

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

DEUTSCHE BANK AG

v.

DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA
ICSID CASE NO. ARB/09/02

AWARD

Rendered by an Arbitral Tribunal composed of
Mr. Makhdoom Ali Khan, *Arbitrator*
Professor David A.R. Williams QC, *Arbitrator*
Professor Dr. Bernard Hanotiau, *President*

Secretaries of the Tribunal
Ms. Frauke Nitschke
Ms. Eloïse Obadia

DATE OF DISPATCH TO THE PARTIES: *OCTOBER 31, 2012*

REPRESENTATION OF THE PARTIES:

<i>Representing the Claimant:</i>	<i>Representing the Respondent:</i>
<p>Ms. Judith Gill QC Mr. Matthew Gearing Mr. Anthony Sinclair Mr. Andrew Battisson Mr. Matthew Hodgson <i>Allen & Overy LLP</i></p> <p>and</p> <p>Ms. Dilumi de Alwis Mr. R. Senathi Rajah <i>Julius and Creasy</i></p>	<p>The Honorable Mohan Pieris, P.C. <i>Former Attorney General (until Oct. 2011)</i> The Honorable Eva Wanasundera, P.C. <i>Former Attorney General</i> (Nov. 2011 to July 2012) The Honorable Palitha Fernando, P.C. <i>Attorney General (since July 2012)</i> Mr. Janak de Silva Mr. Milinda Gunetilleke Mr. Rajitha Perera Ms. Ruwanthi Herath-Gunaratne <i>Attorney-General's Department</i> <i>Democratic Socialist Republic of Sri Lanka</i></p> <p>and</p> <p>Professor James Crawford SC <i>Matrix Chambers</i></p> <p>and</p> <p>Mr. Ali Malek QC Mr. Clive Freedman <i>3 Verulam Buildings</i></p> <p>and</p> <p>Mr. Simon Olleson <i>Thirteen Old Square</i></p>

TABLE OF CONTENTS

CHAPTER I. THE PARTIES	1
CHAPTER II. THE PARTIES' CLAIMS AND PRAYERS FOR RELIEF	2
CHAPTER III. SUMMARY OF THE MAIN FACTS	3
SECTION I. THE HEDGING AGREEMENT	3
Sub-Section I. The Regulatory Framework and Background of the Hedging Agreement	3
I. The Study Group Recommendations and the Cabinet of Ministers' Decision	5
II. CPC's Board Resolutions of February and March 2007	5
Sub-Section II. The 8 July 2008 Hedging Agreement and its Key Terms	6
I. The Term Sheet	7
II. The Risk Disclosure Statement	7
III. The Confirmation	7
Sub-Section III. Subsequent Events Related to the Hedging Agreement	8
I. Payments under the Hedging Agreement	8
II. Restructuring Discussions and Establishment of the Hedging Risk Committee	9
III. Early Termination of the Hedging Agreement	9
SECTION II. THE SUPREME COURT PROCEEDINGS	10
SECTION III. THE CENTRAL BANK'S ACTIONS	11
Sub-Section I. Requests for information	11
Sub-Section II. The Central Bank's Assessment of Compliance of 5 December 2008	12
Sub-Section III. The Central Bank's Directions of 16 December 2008	13
Sub-Section IV. The Central Bank's Investigation Report	13
CHAPTER IV. THE PROCEDURE	15
SECTION I. INSTITUTION OF THE PROCEEDINGS	15
SECTION II. PROCEDURAL RULES AND AGENDA: MINUTES OF THE FIRST SESSION	16
SECTION III. THE ISSUE OF BIFURCATION	16
SECTION IV. CLAIMANT'S REQUESTS FOR PRODUCTION OF DOCUMENTS: PROCEDURAL ORDER OF 9 APRIL 2010 AND DECISION OF 9 JUNE 2010	17

SECTION V.	RESPONDENT’S REQUESTS FOR PRODUCTION OF DOCUMENTS: PROCEDURAL ORDERS OF 23 JUNE AND 5 JULY 2010.....	18
SECTION VI.	EXCHANGE OF WRITTEN PLEADINGS	19
SECTION VII.	ADJOURNMENT OF THE HEARING.....	19
SECTION VIII.	CLAIMANT’S ADDITIONAL REQUESTS FOR PRODUCTION OF DOCUMENTS: PROCEDURAL ORDER OF 22 DECEMBER 2010.....	20
SECTION IX.	RESPONDENT’S REQUEST FOR RECONSIDERATION OF THE TRIBUNAL’S PROCEDURAL ORDER: PROCEDURAL ORDER OF 9 FEBRUARY 2011	21
SECTION X.	CLAIMANT’S FURTHER APPLICATION FOR AN ORDER IN RELATION TO DOCUMENT PRODUCTION: PROCEDURAL ORDER OF 11 APRIL 2011	21
SECTION XI.	THE PARTIES’ FURTHER APPLICATIONS FOR INCLUSION OF EVIDENCE: DECISION OF 29 JULY 2011, PROCEDURAL ORDER OF 16 AUGUST 2011 AND PROCEDURAL ORDER OF 20 AUGUST 2011	21
SECTION XII.	THE HEARING.....	23
SECTION XIII.	POST-HEARING SUBMISSIONS; SUBMISSIONS ON THE JUDICIAL COMMITTEE’S DECISION IN GÉCAMINES AND THE COURT OF APPEAL’S DECISION IN SCB; CLOSURE OF THE PROCEEDINGS	24
CHAPTER V.	JURISDICTION	25
SECTION I.	CLAIMANT’S POSITION.....	25
Sub-Section I.	The Treaty	25
I.	Investment under Article 1(1) of the Treaty	25
II.	Territorial nexus with Sri Lanka	26
Sub-Section II.	Article 25(1) of the ICSID Convention.....	28
I.	Contribution	28
II.	Duration.....	31
III.	Risk	32
IV.	Contribution to economic development.....	32
V.	Expectation of regular profit or return	32
VI.	There is no “Ordinary commercial transaction” test.....	32
VII.	The Hedging Agreement is not a “Contingent Liability”	34

