with Petrobart (Article 10(1) of the Treaty)*

KGM, as a state-owned company acting for and on behalf of the Kyrgyz Republic, had a clear duty to honour its undertaking by making payment to Petrobart for goods received in accordance with the Contract. The Republic has a duty, pursuant to Article 10(1) of the Treaty, to observe any obligation it has entered into with an investor. This obligation has not been honoured by the Republic. Presidential Decree No. 282, Government Decree No. 11, and the letter of the Vice Prime Minister dated 11 February 1999 requesting the courts to delay the enforcement of the judgment of 25 December 1998 all constitute forms of deliberate interference with Petrobart's economic activities, rights and legally recognised interests. These interferences cannot be described as anything other than clear breaches of

the Treaty obligation to observe “any obligations” the Republic has entered into with Petrobart.

Applying the proper rule of interpretation as expounded in Article 31 of the Vienna Convention on the Law of Treaties, the phrase “any obligations” is broad enough to include both specific contractual obligations and the more general commitments made under the state’s domestic investment legislation. Not only has the Kyrgyz Republic breached its contractual obligation to Petrobart, but it has also contravened its obligation under this heading by failing to observe the promise inherent in its Foreign Investment Law in which Petrobart placed trust when making its investment in the Republic. For example, Article 3 paragraph 1 of the Foreign Investment Law provides, *inter alia*, that “[t]he Kyrgyz Republic through its authorised governmental bodies shall abstain from interference in the economic activity, rights and legally recognised interests of foreign investors”.

It follows that the Kyrgyz Republic should be held responsible under international law for the breach of its obligation to observe the obligation it has entered into with Petrobart.

*(e) The Republic has accorded Petrobart’s investment a treatment less favourable than that required by international law (Article 10(1) of the Treaty)*

A fundamental principle of international law underscores the concept that a foreign entity must not be denied justice (the prohibition of denial of justice). The Bishkek Court’s order carried out in direct response to the Vice Prime Minister’s letter of 11 February 1999 to grant the stay of execution of its valid judgment of 25 December 1998 constitutes a clear denial of justice contrary to international law. In violation of Article 10(1) of the Treaty, the Kyrgyz Republic has accorded Petrobart’s investment a treatment less favourable than that required by international law. There is no doubt that the collusion between the executive (as manifested by the Vice Prime Minister’s letter of 11 February 1999) and the Bishkek Court which was ready to grant the Republic’s request to stay the execution of its judgment in favour of Petrobart constitutes a clear breach of the prohibition of denial of justice under international law. Thus, the Republic is in breach of its obligation to accord Petrobart’s investment a treatment which is no less favourable than that which is required by international law.

*(f) The Republic has failed to ensure that its domestic law provides effective means for the assertion of claims and the enforcement of rights with respect to investments (Article 10(12) of the Treaty)*

The Kyrgyz Republic has failed, contrary to Article 10(12) of the Treaty, to ensure that its domestic law provides effective means for the assertion of claims and the enforcement of rights with respect to investments. That Petrobart was a victim of unpredictability and inconsistency and that the Republic failed to provide Petrobart with effective means by which to assert its legitimate claims and enforce its rights is confirmed by (i) the Republic’s direct and capricious intervention in its own court procedures by the Vice Prime Minister’s letter of 11 February 1999 requesting the stay of execution of a valid judgment and the willingness of the Bishkek Court to readily accord the requested stay of execution, (ii) Presidential Decree No. 282 and its subsequent implementation by the Government which resulted in the transfer of KGM’s assets to two other state-owned companies prior to the formal declaration of KGM’s bankruptcy, and (iii) the Republic’s attempt to restrict the definition of investment in its Foreign Investment Law by

promulgating the Foreign Investment Interpretation Law and to seek a judicial confirmation thereof.

These acts of the Kyrgyz Republic cannot be regarded as anything other than conscious attempts to deliberately prevent Petrobart from asserting and enforcing its legitimate rights. This clearly perverted the administration of justice to which Petrobart was entitled under any civilised system of law.

Accordingly, the Kyrgyz Republic is in clear breach of its obligation owed to Petrobart under Article 10(12) of the Treaty.

*(g) Petrobart has been subject to expropriation or measures equivalent to expropriation (Article 13(1) of the Treaty)*

Petrobart has been subject to expropriation or measures equivalent to expropriation in circumstances which are not in conformity with Article 13(1) of the Treaty. Presidential Decree No. 282 which ordered the transfer of KGM's assets but not its liabilities, Government Decree No. 11 which implemented the same, the Vice Prime Minister's deliberate interference with the judicial powers by his letter of 11 February 1999 requesting the stay of execution of an enforceable judgment, the Bishkek Court's compliance with this request, the Kyrgyz Republic's transfer of KGM assets during the stay of execution and the decision to place KGM in bankruptcy all constitute acts which have contributed to rendering the remainder of Petrobart's investment, i.e. the Contract, completely worthless. Thus, Petrobart's entire investment has been subject to expropriation and/or to measures the effect of which is indeed equivalent to expropriation.

In other words, these governmental acts taken together constituted "creeping" or "constructive" expropriation. It is clear from the facts of the present case that the Kyrgyz Republic's cumulative actions are typical of the kind of expropriatory measures which are prohibited by the Treaty and indeed by international law. The Republic's attempts to justify its creeping expropriatory actions as measures taken in order to "restructure" or rationalise KGM do not render these same actions lawful under international law.

The Kyrgyz Republic is thus in breach of Article 13(1) of the Treaty.

*(h) The Republic has failed to ensure that its state enterprise conducts its activities in a manner consistent with the Republic's obligations under Part III of the Treaty (Article 22(1) of the Treaty)*

KGM was a state-owned enterprise, maintained and established and indeed wholly controlled by the Kyrgyz Republic. KGM, by failing to honour its contractual commitments when due, has clearly acted in a manner inconsistent with the Republic's obligations under Part III of the Treaty, having particularly failed to observe the agreement it entered into with an investor (last sentence of Article 10(1)). The obligation under Article 22(1) of the Treaty does not only apply to non-discrimination and expropriation. When applying the proper rules of treaty interpretation, the ordinary meaning of the phrase "Contracting Party's obligations under Part III of this Treaty" applies to all obligations under the investment section of the Treaty, including the obligation to encourage and create stable, equitable, favourable and transparent conditions and, more importantly, the obligation to observe any obligations entered into with an investor.

KGM's failure to observe its contractual obligations with Petrobart amounts to a breach by the Kyrgyz Republic of its obligations under Article 22(1) of the Treaty.

*D. Damage suffered by Petrobart*

The losses suffered by Petrobart have arisen as a direct consequence of the breach by the Kyrgyz Republic of its obligations under the Treaty. Under international law, the Republic cannot rely on the provision of its domestic law as justification for its failure to comply with its obligation to make good the injury inflicted by its incriminating acts.

Petrobart considers the correlation between KGM's insolvency and Petrobart's damage to be irrelevant for the following reasons. First, the case concerns an international law claim brought by an investor against the Kyrgyz Republic. The correct assessment is therefore what damage Petrobart has suffered as a result of the Republic's interferences with Petrobart's rights. Second, KGM's insolvency is irrelevant as a question of causation to Petrobart's damage since the insolvency was created by the Republic itself through acts that are illegal under international law (and, as it appears, also under domestic law). Third, a contracting state to the Treaty cannot as a legitimate defence for not adhering to its international law obligations rely upon the insolvency of its state-owned entity. On the contrary, the contracting state must in such a case assume liability not only for its own acts but also for the acts of the state-owned entity. This appears from Article 22(1) of the Treaty.

In any case, Petrobart is of the opinion that it would have received full compensation for its claim according to the Bishkek Court's judgment, if the execution had not been stayed following the unlawful request by the Vice Prime Minister. Similarly, Petrobart would have been able to execute the judgment of the Bishkek Court in due process if the asset transfers to Kyrgyzgaz and Munai had not taken place. Furthermore, if the asset transfers had not taken place, KGM would have continued to operate its business. Following the execution Petrobart could therefore have resumed its remaining deliveries under the Contract for which KGM would have been obliged to render payment.

In any case, it is clear from the facts of this case that the transfer of assets from KGM to Kyrgyzgaz and the lease of assets to Munai for a wholly inappropriate consideration, if not created the insolvency of KGM, definitely aggregated the same. Petrobart held an enforceable judgment against KGM, and the judicial auctions were scheduled and announced when the decision to stay execution was rendered. During the three months' stay of execution, KGM, by order of the Kyrgyz Republic, transferred its gas related assets to Kyrgyzgaz and leased its oil related assets to Munai, leaving KGM with nothing but liabilities. These actions ultimately made it impossible for Petrobart to enforce the award. The Republic's actions were therefore detrimental to KGM's creditors in general and to Petrobart in particular.

According to a well-recognised principle of international law, a state that breaches its international obligations is under an obligation to make reparation. This principle was aptly stated by the Permanent Court of International Justice ("PCIJ") in the *Factory at Chorzów* case:

"[...] it is a principle of international law, and even a general conception of law, that any breach of an engagement involves an obligation to make reparation. [...] reparation is the indispensable complement of a failure to apply a convention, and there is no necessity for this to be stated in the convention itself."

At a later stage of this case, the PCIJ further elaborated the above principle:

“The essential principle contained in the actual notion of an illegal act – a principle which seems to be established by international practice and in particular by the decisions of arbitral tribunals – is that reparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed.”

This principle has now been codified by the International Law Commission. Article 31 of the International Law Commission’s Draft Articles on Responsibility of States for Internationally Wrongful Acts reads as follows:

“1. The responsible State is under an obligation to make full reparation for the injury caused by the internationally wrongful act.

2. Injury includes any damages, whether material or moral, caused by the internationally wrongful act of a State.”

According to Article 36(2) of the Draft Articles, the compensation shall cover any financially assessable damage, including loss of profits in so far as it is established.

It is also a well-recognised principle of international law that both the nature and the extent of the breach are to be taken into account in the assessment of damages. The Kyrgyz Republic, through its organs and officials, has displayed a consistent and deliberate disregard for all its legal commitments, both under the Treaty and under the rules and principles of international law. Petrobart is therefore entitled to receive full compensation for all material and moral damage, including lost future profits and interest, suffered as a result of such breaches by the Republic.

It is also to be noted that KGM as a state-owned company could not be legitimately rendered insolvent by an order from the owner, i.e. a sovereign state. This is particularly the case if the insolvency has been brought about by the direct involvement of the Kyrgyz Republic itself through activities such as ordering KGM to supply other state-owned companies with petroleum products without receiving payments for the same.

KGM’s letters of 2 June and 14 July 1998 to Petrobart indicate KGM’s inability to satisfy Petrobart’s claim for payment for the delivered gas condensate at that time. However, they cannot be accepted as evidence of KGM’s insolvency according to Article 9 of the Bankruptcy Law, particularly since the balance sheet of 1 October 1998 shows that at that time KGM had substantial assets exceeding its liabilities.

Petrobart denies that KGM was insolvent when the Contract was entered into. Petrobart also denies that KGM became insolvent during the following months. This is evidenced by the uncontested fact that KGM, following the invoices dated 24 February and 2 March 1998, effected payments on 16 and 24 March 1998 for the first two deliveries of gas condensate. Petrobart denies that KGM was insolvent prior to the Government’s interference with KGM assets and considers that, as a consequence, Petrobart could have secured its claims by enforcing its judgment against KGM’s assets. There is an important distinction between “being insolvent” and “not having sufficient assets” against which the Bishkek Court judgment could have been enforced. To the best of Petrobart’s knowledge, KGM’s insolvency was a result of the transfer of assets (approximately USD 23,000,000) to Kyrgyzgaz and Munai, as confirmed by the extraordinary shareholders’ meeting of 4 March 1999. This view is furthermore supported by the individual programme for

privatisation of 11 February 1999 in which KGM was characterised as an insolvent company.

Petrobart contends that prior to the Kyrgyz Republic's interference, KGM's assets were more than sufficient to cover all of Petrobart's claims. Kyrgyz law – if applied correctly and independently during this time – would have allowed Petrobart to complete the execution sale of KGM's assets and to benefit from the proceeds thereof.

According to the balance sheet, KGM's assets as of 1 October 1998 amounted to 2.5 billion Soms, the approximate equivalent of USD 83 million. Furthermore, and to paint the correct picture of the assets at this time, also the assets of Kyrgyzgaz should be considered. This is so because at this point in time Kyrgyzgaz formed an integral part of KGM. The Kyrgyzgaz assets as of 1 October 1998 amounted to 548 million Soms, the approximate equivalent of USD 18 million. Thus, it is clear that KGM's assets were substantial at the time it was effectively dismantled by the Republic. It follows from the balance sheet of 1 October 1998 that the assets of KGM at that time exceeded the liabilities by 487 million Soms. Hence, KGM was not insolvent at that time.

Moreover, KGM's liabilities were irrelevant for Petrobart's own prospects of enforcing the Bishkek Court's judgment in its favour. The reason for this is clear: pursuant to Kyrgyz law, creditors are entitled to enforce judgments obtained against the debtor so long as the debtor has not been declared formally bankrupt by a Kyrgyz court, and provided that the enforcement is carried out in accordance with the prescribed procedures. According to Article 103 of the Kyrgyz Civil Code it is only subsequent to a court bankruptcy declaration by a debtor that the creditors' claims actually become subject to the bankruptcy process.

The KGM "stabilisation programme" referred to in the Vice Prime Minister's letter of 11 February 1999 was initiated by presidential decrees and governmental acts and effectively transferred all KGM's assets, but none of its liabilities, to the newly established state-owned companies Munai and Kyrgyzgaz, thus rendering KGM bankrupt. The decisions of the shareholders' meeting on 4 March 1999 resulted in parts of KGM's assets being transferred to Kyrgyzgaz. Under the lease contract of 13 March 1999, various remaining assets were leased to Munai. The total value of the transferred and leased assets was some 3 billion Soms. Since a lease agreement is regarded as a secured right, the property which was leased to Munai is not available for distribution among KGM's creditors. In this context Article 18 of the Kyrgyz Bankruptcy Law is of relevance. This Article specifies acts which are to be considered wrongful in the process of bankruptcy. Under this Article it is wrongful, *inter alia*, to initiate fraudulent bankruptcy, to illegally conceal, transfer or remove the property or debts of the debtor, also after commencement of the special administration, and to deliberately create or increase the insolvency of the debtor, or incur damage to the debtor in his personal interests or in the interests of other persons.

It is a fact that the Kyrgyz Republic, in promulgating Decree No. 282, Decree No. 649 and Decree No. 11 and in concluding the Munai lease contract, illegally withdrew, transferred and took complete control of KGM's property. Further, the Republic through its deliberate acts both provoked and aggravated KGM's insolvency. The cumulative effect of these activities was the comprehensive violation of Article 18 of the Kyrgyz Bankruptcy Law. According to the last section of Article 18 of the Bankruptcy Law, individuals who commit the wrongful actions referred to in this Article are answerable in accordance with the legislation of the Kyrgyz Republic.

Article 23 of the Kyrgyz Bankruptcy Law explains the manner in which the assets of a debtor may be disposed of when there is a risk of commencement of a bankruptcy action. Article 23(1) stipulates that the Article applies, *inter alia*, from the moment the owners of the debtor or its managers inform any of the creditors by any means that the debtor is insolvent and is unable to pay its debts. It is an uncontested fact that KGM on several occasions informed Petrobart that KGM was unable to pay the outstanding debts to Petrobart.

Paragraph 2 of Article 23 of the Bankruptcy Law further states that, after the occurrence of one of the events mentioned in paragraph 1 of the Article, the participant of the debtor, i.e. in this case the State Property Fund, has no right to demand return of his contribution from the charter capital of the debtor and/or withdraw that contribution (*dolya*) by other means.

Paragraph 3 of the same Article lists the proper bodies which are entitled to take control or dispose of the assets of a bankrupt entity. In particular, the owners or managers of the debtor may not dispose of its assets or funds or voluntarily discharge their obligations, without coordinating that issue with (i) the court, (ii) the temporary administrator, (iii) the special administrator, (iv) the conservator, and (v) the debtor, with the permission of the properly called meeting or creditors' committee.

The consequence of violating the above provisions is set out in Article 23(7) of the Bankruptcy Law which provides that those wrongly disposing of assets of the debtor after any of the events mentioned in paragraph 1 of this Article shall also be personally liable for indemnification of losses incurred by creditors if the aforementioned assets were not returned in full.

The above cited provisions of the Kyrgyz Bankruptcy Law make it clear that once KGM had notified its creditors that it was unable to pay its outstanding debts, the Kyrgyz Republic was not entitled to transfer or lease any of KGM's assets to any other companies. Nor was the Republic entitled to transform KGM's shares into Kyrgyzgaz shares. By actually doing so, the Republic breached its own domestic law and is accordingly "personally" liable to indemnify creditors' losses. Finally, according to Article 19(2) of the Bankruptcy Law, the Republic itself is answerable for aggravating the insolvency of KGM to the point of bankruptcy. It follows from Article 19(2) that, if the bankruptcy is caused by actions or omissions by the leader of the debtor (debtor's owner or individual business man) – such as in this case the State Property Fund – which lead to predetermined creation or increase of insolvency in personal interests, or in the interests of other individuals (predetermined bankruptcy), the creditors may demand that guilty persons indemnify the inflicted damage and make them otherwise answerable in compliance with the procedure established by law.

From the undisputed facts of this case and from the clear wording of the Kyrgyz Bankruptcy Law, it is evident that any arguments regarding KGM's "stabilisation programme" and any reliance on the Kyrgyz Bankruptcy Law are untenable and incorrect and are little more than an attempt to camouflage the Kyrgyz Republic's failure to comply with both its international obligations and its own domestic law. In fact, the Bankruptcy Law has quite clearly codified the concept of subsidiary liability for e.g. shareholders in case of non-compliance with the relevant cited provisions. This concept corresponds well with the general principle of law known as "lifting of the corporate veil". Thus, any

attempt to rely upon domestic law highlights rather than mitigates the Republic's responsibility under international law.

Petrobart also contests the argument that, even if KGM had not been insolvent and even if the scheduled judicial auctions had indeed taken place, Petrobart would not have received any proceeds thereof, because the scheduled auctions were being held for the benefit of the Central Asian Bank, which as a creditor held prior judgments against KGM in excess of USD 3 million, and the seized KGM property was worth significantly less than that amount. This argument is contradicted by the facts of the case.

It is correct that the Central Asian Bank held two judgments that were enforceable in February 1999, the first judgment, dated 13 October 1998, in the approximate amount of USD 1.5 million and the second judgment, dated 4 January 1999, in the approximate amount of USD 1.8 million.

The judgment in favour of Petrobart was issued on 25 December 1998, and amounted to approximately USD 1.5 million, becoming enforceable on 25 January 1999 (as was confirmed by the "writ of execution" from the Bishkek Court). Since Petrobart was aware of the lack of KGM's liquid funds, and in accordance with the ruling obtained on 15 December 1998, Petrobart immediately instructed the court bailiffs to seize KGM's assets. To that end, the bailiffs seized on Petrobart's behalf, *inter alia*, all assets of the Tokmak and Kant branches of KGM on 2 and 4 February 1999. In fact, Petrobart was working jointly with the Central Asian Bank to secure further KGM assets, a process enacted pursuant to Article 422 of the Kyrgyz Civil Procedure Code, in which monetary claims of creditors who have obtained enforceable judgments must be satisfied proportionally (i.e. the proceeds of an auction must be divided proportionally, irrespective of on whose behalf the assets were seized). Petrobart also requested and indeed was permitted to levy its claim against the property of KGM as per the court ruling dated 10 February 1999. Pursuant to the writ of execution, this ruling was enforceable immediately upon its issue.

Article 21 of the Bankruptcy Law sets out the various situations in which a debtor who is insolvent but not in bankruptcy may dispose of his assets. One such situation is where a court order has been issued. The reference to a court in Article 21(3) is of a general nature and cannot be understood as a reference to the court before which the bankruptcy is pending. On the other hand, according to Kyrgyz law a decision to initiate bankruptcy proceedings renders all previous decisions on seizures null and void, since the purpose of the bankruptcy is to distribute the assets among the creditors in one single proceeding.

In preparing for the planned auctions of KGM's property, the Lenin Regional Court issued letters to the Kant oil terminal and to the Agency for Assessment of Assets requiring information regarding KGM's stock of oil products and the starting price for KGM's assets. The principle of proportional satisfaction is reflected in the letters of the Lenin Regional Court as they refer to the judgments in favour of both the Central Asian Bank and Petrobart. Bearing in mind the principle of proportional satisfaction, it is also to be noted that the bailiffs seized the following assets on behalf of the Central Asian Bank:

- the assets of the Karabalta branch,
- 299 rail wagons,
- 39 vehicles, and
- 14 petrol stations.

Furthermore, it is important to note that the starting price of USD 2,600,000 for KGM's assets to be sold at auction included neither the listed vehicles nor the various other assets seized on behalf of Petrobart and the Central Asian Bank. The starting prices for the auctions were not inflated but were professionally assessed by the Agency for Assessment of Assets. The referenced prices represented only the starting prices, and the actual sales prices were expected to be considerably higher.

To sum up, the value of the seized KGM assets can be estimated to be well above USD 5,000,000 and thus covering both Petrobart's and the Central Asian Bank's claims. Should, however, such judicial sales have proved to only cover parts of both creditors' claims, the satisfaction of each creditor would have been proportionate to its respective claim. Finally, it is to be noted that the Central Asian Bank, which interestingly enough is partially owned by the Kyrgyz Republic (and two other states), seems to have received full satisfaction of its claims, whereas Petrobart has as yet received no payment whatsoever.

Petrobart has been denied updated information about the value of assets and liabilities in the pending bankruptcy proceedings of KGM. However, according to a list of creditors as per 10 June 1999, the liabilities then amounted to more than 3.8 billion Soms. On 1 October 1998, i.e. before the transfer of assets to Kyrgyzgaz and Munai, KGM's assets amounted to approximately 3 billion Soms.

