

Date of Dispatch to the Parties: January 19, 2007

**INTERNATIONAL CENTRE FOR SETTLEMENT
OF INVESTMENT DISPUTES
WASHINGTON, D.C.**

In the Proceeding Between

**PSEG GLOBAL INC. AND KONYA ILGIN ELEKTRİK ÜRETİM VE TİCARET LİMİTED ŞİRKETİ
(CLAIMANTS)**

and

**REPUBLIC OF TURKEY
(RESPONDENT)**

(ICSID Case No. ARB/02/5)

AWARD

Members of the Tribunal

Professor Francisco Orrego Vicuña
Mr. L. Yves Fortier, CC, QC
Professor Gabrielle Kaufmann-Kohler

Secretary of the Tribunal

Mr. Ucheora Onwuamaegbu

Representing the Claimants:

Carolyn B. Lamm
Abby Cohen Smutny
Francis A. Vasquez, Jr.
Lee A. Steven
White & Case LLP

Mesut Çakmak
Tuğba Bayman Keskin
Çakmak Avukatlık Bürosu

Prof. Dr. M. Fadlullah Cerrahoğlu
Cerrahoğlu Avukatlık Bürosu

John F. Doherty
PSEG Global

Representing the Respondent:

Mr. Daniel M. Price
Mr. Stanimir A. Alexandrov
Mr. Samuel B. Boxerman
Ms. Marinn F. Carlson
Ms. Jennifer Haworth McCandless
Sidley Austin LLP
Washington, DC

Judge Stephen M. Schwebel
Washington, DC

Mr. Serdar Paksoy
Paksoy & Co.
Istanbul, Turkey

Table of Contents

I. Procedure	3
A. Procedure Leading to the Decision on Jurisdiction	3
B. Procedure Leading to the Award	4
II. Considerations	6
A. The Claimants' Participation in the Development of Turkey's Energy Sector	6
B. The Commercial Terms of the Contract	8
C. The Claimants' Understanding of the Commercial Terms of the Contract	8
D. The Respondent's Understanding of the Commercial Terms of the Contract	13
E. The Benefits of a Private Law Framework under Law No. 4501	18
F. The Treasury Guarantee, Energy Sales Agreement and Fund Agreement	19
G. The Completion of Pre-Construction Development of the Project	22
H. The Tribunal's Evaluation of the Facts	22
1. <i>Was the Konya Ilgin Project Important to Turkey's Energy Sector or was it a Mere Gold Rush?</i>	22
2. <i>Did the Implementation Contract Govern the Final Terms of the Project?</i>	24
3. <i>Did MENR Accept the Cost Increase of the Revised Mine Plan?</i>	26
4. <i>For whom was the Tax Burden of the Project in Connection with the Corporate Structure?</i>	31
5. <i>Was there Agreement on the Revised Tariff Structure Resulting from Increased Costs?</i>	35
6. <i>Were the Parties Engaged in Subsequent Negotiations in Bad Faith?</i>	42
7. <i>Did the World Bank and the IMF Apply Pressure on Turkey to Terminate the Project?</i>	48
8. <i>Were the Claimants Arbitrarily Denied the Benefits of Law No. 4501?</i>	50
9. <i>Did the Respondent Interfere with the Issuance of the Treasury Guarantee and Supplementary Agreements?</i>	52
10. <i>Did the Claimants Abandon the Project?</i>	54
11. <i>Were the Technical and Economic Aspects of the Project Feasible?</i>	55
III. Considerations on Liability	58
A. Was there a Breach of Fair and Equitable Treatment?	58
1. <i>The Legal Arguments of the Parties</i>	58
2. <i>The Tribunal's Findings</i>	62
B. Was there a Breach of the Obligation to Provide Full Protection and Security?	67
C. Was there Arbitrariness or Discrimination?	67
D. Was there a Breach of Obligations Entered into with Regard to the Investment?	68
E. Was the Investment Expropriated through Measures Tantamount to Expropriation?	70
IV. Damages and Compensation	72
A. Claims	72
1. <i>The Claim for Compensation of Damages</i>	72
2. <i>Fair Market Value</i>	73
3. <i>Loss of Profits</i>	73
4. <i>Amount of Investment</i>	74
5. <i>The Respondent's Opposition to the Claim for Damages</i>	75
B. The Tribunal's Findings	78
1. <i>Fair Market Value</i>	79
2. <i>Loss of Profits</i>	80
3. <i>Compensation of Investment Expenses</i>	82
4. <i>Interest</i>	87
5. <i>Costs</i>	89
AWARD	90
ANNEX (DECISION ON JURISDICTION)	

I. Procedure

A. Procedure Leading to the Decision on Jurisdiction

1. On May 2, 2002, the International Centre for Settlement of Investment Disputes (“ICSID” or “the Centre”) registered a request for arbitration against the Republic of Turkey (“Turkey” or the “Respondent”) submitted by PSEG Global Inc. (PSEG), a company incorporated under the laws of New Jersey, United States of America (USA); the North American Coal Corporation (“North American Coal”), a company incorporated under the laws of Delaware, USA; and Konya Ilgın Elektrik Üretim ve Ticaret Limited Şirketi (the “Project Company”), described in the request for arbitration as a special purpose limited liability company incorporated under the laws of Turkey and wholly owned through several subsidiaries by PSEG (together referred to as the “Claimants”).

2. The request invoked the ICSID arbitration provisions in the Treaty between the United States of America and the Government of the Republic of Turkey Concerning the Reciprocal Encouragement and Protection of Investments (the “Treaty” or the “BIT”), which was signed on December 3, 1985, and entered into force on May 18, 1990.

3. Following the registration of the request, pursuant to the agreement of the parties on the method for constituting an arbitral tribunal, the Claimants appointed Mr. L. Yves Fortier, CC, QC, a Canadian national, as arbitrator and the Respondent appointed Professor Gabrielle Kaufmann-Kohler, a Swiss national, as arbitrator. By agreement, the parties appointed Professor Francisco Orrego Vicuña, a national of Chile, as the presiding arbitrator. All three arbitrators having accepted their appointments, the Centre by a letter of October 25, 2002, informed the parties of the constitution of the Arbitral Tribunal (the “Tribunal”). By the same letter, the Centre also informed the parties that pursuant to ICSID Arbitration Rule 6(1), the proceeding was deemed to have commenced on that day.

4. The Tribunal held its first session on January 8, 2003, at the seat of the Centre in Washington, D.C. In accordance with the agreed upon schedule, the Respondent filed

its Memorial on Jurisdiction on April 3, 2003, and the Claimants filed their Counter-Memorial on Jurisdiction on June 27, 2003. In compliance with a revised schedule, the Respondent's Reply on Jurisdiction was filed on September 10, 2003, and the Claimants' Rejoinder on Jurisdiction was filed on November 24, 2003. The hearing on jurisdiction was held at the seat of the Centre in Washington, D.C., from February 22 to 25, 2004.

5. On June 4, 2004, the Tribunal issued its Decision on Jurisdiction in which it unanimously decided that:

“(1) The dispute submitted by PSEG and Konya Ilgın Ltd. is within the jurisdiction of the Centre and the competence of the Tribunal.

(2) The dispute submitted by [North American Coal Corporation] is not within the jurisdiction of the Centre and the competence of the Tribunal.

(3) The costs of the jurisdictional phase of the arbitration are reserved.”

6. The procedure leading up to the Tribunal's Decision on Jurisdiction is set out in greater detail in the Decision, a copy of which is attached to the present Award as an integral part of it.

B. Procedure Leading to the Award

7. Having dismissed the objections to jurisdiction with respect to PSEG and Konya Ilgın Ltd., the Tribunal, pursuant to ICSID Arbitration Rule 41(4), invited the parties, by letters of June 9 and July 19, 2004, to confer and advise the Tribunal on how to fix the time limits for the remainder of the proceeding.

8. By a joint letter dated July 28, 2004, the parties informed the Tribunal that they had agreed to a schedule for written submissions and for the hearing on the merits. According to that schedule, the Claimants were to file their Memorial on the Merits by February 18, 2005; Respondent was to file its Counter-Memorial by September 19, 2005; the Claimants were to file their Reply on the Merits by November 23, 2005; and the Respondent was to file its Rejoinder by January 31, 2006 (with the understanding that the deadline for the two latter submissions could be extended). In the event that the Respondent was to file a Counterclaim, the Claimants' Surreply, if any, was to be filed by March, 20, 2006. According to that schedule, the Hearing on the Merits was set for May 1, 2006.

9. The Claimants filed their Memorial on the Merits on February 22, 2005, and the Respondent filed its Counter-Memorial on September 19, 2005. By a letter dated November 9, 2005, the parties informed the Tribunal of their agreement that the Claimants' Reply would be filed by December 9, 2005, and the Respondent's Rejoinder by March 10, 2006. The Claimants filed their Reply on December 12, 2005. The Respondent filed its Rejoinder on March 17, 2006, after having been granted a one-week extension.

10. In accordance with a revised schedule agreed upon by the parties, the hearing on the merits was held at the seat of the Centre in Washington, D.C., from April 3 to April 12, 2006. The parties were represented by their respective counsel who made presentations to the Tribunal and examined witnesses and experts from their side and the opposing side. Present at the hearing were:

Members of the Tribunal: Professor Francisco Orrego Vicuña, President, Mr. L. Yves Fortier, CC, QC and Professor Gabrielle Kaufmann-Kohler.

ICSID Secretariat: Mr. Ucheora Onwuamaegbu, Secretary of the Tribunal, Mr. Tomas Solis, ICSID Consultant.

Attending on behalf of the Claimants: as representatives Mr. Matthew J. McGrath, Vice President, Chief Operating Officer and General Counsel, *PSEG Global LLC*, Mr. Michael J. Thompson, President, *PSEG Fossil LLC*, Mr. John F. Doherty, Counsel, *PSEG Global LLC*, and Mr. Thomas A. Koza, Vice President, Law and Administration, *The North American Coal Corporation (NACC)*; as counsel, Ms. Carolyn B. Lamm, Ms. Abby Cohen Smutny, Mr. Christopher M. Curran, Mr. Francis A. Vasquez Jr., Mr. Frank Panopoulos, Ms. Anne Smith, Mr. Lee A. Steven, Ms. Muge Onal, Ms. M. Megan Smith, Mr. Matthew S. Leddicotte, Mr. Daniel Gilbert, and Ms. Katherine Southwick;

Attending on behalf of the Respondent: as representatives, Mr. Sami Demirbilek, Undersecretary, *Ministry of Energy and Natural Resources*, Mr. Selahattin Çimen, Deputy Undersecretary, *Ministry of Energy and Natural Resources*, Ms. Sevim Argun, Chief Legal Advisor, *Ministry of Energy and Natural Resources*, Mr. Budak Dilli, General Manager, *Ministry of Energy and Natural Resources*, Mr. Osman Emed, Deputy General Director, *General Directorate of Foreign Investment, Undersecretariat of the Treasury*, Mr. Mustafa Boran, Acting Deputy General Director, *General Directorate of Foreign Economic Relations, Undersecretariat of the Treasury*, Mr. Murat Lutem, *Embassy of the Republic of Turkey*, and Mr. Mehmet Çağıl, *Embassy of the Republic of Turkey*; as counsel, Mr. Daniel M. Price, Mr. Stanimir A. Alexandrov, Mr. Samuel B. Boxerman, Mr. P. David Richardson, Ms. Marinn F. Carlson, Ms. Jennifer Haworth McCandless, Ms. Sharon H. Yuan, Ms. Dara Levinson, Mr. Gus Kryder, Ms. Vilma Belen-Pettorino, Ms. Rhonda Diggins, Mr. Serdar Paksoy, Ms. Değer Boden, and Mr. Zeynel Tunç.

11. As agreed with the Tribunal, the parties filed submissions after the hearing on the merits. Also, following the hearing on the merits, the members of the Tribunal deliberated by various means of communication, including a meeting in Washington, D.C., on September 11 and 12, 2006.

12. The Tribunal considers it unnecessary to describe the numerous procedural issues that it was called upon to resolve, or to recount the parties' many submissions, requests and applications relating to these issues. Suffice it to say that the Tribunal was required to consider and determine a myriad of questions relating to the production of documents, time limits as well as issues concerning witnesses and experts.

II. Considerations

A. The Claimants' Participation in the Development of Turkey's Energy Sector

13. As a result of the growing demand for electricity that Turkey experienced in the 1980's, the Government undertook measures to privatize the energy sector, including the participation of foreign investors therein under the model of Build-Operate-Transfer ("BOT") projects. The Claimants in this case were specifically interested in the generation of electricity in connection with coal reserves in the Konya Ilgın area of the Central Anatolian region. The Decision on Jurisdiction of June 4, 2004, provides a detailed explanation of this policy and the governing laws, as well as of the essential elements of the relationship between the parties. These elements shall only be repeated in this Award to the extent necessary for consideration of the parties' arguments on the merits.

14. The contractual arrangements for the organization of the BOT projects proved to be difficult to conclude as there were shifting policies and models that came into play. These difficulties had a very specific impact on the present dispute. In 1984, Law No. 3096 had envisaged that there would be concession contracts governed by Turkish administrative law, subject to the approval and review of the Turkish Council of State (the "Danıştay"). The use of such a model, however, would have made the international financing of projects and the consent to international arbitration of any dispute problematic. Therefore, Law No. 3996, enacted in 1994, introduced in its Article 5 the possibility of concluding implementation contracts governed by private law.

15. Two years later, however, Turkey's Constitutional Court invalidated Article 5 of Law No. 3996 because, in its view, BOT projects constituted a public service that had to be organized under a concession contract subject to Turkish administrative law. Yet another change was introduced on January 22, 2000, with the enactment of Law No. 4501, which allowed parties to existing concession contracts to convert these instruments to private law contracts and submit disputes to domestic or international arbitration.

16. Another legal difficulty that had a specific impact on the present dispute was one related to the corporate structure of the Claimants' investment in the Konya Ilgin BOT project. A Turkish joint stock company was first considered as the corporate vehicle for the investment. However, as a consequence of the changes in the law outlined above, which had various tax implications, PSEG later proposed that the corporate structure should be a Turkish Branch Office of a Dutch company that had been incorporated to channel the investment. The Project Company was thus organized in accordance with the latter option.

17. This alternative did not find favour with the Turkish Government and ultimately the Project Company was incorporated in Turkey as a limited liability company, one of the Claimants in this case. These various corporate structures had different tax implications that had an impact on the Claimants' expected return on their investment. They also had implications in respect of the tariff that had to be agreed for the sale of electricity.¹ As further discussed below, this proved to be a key element of the dispute presently before the Tribunal.

18. PSEG Global applied to the Ministry of Energy and Natural Resources ("MENR") in 1994 to build a lignite-fired thermal power plant in the area of Konya Ilgin. Authorization was granted that same year to prepare a Feasibility Study which was submitted in early 1995. The Feasibility Study was approved by MENR on November 29, 1995. This was the first of the various documents that later became central to the present dispute.

19. This Feasibility Study proposed a power plant with a net output of 375 megawatts (MW) of electric power and an average unescalated tariff of US\$4.98 cents/kwh over a period of 38 years, with an average plant availability of 85%. This

¹ Expert Report of Mr. Faruk Sabuncu, March 15, 2006, paras. 9–40.

last figure also turned out to be a crucial element of the dispute. Pre-construction costs were estimated to be in excess of US\$10.5 million, including engineering and consultant studies, development costs and legal fees. In addition, the Feasibility Study set out in detail the benefits the project would bring to the Turkish economy by increasing the availability of electricity.

20. The next step in the preparation of the project was the negotiation of the Implementation Contract, which was concluded and initialed on August 9, 1996. At this point, because of the ruling of the Constitutional Court noted above, the contract could no longer be governed by private law as originally envisaged. It was accordingly submitted for approval of the Danıştay as a concession contract under Turkish administrative law. Before giving its approval, the Danıştay requested from PSEG a Letter of Undertaking to MENR that the company would abide by the terms of the Implementation Contract until the Concession Contract was executed.

21. The Danıştay approved the Concession Contract on March 30, 1998. The Project Company signed the Concession Contract on December 10, 1998 and MENR on March 8, 1999, which thus became the date of execution. Intense negotiations and discussions between the parties during this period account for this rather lengthy process of execution. A performance bond for US\$8.04 million was posted by the Project Company on February 23, 1999.

B. The Commercial Terms of the Contract

22. One of the important issues debated between the parties concerns the commercial terms of the Contract. The Tribunal will now set out the facts as submitted by each Party.

C. The Claimants' Understanding of the Commercial Terms of the Contract

23. According to the Claimants, the essential commercial terms of the Concession Contract were the same as those envisaged by the Implementation Contract. This, in the Claimants' view, was further confirmed by the fact that PSEG was required by the Danıştay to submit the Letter of Undertaking mentioned above reaffirming its commitment to those terms.

24. Those terms provided for a total installed capacity of 425 MW gross/375 MW net, an average availability factor of 85.08% and an average unescalated tariff of 4.98 cent/kWh. The Project envisaged 38 years of commercial operation and a total investment cost of US\$804.8 million. In addition, the Implementation Contract required the Project Company to conclude several agreements and protocols, including most importantly the Energy Sales Agreement, the Fund Agreement and the Treasury guarantee ICSID arbitration was also provided for.

25. One clause which is also at the heart of this dispute is Article 5.1 of the Implementation Contract. This provision authorized the Project Company to conduct further studies at the mine site and, as a result of such studies, to prepare a Revised Mine Plan. The Project Company would then submit to MENR a revision of the tariff structure to cover any increase in the Project's fuel production costs that may have resulted from the Revised Mine Plan. The Claimants stress that under this provision, MENR "shall approve such revised energy tariff if it reasonably incorporates the Company's increased fuel production cost and results in a reasonable cost of energy and capacity based on the Facility's cost of production."

26. During the review and approval of the Concession Contract by the Danıştay, Article 5.1 of the Implementation Contract became Article 8 of the Concession Contract. However, as noted in the Decision on Jurisdiction, the new provision, while maintaining the authorization to prepare a Revised Mine Plan, introduced amendments to the language concerning the eventual revision of the tariff. Article 8, paragraph 3, provides as follows:

If such revised mine plan increases the Company's estimated fuel production cost, the Company shall submit to the Ministry a revised tariff reflecting such cost increase, which the Ministry shall approve or disapprove in no later than sixty days after the submission by the Company. In the event the Ministry withholds its approval for the revised tariff on the basis of reasonable grounds and if the Company abandons the project prior to the construction start date, the Company and the Ministry shall have no claims against the other.

27. In the Claimants' submission, Article 5.1 of the Implementation Contract meant that unless the cost of fuel production proved to be unreasonably high in light of the Revised Mine Plan, the agreement to develop the power plant and the mine would be binding on the parties.

28. The Claimants explain that on the basis of technical studies conducted at the mine site and the evaluation done by North American Coal, which later became one of the Project sponsors, the cost per ton of lignite would be US\$31.05, a figure which was within the range accepted by the Turkish Coal Enterprise in other mines in Turkey.

29. The Revised Mine Plan was submitted to MENR on December 3, 1997, together with a revised tariff proposal resulting from the increased cost of fuel. Investment cost, would also need to be increased by US\$361.6 million which, according to the Claimants' explanation, could be accommodated through the tariff structure "either by raising the energy tariff rate, or by increasing plant output, or by adjusting both variables."²

30. The Claimants also aver that, because the Project needed to service debt in a period shorter than the term of the energy project, the different tariff structures proposed to MENR had to be "front-end loaded." Those structures envisaged a tariff rate that was higher for the first 12 years and thereafter declined significantly. MENR had insisted on an overall average tariff of 4.98 cents/kWh for the 38-year term of the Project. In addition, the Project Company had to ensure a return on equity that was satisfactory both to international lenders and the investors. The long-term Energy Sales Agreement, the Fund Agreement and the Treasury guarantee were also key factors in ensuring the economic viability of the Project.

31. The Revised Mine Plan was formally approved by MENR on June 19, 1998 (the "Ministerial Approval"), following the favorable opinion of the Turkish Coal Enterprise issued on May 4, 1998. The Tribunal notes at this stage the significance of these dates in the context of the present dispute, as it evolved.

32. The first tariff proposal was made in conjunction with the presentation of the Revised Mine Plan in December 1997. In order to meet the increased costs, it was at this point proposed to build a power plant of 500 MW gross and a net dependable capacity for sale to TEAS of 433.5 MW. In this proposal, the average availability factor was 87% (increased from 85% in the Feasibility Study), while the average tariff was kept at 4.98 cents/kWh as required by MENR.

33. The Claimants also state that in February 1998 MENR requested that the Project Company submit a cash flow table for the December 1997 proposal. This was done on

² Claimants' Memorial, para. 37.

the basis that the Project Company would operate as the Turkish Branch Office of the Dutch investment company incorporated by PSEG for this purpose (Konya Ilgın Electric Production B.V.), which was the structure then in place. In a proposal made on February 10, 1998, using this corporate structure, the Claimants submitted a tariff table to accommodate the increased costs that maintained the plant capacity at 425 MW gross/375 MW net, but raised the average selling price per kWh.

34. The Claimants explain that at that point MENR demanded that the Project Company be incorporated as a Turkish limited liability company. The Claimants add that such a change would increase the tax burden by approximately US\$256 million during the life of the Project which had to be compensated with an adjustment of the tariff. Three new proposals were made by the Project Company on February 13, 1998, accounting for both the increased costs reflected in the Revised Mine Plan and the additional tax burden. As will be noted below, the Respondent denies that it agreed that the higher tax costs could be absorbed by means of the revised tariff structure, as argued by the Claimants.

35. In the Decision on Jurisdiction, the Tribunal noted that these proposals ranged from 433 MW gross/375 MW net to 500 MW gross/433.5 MW net; from an average availability factor of 85% to 87%; and all involved an increase in the average tariff from 4.98 cents/kWh: to 5.71, 5.23 and 6.34, respectively. Meetings to discuss these various alternatives were held on February 19, 1998, and May 15, 1998. The Tribunal notes that the parties have very different recollections about what was or was not agreed during these meetings. In fact, these disagreements later became irreconcilable.

36. The Claimants further explain that after the meeting of May 15, 1998, a new proposal was made on the basis of a 465 MW net capacity, an average availability factor of 87% and an unchanged tariff of 4.98 cents/kWh. According to the Claimants, they presented this proposal to Respondent at a meeting on May 18, 1998. They then informed the Respondent that with a 465 MW net capacity the gross capacity would have to exceed 500 MW. The Respondent denies that such meeting ever took place. However, according to the Claimants, this proposal was accepted by the Respondent and further confirmed by them in a letter delivered the same day. A draft amendment protocol to the Concession Contract, reflecting the new tariff structure, was prepared by the Project Company on June 12, 1998. The Claimants assert that additional confirmations were obtained at a meeting held on June 16, 1998.

37. The crucial element of the dispute turns on the Ministerial Approval of the Project on June 19, 1998, which provided that “in order to ensure that the average sale tariff of 4,98c/kWh shall remain unchanged...the installed capacity of 425 MW shall be increased to 500 MW, the amount of electricity generation shall also be increased and the cost increases arising from such additional investments shall also be financed.” The Tribunal notes that the Approval did not refer specifically to any net capacity. The Claimants concluded that the Approval implicitly referred to and accepted the 465 MW net capacity envisaged in the May 18, 1998 proposal. This was not the Respondent’s understanding, as will be explained later. It believed that the approved structure was the one discussed in February 1998.