Sub-Section III.	Is the Hedging Agreement valid? Did CPC have the capacity to enter into it?	35
I.	Is Sri Lanka entitled to dispute the validity of the Hedging Agreement?	35
(A)	Sri Lanka’s denial of the validity of the Hedging Agreement is unconscionable in light of its involvement and knowledge of CPC’s hedging program	35
1)	The hedging program was initiated by Sri Lanka in the national interest	35
2)	Sri Lanka was kept fully informed of CPC’s hedging program	36
3)	Sri Lanka took public credit and financial benefits from the Hedging Agreements	37
4)	Sri Lanka intervened only when payments by CPC were required	38
(B)	Sri Lanka may not deny the validity of the Hedging Agreement as a matter of international law	39
1)	The alleged illegality is attributable to CPC and not to Deutsche Bank	39
2)	Sri Lanka may not rely on a breach of domestic law by it is own State entity	40
3)	Sri Lanka is estopped from denying the validity of the Hedging Agreement	40
II.	Is the Hedging Agreement void because it was outside CPC’s statutory authority?.....	40
(A)	The Hedging Agreement was both “incidental” and “conducive” to CPC’s business.....	41
(B)	The Hedging Agreement was a real hedge and did not amount to speculation	43
SECTION II.	RESPONDENT’S POSITION.....	44
Sub-Section I.	The Treaty	45
I.	Investment under Article 1(1) of the Treaty	45
II.	Territorial nexus with Sri Lanka	45
Sub-Section II.	Article 25(1) of the ICSID Convention.....	47
I.	Contribution	47
II.	Duration.....	48
III.	Risk	49

IV.	Contribution to economic development	49
V.	Ordinary commercial transaction	49
VI.	Purely contingent financial instrument	50
Sub-Section III.	Is the Hedging Agreement valid? Did CPC have the capacity to enter into it?	50
I.	Is Sri Lanka entitled to dispute the validity of the Hedging Agreement?	50
II.	Is the Hedging Agreement void because outside CPC statutory authority?.....	52
(A)	Was the Hedging Agreement “incidental” or “conducive” to CPC’s business?.....	52
(B)	Was the Hedging Agreement a transaction which managed CPC’s risks or did it amount to speculation?.....	53
SECTION III.	THE TRIBUNAL’S ANALYSIS AND DECISION	57
Sub-Section I.	The Treaty	57
Sub-Section II.	Article 25(1) of the ICSID Convention.....	59
Sub-Section III.	Is the Hedging Agreement valid? Did CPC have the capacity to enter into it?	64
(A)	Was the Hedging Agreement “incidental” or “conducive” to CPC’s business?.....	64
(B)	Was the Hedging Agreement a transaction which managed CPC’s risks or did it amount to speculation?.....	65
(C)	Conclusion	74
Sub-Section IV.	Conclusion on Jurisdiction.....	74
CHAPTER VI.	ATTRIBUTION	75
SECTION I.	CLAIMANT’S POSITION.....	75
Sub-Section I.	The issue of attribution for a general conduct in relation to the Hedging program.....	75
I.	Is Sri Lanka responsible for actions of the Cabinet, the Ministry of Petroleum, the Central Bank and the Supreme Court?.....	75
II.	Is Sri Lanka responsible for the actions of CPC? Are Articles 4(1) and (2) of the ILC Articles satisfied on the facts? Or alternatively, Article 5 or Article 8?	75
(A)	Sri Lanka’s responsibility under Article 4	75
(B)	Sri Lanka’s responsibility under Article 5	77
(C)	Sri Lanka’s responsibility under Article 8	78
(D)	CPC’s actions are attributable to Sri Lanka even if they were ultra vires	80

Sub-Section II.	The issue of attribution by application of the Umbrella Clause of the BIT: Is the Hedging Agreement an obligation of Sri Lanka? Is it so on the basis that the conclusion of the Hedging Agreement was a State action, therefore attributable to Sri Lanka?.....	80
SECTION II.	RESPONDENT’S POSITION	82
Sub-Section I.	The issue of attribution for a general conduct in relation to the hedging program	82
I.	Is Sri Lanka responsible for actions of the Cabinet, the Ministry of Petroleum, the Central Bank and the Supreme Court?.....	82
II.	Is Sri Lanka responsible for actions of CPC? Are Articles 4(1) and (2) of the ILC Articles satisfied on the facts? Or alternatively, ILC Article 5 or Article 8?.....	82
(A)	Sri Lanka’s responsibility under ILC Article 4.....	82
(B)	Sri Lanka’s responsibility under ILC Article 5.....	83
(C)	Sri Lanka’s responsibility under ILC Article 8.....	83
Sub-Section II.	The issue of attribution by application of the Umbrella Clause of the BIT: Is the Hedging Agreement an obligation of Sri Lanka? Is it so on the basis that the conclusion of the Hedging Agreement was a State action, therefore attributable to Sri Lanka?.....	85
SECTION III.	THE TRIBUNAL’S ANALYSIS AND DECISION	86
CHAPTER VII.	THE MERITS	90
SECTION I.	FAIR AND EQUITABLE TREATMENT	90
Sub-Section I.	The Standard	90
I.	Claimant’s position	90
II.	Respondent’s position	91
III.	The Tribunal’s analysis and decision.....	92
Sub-Section II.	Application of the Standard	93
I.	Claimant’s position	93
(A)	The violations alleged by Claimant	93
(B)	The Supreme Court proceedings.....	94
(C)	The Central Bank’s investigation and Stop-Payment Order of 16 December 2008.....	96
1)	The investigation was improperly motivated and in bad faith.....	96
2)	Lack of transparency and due process	98

3)	Inconsistency and breach of legitimate expectations.....	99
4)	The findings of the investigation do not withstand any scrutiny.....	99
5)	The Central Bank acted in excess of powers	100
6)	The Central Bank’s action was disproportionate	100
7)	Additional remarks.....	100
II.	Respondent’s position	101
(A)	The Supreme Court Interim Order	101
(B)	The Central Bank’s Investigation and Stop-Payment Order of 16 December 2008.....	101
III.	Tribunal’s analysis and decision	104
(A)	The Supreme Court proceedings.....	104
(B)	The Central Bank’s investigation and Stop-Payment Order of 16 December 2008.....	106
1)	The investigation was improperly motivated.....	106
2)	The Government acted in bad faith.....	106
3)	Lack of transparency and due process	107
4)	The Central Bank acted in excess of its powers.....	108
5)	Conclusion	108
SECTION II.	EXPROPRIATION.....	108
Sub-Section I.	The standard of indirect expropriation.....	108
I.	Claimant’s position	108
II.	Respondent’s position	110
III.	The Tribunal’s analysis and decision.....	110
Sub-Section II.	Application of the standard	111
I.	Claimant’s position	111
II.	Respondent’s position	112
III.	The Tribunal’s analysis and decision.....	113
SECTION III.	FULL PROTECTION AND SECURITY.....	115
I.	Claimant’s position	115
II.	Respondent’s position	115
III.	The Tribunal’s analysis and decision.....	116
SECTION IV.	UMBRELLA CLAUSE.....	117