#### *E. Calculation of Petrobart's losses*

Petrobart had a secure judgment regarding its claim rendered by the Bishkek Court. Petrobart was awarded the amount of USD 1,499,143.244 of principal and 318,058 Soms (the equivalent of USD 8,669.45) in state duty by the Bishkek Court. Thus, the total debt in this case is USD 1,507,812.60. This claim for money constitutes an investment under Article 1(6) of the Treaty. This investment (asset) owned by Petrobart was frustrated by the direct acts of the Kyrgyz Republic (i.e. acts which constituted a violation of the Republic's Treaty obligations). The Republic is therefore wholly liable to pay the said amount to Petrobart.

Prior to entering into the Contract, Petrobart – in agreement with KGM – was in the process of establishing various investment arrangements in the Kyrgyz Republic. With this firm understanding between itself and KGM in place, Petrobart entered into the Contract with KGM for the supply of 200,000 tons of gas condensate. The agreed price of the goods, according to Section 4.1 of the Contract, was set at USD 143.50 per metric ton. The total price for the performance of the entire Contract was thus USD 28,700,000.00.

Petrobart purchased the gas condensate from the Uzbek company Uzneftegazdobicha at the price of USD 95.00 per metric ton. Reference is made to Section 5 of the contract of 21 January 1998 between Petrobart and Uzneftegazdobicha. The agreed purchase price was *ex works*, meaning that Petrobart arranged and paid for the transportation of the gas condensate to KGM's refinery in Kant. The costs for this transportation amounted to USD 35.50 per metric ton, allowing Petrobart a foreseen profit of USD 13.00 per metric ton.

Petrobart thus entered into an agreement in good faith to deliver 200,000 tons of gas condensate to KGM and contracted with a third party, Uzneftegazdobicha, to secure the goods to be delivered to KGM. Moreover, Petrobart delivered 17,204.644 tons of gas condensate but received payment for only 6,634 tons. The Kyrgyz Republic, through its deliberate interventions and the various questionable acts, has frustrated in the extreme the

performance of the Contract and/or expropriated the same, thus depriving Petrobart of its foreseen profits had the Contract been performed fully.

While specific performance is the primary remedy for a breach, it is no longer materially possible in this case. This is so for the following reasons: (i) the Contract has been frustrated; (ii) Petrobart's supply contract with Uzneftegazdobicha has been terminated; (iii) should Petrobart be forced to deliver the remaining quantities under the Contract to KGM, Petrobart would have to re-negotiate the price of the natural gas at present market level; (iv) the delivery of gas condensate is impossible for practical reasons since Petrobart is no longer engaged in Kyrgyzstan.

Indeed, if specific performance is not possible, compensation in lieu of specific performance should be awarded instead. This well established principle of international law of state responsibility has been confirmed in Articles 35 and 36 of the International Law Commission's Draft Articles on Responsibility of States for Internationally Wrongful Acts, and also upheld by international case-law. According to Article 36(2) of the Draft Articles, compensation for an internationally wrongful act shall include loss of profits. Petrobart has established the exact amount of the legitimate profits it would have received had the Contract been performed without the Kyrgyz Republic's interference.

It should be recalled that the Bishkek Court's judgment was rendered for the specific purpose of awarding Petrobart payment for goods already delivered, and indeed received by KGM. The Court did not rule on the termination of the Contract. However, the Contract was expropriated or frustrated completely with the Kyrgyz Republic's transfer of KGM's assets which eventually led to the dissolution of KGM. Because of its clear and direct intervention, the Republic must assume responsibility for the frustration or expropriation of the Contract.

Concerning calculation of lost profits, it follows from the Contract that KGM was obliged to purchase all of the stipulated 200,000 tons of gas condensate. Indeed, Section 1.1 of the Contract states that "[Petrobart] shall supply and transfer ownership of two hundred thousand (200,000) tons of stable gas condensate (the "goods") to [KGM] over the course of one year on a monthly basis". Furthermore, Section 1.2 of the Contract stipulates that "[KGM] shall accept the supplied goods and make payment under the conditions in this agreement". Thus, it follows that Petrobart was bound to deliver all of the 200,000 tons and that KGM was obliged to accept and pay for the full quantity.

Moreover, concerning lost profits it is interesting to note that in case of failure to perform under the Contract, Section 8.4 of the same specifically includes liability for "lost benefit".

Accordingly, Petrobart is entitled to the amount of USD 2,376,339.60 in lost foreseen profits calculated as follows:

$$200,000 \text{ metric tons} - 17,204.644 \text{ metric tons} = 182,795.36 \text{ metric tons}$$

$$182,795.36 \text{ metric tons} \times \text{USD } 13.00 = \text{USD } 2,376,339.60$$

Petrobart has incurred various outlays and related expenses in pursuing the performance of the Contract calculated in the amount of USD 200,500.00.

That outlays and related expenses constitute assets covered by the Treaty is clear from the wording of the last paragraph of Article 1(6) which stipulates that "Investment" refers to "any investment associated with an Economic Activity in the Energy Sector [...]".

Petrobart's claim for outlays and related expenses constitutes assets associated with both the fulfilment of the Contract (which is in its own right an investment under the Treaty) and indeed with Petrobart's attempt to secure a valid court's judgment in its favour. These expenses were clearly associated with the investments. This claim constitutes a legitimate element of the actual losses suffered by Petrobart and represents an integral part of the overall damages to which Petrobart is entitled. It cannot be questioned that under the Treaty and applicable rules and principles of international law, Petrobart is entitled to the amount claimed for outlays and related expenses.

In addition to other claims, Petrobart has requested "such other relief as the Arbitral Tribunal may deem appropriate". Petrobart is of the opinion that the Arbitral Tribunal is competent to grant any additional remedy that has not been identified in Petrobart's prayer for relief. This could be of importance in the event that subsequent precise losses have been identified during the arbitration proceedings which were not listed in the prayer for relief. Petrobart considers that it is within the Arbitral Tribunal's discretion to ascertain whether under the circumstances of this case additional relief is warranted to cover the total loss of Petrobart.

#### *F. Conclusion*

In light of the above, Petrobart is entitled to receive:

- (a) compensatory damages in the amount of USD 1,507,812.60 (the total sum awarded by the Bishkek Court) together with interest thereon at an annual rate determined in accordance with Article 7.4.9 of the UNIDROIT Principles of International Commercial Contracts from 25 December 1998 (the date of the Bishkek Court's award) until payment has been made;
- (b) an amount of USD 2,376,339.60 in lost future profits arising as a consequence of the Republic's breach of its obligations under both the Treaty and international law, together with interest thereon at an annual rate determined in accordance with Article 7.4.9 of the UNIDROIT Principles of International Commercial Contracts from 4 March 1999 (the date when the Government Decree No. 11 was executed at the extraordinary shareholders' meeting in KGM) until payment has been made;
- (c) an amount of USD 200,500.00 for outlays and related expenses together with interest thereon at the annual rate determined in accordance with Article 7.4.9 of the UNIDROIT Principles of International Commercial Contracts from 1 September 2003 (the date of the Request for Arbitration) until payment has been made;
- (d) a declaration that all costs, as between the parties, of this arbitral proceeding, including legal fees, are to be borne by the Republic; and
- (e) such other relief as the Arbitral Tribunal may deem appropriate.

## ***2. The Kyrgyz Republic:***

### *A. Background*

Petrobart apparently tries to characterise the Kyrgyz Republic as some sort of rogue state in which the instrumentalities of the state do not function, and to otherwise impair the Republic's credibility. However, Petrobart's own descriptions and allegations reveal that, although the Kyrgyz Republic is a fledgling nation-state, its institutions do operate.

For example, Petrobart cites a parliamentary commission that criticised the Government regarding KGM. If the Kyrgyz Republic were the rogue state that Petrobart attempts to characterise it as being, such democratic institutions would not function, and certainly would not openly criticise the Government. Moreover, Petrobart's primary underlying allegation that Petrobart recovered a judgment and was rendered unable to collect it belies Petrobart's entire thesis. That Petrobart, an allegedly foreign investor, was able to obtain a judgment against a state-owned company testifies to the Republic's adherence to the rule of law.

Finally, the Kyrgyz Republic notes that much of Petrobart's remarks on these matters relies upon an article from 2000 in the local Kyrgyz news-magazine *Rinok kapitala*. On the territory of the Republic, the print media find themselves in relative infancy, and salaries for reporters and other staff are low. Often, stories are "commissioned" such that the author of the story is paid by someone with an interest (whether political or economic) in the substance of the story. In fact, in the course of the UNCITRAL Arbitration, it was discovered that Petrobart appears to have engaged in such a practice on at least one occasion.

#### *B. Res judicata and collateral estoppel*

The Treaty came into force on 16 April 1998, nearly two months after Petrobart and KGM signed the Contract. Article 26 of the Treaty permits (and, at all times relevant hereto, permitted) Petrobart to raise its Treaty-based claims in the courts of the Kyrgyz Republic (see Article 26(2)(a) of the Treaty). The Republic acknowledges that the SCC Institute is one forum in which Treaty-based claims may be lodged. However, the Republic denies that, in this case, Petrobart can be heard in this or any other arbitral forum. In particular, the Republic denies that this Arbitral Tribunal may determine whether Petrobart is an "investor" that made an "investment". In the Show-Cause Case in December 2000, the Bishkek Court made that determination. Indeed, the question of whether Petrobart's judgment based on the Contract was an arbitrable "investment" has already been determined by (i) the Bishkek Court in the Show-Cause Case, and (ii) the arbitral tribunal in the UNCITRAL Arbitration. In both cases Petrobart had ample opportunity to assert that it is an investor with an arbitrable dispute under the Treaty, but Petrobart chose not to do so. Thus, the seminal issue of whether Petrobart is an "investor" who is entitled to arbitrate is not reviewable by this Tribunal.

In the Show-Cause Case, the Kyrgyz Republic (by its lawyers) commenced a proceeding in the Bishkek Court on 6 December 2000. The request initiating the proceeding was entitled "Application for the Establishment of Facts of Legal Value". The said application was delivered to Petrobart at its Gibraltar address and at its offices in Moscow. Pursuant to applicable procedures, the Republic requested that the Bishkek Court involve Petrobart as an "interested party", and the Republic so advised Petrobart.

In the application, the Kyrgyz Republic sought a ruling that Petrobart did not, by way of the Contract, make a "foreign investment". The Bishkek Court accepted the application for filing and the judge set a hearing for 19 December 2000 and advised that attendance of

both the Republic and Petrobart was necessary. The Republic caused that court ruling to be delivered to Petrobart.

On 18 December 2000, Petrobart's counsel sent a letter to the Bishkek Court in which Petrobart advised that it "does not intend to take part in the hearing" of the Kyrgyz Republic's application. Petrobart did not appear at the 19 December hearing, and, because the Bishkek Court deemed the participation of Petrobart necessary, the Court postponed the hearing until 26 December 2000. On 19 December 2000, the Republic, by its then counsel, sent a letter to Petrobart's then counsel in which the Republic's counsel stated:

"We write today to urge Petrobart to take advantage of this opportunity, and to reconsider its decision regarding participation in the Bishkek proceeding. We understand that it is Petrobart's position that the Court lacks jurisdiction. While we disagree, we suggest that at this juncture the forum to address the jurisdiction of the Court is the Court. In this regard, should Petrobart wish to take part in the hearing, and considering that it is now scheduled for the day after Christmas, I am sure that [the Republic] would not object if you would like to ask for a few days' additional postponement."

The hearing was held on 26 December 2000 as scheduled. The Kyrgyz Republic appeared, but Petrobart did not. Pursuant to Article 100 of the Kyrgyz Code of Arbitration Procedure, the Court decided to proceed with the hearing on the Republic's application. In a decision dated 26 December 2000, the Bishkek Court determined that the Contract did not and does not constitute a "foreign investment". Petrobart received timely notice of the Bishkek Court's decision and of Petrobart's right to appeal the Bishkek Court's decision. Petrobart did not appeal, and the decision became effective on 25 January 2001.

The Kyrgyz Republic considers that, whether viewed under "applicable rules and principles of international law" or under *lex arbitri*, the present proceeding is barred by the doctrine of *res judicata*. It is a generally accepted principle of international law that this doctrine applies to arbitration cases. Swedish law also recognises the doctrine and applies it to proceedings such as this one. Petrobart and the Republic were parties to the Show-Cause Case in which Petrobart could have raised its claims under the Treaty. The same core facts, i.e. the Bishkek Court's judgment, the Contract and the delivery of gas condensate, were present. However, Petrobart chose not to participate in the Show-Cause Case, basing its decision not to participate primarily upon the assertion that jurisdiction was vested in the arbitral tribunal then to be formed, i.e. the UNCITRAL Arbitration. Given that the tribunal in the UNCITRAL Arbitration did not, ultimately, possess such jurisdiction, and, further given that the court in the Show-Cause Case considered whether Petrobart was an "investor" that made an "investment", Petrobart's failure to raise its Treaty-based claims in that forum renders this Treaty-based proceeding barred by virtue of the doctrine of *res judicata*. When considered in light of Article 11 of Chapter 17 of the Swedish Code of Judicial Procedure, it is clear that the application of *lex arbitri* would produce a result that is no different from that urged by the Republic.

In fact, the doctrine of *res judicata* prevents relitigation of a claim that was or could have been litigated in a prior action. Given (i) that the Show-Cause Case was fully litigated, (ii) that it resulted in a final judgment on the merits, (iii) that the parties thereto are the same as the parties to this arbitration, and (iv) that there existed in the Show-Cause Case no procedural, substantive, or practical impediment to Petrobart's asserting before the Bishkek Court its belief that it is entitled to relief from the Republic based upon the Treaty, this matter cannot now be relitigated. Local courts of Contracting Parties are appropriate forums for raising Treaty-based investment dispute claims (Article 26(2)(a) of the Treaty).

Nor does the doctrine of *competence/competence* operate to invalidate the *res judicata* that is present here. *Competence/competence* envisions stages during which the jurisdiction of an arbitral body might be examined. The first of these “stages” encompasses litigation. Thus, nothing that would compromise the doctrine of *competence/competence* and nothing radical would result if this Arbitral Tribunal were to hold that this proceeding is barred by the doctrine of *res judicata*.

Petrobart’s assertion that the Bishkek Court lacked jurisdiction was baseless and cannot, in any event, provide an exception to the preclusive effect of the Show-Cause Case. Petrobart’s assertion of the Bishkek Court’s lack of jurisdiction was primarily based upon Petrobart’s position that its dispute with the Kyrgyz Republic regarding the Contract was an “investment dispute” between an “investor” who made a “foreign investment” pursuant to the Kyrgyz Foreign Investment Law, and that, in accordance with that law, the dispute was subject to private arbitration. However, the tribunal in the UNCITRAL Arbitration determined, after a full hearing and extensive briefing by counsel, that the dispute was not subject to arbitration. Thus, Petrobart had no basis for relinquishing its rights to appear and advance its Treaty-based claims before the Bishkek Court.

Petrobart argues, as it forcefully did in the UNCITRAL Arbitration, that KGM was essentially an *alter ego* of the Kyrgyz Republic. If that is so, then Petrobart should have raised its Treaty-based claims against the Republic in the context of the case that Petrobart filed against KGM in November 1998. There existed no legal or practical impediment to Petrobart doing so, and Petrobart’s failure to do so should operate to bar this proceeding on the basis of the doctrine of *res judicata*.

However, even if Petrobart would have been required (or if it opted) to pursue a parallel arbitration, the policy underpinnings of *res judicata* would have been served, i.e. (i) the claim would have been adjudicated efficiently, (ii) judicial and arbitral resources would have been preserved, and (iii) the Republic would have enjoyed finality.

Indeed, an examination of the present arbitration on the merits would violate the policy underpinnings of the doctrine of *res judicata*: the avoidance of claim splitting, finality, and judicial economy. Petrobart actually appears to argue that Petrobart would have the right to pursue this case, even if it had won in the Kyrgyz domestic courts or in the UNCITRAL Arbitration. The Arbitral Tribunal should find that position wholly untenable. In the Show-Cause Case, Petrobart could have raised its Treaty-based claims and could, alternatively, have raised an objection and removed the dispute to an arbitral forum. Petrobart knowingly and voluntarily, after due notice, did neither and allowed the Show-Cause Case to be decided without the benefit of argument from Petrobart. If Petrobart had interposed its Treaty-based claims in the Show-Cause Case, the present re-litigation exercise would be unnecessary.

Moreover, the jurisdictional decision rendered by the tribunal in the UNCITRAL Arbitration, standing alone, serves to bar, on the basis of the *res judicata* doctrine, the present Arbitral Tribunal’s consideration of the merits of Petrobart’s Treaty-based claims. Arbitration, unlike litigation, requires consent. An empanelled arbitral tribunal’s first duty is to examine whether the Kyrgyz Republic has given that consent. A sovereign state, such as the Republic, may consent to arbitrate only via an express agreement, a law, or an international undertaking such as a treaty. In the UNCITRAL Arbitration, the relevant arbitral tribunal examined whether or not the Republic had given its consent by way of any

of those methods. Petrobart could have raised its Treaty-based assertion that it is an “investor” that made an “investment” in the course of its jurisdictional argument in the UNCITRAL Arbitration.

Consequently, the UNCITRAL Arbitration should operate to bar this proceeding. While it is true that the UNCITRAL Arbitration did result in a finding of no jurisdiction, the parties consolidated the “jurisdiction” portion of the hearing and the hearing on the merits. As such, the parties prepared an entire case, and the tribunal heard an entire case. All of the expenses associated therewith were borne by the parties. All of the policy reasons that underlie the *res judicata* doctrine are, thus, present in this case and the UNCITRAL Arbitration.

The Kyrgyz Republic considers that a court or arbitral tribunal, i.e. the UNCITRAL tribunal, has already examined the merits of the case – indeed in full – and, with specific regard to jurisdiction, that arbitral tribunal has examined the omnibus issue of whether the facts alleged by Petrobart give rise to an arbitrable dispute. Having done that, the UNCITRAL tribunal ruled that the general nucleus of operative facts does not give rise to an arbitrable dispute. Petrobart could have raised the Treaty-based jurisdictional argument during that proceeding, but its failure to do so renders the present Arbitral Tribunal incompetent to reconsider the question of jurisdiction.

As an alternative to the doctrine of *res judicata*, the Arbitral Tribunal could also apply the doctrine of collateral estoppel.

Since Petrobart had the right to bring to the Bishkek Court’s attention its argument that it is an “investor” that made an “investment” because of the rights allegedly conferred on Petrobart by way of the Treaty but did not do so, and since the Show-Cause Case was fully litigated (albeit in Petrobart’s absence, but such absence was knowing and voluntary), the entire question of Petrobart’s status as an “investor” who made an arbitrable “investment” is barred by the doctrine of collateral estoppel.

Similarly, since the UNCITRAL Arbitration was, at Petrobart’s request (to which request the Kyrgyz Republic expressly acquiesced), not bifurcated into an initial “jurisdictional” hearing and a subsequent hearing on the merits, as is typically done in UNCITRAL arbitration matters that contain a jurisdictional question, but included a hearing on both jurisdiction and merits, a consequence thereof should be that the doctrine of collateral estoppel is applicable in the present arbitration despite the fact that the UNCITRAL Arbitration was dismissed for lack of jurisdiction.

### *C. The applicability of the Treaty and the Republic’s alleged breaches of the Treaty*

#### *(a) Petrobart as a Gibraltar company*

Petrobart states that it is a company registered in Gibraltar and relies implicitly on the United Kingdom’s status as a signatory of the Treaty as a basis for Petrobart’s alleged entitlement to investor protection under the Treaty. Petrobart has never stated that its relation to Gibraltar is anything other than its incorporation there. Petrobart appears to conduct operations through two individuals who reside, at varying times, in Almaty and Moscow. These two persons, Mr. Josif Todorovski and Mr. Ratko Zatazelo, are, upon

information and belief, citizens of Serbia and Montenegro which is not a Contracting Party to the Treaty.

Petrobart's incorporation number indicates that it is organised as a Gibraltar non-resident company, i.e. a legal entity incorporated in Gibraltar but owned, managed and controlled by non-residents. Such an entity is not subject to Gibraltar local corporate tax, except for profits remitted to Gibraltar, so long as the entity conducts no business operations in Gibraltar.

According to Article 17 of the Treaty, a Contracting Party may deny the advantages of that part of the Treaty to a legal entity if citizens or nationals of a third state own or control such entity and if that entity has no substantial business in the Area of the Contracting Party in which it is organised. The plain language of this provision makes it clear that the intent of the Treaty's signatories was that a legal entity, if it is to enjoy the benefits of the Treaty, must control its alleged investment from the state of incorporation. Petrobart has never alleged that it conducts any business in Gibraltar, and if Petrobart were so to allege, it would lose its offshore status and be liable to Gibraltar taxation. According to a renowned authority on the Energy Charter Treaty, the "test" as to whether an investment of an entity controlled by nationals of a third state is "controlled" from the entity's state of incorporation may be expected to be handled "quite strictly; otherwise, non-contracting states which do not accept the obligations of the Treaty would enjoy the benefits, and free-loading is unlikely to be encouraged".

It should be noted that any alleged presence of Petrobart in, for example, London would not place its principals in the "Area of the Contracting Party in which [Petrobart] is organized", as is expressly required by Article 17(1) of the Treaty, because Petrobart is, by its own admission, incorporated and registered in Gibraltar. Moreover, in any event, Gibraltar is not a component country of the United Kingdom but a crown colony that looks to the United Kingdom for matters of defence and international relations only. Gibraltar registers its own legal entities.

Moreover, Petrobart is not now and never was in a position to be protected under the Treaty, because the United Kingdom never ratified the Treaty on Gibraltar's behalf. It is true that, on 17 December 1994, the United Kingdom stated that it intended to provisionally apply the Treaty to Gibraltar under Article 45(1) of the Treaty. Such provisional application is, in accordance with the express language of Article 45(1), effective only during the pendency of the Treaty's entry into force in accordance with Article 44.