38. The Project Company followed-up this Ministerial Approval with a new draft amendment protocol on June 25, 1998, which included its understanding about a 465 MW net capacity and a total investment cost of US\$1,166.4 million. After the Concession Contract entered into force on March 8, 1999, the parties scheduled a meeting for March 24, 1999, in order to finalize the written amendments to the Concession Contract. As explained in the Decision on Jurisdiction, the parties had different understandings and explanations on why the 465 MW net figure was set out in the draft amendment protocol prepared by MENR.

39. The Claimants believe that by that time the Government of Turkey had begun to have second thoughts about the desirability of BOT projects in light of a difficult domestic economic situation and alleged pressure from the World Bank and the International Monetary Fund to liberalize the energy market as a condition for much needed financial support.

40. The Claimants explain that, as a result, BOT projects under negotiation were delayed and ultimately abandoned, just as Treasury guarantees were discontinued. Although the Government approved a list of eligible BOT projects in May 2000, Konya Ilgin was not included; its inclusion at a later date did nothing to change the end result as none of the projects ultimately materialized.

41. The Claimants also allege that Article 8(1) of the Electricity Market Law No. 4268, enacted on February 20, 2001, eliminated the Treasury guarantees and that the law further restricted energy sales agreements with TEAS to terms not exceeding one year, as opposed to the previous practice of being in effect for the whole duration of the

project. The Electrical Energy Fund was also abolished by Law No. 4684 and projects not having yet executed a fund agreement no longer qualified for this benefit.

42. In the Claimants' view, this background explains why MENR changed its position in May 1999. MENR now took the position that it had never approved a 465 MW net capacity, either on May 18, 1998, or in the Ministerial Approval of June 19, 1998. On May 6, 1999, a MENR official observed that the revised tariff table submitted was not the same as that accompanying the Revised Mine Plan in 1997 and later expressly stated that such figures had never been approved.

43. After additional exchanges, the Claimants aver that, on October 26, 1999, they accepted what they understood to be MENR's position at the time, namely a 500 MW gross/433.5 MW net plant. This alternative they allege had again become viable as a result of the fact that the adverse tax consequences arising from the limited liability company structure had been neutralized by further changes in the law. The Tribunal also notes at this point that this tax issue, including the content of the letter of October 26, 1999, has become relevant in the context of the present dispute.

44. The Claimants submit that MENR then required that the same availability factor indicated in the Feasibility Study (85%) be used by the Project Company with its 500/433.5 MW proposal, in spite of the fact that every single proposal made to accommodate the Revised Mine Plan had been based on an availability factor higher than that of the Feasibility Study. The Claimants believe that the figure of 85% did not allow for the generation of an amount of electricity sufficient to make the Project viable. They also state that this figure had already been changed to 87% in the February 1998 proposal and that the Ministry had accepted it. Additional discussions did not lead to an agreement, not even in the terms of another proposal made by the Project Company on February 10, 2000, which was described as the "final possible situation of what can be done with the project economics." The Tribunal notes that a dead end was reached at this point.

D. The Respondent's Understanding of the Commercial Terms of the Contract

45. The Respondent alleges that all difficulties that have characterized the implementation of the Concession Contract stem from the fact that the Claimants badly

underestimated the costs and risks of the Project, as reflected in particular in the Revised Mine Plan. As a result, there was no agreement about the renegotiation of the commercial terms envisaged in the Contract. Many efforts directed at securing an amendment to the Concession Contract to accommodate the increased costs did not bear fruit and no new terms or amendments were ever approved by the Danıştay.

46. The Respondent also explains that the BOT model envisaged at the time under Turkish legislation involved a complex process of negotiation, financing and execution of many different contracts, obtaining of permits and financing. Very often, Respondent says, applicants never reached a financial closure.

47. According to the Government of Turkey, and contrary to the Claimants' position, the country was not facing imminent electricity shortages and there was no need to develop electricity generating capacity to serve a particular region as the interconnected grid was continuously expanding and had an efficient transmission system. This issue was different from that of the distribution of electricity by means of local infrastructure, to which the Project would not have added anything as it was only conceived to contribute electricity to the national grid.

48. The Respondent asserts that at the time the Claimants applied for a BOT project in April 1994, Turkish legislation required that contracts to generate and supply electricity had to be in the form of a concession contract issued by the Danıştay. Shortly after, in June 1994, Law No. 3996 mandated the form of a private law contract for such projects. However, one year later, in June 1995, the Turkish Constitutional Court held such a provision to be unconstitutional. The Respondent submits that the Claimants knew well that unless the Constitution was amended the contract for this project had to be reviewed and approved by the Danıştay. The Government did nothing to encourage the Claimants' proposal and this responded only to the Claimants' search for business opportunities the world over.

49. The Feasibility Study submitted by the Claimants proposed to build and operate a 425 MW gross capacity power plant with two units of 212.5 MW each using circulating fluidized bed technology ("CFB") with an internal load of 50 MW that would supply 375 MW net. According to Respondent, there was no 425 MW CFB plant yet in commercial operation.

50. The first tariff proposal made by PSEG envisaged an unescalated average price of 5.20 cents/kWh, with an annual availability factor of 81% and a total investment of US\$920.7 million. This tariff was based on the assumption that the Project Company would be a Turkish capital company. After initial negotiations, the tariff that accompanied the Feasibility Study arrived at the figures set out above: 4.98 cents/kWh, 85.08% availability, and an US\$804.8 million investment. The Respondent's submission is that the approval of the Feasibility Study issued by MENR on November 29, 1995, only authorized the Parties to proceed to negotiate a contract based on the amended commercial terms.

51. The Respondent adds that shortly thereafter the negotiations became very difficult when PSEG requested that the Project Company be structured as a branch office of a foreign company. This type of structure, unknown to MENR, would have resulted in a US\$250 million windfall for the Company at the expense of the Turkish Republic. Furthermore, PSEG demanded the inclusion in the contract of an international arbitration clause, knowing that this could not be accepted by the Danıştay in the context of a concession contract. More importantly, additional mine studies would have to be conducted by Claimants because the Feasibility Study had been based on scant information. Article 5.1 of the Implementation Contract was intended precisely to take into account the increased costs that could result from the new studies.

52. The Respondent indicates that Article 5.1 left little or no discretion to the Government with respect to the approval of the tariff resulting from increased costs. Therefore, the Danıştay decided to replace this provision with Article 8 of the Concession Contract which gave MENR discretion to reject the proposed tariff on reasonable grounds.³ The Project Company was required to be structured as a Turkish capital company, as PSEG had originally proposed.

53. The Revised Mine Plan reflected the drastic increase in costs and risks of the Project. According to the Respondent, the mining costs alone would have increased by more than US\$1 billion because the mine would have to be much deeper, enormous amounts of non-coal material would have to be removed, dewatering would have to be intense and the soil stability would require flattening the mine slopes, among many other geological and operating problems. The cost per ton of coal mined would have increased from US\$21.5/metric ton to more than US\$31/metric ton.

³ Affidavit of Judge Harun Çetintemel, September 9, 2006, paras. 9–12.

54. Because of the conclusions of the Revised Mine Plan, the Respondent submits that the terms of the draft Concession Contract then before the Danıştay were no longer feasible and the Claimants, it says, have never offered to implement the commercial terms that were ultimately approved by that body. The Respondent also states that since these fundamental changes were not reasonable, MENR was not under any obligation to approve the resulting revised tariff structure. In any event, any change had to be reviewed and approved by the Danıştay. This was never done.

55. Despite the cost increase, MENR continued the negotiations and tried to come to an agreement with PSEG on new terms. After consideration of various tariff proposals, including those discussed in February 1998, the Respondent submits that the parties had agreed at that point a tariff structured on a 500 MW gross/433.5 MW net, as proposed in the Revised Mine Plan.⁴ The Respondent also alleges that it was under no obligation to compensate PSEG for the costs it incurred as a result of changes to the corporate structure of the Project Company from a foreign branch office to a Turkish capital company, on which it had insisted. Respondent points out that PSEG had not changed the tariff when the foreign branch office option was adopted and enormous tax savings had ensued.

56. The crucial divergence of position in this case, as noted earlier, arises from the fact that, according to Respondent, the June 19, 1998 approval was based on the February agreement. The Respondent submits that nothing different was agreed to in the alleged May 18, 1998 meeting, of which MENR has no official record. Even assuming that the meeting did take place, Respondent pleads that the officials allegedly involved had no authority to agree to such a fundamental change in the commercial terms of the Project. Moreover, the Respondent explains that a 500 MW gross/465 MW net tariff structure was not feasible as that net can only be supported by a 545 MW gross which PSEG itself had acknowledged.

57. The Respondent also explains that the June 19, 1998 Ministerial Approval was only an internal authorization to proceed with the negotiations. No amendment to the Concession Contract could be decided without the review and approval of the Danıştay. The parties, however, never agreed to such an amendment. Neither were there any underlying promises made by MENR, as the Claimants now assert, that led to their

⁴ Testimony of Mr. Ahmet Oktay Kavas, April 10, 2006, Hearing transcripts, Vol. 8, at 1960–61, 2014.

signature of the Concession Contract. The various proposals considered between March 1999 and March 2000 entailed commercial terms that were not acceptable to MENR.

58. The Respondent explains that, in fact, the Claimants' proposed tariff structure would have placed an unacceptable financial burden on Turkey, as much as US\$15.6 billion over the life of the Project. Moreover, the real rate of return expected by the Claimants was over 20% and not the 15.4% that was mentioned in every proposal.

59. Various other proposals were considered in June 1999, but MENR believes that all of them would have shifted cost increases to the public and were thus not acceptable. The October 26, 1999 proposal was based on the 500 MW gross/433.5 net structure the parties had agreed upon in February 1998. It used an availability factor of 87% instead of the 85% of the Feasibility Study which, in the Respondent's submission, had not been changed and thus made the proposal unacceptable. As noted above, the Claimants believed that the February 1998 structure had included the 87% availability factor.

60. The Respondent complains that the October 26, 1999 proposal also took into account the need to compensate the Project Company through the tariff for the corporate change to a limited liability company and the resulting additional tax burden of US\$256 million at a time when the Claimants knew the tax law had changed again and the heavier burden had, in fact, been offset. According to the Respondent, this was never disclosed to MENR and hence a higher tariff was sought for a tax burden that no longer existed.

61. Neither was the February 10, 2000 proposal acceptable to MENR because, although lowering the average availability factor to 82.70%, a much higher availability factor would have been used during the first twelve years of commercial operation of the Project. This envisaged solution thus also failed to lead to an agreement.

62. The Respondent believes that MENR acted at all times within the discretionary authority granted by Article 8 of the Concession Contract as it was under no obligation to accept commercial terms proposed by the Claimants that were, in its sole judgment, disadvantageous to the Turkish Republic and its consumers. The grounds on which the various tariff proposals were rejected were "reasonable" from the Ministry's perspective, even if the Claimants did not agree.

E. The Benefits of a Private Law Framework under Law No. 4501

63. The parties have also made extensive submissions to the Tribunal in respect of the parallel issue of the benefits provided by Law No. 4501 enacted in January 2000 in order to implement a prior constitutional amendment allowing once again a private law regime for concession contracts. Under this law, a BOT project company with an executed concession contract had the right to apply to conclude an arbitration agreement or, alternatively, to convert its contract into a private law contract which also allowed for arbitration, with a view to facilitating international financing of such projects. The Claimants applied for the benefits of this law within the deadline of February 22, 2000 by first requesting the conversion of the Concession Contract and immediately after, in the alternative, requesting the inclusion in the Contract of an international arbitration clause.

64. The Claimants submit that MENR demanded terms and conditions that were not within its authority under this law. These terms and conditions concerned, in particular, the requirement to revise the procedure for determining the escalation of the price set out in the tariff, the requirement to pass on to Turkey cost savings realized in financing the Project by lowering the energy tariff, the requirement to lower the tariff in the early years of the Project, the requirement to agree to comply with any future changes in Turkish law, the requirement to commit to reach financial closure of the Project within a fixed period of time and the requirement to bear the risk of unforeseeable geological conditions.

65. According to the Claimants, all of these terms and conditions fundamentally changed the equilibrium of the Project and, except for certain amendments that the Claimants were willing to accommodate, the end result was unacceptable. The Claimants also submit that such requests interfered with and threatened their ongoing negotiations to secure international financing for the Project. The Claimants further explain that MENR, notwithstanding its obligation, refused to forward the application to the Council of Ministers.

66. The Respondent, on the other hand, answers that, according to the law, MENR was not expected merely to transmit PSEG's request to the Council of Ministers and that PSEG did not have an automatic right to convert the Concession Contract. MENR

acted within its authority in requesting that all project sponsors share with the Ministry the advantages the project would receive under the new law.

67. The Respondent adds that the terms MENR defined were addressed to all project sponsors who were all treated alike. In rejecting such terms, PSEG would have benefited unfairly from the improved loan conditions resulting from the conversion or would have imposed risks on the Ministry that were not justified. Neither, it says, could there have been any interference with international financing, since the process, according to Turkey, had not even begun.

F. The Treasury Guarantee, Energy Sales Agreement and Fund Agreement

68. The parties also have different views with respect to the facts and issues pertaining to the Treasury guarantee, the long-term Energy Sales Agreement and the Fund Agreement. All these additional contracts were contemplated by Articles 15 and 20 as well as Annexes 2 and 3 of the Concession Contract as key elements of the commercial terms of the Project.

69. The Claimants submit that the Electricity Market Law (Law No. 4628), enacted on March 3, 2001, had the effect of cancelling the Project Company's contract rights to a Treasury guarantee and to the long-term Energy Sales Agreement, just as Law No. 4684, in July 2001, cancelled their rights to the Electrical Energy Fund and all Fund Agreements related thereto.

70. In February 2002, the Constitutional Court invalidated Article 8(1) of the Electricity Market Law that had cancelled the right to a Treasury guarantee for all but 29 BOT projects, since such guarantees were part of the concession contracts concluded. Konya Ilgin was not one of the 29 projects. MENR requested a clarification from the Treasury and asked if it could begin to honor the contractual provisions for those guarantees in respect of a list of 30 BOT projects that had signed concession contracts; this time, the list included the Konya Ilgin Project. The Claimants allege that no action was taken because the Respondent was, at that time, pressured by the World Bank to change its policies in respect of such Treasury Guarantee.

71. The Respondent answers that there were never any external pressures affecting the conduct of negotiations in respect of concession contracts and that, in fact, the dispute in this case originated in late 1997 when the Revised Mine Plan was submitted.

This, says Turkey, was much earlier than the discussions that took place later with the World Bank and the IMF. The Respondent adds that the Government repeatedly issued instructions to various ministries to proceed with the negotiations of the supplementary agreements needed. It refers, in this connection, to a letter from the General Secretariat for the President to MENR dated May 13, 1999.⁵

72. The Respondent submits that, in fact, the Project never reached the stage where it could have received a Treasury guarantee. The Treasury, says Respondent, can only evaluate the financial risks of a project once the contracts and approvals, including financing, are completed. With such a Guarantee, the Treasury guarantees in particular that the payments for energy sales are made in the terms of an Energy Sales Agreement. It also guarantees payments under a Fund Agreement. None of these agreements had been concluded in the present case nor was there an agreement on the commercial terms of the Project. Many other agreements relating to insurance, contractors, loans, investment authorization, mining, plant performance and other matters had not been concluded either.

73. It follows, in the Respondent's view, that this benefit was never denied. In fact, the Respondent asserts, PSEG never applied for the guarantee. In any event, the Respondent asserts that there is no "right" to such a guarantee as the Government has full discretion to decide whether or not to issue it. This discretion was not fettered by the Concession Contract or the decision of the Constitutional Court. Respondent also explained that the limits the Government placed on Treasury guarantees for BOT projects were only introduced in May and June 2000, and that the Electricity Market Law was passed in March 2001, after the Project had failed since PSEG had abandoned it in early 2001.

74. The Claimants also allege that some of the amendments introduced by the Danıştay in respect of the Implementation Contract, particularly the elimination of the arbitration clause and the change of risk allocation concerning geological conditions of the mine, had negative implications since it made the financing of the Project more difficult to obtain. The Project Company, as recommended by MENR, worked diligently with TEAS and the Electrical Energy Fund in order to incorporate the

⁵ Letter from General Secretary for the President to the Ministry of Energy and Natural Resources, May 13, 1999, Exhibit 74 to Respondent's Counter-memorial on the Merits, R 6690-91; and discussion in Respondent's Counter-memorial, para. 170, n. 320.

necessary safeguards for debt financing into the Energy Sales Agreement and the Fund Agreement.

75. These safeguards included, among others, broadening the scope of what constituted a force majeure and reinstating the arbitration clause. As a result, the draft agreements which followed had corrected many of these problems, including provision for ICSID arbitration. It is on this basis that the Project Company signed the Contract in December 1998. Soon thereafter the groundbreaking ceremony took place with the participation of Turkish dignitaries and U.S. officials.

76. According to the Claimants, all that remained in late 1999 to finalize these supplementary agreements was the incorporation of the revised tariff structure; as explained earlier, there was an ongoing process. Yet, the Claimants submit that, as a result of policy changes within the Turkish Government, TEAS and the EEF were not authorized to include the revised tariff figures which, they maintain, had been approved on June 19, 1998. In the end, the relevant agencies would not sign these agreements without the written approval of MENR, which was never granted.

77. The Respondent's view of these agreements is very different. Negotiations between TEAS and the Company they say were carried out in good faith for many months and a number of matters were settled, but the Claimants never concluded the negotiations. Among the various unresolved issues was the dispute settlement provision. TEAS could not insert in the Sales Agreement a mechanism which was different from that found in the Concession Contract; there could be no reference to ICSID arbitration in the drafts if such a clause was not included in the Contract.⁶

78. According to the Respondent, the situation was similar with respect to the Fund Agreement, which was never finalized. There were many unresolved issues when the Claimants abandoned the process. Prominent among these issues was the fact that the Agreement could not include a risk allocation clause found in private law contracts which the Claimants demanded, unless it was also included in the Contract. Furthermore, as noted earlier, there could not be any ICSID clause.

⁶ Affidavit of Mr. Abdulkadir Demirci, September 13, 2005, para. 11; Affidavit of Ms. Serpil Serdar, September 14, 2005, para. 13.

G. The Completion of Pre-Construction Development of the Project

79. A last factual question at issue between the Parties concerns the stage of development that the Project had reached when the process came to a standstill. In the Claimants' submission, the financial close of the Project after seven years of efforts was imminent. Construction was ready to commence. A lengthy list of authorizations, permits and contracts was included in the Claimants' pleadings to demonstrate that the Project was on the verge of financial close when the Respondent changed course and, without prior notice, decided to terminate the Contract.

80. The Respondent, on the other hand, alleges that the Government had enabled the conclusion of numerous authorizations and permits required to allow the Project to go forward. The Respondent submitted a list detailing the steps which it had taken. However, the Respondent concludes that by January 2000 the Project was no longer feasible as a consequence of the increase in diesel fuel costs, the unproven CFB technology offered and other factors. As a result, the Claimants were a long way from obtaining international financing. Numerous risks remained unmitigated, such as shareholders arrangements, fuel supply questions, technology and the absence of an arbitration clause.

H. The Tribunal's Evaluation of the Facts

81. The Tribunal is grateful to the parties' counsel who provided detailed explanation of the facts, together with a myriad of documents and the statements of numerous witnesses and opinions of learned experts. The Tribunal will now undertake the difficult task of considering and weighing these statements and opinions, as well as the evidence of the many witnesses in order to reach its own conclusions with respect to the facts of the case in terms of the rights and obligations of the parties.

1. Was the Konya Ilgın Project Important to Turkey's Energy Sector or was it a Mere Gold Rush?

82. The explanations given by the parties are based on totally different assumptions concerning the significance of this Project. For the Claimants, this Project was crucial

for the development of Turkey's energy sector in light of both a growing demand and the need to diversify the energy fuel sources. For the Respondent, this Project was simply part of a gold rush type of U.S. domestic power companies looking for new investment opportunities around the world. These different perspectives have, of course, a real impact on the way each party explains today the developments that took place in this case.

83. The Tribunal has no difficulty in concluding that Turkey was, in fact, faced with a growing need for electricity at that time in direct relationship with the expansion of its economy and industrial output. There is no doubt either about the fact that the BOT program was conceived to meet such needs in the medium and long-term. The Claimants recall in this respect that the very approval of the Konya Ilgın Project by the State Planning Organization in 1996 was expressly related to the need to "meet the increasing electricity demand of our country in a reliable manner."⁷

84. For the Tribunal, the question whether the location of the power plant in Central Anatolia was crucial for this development, as Claimants maintain, or whether it was just another input into an efficient national grid system, as the Respondent asserts,⁸ is not a significant factor for the interpretation of the rights and obligations of the parties pursuant to their contractual arrangements. The location of the power plant has, of course, an incidence on the costs of the project having regard in particular to the losses of electricity transmission for long distances. However, it does not change the commitments that the parties did or did not undertake in respect of the Project in the negotiation and execution of the Concession Contract and related instruments.

85. It is therefore easy for the Tribunal to conclude that both parties undertook negotiations with a genuine interest in attaining a result conducive to the fulfillment of their respective expectations. Only this common interest can explain the many authorizations, approvals, proposals, meetings and discussions that continuously took place over many years in order to complete preparations for the Project, both legally and technically. Yet, it is also a fact that these efforts failed. The Tribunal must accordingly examine why this happened and who and to what extent was responsible for this failure.

⁷ Letter from the Undersecretariat of the State Planning Organization to the Ministry of Energy and Natural Resources, April 12, 1996, Exhibit C141 to Claimants' Memorial; *see also* discussion in Claimants' Reply, para. 50, n. 88.

⁸ Affidavit of Mr. Budak Dilli, September 14, 2005, para. 4.

2. Did the Implementation Contract Govern the Final Terms of the Project?

86. The Claimants argue that the Implementation Contract represented a fully formed understanding between the parties and that this instrument, as the Protocol to the Implementation Contract recites, had been “negotiated, exchanged, and agreed upon as the final form.”⁹ It follows, in the Claimants’ view, that the subsequent Danıştay review process was not meant to allow a rewrite of the commercial and technical terms of the Implementation Contract but simply to ensure its legal sufficiency and validity, a process which the Claimants characterize as an “imprimatur.”

87. The Claimants assert that the Danıştay review was only made necessary because of changes in the law concerning the legal status of BOT projects that resulted from the Constitutional Court decision of June 28, 1995, that invalidated private law contracts. The Implementation Contract had been negotiated under a private law framework. Because the Constitutional Court decision came into effect in March 1996, the Contract, completed in August 1996, could only be implemented under the new framework of concession contracts approved by the Danıştay.

88. The Project, however, was only one. According to the Claimants, this explains why the Respondent directed and encouraged many of the technical services of the Turkish Government, including TEAS, the Electrical Energy Fund and the Treasury, to implement the Project as defined in the Implementation Contract while the Danıştay undertook its process of review. The Claimants invoke in support of their view many instances where MENR referred to the draft Contract agreed by the Parties including the June 19, 1998 Ministerial Approval.