CHAPTER VIII. THE DAMAGES	118
SECTION I. THE ISSUE OF CAUSATION.....	118
Sub-Section I. Respondent’s position	118
Sub-Section II. Claimant’s position	119
Sub-Section III. The Tribunal’s analysis and decision.....	120
SECTION II. THE RELIEF	123
Sub-Section I. Claimant’s position	123
Sub-Section II. Respondent’s position	123
Sub-Section III. The Tribunal’s analysis and decision.....	124
CHAPTER IX. THE COSTS	125
SECTION I. THE PARTIES’ SUBMISSIONS	125
SECTION II. THE TRIBUNAL’S ANALYSIS AND DECISION	126
CHAPTER X. SUMMARY OF FINDINGS AND FORMAL AWARD.....	128

CHAPTER I. THE PARTIES

THE CLAIMANT

1. The Claimant in this arbitration is Deutsche Bank AG (hereinafter “Deutsche Bank” or “Claimant”). Deutsche Bank AG is a stock corporation (“Aktiengesellschaft”) incorporated under the laws of Germany. It is registered with the district court (“Amtsgericht”) in Frankfurt am Main under No. HRB 30 000. The Claimant’s registered address is Theodor-Heuss-Allee 70, 60486 Frankfurt am Main, Germany.
2. The Claimant is a bank with headquarters in Germany and a network of branches all around the world, including in London (Deutsche Bank London), in Colombo (Deutsche Bank Colombo) and Singapore (Deutsche Bank Singapore).
3. Claimant is represented in this arbitration by Ms. Judith Gill QC, Mr. Matthew Gearing, Mr. Anthony Sinclair, Mr. Andrew Battison and Mr. Matthew Hodgson of Allen & Overy LLP (Hong Kong, London, Singapore); by Mr. R. Senathi Rajah and Ms. Dilumi de Alwis of Julius & Creasy Attorneys-at-Law Solicitors and Notaries Public (Colombo).

THE RESPONDENT

4. The Respondent in this arbitration is the Democratic Socialist Republic of Sri Lanka (hereinafter “Respondent”, “Sri Lanka” or the “Republic”).
5. It is represented in this arbitration by The Honorable Palitha Fernando, P.C., Attorney General (from July 2012), The Honorable Eva Wanasundera, P.C., former Attorney General (November 2011 to July 2012), and The Honorable Mohan Pieris, P.C. , former Attorney General (until October 2011), and Mr. Janak de Silva, Mr. Milinda Gunatilleke, Mr. Rajitha Perera, Ms. Anusha Jayatilake and Ms. Ruwanthi Herath-Gunaratne, Attorney-General’s Department, (Colombo); Professor James Crawford SC, Matrix Chambers; Mr. Ali Malek Q.C. and Mr. Clive Freedman, 3 Verulam Buildings; and Mr. Simon Olleson, Thirteen Old Square (all London).

CHAPTER II. THE PARTIES' CLAIMS AND PRAYERS FOR RELIEF

6. The dispute has its origins in an oil Hedging Agreement dated 8 July 2008 (the "Hedging Agreement" or the "Agreement") between Deutsche Bank and Ceylon Petroleum Corporation ("CPC"), Sri Lanka's national petroleum corporation.
7. Deutsche Bank submits that Sri Lanka has violated Articles 2, 3, 4 and 8 of the Treaty between the Federal Republic of Germany and the Democratic Socialist Republic of Sri Lanka concerning the Promotion and Reciprocal Protection of Investments of 7 June 2000 (the "BIT" or "Treaty"). This is disputed by Respondent.
8. In the Request for Arbitration, Deutsche Bank requests the following relief:
 - 1) a declaration that the Respondent has violated Articles 2, 3, 4 and 8 of the Treaty, as well as its obligations under general international law and Sri Lankan law;
 - 2) an order that the Respondent make full reparation to Deutsche Bank for the injury to its investment arising out of Sri Lanka's violations of the Treaty and international law, such full reparation being in the form of damages or compensation paid to Deutsche Bank of USD 60,368,993, or alternatively such other amount as the Tribunal shall determine;
 - 3) interest in respect of paragraph (2) from 9 December 2008 to the date of the Award, and thereafter until the date of payment at the rate set forth in its Memorial of 25 September 2009, or alternatively on such other basis as the Tribunal shall determine;
 - 4) an order that the Respondent pay the costs of the arbitration proceedings including the costs of the arbitrators and ICSID, as well as the legal and other expenses incurred by Deutsche Bank including the fees of its legal Counsel, experts and consultants, as well as Deutsche Bank's own employees on a full indemnity basis, plus interest thereon at a reasonable rate to be determined by the Tribunal; and
 - 5) any other relief the Arbitral Tribunal may deem appropriate in the circumstances.

Deutsche Bank also requests the Tribunal to deny all relief sought by the Respondent.

9. Respondent requests the Tribunal to decide:
 - 1) that it lacks jurisdiction to hear the Claimant's claims;
 - 2) that the claim in contract based on CPC's failure to pay amounts set to be due to Deutsche Bank AG under the Hedging Agreement is inadmissible;
 - 3) in the alternative:
 - a) that Deutsche Bank AG's claim for damages under the Treaty fails and is dismissed;
 - b) that the Claimant pay the Respondent's costs of the proceeding, and the costs and expenses of the Tribunal.

CHAPTER III. SUMMARY OF THE MAIN FACTS

10. The subsequent summary is intended to provide a general overview of the issues in dispute between the parties. It is not intended to be an exhaustive description of all facts considered relevant by the Tribunal. These will be addressed in the context of the Tribunal's analysis of the issues in dispute, and will be supplemented by relevant facts including those provided by witnesses in the course of oral examination at the hearing.
11. The summary in this chapter is a chronology of events drawn from material submitted jointly by the parties to this Tribunal.