On 13 December 1996, the United Kingdom signed its instrument of ratification of the Treaty in respect of the United Kingdom, the Bailiwick of Jersey and the Isle of Man. Thus, between the time of expression of provisional application and actual ratification, the United Kingdom chose not to include Gibraltar in its final ratification of the Treaty. It would appear that the United Kingdom elected to refrain from extending the coverage of the Treaty to Gibraltar after a dispute with Spain. Given that the instrument of ratification is the sole device by which the United Kingdom expressed its ratification of the Treaty, it is clear that it was and continues to be the irrefutable intention of the United Kingdom that the Treaty not apply to Gibraltar. As such, Petrobart, as a Gibraltar legal entity, is not now, and never was, entitled to bring this or any arbitration case under Article 26 of the Treaty.

*(b) Request for amicable settlement*

According to Article 26(1) of the Treaty, disputes under the Treaty shall, if possible, be settled amicably. If a dispute cannot be settled within a period of three months from the date on which either party requested amicable settlement, the investor party to the dispute, according to Article 26(2), may choose to submit it for resolution under a settlement procedure. Petrobart has submitted copies of three letters addressed to the Prime Minister of the Kyrgyz Republic regarding the issue of an amicable settlement. However, Petrobart knew that management of this case had been assigned to two individuals within the Ministry of Finance and, tangentially, to an additional individual in the Prime Minister's legal apparatus. Petrobart's principals have met on at least two (although likely several) instances with these individuals, and these principals are in possession of their contact coordinates. As such, the settlement letters cryptically addressed to the Prime Minister reveal that Petrobart never intended that any settlement discussions occur. Indeed, none did. Thus, Petrobart acted without regard to the good faith requirement of Article 26(1) and (2).

*(c) Petrobart is not an investor*

The Kyrgyz Republic continues to take the position that Petrobart is not an investor who made an investment or that Petrobart is an investor to whom the rights provided by Part III (or any part) of the Treaty apply. In any case, the Kyrgyz Republic is not indebted to Petrobart for breach of any of the provisions of the Treaty.

Petrobart was never a "foreign investor" within the meaning of the then effective Kyrgyz Foreign Investment Law, Petrobart never having made a foreign investment thereunder. Thus, it follows that the Kyrgyz Republic never entered any obligation with Petrobart based upon that law, and the Republic cannot be held liable thereunder.

The Kyrgyz Republic acknowledges that Petrobart and KGM concluded the Contract on 23 February 1998 but denies that Petrobart and KGM arranged to enter into further contracts with the aim of supplying KGM with raw materials. The Republic denies that the Contract provides that further contracts for additional supply of gas condensate would follow, as is alleged by Petrobart. Even if discussions regarding these so-called arrangements and further contracts did occur, they (i) are not relevant to Petrobart's Treaty-based claims, (ii) are barred by Section 9.2 of the Contract, which renders "null and void" all previous correspondence and relations between the parties thereto, and, most significantly, (iii) have already been treated by the arbitral tribunal in the UNCITRAL Arbitration as constituting nothing more than Petrobart's desire to do more business with KGM, not representing a meeting of minds between KGM and Petrobart. It is the Republic's position that the Contract expired in accordance with its terms in or about February 1999.

As to Petrobart's assertion that Petrobart and KGM agreed that Petrobart would supply KGM with 200,000 tons of gas condensate over a period of twelve months, the Kyrgyz Republic notes that the Contract, when viewed in its totality, is nothing more than an "open account" supply contract, by which KGM was entitled to request deliveries and, in return, Petrobart was entitled to payment from KGM for deliveries actually made. The Contract was not, in other words, any sort of an "outputs" contract.

The Kyrgyz Republic acknowledges that the price of gas condensate in the Contract was fixed, and further acknowledges that, in markets, prices can fluctuate. However, the Republic denies that this provision conferred a particular advantage to KGM. Either party

to the Contract was in a position to enjoy a benefit or suffer a detriment depending upon the direction of any market price change. Moreover, because the price in the Contract was fixed in U.S. dollars, KGM alone would suffer a detriment if the value of the Kyrgyz Som (the lawful currency of the Kyrgyz Republic) weakened with respect to the dollar, which, in fact, actually occurred during 1998. In any event, these elements do not appear to be relevant to Petrobart's Treaty-based claims.

*(d) Alleged breaches of the Treaty*

As to the allegations of "denial of justice", Petrobart was denied no justice, because, if Petrobart's version of "justice" (i.e. the sale of seized assets) had run its course, Petrobart would have received nothing in any event. The acts of which Petrobart complains were legitimate acts of a sovereign state and were calculated to benefit creditors of KGM, including Petrobart.

As it was in the UNCITRAL Arbitration, Petrobart, in essence, seeks to transform claims against an insolvent company, KGM, into claims against the Kyrgyz Republic. For a number of reasons, Petrobart's claims do not demonstrate that the Republic violated its obligations under the Treaty. Instead, this entire proceeding is an attempt, as was the UNCITRAL Arbitration, to circumvent the bankruptcy laws of the Kyrgyz Republic.

The Kyrgyz Republic conducted itself to the best of its then abilities, consistent with its resources and the experience of its personnel. It hid nothing from Petrobart, and, indeed, communicated with Petrobart frequently. Indeed, all, or nearly all, of the Republic's actions with regard to Petrobart were done via publicly promulgated decrees or acts.

Petrobart alleges expropriation by way of (i) asset stripping, and (ii) interfering with its judgment execution sale. As to the "asset stripping" allegations, the Kyrgyz Republic was merely attempting to restructure or rationalise KGM. The Republic was attempting to resolve a difficult situation. Regarding the "expropriation of the judgment" allegations, even if these allegations are proven to be true, Petrobart suffered no compensable damages thereby.

The Kyrgyz Republic contests all inferences and accusations made by Petrobart in connection with the letter of Vice Prime Minister Silayev of 11 February 1999. The Republic denies that the "true intention" of the Vice Prime Minister's letter was to bankrupt KGM or to "strip it of its assets". The letter merely served notice on the Court of the Government's attempts to address the situation at KGM. It was written in connection with an effort by the Government of the Kyrgyz Republic to improve the management and operation of the fuels and lubricants sector. Those efforts included addressing the financial shortcomings of KGM, which were apparent before Petrobart and KGM entered the Contract or the Treaty became effective and binding upon the Republic. The letter from Vice Prime Minister Silayev was thus in fact offered in furtherance of the Kyrgyz Government's attempt to stabilise the Kyrgyz Republic's oil and gas infrastructure. That those efforts failed does not constitute a breach of the Treaty.

The Kyrgyz Republic denies that the intent of the Republic or any of its officials was to cause KGM's bankruptcy and stresses that KGM was already insolvent at the time the Vice Prime Minister's letter was sent to the Chairman of the Bishkek Court. In any event, KGM itself had already petitioned the Bishkek Court for a three-month stay of execution, and this petition was submitted before Petrobart's request for permission to execute was

granted. The petition noted the “grave financial state” of KGM. In support of the petition, KGM’s representative noted therein (i) that the Government of the Kyrgyz Republic was developing a “programme for the development of the financial state” of KGM, (ii) that the programme included “active measures ... to seek resources and attract investors to pay off the outstanding debt” of KGM, and (iii) that, in connection with the programme, it was expected that a credit line in an amount sufficient to cover the debt would be open in the near future. At that time KGM was already insolvent, and this fact was well known to Petrobart. KGM lacked only an official adjudication as a bankrupt, and the Republic (which was and is a creditor) could easily have obtained such a ruling through direct measures, if that is what the Republic had intended. The Republic could easily and much less transparently have undertaken true “asset stripping” without going to the trouble of creating a commission and acting publicly and openly, if that is what the Republic had intended.

The Kyrgyz Republic’s efforts in this regard were far broader, and far more circumspect, than Petrobart alleges. In other words, the Republic, as a sovereign nation-state, recognised that it had a problem with the delivery and distribution of fuels and lubricants, and it took action, to the best of its ability, to resolve that problem. These actions and their underpinnings included recognising that KGM was operating in an unsatisfactory manner from a financial point of view, and that KGM was not fulfilling its function of supplying fuels to the people of the Kyrgyz Republic.

On 12 January 1998, the Government of the Kyrgyz Republic enacted Decree No. 28 on measures for improving the supply of natural gas to consumers of the Kyrgyz Republic and stabilising the activity of KMG. Among other things, Decree No. 28 recognised that KGM was losing more than 1 million Soms per day related to the distribution of natural gas. Pursuant to the Decree, it was determined that the Government would advance 50 million Soms, to be repaid by KGM within one year, in order to supply heating fuel in the Kyrgyz Republic for the remainder of the winter heating season. As reflected in Presidential Decree No. 282, dated 23 September 1998, the Republic later decided to create a commission for restructuring the debts of both Kyrgyzgaz and KGM. The Republic determined, by way of Decree No. 649 of 5 October 1998, that Kyrgyzgaz should be separated from KGM in order to rationalise the “transport, distribution and supply” of natural and liquid gas in the Kyrgyz Republic.

Whatever the contents of the balance sheet of 1 October 1998, that balance sheet is not decisive as to the question of KGM’s insolvency at that time. Accounting practices prevalent at the time of the said balance sheet were such that businesses that were facing cash flow problems or other financial constraints typically characterised all accounts receivable as “assets”, regardless of the likelihood that the sums receivable thereby would ever be paid. The said balance sheet evidences that KGM undertook the same practice. Account should also be taken of the Soviet practice of inflating values.

In a letter dated 9 February 1999, KGM advised Petrobart that the Kyrgyz Republic was elaborating “a programme for financial stabilisation of KGM”. That letter was a reference to a programme which, shortly thereafter, was documented in Decree No. 79 on the individual privatisation programme of KGM, dated 11 February 1999. That Decree, which incorporated the individual programme for privatisation of KGM, was the culmination of the efforts to that point by the Republic to improve the situation of KGM.

Among other things, the KGM programme recognised that KGM had “huge debts and losses” and was “an insolvent enterprise that has no chance to restore its solvency” without assistance. Thus, the Kyrgyz Republic hoped to attract foreign and domestic capital through the sale of state-owned shares, which would include a repayment of the debts.

Petrobart alleges that the order of the Bishkek Court granting the three-month stay of execution is the exclusive product of the Vice Prime Minister’s letter. However, the order granting the stay of execution, by its express terms, reveals that the Court was ruling on the request by KGM itself for a stay of execution.

Petrobart alleges that because of the restructuring of KGM and because of KGM’s bankruptcy, Petrobart was deprived of the ability to recover its claim against KGM. The Kyrgyz Republic notes firstly that, if Petrobart’s lien against the seized assets of KGM were properly created and perfected, Kyrgyz law would permit Petrobart to pursue the transferees of the allegedly transferred property. Possibly because Petrobart recognises that such property is of little value, Petrobart has not, in the course of more than five years, sought to pursue the remedies available to it in this regard. This entire action is an attempt by Petrobart to obtain from the Republic a benefit for which Petrobart never bargained.

On 11 May 1999, Petrobart filed a request with the Supreme Arbitration Court of the Kyrgyz Republic seeking to withdraw its appeal against the Bishkek Court’s 16 February 1999 ruling, which had imposed the stay of execution. This request was granted later that month. In June 1999, Petrobart filed a claim against KGM in the bankruptcy proceeding. The principal amount Petrobart sought by way of that claim was USD 1,499,143. Petrobart also claimed penalties and interest. There is no mention in that claim of any “lost future profits” or “investment arrangements” with KGM. In March 2000, the Special Administrator allowed Petrobart’s claim as a third priority creditor for approximately 65 million Soms.

KGM was a Kyrgyz joint stock company that entered the Contract with Petrobart. The Kyrgyz Republic never entered any obligation with Petrobart, and the Treaty does not operate to interpose such direct contractual privity between Petrobart and the Republic. If Petrobart thought that it was dealing with the Republic in the Republic’s capacity as a nation-state, Petrobart should have obtained a sovereign guarantee. Again, neither the Treaty nor the Arbitral Tribunal exists to remedy Petrobart’s imprudence and poor business practices.

The Kyrgyz Republic denied Petrobart nothing. Petrobart is in a position that is no different from what its position would have been if the Republic had done none of the deeds that Petrobart alleges. This is so because (i) general, unsecured creditors typically recover very little of their claims in large bankruptcies, and (ii) judgment creditors who seize property during the pre-bankruptcy preference period must disgorge that property or the proceeds thereof.

The Kyrgyz Republic’s domestic law provides very effective means for the assertion of claims and the enforcement of rights. Petrobart’s problem is that Petrobart did not use those devices. The Kyrgyz Republic has an extremely effective law and system regarding the creation, perfection and enforcement of security interests. It is designed to be inexpensive and user friendly, having been created in co-operation with the Republic’s development co-operation partners. Had Petrobart retained competent local counsel (indeed, any counsel at all) and filed a simple form, Petrobart would have been treated in

the KGM bankruptcy case as a secured party and would have been paid. Moreover, Petrobart could have sought a sovereign guarantee from the Republic.

*D. The question of damage suffered by Petrobart*

*(a) No damage because of KGM's insolvency*

Even if the Kyrgyz Republic should be considered to have breached its Treaty obligations, this did not cause any damage to Petrobart, since KGM was hugely insolvent. The relevant presidential and governmental decrees were attempts to address that problem. Whatever rights and favourable conditions the Treaty can be alleged to provide Petrobart, the Treaty cannot be said to provide Petrobart insurance against dealing with insolvent companies.

No action by the Kyrgyz Republic operated to expropriate anything from Petrobart. Indeed Petrobart would be in the same position today if the Republic had done nothing. Petrobart ignores the fact that KGM was insolvent at the time Petrobart entered the Contract and throughout 1998 and 1999. Petrobart ignores the effect of the provisions of the bankruptcy law and rules that prohibit seizures of property during the preference period.

Thus, on 10 February 1999, when the Bishkek Court ruled that Petrobart would be permitted to execute its judgment against KGM's property, KGM had long been insolvent. Although Petrobart alleges that KGM became bankrupt as a result of actions of the Kyrgyz Republic in late 1998 and early 1999, KGM was already very much insolvent before these actions were taken. Thus, whatever harm Petrobart has suffered as a result of its doing business with KGM, such harm is unrelated to the alleged government action about which Petrobart complains.

The Kyrgyz Republic's actions, viewed in their totality, were not inconsistent with the Republic's Treaty obligations, particularly in view of KGM's pre-existing insolvency. The Republic's alleged actions were undertaken for the purpose of "rationalising" the use of state-owned infrastructure that remained from the former system.

As part of the process in the Kyrgyz Republic of denationalisation and privatisation of state companies, KGM was established in 1997 as a joint stock company in order to create a single infrastructure for the supply of oil and gas products (Presidential Decree No. 30). The Republic acknowledges that, at that point, and during the period relevant to this proceeding, the State Property Fund owned at least 90 per cent of the shares of KGM. However, as Petrobart knew at the time it entered the Contract, the Republic is not generally liable for the obligations of KGM, in accordance with section 2.4.24 of KGM's charter and Article 139 of the Kyrgyz Civil Code ("Basic Provisions of a Joint Stock Company"), which provides that a shareholder of a joint stock company "shall not be liable for its obligations".

The Kyrgyz Republic acknowledges that the sum of the monetary amounts stated in the referenced letters regarding the planned public auctions is approximately 80,000,000 Soms. The Republic also acknowledges that, at the alleged exchange rate (USD 1.00 =

30.56 Soms), 80,000,000 Soms would amount to more than USD 2.6 million. However, the Central Asian Bank judgments that were to be enforced against the proceeds of the auctions amounted to USD 3.4 million, thus exceeding the USD 2.6 million that Petrobart alleges was the value of the assets to be auctioned. Thus, not only were the auctions not for the benefit of Petrobart, but based upon Petrobart's own claimed monetary values, there would have been no assets or proceeds remaining from the auctions that could have benefited Petrobart.

The "starting prices" announced for the auction of the assets are, in any event, hugely inflated, and would not have been, as a practical matter, realisable. A judgment debt in the Kyrgyz Republic rarely, if ever, produces sale proceeds sufficient to satisfy the relevant judgment creditor or creditors. Also, the practice of naming a "starting price" in the auction announcement does not bind the court executor (i.e. the auctioneer) to such minimum prices if the initial bids do not equal those stated starting prices.

Consequently, the Kyrgyz Republic denies Petrobart's assertion that the available assets were more than sufficient to satisfy the claims of Petrobart and the Central Asian Bank. The Republic also denies that Petrobart was in the process of securing other valuable KGM assets. There does not appear to exist documentary evidence that Petrobart sought seizure of any other assets in proper accord with Kyrgyz law.

Petrobart effectively admits that KGM was insolvent at the time of the Kyrgyz Republic's alleged actions. Under Kyrgyz law, insolvency is the trigger for the initiation of bankruptcy proceedings. In those proceedings, a Special Administrator is appointed to amass the debtor's property and dispose of it for the benefit of creditors.

With regard to the effect of KGM's bankruptcy, Petrobart would today be in no different position even if the February 1999 auctions had occurred, and even if those auctions had been held for Petrobart's benefit. One of the powers that Special Administrators use in the bankruptcy process is the power to disgorge creditors who have been paid by the debtor or who have seized property from the debtor during a pre-bankruptcy period known as the "preference period". The relevant seizures of KGM's assets occurred during the "preference period" as such is set forth in the Kyrgyz law and rules on bankruptcy. As such, those seizures (and any subsequent sale of the seized assets) would have been voidable by the Special Administrator in the KGM bankruptcy case, and those assets (or the money received by Petrobart from their sale) would have been brought into the bankruptcy estate for equitable distribution amongst all creditors according to their classification. Petrobart, as a general, unsecured creditor of KGM, would have been (and, indeed, is) entitled to any distribution only if secured claims, certain wage claims, and certain workers' rights claims had been paid in full (Articles 9.1 and 21 of the Kyrgyz Bankruptcy Law and Rule 6.2.3 of the Kyrgyz Bankruptcy Rules). Hence, Petrobart would have received (and, in fact, appears to be receiving) payment of its debt claim against KGM on a *pari passu* basis via the bankruptcy process. That the amount of these payments and the speed with which they are made are not to Petrobart's liking does not constitute a violation of the Kyrgyz Republic's Treaty obligations. It follows that Petrobart has suffered no compensable damage.

With regard to the bankruptcy of KGM, the Kyrgyz Republic also notes the following facts. In early March 1999, while the stay of execution was in effect, Petrobart itself filed a petition in the Bishkek Court by which Petrobart sought to have KGM declared bankrupt. Petrobart's petition for bankruptcy of KGM was accepted for filing on 5 April 1999 (it had

been returned to Petrobart because of a pleading defect, which Petrobart subsequently cured). In April 1999, the General Director of KGM applied to the Bishkek Court under the bankruptcy law for recognition that KGM was insolvent. In a Bishkek Court decision in April 1999, KGM was adjudicated bankrupt. According to the ruling, KGM had assets of 1,285,000,000 Soms, and liabilities of 2,246,000,000 Soms. The ruling states that KGM was thus insolvent by 1,180,000,000 Soms. Using the exchange rate alleged by Petrobart, the Republic submits that KGM was thus insolvent by USD 36,647,000. KGM did not become insolvent because of the separation of Kyrrgyzgaz or because of the Munai lease. KGM was very much insolvent far in advance of those transactions. The Republic suggests that the value stated by Petrobart is hugely inflated.

The Kyrgyz Republic does not deny that as a general principle international obligations trump local law. Indeed, the Republic's own Constitution sets forth that very principle. However, the Republic's domestic law is relevant as a question of evidence and fact. This is significant in the context of the damage that Petrobart allegedly suffered by way of the Republic's alleged interference with Petrobart's judicial sale, for under Kyrgyz law Petrobart would have had no right to the proceeds of the said sale (or would have had to disgorge any proceeds it did receive) because Petrobart seized property of KGM at a time when KGM was insolvent. Under the Kyrgyz Bankruptcy Law, the preference period is triggered by insolvency which is defined, *inter alia*, as inability to pay debts when due.

As to Petrobart's assertion that KGM was solvent at the time that the Contract was engaged, Petrobart points out that KGM paid invoices in March 1998. This is not entirely relevant, however, because, if KGM were insolvent at any time during the preference period, Petrobart would have had to surrender any seized assets to the bankruptcy administrator or disgorge to KGM's bankruptcy administrator any proceeds of the sale of those seized assets for distribution by way of the scheme set forth in Article 87 of the Bankruptcy Law. There is no doubt that Petrobart's seizure of KGM's assets constituted a preference under Article 21 of the Bankruptcy Law, and that preference would have been voidable under Article 21. As such, Petrobart is now in a position that is no worse than the position in which it would have found itself if the Kyrgyz Republic had not committed the "interference" that Petrobart alleges.

Petrobart argues that the Kyrgyz Bankruptcy Law which, by Petrobart's own admission, is a bankruptcy law that provides for *pari passu* treatment of similarly situated creditors and which prohibits a creditor's seizure of a debtor's property after the occurrence of certain events, i.e. during the so-called preference period, nonetheless permits any judgment creditor to seize assets during the preference period to the exclusion of other similarly situated creditors. Also, Petrobart suggests that Article 21 of the Bankruptcy Law deals exclusively with situations in which a debtor may dispose of its assets prior to bankruptcy.

Firstly, with regard to what pre-bankruptcy transfers of a debtor's property are permissible, it should be observed that Article 21 aims to freeze the debtor's property at the inception of the preference period, i.e. after the occurrence of one of the events mentioned in point 1 of that Article, such that the interests of the creditors in that property are preserved. Then, in Article 21(3) the Bankruptcy Law sets forth three exceptions to its general prohibition on the transfer of the assets of the debtor: (i) transfers made with the consent of the arbitration court, (ii) transfers made with the consent of the administrator, and (iii) transfers made with the consent of the meeting of creditors.

Each of these three institutions bears a specific and exclusive relation to the bankruptcy process. The arbitration court is the only court of the several different courts in the Kyrgyz Republic that is empowered to adjudicate bankruptcy cases. The administrator is granted numerous exclusive powers and duties regarding a bankruptcy case by Articles 63 *et seq.* and Article 8 of the Bankruptcy Law. A meeting of creditors is an organisation created and governed by Articles 12 and 13 of the Bankruptcy Law. Hence, it follows that the legislature intended that the exceptions to the general pre-bankruptcy freeze of the debtor's assets be overseen by the three institutions that the Bankruptcy Law created to govern bankruptcy cases and, as such, to enforce the doctrine of *pari passu*. Indeed, the entire integrity of the bankruptcy process would be thwarted by a bankruptcy law that permitted any aggrieved creditor to simply obtain a money judgment and be treated differently from other aggrieved creditors.