89. The Respondent does not deny that the Implementation Contract represented the negotiated terms the parties had reached at the time, but argues that such terms had not finalized the key issue of the tariff structure as evidenced by Article 5.1 of the Implementation Contract and subsequently by Article 8 of the Concession Contract. The Respondent argues that this was the important issue which was never resolved as a result of the Revised Mine Plan and that, in any event, as noted above, an agreement on the commercial terms of the Project had to be approved by the Danıştay.

⁹ Protocol to Implementation Contract, August 9, 1996; and discussion in Claimants’ Reply, para. 64, n. 123.

90. The Implementation Contract was undoubtedly an important milestone in the process of completion of the Project and its terms were clearly agreed by the parties. The Claimants' explanations to this effect are convincing and supported by both the text of the Implementation Contract itself and the Letter of Undertaking of November 27, 1996 which PSEG was requested to provide while the Danıştay proceeded with the review. In fact, the Project Company declared in this letter that it "shall be unconditionally bound by the presently existing terms of the Contract."¹⁰ It also specified very clearly that the Project Company would be entitled to refuse to sign the Concession Contract if it incorporated provisions materially different from the Implementation Contract which could impede international financing.

91. However, in the view of the Tribunal, there are two important elements which weaken the Claimants' interpretation of the Implementation Contract. Firstly, although the Implementation Contract contained the agreed commercial terms and corresponding tariff structure, this matter was not considered closed as the parties agreed on a possible adjustment in light of the pending Revised Mine Plan. Article 5.1 of the Implementation Contract so provides unequivocally, as did subsequently Article 8 of the Concession Contract.

92. Thus, the commercial terms of the Project could not be considered final. Otherwise, the Claimants would have been bound by the commercial terms originally envisaged by the Feasibility Study, including the question of the availability factor that later became so prominent in their dispute with Respondent. It is quite evident from the totality of the whole process that, important though it was, the Terms of the Implementation Contract were not cast in stone. The Respondent argues rightly, in the opinion of the Tribunal, that the Claimants had never agreed to develop the Project according to the terms of the Implementation Contract.

93. Secondly, there is the key role of the Danıştay. As the highest administrative body in Turkey, it is clear that its role was mostly confined to the legal and administrative issues arising from the Implementation Contract, particularly in light of the evolving legal structure governing BOT projects. It follows that highly technical issues would normally be resolved by MENR.

¹⁰ Letter of Undertaking from the Community Energy Alternatives Inc. to the Ministry of Energy and Natural Resources, November 27, 1996, Exhibit C45 to Claimants' Memorial; *see also* discussion in Claimants' Reply, par. 65, n. 126.

94. This does not mean, however, that the Danıştay's role was merely to rubber stamp the Implementation Contract or grant an "imprimatur." This important body has the authority to review and approve concession contracts, including all the terms contained therein, not just some of them. This is evidenced by the fact that among other issues that were still pending, there was the question of the ICSID arbitration clause. More importantly, any agreements the parties could have reached later had to be submitted to the Danıştay for final approval. There are numerous instances in the record of discussions between the Parties, always at the initiative of the Claimants, of amendments to the Concession Contract and the preparation of pertinent Protocols.

95. Important as the Implementation Contract was, it cannot be viewed by the Tribunal as the final word in the process. Other equally important steps were to follow.

3. Did MENR Accept the Cost Increase of the Revised Mine Plan?

96. The parties do not disagree about the fact that the Revised Mine Plan resulted in an increase in costs. The disagreement is whether such increase was "large," as the Claimants describe it, or whether it would have put the Project "among the most expensive power projects anywhere in the world," as the Respondent asserts. The parties also disagree whether MENR was at all times fully informed and aware of this increase and its magnitude or whether it came to the Ministry as complete surprise.

97. The Tribunal must first note that the parties have made different estimates in support of their respective positions. Based on the technical studies of Norwest,¹¹ the Claimants assert that in January 2004, Konya Ilgın came in at a cost of US\$2.75/Mbtu. That is lower than the US\$3.97/Mbtu weighted average cost of the six State-owned mine mouth power plants in Turkey and, indeed, the second least expensive of all such projects.

98. The expert report of Dr. Houser for Claimants estimated a fuel cost of US\$2.87/MBtu for January 2000, while the Respondent's expert, Dr. Sansom, estimated a cost of US\$5.05/MBtu.¹² In the Claimants' view, the difference stems from the fact that Dr. Sansom's report adds various costs that would be incurred if the mine was

¹¹ Expert Report of Norwest's Messrs. Conrad Houser and Andrew Scrymgeour, December 6, 2005, paras. 16–17.

¹² Testimony of Mr. Conrad Houser, April 7, 2006, Hearing transcripts, Vol. 5, at 1105–06; Testimony of Mr. Robert Sansom, April 8, 2006, Hearing transcripts, Vol. 6, at 1450–51.

separately managed and operated. However, the Claimants note that this Project was vertically integrated as a part of the overall Project.¹³

99. The parties also disagreed about the comparable cost of the TKI operated mines. The Claimants assert that TKI does not have to pay some taxes applicable to private developers and is subsidized by the government. This lowers its costs.¹⁴ The Respondent submits to the contrary that TKI has to bear the same costs as private developers.¹⁵

100. The Respondent also argued that the total costs kept increasing: US\$361 million more for the initial capital investment, US\$557 million more in additional capital for the mine and US\$20 million more each year for operation and maintenance. These increases in costs resulted by far, it says, in the most expensive thermal power project then under consideration by MENR. In his expert statement, Mr. Carlos Lapuerta concludes that each of the Claimants' proposals would have resulted in a substantial increase of the Project's total cost and a resulting increase in the "levelized" price for the electricity that the government would have to purchase.¹⁶

101. The Claimants further assert that at no time did MENR inform them that the price of electricity of the tariff proposals would be evaluated on a "levelized" basis. They aver that they were only told there would be an unescalated simple average tariff criterion. They say that their earlier suggestions to use a levelized price of electricity were rejected.¹⁷

102. The parties also disagree about the technical characteristics of the Project and the incidence they could have had on the cost increase. While the Respondent believes that the mine was "astonishingly complex," for the Claimants it "would have been reasonable easy to mine" and there was nothing particularly risky about it. On another issue, the Respondent asserts that the dewatering program would have ended up affecting a nearby lake, but the Claimants argue that the Environmental Impact Assessment had concluded that this was impossible in view of the geology of the area. For the Respondent, the area to be mined was so great that three towns had to be

¹³ Testimony of Mr. Conrad Houser, April 7, 2006, Hearing transcripts, Vol. 5, at 1058–61.

¹⁴ Claimants' Response to Respondent's new evidence, July 11, 2006, paras. 2–11.

¹⁵ Respondent's Post-hearing Brief, n. 1.

¹⁶ Expert Report of Mr. Carlos Lapuerta, September 19, 2005, paras. 47–48; Rejoinder Expert Report of Mr. Carlos Lapuerta, March 15, 2006, para. 15; Testimony of Mr. Carlos Lapuerta, April 9, 2006, Hearing transcripts, Vol. 7, at 1647–56.

¹⁷ Claimants' Post-hearing Brief, paras. 44–49.

moved; for the Claimants this decision was entirely unrelated to the mine. While for the Respondent the mine would have been the size of Manhattan and an amount of overburden would have to be removed equaling that removed for the construction of the Panama Canal, for the Claimants there was nothing unusual in this project as evidenced by the existence of mines larger than Konya Ilgın throughout the world.

103. In the end, the Claimants argue that it did not matter that the investment or operational costs were higher than those accepted by MENR under the Revised Mine Plan as this was a risk of the Project Company; tariff adjustment and escalation were exceptional and specifically regulated under the Contract and no minimum profits or returns were guaranteed.¹⁸ The Claimants assert in this respect that they were not seeking to recoup the extra costs of building a 500/465 MW plant or even a 545 MW plant, and that “they would have constructed a power plant producing a larger output for absolutely no additional investment cost.” Yet, as will be seen later, to accommodate the higher costs of the Revised Mine Plan would have required TEAS to purchase more electricity. This was thus an expenditure which concerned MENR and which it wanted to limit.

104. While the Tribunal is not called upon to measure the real impact of the cost increase of the Revised Mine Plan on the economics of the Project, it is quite evident that this impact was significant. Clearly, it was inevitable that a series of factors would have to change, beginning with the plant capacity, followed by the amount of electricity that TEAS would have to buy and ending with the adjustment of the tariff.

105. The issue then becomes whether these changes were of the ilk envisaged in Article 5.1 of the Implementation Contract and Article 8 of the Concession Contract. The Respondent asserts that the Project Company was to some extent negligent in not having undertaken a complete mine study before the Feasibility Study and that MENR was not aware of the scope of the cost increases that were finally revealed by the Revised Mine Plan. The Tribunal must note in this respect that a witness for the Claimants in responding to a question from the Tribunal concluded that the Feasibility Study was an “educated guess” and that perhaps it should be more properly regarded as a “pre-Feasibility Study.”¹⁹

¹⁸ Claimants’ Post-hearing Brief, paras. 25–31.

¹⁹ Testimony of Mr. Conrad Houser, April 7, 2006, Hearing transcripts, Vol. 5, at 1135–36.

106. To this extent, the Respondent maintains that the articles of both the Implementation Contract and the Concession Contract with respect to the Revised Mine Plan were included, first, at the request of the Company and, secondly, with the understanding that the resulting changes would be limited and not too significant. It was on this basis that the Danıştay was seized of the issue.

107. The Claimants maintain that, on the contrary, MENR knew from the very beginning that the Feasibility Study would have to be supplemented by in-depth mine studies and that it would have been imprudent to do this before a government authorization to proceed with the Project was obtained. Moreover, the Claimants argue, MENR never questioned the need for these subsequent studies during the discussions held both before and after the Feasibility Study was completed. This explains why both the Implementation Contract and the Concession Contract provided for the preparation of the Revised Mine Plan. The Claimants explain that MENR was kept abreast of the significance of the Revised Mine Plan much earlier than the date it was submitted and still no objection was raised or even alluded to either directly or during the discussions before the Danıştay.

108. The Claimants submit that the Respondent accepted the new cost structure since the Revised Mine Plan was approved by the Turkish Coal Enterprise without amendment on May 4, 1998, and MENR issued its Ministerial Approval after a careful review that included the increased costs and their effect on the tariff and the amount of electricity needed to offset such costs. As noted above, the Respondent for its part has argued that MENR proceeded at all times with a different understanding about what would be acceptable in terms of a tariff adjustment resulting from such increase in the mine costs.

109. The Tribunal is persuaded that in the context of the many discussions that preceded the submission of the Revised Mine Plan, MENR, and to some extent, TKI, were aware that this study would lead to a new situation in terms of the costs involved. Yet, the Tribunal must note that when the Claimants informed MENR by letter of July 9, 1997, of the progress made in the preparation of the Revised Mine Plan and its likely effects on the electricity tariff, they stated that “initial computation indicates that there will be an impact to the electricity tariff” and that there would be a need for an increase

in the net capacity of the plant, concluding that “[a] minor adjustment to the electricity tariff may still be needed.”²⁰

110. MENR was therefore under the impression that these changes would be “minor,” and this was so reported to the Danıştay. It is therefore plausible that this characterization is reflected in both Articles 5.1 and 8 of the Concession Contract. The reference in Article 5.1 to MENR’s approval of a revised tariff “reasonably” incorporating the increase in fuel costs, seems to reflect this understanding. Article 8 of the Concession Contract refers to “reasonable grounds” for withholding approval. Major changes would appear to fall outside the scope of the standard of reasonableness envisioned in those provisions.

111. As the real extent of the increase in costs and their likely effect on the other factors in the process came to be fully known only with the submission of the Revised Mine Plan in December 1997, it is justifiable for the Respondent to argue that MENR was, to a certain extent, shocked by the results of the study. An expert for the Respondent stated that the Revised Mine Plan involved changes that were so dramatic that it resulted in “essentially presenting the Turkish Government with a second, entirely different project . . . that . . . , if pursued, would have been one of the most costly and risky power projects in the world.”²¹ However, the Tribunal notes that MENR, at the time, did not voice objections to these findings.

112. After the submission of the Revised Mine Plan, the discussions appeared to follow a two-track approach. First, there was the technical evaluation of TKI that led to the approval of the Revised Mine Plan, although reservations were made about cost and risk.²² There was also the concern about the effects of the study on the commercial terms of the Project. This is undoubtedly where the attention of MENR was concentrated. In fact, while the Claimants’ assertion that the Revised Mine Plan was approved is correct, this does not mean that the approval of the impact the increased costs had on the commercial terms of the Project automatically followed.

113. The two-tracks came together with the Ministerial Approval of June 19, 1998. However, this is where the differences between the parties become crucial. The technical aspects of the Revised Mine Plan were indeed approved, as noted. But was

²⁰ Letter from Mr. Halil Sunar to the Ministry of Energy and Natural Resources, July 9, 1997, at 15, Exhibit C143 to Claimants’ Memorial, *see also* discussion in Claimants’ Reply, para. 74, n. 143.

²¹ Written Statement of Mr. Robert Sansom, September 10, 2003, paras. 5–6.

²² Affidavit of Mr. Ömer Ünver, September 3, 2003, para. 6.

this also the case for the new tariff structure? The Claimants believe that it was. The Respondent believes that this was not so. The Tribunal will discuss this issue later.

4. For whom was the Tax Burden of the Project in Connection with the Corporate Structure?

114. The discussion about the incidence of the corporate structure on the tax burden of the Project is a crucial factor in understanding the differences between the parties with respect to the commercial terms of this Project. This discussion took place during three different time periods: the negotiations concerning the Implementation Contract in 1996, the consideration of a change of structure in February 1998 and the disclosure about the effects of tax changes in 1999.

115. As noted earlier, the Respondent explains that, at the early stage of negotiations of the Project, a Turkish capital company was considered as the appropriate corporate structure for the Project Company, but that this was changed to a branch office of a Dutch incorporated company at the insistence of PSEG. The Respondent argues that the Claimants intended to obtain a tax windfall as a result of a lower tax burden but without disclosing it to MENR.

116. As also noted earlier, the Claimants explain that when the Feasibility Study was submitted in 1995 the law required BOT project companies to be formed as joint-stock companies. This law was amended in 1996 by Law No. 6224 allowing BOT project companies to be structured as branch offices of foreign corporations in order to promote foreign investments.²³ In the Claimants' view, it was only this consideration that led to the change in corporate structure.

117. The Claimants argue that there was nothing sinister in this change. Firstly, the Respondent must have been aware of the tax implications of the changes its own law was authorizing. Secondly, and more importantly, the Respondent specifically agreed to this change both in the Implementation Contract and in the Letter of Undertaking from the Claimants required by the Danıştay. The branch office was also authorized by the Permission Certificate of the Foreign Investment General Directorate issued on May 5, 1997, which the Tribunal addressed in its Decision on Jurisdiction.

²³ Claimants' Reply, para. 98, n. 208.

118. The Tribunal has no difficulty in concluding that the change from a Turkish joint-stock company to a branch office of a foreign company was both authorized by the law as amended and duly agreed to and approved by the Respondent. Indeed, there were tax advantages and such was the intent of the law, which was conceived as an incentive to attract foreign investment capital. The Respondent cannot be heard to argue that such advantages were unknown to MENR or, indeed, to the Turkish Government generally.

119. The evidence submitted by the Claimants on this question is convincing. The Implementation Contract made specific reference to Konya Ilgın Electric Production B.V. Turkey Branch and to Law No. 6224 Concerning the Encouragement of Foreign Investment Capital. The Letter of Undertaking made specific reference to the foreign capital company and to the commitment of the foreign investment company to bring a sufficient amount of capital to be determined by the Treasury.

120. The second time period when the corporate structure becomes relevant pertains to the negotiations that took place in February 1998 following the submission of the Revised Mine Plan. The Respondent alleges that because of the increase in the size of the Project resulting from the Revised Mine Plan, MENR requested that it be structured as a Turkish capital company, the corporate structure then in use for all BOT projects. The Claimants had no objection to the change provided they were compensated for the additional cost this change entailed, estimated at US\$256 million. Compensation could be made by way of an adjustment in the tariff.

121. The issue then became one of compensation and whether it was agreed by the Parties. The Respondent avers that there should be no compensation for reverting to the original corporate structure proposed in the Feasibility Study as there had been no reduction in the tariff when the change to a branch office was made. The Respondent also asserts that the real tax cost of the change, as evidenced by the Claimants' financial models, was only US\$96 million.

122. The Claimants argue that, on the contrary, they were entitled to be compensated. They claimed compensation from MENR by letter of February 10, 1998. The cash flow tables discussed in connection with the February 1998 proposals were explicit; they reflected the various corporate structures then considered. The Claimants assert that, moreover, all tax benefits of the foreign branch status had been computed in the revised tariff accompanying the Revised Mine Plan; there would have been no windfall, as the

internal rate of return under the Revised Mine Plan turned out to be lower than under the Feasibility Study.

123. The Claimants argue that the Parties agreed in February 1998 to adjust the tariff structure so as to compensate for the higher tax costs of the corporate change, and this was the basis for the various proposals made on February 13, 1998. The Respondent denies having so agreed.²⁴

124. The evidence of the Parties on this issue is not very convincing. Their respective positions rest mainly on the witness statements they have each submitted. There are, however, two elements that the Tribunal finds helpful. First, according to two witnesses for the Respondent, MENR agreed to consider different proposals from the Claimants addressing the increased costs associated with the change in the corporate structure.²⁵ While this, in itself, is not dispositive, it does demonstrate that the Respondent was aware of the problem at the time and, as the Respondent later argued, that one of these proposals had been agreed as establishing the commercial terms of the Project. This evidence lends weight to the Claimants' argument that the agreement addressed the effects of the new corporate structure.

125. This acknowledgment also responds to a legal reality since the Feasibility Study in Section 11.1.1 and the Implementation Contract in Schedule 4 had envisaged a specific list of assumptions which defined the commercial terms with the express provision that if the bases for these assumptions changed, "the prices in the Tariff will be adjusted accordingly." The Claimants point out that these assumptions included taxation issues and the incentive allowances.²⁶

126. A second element of evidence invoked by the Claimants is more direct and to the point. The minutes of the meeting held on February 11, 1998 refer to the fact that the new proposals "will be based on the establishment of a limited liability company,"²⁷ while those of the meeting held on February 12, 1998, refer to a consensus that there would be a change in corporate structure if the Revised Mining Plan and the tariffs were approved.²⁸ The discussion that followed in the Danıştay does not reflect that this body

²⁴ Affidavit of Mr. Metin Başlı, August 28, 2003, para. 8.

²⁵ Affidavit of Ms. Selda Bilgiç, September 13, 2005, para. 7; Affidavit of Mr. Ahmet Oktay Kavas, March 27, 2003, para. 23.

²⁶ Claimants' Post-hearing Brief, paras. 59–61.

²⁷ Resolutions of Meeting, February 11, 1998, Exhibit C583 to Claimants' Reply.

²⁸ Minutes of Meeting, February 12, 1998, at 1, Exhibit C148 to Claimants' Memorial.

required a specific corporate structure as the Respondent argues, since it referred to the fact that the law provided for both “domestic or foreign companies.”²⁹

127. The Tribunal can therefore conclude that it was reasonable for the Claimants to proceed to further stages of negotiations on the assumption that in accepting the corporate form of a limited liability company, the revised tariff would reflect this particular choice of form and its associated costs. As it has not been established that the change was required by law, it is also possible to conclude that the requirement for such change was more a matter of preference for MENR than a legal obligation.

128. The third time period when the issue of the corporate structure became relevant to this dispute was in late 1999. As noted earlier, additional tax changes made in early 1999 had the effect of offsetting the tax consequences that a limited liability company structure would have incurred as a result of the Project. The Claimants assert that they became aware of such results in October 1999. On this basis, they were prepared to accept what they understood was MENR’s position at the time, which is what the Ministry had interpreted as the commercial terms approved on June 19, 1998. Yet, in the Claimants’ submission, the Respondent once again changed its position and demanded the availability factor of the Feasibility Study.

129. The Respondent argues that the Claimants had ample time to consider the tax changes introduced on January 1, 1999, and yet, in October 1999, they were still proposing a tariff that included compensation for the effects of the limited liability corporate structure that was no longer relevant. They insisted on compensation as late as December 2000. The Respondent asserts in this regard that the new tax structure would have resulted in a US\$250 million tax reduction for the Claimants even if the corporate structure had remained a Turkish capital company. The Claimants never disclosed this benefit and this, argues Respondent, evidences a bad faith negotiation strategy on their part.

130. The Tribunal is persuaded that it is quite possible that the Claimants became aware of the offsetting effects of the tax change in October 1999. The Respondent has pointed to convincing evidence showing that there were discussions earlier with advisors and executives to assess the changes.³⁰ However, it was not until October

²⁹ Minutes of Meeting, March 11, 1998, at R 0915.

³⁰ Letter from Deloitte and Touche to PSEG, October 8, 1999, Exhibit C571 to Claimants’ Reply; Respondent’s Post-hearing Brief, paras. 41–42.

1999 that firm conclusions emerged. The Tribunal finds plausible that, while at the time the Claimants were still demanding compensation for the corporate tax changes, the assessment of the tax situation was leading them to a different conclusion. A witness for the Claimants explained that it was shortly after that letter was written that PSEG learned of the offsetting effects of the tax changes.³¹ In the circumstances, this is not evidence of bad faith negotiation.

131. But what might have been justified in October 1999 became less defensible later on. On November 17, 1999, a further letter was sent to MENR by the Claimants.³² The Tribunal finds surprising that Claimants, by that date, would have been unaware of the changes. A proposal from PSEG on February 10, 2000 which still ignored the change in the tax law cannot be justified.³³ Even if the Claimants were under no obligation to inform MENR of the effects of the changes in Turkey's own tax laws,³⁴ in the context of this particularly complex negotiation the Tribunal would have expected the Claimants to proceed with greater transparency and to discuss the tax changes openly.

132. While the Tribunal will examine later the allegations of each Party concerning good or bad faith of the other Party, it can now positively conclude that the many successive changes that took place over the years in the law relating to the corporate structure of BOT projects and their resulting tax effects, in addition to the changing positions the parties adopted in the negotiations, whether or not these changes related to these legal changes, quite naturally led to misunderstandings and disagreements. This is one factor that contributed to the eventual total collapse of the negotiations.

5. Was there Agreement on the Revised Tariff Structure Resulting from Increased Costs?

133. The differences between the Parties on this issue have been outlined earlier. The Claimants assert that MENR had specifically considered two options after submission of the Revised Mine Plan as evidenced by the approval of June 19, 1998. The first was an installed capacity of 425 MW with an increase in the price of electricity to

³¹ Third Written Statement of Mr. Halil Sunar, February 18, 2005, para. 57.

³² See Letter from PSEG to Ministry of Energy and Natural Resources, November 17, 1999, Exhibit 110 to Claimants' Memorial; see also discussion in Respondent's Rejoinder, para. 103, n. 161.

³³ See Letter from PSEG to the Ministry of Energy and Natural Resources, February 10, 2000, Exhibit 111 to Claimants' Memorial; see also discussion in Respondent's Rejoinder, para. 105, n. 163.

³⁴ Testimony of Mr. Halil Sunar, April 5, 2006, Hearing transcripts, Vol. 3, at 503.

accommodate the higher costs while, in the second option, the capacity would be increased to 500 MW without changing the price per kWh.