SECTION I. THE HEDGING AGREEMENT

Sub-Section I. **The Regulatory Framework and Background of the Hedging Agreement**

12. As indicated above, the dispute has its origins in the Hedging Agreement concluded on 8 July 2008 between Deutsche Bank and CPC.
13. CPC is a 100% State-owned petroleum company established by an Act of the Sri Lankan Parliament, namely Act No. 28 of 1961 (the "CPC Act"). Section 5 of the CPC Act states the objectives of CPC as follows:
 - (a) *to carry on business as an importer, exporter, seller, supplier or distributor of petroleum;*
 - (b) *to carry on business of exploring for, and exploiting, producing, and refining of, petroleum; and*
 - (c) *to carry on any such other business as may be incidental or conducive to the attainment of the objects referred to in [the] paragraphs [above].*
14. The Hedging Agreement was concluded in order to protect Sri Lanka against the impact of rising oil prices. Indeed, between 2003 and 2008, oil prices followed an upward trend rising from a monthly average of USD 28 per barrel in January 2003 to over USD 130 per barrel in July 2008. Consequently, starting in August 2006, various government agents advocated the conclusion of oil hedging transactions by CPC.
15. The regulatory framework for derivative products in Sri Lanka is constituted by the "Directions on Financial Derivative Products in Foreign Exchange" issued in December 2005 by the Central Bank of Sri Lanka (the "Central Bank") (the "2005 Directions")¹. The explanatory notes to the Directions indicate that oil is among the commodities identified for possible derivative transactions². Prior to the issuance of the 2005 Directions,

¹ Parties' Core Bundle Volume 1/Tab19 [hereinafter "Core" [Vol. #]/[Tab #]].

² Claimant's Memorial on the Merits [hereinafter "Claimant's Memorial"], para. 70; Respondent's Counter-Memorial on the Merits [hereinafter "Respondent's Counter-Memorial"], para. 32.

derivative transactions required a transaction-by-transaction approval of the Central Bank and the Controller of Exchange.

16. On 1 August 2006, Mr. Rodrigo of Deutsche Bank Colombo and Mr. Kelvin Wong of Deutsche Bank Singapore³ made a presentation on oil hedging to the Central Bank, and other attendees including Mr. Lalith Karunaratne, Deputy General Manager (Finance) of CPC⁴.
17. Following this presentation, Dr. H. M. Thenuwara, at the time the Central Bank's Director of Economic Research, gave a presentation to the Central Bank's governing body, the Monetary Board⁵, and on 17 August 2006, the Central Bank's Economic Research Department produced a paper on "Hedging to Protect CPC Imports Against Oil Price Volatility"⁶. The stated purpose of this paper was "to evaluate the need for hedging mechanisms and recommend suitable mechanisms"⁷. The paper recommended *inter alia* that "the best option for Sri Lanka at the initial state will be ZC [zero cost] collar hedging"⁸. The paper further advised CPC to pursue the matter with counter parties based on quantum of hedging and instrument offered⁹. The Central Bank subsequently requested indicative quotes for swaps and zero cost collars from Deutsche Bank's Colombo branch.
18. In early September 2006, A. N. Cabraal, Governor of the Central Bank, gave a presentation to the President of Sri Lanka and the Cabinet of Ministers, explaining different hedging mechanisms available to mitigate the impact of high oil prices¹⁰. The Central Bank further issued in late September 2006 a press release entitled "Protection from High Oil Prices" dealing in some detail with oil-hedging instruments considered by it¹¹. During the fall of 2006, various Sri Lankan Government officials also made statements in the press concerning the potential use of hedging instruments¹².

³ Mr. Wong was at the time Director of Global Markets – Commodities Trading Division, Deutsche Bank Singapore. As stated by the Claimant, "Deutsche Bank Colombo does not directly engage in derivative trades such as oil hedging transactions." Claimant's Memorial, para. 86.

⁴ Mr. Karunaratne held office from February 2005 until his suspension in December 2008.

⁵ Risk Management Strategies for CPC, Core 1/21.

⁶ Core 2/27. Claimant's Memorial, para. 92; Respondent's Counter-Memorial, para. 43.

⁷ Core 2/27.

⁸ Core 2/27, para. 6.2.

⁹ Core 2/27, para. 6.2.

¹⁰ Claimant's Memorial, para. 99, Core 2/32, Respondent's Counter-Memorial, para. 46

¹¹ Core 2/35, Claimant's Memorial, para. 107, Respondent's Counter-Memorial, para. 46.

¹² Exhibits C-74, C-75, C-76.

I. The Study Group Recommendations and the Cabinet of Ministers' Decision

19. In October of 2006, the Parliament established a Cabinet Study Group to consider oil-hedging. Its members included, *inter alia*, Dr. Thenuwara of the Central Bank, Ms. Wijetunge of the Ministry of Petroleum and a Director of CPC, as well as Mr. Karunarante¹³. On 16 November 2006, the Study Group issued its report (the "Study Group Report"), and submitted its findings to the Ministry of Finance.
20. The Study Group recommended the following:¹⁴
 - CPC to hedge the purchase of crude oil and refined petroleum products;
 - use zero cost collar as the hedging instrument with the upper bound based on market developments;
 - commence hedging with smaller quantities for a shorter period and gradually increase the quantity and duration;
 - grant CPC authority to call for quotations for oil hedging, to decide on future prices and to purchase hedging instruments from reputable banks; and
 - grant CPC authority to change instruments based on the developments of the market.
21. In January of 2007, the Minister of Petroleum, Minister A. H. M. Fowzie, sought approval of the Study Group's Recommendations by the Cabinet of Ministers. By Cabinet Decision of 24 January 2007, the Cabinet granted approval to the Recommendations, which were to be implemented without delay¹⁵.
22. By letter of 29 January 2007, the Ministry of Petroleum sent the Cabinet's decision to the Chairman of CPC, which the parties to this arbitration both consider to amount to a direction to CPC under section 7(1) of the CPC Act¹⁶.
23. In February of 2007, CPC entered into its first derivative transaction with Standard Chartered Bank ("SCB").