This view is buttressed by the reference in Article 21(3) to the arbitration court, this being the court which handles commercial cases. There were in 1998 and 1999, and still are, other courts in the Kyrgyz Republic empowered to render money judgments. These courts are commonly known as general jurisdiction courts and they handle matters involving individuals versus individuals, individuals versus legal entities and labour relations. Thus, if Petrobart's argument should be accepted, it would mean that the legislature and the executive branch, by adopting Article 21(3), were attempting to confer some special privilege upon creditors whose status happened to place them within the jurisdiction of the arbitration court, as opposed to any of the other courts. Neither Kyrgyz law nor Petrobart's submissions or indeed common sense can support such a conclusion.

Moreover, Petrobart's 1999 seizure order was never consented to by the arbitration court after the occurrence of one of the events mentioned in point 1 of Article 21(3). Petrobart obtained its judgment and proceeded to seize and attempt to sell the assets of KGM via the Lenin Regional Court (a different court) thereafter.

Secondly, as to Petrobart's insinuation that Article 21 applies only to disposal of property made by debtors, the Republic refers to the express language of Article 21(3) which states "including [the] creditor ...".

It is correct that a court-ordered seizure would generally be unavailable to creditors during a pending bankruptcy. An exception to this is the powers granted to the administrator by Chapter 4 of the Bankruptcy Law.

Rule 6.3.2 of the Kyrgyz Bankruptcy Rules unambiguously sets forth the degree of knowledge of insolvency on the part of a creditor such as Petrobart that activates the prohibition set forth in Article 21 of the Bankruptcy Law. It is minimal: it only requires that the seizing creditor knows that the debtor is insolvent pursuant to point 1 or point 2 of Article 9 of the Bankruptcy Law which provides, *inter alia*, that a debtor is deemed insolvent and may be found or declared bankrupt if, when payment becomes due, the debtor does not fully satisfy the lawful claims of a creditor (or creditors) for payment of debts and for fulfilment of other obligations (for goods or services, etc.).

Thus, Petrobart, by its own admission and also because the Bishkek Court's judgment was a judicial determination of the existence of an unpaid debt (Article 9.1 of the Bankruptcy Law), already knew that KGM was insolvent at the time when Petrobart seized KGM's property.

Article 18 of the Bankruptcy Law, for its part, produces an identical result. In the Kyrgyz Republic, non-payment of a debt equals insolvency and insolvency triggers the preference period. If a creditor seizes or arrests a debtor's assets during the preference period, the Special Administrator is empowered to recover from that creditor the seized assets or their equivalent. As such, Petrobart's seizure was subject to avoidance by the Special Administrator upon the first Special Administrator's appointment. Petrobart has, thus, suffered no compensable damages.

The fact that the seizures were effected by order of a court does nothing to change the fact that those seizures violated the ban in Article 21 on preferential transfers. In Kyrgyz jurisprudence, there is no way for a private sector creditor, such as Petrobart, to "seize" (*zakhatyvat*) or to "arrest" (*nakladyvat arest*) property of a debtor other than through the instrumentalities of a court. The aforesaid words *zakhatyvat* (seize) and *nakladyvat arest* (arrest) are the exact words that are used in the Russian text of Article 21 of the Bankruptcy Law.

Stays of execution are regulated by Article 178 of the Code of Arbitration Procedure which provides that the arbitration court, upon petition by the execution creditor, the debtor or a marshal of the court, has the right to suspend the execution of a judicial act, or permit execution by instalments, or alter the manner or procedure of the execution.

Regarding the Kyrgyz Republic's alleged misconduct in connection with the bankruptcy of KGM, the Republic states that:

- (i) the Republic itself never took possession of the assets of KGM;
- (ii) the Republic never concealed any plan regarding KGM from Petrobart or from the public in general;
- (iii) the Republic never committed any fraudulent conduct;
- (iv) the Republic never withdrew its contribution from KGM; and
- (v) the Republic never derived any benefit from any alleged transfer of assets of KGM.

Each of the foregoing is a prerequisite to a finding of liability under Articles 18 and 21 of the Kyrgyz Bankruptcy Law.

Article 19 of the Bankruptcy Law – which deals with fictitious and predetermined bankruptcy – is rarely, if ever, employed in bankruptcy cases in the Kyrgyz Republic, and for the Arbitral Tribunal to apply it against the Republic would be a perversion of Kyrgyz law. It appears that the courts are satisfied with the other "asset stripping" and "insolvency causation" provisions of the Bankruptcy Law, and choose not to employ this vaguely worded provision.

As to the value of KGM's assets, the Kyrgyz Republic considers it irrelevant whether or not these assets are as valuable as Petrobart contends, because they were not Petrobart's to seize and sell, given KGM's insolvency. They were, in effect, property to be administered by the Special Administrator for the benefit of all creditors. If Petrobart believes that those assets have been improperly transferred, there is nothing in Kyrgyz law to prevent Petrobart from pursuing those transferees or from effecting the Special Administrator's recovery of transferred assets. Nothing in the Treaty empowers the Arbitral Tribunal to remedy Petrobart's laches.

Thus, given that Petrobart never had any property interest in the assets of KGM, no action of the Kyrgyz Republic regarding KGM can be said to have cost Petrobart anything. Moreover, even if Petrobart did have such an interest, KGM was hugely insolvent (i) at the time Petrobart elected to do business with KGM, (ii) at the time Petrobart obtained judgment against KGM, and (iii) at the time of KGM's bankruptcy. No action of the Republic caused this insolvency, and the mere fact of KGM's insolvency does not give rise to a breach of the Treaty. KGM was, in any event, insolvent before the Treaty came into effect.

The Bankruptcy Law and the Bankruptcy Rules operate to ensure fairness amongst similarly situated creditors. Petrobart is simply dissatisfied with the reality that Petrobart failed to prudently document a USD 1.5 million transaction. The Treaty should not be interpreted as a remedy for traders who put themselves in the position that Petrobart has put itself, particularly since the Treaty was not even effective at the time Petrobart and KGM signed the Contract.

Article 22(1) of the Treaty cannot be read as an effective sovereign guarantee by the Kyrgyz Republic of KGM's debt. This Article merely requires a Contracting Party that owns a state enterprise to ensure that the state enterprise acts consistently with Part III of the Treaty. The Republic's obligations under Part III are, in essence, to refrain from expropriation and to accord national treatment to companies from other Contracting Parties (as Petrobart alleges it is). KGM's insolvency, which existed prior to the effective date of the Treaty and which was not caused by the Republic, does nothing to breach those Part III obligations. The actions of the Vice Prime Minister, as explained herein, did not effect an expropriation. Finally, all similarly situated creditors in the KGM bankruptcy are being treated in accordance with the bankruptcy law and rules.

*(b) The Central Asian Bank's claims*

Even if KGM had not been insolvent at the time that Petrobart dealt with KGM and seized KGM's assets, and even if the judicial auctions had occurred, Petrobart would not have realised any of the proceeds thereof. This is so because the scheduled auctions were to have been held for another creditor of KGM, i.e. the Central Asian Bank, and that creditor held prior judgments against KGM in excess of 3 million U.S. dollars. The seized property was worth significantly less than that amount. Given that the property allegedly expropriated by the Kyrgyz Republic can only be construed to be Petrobart's rights to the proceeds of the auction sales, and further given that those rights are highly unlikely to ever have been realised, Petrobart has not been damaged in any compensable amount.

The two auctions of KGM's assets which were scheduled for dates in February 1999 were not related to the judicial rulings in Petrobart's favour, and the assets that were to be sold at those auctions were not to be sold for the benefit of Petrobart or, alternatively, the sale of those assets would not have produced proceeds sufficient to satisfy any portion of Petrobart's judgment. At the time of the scheduled auctions, the Central Asian Bank had obtained three judgments against KGM, all of which pre-dated 10 February 1999, and these judgments aggregated USD 3,400,000.

The Kyrgyz Republic acknowledges that the scheduled auctions were never held, but denies that they were "cancelled". They were rescheduled as one auction to be held on 16 April 1999. (Once KGM's bankruptcy case was pending, that auction was adjourned.) The Republic acknowledges that a small number of individuals made inquiries on the day of

the originally scheduled auction, but none of these people formally presented themselves as bidders, and the relevant file from the Lenin Regional Court contains no evidence of the presence of any formal bidders. In any event, the auctions would only have benefited the Central Asian Bank, not Petrobart.

Petrobart would have the Arbitral Tribunal believe that, simply because KGM was in breach of the Contract, Petrobart had some property interest in the assets of KGM. This is not accurate. In the Kyrgyz Republic, one may obtain a property interest in the assets of another only by way of a security interest (such as a mortgage or a movable property lien) or a seizure. Petrobart failed to document the Contract as a secured transaction (had Petrobart done so, this case would not exist), and it did not seize any of KGM's property post judgment. That seizure was undertaken by the Central Asian Bank and was for the benefit of that bank.

The Central Asian Bank appears to have been paid by the Government of the Kyrgyz Republic outside the KGM bankruptcy case. The Republic effected this payment because demand was made by another sovereign state, i.e. Uzbekistan, acting pursuant to the inter-sovereign agreement that created the Central Asian Bank.

#### *E. Calculation of Petrobart's losses*

Even if the Kyrgyz Republic is indebted to Petrobart, the Republic is not indebted to Petrobart to the extent that Petrobart alleges. If the Republic's conduct, as alleged by Petrobart, ever violated any of the Republic's obligations under the Treaty, such violations do not entitle Petrobart to the excessive relief that Petrobart seeks. This is so because Petrobart is in no worse position than it would have found itself had the Republic not conducted itself as Petrobart alleges.

As to Petrobart's allegation of "principal debt", the Kyrgyz Republic denies that it owes Petrobart anything, since Petrobart suffered no compensable damages. However, the Republic acknowledges that the amount of the principal debt stated by Petrobart approximates the amount of KGM's debt to Petrobart for goods sold and delivered, as set forth in the original Bishkek Court judgment and Petrobart's statement of claim in the KGM bankruptcy case.

Petrobart's asserted right to future profits is misplaced. The claim is novel, and was never made in the original Bishkek Court case, the KGM bankruptcy, the Show-Cause Case, the UNCITRAL Arbitration, or the appeal thereof. This Arbitral Tribunal does not exist to cure Petrobart's laches and waivers, which now are nearly six years old.

Even if the Arbitral Tribunal were inclined to entertain Petrobart's future profit claim, such claim must fail nonetheless. Neither the Contract nor Petrobart's contract with Uzneftegazdobicha is an "outputs" contract. That is to say, these contracts do not bind Petrobart to purchase from Uzneftegazdobicha, and they do not bind KGM to purchase from Petrobart. They are both contracts that provide a mechanism for Petrobart and KGM, respectively, to order shipments of gas condensate and to pay for those shipments when they are delivered. KGM could have stopped ordering gas condensate at any time. As such, Petrobart has no legitimate expectation interest in potential future profits. Moreover, Petrobart's allegations regarding "investment arrangements" and "firm understanding" were found by the arbitral tribunal in the UNCITRAL Arbitration to, in effect, not have existed. Finally with regard to future profits, Petrobart has, apparently, done nothing to

mitigate its so-called damage. That alone is more than ample reason, given the passage of so much time and Petrobart's failure to include this claim in any previous proceeding, for the Arbitral Tribunal to dismiss this portion of Petrobart's claim. Petrobart's lost future profits claim is an example of vexatious claim splitting that should not be tolerated.

Moreover, even if Petrobart were to persuade the Arbitral Tribunal otherwise, the Kyrgyz Republic could be ordered to cause the acceptance of the remaining gas condensate allegedly due under the Contract and to cause payment to be made therefor. As Petrobart notes, specific performance is the primary remedy for breach. It is the Republic's position that the Arbitral Tribunal is competent in this case to order specific performance.

Petrobart's assertion that any form of specific performance is now impossible is wrong. For example, if the Arbitral Tribunal were to render an award in Petrobart's favour, such award would seek to return Petrobart to the position in which Petrobart found itself prior to the Kyrgyz Republic's alleged interference. This might include requiring the Republic to accommodate Petrobart's execution of its 1998 judgment or to make any other accommodations that the Arbitral Tribunal sees fit.

The Kyrgyz Republic acknowledges that the *Factory at Chorzów* case stands for the general principle of reparations. The Republic denies that said case entitles Petrobart to the damages that Petrobart seeks. As to Petrobart's argument under the *Factory at Chorzów* case and the Draft Articles on Responsibility of States for Internationally Wrongful Acts that Petrobart should be put into the position that it would occupy if the alleged wrongful acts had not occurred, the Republic considers that Petrobart is in said position, i.e. the position of an unsecured, general creditor of a bankrupt company.

Petrobart's assertion that it is entitled to "outlays and related expenses" is not supported by the Treaty. While the Kyrgyz Republic concedes that, in general, Petrobart might be entitled to reimbursement of costs and fees if it were to prevail in this case, nothing in the Treaty or the SCC Institute's Rules entitles Petrobart to reimbursement of these amounts.

If the Arbitral Tribunal is inclined to award Petrobart any interest at all, that interest should accrue at the "judgment rate" effective in the Kyrgyz Republic. This is so because the gravamen of Petrobart's case is that a judgment of which it was the lawful holder was expropriated. Interest should, moreover, accrue only from 1 September 2003 because Petrobart could have brought this claim in at least two (arguably four) other forums dating back to 1999.

#### *F. Conclusion*

The Kyrgyz Republic concludes that Petrobart's claims should be dismissed and that in any case compensation for damage should not include lost profits and outlays and related expenses.

The Kyrgyz Republic further requests that the Arbitral Tribunal refrain from awarding Petrobart any costs or fees associated with this proceeding, even if Petrobart should prevail, since Petrobart could have made its Treaty-based claims in the course of the UNCITRAL Arbitration.

### **3. Petrobart:**

### *A. Res judicata and estoppel*

According to the well-established principle of *competence/competence* in international arbitration law, an international arbitral tribunal has the power to determine its jurisdiction. This is incontestable. However, the Kyrgyz Republic argues that the present Arbitral Tribunal lacks jurisdiction to entertain Petrobart's present claim. Petrobart contests this. Article 26 of the Treaty is entitled "Settlement of Disputes Between an Investor and a Contracting Party". This Article grants an investor the right to bring a legal action against a Contracting Party that has breached its obligations under Part III of the Treaty.

Article 26(2) of the Treaty stipulates that the investor party to the dispute may choose to submit it for resolution either to domestic courts, to previously agreed dispute settlement procedures, or to international arbitration or conciliation. It is clear from the wording of this paragraph that it is only the investor who has the option of submitting the dispute based on the Treaty to any of the listed fora. A Contracting Party is not in a position to do so. This is because the subject matter of the dispute pertains to an alleged breach by a Contracting Party of obligations it has assumed under the Treaty. There are no obligations in the Treaty *vis-à-vis* investors. It is also important to remember that Article 26(2) applies only to disputes arising under the Treaty and not, for example, under a contract.

To argue, as attempted by the Kyrgyz Republic, that Petrobart is barred from initiating the present claim under the Treaty because it should have presented such a claim in the Show-Cause Case displays a clear misunderstanding of the Treaty. Indeed, the logic of the Republic's argument actually renders the application of the Treaty redundant. First, the Show-Cause Case was concerned with the interpretation of a term in domestic legislation (introduced by the Republic in order to frustrate Petrobart's various attempts to secure its established rights). Second, the Republic's argument implies that any Contracting Party to the Treaty could prevent an investor from exercising its right to initiate a claim under the Treaty simply by submitting any dispute with the investor to domestic courts. This was clearly not the intention of the drafters of the Treaty.

Paragraph 3 of Article 26 of the Treaty makes it clear that each Contracting Party to the Treaty has given its unconditional consent to having a dispute arising under the Treaty submitted to international arbitration. However, there are two exceptions to this unconditional consent. Only the first exception is relevant here, and it applies to those states that are listed in Annex ID. However, the Kyrgyz Republic is not a Contracting Party listed in Annex ID.

Thus, paragraph 3 of Article 26 makes the following clear. First, all Contracting Parties to the Treaty have given their unconditional consent to arbitration. This constitutes a clear offer and thus an agreement to arbitrate. Second, those countries that are not listed in Annex ID have extended their unconditional consent to arbitrate a dispute under the Treaty, even if such a dispute had already been submitted to domestic courts or to previously agreed dispute settlement procedures.

Petrobart did not submit any claim under the Treaty to either domestic courts or arbitration. Instead, its previous disputes were submitted to domestic courts under the Contract and to UNCITRAL arbitration under the Kyrgyz Republic's Foreign Investment Law.

It is to be noted, however, that even if Petrobart had submitted its claims based on the Treaty to any of the above fora (i.e. domestic court or UNCITRAL arbitration), which it did not, subsequent submission to arbitration under Article 26 would still have been permissible. This would have been the case because, as illustrated above, the Kyrgyz Republic chose not to be listed in Annex ID of the Treaty.

Accordingly, the Kyrgyz Republic's argument that Petrobart could have raised its Treaty-based assertion that it is an "investor" that made an "investment" in the course of the jurisdictional argument in the UNCITRAL Arbitration is of no consequence as to the jurisdiction of the present Arbitral Tribunal. Additionally, for the purposes of this claim, whether Petrobart has made an investment is a matter to be decided entirely on the basis of the Treaty and nothing else. Again, paragraph 4 of Article 26 of the Treaty gives the investor the right to submit the dispute for resolution to various fora, including the SCC Institute. This Petrobart has done, thereby exercising a legitimate right under the Treaty.

In light of the above, the Kyrgyz Republic's affirmation that Petrobart cannot be heard in this or any arbitral forum is not only without legal foundation but also patently wrong.

The Kyrgyz Republic invokes both the doctrine of *res judicata* and the so-called doctrine of collateral estoppel in an attempt to argue that the present claim is procedurally barred. The Republic not only makes certain sweeping and unsubstantiated remarks regarding these doctrines, but also fails to mention under which legal system the two doctrines are held to apply, thus diminishing the utility of its arguments.

According to Article 26(6) of the Treaty, the issues in dispute shall be decided in accordance with the Treaty and the principles of international law. However, when properly applied, the principle of *res judicata* is irrelevant under the circumstances of this case under both international law and the institutional rules of this arbitration including the law of the seat (*lex arbitri*), namely Swedish arbitration law.

From the perspective of international law, there are three conditions for the application of the *res judicata* principle: identity of the parties, identity of cause of action, and identity of object (or subject matter) in the subsequent proceedings. Where two claims differ radically in their object, a decision on the first would not constitute *res judicata* for the subsequent case.

It is clear that the two proceedings relied on by the Kyrgyz Republic (i.e. the Show-Cause Case and the UNCITRAL Arbitration) were faced with an entirely different cause of action and also a different subject matter from the one presented in the present case. The cause of action in the present proceeding is a breach by the Republic of its obligations under the Treaty. This is not the same cause of action as under either the Show-Cause Case or the UNCITRAL Arbitration. Additionally, in the UNCITRAL Arbitration, Petrobart's claim was dismissed for lack of jurisdiction which means that Petrobart is not prevented by the *res judicata* doctrine from presenting the same issue again before another tribunal which may be competent.

In its attempt to challenge Petrobart's claim, the Kyrgyz Republic also invokes the American doctrine of collateral estoppel (also known as "claim preclusion"). Petrobart fails to see the relevance of this purely American statutory procedural doctrine to the instant case. However, even if, for the sake of argument, the doctrine of collateral estoppel was considered relevant here, it would still not apply under the circumstances of this case.

This is for the following reasons. First, none of the questions arising in the present proceedings has been fully decided in any of the previous judicial or arbitral proceedings. Second, Petrobart did not appear and was not heard in the pre-determined Show-Cause Case. Third, the determination by the Republic's domestic court and the tribunal in the UNCITRAL Arbitration that Petrobart's Contract was not an investment under the Foreign Investment Law is materially different from the issue in front of this Arbitral Tribunal, namely, whether the Republic has breached its obligation under the Treaty.

In view of the above, it is clear that from the viewpoint of international law, the present claim is not barred by either the principle of *res judicata* or the so-called collateral estoppel doctrine, as alleged by the Kyrgyz Republic.

Swedish law constitutes the *lex arbitri* of this arbitration. Swedish procedural law recognises the doctrine of *res judicata*. Article 11 of Chapter 17 of the Swedish Code of Judicial Procedure provides that a final judgment is vested with legal and binding force with regard to the issue examined in the proceedings. In addition, a legally binding judgment precludes the examination of the same issue in a subsequent legal action. Such a submission is barred on the basis of *res judicata*.

The key question in determining whether the resubmission of a claim may be barred is to establish whether the two proceedings relate to the same issue (subject matter). If this is not the case, the subsequent claim may proceed. The issues at hand in the present arbitration are entirely different from the issues previously examined. As stated previously, this arbitration concerns the Kyrgyz Republic's breach of its Treaty obligations, whereas both previous proceedings (i.e. the Show-Cause Case and the UNCITRAL Arbitration) concerned the application of Kyrgyz law.

Furthermore, the mere fact that this Arbitral Tribunal derives its jurisdiction from an international treaty illustrates the fact that this arbitration is not concerned with the same issue that has previously been argued, regardless of whether or not the same circumstances were presented in the previous proceedings.

The Show-Cause Case constituted a proceeding initiated by the Kyrgyz Republic in its domestic courts allegedly to establish whether or not Petrobart's investment constituted a foreign investment under the domestic Kyrgyz Foreign Investment Law. Such questionable investigation cannot bar the same question from being examined under international law, as is the case in the present arbitration.

With regard to the UNCITRAL Arbitration, it is now well established that the previous tribunal proceeded exclusively on the basis of the Kyrgyz Foreign Investment Law. Petrobart's claim in the present proceedings has been asserted under the Treaty, which is wholly independent of and indeed dissimilar to the Kyrgyz law relied upon in the UNCITRAL Arbitration.