134. The latter approach was the one the Claimants maintain was embodied in the tariff structure of the Revised Mine Plan. It resulted in keeping the same price of 4.98 cents per kWh and in the increase in the net generation capacity of the plant and the applicable availability factors from an average of 85.08% in the Feasibility Study to an average of 87.19% in the Revised Mine Plan. The sum total of these figures would yield “the amount of money in US dollars that TEAS would pay the Project Company in each year of the Project for the generated electricity.”

135. The proposal accompanying the Revised Mine Plan was supplemented by the cash flow table that the Claimants sent to MENR on February 5, 1998. Yet, as this proposal was based on the corporate structure of a branch office of a foreign company which was no longer acceptable to MENR, the three above-mentioned new proposals submitted on February 13, 1998, envisaged an increase in the price which reflected the limited liability company structure favored by the Ministry. The Claimants assert that these various proposals were rejected by MENR in May 1998 only because of the increase in the price of electricity, not because it would have shifted the costs to the Republic as argued by the Respondent.

136. The Respondent, indeed, argues that such proposals would have resulted in an unfair shift of the costs to the Republic and that MENR was not willing to proceed regardless of the costs of building a larger plant that would be selling more electricity, all of which, as noted earlier, would have resulted in the most expensive power project in Turkey.³⁵

137. The Respondent asserts that on February 13, 1998, the parties agreed to proceed on the basis of an increase in the installed capacity as proposed in the Revised Mine Plan (500 MW gross/433.5 MW net) provided the tariff did not change.³⁶ According to the Respondent, this was precisely what was approved on June 19, 1998.

138. As explained earlier, the Claimants, on the other hand, argue that the June 19, 1998 approval was based on the 500/465 MW figures the parties had agreed on May 18,

³⁵ Expert Report of Mr. Carlos Lapuerta, September 19, 2005, para. 30.

³⁶ Affidavit of Mr. Ahmet Oktay Kavas, September 13, 2005, para. 12.

1998.³⁷ A witness for the Respondent testified that the meeting when this agreement was allegedly reached never took place: “These were not meetings per se. These were, say, interviews...” within the many ongoing talks between the parties,³⁸ and if any meeting actually took place on that date it was possibly because “PSEG’s representatives dropped by my office for an informal visit in those days,”³⁹ or possibly “a courtesy” visit.⁴⁰

139. An additional aspect of the dispute is what the parties understood as the “tariff.” The discussion on this issue before the Tribunal has been somewhat confusing, but in essence it appears that while the Claimants understood the electricity tariff as the price of electricity (cents/kWh), the Respondent used the term in a technical sense that includes also the net dependable capacity, the Annual Net Generation (ANG) and the availability factors.⁴¹ It follows that when the Claimants referred to the tariff remaining unchanged in its various proposals, they were only referring to the price of electricity which remained the same while other commercial terms such as ANG and availability factor were indeed changing. But for the Respondent if the tariff remained unchanged, it meant that all the components remained the same, not only the price of electricity.

140. These differences became significant when the parties disagreed in respect of which availability factor they were each relying on. The Claimants maintain that it made no sense to leave out the ANG factor which determined a sufficient level of generation to ensure enough revenue to cover the higher costs of the Project. The Respondent asserts that such element was defined in the Feasibility Study and was not open to change.

141. The parties have also disagreed about a number of other aspects of a technical or legal nature associated with the approval of the commercial terms of the Project. The Claimants assert that all the elements of such approval were finally agreed in a meeting held on May 18, 1998, at which a specific cash flow table showing the ANG for a 500 MW/465 MW plant was made available. The Respondent does not even admit that the meeting took place or that a cash flow table for that capacity was produced. In any

³⁷ Third Written Statement of Mr. Halil Sunar, February 18, 2005, paras. 38–39; Written Statement of Mr. Mesut Çakmak, February 18, 2005, paras. 6–9.

³⁸ Testimony of Mr. Metin Başlı, April 9, 2006, Hearing transcripts, Vol. 7, at 1864–67.

³⁹ Affidavit of Mr. Metin Başlı, August 28, 2003, para. 11.

⁴⁰ Second Affidavit of Mr. Metin Başlı, August 22, 2005, para. 15; Testimony of Mr. Metin Başlı, April 10, 2006, Hearing transcripts, Vol. 8, at 1896–98.

⁴¹ Claimants’ Post-hearing Brief, para. 37.

event, the Respondent argues that a commitment of billions of dollars could not be made at a meeting of which there is no record. A witness for the Respondent also explains that no agreement could have been reached without defining precisely the net capacity and the availability as the Ministry wanted to keep the cost as low as possible.⁴²

142. From a legal and administrative viewpoint, the parties also give very different meanings to the June 19, 1998 MENR approval. The Claimants see it as a binding legal commitment recognized as such by MENR until as late as January 2001 and on the basis of which MENR instructed TEAS and the Electrical Energy Fund to finalize the additional agreements required. The Respondent, on the other hand, regards such approval by the Minister as a formal authorization for the staff to proceed with the negotiations on the terms agreed to in February 1998 but which resulted in no agreement to amend the Concession Contract. Eventually, the relevant Protocol would have to be submitted to the Danıştay.

143. Although the evidence on which the parties rely in support of their respective positions is not always decisive as it is based for the most part on notes written by one party or on witness statements produced by one or the other party, there is some evidence which is persuasive. In particular, the Tribunal finds that a meeting did take place on May 18, 1998, and that the relevant net equity buyout tables were submitted with the corresponding ANG figures, as a letter was sent by the Claimants with such information on the same date.⁴³ The notes of that meeting, which surfaced later in the course of the document production phase of the present proceeding support the Claimants' assertion to this effect.

144. The Tribunal finds that the explanations as to whether or not this meeting took place, as well as in respect of other events in the negotiations, given at the hearing by Mr. Başlı, the then Deputy General Manager of Energy Affairs at MENR, who led the discussions on the Ministry's side, were elusive and vague. He did not recollect facts he

⁴² Third Affidavit of Mr. Metin Başlı, March 6, 2006, para. 16.

⁴³ See PSEG Letter to the Ministry of Energy and Natural Resources, May 18, 1998, Exhibit 41 to Respondent's Memorial on Jurisdiction; Written Witness Statement of Mr. Halil Sunar, June 26, 2003, submitted in support of Claimants' Counter-memorial on Jurisdiction, para 67; Respondent's Memorial on Jurisdiction, paras. 48–50; Respondent's Reply on Jurisdiction, paras 36–46, 102; Affidavit of Ms. Selda Bilgiç, March 27, 2003, para. 39, Exhibit 1 to Respondent's Memorial on Jurisdiction.

should have remembered and he made himself appear not to be aware of key aspects of the negotiations which he had responsibility for.⁴⁴

145. What was agreed at the time or approved on June 19, 1998, is a different matter. The Tribunal finds no convincing evidence of an agreement reached on February 13, 1998. There is no document in the record which evidences this alleged agreement. Witness statements are contradictory on this question. A witness for the Respondent explains that “there was never a final agreement with PSEG on terms that are essential for any BOT power project, such as the net/gross capacities of the power plant and the electricity tariff, which includes the price per kilowatt hour and the availability of the electricity that would have to be purchased.”⁴⁵ Yet, another witness for the Respondent contradicts that assertion and states that Energy Affairs and PSEG specifically agreed in February 1998 “to increase the gross capacity of the proposed project to 500 MW (from 425 MW) and the net capacity to 433.5 MW (from 375 MW)”⁴⁶

146. True enough, many alternatives were discussed by the Parties during February 1998 and it is quite plausible that each Party may have come out of those meetings with different understandings about the basis on which the negotiations were to proceed. Yet, the Tribunal cannot conclude that an agreement was reached.

147. The evidence is also confusing with respect to the thrust of the negotiations when they resumed in May 1998. It is quite clear that, at that point, MENR had decided that any agreement necessarily had to be based on a price of 4.98 c/kWh and that no increase in the price would be acceptable. To this extent, it also follows that none of the proposals made in February that included a higher price were acceptable. It is also evident from the June 19, 1998 approval that a 500 MW gross capacity was acceptable. Leaving aside these two elements, what the Parties agreed with respect to the ANG and the resulting net capacity is less than clear.

148. The letter sent by the Claimants on May 18, 1998, further corroborated by the notes taken by the Claimants’ representatives at the meeting held on that date, are however quite explicit about an agreement having been reached on the increase of the ANG so as to attain an average of 465 MW net. A witness for the Claimants, Mr. Halil Sunar, considers that this agreement was possible because “it met the Ministry of

⁴⁴ Testimony of Mr. Metin Başlı, April 10, 2006, Hearing transcripts, Vol. 8, at 1912–18.

⁴⁵ Written Statement of Dr. H. Yurdakul Yiğitgüden, August 25, 2003, para. 6.

⁴⁶ Second Affidavit of Mr. Metin Başlı, August 22, 2005, para. 12.

Energy's primary concerns, that the Project was structured as a Turkish limited liability company, the installed gross capacity was 500 MW, and the average tariff remained at 4.98 cents/kWh."⁴⁷ In the view of Mr. Sunar, the Claimants explained at this time that the power plant output would possibly have to exceed 500 MW, but the proposal was acceptable to MENR "because the only issue of concern for the MENR was the net amount of electricity delivered to TEAS."⁴⁸

149. However, Respondent denies that this meeting ever took place and it has produced no record evidencing that it was held. Furthermore, no net figure is mentioned in the June 19, 1998 approval. The Respondent's argument that no Turkish official allegedly involved in these discussions had the authority to commit the Ministry on such a major issue is persuasive given the hierarchical structure of the Turkish public administration and MENR.⁴⁹ But, in the opinion of the Tribunal, as a letter was later sent by Claimants confirming their understanding, the Respondent had the obligation to clarify the matter and to reply to the letter if it did not accept that such an understanding had been reached. It never did so.

150. The Tribunal notes that the Claimants' evidence in respect of the meaning of the May 18, 1998 meeting was challenged at the hearing when it was revealed that the meeting had been conducted in Turkish. The non-Turkish speaking PSEG representatives participating in the meeting, according to the evidence of Mr. Clark Moseley, understood that MENR officials had agreed because of "their body language, their actions, nodding of heads, that sort of thing."⁵⁰ This evidence is far from persuasive and, in the view of the Tribunal, does not support the statement of those witnesses that MENR had unequivocally agreed to the 465 MW net figure.⁵¹

151. The Claimants have submitted additional evidence about the acceptance of the 465 net figure by the Respondent. This evidence pertains to the amendment of the Concession Contract that the Claimants proposed on June 12 and June 17, 1998, which was discussed at a meeting with MENR on June 25, 1998. A cash flow table corresponding to the 500/465 figures was also submitted by the Claimants on July 23,

⁴⁷ Written Statement of Mr. Halil Sunar, June 27, 2003, para. 69.

⁴⁸ Fourth Written Statement of Mr. Halil Sunar, December 9, 2005, para. 34.

⁴⁹ Affidavit of Mr. Ahmet Oktay Kavas, September 13, 2005, para. 5; Second Affidavit of Mr. Haldun Atif Danişman, March 10, 2006, para. 11.

⁵⁰ Testimony of Mr. Clark Moseley, April 7, 2006, Hearing transcripts, Vol. 5, at 1046–47.

⁵¹ Rejoinder Statement of Mr. Clark Moseley, November 20, 2003, para. 13; Fourth Written Statement of Mr. Clark Moseley, December 6, 2005, para. 17.

1998. The first draft of the TEAS agreement indicated a figure of 465 net, as did the first draft of the Plant Performance Report. Yet, all these documents were prepared by the Claimants and none was explicitly accepted by MENR. The evidence of Claimants is to the effect that neither of these documents was, in fact, rejected.

152. On the basis of the evidence adduced, the Tribunal has to determine whether a firm agreement had been reached as a result of the May 18, 1998 meeting and the June 19, 1998 approval. The Tribunal cannot so conclude. The fact that the Claimants did not sign the Concession Contract until December 10, 1998, while some valid reasons having to do with the arbitration and force majeure clauses were offered, denotes some real, uncertainty about the commercial terms that would finally be included. The Tribunal must note at this point that the Claimants' argument that they did not become aware of the Respondent's position until a year later is not convincing. The Respondent has demonstrated that this was not the case since the Claimants were aware of the wording of the Ministerial Approval soon after June 19, 1998.

153. The fact that MENR included the 465 figure in a draft amendment protocol on March 19, 1999, has also been invoked by Claimants as evidence of the Ministry's agreement. The Respondent answers that this was due to a mistake in a draft which had been sent earlier by the Claimants. The Tribunal has difficulty in accepting the evidence of Respondent that this was a mistake. However, the Tribunal is not persuaded that there was an agreement on this crucial question between the parties. The Tribunal cannot make a definitive finding on the basis of evidence that is less than clear of an agreement between the parties. It is not irrelevant to note that the fact that the Claimants did refer to a 433.5 net figure in letters they sent on January 23, 2001, does not constitute evidence that they had agreed to such net capacity after submission of the Revised Mine Plan.

154. The Tribunal thus concludes, based on the totality of the evidence which it has reviewed, that the commercial terms of the Project were not finalized on June 19, 1998, and that negotiations did not end at that time. This became only too evident in the months that followed as well as through 1999 and early 2000. Changing circumstances, legislation and information led to continuing negotiations in the midst of what can only be described as a very confusing setting.

155. The June 19, 1998 approval was another milestone in the process. Yet, the omission of the net capacity cannot be filled in simply by relying on what would have

been agreed on February 13, 1998, May 18, 1998, or at any other time if the terms of such agreements, as the Tribunal finds were not explicit and unequivocal. No binding effect can be given to a document that only defines some of the key elements of the commercial terms.

156. While the parties have discussed at length the translation of the Approval, the fact is that no reference to other key factors of the commercial terms were included. Such essential elements of the contractual relationship cannot be replaced by assumptions based on translations or confusing understandings.

157. This conclusion, however, does not excuse the Respondent's lack of diligence in clarifying the issue as the negotiations progressed. While the Claimants did attempt to clarify on numerous occasions what their understanding of the commercial terms was, the Respondent, in many instances, remained silent. The Respondent's explanations of their silence were not convincing. Bureaucratic paper shuffling is not a credible explanation.⁵²

158. The Respondent has presented to the Tribunal a detailed list in order to rebut the Claimants' accusation that many of their communications and proposals went unanswered. The Tribunal has no reason to disagree with the Respondent's explanation.⁵³ That is not the issue, however. The issue is that when presented by Claimants with information – documents, letters – that did not reflect the Respondent's understanding, it did not record its objections or otherwise invited further discussions. This lends support to the Claimants' argument that the Respondent was rewriting the script of the negotiations, even if it is not the case.

6. Were the Parties Engaged in Subsequent Negotiations in Bad Faith?

159. During the second half of 1998, the Project progressed slowly. There were no major surprises. As noted, in December 1998 the Claimants signed the Concession Contract and shortly thereafter MENR also signed. The friendly state of affairs, however, did not last long. Soon after the Contract was signed, according to Respondent, it became clear to MENR officials that the parties had different understandings about the significance of the June 19, 1998 approval. A meeting to

⁵² Testimony of Dr. H. Yurdakul Yiğitgüden, April 9, 2006, Hearing transcripts, Vol. 7, at 1793–95.

⁵³ Respondent's Post-hearing Brief, Annex A.

discuss these differences was held on May 26, 1999⁵⁴ and another on June 9, 1999. Two new proposals by the Claimants followed on June 15 and 16, 1999.

160. The Respondent asserts that new financial calculations on the basis of the 500/465 MW concept translated in cost nearly twice as high as the cost MENR had considered in February 1998; the US\$380 million Turkey was willing to spend in buying additional power, would have been further increased by US\$378 million. On the other hand, the Respondent maintains that a 500 MW gross capacity does not allow for a 465 MW net output because of the high demand for electricity needed to operate the plant.⁵⁴ The Respondent asserts that the new proposals presented in June 1999 were not acceptable to MENR, because one increased the gross capacity to 545 MW while the other also changed the gross capacity but with a different formula. These, in the Respondent's view, were more than reasonable grounds on which to withhold its acceptance.

161. The Claimants regard MENR's attitude at the time as a bad faith effort to reject what had been agreed on June 19, 1998. The Claimants recall that in submissions made by the Respondent during the jurisdictional phase of the present case, further corroborated by some of its witness statements, the 500/433.5 MW figure allegedly agreed to in February 1998 was at all times based on the tariff structure of the Revised Mine Plan. The Claimants argue that the Respondent had available and actually used in the negotiations that followed through 1999 the very cash flow tables of the Revised Mine Plan,⁵⁵ which indicated a specific availability factor that could not be ignored.

162. In the Claimants' view, the only element that would have remained unchanged was the price of electricity of 4.98 c/kWh, understood strictly as the "sales tariff," and this was the reason why the Ministerial Approval expressly referred to the objective of ensuring "that the average sale tariff of 4,98c/kWh shall remain unchanged." The Claimants also assert that the financial estimates made by MENR in May 1999 were completely distorted, perhaps even deliberately so.

163. In spite of these difficulties, the Claimants explain that they were willing to consider further accommodation of the tariff structure as long as it would cover the

⁵⁴ Affidavit of Ms. Selda Bilgiç, September 1, 2003, para. 8.

⁵⁵ Written Witness Statement of Mr. Halil Sunar, June 26, 2003, submitted in support of Claimants' Counter-memorial on Jurisdiction, para. 98, in reference to the meeting with Mr. Ahmet Oktay Kavas of the Ministry of Energy held on May 26, 1999; *see also* Ministry's Memorandum on Konya-Ilgın Thermal Power Plant Subject to BOT Model, May 26, 1999, Exhibit 32 to Respondent's Memorial on Jurisdiction.

increased costs of the Revised Mine Plan. To this end, the Claimants believe, a higher gross output of MW discussed in May and June 1999 would have made no difference to the Respondent as it would remain committed only to the purchase of a given amount of electricity resulting from the ANG each contract year. This would not have required any additional investment by the Respondent. The Claimants assert that, in any event, a 500/465 figure was technically feasible because the equipment was designed to allow for substantial margins, sufficient to support the internal need of electricity and still meet the net generation for sale to TEAS.⁵⁶

164. The negotiations reached a new stage in the fall of 1999. On October 26, 1999, the Claimants wrote to MENR proposing a new approach to unlock the negotiations: the Project could be based on the 500/433.5 MW figures that the Ministry had allegedly approved in February 1998, adjusting the tariff to 4.98 c/kWh. The Claimants assert that they still understood that the availability factor was as reflected in the cash flow tables from the Revised Mine Plan they had made available to Respondent for the February 1998 meetings.

165. The letter of October 26, 1999, referred to the need to solve the question of the effects of the change of the corporate structure to a limited liability company. The Respondent argues that this request was made in bad faith since at that point the Claimants were aware of the changes in the law that had offset such effects, but ignored the question in order to increase their benefits. This issue has been addressed by the Tribunal earlier.

166. The Respondent's understanding about the availability factor, as explained earlier, was different as it asserts that it believed that factor to be the same as that found in the Feasibility Study and not the one in the Revised Mine Plan. This position was confirmed in a MENR letter to the Claimants on November 9, 1999.⁵⁷ The Respondent also asserts that the new proposal from the Claimants was not at all new and had in fact been rejected in February 1998. The Claimants interpret this stated position of MENR as an abrupt change, never before expressed and developed in bad faith in order to kill the project.⁵⁸

⁵⁶ Second Written Statement of Mr. William Van Herwarde, February 18, 2005, paras. 15–17.

⁵⁷ Affidavit of Ms. Selda Bilgiç, March 27, 2003, para. 37; Affidavit of Mr. Mustafa Mendilcioğlu, September 15, 2005, para. 11.

⁵⁸ Rejoinder Statement of Mr. Clark Moseley, November 20, 2003, paras. 15–16.

167. The Claimants, however, were not easily discouraged, if such was the objective of Respondent. Indeed, on February 10, 2000, the Claimants made yet another proposal that was based on the figures the Ministry had said was the basis of its acceptance, that is 500/433.5, with an availability factor lower than that of the Feasibility Study at an average of 82.70%.⁵⁹ The difference was that this new proposal would result in a higher generation capacity in the debt-service years so as to produce enough revenue to satisfy the lenders. The Claimants add that, overall, the Respondent's cash outlay for the life of the Project would remain the same.

168. MENR was not persuaded of the merits of this approach and stated on April 12, 2000, that only the exact pattern of the tariff structure of the Feasibility Study was only acceptable. The Respondent considers that such proposal would have shifted even more of a burden onto the Government as the availability for the first ten years would have been above 90%, when the price per kWh was much higher. The Respondent asserts that this proposal would have imposed an additional cost of US\$536 million on the Turkish Government. The Respondent further explains that this proposal departed from the stated requirement of the November 9, 1999 letter to the effect of the availability ratios "being stable over the years."

169. The Project's internal rate of return (IRR) causes an additional exchange of accusations of bad faith. The Respondent argues that every proposal made by the Claimants indicated a 15.4% IRR in spite of the fact that each such proposal was based on different commercial terms, and that this was done to conceal the real figures from MENR. At the hearing it became clear that while only the Project's IRR had been discussed by the parties, the equity IRR showed different results in the area of 18-20%.⁶⁰ An expert for the Respondent stated in this respect that with the Contract's ANG levels, the equity IRR would have fallen to 14%. Accordingly, the Project failed to meet PSEG's minimum equity return expectations since the outset.⁶¹

170. In the Claimants' submission, the uniform reference to a 15.4% figure was never an issue in the discussions and negotiations and MENR never inquired about the Project's return. Since the legal requirement to maintain IRRs in the range of 16% was

⁵⁹ Written Statement of Mr. Julian Beere, December 9, 2005, paras. 15–16.

⁶⁰ Cross-examination of Mr. Julian Beere by Mr. Samuel Boxerman, April 6, 2006, Hearing transcripts, Vol. 4, at 784–85.

⁶¹ Second Expert Report of Mr. Robert Sansom, September 19, 2005, para. 73.

eliminated in 1996, the question had lost relevance.⁶² In any event, in the Claimants' view, the Project never in fact exceeded a 15.4% IRR.

171. The Tribunal must note, however, that witnesses for the Claimants accepted at the hearing that the Project IRR had to be necessarily different in every proposal⁶³ and that it had to change according to the different sets of conditions of the proposals.⁶⁴

172. Perhaps much to the disappointment of the parties, the Tribunal does not find bad faith in the negotiations undertaken after June 19, 1998, particularly in the context of the 1999 and 2000 discussions on the tariff structure. There was definitely an interest on the part of the Claimants to ensure a revenue sufficient to cover the higher costs of the Project and, preferably, to have this revenue at hand in the front-end years so as to meet the debt service requirements and promptly reach the financial close still pending. There was definitely an interest on the part of the Turkish Government to keep the costs as low as possible and not to bear expenditures that might be considered excessive. The two interests never came to meet.

173. It is also quite clear to the Tribunal that there was in this situation a lack of transparency on the part of MENR, which is particularly troublesome in connection with the June 19, 1998 approval. It has never been explained that there was a difference in the parties' understanding notwithstanding the large number of petitions containing a contrary point of view that the Claimants sent. It is also most troubling in connection with the November 9, 1999 statement that the availability factor would still be the same as in the Feasibility Study, which had not been raised before, not even in connection with the Respondent's understanding of the June 19, 1998 approval or the alleged February 1998 agreement. The argument that this was implicit in the negotiations is not only unpersuasive but neither does it help the case of MENR.