II. CPC's Board Resolutions of February and March 2007

24. On 9 February 2007, the Board of Directors of CPC held a board meeting, in the course of which the following resolution was passed "*The Board discussing this subject again approved to take the hedge position of 0.05 Sin. Gas Oil on Zero Cost Collar or any other suitable instrument for quantity of 450,000 bbls. for a period of 3 – 6 months*"¹⁷.

¹³ Core 2/39.

¹⁴ Exhibit C-44, Claimant's Memorial, para. 112 (slightly different language); Respondent's Counter-Memorial, para. 52, Core 2/49.

¹⁵ Core 2/49; Respondent's Counter-Memorial, para. 56; Claimant's Memorial, para. 119.

¹⁶ Claimant's Memorial, para. 121 *et seq.*; Respondent's Counter-Memorial, para. 57.

¹⁷ Exhibit R-40, Exhibit C-84, Core 3/81; Board Meeting 1060, Board Paper 24, Claimant's Memorial, para. 123; Respondent's Counter-Memorial, para. 64.

25. On 26 March 2007, the Board of Directors of CPC passed a further resolution “empowering Chairman and Managing Director, Mr. Ashantha de Mel and Deputy General Manager (Finance), Mr. Lalith Karunaratne to execute hedging transactions by using appropriate hedging instruments”¹⁸.
26. Governor Cabral and the Ministry of Petroleum requested Mr. de Mel to provide information on hedging activities. Throughout 2007, Mr. de Mel sent to the Ministry of Petroleum memoranda setting out proposed quotes and structures received from various commercial banks (including Deutsche Bank, SCB and Citibank), and explained key terms of certain derivative transactions entered into during 2007. Mr. de Mel also responded to inquiries from Governor Cabraal regarding strategies to generate export income including hedging to generate export income.

Sub-Section II. **The 8 July 2008 Hedging Agreement and its Key Terms**

27. Deutsche Bank, through its offices in Colombo and London, exchanged numerous communications with CPC. Through late 2007 and 2008, several transaction possibilities, such as target profit forwards (TPF) were discussed but not executed.
28. On 8 July 2008, oil prices stood at USD 137.52 per barrel. On the same day, Deutsche Bank and CPC entered into the Hedging Agreement that lies at the core of the present dispute. The Hedging Agreement consisted of the following documents:
 - (i) the 12 Month Target Profit Forward on Dubai Indicative Terms and Conditions (the “Term Sheet”), dated 8 July 2008 (signed by Mr. de Mel and Mr. Karunaratne)¹⁹;
 - (ii) the Risk Disclosure Statement for Treasury and Financial Derivative Transactions (the “Risk Disclosure Statement”), dated 8 July 2008 (signed by Mr. de Mel and Mr. Karunaratne)²⁰; and
 - (iii) the Confirmation Letter with Term Sheet from Deutsche Bank to CPC confirming the terms and conditions of the transaction (the “Confirmation Letter”), dated 10 July 2008 (signed by Mr. de Mel and Mr. Karunaratne and Deutsche Bank London),²¹ which incorporated by reference the 2005 International Swap Dealers Association (“ISDA”) Commodity Definitions, the 2000 ISDA Definitions, and the 1992 ISDA Master Agreement (the latter however remaining unsigned and undated).
29. The relevant terms of the Hedging Agreement were as follows (using the summary by the Claimant in para. 158 of its Memorial):

¹⁸ Core 3/94 and 3/95.

¹⁹ Exhibit C-3.

²⁰ Exhibit C-4.

²¹ Exhibit C-5.

I. The Term Sheet

30. The Term Sheet contained the key terms of the Hedging Agreement, providing as follows:
- (i) The Hedging Agreement was effective from 1 August 2008 and was to terminate on 31 July 2009. (The trade date was not finalised in the Term Sheet.)
 - (ii) The Strike Volume (also called the Commodity Notional Amount), or the number of barrels of oil that the Hedging Agreement applied to, was set at 100,000 barrels for each of the parties.
 - (iii) The payments due under the Hedging Agreement were to be calculated on a monthly basis, starting from the effective date of 1 August 2008 (the Calculation Periods), and the Payment Dates were set for 14 Calendar days after the calculations. In practice this would mean that payments were due monthly commencing on 14 September, subject to adjustment in accordance with Following Business Day Convention.
 - (iv) The agreed Strike Price was USD 112.50 per barrel, with the reference for the price of oil being the Specific Price per barrel of Dubai crude oil for delivery on the Delivery Date published in the Platts Marketwire (the Benchmark Oil Price).
 - (v) The Monthly Oil Price was the arithmetic average of the Benchmark Oil Price during each business day of the calendar month of the relevant Calculation Periods.
 - (vi) The formula for calculating the floating payments due from each party on the Payment Dates was set out in full. Where the Monthly Oil Price was greater than the Strike Price, Deutsche Bank was obliged to pay CPC the difference between the Strike Price and the Monthly Oil Price (up to a maximum price difference of USD10 per barrel), multiplied by the Strike Volume. Where the Monthly Oil Price was lower than the Strike Price, CPC was obliged to pay Deutsche Bank the difference between the Strike Price and the Monthly Oil Price multiplied by the Strike Volume.
 - (vii) CPC's Target Profit Level was set at USD 2,500,000 and therefore the trade terminated if payout by Deutsche Bank reached this level.
 - (viii) CPC's failure to enter into and execute an ISDA Master Agreement with Deutsche Bank on or before 90 days after the Trade Date would amount to a termination event.

II. The Risk Disclosure Statement

31. The Risk Disclosure Statement identified the types of risks to be taken into consideration prior to entering into such derivatives transaction²².

III. The Confirmation

32. The Confirmation Letter reflected the principal terms of the Term Sheet. In addition, the Confirmation Letter identified the Trade Date as 8 July 2008, incorporated the 2005 ISDA Commodity Definitions, and the 2000 ISDA Definitions.

²² Exhibit C-4; Claimant's Memorial, para. 159.