Furthermore, a prerequisite in Swedish law for the application of the principle of *res judicata* is that the court has already examined the merits of the issue at hand. A decision to dismiss a claim due to lack of jurisdiction will have no binding effect should the same case be filed with another, competent court. Even though the UNCITRAL tribunal joined the issues of jurisdiction and merits, it dismissed the claim for lack of jurisdiction. The UNCITRAL tribunal did not consider or remotely examine any issues of substance.

It follows from the foregoing that under the *lex arbitri*, the doctrine of *res judicata* does not apply to the circumstances of the present dispute.

Finally, it is to be noted that Swedish law does not recognise the American doctrine of collateral estoppel.

In light of the above, the Arbitral Tribunal has jurisdiction to entertain Petrobart's claim under the Treaty.

#### *B. Other issues*

As regards the attempts to secure a settlement of the dispute, Petrobart has complied fully with the procedural requirement of Article 26(2) of the Treaty. The present claim has been submitted under the Treaty to which the Kyrgyz Republic is a Contracting Party. The Prime Minister is the executive head of the Republic's Government. Petrobart has written three separate letters requesting an amicable settlement of the dispute, none of which were acknowledged by the Republic. Moreover, upon receiving the request for arbitration the Republic could at any time have offered amicable settlement to which it is entitled under Article 26(2) of the Treaty. This was not offered by the Republic.

As regards the Kyrgyz Republic's novel arguments regarding Petrobart's status as a Gibraltar company and the applicability of the Treaty to Gibraltar, Petrobart considers that these new arguments have been raised in violation of a procedural agreement between the parties and that they have also been raised too late. In Petrobart's opinion they should therefore be rejected on formal grounds. However, they are also unfounded, and Petrobart refers in this respect to two expert opinions.

Petrobart points out that Gibraltar is a territory for the international relations of which the United Kingdom is responsible. More importantly, the Kyrgyz Republic itself never doubted that a company registered in Gibraltar qualifies as an investor for the purposes of Article 1(7) of the Treaty. It is only at a very late stage of the arbitration proceedings that the Republic is desperately trying to tarnish the commercial character of Petrobart. This is an unfortunate strategy as Petrobart is a reputable petroleum company with business and investment activities in many countries. Having been legally registered in Gibraltar but owned and managed by nationals of a Contracting Party, even though not residents of Gibraltar, this in no way undermines the legal character of Petrobart or affects its status as an investor under the Treaty.

Petrobart is managed by Pemed Ltd., a company registered in England with its principal office in London which is handling many of Petrobart's strategic and administrative matters. It is therefore clear that Petrobart indeed has substantial business activities in the Area of a Contracting Party, i.e. the United Kingdom, within the meaning of Article 17 of the Treaty.

As regards the two individual employees singled out by the Kyrgyz Republic, Mr. Josif Todorovski is a national of both the United Kingdom and Macedonia and Mr. Ratko Zatazelo is a Serbian national who also holds permanent residency in France. Moreover, the Republic misrepresents the scope of Article 17 of the Treaty and reads into it more than it can bear.

Article 17 does not apply automatically but provides for certain defined exceptions to Part III obligations of the Treaty, which must be pleaded by a Contracting Party for breaching

its obligations under Part III of the Treaty. As such, the denying Contracting Party must establish (i) that the legal entity to which it wishes to deny the advantages of Part III of the Treaty is a legal entity owned or controlled by citizens or nationals of a third state, and (ii) that the entity in question has no substantial business activities in the Area of the Contracting Party in which such an entity is organised. It is clear that the conjunction “and” makes the test a cumulative one. Both of these conditions must be present for Article 17(1) to apply and in this case neither of them applies to Petrobart.

Neither before nor after the present proceedings did the Kyrgyz Republic invoke Article 17, expressing the wish to deny the advantages of Part III of the Treaty to Petrobart in order to justify the Republic’s breaches of Part III obligations of the Treaty. In fact, the Republic has consistently denied that it has committed any breach of its Treaty obligations. The Republic is now attempting to deliberately confuse the issue and possibly stall the proceedings by erroneously arguing that Article 17 of the Treaty applies automatically because Petrobart is registered in Gibraltar and that the physical presence of Mr. Zatazelo and Mr. Todorovski in Gibraltar is an essential condition for the application of Part III of the Treaty. Such a strategy should not be allowed by the Arbitral Tribunal.

In reply to a question from the Arbitral Tribunal, the Kyrgyz Republic has stated that it continues to take the position that Petrobart is not an investor who made an investment under the Treaty. However, it does not appear that such a position was ever taken by the Republic in any of its submissions. According to the well established legal principle of estoppel, the Republic should therefore be prevented from raising such a futile assertion at a late stage of the proceedings.

The Kyrgyz Republic has referred to Article 178 of the Kyrgyz Code of Arbitration Procedure which provides that the arbitration court has the right to suspend the execution of a judicial act upon the petition of the execution creditor, the debtor or a marshal of the court. It is thus to be noted that the execution at issue in these proceedings was unlawfully cancelled upon the request of the Vice Prime Minister, who was clearly not vested with such right under Article 178.

The Kyrgyz Republic argues that the exception in Article 21 of the Bankruptcy Law, from which it follows that the judicial auctions of the insolvent KGM’s property were allowed to be executed for the benefit of Petrobart, is not applicable. The Republic asserts that the execution could only be allowed to take place following a decision by an arbitration court. In this respect, Petrobart points out that the judgment to be executed in favour of Petrobart was in fact rendered by an arbitration court, i.e. the Bishkek City Court of Arbitration.

The Kyrgyz Republic admits that the Central Asian Bank appears to have been paid by the Government of the Kyrgyz Republic outside the KGM bankruptcy case. The Republic attempts to justify such a payment by stating that it was effected pursuant to an agreement with Uzbekistan. This admission is significant, because it highlights that the Republic has indeed discriminated between the investments of two investors, namely the Central Asian Bank and Petrobart. Such discriminatory treatment is contrary to Article 10(1) and (7) of the Treaty. It should be noted that the Treaty is an international agreement which has been entered into by a large number of sovereign states, including the Kyrgyz Republic. Effecting payment to the Central Asian Bank while withholding payment to Petrobart is an act of blatant discrimination contrary to the Treaty. To argue that there was a bilateral agreement between the Republic and Uzbekistan does not justify breaching the Treaty.

In so far as the Kyrgyz Republic refers to the SCC Institute's Rules as not entitling Petrobart to compensation for outlays and expenses, it should be observed that the issue of damages is one of substance. It must be determined under the law applicable to the dispute as stated in Article 26(6) of the Treaty and not under the Rules of the SCC Institute, as alleged erroneously by the Republic.

As regards interest, determining both the rate of interest and when it should accrue must be undertaken in accordance with rules and principles of international law as made explicit in Article 26(6) of the Treaty and not in accordance with the rate applicable in the Kyrgyz Republic.

## **VIII. Reasons**

### ***1. Introductory remarks***

On 23 February 1998, Petrobart concluded a contract ("*the Contract*") with the state joint stock company Kyrgyzgazmunaizat ("*KGM*") about the supply and transfer of ownership from Petrobart to KGM of 200,000 tons of gas condensate which should be delivered over a period of one year on a monthly basis and paid for by KGM at a fixed price of USD 143.50 per metric ton.

In February and March 1998, Petrobart delivered altogether about 17,205 tons of gas to KGM for which it issued five invoices in a total amount of USD 2,457,620. KGM paid two invoices of totally USD 951,976 but failed to pay the three other invoices. As a result Petrobart did not deliver the remaining quantities of gas but took legal action against KGM in order to get payment for the gas that had been delivered and not paid for. On 25 December 1998, Petrobart obtained from the Bishkek City Arbitration Court ("*the Bishkek Court*") a judgment in its favour, but on 16 February 1999 the Bishkek Court granted a request by KGM for a three months' stay of execution of the judgment. On 15 April 1999, the Bishkek Court declared KGM bankrupt.

Petrobart requests compensation for the damage it has suffered and bases its claims on the Energy Charter Treaty ("*the Treaty*"). Petrobart argues that it was an investor and had an investment in the Kyrgyz Republic which enjoyed protection under the Treaty and that the Kyrgyz Republic failed to fulfil its obligations under the Treaty, thereby causing damage to Petrobart.

The Kyrgyz Republic contests Petrobart's claims on various grounds relating both to the Arbitral Tribunal's jurisdiction and to the merits of Petrobart's claims.

The Arbitral Tribunal notes that Article 26 of that Treaty provides for alternative procedures for the settlement of investment disputes between a Contracting Party and an investor of another Contracting Party. One such procedure is arbitration under the Rules of the Arbitration Institute of the Stockholm Chamber of Commerce ("*the SCC Institute*"). When initiating the present arbitration, Petrobart opted for proceedings under the Rules of the SCC Institute.

### ***2. The applicability of the Treaty***

The United Kingdom and the Kyrgyz Republic are both parties to the Treaty. Petrobart considers that as a company registered in Gibraltar it enjoys protection under the Treaty.

In its replies of 7 December 2004 to a questionnaire addressed to the parties by the Arbitral Tribunal, the Kyrgyz Republic states that since the United Kingdom has not ratified the Treaty on Gibraltar's behalf, Petrobart cannot be considered an investor who made an investment under the Treaty.

Petrobart objects that, by raising this point at a very late stage of the proceedings, the Kyrgyz Republic violated an agreement between the parties from October 2004 that in the further proceedings the parties should only answer specific questions asked by the Arbitral Tribunal. Petrobart also considers that the argument regarding the alleged non-applicability of the Treaty to Gibraltar could be rejected as having been raised too late. In addition to these arguments relating to the admissibility of the Kyrgyz Republic's objection, Petrobart also argues that this objection is unfounded on the merits, since in Petrobart's view the Treaty does apply to Gibraltar. In this respect, Petrobart adduces as evidence expert opinions by Professor Adnan Amkhan and Sir Arthur Watts.

The Kyrgyz Republic replies that the parties have agreed to answer the questions asked by the Arbitral Tribunal and that it was in reply to one such question that the Republic raised the issue of the applicability of the Treaty to Gibraltar.

The Arbitral Tribunal notes that the Kyrgyz Republic did not in any of its submissions before 7 December 2004 argue that Petrobart in its capacity as a Gibraltar company falls outside the protection provided by the Treaty.

The Arbitral Tribunal further notes that, in connection with their agreement to refrain from an oral hearing, the parties agreed in October 2004 to limit their further exchange of written submissions to replies to questions formulated by the Arbitral Tribunal and comments on those replies. It is true that formally the Kyrgyz Republic raised its argument regarding the applicability of the Treaty to Gibraltar in its reply to a question by the Arbitral Tribunal as to whether the Republic had any comments on a report by Professor Adnan Amkhan. The Arbitral Tribunal notes, however, that Professor Amkhan's report did not deal with the question of the applicability of the Treaty to Gibraltar and that the Republic, by raising this argument, went further than just giving an answer to the Arbitral Tribunal's question. By doing so, the Republic did not act in conformity with the parties' agreement.

In the Arbitral Tribunal's opinion, however, it does not follow from the parties' agreement that the Kyrgyz Republic's new argument must necessarily be disregarded and rejected as being in violation of that agreement. The Arbitral Tribunal will therefore proceed to examining whether the argument should be rejected on another procedural ground or whether it requires an examination on its merits.

As regards Petrobart's further objection that the argument regarding the applicability of the Treaty to Gibraltar was raised too late in the proceedings, the Arbitral Tribunal notes Article 10(2) of the Rules of the SCC Institute which provides as follows:

"If the Respondent wishes to raise any objection concerning the validity or applicability of the arbitration agreement, such objection shall be made in the Reply [to the Request for Arbitration] together with the grounds therefore."

In its Reply to the Request for Arbitration, submitted on 15 October 2003 to the SCC Institute, the Kyrgyz Republic did not argue that the Treaty is inapplicable to Gibraltar.

Nor did it do so in its Statement of Defence, submitted to the Arbitral Tribunal on 24 March 2004, or in its Rejoinder of 11 October 2004. The argument was raised for the first time in its brief of 7 December 2004 which contained the Republic's replies to the Arbitral Tribunal's questionnaire.

It is true that, according to its wording, Article 10(2) of the Rules concerns arbitration based on an arbitration agreement between the parties. However, the Arbitral Tribunal finds no substantive reason why the same principle should not apply in cases like the present one in which the arbitration is based on an international treaty. Consequently, there are strong reasons in favour of applying Article 10(2) by analogy to such situations. Nevertheless, since there could be some doubt as to whether Article 10(2) covers this situation, the Arbitral Tribunal is reluctant to reject the Kyrgyz Republic's argument for this formal reason and finds it appropriate to proceed to an examination of the merits of the argument that the Treaty does not apply to Gibraltar.

In this respect, the Arbitral Tribunal notes that the United Kingdom, at the time of the signature of the Treaty on 17 December 1994, made a declaration under Article 45(1) of the Treaty regarding its provisional application. According to this declaration the provisional application of the Treaty should extend to the United Kingdom of Great Britain and Northern Ireland and to Gibraltar. When the United Kingdom ratified the Treaty, it was specified in the instrument of ratification of 13 December 1996, that the ratification was in respect of the United Kingdom of Great Britain and Northern Ireland, the Bailiwick of Jersey and the Isle of Man. Gibraltar was not mentioned in the instrument of ratification.

It is necessary to examine the legal effect of this difference in the coverage of the declaration regarding provisional application, on the one hand, and of the instrument of ratification, on the other.

According to Article 45(1) of the Treaty, provisional application of the Treaty undertaken by a signatory shall be valid "pending its entry into force for such signatory". Article 45(3)(a) provides that provisional application may be terminated by written notification by a signatory of its intention not to become a Contracting Party to the Treaty.

It is obvious that Article 45(1) envisages, at least primarily, the simple case where a signatory first accepts provisional application and subsequently ratifies the Treaty in respect of the same territory with the effect that upon its entry into force the provisional application ceases and is succeeded and replaced by the direct application resulting from the ratification. As regards the unusual situation where the territory accepted for provisional application and for application upon ratification does not coincide, no rule is to be found in the Treaty, and a problem of interpretation therefore arises.

The Arbitral Tribunal considers that in principle, on matters of this kind, a rather formal approach based on the wording of the Treaty is appropriate. It is then to be noted that according to the text of the Treaty provisional application ceases if it is terminated either by a special notification under Article 45(3)(a) of the Treaty or by transition from provisional application to a corresponding and final legal commitment resulting from the entry into force of the Treaty. It could indeed be expected that the United Kingdom, if it wished the provisional application of the Treaty to Gibraltar to be terminated as a result of a ratification not including Gibraltar, should have made this clear by making a notification in line with Article 45(3)(a) or a declaration in some other form in connection with the ratification. In the Arbitral Tribunal's opinion, the fact that the ratification, for political or

other reasons, did not include Gibraltar does not justify the conclusion that the United Kingdom intended to revoke the application of the Treaty to Gibraltar on a provisional basis. It may be observed that what is at issue here is not only the rights of investors from Gibraltar in other states but also the protection of foreign investors in Gibraltar.

The Arbitral Tribunal therefore finds that the Treaty continues to apply on a provisional basis to Gibraltar despite the fact that the United Kingdom's ratification does not cover Gibraltar.

### ***3. Article 17 of the Treaty***

In its reply of 7 December 2004 to the Arbitral Tribunal's questionnaire, the Kyrgyz Republic further refers to Article 17(1) of the Treaty according to which a Contracting Party may deny the advantages of Part III of the Treaty to "a legal entity if citizens or nationals of a third state own or control such entity and if that entity has no substantial business in the Area of the Contracting Party in which it is organized". The Republic argues that Petrobart conducts business via two persons, Mr. Josif Todorovski and Mr. Ratko Zatazelo, who, as the Republic understands, are probably citizens of Serbia and Montenegro and not residents of Gibraltar and who do not conduct business activities in or from Gibraltar.

Petrobart objects that the Kyrgyz Republic, when raising this point, is again not acting in accordance with the parties' agreement from October 2004 that the parties, in the further proceedings, should limit themselves to answering the specific questions asked by the Arbitral Tribunal. Petrobart also suggests that the argument should be rejected as having been raised too late. The Kyrgyz Republic responds that the point was raised in its reply to one of the questions asked by the Arbitral Tribunal.

Petrobart provides the following information about its status and activities. Petrobart is managed by Pemed Ltd, a company registered in England with its principal office in London, which is handling many of Petrobart's strategic and administrative matters. Petrobart therefore has substantial business activities in the Area of a Contracting Party, i.e. the United Kingdom, in the meaning of Article 17 of the Treaty. As regards the two individual employees mentioned by the Kyrgyz Republic, Mr. Todorovski is a national of both the United Kingdom and Macedonia, whereas Mr. Zatazelo is a Serbian national who is permanently resident in France.

The Arbitral Tribunal refers to its reasoning above under 2 as regards Petrobart's objections that the Kyrgyz Republic did not act in conformity with the parties' agreement and that it also raised its arguments regarding the applicability of the Treaty too late. For the same reasons as under 2, the Arbitral Tribunal is not prepared to reject the Republic's arguments on formal grounds but will proceed to an examination of the merits.

The Arbitral Tribunal attaches weight to the information about Petrobart provided by Petrobart itself which, in the Arbitral Tribunal's view, contradicts the view that Petrobart is a company owned or controlled by citizens or nationals of a state other than the United Kingdom and that Petrobart has no substantial business in the United Kingdom. The Arbitral Tribunal therefore considers that the conditions for application of Article 17(1) of the Treaty are not present in this case.

### ***4. Res judicata***

The Kyrgyz Republic argues that the Arbitral Tribunal has no jurisdiction to examine Petrobart's claims because the matter is covered by the rules of *res judicata*. In this respect the Republic refers both to the domestic proceedings before the Bishkek Court in the so-called Show-Cause Case and to the UNCITRAL Arbitration. The Republic argues that, whether viewed under "applicable rules and principles of international law" or under Swedish law as *lex arbitri*, this case is barred by the doctrine of *res judicata* which, according to a generally accepted principle of international law and also according to Swedish law, applies to arbitration cases.

Petrobart considers that the issues in dispute shall be decided in accordance with the Treaty and applicable rules and principles of international law and that the concept of *res judicata* is not applicable in the circumstances of this case, because the arbitration does not concern the same matter as the previous proceedings. Petrobart adds that the conclusion would be the same under Swedish law.

The Arbitral Tribunal notes that according to Article 26(6) of the Treaty a tribunal set up to rule on disputes under the Treaty shall apply the Treaty itself as well as applicable rules and principles of international law. The Treaty contains no provisions about *res judicata*, but the notion of *res judicata* is undoubtedly recognised in international law (see for instance International Court of Justice, Effect of Awards of Compensation made by the United Nations Administrative Tribunal, Advisory Opinion, ICJ Reports 1954 p. 53, Bin Cheng, General Principles of Law as applied by International Courts and Tribunals, 1987, p. 337 *et seq.*, and Vaughan Lowe, *Res judicata* and the Rule of Law in International Arbitration, African Journal of International and Comparative Law, 1996, the latter two works referred to by Petrobart). The Arbitral Tribunal considers that procedural fairness requires that a matter which has been examined and finally decided by a court or an arbitral tribunal shall as a rule not be subject to a new examination in proceedings between the same parties (cf. the principle of *ne bis in idem*). There may however be special reasons, such as the appearance of new evidence, which justify a new examination. Moreover, the *res judicata* doctrine applies only when there is identity of object and does not prevent a new examination of a matter which differs significantly from that which has previously been decided. Nor does it prevent a new examination if the parties are not the same as in the previous proceedings.

(a) *The Show-Cause Case*

The Arbitral Tribunal notes that the domestic proceedings in the Show-Cause Case were initiated by the Government of the Kyrgyz Republic. The Government brought these proceedings on the basis of the Foreign Investment Law and the Foreign Investment Interpretation Law and asked the Bishkek Court to establish that, according to these laws, (a) Petrobart had no foreign investment in the Kyrgyz Republic, (b) there was no investment dispute between Petrobart and the Government, and (c) there was no subject-matter to be arbitrated in an arbitral tribunal between Petrobart and the Government according to the Foreign Investment Law. Petrobart chose not to participate in the proceedings. In its decision of 26 December 2000, the Bishkek Court granted the Government's request on all three points and issued a declaratory judgment to that effect.

It thus appears that the Show-Cause Case concerned exclusively the interpretation and application of Kyrgyz domestic law and that the Treaty was not in issue in that case. While Petrobart might have been able to raise issues under the Treaty in those proceedings, there

is no provision in the Treaty indicating that the failure to do so would deprive Petrobart of the right to institute subsequent proceedings on the basis of Article 26 of the Treaty. Moreover, it is important to note that the Show-Cause Case was initiated by the Government and not by Petrobart, whereas Article 26 of the Treaty gives an investor but not a Contracting Party the right to initiate proceedings. It would run counter to the idea of providing the investor with an effective legal remedy if a Contracting Party, by bringing proceedings before a domestic court, could deprive the investor of his right to have an investment dispute examined at international level.

The Arbitral Tribunal therefore concludes on this point that the domestic proceedings in the Show-Cause Case did not have a *res judicata* effect which prevents Petrobart from now bringing arbitration proceedings under the Treaty.

*(b) The UNCITRAL Arbitration*

The UNCITRAL Arbitration differs from the Show-Cause Case in so far as the proceedings were instituted by Petrobart and not by the Kyrgyz Republic. One of the reasons for denying a *res judicata* effect in the Show-Cause Case is therefore absent in regard to the UNCITRAL Arbitration. However, there remains another difference, i.e. that the UNCITRAL Arbitration was not based on the Treaty but on Article 23(2) of the Kyrgyz Foreign Investment Law according to which one of the alternative ways of settling a dispute between the government organs of the Republic and a foreign investor is to institute arbitration proceedings according to the UNCITRAL Arbitration Rules. The issue in the UNCITRAL Arbitration – like in the Show-Cause Case – was therefore whether the provisions of the Foreign Investment Law had been respected and not whether the Republic had respected its obligations under the Treaty. On that crucial point, the subject-matter of the proceedings differs from that of the present arbitration.