174. There is thus a cumulative lack of transparency that, short of bad faith, comes at the very least close to negligence, compounded by the fact that various witnesses admitted not having read key documents or taken appropriate action on them for long periods.⁶⁵

⁶² Claimants' Post-hearing Brief, paras. 52–53.

⁶³ Testimony of Mr. Julian Beere, April 6, 2006, Hearing transcripts, Vol. 4, at 760–63.

⁶⁴ Testimony of Mr. Robert Dougherty, April 6, 2006, Hearing transcripts, Vol. 4, at 929–33; Testimony of Mr. Michael Rozensweig, April 8, 2006, Hearing transcripts, Vol. 6, at 1431.

⁶⁵ Closing Statement of Ms. Carolyn Lamm, making reference to Messrs. Metin Başlı and Ahmet Oktay Kavas, April 11, 2006, Hearing transcripts, Vol. 9, at 2202–03.

175. Yet, the Tribunal also finds that the Claimants were not fully transparent in connection with the unfolding events. The Claimants' position was fully and clearly stated throughout the negotiations. There are, however, two events with which the Tribunal is not comfortable.

176. The first event concerns the October 26, 1999 letter and subsequent references to the need to obtain compensation for the change in the corporate status. As concluded earlier, it is plausible that at the time this letter was written, the conclusion about the offsetting effects of the law was not final, but was certainly being discussed in detail internally. The issue could have been raised in that letter or at any other point, but it was not. As concluded above, nothing justifies that references to this matter kept appearing at later points in time, despite the fact that the parties also have different understandings about the context in which these references were made.⁶⁶ The Tribunal does not pass judgment on the parties' intentions, but simply notes that full transparency would have helped to reach a genuine understanding.

177. The second event by which the Tribunal is even more troubled emerged during the hearing on the merits. The Claimants have relied on the witness testimony of Mr. Halil Sunar, a leading company executive in charge of the Project's negotiation, to support the argument that they were not aware of the content of the June 19, 1998 approval until a year later and that in the meantime the Project's expenses had continued.⁶⁷ Yet, Counsel for the Respondent demonstrated at the hearing that there was evidence proving the contrary, in particular the lawyers' billings to the Claimants for meetings held with Mr. Sunar to discuss the ministerial approval on June 26, 1998, and additional expenses for translations of such approval and related communications of June 29, 1998.⁶⁸

178. The conclusion that inescapably follows is that Mr. Sunar was quite aware of the content of the approval a few days after it was signed. Irrespective of the evidence, it would have been quite surprising if the Claimants had not made their best efforts to learn about the content of a document of such importance in the process, to which they even assign binding effect.

⁶⁶ Testimony of Mr. Halil Sunar, April 5, 2006, Hearing transcripts, Vol. 3, at 448–50.

⁶⁷ Testimony of Mr. Halil Sunar, April 6, 2006, Hearing transcripts, Vol. 4, at 710–11.

⁶⁸ Respondent's Post-hearing Brief, paras. 25–26; Closing Statement of Mr. Stanimir Alexandrov, April 12, 2006, Hearing transcripts, Vol. 10, at 2471–73.

7. Did the World Bank and the IMF Apply Pressure on Turkey to Terminate the Project?

179. One of the main allegations of the Claimants as to why the negotiations on the Project ultimately failed is that the Government of Turkey changed its position on the BOT approach as a result of pressure from the World Bank and the IMF in the context of the discussion and approval of stand-by agreements and other loans essential to the country's economic recovery. The Respondent asserts in this respect that no such pressure related to existing Projects or negotiations underway existed and that the approach suggested by those international agencies only concerned future contracts.

180. The parties do not disagree that both the World Bank and the IMF unequivocally made their views known to the Government of Turkey about the need to develop a competitive energy market. This would eliminate electricity purchases by TEAS at prices that could be higher than those charged to the consumer, a policy which had a strong impact on the financial health of the country and the Treasury. Neither do the parties disagree about the fact that this policy related to future projects. The disagreement is about whether the issue also affected BOT projects already in the process of negotiation.

181. The Claimants have submitted persuasive evidence that the changes sought by the World Bank and the IMF also applied to projects under negotiation.⁶⁹ In the "Turkey: Country Economic Memorandum: Structural Reforms for Sustainable Growth" of September 15, 2000, it is stated, for example, that the "authorities project that, based on existing projects under construction and additional projects for which government guarantees have already been issued, supply will be sufficient to meet market demand in the period 2003 – 2004 . . . and no further take-or-pay guarantees are expected for projects coming on stream after 2002."⁷⁰

182. Turkey's Letter of Intent with the IMF of December 9, 1999, also included a commitment to limit new Treasury guarantees in its 2001 budget. More specifically the Treasury explained to MENR in April 2000 that under the Stand-by Agreement with the IMF, the Turkish government had decided "not to continue the transactions regarding

⁶⁹ Expert Report of Mr. Rex Pingle, December 9, 2005, paras. 62–82.

⁷⁰ See Turkey: Country Economic Memorandum: Structural Reforms for Sustainable Growth (In Two Volumes) Volume I: Main Report, September 15, 2000, The World Bank, para. 183, submitted as C16 (selected paras.).

any new Build-Operate-Transfer (BOT) projects . . . in particular, the BOT projects of which concession contracts have been signed by your Ministry but the other agreements, including the Treasury Guarantee, have not been signed.”⁷¹

183. The new policy resulted in the preparation of the list of 29 projects mentioned above for which Treasury guarantees would be considered. Konya Ilgın was later added to that list, but the Claimants explain that none of these projects ultimately came to completion. The Electricity Market Law enacted on March 3, 2001, also reflected that policy in eliminating Treasury guarantees and long-term energy sales agreements.

184. The broad macro-economic changes introduced in Turkey to overcome the crisis directly impacted on any specific policy running contrary to their goals, among which were the BOT projects. While there was no specific directive issued either by the World Bank or the IMF affecting concession contracts that had already been executed, it is not surprising that the Turkish Government was greatly reluctant to implement projects that had not yet been finalized and closed.

185. While a witness for the Respondent testified that MENR only checked the compatibility of projects with macroeconomic policies of the State Planning Organization and the Treasury at the outset of the process,⁷² another witness clearly conveyed the view that MENR was well aware of the World Bank macroeconomic concerns and had the relevant information.⁷³

186. Irrespective of the precise impact of the dealings of the Turkish Government with the World Bank and the IMF on this very project, it is clear that the changes of policy involved were not conducive to furthering negotiations that already encountered various other difficulties. This state of affairs may well have been one of the factors contributing to the failure of negotiations. The Tribunal thus accepts the Claimants’ contention that the Respondent should have raised the change of policy openly and discussed any possible consequences or lack thereof.

⁷¹ Letter from Undersecretary of Treasury to the Ministry of Energy and Natural Resources, April 28, 2000, Exhibit C124 to Claimants’ Memorial; *see also* discussion in Claimants’ Reply, para. 216, n. 427.

⁷² Testimony of Mr. Metin Başlı, April 10, 2006, Hearing transcripts, Vol. 8, at 1947–52.

⁷³ Testimony of Mr. Haldun Atif Danişman, April 10, 2006, Hearing transcripts, Vol. 8, at 2092–99.

8. *Were the Claimants Arbitrarily Denied the Benefits of Law No. 4501?*

187. The differences of opinion between the parties concerning the application made by the Claimants to convert the Contract to private law status under Law No. 4501 have been explained earlier. The essence of the difference is whether Article 7 of this Law provides an automatic right to conversion as Claimants argue, or whether the conversion requires a renegotiation of certain terms to rebalance the Contract as the Respondent believes.

188. Within the purview of its understanding of the Law, MENR defined various conditions that the applicants had to meet in order for the application to be forwarded for approval to the Council of Ministers. The Respondent argues that, as the projects would benefit from the change in status, the Government was entitled to part of these added benefits, which in the case of Konya Ilgin related principally to updating the escalation formula.

189. The parties first discussed the question of MENR's authority under the Law. In spite of different interpretations the parties have invoked about the intention of drafters of the Law, the Tribunal first considers it quite improbable that in a highly bureaucratized system of administration, an application would be forwarded automatically to a higher political body without a detailed discussion with the relevant technical service, in the present case MENR. This reality lends support to the Respondent's argument that there was no automatic forwarding entailed in the process.

190. The terms of Article 7 of the Law also confirm this point in stating that the Council of Ministers "may" decide on the application. In this case, the agreement was to be restated "by considering the necessary criterion to secure international financing and similar implementational contracts of the administration," within specific datelines. This mandate appears to involve a degree of discretionary authority and technical evaluation that the Council of Ministers would unlikely exercise on its own. The Claimants explain that MENR's involvement was only required because private companies have no standing to apply to the Council of Ministers, an argument which is not quite convincing.

191. The extent of that discretion is a different question. The Respondent contends that the mandate of Article 7 allowed MENR to seek improvements to existing concession contracts that would benefit the Ministry, especially since the private law

status or international arbitration allowed under that Law would have resulted in lower financing costs for the Project. This interpretation goes as far as to state that “the Ministry had the authority to revise existing concession contracts when converting them into private law contracts” under Law 4501⁷⁴ or even under Turkish administrative law.⁷⁵

192. For the Respondent, the Claimants themselves envisaged the renegotiation of certain aspects of the Contract on this occasion as reflected in a memorandum of Allen & Overy, legal advisors to Citibank in respect of this Project.⁷⁶

193. The Claimants argue, on the contrary, that MENR had no authority to undertake new negotiations as a condition of the submission of the application to the Council of Ministers.⁷⁷ The Claimants assert that, in any event, the proposed terms would have resulted in making the Project wholly unfinanceable as explained by a witness for the Claimants.⁷⁸ This result contradicted the purpose of the Law. Moreover, the Claimants assert that none of these advantages would have resulted in lower financing costs but would only have made possible the obtaining of the required financing.

194. The Tribunal is persuaded by this last argument. If the whole purpose of the Law was to improve conditions of international financing for BOT projects by means of their conversion to private law status, following the long discussion about the status of such projects outlined above, it would make no sense to allow for a renegotiation that could have ended with the opposite result. This means that under Article 7 of the Law, MENR indeed had a role to play. This role was to make sure that the conversion was in harmony with the criterion to secure international financing and that the pattern of other similar contracts was observed, a mandate which does not allow for a full-fledged renegotiation as was apparently envisaged by MENR in this case. In any event, the full revision of concession contracts was a prerogative of the Danıştay which MENR could not have supplanted.

⁷⁴ Affidavit of Dr. H. Yurdakul Yiğitgüden, September 13, 2005, para. 20; Affidavit of Mr. Cumhuri Ersümer, September 14, 2005, paras. 15–16.

⁷⁵ Legal Opinion of Mr. Mümtaz Soysal, September 4, 2003, paras. 33–35.

⁷⁶ Opening Statement of Mr. Stanimir Alexandrov, April 4, 2006, Hearing transcripts, Vol. 2, at 322–23.

⁷⁷ Legal Opinion of Professors Mahmut Birsal and Arzu Aksaç Yeşilirmak, December 9, 2005, para. 25.

⁷⁸ Written Statement of Mr. Julian Beere, December 9, 2005, para. 19.

9. Did the Respondent Interfere with the Issuance of the Treasury Guarantee and Supplementary Agreements?

195. The Claimants' argument about the issue of the Treasury Guarantee explained above is mainly based on the February 2002 ruling of the Constitutional Court. This ruling nullified Article 8 (1) of the Electricity Market Law because it eliminated the right to have a Treasury Guarantee issued in pursuance of concession contracts. Since the Treasury Guarantee is an integral part of the concession contracts, the Court indeed found that there was no discretion on the part of the Treasury to deny such a guarantee if MENR had made a binding commitment to this effect in the contract.⁷⁹

196. Although the Respondent argues that Article 15 of the Contract in referring to the Company as the entity which shall conclude agreements such as the Treasury Guarantee, imposes an obligation only on the Claimants and not on MENR, the Tribunal has no difficulty in finding that this Article can only be understood as committing both parties to conclude such agreements. If the Government does not fulfill its own obligation the Claimants cannot attain the result envisaged by the Contract.

197. The Tribunal is not convinced by the Respondent's argument that the Guarantee could not have been denied because it was never requested. Even if this were true formally, in light of the history of the case there can be no doubt that the administration was moving towards a policy that aimed at the restriction and ultimate elimination of the Treasury guarantees. The list of 29 projects speaks for itself, and the fact that Konya Ilgın was added in May 2002 does not change the trend.

198. The Respondent also argued in this matter that the Treasury Guarantee was in fact the last step after a series of other agreements,⁸⁰ beginning with the commercial terms of the Project, followed by the Energy Sales Agreement and the Fund Agreement. It has argued that the Guarantee could not be issued until the terms of such other agreements were completed since the precise obligations and financial commitments to be guaranteed were only known at that point.⁸¹ A witness for the Respondent stated

⁷⁹ Legal Opinion of Mr. Ergun Özbudun, February 14, 2005, paras. 16–19.

⁸⁰ Respondent's Rejoinder, para. 67, n.103, with reference to the Expert Report of Ms. Dianne Rudo, March 15, 2005, para. 134–36; Affidavit of Mr. Arif Erden, September 13, 2005, para. 10.

⁸¹ Respondent's Post-hearing Brief, paras. 54–55.

that the Treasury only intervened after the parties had reached an agreement on the basic parameters of the project in the form of a firm draft.⁸²

199. This argument of the Respondent is convincing. The purpose of the Guarantee is for the Treasury to back specific financial obligations which the State entities undertake in light of those other agreements, with particular reference to the amount to be paid for the electricity each year. A witness for the Respondent explained that one of the “primary roles of Treasury guarantees in power projects is to guarantee payments by TEAS under any ESA. Treasury guarantees also ensure that payments by the EEF to the project company will be made pursuant to the terms provided in any Fund Agreement.”⁸³

200. A witness for the Claimants admitted that, to the extent that the Project would be producing more electricity, TEAS would have to pay more under the Energy Sales Agreement.⁸⁴ This is why the Treasury Guarantee is decisive in ensuring international financing.⁸⁵ But it is obvious that no Treasury would issue a blank guarantee.

201. This conclusion does not discharge the Respondent from the obligations that it might have had in pursuing the successful completion of those other agreements. It does mean that the fact that the Guarantee was not issued at that time is not in itself a breach of the Respondent’s contractual obligations if the required terms for so doing were not available.

202. A similar pattern characterizes the negotiations concerning the Energy Sales Agreement and the Fund Agreement. There can be no doubt either that, under the new macroeconomic policy Turkey was pursuing to put an end to the crisis, these kinds of agreements were not quite welcome. Yet, the issue here is whether these agreements could be concluded in the event that the commercial terms of the Contract had not been finalized.

203. The Tribunal concluded earlier that the commercial terms of the Project were not completed in light of the parties’ different understandings. In such circumstances, it was not possible to complete either a Sales agreement when the amount of electricity to be purchased was not defined or a Fund agreement when the amount of money required

⁸² Testimony of Mr. Sedat Çal, April 9, 2006, Hearing transcripts, Vol. 7, at 1826–29.

⁸³ Affidavit of Mr. Sedat Çal, September 14, 2005, paras. 6, 15; Affidavit of Mr. Nurhan Uyduanoğlu Karaca, September 14, 2005, para. 8.

⁸⁴ Testimony of Mr. Halil Sunar, April 6, 2006, Hearing transcripts, Vol. 4, at 718–23.

⁸⁵ Written Statement of Mr. John Watkins, February 18, 2005, para. 19.

by TEAS to that effect was not known. This is the chain of definitions and agreements that ultimately ends up with the Treasury Guarantee. As noted by a witness for the Claimants, the Treasury would guarantee payments by TEAS and EEF, thus making it necessary to complete these arrangements beforehand.⁸⁶

204. The Claimants are right in arguing that progress was made with the technical services responsible for those agreements, including questions relating to the arbitration clause. It is also quite evident that such services would not finalize any agreement without being specifically backed up by the terms previously defined by MENR in respect of the commercial terms of the Project or even the Danıştay in respect of the amendment of the dispute settlement clauses of the Contract. As these definitions and terms were not forthcoming, neither was the approval of the supplementary agreements based on them.

205. Again this conclusion does not discharge the Respondent of its obligations concerning the overall conclusion of the Project, but it does mean that in itself the situation of the supplementary agreements cannot be considered a breach of the Contract.

206. The Claimants also complained about MENR interfering with the Ministry of the Environment so as to prevent the approval of the Project's Environmental Impact Assessment. However, as this approval was given on April 11, 2002, there is no point in the Tribunal examining the complaint.

10. *Did the Claimants Abandon the Project?*

207. The parties also exchanged accusations as to which of them was ultimately responsible for the failure of the negotiations. The Claimants argue that the Respondent abruptly changed its policy and actively interfered with the agreements attained or under negotiation in an arbitrary manner and made the ultimate completion of the Project impossible. The Respondent asserts that at all times it pursued negotiations with interest, diligence and good faith but that ultimately the Claimants decided to abandon the Project because it had proved to be unfinanceable and technically unviable. In the Respondent's view, the Project was actually abandoned before the alleged expropriation on March 3, 2001, namely the date of the enactment of the Electricity Market Law.

⁸⁶ Fourth Written Statement of Mr. Mesut Çakmak, December 9, 2005, para. 13.

208. The Tribunal is convinced by the evidence adduced by the Claimants that they did not abandon the Project or walk away from the negotiations. In fact, the record is plentiful of letters, proposals, meetings and other activities that were conducted throughout the year 2000 and early 2001 revealing that there was an ongoing effort to unlock the negotiations. The Respondent incorrectly considered the Claimant's proposal of February 10, 2000, as a "final" one. That letter does refer to "final figures" as every option appeared to have been exhausted, but there were many other subsequent initiatives and which, if successful, would have ended up with different figures. Neither was this an obstacle to the efforts made in achieving progress in many other matters related to the Contract.

209. The fact of the matter is that by early 2001 the deadlock was total and there was no point in taking additional initiatives. This was understood by both the Claimants and the Respondent who at that time ceased to devote additional time and resources to a project which obviously offering few or no perspectives. A witness for the Claimants mentioned the numerous efforts made to persuade Turkey to reconsider its views, but to no avail and in the end the only choice left was to begin this arbitration.⁸⁷

11. *Were the Technical and Economic Aspects of the Project Feasible?*

210. The discussion about who was ultimately responsible for the failure of the Project also relates to its technical and economic viability, a matter on which the parties also have very different views.

211. The Respondent asserts that by early 2000 the Project was no longer economically feasible and quite likely would never reach financial close. This was the result of the dramatic increases in mine costs discussed earlier, as well as of the increase in diesel fuel costs. The Respondent contends that, moreover, the CFB technology of the power plant was unproven and could not handle the necessary availability requirements, a matter also discussed above.

212. In the Respondent's submission, the Project could not obtain financing in these conditions as it involved too many unmitigated risks,⁸⁸ including the absence of an

⁸⁷ Written Statement of Mr. Michael Thomson, December 9, 2005, para. 21.

⁸⁸ Rejoinder Expert Report of Mr. Robert Sansom, March 17, 2006, paras. 10–15.

arbitration clause and the technical risks associated with the mine and the power plant.⁸⁹ The Respondent further asserts that the Project's finance lacked the necessary documents for it to be considered by international or national credit agencies.⁹⁰

213. The Claimants have exactly the opposite view as they contend that the Project was technically and economically viable. The technology had been proven in other power plants, the rise in fuel costs was not as severe as depicted by the Respondent and its effects would be mitigated by the adjustments based on the US Consumer Price Index. In addition, the technology for the operation of the mine had various feasible options. In these conditions, the Claimants further maintain that the Project would have met without difficulty the ANG targets.⁹¹

214. Were it not for the actions of the Respondent, the Claimants argue that the financing of the Project would have been achieved without question and that the necessary documents required by credit agencies would have been supplied as the applications progressed in these institutions, in line with usual practice. According to the Claimants, what mattered for financing purposes, was the adequate debt/equity ratio of the Project, which was better than in other projects financed by EximBank. In any event, the Claimants argue that there were alternative sources of financing if necessary. The assessment of the financial advisors was equally encouraging.

215. The Claimants also argue that none of the risks the Respondent mentions as obstacles to obtaining financing were an issue or could not have been resolved satisfactorily. These include legal matters such as the shareholders' agreement, as well as technical or economic issues, such as the fuel supply risk, the price of diesel, the mine technology and the plant CFB technology. The lack of an international arbitration clause was the only real difficulty, the Claimants explain, but even there progress was being made with TEAS and the Energy Fund, as discussed above.

216. Admittedly there were many unknown factors about the technical aspects of the plant and the mine, and the experts have extensively discussed the feasibility of one and

⁸⁹ Rejoinder Expert Report of Ms. Dianne Rudo, March 15, 2006, paras. 88–91; Testimony of Ms. Dianne Rudo, April 8, 2006, Hearing transcripts, Vol. 6, at 1543–52.

⁹⁰ Expert Report of Ms. Dianne Rudo, September 19, 2005, paras. 44–62.

⁹¹ Written Statement of Mr. Dominique Chaniolleau, December 9, 2005, para. 4; Written Statement of Mr. Scott Darling, December 9, 2005, para. 6; Expert Report of Mr. Robert Gamble, December 9, 2005, para. 11; Written Statement of Mr. John Philipp, November 19, 2003, paras. 17–19; Second Written Statement of Mr. John Philipp, February 18, 2005, paras. 11–15; Claimants' Post-hearing Brief, n. 30.

the other, including by way of the comparison with other plants.⁹² Nevertheless, the Tribunal is persuaded that the project was feasible. The successful operation of the Turow CFB plants manufactured by Foster Wheeler, the same manufacturer as in Konya Ilgın, is sufficient evidence to this effect.⁹³ A witness for the Claimants also referred to the successful operation of various other plants of the same kind worldwide.⁹⁴

217. More convincing still is the Claimants' argument that Foster Wheeler would have provided significant performance guarantees to the Project, which in the discussions underway with the Claimants would reach as much as 30% of the total EPC contract price, or US\$141 million in potential liability. As a witness for the Claimants explained that Foster Wheeler would pay liquidated damages by means of "completion guarantees" and "performance guarantees."⁹⁵

218. Many unknown factors also surround the question of international financing, but the Tribunal finds the Claimants' evidence to this effect persuasive. First, it would have been impossible to secure the necessary capital contribution if the Project were not financially sound. The same rationale would guide the decision of lenders.⁹⁶ Although a witness for the Respondent set out the risks which the Project faced, including the difficult integration of the mine with the power plant,⁹⁷ the Tribunal is certain that no one would have raised the necessary financing if such risks had remained unmitigated. Thus this uncertainty factor would have been eliminated.

219. Next, experienced companies and advisors would have made sure that the appropriate documentation were available at the right time for anyone deciding to provide the necessary loans.⁹⁸ And lastly, witnesses have adequately described the process of approval by lending agencies and shown by witness testimony evidencing

⁹² Expert Report of Mr. Robert Gamble, December 9, 2005; Rejoinder Expert Report of Mr. Robert Sansom, March 17, 2006, paras. 123 et seq.

⁹³ Written Statement of Mr. Scott Darling, December 9, 2005, para. 13.

⁹⁴ Third Written Statement of Mr. John Philipp, December 9, 2005, para. 12.

⁹⁵ Written Statement of Mr. Dominique Chaniolleau, December 9, 2005, paras. 21–24.

⁹⁶ Reply Statement of Mr. Michael Austell, December 5, 2005, para. 9.