33. The ISDA 1992 Master Agreement was further incorporated into the Confirmation as follows: the “Confirmation...shall supplement, form a part of, and be subject to an agreement in the form of the ISDA Form as if we had executed an agreement on the Trade Date.”
34. The ISDA 1992 Master Agreement further states that each party “submits to the jurisdiction of the English courts, if this Agreement is expressed to be governed by English law,”²³ while also stating that “nothing in this Agreement precludes either party from bringing Proceedings in any other jurisdiction ... nor will the bringing of Proceedings in any one or more jurisdictions preclude the bringing of Proceedings in any other jurisdiction”²⁴.
35. The Confirmation Letter further indicated that, unless specified otherwise upon execution of the ISDA Agreement, the governing law was English Law and the Termination Currency was US Dollars.
36. With regard to early termination, the Confirmation Letter provided as follows:

“if the [ISDA Master Agreement] has not been executed by both Party A and Party B within 90 calendar days following the Trade Date, then Party A may, but shall not be obligated to, by at least five (5) Business Days prior notice (which notice, if by telephone, shall be promptly confirmed in writing) to the other party set a date to terminate this Transaction (which termination date shall be the Early Termination Date with respect to this Transaction), whereupon a termination payment shall be made on the Early Termination Date, as if such Transaction were a Terminated Transaction and there were two Affected parties and, for this purpose, Market Quotation applies”²⁵.

Sub-Section III. **Subsequent Events Related to the Hedging Agreement**

I. Payments under the Hedging Agreement

37. On 15 July 2008, Dubai Crude Oil prices peak at USD 140.24 per barrel. On 19 September 2008, Deutsche Bank made a payment pursuant to the Hedging Agreement of USD 35,523.81 to CPC.
38. Oil prices began however to fall in late July and August 2008. CPC made payments under the Hedging Agreement to Deutsche Bank in the amount of USD 1,659,636.36 on 17 October 2008, and USD 4,507,857.14 on 14 November 2008²⁶.

²³ Section 13(b)(i) of the ISDA 1992 Master Agreement, Exhibit C-6.

²⁴ Exhibit C-6.

²⁵ Details regarding the calculation the payment due on termination are set forth in clause 6(d)(i) of the 1992 ISDA Master Agreement, Exhibit C-6.

²⁶ Exhibit C-14.

39. On 13 November 2008, Deutsche Bank inquired with the Controller of Exchange of the Central Bank whether approval of currency conversion of the upcoming payment by CPC was required²⁷. On 14 November 2008, the Controller of Exchange sent a letter to Deutsche Bank, indicating that such approval was generally not required, unless special circumstances have cast doubt on the respective transaction²⁸.
40. On 24 November 2008, the CPC Board further approved a payment under the Hedging Agreement to Deutsche Bank; however such payment seems not to have been received by the Claimant²⁹.

II. Restructuring Discussions and Establishment of the Hedging Risk Committee

41. In the fall of 2008 and against the background of falling oil prices, Deutsche Bank and CPC discussed possibilities to restructure the Hedging Agreement, and Deutsche Bank submitted various restructuring proposals to CPC, the last two of which were provided to CPC on 25 November 2008.
42. On 21 November 2008, the Cabinet further established a “Hedging Risk Management Committee” composed of members from the Ministry of Petroleum, the Treasury, the Central Bank and CPC, which subsequently held meetings³⁰. The Committee was established “for management of oil hedging risk in the interest of the country,³¹ and deliberated proposals for managing risks associated with hedges in operations, submitted by the Chairman of CPC³².

III. Early Termination of the Hedging Agreement

43. On 3 December 2008, Deutsche Bank terminated the Hedging Agreement with CPC. The termination letter read in relevant part:

“Deutsche Bank hereby notifies [CPC] that, Deutsche Bank is exercising its right to terminate the Transaction pursuant to the Confirmation as a result of a failure

²⁷ Claimant’s Memorial, para. 193, quoting Mr. Rohan Sylvester Rodrigo’s First Witness Statement, 23 September 2009, paras. 94 *et seq* [hereinafter “Rodrigo First Witness Statement”]. The Exchange Control Department of the Central Bank regulates the movement of currency in Sri Lanka.

²⁸ Core 5/204; Claimant’s Memorial, paras. 195/6.

²⁹ Core 5/227; Claimant’s Reply Memorial on the Merits and Counter-Memorial to Objections to Jurisdiction, para. 564 [hereinafter “Claimant’s Reply”]. Claimant argues that the only payments received under the hedging agreement were those of 14 November 2008 and 17 October 2008. Claimant’s Memorial, para. 163.

³⁰ Core 5/221; Core 5/233, Core 5/234

³¹ Core 5/221, para. 38.

³² Core 5/233.

by [CPC] to execute the ISDA Master Agreement within 90 days of the Trade Date”³³.

44. By letter of 10 December 2008, Deutsche Bank calculated the close-out amount payable by CPC to Deutsche Bank following the early termination as USD 60,368,993³⁴.

SECTION II. THE SUPREME COURT PROCEEDINGS

45. On 26 November 2008, two fundamental rights applications were filed in the Supreme Court of Sri Lanka³⁵. Fundamental Rights are identified in Chapter 3 of the Constitution of Sri Lanka, and are vested in every citizen. Actual or imminent infringement of such right may be brought before the Supreme Court³⁶.
46. In one such application, the petitioner sought to challenge the authority of CPC to enter into the Hedging Agreement with Deutsche Bank (and the transactions entered into with SCB and Citibank)³⁷. The grounds set forth by the petitioner included *inter alia* that (i) CPC did not have the authority to enter into such derivative transactions, (ii) the Chairman did not have authority to execute such transactions without specific approval by CPC’s Board of Directors, and that (iii) the transactions were “prima facie iniquitous since they are structured entirely for the benefit of the respective banks”³⁸.
47. On 28 November 2008, the Supreme Court issued an Interim Order by which it granted the petitioners leave to proceed, joined the two petitions, and adopted an Interim Order (the “First Interim Order”) directing that:³⁹
- (i) all payments by CPC to Deutsche Bank and other banks be suspended;
 - (ii) Mr. de Mel, Chairman of CPC, be suspended for alleged misconduct;

³³ Core 5/246.

³⁴ Exhibit C-16. Deutsche Bank sent subsequent letter of demand on 13 January 2009. Core 6/284.