A question which requires consideration in this context is whether Petrobart, in order to avoid imposing an undue procedural burden on the Kyrgyz Republic, was required to raise the issues under the Treaty in the same proceedings or in a parallel arbitration jointly with the issues relating to the Foreign Investment Law. The Arbitral Tribunal notes in this regard that both the Foreign Investment Law and the Treaty make it possible to have disputes settled under the UNCITRAL Arbitration Rules.

The Kyrgyz Republic argues that Petrobart could have raised the Treaty-based claims in the UNCITRAL Arbitration and that the arbitrators in that case would have been empowered to entertain those claims. Moreover, the Republic considers that the underpinnings of *res judicata* would have been served even if Petrobart had at the same time pursued a parallel arbitration, since the claim would then have been adjudicated efficiently, judicial/arbitral resources would have been preserved, and the Republic would have enjoyed finality.

Petrobart states that it could not have requested the arbitral tribunal in the UNCITRAL Arbitration to examine breaches of the Treaty for several reasons. First, the arbitral tribunal in the UNCITRAL Arbitration derived its competence exclusively from the Kyrgyz Foreign Investment Law, a legal regime totally different from the Treaty. Second, the mode of procedure for appointing the arbitrators is different in that the appointing authority is not the same as under the Treaty. Moreover, Petrobart was not under an obligation to commence parallel proceedings in order not to preclude a subsequent claim under the Treaty.

In any case, Petrobart attaches weight to the fact that the arbitral tribunal in the UNCITRAL Arbitration dismissed the claim for lack of jurisdiction without examining the merits of the case and that the question whether or not Petrobart could have raised its Treaty-based claims in the UNCITRAL proceedings is of no relevance for the competence of the present Arbitral Tribunal to examine the claims under the Treaty. On this point, the Kyrgyz Republic responds that the UNCITRAL arbitral tribunal already examined the omnibus issue whether the facts alleged by Petrobart gave rise to an arbitrable dispute and found that the general nucleus of operative facts did not give rise to such a dispute. The Republic considers that Petrobart could have raised the Treaty-based jurisdictional argument during that proceeding and that its failure to do so renders the present Arbitral Tribunal incompetent to reconsider the question of jurisdiction.

The Arbitral Tribunal does not doubt that it would have been possible for Petrobart to ask for arbitration under the UNCITRAL Arbitration Rules in regard to domestic law issues as well as Treaty issues. However, if Petrobart had wished to initiate UNCITRAL arbitration based on both the Foreign Investment Law and the Treaty, there would have been two separate UNCITRAL proceedings, based on different arbitration clauses, one in the Foreign Investment Law and the other in the Treaty, the first one dealing with the question of investments under Kyrgyz law and the other one with compliance or not with the Treaty. There would have been no certainty that the two arbitral tribunals would have the same composition, since the Foreign Investment Law designates the Secretary General of ICSID as appointing body, whereas under Article 6(2) of the UNCITRAL Arbitration Rules, to which reference is made in the Treaty, the Secretary-General of the Permanent Court of Arbitration designates the appointing authority. Nor would it presumably have been possible to merge the two arbitrations into one joint proceeding.

Furthermore – and more importantly – there is no provision in the Treaty which would have compelled Petrobart to initiate proceedings under the Treaty at a particular time in order to conduct the arbitration jointly with other domestic or international proceedings regarding issues arising under domestic law. The Arbitral Tribunal notes in this regard that the Kyrgyz Republic is not a Contracting Party listed in Annex ID to the Treaty for which there is a special rule in Article 26(3)(b) of the Treaty.

The Arbitral Tribunal must therefore conclude that the UNCITRAL Arbitration did not have a *res judicata* effect which prevented Petrobart from raising its Treaty claims in the present arbitration.

### ***5. Collateral estoppel***

The Kyrgyz Republic also refers to the doctrine of collateral estoppel as an obstacle to examination of the present case on the merits. The Republic's argument appears essentially to be that Petrobart had the opportunity to bring to the domestic court's or, alternatively, the UNCITRAL arbitral tribunal's attention the claim that Petrobart is an investor that made an investment under the Treaty but failed to do so, and that this should prevent Petrobart from having this issue examined by the present Arbitral Tribunal. Petrobart responds that the doctrine of collateral estoppel is an American doctrine which is not recognised in Swedish law and has no application in the present case.

The Arbitral Tribunal observes that, while the doctrine of collateral estoppel seems to have primarily developed in American law, other legal systems have similar rules which in some

circumstances preclude examination of an issue which could have been raised, but was not raised, in previous proceedings. A doctrine of estoppel is also recognised in public international law. The Kyrgyz Republic's argument on this point may indeed be understood as raising the question whether the fact that the Treaty-related issues were not relied on in previous proceedings should prevent Petrobart from raising them in the present proceedings.

A fundamental question in this case is therefore whether the Treaty can be interpreted in such a manner as to deprive an investor – or an alleged investor – of his procedural rights under the Treaty due to the fact that he failed to raise the relevant Treaty issues in a previous case of litigation or arbitration.

The Arbitral Tribunal first refers to its reasoning in respect of the *res judicata* issue which to a large extent is applicable also to preclusion. In particular, the Arbitral Tribunal finds no provision in the Treaty which would have obliged Petrobart to raise the Treaty issues in the domestic proceedings or the previous arbitration proceedings, both of which concerned the application of domestic law.

The Arbitral Tribunal also refers to the ICSID award rendered on 6 August 2003 in the case of *SGS Société Générale de Surveillance S.A. v. the Islamic Republic of Pakistan*. In this award, the arbitral tribunal dealt with the question as to whether the Claimant's conduct in previous Swiss legal proceedings and in a previous arbitration regarding contract and tort claims precluded the Claimant from raising claims under the Bilateral Investment Treaty (*BIT*) between Switzerland and Pakistan. The arbitral tribunal stated as follows:

“175. The Tribunal notes that the estoppel argument has been advanced by the Respondent on a general basis regarding SGS's contract and tort claims and its BIT claims. However, as SGS points out, whatever may have occurred in the prior proceedings, SGS has not alleged a breach of the BIT either in the Swiss courts or in its counter-claim before the PSI Agreement arbitrator.

176. Unlike some BITs and investment protection treaties, the Swiss-Pakistan BIT does not contain a ‘fork in the road’ provision akin to Article 8(3) of the France-Argentina BIT, which provides that ‘[o]nce an investor has submitted the dispute to the courts of the Contracting Party concerned, or to international arbitration, the choice of one or the other of these procedures is final.’ Neither does the BIT set out a provision like Article 1121 of the NAFTA which requires that the would-be claimant must waive its ‘right to initiate or continue before any administrative tribunal or court under the law of any Party, or other dispute settlement procedures, any proceedings with respect to the measure of the disputing [NAFTA] Party that is alleged to be a breach’ of Section A of Chapter Eleven of NAFTA and must desist from pursuing claims for damages in relation to such measure.

177. In the absence of such treaty language, we are not free to read into the Swiss-Pakistan BIT a requirement that would preclude a would-be claimant from resorting to other remedies in respect of contract claims prior to the exercise of its BIT rights. Moreover, given the general purpose of the ICSID Convention and the object and purpose of the BIT, we would be hesitant to imply estoppel (or waiver for that matter) with respect to BIT claims that have not in fact been alleged in another forum. As they have not been advanced, and SGS did not hold out in any way that they would not be advanced, we cannot find that it is estopped from advancing its BIT claims now.”

The Arbitral Tribunal considers that for similar reasons there is no estoppel in the present case. There is not in the Treaty a “fork in the road” provision stipulating that the investor, after first choosing one procedure, cannot later also make use of another procedure. Moreover, as pointed out above, the domestic litigation in the Show-Cause Case was not initiated by Petrobart and did not therefore reflect a choice of procedure by Petrobart. The UNCITRAL Arbitration was Petrobart's choice, but its aim was to have the issues under

domestic law decided and it did not even result in an examination on the merits, since the arbitral tribunal found that Petrobart had no foreign investment under the Foreign Investment Law.

In these circumstances, the Arbitral Tribunal concludes that Petrobart is not prevented from raising its claims under the Treaty and is entitled to have these claims examined by the Arbitral Tribunal.

#### **6. Investor and investment**

Petrobart claims that it fulfils the conditions of being an investor which has an investment in the Kyrgyz Republic within the meaning of the Treaty. In Petrobart's opinion, the Contract, Petrobart's claim for money and the Bishkek Court's judgment of 25 December 1998 in favour of Petrobart all represent investments pursuant to Article 1(6) of the Treaty.

In its Reply to the Request for Arbitration, the Kyrgyz Republic denies any allegation that Petrobart is an "investor" under the Treaty, and that Petrobart made an "investment" under the Treaty. In the same brief, the Republic states as an "affirmative defence" that Petrobart is not an "investor" who made an "investment", as these words are defined in the Treaty, and that, as such, Petrobart possesses no right to arbitrate. However in its Statement of Defence and its Rejoinder, the Kyrgyz Republic does not make a specific statement on this matter but mainly argues that it has been decided in previous proceedings that Petrobart was not an investor who had made an investment and that this determination has *res judicata* and collateral estoppel effects.

In view of the ambiguity of the Kyrgyz Republic's position, the Arbitral Tribunal, in its questionnaire of 3 November 2004, included a question as to whether the Republic still took the position that Petrobart is not to be regarded as an investor who made an investment under the Treaty, or whether the Republic's objection was limited to the argument that the matter could not be examined on account of *res judicata* or collateral estoppel rules.

The answer given by the Kyrgyz Republic is that it "continues to take the position that the Claimant is not an Investor who made an Investment or that the Claimant is an investor to whom the rights provided by Part III (or any part) of the Treaty apply".

Petrobart has responded by stating that it is nowhere to be found that such a position was ever taken by the Kyrgyz Republic in any of its submissions. Instead, the Republic had consistently argued that the question whether Petrobart was an investor that made an investment had already been decided in the negative under Kyrgyz law and that this decision constituted *res judicata*. Since, in Petrobart's opinion, the Republic had never denied that Petrobart's investments were investments under the Treaty, the Republic should be prevented from raising this assertion at a late stage of the proceedings.

The Arbitral Tribunal notes that, since the Kyrgyz Republic argued in its Reply to the Request for Arbitration that Petrobart was not an investor who had made an investment under the Treaty but did not revert to this matter in subsequent submissions, the Arbitral Tribunal considered the Republic's position unclear and asked the Republic for a clarification. In its reply, the Republic informed the Arbitral Tribunal that it continues to deny Petrobart's status as an investor who made an investment under the Treaty. In these circumstances, the Arbitral Tribunal accepts that this argument, which was clearly stated at

the initial stage of the proceedings, has remained the Republic's position throughout the proceedings. Consequently, the Arbitral Tribunal cannot find a basis for rejecting the argument as having been raised too late.

The Arbitral Tribunal will therefore examine whether Petrobart can be regarded as an investor who made an investment protected under the Treaty.

As to the scope of the commercial relations between Petrobart and KGM, Petrobart argues that, while the Contract was an agreement that Petrobart should deliver 200,000 tons of gas condensate over a period of twelve months, the Contract also provided for additional supply of gas condensate at a later stage. The Republic denies that there was any agreement about further deliveries or about any kind of further co-operation between Petrobart and KGM.

The Arbitral Tribunal finds that the Contract concerned delivery of 200,000 tons of gas condensate and that, whatever discussions may have taken place between the parties about further business relations, they did not result in any binding undertakings in the Contract.

As regards the delivery of 200,000 tons of gas condensate, however, the Arbitral Tribunal notes that in Section 1.1 of the Contract Petrobart undertook to deliver this quantity over the course of one year and that in Section 1.2 of the Contract KGM agreed to accept and pay for the goods. The Arbitral Tribunal finds no basis in the Contract for considering that Petrobart was entitled to deliver less than 200,000 tons or that KGM was entitled to reduce the deliveries to a level below 200,000 tons.

The Arbitral Tribunal further notes that the Contract did not involve any transfer of money or property as capital in a business in the Kyrgyz Republic but was a sales contract. It concerned the sale of goods at an agreed price. The arbitral tribunal in the UNCITRAL Arbitration found that this did not constitute a foreign investment under the Foreign Investment Law. The question in the present arbitration is whether it constitutes an investment according to the Treaty.

There is no uniform definition of the term investment, but the meaning of this term varies (cf. Dolzer-Stevens, *Bilateral Investment Treaties*, 1995, p. 25-31, and Sacerdoti, *Bilateral Treaties and Multilateral Instruments on Investment Protection*, Collected Courses of the Hague Academy of International Law 1997, Tome 269, p. 305-310). While in ordinary language investment is often understood as being capital or property used as a financial basis for a company or a business activity with the aim to produce revenue or income, wider definitions are frequently found in treaties on the protection of investments, whether bilateral (*BITs*) or multilateral (*MITs*).

The term investment must therefore be interpreted in the context of each particular treaty in which the term is used. Article 31(1) of the Treaty on the Law of Treaties provides, as the main rule for treaty interpretation, that a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose. It is obvious that, when there is a definition of a term in the treaty itself, that definition shall apply and the words used in the definition shall be interpreted in the light of the principle set out in Article 31(1) of the Treaty on the Law of Treaties.

The relevant treaty in this case is the Energy Charter Treaty which protects investments of an investor of one Contracting Party in the Area of another Contracting Party, and the terms “Investor” and “Investment” are defined in Article 1 of the Treaty.

According to Article 1(7), the term “Investor” means:

- “(a) with respect to a Contracting Party:  
 (i) a natural person having the citizenship or nationality of or who is permanently residing in the Contracting Party in accordance with its applicable law;  
 (ii) a company or other organization organized in accordance with the law applicable in that Contracting Party;  
 (b) with respect to a ‘third state’, a natural person, company or other organization which fulfils, *mutatis mutandis*, the conditions specified in subparagraph (a) for a Contracting Party.”

Petrobart is a company organised in accordance with the law of Gibraltar. The Arbitral Tribunal has found above that the Treaty should be considered to continue to apply provisionally to Gibraltar, and the law of Gibraltar must in this context be regarded as being part of the law of one of the Contracting Parties, i.e. the United Kingdom. Petrobart therefore satisfies the condition of being an investor under Article 1(7).

It remains to examine whether Petrobart also had an investment in the Area of another Contracting Party, i.e. the Kyrgyz Republic.

According to Article 1(6), the term “Investment” means:

- “every kind of asset, owned or controlled directly or indirectly by an Investor and includes:  
 (a) tangible and intangible, and movable and immovable, property, and any property rights such as leases, mortgages, liens, and pledges;  
 (b) a company or business enterprise, or shares, stock, or other forms of equity participation in a company or business enterprise, and bonds and other debt of a company or business enterprise;  
 (c) claims to money and claims to performance pursuant to contract having an economic value and associated with an investment;  
 (d) Intellectual Property;  
 (e) Returns;  
 (f) any right conferred by law or contract or by virtue of any licences and permits granted pursuant to law to undertake any Economic Activity in the Energy Sector.”

It is added in Article 1(6) that the term “Investment” includes all investments whether existing or made after the later of the date of entry into force of the Treaty for the Contracting Party of the investor making the investment and that for the Contracting Party in the Area of which the investment is made, provided that the Treaty shall only apply to matters affecting such investments after the Effective Date.

The provisions which require particular attention in this case are items (c) and (f) of Article 1(6). In connection with item (f), the following definitions in Article 1(4) and Article 1(5) are also of interest:

“(4) ‘Energy Materials and Products’, based on the Harmonized System of the Customs Co-operation Council and the Combined Nomenclature of the European Communities, means the items included in Annex EM.

(5) ‘Economic Activity in the Energy Sector’ means an economic activity concerning the exploration, extraction, refining, production, storage, land transport, transmission, distribution, trade, marketing, or sale

of Energy Materials and Products except those included in Annex NI, or concerning the distribution of heat to multiple premises.”

Petrobart considers that the Contract, the claim and the Bishkek Court’s judgment were all assets according to Article 1(6) of the Treaty. In the Arbitral Tribunal’s view, a correct legal analysis leads to the conclusion that the Contract and the judgment are not in themselves assets but merely legal documents or instruments which are bearers of legal rights, and these legal rights, depending on their character, may or may not be considered as assets. The relevant question which requires consideration is therefore whether the rights provided for in the Contract and confirmed in the judgment constituted assets and were therefore an investment in the meaning of the Treaty. In other words, the question is whether Petrobart’s right under the Contract to payment for goods delivered under the Contract was an asset and constituted an investment under the Treaty.

Item (c) of Article 1(6) of the Treaty provides that as assets constituting an investment are to be counted “claims to money and claims to performance pursuant to contract having an economic value and associated with an investment”.

In various BITs and MITs, claims to money are mentioned among assets which are to be regarded as investments. There is also case-law dealing with the interpretation of such treaty clauses. It follows from such case-law that investment is often a wide concept in connection with investment protection and that claims to money may constitute investments even if they are not part of a long-term business engagement in another country.

In the case of *Fedax N.V. v. the Republic of Venezuela* (ICSID decision of 11 July 1997 on Objections to Jurisdiction), the arbitral tribunal applied a BIT between the Netherlands and Venezuela according to which the term “investments” should comprise *inter alia* “titles to money”. The tribunal noted (para. 18 of the decision) that this was evidence of a wide definition of “investments” and found that promissory notes issued by Venezuela and acquired by Fedax from the original holder were an investment. The tribunal added in particular:

“20. A broad definition of investment such as that included in the Agreement [between the Netherlands and Venezuela] is not at all an exceptional situation. On the contrary, most contemporary bilateral treaties of this kind refer to ‘every kind of assets’ or to ‘all assets’, including the listing of examples that can qualify for coverage; claims to money and to any performance having a financial value are prominent features of such listings. - - - Indeed, only very exceptionally do bilateral investment treaties explicitly relate the definition of the assets or transactions included in this concept to questions such as the existence of a lasting economic relation, or specifically associate titles to money and similar transactions strictly to a concept of investment.

21. A similar trend can be identified in the context of major multilateral instruments. It has been rightly noted that the World Bank Guidelines on the Treatment of Foreign Direct Investment are not at all restricted to ‘direct’ investments. The explanatory Report makes clear that there are no restrictions in this context as to the nature of covered investments and that the Guidelines are applicable to ‘indirect, as well as to direct, investments and to modern contractual and other forms of investment’. The Energy Charter Treaty and Mercosur Protocols have included ‘every kind of asset’, the former listing ‘claims to money and claims to performance pursuant to certain contracts’, and the latter referring to ‘claims to performance having an economic value’. Again only exceptionally has a multilateral treaty strictly related the listing of given assets such as interests to equity investments, or excluded claims to money that arise solely from commercial contracts for the sale of goods and services.”

Another arbitration, *Salini Costruttori and Italstrade v. Morocco* (ICSID award of 23 July 2001), concerned Morocco’s failure to pay for services rendered under a contract regarding the construction of a highway. The arbitral tribunal held that there was an investment under

the BIT between Italy and Morocco which defined the term “investment” broadly so as to include “any contractual benefit having an economic value” and “any right of an economic nature conferred by law or by contract”.

Similarly, in the above-mentioned arbitration *SGS Société Générale de Surveillance S.A. v. the Islamic Republic of Pakistan* (ICSID award of 6 August 2003), which concerned payment under a contract on customs inspections for the Pakistani Government at foreign and Pakistani ports, the arbitral tribunal considered that the claims for payment for services fell within the notion of “claims to money”, mentioned in the Swiss-Pakistan BIT as an example of investments.

It is thus not unusual that claims to money, even if not based on any long-term involvement in a business in another country, are included in treaties within the concept of “investment”. Such a broad definition of that concept has been accepted by the Kyrgyz Republic in its BITs with, for instance, the USA (“a claim to money or a claim to performance having economic value, and associated with an investment”), the United Kingdom (“claims to money or to any performance under contract having a financial value”) and Sweden (“title to money or any performance having an economic value”).

As regards the Energy Charter Treaty – which was specifically referred to in the Fedax case as a treaty with a broad definition of “investment” – the Arbitral Tribunal considers that the wording “claims to money and claims to performance pursuant to contract having an economic value and associated with an Investment” presents certain ambiguities. In particular, it is not entirely clear whether the words “pursuant to contract having an economic value and associated with an Investment” or parts of these words – “having an economic value and associated with an Investment” or “associated with an Investment” – relate only to “claims to performance” or also to “claims for money”. If we assume that at least the terms “associated with an Investment” also relate to “claims for money”, we are faced with the logical problem that the term “Investment” is not only the term to be defined but is also used as one of the terms by which “Investment” is defined. This means that the definition is in reality a circular one which raises a logical problem and creates some doubt about the correct interpretation.

However, in this case further guidance can be sought in Article 1(6)(f) which provides that as an asset constituting an investment shall also be counted “any right conferred by law or contract or by virtue of any licences and permits granted pursuant to law to undertake any Economic Activity in the Energy Sector”. “Economic Activity in the Energy Sector” is in Article 1(5) defined as “economic activity concerning the exploration, extraction, refining, production, storage, land transport, transmission, distribution, trade, marketing, or sale of Energy Materials and Products except those included in Annex NI, or concerning the distribution of heat to multiple premises”. It is not contested that the gas condensate which Petrobart sold in the Contract is to be regarded as Energy Materials and Products. It may be added that gas condensate is not one of the exceptions in Annex NI. Thus, a right conferred by contract to undertake an economic activity concerning the sale of gas condensate is an investment according to the Treaty. This must also include the right to be paid for such a sale.

The Arbitral Tribunal thus concludes on this point that Petrobart was an investor having an investment in the Kyrgyz Republic and that the Republic owed Petrobart protection under the Treaty.

## ***7. Preliminaries to arbitration***

According to Article 26(1) of the Treaty, disputes between a Contracting Party and an investor of another Contracting Party relating to an investment of the latter in the Area of the former, which concern an alleged breach of an obligation of the former under the provisions in the Treaty concerning investment promotion and protection, shall, if possible, be settled amicably. Article 26(2) of the Treaty provides that a dispute shall not be submitted for resolution in court or arbitration proceedings until a period of three months has elapsed from the date on which either party to the dispute requested amicable settlement.