⁹⁷ Testimony of Ms. Dianne Rudo, April 8, 2006, Hearing transcripts, Vol. 6, at 1537–44.

⁹⁸ Written Statement of Mr. Ian Catterall, November 21, 2003, paras. 6–7; Second Written Statement of Mr. Ian Catterall, February 15, 2005, paras. 12–14.

that the Project was not misguided in this respect and followed a normal time schedule.⁹⁹

III. Considerations on Liability

220. As it is by now customary in investment arbitration, the aggrieved party invokes the breach of every BIT clause dealing with the standards of the investor's protection, while the Respondent vehemently denies any breach. This the Claimants have done in the present case, with the sole exception that they have not claimed direct expropriation of the investment. The Government of Turkey denies any breach of the BIT.

221. The Claimants argue first that the Respondent violated the standard of fair and equitable treatment, failed to provide full protection and security, impaired the maintenance, use and enjoyment of the investment by arbitrary and discriminatory measures and failed to observe the obligations it entered into with regard to the investment. The Claimants also argue that the investment was expropriated through measures tantamount to expropriation. The Tribunal will examine each of these claims separately.

A. Was there a Breach of Fair and Equitable Treatment?

1. *The Legal Arguments of the Parties*

222. The Claimants argue that the fair and equitable treatment standard of Article II (3) of the BIT has been breached. Under this Article "Investments shall at all times be accorded fair and equitable treatment . . . in a manner consistent with international law," while the Preamble of the BIT recalls that such treatment is "desirable in order to maintain a stable framework for investment and maximum effective utilization of economic resources"

223. In light of recent decisions,¹⁰⁰ the Claimants assert that the standard specifically imposes the obligation not to act arbitrarily, in a manner that is grossly unfair and

⁹⁹ Testimony of Ms. Carol Hessler, April 7, 2006, Hearing transcripts, Vol. 5, at 1175–77; Expert Report of Ms. Carol Hessler, December 6, 2005, paras. 34–44; Testimony of Mr. Sikander Zaman, April 7, 2005, Hearing transcripts, Vol. 5, at 1151–55; Written Statement of Mr. Sikander Zaman, December 9, 2005, paras. 78–83; Expert Report of Mr. Frank Langhammer, December 8, 2005, paras. 88–98.

unjust, or that will be idiosyncratic and harmful. It also requires transparency and candor, particularly in administrative proceedings, as well as observance of the representations reasonably relied upon by the investor and sanctions acts performed in bad faith.

224. The Claimants assert in this respect that the Respondent's conduct was arbitrary, particularly because, as in the *Tecmed* case, prior decisions relied upon by the investor were revoked. In the Claimants' view, such arbitrary conduct is apparent in the actions of MENR when it denied the approval of the revised tariff structure of June 19, 1998, and later insisted on the availability factors of the Feasibility Study. The Claimants assert that there was also arbitrariness in the governmental disregard of the Constitutional Court's decision safeguarding vested contract rights.

225. Following the *MTD* and the *CME* cases, the Claimants next argue that their legitimate expectations originating in government assurances were also entirely disregarded, particularly since the legal and business environment of the investment was dramatically altered, as held by the Tribunal in *OEPC* in connection with the violation of fair and equitable treatment. The Claimants recall that Article 48 of the Turkish Constitution provides that the State "shall take measures to ensure private enterprises operate...under conditions of security and stability."

226. The Claimants argue that the changes in the law directed at enabling the development of BOT projects (courting foreign investors to this end) as well as the approval of the Feasibility Study, the Implementation Contract, the required Letter of Undertaking, the assurance that a Treasury Guarantee would be issued and that the Energy Sales Agreement and Fund Agreement would be signed, together with further legal changes in Law 4501, all gave rise to legitimate expectations. They also allege that these expectations were later frustrated when the Respondent revoked agreements and approvals and took away contractual rights.¹⁰¹

227. The Claimants also contend that the Respondent abused its sovereign prerogatives and authority in using its regulatory power to deprive the Project in 1999 and 2000 of the June 19, 1998 approval of an increased capacity, when it prevented the finalization of the supplementary contracts and attempted to force the Claimants to give

¹⁰⁰ *MTD Equity Sdn. Bhd. & MTD Chile S.A. v. Republic of Chile* (ICSID Case No. ARB/01/7), Award of May 25, 2004; *Waste Management, Inc. v. United Mexican States* (ICSID Case No. ARB(AF)/00/3), Award of April 30, 2004.

¹⁰¹ Legal Opinion of Professor Sait Güran, February 18, 2005, para. 2.

up concession rights in connection with the negotiations on the application under Law 4501. A legal opinion by Professors Birsal and Yeşilirmak notes that “under the principles of good faith and trust in the administration, it is our view that the Claimants had justified grounds to rely on the agreement of the MENR to increase the net capacity of the power plant to 465 MW.”¹⁰²

228. According to Claimants, such abuse of regulatory power ultimately resulted in the termination of the Project through a process characterized by a total lack of transparency and candor, within the meaning of the *Metalclad*, *Maffezini*, *Tecmed* and *OEPC* decisions. This failure, in the Claimant’s view, finally led to the unreasonable rejection of all proposals aimed at breaking the deadlock in negotiations.

229. As a consequence, the Claimants argue that good faith, the most basic component of fair and equitable treatment, was deliberately breached so as to obstruct the completion of the Project, revealing in passing the complete lack of administrative competence and effectiveness as required in recent awards.¹⁰³

230. A legal opinion submitted by the Claimants also underlines that the duty of good faith “includes refraining from behavior that may mislead the other party, the immediate notice to the other party when that party is understood to be acting on the basis of a misinterpretation of one’s statements or acts, and acting with a genuine intent and desire to complete negotiations with the aim of reaching an agreement with the other party.”¹⁰⁴ The Claimants thus conclude that the Respondent failed to maintain even a minimally adequate legal, regulatory and administrative structure to support the investment.

231. The Respondent dismisses these allegations on the ground that the Project was technically and financially unworkable and that every single discussion led to a dead end as substantial defects could not be remedied. According to the Respondent, the Project implied risks which result from business decisions and for which Turkey cannot

¹⁰² Legal Opinion of Professors Mahmut Birsal and Arzu Aksaç Yeşilirmak, February 18, 2005, para. 27.

¹⁰³ *Gami Investments, Inc. v. The Government of the United Mexican States*, UNCITRAL, Award of November 15, 2004; *Occidental Exploration and Production Company v. The Republic of Ecuador*, LCIA Case No. UN 3467, Award of July 1, 2004; *Pope and Talbot, Inc. v. The Government of Canada*, UNCITRAL, Award on the Merits of Phase 2, April 10, 2001.

¹⁰⁴ Legal Opinion of Professors Mahmut Birsal and Arzu Aksaç Yeşilirmak, June 27, 2003, para. 53.

be blamed.¹⁰⁵ An investor might end up disappointed, but BITs are not designed to guard against disappointment.¹⁰⁶

232. In the Respondent's view, fair and equitable treatment is a standard that depends on the facts of each case,¹⁰⁷ has to be applied with flexibility¹⁰⁸ and, in any event, requires a high standard of proof.¹⁰⁹ Only acts showing a willful neglect of duty far below international standards¹¹⁰ and bad faith would qualify under this standard.

233. On the basis of its understanding of the facts as explained above, the Respondent asserts that since no common agreement was embodied in the June 19, 1998 Ministerial Approval, there was no prior decision that could have been later revoked by MENR. That approval was, it is further maintained, an internal document that created no rights for a private party.

234. In the Respondent's view, the situation is thus clearly distinguishable from all the cases cited by the Claimants as reasonable expectations had originated in formal decisions or permits on which the investors had relied. The Respondent asserts that here there was a willful misunderstanding by the Claimants, just as there was bad faith in concealing essential facts or issues. But even if there had been an approved agreement, the Respondent argues further, there would still be no violation of the fair and equitable treatment in light of the *Genin* award.¹¹¹

235. For the same reason, the Respondent states that there could have been no breach of the Treasury Guarantee or the supplementary agreements as there was no agreement on the terms of such contracts. An unfinished negotiation cannot be converted into a Treaty breach, contrary to the Claimants argumentation. The Respondent add that the Contract did not either guarantee that any such agreements would be successfully concluded, but only that there was a right to negotiate those agreements.

¹⁰⁵ *Emilio Agustín Maffezini v. The Kingdom of Spain* (ICSID Case No. ARB/97/7), Award of November 13, 2000, para. 64.

¹⁰⁶ *Robert Azinian, Kenneth Davitian, & Ellen Baca v. The United Mexican States* (ICSID Case No. ARB(AF)/97/2), Award of November 1, 1999, para. 83.

¹⁰⁷ *Mondev International, Ltd. v. United States of America* (ICSID Case ARB/99/2), Award of October 11, 2002, para. 118.

¹⁰⁸ *Waste Management, Inc. v. United Mexican States* (ICSID Case No. ARB(AF)/00/3), Award of April 30, 2004, para. 99.

¹⁰⁹ *S.D. Myers, Inc. v. Government of Canada*, UNCITRAL, Partial Award of November 13, 2000, para. 263.

¹¹⁰ *Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil v. The Republic of Estonia* (ICSID Case No. ARB/99/2), Award of June 25, 2001, para. 367.

¹¹¹ *Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil v. The Republic of Estonia* (ICSID Case No. ARB/99/2), Award of June 25, 2001, paras. 370–71.

236. The Respondent argues that the Claimants only had a right to apply for a private law contract under Law 4501, and that the Law offered no guarantee that such private contract would be automatically granted. It further argues that arbitrariness and discrimination are thus unfounded allegations, which could not lead to the frustration of any legitimate expectation. For the Respondent, there can be no legitimate expectation that the proposed revisions of the Contract would be accepted no matter the cost to the Government.

237. The Respondent concludes that it acted in an equitable, transparent, and reasonable manner, in good faith and full compliance with the domestic law, and that there is thus no breach of the fair and equitable treatment standard under the Treaty. The Respondent further concludes that absent evidence to the contrary, negotiations must be presumed to be done in good faith,¹¹² and in light of both the UNIDROIT Principles of International Commercial Contracts (Article 2.1.15) and the *Wintershall* case,¹¹³ there is no obligation to reach an agreement or liability for failure to do so.

2. *The Tribunal's Findings*

238. The standard of fair and equitable treatment has acquired prominence in investment arbitration as a consequence of the fact that other standards traditionally provided by international law might not in the circumstances of each case be entirely appropriate. This is particularly the case when the facts of the dispute do not clearly support the claim for direct expropriation, but when there are notwithstanding events that need to be assessed under a different standard to provide redress in the event that the rights of the investor have been breached.

239. Because the role of fair and equitable treatment changes from case to case, it is sometimes not as precise as would be desirable. Yet, it clearly does allow for justice to be done in the absence of the more traditional breaches of international law standards. This role has resulted in the concept of fair and equitable treatment acquiring a standing on its own, separate and distinct from that of other standards, albeit many times closely related to them, and thus ensuring that the protection granted to the investment is fully safeguarded.

¹¹² *Mobil Oil Iran, Inc. v. Government of the Islamic Republic of Iran and National Iranian Oil Company*, Award No. 311-74-3 of July 14, 1987, para. 160.

¹¹³ *Wintershall, A.G. et al v. Government of Qatar*, 28 I.L.M. 795, 814–15 (1989).

240. Recent awards have applied this standard to the assessment of rights affected by inconsistent State action,¹¹⁴ arbitrary modification of the regulatory framework¹¹⁵ or endless normative changes to the detriment of the investor's business and the need to secure a predictable and stable legal environment.¹¹⁶ This includes most significantly the issue of legitimate expectations which, as the Tribunal in *Tecmed* concluded, requires a treatment that does not "detract from the basic expectations on the basis of which the foreign investor decided to make the investment."¹¹⁷

241. Although the Claimants, as noted above, provide a long list of legitimate expectations that in their view have not been met, the Tribunal is not persuaded that all such complaints relate to legitimate expectations. Legitimate expectations by definition require a promise of the administration on which the Claimants rely to assert a right that needs to be observed.¹¹⁸

242. In fact, the Claimants invoke issues on which the Tribunal has found that no promise or commitment had been made by the Respondent. This is particularly the case of the lack of evidence about the alleged agreement of the commercial terms of the Project. Had these terms been missing, no Energy Sales Agreement or Fund Agreement, and ultimately no Treasury Guarantee could have been issued. As no such agreements were reached, the Tribunal finds that the Respondent is right in arguing that they could not be later revoked.

243. Neither does the Tribunal find merit in the Claimants' argument that the investment was actively requested by the Turkish Government. True enough, the whole BOT policy was built on the premise that foreign investments would be needed, encouraged and welcome,¹¹⁹ but this was a matter of general policy that did not entail a promise made specifically to the Claimants about the success of their proposed project.

244. The evidence in fact points to the contrary conclusion. A witness for the Claimants testified that two high-ranking corporate executives made two short trips to

¹¹⁴ *MTD Equity Sdn. Bhd. & MTD Chile S.A. v. Republic of Chile* (ICSID Case No. ARB/01/7), Award of May 25, 2004, para. 164).

¹¹⁵ *Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States* (ICSID Case No. ARB(AF)/00/2), Award of May 29, 2003, para. 154.

¹¹⁶ *Occidental Exploration and Production Company v. The Republic of Ecuador*, LCIA Case No. UN 3467, Award of July 1, 2004, para. 183.

¹¹⁷ *Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States* (ICSID Case No. ARB(AF)/00/2), Award of May 29, 2003, para. 154.

¹¹⁸ *See J*, Decision No. 349, World Bank Administrative Tribunal, 2006.

¹¹⁹ Opening Statement of Ms. Carolyn Lamm, April 3, 2006, Hearing transcripts, Vol. 1, at 80–81.

Turkey, because they “wanted to meet with senior government officials, make sure they’re aware of the Project, make sure that they viewed this as a beneficial development that they were happy to host in their country.”¹²⁰ It thus appears that it was rather the Claimants who approached the Turkish Government.

245. In the present case, the Claimants contend, moreover, that the breach of fair and equitable treatment goes as far as to have reached the level of bad faith and have entailed the deliberate attempt by the Respondent to destroy the investment without paying compensation. The Tribunal, however, has found no evidence of bad faith or ultimately of a kind of conspiracy to take away legitimately acquired rights that could result in the deliberate termination of the Project. To that extent, the role of fair and equitable treatment in this case does not bring the standard near to expropriation or other forms of taking.

246. The Tribunal is persuaded nonetheless that the fair and equitable treatment standard has been breached, and that this breach is serious enough as to attract liability. Short of bad faith, there is in the present case first an evident negligence on the part of the administration in the handling of the negotiations with the Claimants. The fact that key points of disagreement went unanswered and were not disclosed in a timely manner, that silence was kept when there was evidence of such persisting and aggravating disagreement, that important communications were never looked at, and that there was a systematic attitude not to address the need to put an end to negotiations that were leading nowhere, are all manifestations of serious administrative negligence and inconsistency. The Claimants were indeed entitled to expect that the negotiations would be handled competently and professionally, as they were on occasion.

247. Secondly, there is a breach of the obligation to accord fair and equitable standard of treatment in light of abuse of authority, evidenced in particular, but not exclusively, by the discussion of the Claimants’ application under Law 4501. As noted above, MENR’s demands for a renegotiation went far beyond the purpose of the Law and attempted to reopen aspects of the Contract that were not at issue in this context or even within MENR’s authority.

248. Inconsistent administrative acts are also evident in this case in respect of some matters. On occasion the administration would ignore rights granted by law as a matter

¹²⁰ Testimony of Mr. Robert Dougherty, April 6, 2006, Hearing transcripts, Vol. 4, at 815–16; Written Statement of Mr. Robert Dougherty, December 9, 2005, para. 9.

of policy or practice. This was particularly the case of the foreign branch corporate structure, recognized under the law, the Implementation Contract, the Letter of Undertaking and the Danıştay, but was nevertheless ignored by MENR from February 1998 onward when it demanded the establishment of a Turkish corporation. A witness for the Claimants testified that since 1996 “the various groups determining energy policy in Turkey have not worked harmoniously.”¹²¹

249. Similar was the situation in respect of the Constitutional Court decision upholding the rights acquired under a contract, which was simply ignored by MENR in its dealings with the Claimants. Such inconsistent acts might be unlawful under Turkish law, but in light of the provisions of the Treaty they are also in breach of the standard of fair and equitable treatment.

250. Thirdly, the Tribunal also finds that the fair and equitable treatment obligation was seriously breached by what has been described above as the “roller-coaster” effect of the continuing legislative changes. This is particularly the case of the requirements relating, in law or practice, to the continuous change in the conditions governing the corporate status of the Project, and the constant alternation between private law status and administrative concessions that went back and forth. This was also the case, to a more limited extent, of the changes in tax legislation.

251. Even if some of these changes were introduced to facilitate investments and the conclusion of projects, and to that extent cannot be open to criticism under this standard, the administration again failed to address the consequences of such changes in the negotiations and to accommodate the factors in the equation under discussion, with particular reference to the commercial terms of the Project.

252. Various examples of the breach of fair and equitable treatment obligation are to be found in the record of this case. Among such breaches, the most prominent are indeed those that have been discussed earlier in connection with the administration’s negligence in the handling of the negotiations with the Claimants: an abuse of authority by MENR, in particular with respect to the latter’s demands for renegotiation in connection with the Claimants’ application under Law 4501, and the numerous changes in the legislation and inconsistencies in the administration’s practice, in particular with

¹²¹ Third Written Statement of Mr. Ahmet Eltekin, February 18, 2005, para. 18; Reply Statement of Mr. Ahmet Eltekin, December 9, 2005, para. 8.

respect to the corporate status of the Project Company and the legal status of the concession.

253. The aggregate of the situations explained raise the question of the need to ensure a stable and predictable business environment for investors to operate in, as required not only by the Treaty but also by the Turkish Constitution as noted above. This is what the United States Technical Memorandum on the BIT had very much in mind when it referred to fair and equitable treatment as a standard “that can be invoked in arbitration to protect investments against possible vagaries of the host-Party’s national laws and their administration.”

254. The handling of the case shows the exact opposite. Stability cannot exist in a situation where the law kept changing continuously and endlessly, as did its interpretation and implementation. While in complex negotiations, such as those involved in this case, many changes will occur beyond the control of the government, as was particularly the case with the increased costs, the issue is that the longer term outlook must not be altered in such a way that will end up being no outlook at all. In this case, it was not only the law that kept changing but notably the attitudes and policies of the administration.

255. While noting that no investor “may reasonably expect that the circumstances prevailing at the time the investment is made remain totally unchanged,” the Tribunal in *Saluka* held that the investor can still expect that the conduct of the host State subsequent to the investment will be fair and equitable as the investor’s decision to invest is based on “an assessment of the state of the law and the totality of the business environment at the time of the investment.”¹²²

256. Even if all the above conduct were to comply with good faith, which the Tribunal has no reason not to believe, there still would be an evident breach of the fair and equitable treatment standard under the Treaty, and under Turkish law. To the extent that this caused damage, compensation will of necessity be awarded.

¹²² *Saluka Investments BV (The Netherlands) v. The Czech Republic*, UNCITRAL, Partial Award of March 17, 2006, paras. 301, 305.

B. Was there a Breach of the Obligation to Provide Full Protection and Security?

257. The Claimants have also alleged a breach of the obligation to provide full protection and security as a separate heading of liability. This obligation is indeed embodied in Article II (3) of the Treaty. The Claimants have advanced two arguments in this respect. The first is that, following *CME*, full protection and security includes the adverse effects of the amendments of the law or administrative actions on the investment. The second argument is that, following *OEPC*, the breach of fair and equitable treatment automatically entails the absence of full protection and security. The Respondent opposes both arguments.

258. The Tribunal is mindful of the fact that this particular standard has developed in the context of the physical safety of persons and installations, and only exceptionally will it be related to the broader ambit noted in *CME*. To the extent that there is such an exceptional situation, the connection with fair and equitable treatment becomes a very close one.

259. The Tribunal does not find that in the present case there has been any question of physical safety and security, nor has any been alleged. Neither does the Tribunal find that there is an exceptional situation that could qualify under this standard as a separate heading of liability. The anomalies that have been found are all included under the standard of fair and equitable treatment discussed above. This heading of liability is accordingly dismissed.

C. Was there Arbitrariness or Discrimination?

260. The Treaty also provides in Article II (3) for protection against arbitrary and discriminatory measures that impair the management, operation, maintenance, use, enjoyment, acquisition, expansion or disposal of the investment. This, the Claimants argue, occurred in the present case, particularly in respect of the repudiation of the Ministerial Approval and of the rights under the Contract, the refusal to reinstate such rights following the decision of the Constitutional Court, as well as in connection with the demands related to the application under Law 4501.

261. Again in this different context, the Tribunal finds that, to the extent supported by the facts, the anomalies that took place in connection with the conduct just referred to

are included in the breach of fair and equitable treatment and that there is no ground for a separate heading on liability on account of arbitrariness.

262. As far as discrimination is concerned, the Tribunal notes that all the measures adopted, rightly or wrongly, related to the whole array of BOT projects under consideration, as the Claimants themselves have repeatedly argued. Thus, it is quite evident that Konya Ilgın was not singled out in a discriminatory manner. The Claimants' argument about foreign investments having been discriminated against is equally not supported by the facts. The changes in macroeconomic policy that would have occurred concerned the economy as a whole. The question of foreign investment being particularly intense in the energy sector is a separate matter unrelated to the claim on discrimination. This heading of liability is accordingly also dismissed.

D. Was there a Breach of Obligations Entered into with Regard to the Investment?

263. The Claimants also argue that the Respondent has breached the obligation under Article II (3) of the Treaty to "observe any obligation it may have entered into with regard to investments," including therein not just the undertakings under the Contract but also a host of other commitments originating in the legislative, administrative and regulatory undertakings concerning the investment. Prominent among such alleged breaches is the failure to permit the Claimants to benefit from the laws enacted specifically to improve the financing of the Project, the failure to observe the regulatory undertakings under Article 8 of the Contract, and the failure to exercise the regulatory and administrative authority in good faith and in a reasonable manner.

264. As noted above, the Respondent asserts that under Article 8 of the Contract it had discretion to approve the revised tariff. The discretion contrasted with the more limited language of Article 5.1 of the Implementation Contract,¹²³ with the sole requirement of reasonable grounds, which the Respondent argues was amply satisfied in light of the public interest.¹²⁴ Judge Schwebel also concluded in this respect that

¹²³ Affidavit of Judge Harun Çetintemel, September 9, 2006, para. 11.

¹²⁴ Legal Opinion of Professor Zehreddin Aslan, September 14, 2005, para. 22; Legal Opinion of Professor Ender Ethem Atay, September 15, 2005, para. 22; Second Legal Opinion of Professor Ergun Özsunay, September 13, 2005, para. 12.

MENR “rejected Claimants’ various tariff proposals for what it saw as reasonable grounds and that it did not do so roughly, abruptly, arbitrarily or capriciously.”¹²⁵

265. The Respondent further asserts that at all times it proceeded to negotiate in good faith and, as discussed above, there could be no liability attached to the failure to conclude an agreement if it was deemed to be too onerous for Turkey and if less expensive alternatives were available.¹²⁶

266. The Tribunal concluded in its Decision on Jurisdiction that the existence of the Contract, its validity and binding effects were beyond doubt. The issue that was then left pending for the merits stage was whether the parties had reached agreement on any amendment to some important commercial terms of the Project. As noted above, the Claimants maintain that the parties were under an obligation to complete the negotiations and finalize the Project, while the Respondent asserts that the discretion envisaged in Article 8 was broad enough so as to allow for the disagreements that followed. The Tribunal has found above that important as the Feasibility Study and the Implementation Contract were, they were not self-contained as some of the essential commercial terms were still open to discussion, a conclusion that Article 8 of the Contract clearly corroborates.