³⁵ Supreme Court of the Democratic Socialist Republic of Sri Lanka. Case Nos. S.C.(FR) 535/2008 and S.C.(FR) 536/2008. Case No. 535/2008 was brought against Hon. A.H.M. Fowzie, Minister of Petroleum and Petroleum Resources Development; Ceylon Petroleum Corporation; Ashantha de Mel, Chairman of CPC; Sumith Abeysinghe, Secretary to the Treasury; Hon. G.L. Pieris, Minister of Export Developments and International Trade; Hon. Minister of Finance; Monetary Board of Sri Lanka; and The Attorney General. Exhibit C-131. Case No. 536/2008 was brought against the Hon. A.H.M. Fowzie, Minister of Petroleum and Petroleum Resources and Development, Ashantha de Mel, Chairman of CPC and others. Respondent’s Counter-Memorial, para. 151.

³⁶ The procedure for filing such petition is set out in Article 126 of the Constitution. Respondent’s Counter-Memorial, paras. 147 *et seq.*

³⁷ Claimant’s Memorial, para. 200; Respondent’s Counter-Memorial, para. 152.

³⁸ Claimant’s Memorial, para. 200; Exhibit C-17, Sealed Judgment and Order of the Supreme Court dated 28 November 2008.

³⁹ Core 5/238.

- (iii) President Rajapakse consider suspending Minister of Petroleum Fowzie for his support of the actions of Mr. de Mel;
 - (iv) the Government directly purchase all petroleum products and distribute them through the available network;
 - (v) the Secretary to the Treasury review taxes on petroleum products and submit a report to the Supreme Court for the court to consider the possibility of a formula for the pricing of petroleum products; and
 - (vi) the Monetary Board carry out an investigation “as regards the impugned transactions and to take action thereon.”
48. The Supreme Court issued two further Interim Orders, one on 15 December 2008 (the “Second Interim Order”), addressing the price of petrol and ordering the Monetary Board to continue with its investigations of the transactions, and ordering the suspension of Mr. Karunaratne from the position of Deputy General Manager (Finance) of CPC⁴⁰.
49. On 17 December 2008 the Supreme Court issued a further Interim Order (the “Third Interim Order”), fixing *inter alia* the price of petrol and ordering the Monetary Board to (i) continue its investigations with the assistance of the Criminal Investigation Department of the Police, and to (ii) refer the results of its investigations to the “Commission to Investigate Bribery and Corruption”⁴¹.
50. On 27 January 2009, the Supreme Court made a Final Order (the “Final Order”), terminating the Fundamental Rights proceedings and vacating all previously issued interim orders. The Supreme Court noted that its decision was based on the fact that the Petitioners would not pursue their applications “since the applications have been filed in the public interest which would not be advanced in a situation of non-compliance of the order of Court by the Executive”⁴².

SECTION III. THE CENTRAL BANK’S ACTIONS

Sub-Section I. Requests for information

51. In early November 2008, the Central Bank requested information from Deutsche Bank Colombo relating to the 8 July 2008 Hedging Agreement. An official investigation into this transaction was commenced by the Central Bank on 13 November 2008⁴³.
52. On 19 November 2008, Mr. Rohan Rodrigo, Head of the Global Markets Department, Chief Country Officer of Deutsche Bank’s Colombo branch, attended a meeting at the

⁴⁰ Exhibit C-18.

⁴¹ Exhibit C-19, p.3.

⁴² Exhibit C-20; Respondent’s Counter-Memorial, para.157.

⁴³ Respondent’s Counter-Memorial, para. 171; *See also* Exhibits C-25 and C-26.

request of Governor Cabraal in connection with the investigation⁴⁴. As recalled by Mr. Rodrigo in his witness statement, he was informed during this meeting that the Central Bank believed that Deutsche Bank had not followed proper procedures in executing the Hedging Agreement, and that the Central Bank would prepare an investigation report for its Monetary Board⁴⁵.

53. On 24 and 28 November 2008, the Central Bank sent requests for information to Deutsche Bank regarding the Hedging Agreement, the ISDA Master Agreement, the CPC Board Resolution authorizing the Hedging Agreement, and the approval from the Controller of Exchange. Deutsche Bank responded to these requests by email of 26, 27 November and 2 December 2008.

Sub-Section II. **The Central Bank's Assessment of Compliance of 5 December 2008**

54. Following a meeting on 5 December 2008 between officers of Deutsche Bank and members of the Central Bank, the latter sent on the same day a letter to Mr. Rodrigo, containing an *Assessment of Compliance with the Provisions of the Directions Issued by the Central Bank of Sri Lanka on Financial Derivative Products* (the "Assessment of Compliance")⁴⁶.
55. In the Assessment of Compliance, the Central Bank identified the following five non-compliances in connection with the Hedging Agreement:
- (i) "Failure of Deutsche Bank AG to provide adequate information to the Board of Directors of CPC of the nature of their products and their inherent risks"⁴⁷;
 - (ii) "Failure of Deutsche Bank AG to carry out adequate credit risk assessment in the case of CPC in line with internal credit policy and procedures"⁴⁸;
 - (iii) "Failure of [Deutsche Bank AG] to ascertain CPC's ability to fulfill its obligations arising from the downside risks associated with these hedging contracts"⁴⁹;
 - (iv) "Failure of Deutsche Bank AG to provide adequate information on changes in risk profile with market developments"⁵⁰; and
 - (v) Failure of Deutsche Bank AG "to ensure a high level of transparency with respect to risks and other parameters associated with underlying hedging contract"⁵¹.

⁴⁴ Rodrigo First Witness Statement, *supra* note 27, para. 100; Claimant's Memorial, para. 180, Respondent's Counter-Memorial, para. 171.

⁴⁵ *Id.* para. 101 *et seq.*

⁴⁶ Core 6/250.

⁴⁷ *Id.* p. 2.

⁴⁸ *Id.* p. 3.

⁴⁹ *Id.* p. 4.

⁵⁰ *Id.* p. 5.

⁵¹ *Id.* p. 7.

56. By letter of 11 December 2008, Deutsche Bank (London) objected to the Assessment of Compliance⁵² (to which the Central Bank however never responded).