As regards the condition in Article 26(2), Petrobart refers to three letters of 22 April, 16 May and 17 July 2003 addressed to the Prime Minister of the Kyrgyz Republic in which Petrobart expressed interest in an amicable settlement. The Republic replies that Petrobart knew since at least 1999 that management of this case had been assigned to two persons in the Ministry of Finance and, tangentially, to an additional individual in the Prime Minister's legal apparatus. The Republic therefore considers that the letters addressed to the Prime Minister reveal that Petrobart never intended any settlement discussions to occur. The Republic concludes that Petrobart acted without regard to the good faith requirements of Article 26(1) and (2) of the Treaty.

The Arbitral Tribunal finds that the letters addressed and sent to the Prime Minister must be accepted as requests for amicable settlement for the purposes of Article 26(2) of the Treaty and that Petrobart therefore satisfied the condition laid down in that provision.

## ***8. Breaches of the Treaty***

Having found that Petrobart was an investor and had an investment under the Treaty, the Arbitral Tribunal must examine whether the Kyrgyz Republic acted in breach of the Treaty. The Arbitral Tribunal emphasises that this question is a preliminary to the question as to whether Petrobart suffered any damage as a result of a possible breach. The initial examination will therefore be limited to ascertaining whether there was any breach of the Republic's obligations under the Treaty. Provided that such a breach is found, the Arbitral Tribunal will proceed to an examination of whether or to what degree the breach resulted in damage to Petrobart.

Petrobart alleges that the Kyrgyz Republic breached the following provisions of the Treaty:

- (a) Article 10(1) by failing to create stable, equitable, favourable and transparent conditions for Petrobart's investment,
- (b) Article 10(1) by failing to accord Petrobart's investment a fair and equitable treatment and most constant protection for Petrobart's investment,
- (c) Article 10(1) by breaching its obligation not to accord unreasonable impairment of use and enjoyment of Petrobart's investment,
- (d) Article 10(1) by breaching its obligation to observe the obligation it has entered into with Petrobart,

(e) Article 10(1) by according Petrobart's investment a treatment less favourable than that required by international law,

(f) Article 10(12) by failing to ensure that its domestic law provides effective means for the assertion of claims and the enforcement of rights with respect to investments,

(g) Article 13(1) by subjecting Petrobart to expropriation or measures equivalent to expropriation, and

(h) Article 22(1) by failing to ensure that its state enterprise conducts its activities in a manner consistent with the Republic's obligations under Part III of the Treaty.

The Kyrgyz Republic denies that it breached any of these provisions.

The Arbitral Tribunal notes that, in the period between 23 February 1998 (date of the Contract) and 15 April 1999 (date of KGM's bankruptcy), a number of measures were taken for which the Kyrgyz Republic must be held responsible under the Treaty and which should be examined in respect of their conformity or lack of conformity with the Treaty.

By Presidential Decree No. 282 of 23 September 1998, it was decided to restructure the supply of oil and natural gas in the Kyrgyz Republic by creating a new company Kyrgyzgaz on the basis of KGM's assets. The scheme was subsequently implemented by Government Decree No. 649 of 5 October 1998 under which the new company Kyrgyzgaz was to be set up and be managed by the company Kyrgyzenergo. Under the Government Decree, the State Property Fund was to organise the transfer of assets to Kyrgyzenergo, while KGM's debts for gas until 23 September 1998 were to remain with KGM. This included debts to Petrobart under invoices from March 1998.

The Presidential Decree was further implemented by Government Decree No. 11 of 11 January 1999 which gave instructions to the State Property Fund and the Ministry of Finance to transfer assets to the new company Kyrgyzgaz and to convert the shares of KGM in connection with the reorganisation. It was specified that KGM was to remain responsible for debts relating to the sale and delivery of natural and liquid gases prior to 1 October 1998. Certain decisions regarding the implementation of Decree No. 11 were taken at an extraordinary shareholders' meeting in KGM on 4 March 1999.

Moreover, by Decree No. 141 of 9 March 1999, the Government decided to entrust the state company Munai with the task of organising and carrying out state policy in the petrol sector in the Kyrgyz Republic, and shortly thereafter, on 13 March 1999, KGM leased to Munai a substantial part of KGM's assets for a monthly sum of 500,000 Soms.

The Kyrgyz Republic explains that these measures were part of a large reorganisation scheme which had been rendered necessary to ensure a satisfactory supply of oil and gas to the population.

The Arbitral Tribunal does not doubt that there may have been good reasons for restructuring the system for supply of oil and gas in the Kyrgyz Republic. The Arbitral Tribunal considers, however, that as a Contracting Party to the Treaty the Republic was under an obligation to carry out this reorganisation in a way which showed due respect for investors such as Petrobart. A central element in the restructuring was that assets were transferred from KGM to Kyrgyzgaz. Other assets were leased to Munai, and although this

was not a transfer of ownership, the leased assets apparently became unavailable to KGM's creditors. Moreover, although Kyrzyzgaz and Munai benefited from the assets, they did not take over those of KGM's debts which had originated prior to 1 October 1998. Consequently, while KGM lost its assets, it remained responsible for its debts. The transfer of assets, but not of debts, from KGM to other companies must be assumed to have been disadvantageous to KGM's creditors, including Petrobart.

Moreover, the said measures should be viewed in combination with other measures which also affected Petrobart.

On 25 December 1998, Petrobart obtained from the Bishkek Court a judgment which entitled Petrobart to recover a large amount of money from KGM in payment for its debt for delivered gas condensate, and on 10 February 1999, the Court decided to allow execution of this claim. However, on 11 February 1999, the Vice Prime Minister of the Kyrgyz Republic Mr. Silayev, who referred to KGM's critical financial standing, asked the Chairman of the Court to assist in granting a deferral of the enforcement. A few days later, on 16 February 1999, the Court granted a request by KGM for a stay of execution for three months. In doing so, the Court specifically referred to the Government's letter of 11 February 1999. Before the period of stay of execution ended, KGM was declared bankrupt, which meant that enforcement of the decision of 25 December 1998 was no longer possible.

The Arbitral Tribunal considers that Minister Silayev's letter must be regarded as an attempt by the Government to influence a judicial decision to the detriment of Petrobart. It cannot be easily established what decision would have been taken by the Court on KGM's request for a stay of execution if Minister Silayev's letter had not been sent to the Chairman of the Court. In fact, Article 178 of the Code of Arbitration Procedure, applicable to this case, would seem to have given the Bishkek Court a wide discretion in deciding whether or not to suspend execution. However, the fact that the Court, in its decision, specifically referred to the Government's intervention indicates that the Court attached some weight to Mr. Silayev's letter and that this was one of the elements which the Court took into account in the exercise of its discretion.

The Arbitral Tribunal considers that such Government intervention in judicial proceedings is not in conformity with the rule of law in a democratic society and that it shows a lack of respect for Petrobart's rights as an investor having an investment under the Treaty.

The Arbitral Tribunal further notes that the Law of the Kyrgyz Republic on Foreign Investments in the Kyrgyz Republic (*"the Foreign Investment Law"*), dated 24 September 1997, defines "foreign investments" in Article 1(2) as "investments appearing as contributions of foreign investors into objects of economic activity in the territory of the Kyrgyz Republic to derive profit". However, on 30 May 2000, this definition was changed and expanded according to a new Law on the Interpretation of the Term "Foreign Investments" in Article 1 of the Law of the Kyrgyz Republic on Foreign Investments in the Kyrgyz Republic (*"the Foreign Investment Interpretation Law"*). It was now specified that the term "foreign investments" in Article 1 of the Foreign Investment Law should be understood to mean "a long-term tangible or intangible investment into objects of economic activity in order to realise a profit". Some examples were given in the Foreign Investment Interpretation Law, and it was added that a transaction between two business entities in respect of the supply of goods or services, where the purchaser has to pay for the supplied goods or services, does not fall under the definition of "foreign investment".

Before the adoption of the Foreign Investment Interpretation Law, it was apparently unclear whether or to what extent the Foreign Investment Law was applicable to claims for money under sales or service contracts. Its application or not to such claims was a matter of interpretation which would have to be resolved in one way or the other by the Kyrgyz courts. The Foreign Investment Interpretation Law, however, made it clear that the application of the law to claims for money under such contracts is excluded, and since this is expressed not as a change of the law but as an interpretation of the existing law, it became applicable also to claims existing before the Foreign Investment Interpretation Law entered into force.

It thus follows from the Foreign Investment Interpretation Law that Petrobart's claim cannot be an investment under the Foreign Investment Law. This was indeed confirmed by the Bishkek Court's decision of 26 December 2000 in the so-called Show-Cause Case.

The adoption of a new law which establishes that a previous law shall be interpreted in a restrictive way is retroactive legislation which is likely to have negative effects for some legal or physical persons in respect of previous business transactions. In this case, it is highly doubtful whether the adoption of the Foreign Investment Interpretation Law was compatible with the Kyrgyz Republic's duty under the Treaty to protect foreign investments. As regards Petrobart, however, the Arbitral Tribunal notes that the arbitral tribunal in the UNCITRAL Arbitration found that Petrobart did not have an investment according to the Foreign Investment Law and that the tribunal reached this conclusion without relying on the provisions of the Foreign Investment Interpretation Law. For this reason, the Arbitral Tribunal cannot find it established that the Foreign Investment Interpretation Law caused prejudice to Petrobart.

The Arbitral Tribunal thus finds that the Kyrgyz Republic failed in its respect for Petrobart's rights as an investor in essentially two respects:

- (a) by transferring assets from KGM to Kyrgyzgaz and Munai to the detriment of KGM's creditors, including Petrobart; and
- (b) by intervening in court proceedings regarding the stay of execution of a final judgment to the detriment of Petrobart.

The Arbitral Tribunal attaches particular weight to the transfer of assets but sees the intervention in the court proceedings as an additional element showing lack of respect for Petrobart's rights under the Treaty.

The Arbitral Tribunal does not find it necessary to analyse the Kyrgyz Republic's action in relation to the various specific elements in Article 10(1) of the Treaty but notes that this paragraph in its entirety is intended to ensure a fair and equitable treatment of investments. In the Arbitral Tribunal's opinion, it is sufficient to conclude that the measures for which the Kyrgyz Republic is responsible failed to accord Petrobart a fair and equitable treatment of its investment to which it was entitled under Article 10(1) of the Treaty.

As regards the other provisions of the Treaty relied on by Petrobart, i.e. Articles 10(12), 13(1) and 22(1), the Arbitral Tribunal finds as follows.

The Arbitral Tribunal considers that the Vice Prime Minister's letter to the Chairman of the Bishkek Court, which gave support for a stay of execution of the judgment of 25 December 1998, violated – in addition to Article 10(1) of the Treaty – the Kyrgyz Republic's obligation under Article 10(12) of the Treaty to ensure that its domestic law provides effective means for the assertion of claims and the enforcement of rights with respect to investments.

As to Article 13 (1) of the Treaty, which deals with expropriation, the Arbitral Tribunal notes that this provision gives protection not only in respect of expropriation but also in regard to measures having effect equivalent to expropriation. Such measures are sometimes referred to as “indirect”, “creeping” or “*de facto*” expropriation and are frequently assimilated to formal expropriation as regards their legal consequences (cf. Dolzer-Stevens, *Bilateral Investment Treaties*, 1995, p. 99 *et seq.*).

It is clear that there was no formal expropriation of Petrobart's investment. Nor does it appear that the measures taken by the Kyrgyz Government and state authorities, although they had negative effects for Petrobart, were directed specifically against Petrobart's investment or had the aim of transferring economic values from Petrobart to the Kyrgyz Republic. Petrobart's claims against KGM remained and gave rise to demands in KGM's bankruptcy. The Arbitral Tribunal considers that the measures taken by the Kyrgyz Republic, while disregarding Petrobart's legitimate interests as an investor, did not attain the level of *de facto* expropriation. The Arbitral Tribunal therefore concludes that the Republic's action does not fall within Article 13(1) of the Treaty.

According to Article 22(1) of the Treaty, each Contracting Party shall ensure that any state enterprise which it maintains or establishes shall conduct its activities in relation to the sale or provision of goods and services in its Area in a manner consistent with the Contracting Party's obligations under Part III of the Treaty. KGM was a state enterprise maintained and established by the Kyrgyz Republic. Article 22(1) thus placed certain obligations on the Republic in regard to KGM's conduct of its business activities. However, the Arbitral Tribunal cannot find it established that the Republic failed to ensure that KGM conducted its business in a manner consistent with Part III of the Treaty.

## **9. Damage**

### *(a) Legal remedies*

The Arbitral Tribunal has found above that the Kyrgyz Republic failed to respect Article 10(1) and Article 10(12) of the Treaty. The Republic violated its Treaty obligations by transferring KGM's property to Kyrgyzgaz and Munai, thus withdrawing it from KGM's creditors, including Petrobart. The Vice Prime Minister's intervention in the court proceedings regarding the stay of execution of a judgment in favour of Petrobart was another act which failed to respect Petrobart's rights under the Treaty as an investor.

It remains to consider the legal consequences, if any, of the said breaches of the Treaty.

Petrobart refers to the judgment of the Permanent Court of International Justice in the *Factory at Chorzów* case and to the International Law Commission's Draft Articles on State Responsibility for Internationally Wrongful Acts in order to show that the Kyrgyz Republic is obliged to compensate Petrobart for all damage resulting from its breach of the Treaty. The Arbitral Tribunal agrees that, in so far as it appears that Petrobart has suffered

damage as a result of the Republic's breaches of the Treaty, Petrobart shall so far as possible be placed financially in the position in which it would have found itself, had the breaches not occurred.

The Kyrgyz Republic contests these claims on the ground that KGM was insolvent before its assets were transferred to Kyrgyzgaz and Munai and that, because of KGM's insolvency, Petrobart would have had no right to obtain execution of the Bishkek Court's judgment of 25 December 1998 even if there had been no decision to stay its execution.

Petrobart considers that it is entitled to compensation on three counts, i.e.

- for the amount of USD 1,507,812.60 granted to Petrobart in the Bishkek Court's judgment,
- for lost profits in the amount of USD 2,376,339.60, and
- for outlays and related expenses in the amount of USD 200,500.

The first claim concerns payment for delivered goods. The Arbitral Tribunal considers that in this respect the appropriate remedy, if damage has occurred, is monetary compensation.

As regards the second claim for compensation for lost profits, the question has been raised as to whether, if damage has occurred, specific performance would be an appropriate remedy.

The Kyrgyz Republic states in this respect that specific performance is the primary remedy for breach of obligations in international law and that the Republic could therefore be ordered to accept delivery of the remaining gas condensate allegedly due under the Contract and to pay for it. The Republic does not consider that any form of specific performance is now impossible. An award in favour of Petrobart could, in the Republic's opinion, seek to return Petrobart to the position in which Petrobart found itself prior to the Republic's alleged interference.

Petrobart agrees that specific performance is in principle a primary remedy in international law but considers that in the circumstances of this case such performance is no longer possible because (i) the Contract has been terminated, (ii) Petrobart's supply contract with the Uzbek company Uzneftegazdobicha has been terminated, (iii) if Petrobart were to deliver the remaining quantities under the Contract, it would have to re-negotiate the price of the gas at today's market level, and (iv) the delivery of gas condensate is impossible for practical reasons since Petrobart is no longer engaged in Kyrgyzstan.

The Arbitral Tribunal notes Petrobart's explanation that the company no longer has any activity in the Kyrgyz Republic and that its supply contract with Uzneftegazdobicha is no longer in operation. In such circumstances, the Arbitral Tribunal considers that specific performance is no longer a practical option and finds that also in regard to lost profits monetary compensation would be the only appropriate remedy in this case.

*(b) Effects of KGM's transfer of property*

The Kyrgyz Republic denies that Petrobart suffered any damage, primarily on the ground that KGM was already insolvent before measures were taken to restructure the gas and oil supply system in the Kyrgyz Republic, and argues that Petrobart therefore, even if these measures had not been taken by the authorities, would not have been able to recover any amount from KGM. In the Republic's opinion, the transfer of property was part of the

restructuring measures which were necessary to safeguard the supply of oil and natural gas to the population, and it did not result in any damage to Petrobart.

Petrobart argues that the correlation between KGM's insolvency and Petrobart's damage is irrelevant for various reasons. First, the case concerns an international law claim brought by an investor against the Kyrgyz Republic, and the correct assessment is therefore what damage Petrobart has suffered as a result of the Republic's interferences with Petrobart's rights. Secondly, KGM's insolvency is irrelevant as a question of causation to Petrobart's damage since this insolvency was created by the Republic itself through acts that are illegal under international law and, as it appears, also under domestic law. Thirdly, a Contracting Party to the Treaty cannot, as a legitimate defence for not adhering to its international law obligations, rely on the insolvency of a state-owned entity but must assume liability not only for its own acts but also for the acts of that entity.

Petrobart considers that, if the transfer of assets had not taken place, KGM would have continued to operate its business and Petrobart would have resumed its remaining deliveries under the Contract for which KGM would have been obliged to render payment. In Petrobart's view, the transfer of assets to Kyrgyzgaz and the lease of assets to Munai, if they did not create the insolvency of KGM, definitely aggravated the insolvency. These actions thus ultimately deprived Petrobart of the possibility to obtain payment.

The Arbitral Tribunal agrees that the relevant question in this case is whether the measures taken by the Kyrgyz Republic or for which the Kyrgyz Republic is responsible, in so far as they were inconsistent with the Republic's obligations under the Treaty, resulted in damage for Petrobart. However, in the assessment of this question, it is necessary to take into account KGM's insolvency and subsequent bankruptcy. Indeed, if it appeared that KGM's financial situation before property was transferred to Kyrgyzgaz and Munai was such that Petrobart would in any case not have received any payment for delivered goods, the transfer of property to the other companies could not be considered to have caused any additional damage to Petrobart.

#### General observations

A precise evaluation of whether, or to what extent, damage has been caused to Petrobart would require detailed knowledge of various elements, such as the financial situation of KGM before and after the transfer of assets and the value of the transferred assets. The Arbitral Tribunal found the information on these matters provided by the parties in their briefs insufficient and therefore, on 3 November 2004, asked the parties for certain clarifications. In particular, the Arbitral Tribunal asked what was the nature and the approximate value of the property transferred to Kyrgyzgas, how the property leased to Munai was dealt with in KGM's bankruptcy, and what payments or other economic benefits, if any, Petrobart would have obtained if there had not been a transfer of property from KGM to Kyrgyzgas and a lease of property to Munai. The parties were also invited to give information about the value of assets and liabilities of the bankrupt company KGM, as established in the bankruptcy proceedings, and about the size of the claims of creditors belonging to different categories of payment priority.

The parties replied to these questions, but they did not provide such figures as would permit the Arbitral Tribunal to reach conclusions on the basis of mathematical calculations. The Arbitral Tribunal has therefore considered the possibility of asking the parties for further clarifications.

However, the Arbitral Tribunal, in view of the complexity of these matters, finds it doubtful whether the parties would be able to provide sufficiently clear figures to allow the Arbitral Tribunal to make a precise assessment of the damage, if any, caused by the transfer of assets from KGM. Moreover, the Arbitral Tribunal takes into account that the parties, when refraining in October 2004 from an oral hearing in this case, agreed to apply a strict procedure in writing by which delays in the further proceedings would be avoided. According to this agreement, which was accepted by the Arbitral Tribunal, it would be the task of the Arbitral Tribunal, at its discretion, to ask questions to the parties, and after the parties had replied to these questions, there would be only one opportunity for each party to comment on the other party's replies.

Having regard to the parties' agreement on the procedure, the Arbitral Tribunal considers that it would not be appropriate to prolong the proceedings by asking further questions. Instead, the Arbitral Tribunal will base its considerations on the documents, information and arguments which have already been provided by the parties. In so far as precise calculations of values and debts cannot be made on this basis, it will remain for the Arbitral Tribunal to base itself on a general assessment of KGM's financial situation, its assets and liabilities, and of what were the likely effects of the transfer of property for which the Kyrgyz Republic was responsible.

#### KGM's financial situation

As regards KGM's financial situation before the transfer of property, the Arbitral Tribunal first notes that KGM failed to pay Petrobart's invoices from 10, 19 and 26 March 1998. However, KGM told Petrobart, in a letter of 2 June 1998, that its inability to make payment on time was mainly due to measures it had had to take to assist victims of a natural disaster and that it believed that the debts would be settled in the near future. In a further letter of 14 July 1998, KGM stated that payment would probably be made within the next 10-15 days. While the mere inability to pay a debt, even if of a temporary nature, would seem to constitute insolvency under the wide definition of that term in Article 9(1) of the Kyrgyz Bankruptcy Law, KGM's letters cannot be considered to show more than that KGM was temporarily unable to pay its debt to Petrobart.

The Arbitral Tribunal further notes the balance sheets of KGM and its then associated company Kyrgyzgas, dated 1 October 1998, which, as the Arbitral Tribunal reads them, show that KGM was in a vulnerable position but which do not justify the conclusion that KGM was unable to pay its creditors. The Kyrgyz Republic argues that the values of the assets appearing in these balance sheets are inflated but has provided no evidence to show that this was the case. Nor has the Republic provided the Arbitral Tribunal with any other figures which it would consider to be more correct or realistic.

The Individual Programme for Privatisation of KGM, dated 11 February 1999, gives a more pessimistic picture of the company. According to that document, KGM was in a serious situation due to huge debts and losses. It was added that KGM was an insolvent enterprise which had no chances to restore its solvency, and that KGM was on the verge of bankruptcy.

It should also be observed that KGM, in its bankruptcy petition of 2 April 1999, refers to the the company's balance sheet which, as of 1 January 1999, showed that the liabilities amounted to 2,410,560 Soms (= presumably 2,410,560,000 Soms) and the assets to only

1,317,965 Soms (= presumably 1,317,965,000 Soms). Similar figures appear in the bankruptcy decision of 15 April 1999.

The Arbitral Tribunal does not exclude that the description of the company's economic situation in the Individual Programme was too sombre, since its purpose may have been to provide a justification for the drastic measures of reorganisation which the Government had in mind. Nevertheless, it would seem that at the end of 1998 and during the first months of 1999 the situation had deteriorated to such an extent that KGM, even if assets had not been transferred to other companies, would probably not have been able to survive in its then existing structure. The Arbitral Tribunal therefore finds that, as far as can be deduced from the materials in the case-file, the transfer of property to Kyrgyzgaz and the lease of property to Munai aggravated, rather than created, the company's troublesome economic situation.