267. Although negotiations on the commercial terms were pursued for a long time there is no decisive evidence about an agreement having been unequivocally reached. In view of the fact that the Contract provided for such negotiations to be carried forward, it follows that liability cannot be attached to the fact that agreement was not reached.

268. While a legal expert for the Claimants expressed the view that MENR’s legal options were limited either to approve or disapprove on reasonable grounds,¹²⁷ this was hardly realistic to expect in a project as complex as this. In fact the Claimants were greatly interested in exhausting the possibilities of reaching a negotiated agreement.

269. It follows from the above that the Tribunal cannot conclude that there was a breach of the Contract obligations, except to the extent that the sixty-day time line for a rejection of the revised tariff was never complied with. Such a time limit was in any event not essential as both parties pursued negotiations for many more months and it

¹²⁵ Opening Statement of Judge Stephen Schwebel, April 4, 2006, Hearing transcripts, Vol. 2, at 332–35.

¹²⁶ Affidavit of Mr. Cumhur Ersümer, September 14, 2005, para. 11.

¹²⁷ Legal Opinion of Professor Sait Güran, December 9, 2005, para. 21.

could hardly be expected that it could be met in the context of a negotiation as complex as this.

270. The Tribunal has also found that while both parties were required under the Contract to pursue the negotiations on the additional agreements needed to complete the Project, such as the Treasury Guarantee, the Energy Sales Agreement and the Fund Agreement, such agreements were dependent upon the finalization of the commercial terms of the Contract, a key event that never occurred. It follows that, in spite of the fact that the Contract envisaged these agreements as a part of the overall commitments undertaken by the parties, compliance with such objectives could not be achieved irrespectively of or separately from the commercial terms.

271. A number of recent awards have extensively discussed the meaning of the “umbrella clause”¹²⁸ and there is no point for this Tribunal to go over this discussion again. In the context of the present dispute, it suffices to note that there are different views about whether a contract breach can be transformed into a treaty breach or should be handled differently as an ordinary commercial breach of contract.¹²⁹ As the Tribunal has not found a specific breach of obligations under the Contract, the issue does not arise in this case. Questions concerning the interference arising from the exercise of sovereign powers of the State have been discussed above in connection with the breach of fair and equitable treatment and are, in the light of the facts of this case, independent from contract rights.

E. Was the Investment Expropriated through Measures Tantamount to Expropriation?

272. Although the Claimants have not argued the existence of direct expropriation in this dispute, they have requested a finding of liability on account of the breach of Article III (1) of the Treaty in that various measures adopted are tantamount to expropriation and have resulted in indirect expropriation. Regulatory or creeping

¹²⁸ *SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan* (ICSID Case No. ARB/01/13), Decision of the Tribunal on Objections to Jurisdiction of August 6, 2003; *SGS Société Générale de Surveillance S.A. v. Republic of Philippines* (ICSID Case No. ARB/02/6), Decision of the Tribunal on Objections to Jurisdiction of January 29, 2004; *Salini Costruttori S.p.A. and Italstrade S.p.A. v. The Hashemite Kingdom of Jordan* (ICSID Case No. ARB/02/13), Decision on Jurisdiction of November 19, 2004; *Noble Ventures, Inc. v. Romania* (ICSID Case No. ARB/01/11), Award of October 12, 2005.

¹²⁹ *Joy Mining Machinery Limited v. The Arab Republic of Egypt* (ICSID Case No. ARB/03/11), Award on Jurisdiction of August 6, 2004, paras. 78, 81.

expropriation, the Claimants recall, has been long accepted in the literature of international law and the decisions of international courts and tribunals.

273. Such measures can include, the Claimants assert, covert or incidental interference with the property resulting in the deprivation of economic benefits,¹³⁰ the taking of contract rights and the imposition of unreasonable regulatory regimes.¹³¹ For the Claimants, the aggregate of measures taken in this case resulted in the termination of the Project and the complete destruction of the investment made.

274. The Respondent opposes such allegations on the ground that, as held by the tribunal in *Feldman*, “not every business problem experienced by a foreign investor is an indirect or creeping expropriation”¹³² nor does the protection under the Treaty cover commercial risks.¹³³

275. In the Respondent’s view, the disputed actions were not expropriatory in nature as no rights under the Contract were taken and no vested rights arose from the Implementation Contract, which was only initialed and never signed, from the June 19, 1998 Ministerial Approval, which contained no contractual commitment, or from Law No. 4501, which gave no automatic rights to the conversion of contracts.

276. The Respondent further asserts that neither was there a deprivation of substantial rights, and the Claimants were free, and are still free, to pursue the proposed Project under the terms originally agreed in the Feasibility Study. However, the Claimants chose to abandon the Project even before the actual alleged date of expropriation.

277. In any event, the Respondent argues that, as held in *OEPC*, the deprivation must affect a significant part of the investment, which was also the reason that led the Tribunal in *Noble Ventures* to conclude that no viable company or valuable assets were concerned in the actions taken in that case.¹³⁴ Given that the Respondent asserts that the Project had no economic viability, no value could have been affected by its actions.

¹³⁰ *Metalclad Corporation v. The United Mexican States* (ICSID Case No. ARB(AF)/97/1), Award of August 6, 2004, para. 103.

¹³¹ *Marvin Roy Feldman Karpa v. Mexico* (ICSID Case No. ARB(AF)/99/1), Award of December 16, 2002, at par 103; *CME Czech Republic B.V. v. The Czech Republic*, UNCITRAL, Partial Award, September 13, 2001, para. 603.

¹³² *Marvin Roy Feldman Karpa v. Mexico* (ICSID Case No. ARB(AF)/99/1), Award of December 16, 2002, para. 112.

¹³³ *Middle East Cement Shipping and Handling Co. S.A. v. Arab Republic of Egypt*, (ICSID Case No. ARB/99/6), Award of April 12, 2002, para. 153.

¹³⁴ *Noble Ventures, Inc. v. Romania* (ICSID Case No. ARB/01/11), Award of October 12, 2005, para. 216.

278. The Tribunal has no doubt that indirect expropriation can take many forms. Yet, as the tribunal in *Pope & Talbot* found, there must be some form of deprivation of the investor in the control of the investment, the management of day-to day-operations of the company, interfering in the administration, impeding the distribution of dividends, interfering in the appointment of officials and managers, or depriving the company of its property or control in total or in part.¹³⁵

279. The Tribunal is not persuaded that any such extreme forms of interference took place in this case. Many things were wrongly handled, but none could be considered to amount to regulatory expropriation. The rights that were affected one way or the other, including the Claimants' legitimate expectation, have indeed resulted in a finding of breach of the standard of fair and equitable treatment, yet none of the measures adopted envisaged the taking of property, which is still the essence of expropriation, even indirect expropriation. Although measures tantamount to expropriation may well make the question of ownership irrelevant,¹³⁶ it does require a strong interference with clearly defined contract rights that in this case were in the end incomplete.

280. The Tribunal accordingly concludes that the Respondent has not breached Article III (1) of the Treaty. This conclusion does not mean that there was no value of property or rights affected, but this is a separate question that the Tribunal will address next in the assessment of damages.

IV. Damages and Compensation

A. Claims

1. The Claim for Compensation of Damages

281. In the Claimants' view, the Respondent's violations of the BIT were so severe as to deprive them of the value of their entire investment in the Project, thus resulting in the complete loss of the benefit of such investment and of the value of the contract rights. The Claimants accordingly request, in light of the *Chorzów Factory* case, the full reparation for the injuries caused so as to "as far as possible, wipe out all the

¹³⁵ *Pope and Talbot, Inc. v. The Government of Canada*, UNCITRAL, Award on the Merits of Phase 2, April 10, 2001, para. 100.

¹³⁶ *Waste Management, Inc. v. United Mexican States* (ICSID Case No. ARB(AF)/00/3), Award of April 30, 2004, para. 143.

consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed.”¹³⁷

282. The above claim for compensation, in the Claimants’ submission, should cover all financially assessable damage, including loss of profits arising from either contract arrangements or from a well-established history of dealings, just as the International Law Commission concluded in its comments on Article 36 of the Articles on State Responsibility.

283. Based on the expert reports prepared by Dr. Michael Rosenzweig, the Claimants have put forth three approaches to the assessment of damages: the fair market value, the lost profit valuation, and the investments actually made and out of pocket expenses incurred by the Project sponsors.¹³⁸ The Tribunal will examine each of these heads of claim.

2. Fair Market Value

284. As to the fair market value, the Claimants conclude in their last post-hearing submission that, on the assumption that there has been expropriation, the value of the investment at the time of expropriation was US\$114.951 million. The expert and the Claimants put the expropriation date to be March 3, 2001, the date on which the Electricity Market Law was enacted. Applying interest at the rate of 10.6% per annum, compounded annually, this amount came at the end of 2006, the probable date of the award, to US\$171.986 million. The interest rate retained by the Claimants is the Project’s cost of equity and is thus necessary to return the Claimants to the economic condition they would have been in “but for” the Respondent’s actions.

3. Loss of Profits

285. As to the second approach, if the measure of losing the entire economic benefit that contractual performance would have brought is taken as the basis for compensation, the Claimants estimate their lost profits to be US\$223.742 million. Together with

¹³⁷ *Case Concerning the Factory at Chorzów (Germany v. Poland)*, Judgment of 13 December, 1928, P.C.I.J. at 47.

¹³⁸ Expert Report of Dr. Michael Rosenzweig, February 18, 2005, para. 7; Testimony of Dr. Michael Rosenzweig, April 8, 2006, Hearing transcripts, Vol. 6, at 1262–65.

interest at the rate just noted, lost profits would amount to US\$334.756 million at the end of 2006.

286. All such estimates are without prejudice to certain tax questions concerning the award and the compensation. In the expert's calculation, the net present value of the losses as of the end of 2006 would be US\$301.677 million, which including the avoidance of certain tax effects would amount to US\$494.552 million.

287. The Claimants assert in justification of this approach that they are entitled to the economic equivalent of the contract performance that they were denied, that is the amount of profits that they would have obtained under the Concession Contract.

288. The Claimants argue that such a measure of profits is certain and non-speculative because there was an agreed minimum of electricity to be sold year by year to TEAS under a "take-or-pay" contract, at a defined tariff rate and with guaranteed payments by the Treasury. Moreover, in the Claimants' view, certainty about profits arises from the fact that all Project costs were thoroughly analysed and agreed to, the Project sponsors were highly experienced with a long history of successful projects and the Project was technically and financially practicable.

289. As a consequence of the reliability of the Project, which the Claimants' experts Norwest Corporation describe as "exceptionally high quality," "well-developed" and "fully bankable," the Claimants argue that there was a reasonably certain projected profit stream, much more certain than in other projects considered in other arbitration proceedings where some uncertainty in damage assessment was held not to be an obstacle to the award of damages and lost profits.¹³⁹ The Claimants add that such an approach has been upheld by the award of an ICC tribunal in *SBD v. Turkey*.¹⁴⁰

4. Amount of Investment

290. In the alternative, the Claimants submit, a third approach, arguing that other criteria support their claim for damages. In the Claimants' view, at "the barest minimum," they should be allowed to recoup the amounts invested on behalf of the

¹³⁹ With reference to *Southern Pacific Properties (Middle East) Ltd. v. Arab Republic of Egypt* (ICSID Case No. ARB/84/3), Award of May 20, 1992; *Sapphire International Petroleum Co. v. National Iranian Oil Co. (Sapphire)*, Award of March 15, 1993, and *Karaha Bodas Co. LLC v. Perusahaan Pertambangan Minyak Dan Gas Bumi Negara (Pertamina)*.

¹⁴⁰ Claimants' Reply, para. 347, n. 740, with reference to *SBD Sakarya Bolu Elelrik Dagitim Anonim Sirketi v. The Republic of Turkey*, (ICC Case No. 125751MS), Award of March 20, 2004.

Project Company by its sponsors PSEG Global, North American Coal and Guris. All such amounts expended are, in their submission, reasonable and proper and were all envisaged by the Feasibility Study and the project's authorizing documents. These expenditures include in particular the updated mine costs, the amounts invested by the Project sponsors and out of pocket expenses. Such expenses refer to matters such as the costs of preparing the power plant project and the mine studies, contract negotiations and financing, environmental costs, permits and license fees, and legal and consulting fees.

291. These expenses were estimated by the Claimants' expert on the basis of the "opportunity costs" the Claimants incurred by investing in the Project, that is the "time value of money." In the last post hearing submission, the expenses were estimated to add up to US\$27,941,740.30 by the end of 2006, including prejudgement interest based on the cost of equity. An amount of US\$45,806,131.64 has also been estimated as that resulting from a tax gross up. Alternatively, the Claimants have also calculated prejudgement interest in accordance with the Turkish Bond Yield, which brings these figures to US\$29,050,241.68 and US\$47,623,347.01, respectively.

292. The Claimants finally argue that, contrary to what the Respondent asserts, the contractual rights had a market value even prior to the financial close, as evidenced by the value of the Letter of Guarantee, the Feasibility Study, the Revised Mine Plan and other significant intellectual property and work product worth millions of dollars. The Claimants note that the Contract itself recognized an economic value of between US\$8 million and US\$12 million in connection with the guarantee, just as the applicable BOT regulations¹⁴¹ placed a value of up to 1.5% of the project cost for the completed Feasibility Studies and finalized project documentation.¹⁴²

5. The Respondent's Opposition to the Claim for Damages

293. The Respondent's views start out from the premise that "Claimants did not excavate a mine and never extracted a single shovel of coal or limestone at Konya Ilgın. Claimants did not lay a brick to build a power plant and never delivered a single kilowatt hour of electricity to the Turkish power grid. Claimants did not even start

¹⁴¹ BOT Regulation No. 85/9799.

¹⁴² Claimants' Post-hearing Brief, para. 196; Fourth Legal Opinion of Professors Mahmut Birsal and Arzu Aksa Yeşilirmak, December 9, 2005, CLA 108 to Claimants' Reply on the Merits, paras. 77–78.

work on those projects.” The Respondent accordingly considers that all the activities undertaken were related to a “pre-investment” phase.¹⁴³

294. On these bases, the Respondent argues that the Project had no economic value either in terms of the market for global independent power projects or in terms of an economic project valuation; the amounts allegedly taken were certainly invested elsewhere at competitive rates of return; the expenses allegedly made were “at risk,” as in every power project, and the Claimants should have expected to incur a loss if financial close was not reached; and not even out of pocket expenditures should be recovered because in abandoning the Project the sponsors avoided losses that exceeded the value of the alleged investment.¹⁴⁴

295. The Respondent is in agreement with the principle on reparation laid down in the *Chorzow Factory* case which the Claimants have invoked, but notes that in this case the *status quo ante* that should be restored would leave the Claimants with a project that was “infeasible and not financeable,” that is a project without any value that could have been taken by the Respondent’s acts and, moreover, there was no certainty that the Project would ever have come into existence.

296. The Respondent further argues that the fair market value of any such project is zero as there is no market for projects that are still in development.¹⁴⁵ The Respondent also maintains that the market does not assign a value to a project’s future earnings at least until it has materialized in a full set of contracts and that arbitral awards have refused to accept claims for speculative, uncertain or contingent damages.¹⁴⁶

297. For the same reason, the Respondent maintains that arbitration tribunals will not consider future earnings as a basis for damages when the affected entity is not a “going concern” with a history of actual operations.¹⁴⁷ This is certainly not the case of Konya Ilgin as the revised Concession Contract was not agreed to and none of the other necessary agreements had been concluded either.

¹⁴³ Expert Report of Mr. Rutherford Poats, September 9, 2003, para. 7.

¹⁴⁴ Expert Report of Mr. René Stulz, September 19, 2005, paras. 99–105.

¹⁴⁵ Expert Report of Ms. Dianne Rudo, September 19, 2005, paras. 33–40.

¹⁴⁶ *Occidental Exploration and Production Company v. The Republic of Ecuador*, LCIA Case No. UN 3467, Award of July 1, 2004; *Metalclad Corporation v. The United Mexican States* (ICSID Case No. ARB(AF)/97/1), Award of August 6, 2004; *Wena Hotels v. Arab Republic of Egypt*, (ICSID Case No. ARB/98/4), Decision on Jurisdiction of May, 25, 1994.

¹⁴⁷ *Asian Agricultural Products Ltd. v. Republic of Sri Lanka* (ICSID Case No. ARB/87/3), Award of 21, 1990; *Metalclad Corporation v. The United Mexican States* (ICSID Case No. ARB(AF)/97/1), Award of August 6, 2004; *Autopista Concesionada de Venezuela, C.A. v. Bolivarian Republic of Venezuela* (ICSID Case No. ARB/00/5), Award of September 23, 2003.

298. Neither does the Respondent accept that the contractual arrangements provide a basis to award compensation, particularly in view of the fact that the claim for compensation on this count does not rely on the Contract but on cash flow tables that were a part of the February 13, 1998 Claimants' proposal for a renegotiation that was never agreed upon. The Respondent in particular opposes the Claimants' argument that the *Sapphire* and the *Pertamina* decisions would lend support to the role of contractual arrangements in determining projected income streams subject to compensation. In those cases there were complete contracts that actually described and governed the projects in question, which is far from the case here.

299. In the opinion of an expert for the Respondent, even if the Project had proceeded to construction in 2002, and to operation in 2004, it still would have failed economically by 2005 given the increases in world oil prices, mining costs and other key factors.¹⁴⁸

300. Aside from the fact that the Respondent opposes the valuation methods suggested by the Claimants, in the understanding that both are mere variations of loss of profits calculations, there are numerous disagreements about the specific factors taken into account to this effect by Dr. Rosenzweig, the Claimants' expert, with particular reference to the discount rate used in those calculations and the method for its application.¹⁴⁹ In Dr. Stulz's estimates, the appropriate corrections result in a fair market value put at negative US\$33 million and a loss of profits at negative US\$40 million.

301. The Respondent also opposes the claim for development and out of pocket expenses because of the "at risk" nature of such expenses noted above, and also questions a number of specific expenditures which in the Respondent's view are unrelated to the Project, including expenditures made by NACC and Guris, entities that are not Claimants in this case. The Respondent estimates in its last post hearing submission that if the appropriate corrections are made to this effect, and the risk-free Treasury bill rate is applied as the relevant interest rate, such expenses would amount in 2006 to only US\$8.754 million.

¹⁴⁸ Expert Report of Mr. Robert Sansom, March 17, 2006, paras. 10–15.

¹⁴⁹ Testimony of Mr. René Stulz, April 10, 2006, Hearing transcripts Vol. 8, at 2125–31.

B. The Tribunal's Findings

302. In its jurisdictional decision, the Tribunal found that an investment had been made in the form of a Concession Contract, and distinguished this situation from that considered in *Mihaly*, where the parties never signed a contract and expressly disclaimed any obligations arising from the preparatory work undertaken.¹⁵⁰ So too, this case was distinguished from *Zhinvaly*, where the parties expressly acknowledged that the Claimants did not have an investment. Moreover, the Tribunal is mindful that in *Mihaly* the decision did in fact consider that it might well be the case in other investments that the moneys spent or expenses incurred in their preparation can be swept within the umbrella of such investment.¹⁵¹

303. At the jurisdictional stage, the Tribunal also decided that a different question, pertaining to the merits, is “whether all or some of the activities undertaken qualify as a part of the investment or are to be regarded as merely preparatory. The same holds true of whether the assets of the Project Company constitute an investment.”¹⁵² This is the first issue the Tribunal must now decide on the merits.

304. As noted, the Respondent is of the view that because there was no mining undertaken and the plant never even started to be built, there is nothing to compensate for. It is an accepted fact of the case that, except for a groundbreaking ceremony, there was no mining undertaken or construction started, not even in terms of the necessary preparations to that effect. This, however, is not a reason sufficient in itself to rule out the existence of damages subject to compensation. An investment can take many forms before actually reaching the construction stage, including most notably the cost of negotiations and other preparatory work leading to the materialization of the Project, even in connection with pre-investment expenditures, particularly when, like in this case, there is a valid and binding Contract duly executed between the parties.

¹⁵⁰ *PSEG Global, Inc., The North American Coal Corporation, and Konya Ilgın Elektrik ve Ticaret Limited Sirketi v. The Republic of Turkey* (ICSID Case No. ARB/02/5), Decision on Jurisdiction of June 4, 2004, para. 81.

¹⁵¹ *Mihaly International Corporation v. Sri Lanka*, (ICSID Case No. ARB/00/2), Award of March 15, 2002, para. 50.

¹⁵² *PSEG Global, Inc., The North American Coal Corporation, and Konya Ilgın Elektrik ve Ticaret Limited Sirketi v. The Republic of Turkey* (ICSID Case No. ARB/02/5), Decision on Jurisdiction of June 4, 2004, para. 104.

1. *Fair Market Value*

305. The Tribunal will accordingly consider first whether the claim to a fair market value of the Project is justified in light of the nature of the investment made. It must be noted in this respect that the BIT, like most treaties of its kind, provides for the fair market value as the measure for compensation only in connection with expropriation. Since the Tribunal has found above that there is no expropriation in this case, either direct or indirect, the fair market value does not appear to be justified as a measure for compensation in these circumstances.

306. From a financial point of view, the Tribunal is persuaded by the view of Dr. Carlos Lapuerta, the Respondent's expert, who in answering a question from the Tribunal, first explained that there might be a market for projects that have not reached financial close or started construction or operation, as long as there is a willing buyer and a willing seller prepared to buy and sell for one dollar. However, he noted that this is normally a very limited market, based on private contacts and not on public offers, that never comes anywhere near the amount claimed in this case.¹⁵³

307. From a legal point of view, the Tribunal is mindful that a number of cases accepted the measure of compensation based on the fair market value as appropriate for treaty breaches not amounting to expropriation and relating to the breach of fair and equitable treatment and other standards of protection under the treaty in question, as evidenced by both NAFTA¹⁵⁴ and ICSID¹⁵⁵ cases.

308. Yet, in all these cases the breach that was compensated had resulted in damage to investments that were at the production stage, not merely in planning or under negotiation. While the Tribunal has found that there is in this case a breach of fair and equitable treatment, this breach relates not to damages to productive assets but to the failure to conduct negotiations in a proper way and other forms of interference by the Respondent Government. The appropriate remedies thus do not relate to a

¹⁵³ Testimony of Mr. Carlos Lapuerta, April 9, 2006, Hearing transcripts, Vol. 7, at 1719–72.

¹⁵⁴ *S.D. Myers, Inc. v. Government of Canada*, UNCITRAL, Partial Award of November 13, 2000; *Pope and Talbot, Inc. v. The Government of Canada*, UNCITRAL, Award on the Merits of Phase 2, April 10, 2001.

¹⁵⁵ *Marvin Roy Feldman Karpa v. Mexico* (ICSID Case No. ARB(AF)/99/1), Award of December 16, 2002; *CMS Gas Transmission Company v. The Argentine Republic* (ICSID Case No. ARB/01/1), Award of April 20, 2005; *Azurix Corporation v. The Argentine Republic* (ICSID Case No. ARB/01/12), Award of July 14, 2006, para. 424.

compensation for the market value of those assets but to a different objective. This, as will be discussed below, also entails an economic value but of a different nature.

309. The Tribunal accordingly finds that the fair market value shall not be retained as the measure for compensation in this case and hence it will also not discuss the many technical aspects raised by the parties in connection with the factors that were taken into account for assigning a value to the claim and the appropriate method for its calculation.

2. *Loss of Profits*

310. The second heading of claim for compensation is based on the lost profits approach put forth by the Claimants. The Tribunal is mindful that, as the award in *Aucoven* noted, ICSID tribunals are “reluctant to award lost profits for a beginning industry and unperformed work.”¹⁵⁶ This measure is normally reserved for the compensation of investments that have been substantially made and have a record of profits,¹⁵⁷ and refused when such profits offer no certainty.¹⁵⁸

311. The Respondent convincingly invoked in support of its objections to this approach the awards in *AAPL*¹⁵⁹ and *Metalclad*,¹⁶⁰ which required a record of profits and a performance record, just as the awards in *Wena*,¹⁶¹ *Tecmed*¹⁶² and *Phelps Dodge*¹⁶³ refused to consider profits that were too speculative or uncertain. The Respondent also convincingly noted that in cases where lost profits have been awarded, such as *Aminoil*,¹⁶⁴ this measure has been based on a long history of operations.

312. The Claimants also noted that line of decisions, but distinguish the situation where there have been contractual arrangements “that establish the expectation of profit

¹⁵⁶ *Autopista Concesionada de Venezuela, C.A. v. Bolivarian Republic of Venezuela* (ICSID Case No. ARB/00/5), Award, September 23, 2003, para. 360.

¹⁵⁷ *Autopista Concesionada de Venezuela, C.A. v. Bolivarian Republic of Venezuela* (ICSID Case No. ARB/00/5), Award, September 23, 2003, para. 361.

¹⁵⁸ *Autopista Concesionada de Venezuela, C.A. v. Bolivarian Republic of Venezuela* (ICSID Case No. ARB/00/5), Award, September 23, 2003, para. 365.

¹⁵⁹ *Asian Agricultural Products Ltd. v. Republic of Sri Lanka* (ICSID Case No. ARB/87/3), Award of 21, 1990.

¹⁶⁰ *Metalclad Corporation v. The United Mexican States* (ICSID Case No. ARB(AF)/97/1), Award of August 6, 2004.

¹⁶¹ *Wena Hotels v. Arab Republic of Egypt*, (ICSID Case No. ARB/98/4), Decision on Jurisdiction of May, 25, 1994, paras. 122–24.

¹⁶² *Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States* (ICSID Case No. ARB(AF)/00/2), Award of May 29, 2003.

¹⁶³ *Phelps Dodge Corporation v. Iran*, 10 Iran–US C.T.R. 121, 132–33 (1986).

¹⁶⁴ Respondent’s Counter-memorial, para. 309, n. 564, with reference to *Kuwait v. Aminoil*, 21 I.L.M. 976, 989–94 (1982).

at a certain level and over a given number of years,” which results in the concern regarding speculation being removed. The Tribunal would have no difficulty with this proposition, because in fact a self-contained and fully detailed contract can well determine a basis for the calculation of future profits. However, the Tribunal must also note that in many long-term contracts it is most difficult if not impossible to calculate such future profits with certainty, particularly if the contract is subject to adjustment mechanisms and other possible variations with time.¹⁶⁵

313. Even assuming that none of those difficulties existed, in this case the exercise becomes moot because the parties never finalized the essential commercial terms of the Contract, and as a result neither could the additional agreements concerning the sale of electricity, the Fund payments and the Treasury guarantee be finalized. Relying on cash flow tables that were a part of proposals that did not materialize does not offer a solid basis for calculating future profits either.¹⁶⁶ The future profits would then be wholly speculative and uncertain. By definition, the concept of *lucrum cesans* requires in the first place that there is a *lucrum* that comes to an end as a consequence of certain breaches of contract or other forms of liability. Here such an element is not only entirely absent but impossible to estimate for the future.

314. The Tribunal is also troubled by the economic foundations offered by the Claimants for the lost profit approach. Dr. Rosenzweig’s justification for this claim is based on the “cost of equity to the providers of the equity because that’s the value to them ... the minimum return that the equity providers are willing to accept”¹⁶⁷ The Respondent notes that this approach turns on the subjective assessment of the investor’s own minimum acceptable return on equity, without any objective or market-based assessment of the project and its risks, an approach which results in a claim twice the amount of the claim for fair market value put forth in this case.

315. The Tribunal will accordingly also not retain the lost profits heading of claim as the measure of compensation because it cannot be justified from a legal or economic point of view in the circumstances of the case.

¹⁶⁵ *Autopista Concesionada de Venezuela, C.A. v. Bolivarian Republic of Venezuela* (ICSID Case No. ARB/00/5), Award of September 23, 2003.

¹⁶⁶ *Autopista Concesionada de Venezuela, C.A. v. Bolivarian Republic of Venezuela* (ICSID Case No. ARB/00/5), Award of September 23, 2003, para. 354.

¹⁶⁷ Testimony of Dr. Michael Rosenzweig, April 8, 2006, Hearing transcripts, Vol. 6, at 1335–37.

3. *Compensation of Investment Expenses*

316. The third approach to compensation that the Claimants have put forth concerns the investments made and out of pocket expenses referred to above. While these amounts have been described at various points as pre-investment, pre-closing, pre or post-expropriation and other, they all correspond to the period of preparation and negotiation of the Project's technical and legal aspects.

317. The Tribunal found above that the Respondent was in breach of some Treaty provisions imposing upon it obligations in connection with the protection of the investment. The question remains whether all or only some of the investments made qualify under that protection so as to justify compensation for the damage caused.

318. Dr. Rosenzweig's expert report has grouped these investments into five principal categories: legal; mine and fuel supply; other technical studies; environmental; and Project preparation, which in turn refers to items such as financing, permits, corporate structure, preparations for implementation and drafting and negotiation of commercial terms. The Tribunal notes that such categories correspond to the history of the negotiation of the Project outlined above and the many issues that arose along the way, and thus offer a reasonable framework to examine the specific amounts claimed.

319. All such categories were also envisaged in the Feasibility Study and the Contract, as explained above. It should be noted in particular that Article 6 of the Contract includes in the total investment cost of the Project "all the expenses made by the Company regarding the facilities in accordance with the feasibility report, until the commercial operation date." It is not unusual either for awards to allow for the costs of negotiation of a project.¹⁶⁸

320. The Tribunal also notes that the specific amounts claimed have been subject to a detailed audit by the Claimants' expert, who has also introduced the necessary corrections justified by its own revisions or by some of the comments made by the Respondent's experts. To this end, the Tribunal is mindful that in *Aucon* the award

¹⁶⁸ *Autopista Concesionada de Venezuela, C.A. v. Bolivarian Republic of Venezuela* (ICSID Case No. ARB/00/5), Award of September 23, 2003, para. 263.

did not find any reason to disregard financial statements produced by the Claimants and took into account the corrections made.¹⁶⁹

321. Subject to the Respondent's objections that will be examined below, the Tribunal considers that the approach followed by Dr. Rosenzweig offers a solid basis on which to proceed. The amount of expenses estimated by Dr. Rosenzweig was set at US\$11,467,668, before escalation by interests and tax gross up.¹⁷⁰ Prejudgement interest based on the cost of equity brings this amount to US\$27,941,740.30 by the end of 2006. With the tax gross up that will be discussed the amount claimed further escalates to US\$45,806,131.64. However, the basic amount claimed that the Respondent considered to make its objections was US\$11.722 million. For the sake of avoiding confusion, the Tribunal will take this last amount as the claimed figure.

322. The Respondent's first objection concerns the fact that the Claimants have included in their estimates expenses incurred by NACC and Guris, entities that are not parties to these proceedings. In the Respondent's view, the Claimants' contention that the payments were made on behalf of the Project company does not change the fact that such payments were not made by either the Project company or PSEG, and thus are not actual expenditures subject to compensation.

323. The Claimants have in fact argued that the amounts invested by all the sponsors of the Project represent the minimum value that could be assigned to the rights owned directly by the Project company and indirectly by PSEG, and that, moreover, this view is consistent with the Memorandum of Understanding among the sponsors.

324. The Tribunal found in its Decision on Jurisdiction that indeed NACC had no standing in these proceedings as it had not signed the Contract and was acting basically as the technical operator for the investor; whether there were legal arrangements in place between the sponsors as to actual or potential equity holdings in the Project company did not change the situation. Guris was at an even greater disadvantage to this effect, because its participation as a sponsor was less evident and its field of expertise is construction, which was one of the activities that never came to be.

325. The Tribunal will not undo with one hand what it did with the other. This would be the result if compensation is awarded in respect of investments or expenses incurred

¹⁶⁹ *Autopista Concesionada de Venezuela, C.A. v. Bolivarian Republic of Venezuela* (ICSID Case No. ARB/00/5), Award of September 23, 2003, paras. 248, 258.

¹⁷⁰ Written Statement of Dr. Michael Rosenzweig, September 18, 2005, Annex 17.

by entities over which there is no jurisdiction, even if this was done on behalf of one of the Claimants. As the Tribunal also noted in the Decision on Jurisdiction, these entities might have a claim against PSEG in the light of intra-corporate arrangements, but this is not something for which Turkey is liable, directly or indirectly.

326. The expenses incurred by NACC and Guris, as calculated by Mr. Carlos Lapuerta, the Respondent's expert, amount to US\$2.317 million. The development expenses claimed will be accordingly reduced by this amount.

327. The second objection made by the Respondent's expert, Mr. Carlos Lapuerta, concerns the fact that the claim includes expenses for work performed prior to February 1995, that is before the Feasibility Study was submitted to MENR, as well as expenses incurred after the date of alleged expropriation, that is after March 2001.

328. The Claimants have explained that although some of the expenses were incurred prior to the submission of the Feasibility Study, they were actually paid after that submission. This, however, appears to be inconsistent with the expert's methodology of recording expenses at the time made and not at the time paid, and is also inconsistent with his own description of these being "pre-investment expenses."¹⁷¹ The Tribunal considers the objection tenable and will accordingly reduce the development expenses, as calculated by the Respondent's expert, by an amount of US\$94,126.

329. As the Tribunal has found that there is no expropriation involved in this case, the actual date of the alleged expropriation is immaterial for the purposes of establishing expenses made. As long as these were within the accepted categories and reasonably related to the negotiations and advancement of the Project completion, compensation is not limited to that date. The Tribunal accordingly dismisses the objection made on this count for US\$254,810.

330. A third objection concerns the payments of VAT in the United Kingdom and the Netherlands for US\$62,039, which the Respondent believes are unrelated to the Project and which could be offset by the Project sponsors. In the Claimants' view, these were legitimate expenses incurred in the development of the Project and could not be diminished by theoretical offsets which could have related to other business of the Project sponsors in those jurisdictions. The Tribunal is persuaded by the Claimants'

¹⁷¹ Written Statement of Dr. Michael Rosenzweig, September 18, 2005, para. 46.

views in this respect and finds no reason to believe that VAT could have been improperly claimed. The objection is accordingly dismissed.

331. The Respondent raises a fourth objection concerning the absence of adequate evidentiary support for salaries of PSEG employees, requesting a reduction of US\$820,651. While detailed evidentiary support has not been submitted for every single penny spent on the Project, the Tribunal does not find any reason to doubt that the audit by Dr. Rosenzweig and his associates could have added unjustified entries in respect of salaries. It is only natural that such lengthy expenses, involving in the Respondent's expert argument around 1,085 different entries, will be grouped into more succinct categories and periods. The objection is accordingly dismissed.

332. A fifth objection concerns what the Respondent believes are excessive overhead expenses. Dr. Rosenzweig used a 99% ratio of overhead to salaries as this was PSEG's company wide average for the period. The Respondent's expert believes that a comparison with other U.S. firms would suggest a 57% ratio, which is closer to the 60% ratio used for NACC. In addition, there would appear to be problems of double counting and other expenses irrelevant to the Project, as well as doubts about some items that could have been included also in other expenses claimed. In the light of these objections, the Respondent's expert proposes a reduction of US\$407,199; if overhead is eliminated altogether the reduction would be in the sum of US\$799,294.

333. While it is true that a 99% ratio appears high and that some specific items are unclear, the Tribunal accepts Dr. Rosenzweig's figures in this matter, which are based on the contemporaneous accounts of the Project's sponsors. In addition, the Tribunal does not find that an overall overhead expense of US\$799,294 is excessive for a Project of this kind and its many complexities. The objection is accordingly dismissed.

334. The sixth objection made by the Respondent concerns transcription errors for US\$60,923, double counting of some travel expenses for US\$8,622, and inappropriate expenses, in particular the participation in the American-Turkish Council (US\$21,730) and legal fees relating to the investigation of Guris for possible corrupt practices (US\$67,234). Of 1900 invoices submitted, the objections concern 11.

335. The Claimants' expert reviewed the objected invoices and has established that in some cases corrections were justified. The claimed amount has accordingly been reduced by a total of US\$16,430.66, which is also reflected in the final amount claimed

in the last post hearing submission. The Tribunal is satisfied that these corrections have been made in accordance with appropriate accounting practices and also finds that the explanations to this effect have been satisfactory.¹⁷²

336. The Tribunal finds, however, that the objections made to expenses relating to the American-Turkish Council and legal expenses concerning Guris' investigation are justified. The first is a kind of general forum for policy discussions that, while of interest to the Project, cannot be considered a cost related directly to the Project development. The second objection relates to legal fees also unrelated to the development of the Project and which concern a foreign entity not a party to these proceedings. The amounts claimed will accordingly be reduced by US\$21,730 and US\$67,234 on account of these two expenses.

337. Reducing the basic claimed amount of US\$11.722 million by the objections that the Tribunal has accepted above (US\$2.317 million for NACC and Guris expenses; US\$94,126 for pre-investment expenses; US\$21,730 for participation in the American Turkish Council; and US\$67,234 for Guris' investigation), and further reducing it by the corrections that the Claimants' expert made to some items in the amount of US\$144,000 (as per submission of March 20, 2006) and US\$16,430.66 as noted above, the compensation is set at US\$9,061,479.34.

338. The Claimants escalated the amount claimed by two factors. The first is the interest rate that will be discussed below. The second is a tax gross up resulting from the applicable Turkish taxes to the compensation awarded to the Project Company (39%). This tax gross up is not claimed if the compensation is awarded to PSEG.

339. The Claimants assert in this connection that this tax gross up is the only way to ensure that an award makes the company whole. The Respondent objected to this claim because the Project sponsors wrote-off the development expenses and thus deducted them against the corporate income, thus reducing their tax bill and receiving substantial tax benefits.¹⁷³

340. As the Tribunal has excluded the claims relating to expenses by NACC and Guris, PSEG Global is the only investor remaining in the Project Company. While the Project Company might have assets in its own name, compensation for these values has

¹⁷² Claimants' Response to Respondent's new evidence, July 11, 2006, Annex 3.

¹⁷³ Expert Tax Report of Mr. Faruk Sabuncu, March 15, 2006.

been computed in the development expenses discussed above. Moreover, the Tribunal notes that the Project Company is wholly owned by PSEG Global. The Tribunal accordingly finds no reason to award compensation to the Project Company and will do so only to PSEG Global. The question of the tax gross up is thus no longer relevant in this context.

4. Interest

341. The parties have also extensively discussed the question of interest. The Claimants' expert, Dr. Rosenzweig, has used the date of alleged expropriation, March 3, 2001, to calculate prejudgement interest relating to expenses made before and after this date. For the period prior to March 2001, the estimated interest rate is 12% based on the opportunity cost to the Project Company at that particular point in time and the length of time since the investment was made until the date of expropriation. This opportunity cost is in turn based on the "historic" cost of equity. After March 2001, the estimated interest is 10.6% based on a "forward looking" cost of equity. Post-award interest is also calculated at 10.6%. Alternatively, the Claimants accept the applicable Turkish sovereign rate as reflected in the Turkish Bond yield, which as noted results in an increased amount of the compensation claimed.

342. As noted above, the expenses, including prejudgement interest based on the cost of equity, were estimated by the Claimants to add up to US\$27,941,740.30 by the end of 2006. Alternatively, the calculated prejudgement interest in accordance with the Turkish Bond Yield, brings this figure to US\$29,050,241.68.

343. The Respondent's expert, Mr. Lapuerta, considers this approach unjustified from a methodological point of view. In his view there is no reason to apply a different prejudgement interest rate before and after the alleged expropriation. As noted above, the Respondent also objects to the fact that in Dr. Rosensweig's approach the cost of equity is subjectively established by each investor. Moreover, the Respondent also objects to the computation of expenses before they were actually paid.

344. Another expert for the Respondent, Dr. Stulz, explained that in his view the appropriate interest rate is that of the United States Treasury Bill as it would only be justified to exceed this rate when there is a risk involved, which is not the case of the

compensation resulting from an award.¹⁷⁴ In the Respondent's estimates, total damages after reductions and corrections, including interest at the United States Treasury Bill rates, amount to only US\$8.754 million.¹⁷⁵

345. The Tribunal will examine first the question of the prejudgement interest. The Tribunal is not persuaded by the Claimants' argument that the cost of equity offers an appropriate basis to this effect. As noted above, the cost of equity is based on subjective determinations by the investors. For this reason it does not offer a useful basis for calculating interest that aims at the protection of the value of funds spent rather than the value of expropriated assets, which was in the first place the assumption behind the Claimants' choice.

346. Even less so is the Tribunal persuaded by the alternative reliance on the Turkish Bond yield as the funds not invested in the Project would certainly not be placed in the Turkish financial market at that time. The sovereign risk is not the appropriate measurement for an alternative placement of funds.

347. Neither is the Tribunal persuaded by the Respondent's choice of the US Treasury Bill as the reference point. It would not offer a realistic alternative for the Claimants' investment of funds that were not placed in Turkey, independent of the question as to whether or not the compensation provided in an award involves some measure of risk.

348. In the opinion of the Tribunal, taking into account all the circumstances of the present case, the most appropriate benchmark which will compensate adequately an international company such as PSEG Global is the 6 month average LIBOR plus 2 per cent per year for each year during which amounts are owing. The interest shall start running on the date specified below until payment of the Award. Interest shall be compounded semi-annually.

349. The Tribunal turns now to the discussion of *dies a quo*. Had there been in this case a finding of expropriation, the determination of the starting point for the application of interest could have been certain. As noted by the Tribunal in *Azurix*, however, where there is indirect expropriation or a breach of fair and equitable

¹⁷⁴ Expert Report of Mr. René Stulz, September 19, 2005, para. 114; Rejoinder Expert Report of Mr. René Stulz, March 16, 2006, para. 125.

¹⁷⁵ Review of Development Expenses of Mr. Carlos Lapuerta, May 26, 2006, para. 57.

treatment this determination is more difficult and less certain, except perhaps if the acts in question result in a clear deprivation of the investment.¹⁷⁶

350. In recent cases, the date of termination of a concession agreement has been used as the starting point because it offers a date which is certain.¹⁷⁷ In this case, however, none of those elements is available. The breach of fair and equitable treatment is not of such nature as to be comparable to expropriation or deprivation, and neither was there a specific date of termination of the Contract. It follows that there is no reason to make a distinction based on the date of the alleged expropriation for expenditures made before or after that date.

351. The Tribunal has considered the list of expenses submitted by the Claimants and the comments of the Respondent's experts. Some deductions have been upheld by the Tribunal, as explained above. The yearly apportionment of the expenses which the Tribunal has found the Claimants are entitled to recover from the Respondent is a task which neither the Tribunal nor the parties need to undertake. Some practical solution is needed. The Tribunal notes that the expenses are spread over a period of approximately 7 years, (i.e., from early 1995 until the request for arbitration in early 2002). The Tribunal holds that interest shall run on the total amount awarded, from August 1, 1998, as a mean due date, until payment of the Award. There is accordingly no need for a separate or different determination of the post Award interest.

5. Costs

352. Finally, the Tribunal turns to costs. Although the Claimants did not prevail on the major portions of their monetary claims, they prevailed on jurisdiction and on liability in respect of certain breaches of the Treaty. To obtain justice, they had no option but to bring this arbitration forward and to incur the related costs. For this reason, the Tribunal considers it fair that the parties contribute to the cost in the proportion of 65% for the Respondent and 35% for the Claimants. Without entering into details of the claimed costs, the Tribunal accepts the costs claimed by the parties in

¹⁷⁶ *Azurix Corporation v. The Argentine Republic* (ICSID Case No. ARB/01/12), Award of July 14, 2006, para. 417, with reference to *Malek v. Iran*, award 534-193-3, para. 114 (1992) (citing *Int'l Technical Prods. Corp. v. Iran*, Award No. 190-302-3, at 49, 9 Iran-U.S. Cl. Trib. Rep. 206, 240-241 (1985)).

¹⁷⁷ *Azurix Corporation v. The Argentine Republic* (ICSID Case No. ARB/01/12), Award of July 14, 2006, para. 418; *Autopista Concesionada de Venezuela, C.A. v. Bolivarian Republic of Venezuela* (ICSID Case No. ARB/00/5), Award of September 23, 2003, paras. 369-75.

their post hearing submissions, which are in the total amount of US\$20,851,636.62, including legal costs and fees.

353. The Respondent shall accordingly pay 65% of the costs of the arbitration proceeding and of the legal costs and fees (US\$13,553,563.80), of which it has already advanced US\$8,950,832.10. The Claimants shall pay 35% of the costs of the arbitration proceeding and of the legal costs and fees (US\$7,298,072.81), having paid US\$11,900,804.52. Therefore, the Respondent shall pay to the Claimants US\$4,602,731.70 in respect of such costs.

354. The Tribunal is pleased to extend its appreciation to counsel for both parties for having performed their professional duties with distinction, greatly helping the Tribunal to fully understand the complex issues discussed and to reach this award.

AWARD

1. The Respondent breached its obligation to accord the investor the fair and equitable treatment guaranteed in Article II (3) of the Treaty.
2. The Respondent shall pay PSEG Global compensation in the amount of US\$9,061,479.34.
3. The Respondent shall pay PSEG Global interest at the 6 month average LIBOR rate plus 2 per cent per year for each year during which amounts are owing. Interest shall be compounded semi-annually.
4. Interest on the above amount awarded shall be paid from August 1, 1998, as the mean due date for the period during which expenses were made, until payment of the Award.
5. The total costs of the arbitration, including legal costs and fees, is set at US\$20,851,636.62.
6. The Respondent shall pay 65% of the costs of the arbitration and legal costs and fees (US\$13,553,563.80), of which it has already advanced US\$8,950,832.10. The Claimants shall pay 35% of the costs of the arbitration and legal costs and fees (US\$7,298,072.81), having paid US\$11,900,804.52. Therefore, the Respondent shall pay to PSEG Global US\$4,602,731.70 in respect of such costs.

7. All other claims are hereby dismissed.

[signed]
Francisco Orrego Vicuña
President of the Tribunal
January 17, 2007

[signed]
L. Yves Fortier
Arbitrator
January 17, 2007

[signed]
Gabrielle Kaufmann-Kohler
Arbitrator
January 16, 2007