#### Transfer and value of assets

The Arbitral Tribunal notes that a central element in the restructuring of the gas and oil supply system was that KGM's assets were to be transferred or leased to other companies. This appears from various official documents. Presidential Decree No. 282 of 23 September 1998 provided for the creation, on the basis of KGM's assets, of a new company Kyrgyzgaz, and Government Decree No. 649 of 5 October 1998 envisaged the transfer of assets from the former company Kyrgyzgaz, associated with KGM, to Kyrgyzenergo, which was to manage the new company Kyrgyzgaz. According to Decree No. 11 of 11 January 1999, a new complex of assets was to be created for the new company Kyrgyzgaz on the basis of the old company Kyrgyzgaz.

On 4 March 1999, the shareholders in KGM took a number of decisions to implement Decree No. 11, the result being that KGM's assets in the gas sector were transferred to the new company Kyrgyzgas. A few days later, KGM's assets in the petroleum sector were leased to the state company Munai which had been entrusted with the task of organising and carrying out state policy in that sector.

The Arbitral Tribunal further notes that, while the assets were transferred to other companies, KGM's debts remained with KGM. Government Decree No. 649 provided that the debts for gas until 23 September 1998 were to be on the account of KGM, and according to Government Decree No. 11, KGM was to have responsibility for debts deriving from the sale of natural and liquid gases prior to 1 October 1998. It also appears from the facts of this case that Petrobart as well as other creditors remained KGM's creditors and that their claims were not transformed into claims against the companies that took over KGM's assets.

The Arbitral Tribunal finds it clear that assets of a high value were transferred to Kyrgyzgaz and leased to Munai. The lease contract between KGM and Munai, which has been submitted to the Arbitral Tribunal, shows that the leased assets were considerable and included land, buildings, constructions, tanks for storage of petroleum products and equipment at petrol stations. Petrobart points out – and this has not been contested by the Kyrgyz Republic – that, while the assets mainly of an oil related character were only leased to Munai, the lease constituted a secured right under Kyrgyz law with the result that also the property leased to Munai became unavailable for distribution among KGM's creditors.

The Arbitral Tribunal has found above that the measures undertaken to restructure the gas and oil supply system in the Kyrgyz Republic disregarded Petrobart's rights under the Treaty. If, as the Republic affirms, KGM was at that time an insolvent company, it is also difficult to understand how stripping the company of its assets could be in conformity with the rules and principles of Kyrgyz bankruptcy law. The fact of transferring the assets and of maintaining KGM's responsibility for the debts must have caused considerable damage to KGM's creditors seen as a group. Even if KGM was insolvent at the time of the transfers, these transactions must be considered to have severely aggravated its insolvency to the detriment of the creditors, including Petrobart. The damage caused to each individual creditor depended on various factors, such as KGM's financial status before the transfer of assets and the possibilities which the individual creditor may have had to obtain payment from any remaining assets in the bankruptcy estate. The Arbitral Tribunal considers, however, that there is a strong likelihood that Petrobart, as a creditor, suffered considerable damage as result of this massive transfer of assets.

As regards the value of the transferred and leased assets, Petrobart refers to the balance sheets of 1 October 1998 according to which KGM's assets amounted to approximately 3 billion Soms and states that this could be the estimated value of the transferred and leased assets. The Kyrgyz Republic finds this value to be inflated but has not indicated any other value which would be more accurate.

In KGM's bankruptcy request of 2 April 1999 reference is made to a balance sheet indicating that as of 1 January 1999, i.e. before the transactions with Kyrgyzgaz and Munai, the liabilities were 2,410,560 Soms (the correct figure is presumably 2,410,560,000 Soms) and the assets 1,317,965 Soms (the correct figure is presumably 1,317,965,000 Soms). In the Bishkek Court's decision to declare KGM in a state of bankruptcy it is stated, with reference to a testimony by KGM's accountant and to the 1998 balance, that the assets were in the amount of 1,285 million Soms and that the liabilities amounted to 2,246 million Soms. This, according to the court decision, meant that there was a deficit of some 1,180 million Soms.

The Arbitral Tribunal first notes that the difference between 2,246 million Soms and 1,285 million Soms is not 1,180 but 961 million Soms and that the calculation in the Bishkek Court's judgment is therefore difficult to follow. Moreover, it is not clear if these figures relate to the time of the Court's decision, i.e. after the transactions with Kyrgyzgaz and Munai, or to the time before these transactions. The fact that the figures are similar to those contained in KGM's request and the fact that reference is made in the judgment to the 1998 balance might indicate that the figures relate to 1 January 1999, in which case 1,285 million Soms would represent, or include, the value of the assets subsequently transferred to Kyrgyzgaz and Munai. However, in the absence of any explanations on this point by the parties, the Arbitral Tribunal finds it impossible to draw any safe conclusions from the figures appearing in the Bishkek Court's judgment.

Consequently, the Arbitral Tribunal must conclude that it cannot establish a precise value of the assets transferred to Kyrgyzgaz and Munai. It considers, however, that this value must have been very substantial.

There also remains some uncertainty as to whether any assets of significant value remained with KGM after the transactions with Kyrgyzgaz and Munai. Since the Bishkek Court's reference to assets of 1,285 million Soms may well concern the situation before these transactions, its judgment cannot be regarded as evidence of the existence of assets after

these transactions. The Arbitral Tribunal is not aware of any other evidence showing that there remained any valuable assets still owned by KGM.

### Size of claims

The Arbitral Tribunal again notes that, on 2 April 1999, KGM, in its petition for bankruptcy, stated that, as of 1 January 1999, the company's liabilities amounted to 2,410,560 Soms (= presumably 2,410,560,000 Soms). The bankruptcy judgment of 15 April 1999 contains the figure of 2,246 million Soms, a figure which may also relate to 1 January 1999.

In its reply to the Arbitral Tribunal's question as to the amount of the claims of KGM's creditors, Petrobart submitted a list of creditors relating to 10 June 1999 and containing claims of approximately 3,818 million Soms, a few claims being secured and the rest, including Petrobart's claim, being unsecured. The Kyrgyz Republic, without giving any explanations or making any comments, presented lists of creditors relating to a later date, i.e. 1 January 2002. As the Arbitral Tribunal understands these lists, which were submitted in Russian only, there is one general list of creditors which contains claims totalling about 9,500 million Soms, it being indicated however that most of the claims are non-recognised claims and that a number of claims are under examination. There are also separate lists for creditors of different priorities, Petrobart's claim appearing in the list of creditors of the third class of priority.

The Arbitral Tribunal considers that further information and explanations would have been necessary for making it possible to draw specific conclusions from the – at first sight inconsistent – figures appearing in the various documents. In the absence of such information and explanations, the Arbitral Tribunal is unable to establish the total amount of legitimate and well-founded claims against KGM.

### General evaluation

The Arbitral Tribunal has found above that the figures relating to KGM's insolvency, the transactions with Kyrgyzgaz and Munai and the creditors' claims are too uncertain to allow the Arbitral Tribunal to make precise mathematical calculations of the damage resulting from the transfer and lease of assets. It therefore remains for the Arbitral Tribunal to make a more general assessment of these matters based on probabilities and reasonable appreciations.

In doing so, the Arbitral Tribunal takes into account that the assets transferred to Kyrgyzgaz and leased to Munai clearly represented a high value and that the transfer and the lease must therefore be assumed to have caused considerable damage to the creditors, including Petrobart. At the same time, the Arbitral Tribunal finds evidence showing that KGM was, already before these transactions were effected, in a difficult economic situation. The company's economy was weak and unstable, and it is unlikely that the assets, even if they had remained with KGM, would have sufficed to pay the full amounts of its debts. Bankruptcy or some form of transaction with the creditors by which their claims were reduced would seem to the Arbitral Tribunal to have been a likely solution to KGM's problems.

In any case, the Arbitral Tribunal finds it clear that KGM's economic problems were drastically aggravated by the transactions with Kyrgyzgaz and Munai to the detriment of

Petrobart and other creditors. The Arbitral Tribunal estimates that, if there had been a bankruptcy in which the transferred and leased assets had been available to satisfy the creditors, Petrobart would have been able to obtain payment for a substantial part of its claim for delivered gas. It cannot be established with precision what share of the claim would have been satisfied, and in this respect the Arbitral Tribunal must therefore make a general assessment, based on its appreciation of the situation as a whole. The Arbitral Tribunal, in making such an assessment, finds that the Kyrgyz Republic, as responsible for the transfer and lease of KGM's assets, shall compensate Petrobart for damage which the Arbitral Tribunal estimates at 75% of its justified claims against KGM.

*(c) Relevance of the stay of execution*

The Arbitral Tribunal has found above that the Vice Prime Minister's intervention to support a stay of execution of the judgment of 25 December 1998 showed disrespect for Petrobart's rights as an investor under the Treaty. The question as to whether this action caused damage to Petrobart will depend on whether it can be believed to have influenced the Court's decision to grant a stay of execution and whether, if there had been no stay of execution, Petrobart would have been entitled to execute the Bishkek Court's judgment and obtain payment for its claim.

Petrobart states that in the judgment of 25 December 1998 the Bishkek Court decided that Petrobart was entitled to recover from KGM USD 1,499,143.244 in principal debt and 318,058 Soms in state duty, and that the Court, on 10 February 1999, allowed the execution of this judgment. Petrobart considers that it would have been able to execute this judgment but for the Bishkek Court's decision on 16 February 1999 to stay execution, a decision which had been prompted by the Vice Prime Minister's intervention.

The Kyrgyz Republic responds that in view of KGM's insolvency Petrobart could not have benefited from the judgment and the execution order since, even if execution had taken place, Petrobart would have been under the obligation, according to Article 21 of the Bankruptcy Law, to return the property to the bankruptcy estate.

Petrobart contests the Kyrgyz Republic's argument and points out that since there was a court decision, execution would have been allowed under the exception rule for court decisions in Article 21 of the Bankruptcy Law and would have proceeded in the normal way irrespective of whether or not KGM was insolvent.

The Arbitral Tribunal notes that according to Article 178 of the Kyrgyz Code of Arbitration Procedure a court may suspend the execution of a judgment upon request by a creditor, a debtor or a marshal of the court. No specific conditions for granting such a request are laid down in the Code, which seems to indicate that the court has a wide discretion in this matter. In the present case a request was submitted by KGM as debtor, but the Vice Prime Minister, in his letter to the Chairman of the Bishkek Court, expressed himself in favour of suspension of the execution.

It can hardly be established with any degree of certainty whether or to what degree the Minister's letter had an effect on the Court's decision. What is clear, however, is that that letter was referred to in the Court's decision to grant a stay of execution, which makes it

likely that the Court attached some weight to it and that it was an element which the Court considered relevant for the decision it was going to take on KGM's request.

Article 21(3) of the Bankruptcy Law provides, *inter alia*, that when a debtor is insolvent, the creditors shall not have the right to seize, arrest or appropriate its property except with the consent of "a court of arbitration" (or "the court of arbitration"), an administrator or a meeting of creditors.

There is a divergence of views between the parties as to the interpretation of the exception for a court of arbitration. While Petrobart considers that the exception applies to a decision by any court, the Kyrgyz Republic is of the opinion that it only concerns a decision by the particular arbitration court empowered to adjudicate the bankruptcy case. Both parties have presented arguments in favour of their views, and Petrobart has relied on a legal expert opinion by Professor emeritus Anthony M. Shea, who argues that the reference in Article 21(3) to a court is a reference to any court and does not refer only to the bankruptcy court.

The Arbitral Tribunal does not feel called upon to take a position on the interpretation of Article 21(3) of the Bankruptcy Law, this being a question of Kyrgyz domestic law which is ultimately to be decided by Kyrgyz domestic courts.

However, the Arbitral Tribunal cannot find it established with a sufficient degree of likelihood that Petrobart, even if there had been no decision to stay the execution, would have been able to execute the judgment of 25 December 1998 or, if execution had taken place, to resist a claim from the administrator in KGM's bankruptcy for the recovery of the proceeds from such execution.

Having regard to this conclusion, the Arbitral Tribunal does not find it necessary to make a specific finding in regard to the public auctions which were planned for February 1999 but did not take place.

*(d) Payment for delivered goods*

Taking into account the various circumstances in this case, the Arbitral Tribunal thus:

- finds it sufficiently established that Petrobart suffered damage as a result of the Kyrgyz Republic's action for the restructuring of the gas and oil supply system in the Republic, but
- finds it not established that Petrobart suffered additional damage from the decision to stay the execution of the Bishkek Court's judgment.

The Arbitral Tribunal considers that it should be incumbent on the Kyrgyz Republic to compensate Petrobart for 75% of the damage it suffered by not being able to receive from KGM the amount awarded to Petrobart by the Bishkek Court. Petrobart claims that, according to the Bishkek Court's judgment, it was entitled to receive USD 1,499,143.244 and 318,058 Soms and that these two amounts correspond to a total amount of USD 1,507,812.60. The Kyrgyz Republic makes no objection to the latter amount as such but acknowledges that it approximates the amount of KGM's debt to Petrobart for goods sold and delivered, as set forth in the Bishkek Court judgment. The Arbitral Tribunal interprets the Republic's declaration as meaning that, although the amount granted by the Bishkek Court as state duty was apparently 301,123 Soms rather than 318,059 Soms, the Republic accepts that for the purposes of this case USD 1,507,812.60 represents the amount of KGM's debt to Petrobart in respect of payment for delivered goods. The Arbitral Tribunal further notes that 75% of this amount is USD 1,130,859.

(e) *Lost profits*

As regards lost profits, Petrobart bases its claim on the following elements. According to the Contract, the agreed price for the gas to be delivered to KGM was USD 143.50 per metric ton. According to Petrobart's contract with Uzneftegazdobicha, the price for buying the gas was USD 95.00 per metric ton, to which should be added costs for transportation of USD 35.50 per metric ton. Petrobart argues that it would therefore have made a profit of  $(143.50 - 95.00 - 35.50 =)$  USD 13.00 per metric ton, and since the undelivered quantity was  $(200,000 - 17,204.644 =)$  182,795.36 metric tons, the lost profits amounted to  $(182,795.36 \times 13.00 =)$  USD 2,376,339.60.

The Kyrgyz Republic contests the claim and states that the profits claimed by Petrobart are entirely speculative.

The Arbitral Tribunal notes that Petrobart did not request compensation for lost profits before the Bishkek Court nor did it ask for such compensation in the UNCITRAL Arbitration. The claim seems to have been raised for the first time in the present arbitration which was initiated a considerable time after the period of 12 months during which the deliveries of gas condensate should have been effected.

The Arbitral Tribunal accepts that under the Contract Petrobart was entitled to deliver and receive payment from KGM for the whole quantity of 200,000 tons of gas. It also notes that Petrobart had concluded a contract with Uzneftegazdobicha in order to be provided with 120,000 tons of gas from February to December 1998 with the possibility to increase the quantity.

However, Petrobart made only five deliveries of altogether some 17,205 tons of gas condensate in February and March 1998. Petrobart suspended further deliveries after it had appeared that KGM failed to pay for some deliveries. Petrobart states that it is nowhere to be found that the Contract was terminated *per se* but adds that its performance was frustrated by the Kyrgyz Republic's various interventions which were completed by the decision of the extraordinary shareholders' meeting in KGM on 4 March 1999. The Kyrgyz Republic states that the Contract expired in accordance with its terms in or about February 1999.

The Arbitral Tribunal finds it understandable that Petrobart did not wish to continue delivering gas as long as KGM had not paid for those deliveries which had already been effected. However, Petrobart did not notify KGM of its wish to terminate the Contract on account of KGM's breach of its payment obligations, and the Contract in which Petrobart had undertaken to deliver 200,000 tons within a period of 12 months therefore remained in force during the whole period. As a consequence, the legal relations between Petrobart and KGM became ambiguous in the sense that not only did KGM fail to pay for deliveries, thereby breaching its obligations under the Contract, but Petrobart, instead of terminating the Contract on account of KGM's breach, stopped fulfilling its own contractual obligation to deliver gas.

The Arbitral Tribunal further finds that there remains a great deal of uncertainty as to the consequences of the breakdown of the business relations between Petrobart and KGM. It is for instance unclear whether Petrobart was able, instead of delivering gas to KGM, to sell

the gas elsewhere and, if so, at what price, or if Petrobart could limit the damage in some other way.

The Arbitral Tribunal thus finds it insufficiently established that Petrobart is entitled to compensation for lost profits.

*(f) Outlays and expenses*

As to the outlays and expenses, Petrobart refers to a report by Jeremy Gilliland. In this report it is stated that since 1998 Petrobart has incurred various outlays and related expenses in pursuing the performance under the Contract and that these outlays and expenses include travel costs, accommodation expenses, overheads and local courts and solicitors fees paid in Almaty during 1998. It is added that Petrobart has also had travel and accommodation expenses in relation to the UNCITRAL Arbitration in Stockholm during 2002. The total amount claimed in this regard is USD 200,500.

The Kyrgyz Republic considers that there is no basis in the Treaty or in the Rules of the SCC Institute for such compensation.

The Arbitral Tribunal notes that the claim relates, at least in large parts, to expenses incurred in connection with previous domestic proceedings in the Kyrgyz Republic and the UNCITRAL Arbitration. The costs relating to these previous proceedings were – or should have been – finally settled in connection with those proceedings, and the Arbitral Tribunal finds no basis for granting compensation for them in the present arbitration proceedings. The outlays and other expenses which have been incurred in connection with the present proceedings are to be regarded as arbitration costs and will be dealt with below under 10.

*(g) Other relief*

Petrobart also requests such other relief as the Arbitral Tribunal may deem appropriate and explains that this may be of importance if subsequent precise losses have been identified during the proceedings.

The Arbitral Tribunal finds it doubtful whether a claim of this general and imprecise nature can be accepted, since it makes it difficult, if not impossible, for the Respondent to present an effective defence (cf. Heuman, *Arbitration Law of Sweden: Practice and Procedure*, 2003, p. 287-288). In any event, the Arbitral Tribunal has not identified any additional loss which could entitle Petrobart to compensation.

*(h) Interest*

Petrobart requests interest on any part of its claim which is granted by the Arbitral Tribunal. The interest should in Petrobart's opinion be based on Article 7.4.9 of the UNCITRAL Principles of International Commercial Contracts and be awarded,

- as regards unpaid deliveries, for the time from 25 December 1998 (date of the Bishkek Court's judgment),
- as regards lost profits, from 4 March 1999 (date of the extraordinary shareholders' meeting in KGM), and
- as regards outlays and expenses, from 1 September 2003 (date of the Request for Arbitration),
- in all three cases until payment is made.

The Republic considers that, if any interest is to be awarded, it should accrue at the “judgment rate” effective in the Kyrgyz Republic. Moreover, it should accrue only from 1 September 2003, because Petrobart could have brought its claims in a least two (arguably four) other forums dating back to 1999.

The Arbitral Tribunal finds Petrobart entitled to interest on that part of its claims which the Arbitral Tribunal has considered well-founded, i.e. the claim for payment for delivered goods. This claim is based on the Treaty and is therefore a claim under international law. In accordance herewith, the interest should, in the Arbitral Tribunal’s opinion, be based on international rather than national rules. The Arbitral Tribunal considers the UNCITRAL Principles of International Commercial Contracts, relied on by Petrobart, to be an appropriate basis for determining the interest.

The Arbitral Tribunal further considers that interest on the granted claim should be calculated from the date of the Bishkek Court’s judgment.

### ***10. Costs***

Both parties claim compensation for their costs. Petrobart is winning party in relation to one claim but is losing party in regard to other claims. The Arbitral Tribunal finds that, in view of the outcome of the case, each party should bear its own costs.

On 18 March 2005, the SCC Institute informed the Arbitral Tribunal that, pursuant to Article 39 of its Rules, the SCC Institute had finally decided the costs as follows:

<i>Fees</i>	
Former Justice Hans Danelius	EUR 55,066
Professor Ove Bring	EUR 33,040 and VAT
Mr. Jeroen Smets	EUR 33,040
<i>Administrative Fee</i>	
SCC Institute	EUR 15,942
<i>Expenses</i>	
Former Justice Hans Danelius	SEK 16,458
Mr. Jeroen Smets	EUR 2,426

## **THE AWARD**

1. The Arbitral Tribunal has jurisdiction to rule on the merits of the arbitration.
2. The Kyrgyz Republic shall pay to Petrobart one million one hundred thirty thousand eight hundred fifty-nine United States dollars (USD 1,130,859) with interest thereon at an annual rate to be determined in accordance with Article 7.4.9 of the UNIDROIT Principles of International Commercial Contracts as from 25 December 1998 until payment is made.
3. Petrobart’s other claims are dismissed.
4. Each party shall bear its own costs in the arbitration.
5. In accordance with the decision of the Arbitration Institute of the Stockholm Chamber of Commerce, the arbitrators and the Arbitration Institute shall be entitled to fees and compensation for expenses in the following amounts:

- (a) Hans Danelius: a fee of fifty-five thousand sixty-six EURO (€55,066) and expenses of sixteen thousand four hundred fifty-eight kronor (SEK 16,458),
- (b) Ove Bring: a fee of thirty-three thousand forty EURO (€33,040) and value-added tax of eight thousand two hundred sixty EURO (€8,260),
- (c) Jeroen Smets: a fee of thirty-three thousand forty EURO (€33,040) and expenses of two thousand four hundred twenty-six EURO (€2,426),
- (d) the Arbitration Institute of the Stockholm Chamber of Commerce: an administrative fee of fifteen thousand nine hundred forty-two EURO (€15,942).

6. In relation to the arbitrators and the Arbitration Institute, the parties shall be responsible, jointly and severally, for the payment of the amounts due to the arbitrators and the Arbitration Institute.

7. As between the parties, each party shall be responsible for one half of the amounts due in this arbitration to the arbitrators and the Arbitration Institute.

Hans Danelius

Ove Bring

Jeroen Smets