Sub-Section III. **The Central Bank's Directions of 16 December 2008**

57. On 16 December 2008, the Monetary Board of the Central Bank sent a letter to Deutsche Bank Colombo and other banks with which CPC had concluded derivative transactions (the "16 December 2008 Directions" or "Stop-Payment Order")⁵³. Referring to the Supreme Court's Interim Order of 28 November 2008, which is described under Section II above, the letter requested the banks "not to proceed with, or give effect to, these transactions" as it considered those "materially affected and [...] substantially tainted." The letter also indicated that the Monetary Board would carry out further investigations in light of the Supreme Court's Order of 15 December 2008 (also addressed in C. of Chap. VII, Section I, Sub-Section II).
58. On 27 January 2009, the Central Bank issued a press release confirming that the 16 December 2008 Directions to the banks would remain in force⁵⁴.

Sub-Section IV. **The Central Bank's Investigation Report**

59. Under cover of a letter of 6 January 2009, the Central Bank forwarded to Deutsche Bank Colombo a report entitled "The Investigation Report on Oil Derivative Transactions entered into by Deutsche Bank AG with the Ceylon Petroleum Corporation (the "Investigation Report")"⁵⁵. The report states that the Central Bank's investigation was based on section 29(1) of the Monetary Law Act, and had been widened in scope, following the Supreme Court Order of 28 November 2008⁵⁶.
60. The Investigation Report found that:⁵⁷
- (i) Deutsche Bank failed to obtain the necessary undertakings from the Board of Directors of CPC;
 - (ii) Deutsche Bank failed to carry out adequate credit risk assessments;
 - (iii) it was possible the Hedging Agreement was heavily weighted/structured in favour of Deutsche Bank;
 - (iv) the Chairman and the Deputy General Manager (Finance) of CPC did not possess the necessary authority to enter into the Hedging Agreement;

⁵² Exhibit C-24; Claimant's Memorial, para. 184.

⁵³ Exhibit C-25.

⁵⁴ Exhibit C-28.

⁵⁵ Exhibit C-26. This report had been placed before the Monetary Board on 13 December 2008. Core 6/262.

⁵⁶ For a description of the Supreme Court's Order, *see supra* para.47.

⁵⁷ Core 6/280, pp. 22-26.

- (v) the internal policies and practices of CPC were not adequate to undertake nor commensurate with the level of expertise required to undertake sophisticated derivative transactions;
 - (vi) since Deutsche Bank had not signed the ISDA Agreement with CPC and not obtained prior approval for this transaction, the Hedging Agreement does not appear to be in line with best practices of the industry;
 - (vii) CPC and the banks were not in line with the Cabinet Decision of January 2007 relating to oil hedging;
 - (viii) CPC had not followed the proper and usual governmental procedure/processes in entering into the Hedging Agreement, and that had Deutsche Bank carried out a reasonable due diligence, it should have known about this situation.
61. In concluding, the Investigation Report stated that “the derivative contracts in issue entered into by the Deutsche Bank AG with the CPC have been materially affected, thereby seriously undermining the propriety of the transactions.”⁵⁸
62. Deutsche Bank objected to the Investigation Report by letter of 12 January 2009. By letter of 13 March 2009, the Central Bank replied to Deutsche Bank’s letter⁵⁹, to which Deutsche Bank in turn responded on 25 March 2009⁶⁰.
63. By letter of 13 March 2009 and citing Section 44A of the Banking Act No. 30 of 1988, the Central Bank informed Mr. Rodrigo that he was subject to an Assessment of Fitness and Propriety⁶¹. Mr. Rodrigo responded on 25 March 2009, providing additional information.

⁵⁸ Core 6/280, p. 22.

⁵⁹ Core 6/300.

⁶⁰ Core 6/301.

⁶¹ Core 6/299.

CHAPTER IV. THE PROCEDURE

SECTION I. INSTITUTION OF THE PROCEEDINGS

64. The International Centre for Settlement of Investment Disputes (“ICSID” or the “Centre”) received on 17 February 2009 by email, and on 19 February 2009 in hard copy format, a request for the institution of arbitration proceedings (the “Request for Arbitration”) under the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the “ICSID Convention”) from Deutsche Bank AG, against the Democratic Socialist Republic of Sri Lanka.
65. Having received the necessary contact information from the requesting party, the Centre transmitted on 25 February 2009 copies of the Request for Arbitration and its accompanying documentation to the Republic in accordance with Rule 5(2) of the ICSID Rules of Procedure for the Institution of Conciliation and Arbitration Proceedings (the “ICSID Institution Rules”).
66. By letter of 11 March 2009, the Centre requested from Deutsche Bank AG certain clarifications regarding the Request for Arbitration. By letter of 13 March 2009 addressed to the Secretary-General of ICSID, Respondent objected to the registration of the Request for Arbitration, submitting that the dispute as alleged was manifestly outside the jurisdiction of the Centre and asking that the registration of the Request for Arbitration be refused pursuant to Article 36(3) of the ICSID Convention and ICSID Institution Rule 6(1)(b). Deutsche Bank AG responded to the Centre’s inquiries and Respondent’s objections by letter dated 17 March 2009.
67. On 24 March 2009, in accordance with Article 36 of the ICSID Convention, the Acting Secretary-General registered the Request for Arbitration as supplemented by Claimant on 17 March 2009, and notified the parties of the registration in accordance with ICSID Institution Rule 6(1)(a), inviting them at the same time to proceed as soon as possible with the constitution of an Arbitral Tribunal.
68. Following several rounds of written communications, the parties reached on 19 May 2009 an agreement regarding the method of constitution of the Arbitral Tribunal in this proceeding, pursuant to which the Arbitral Tribunal was to consist of three arbitrators, one appointed by each party, and the third, presiding arbitrator appointed by agreement of the two party-appointed arbitrators. Regarding the timeline, the parties agreed that each party-appointed arbitrator was to be appointed within 21 days of Respondent’s letter of 5 May 2009, *i.e.*, by 26 May 2009, and the President was to be appointed within 30 days of the date the second co-arbitrator accepted his or her appointment. The parties’ agreement further contemplated that if a party or the co-arbitrators failed to make an appointment within the agreed timeframe, either party could request the Chairman of the ICSID Administrative Council to appoint the arbitrator(s) not yet appointed.
69. By letter of 25 May 2009 Respondent informed the Centre of the appointment of Mr. Makhdoom Ali Khan, a national of Pakistan, as party-appointed arbitrator. By letter of 26

May 2009 Claimant informed the Centre of the appointment of Professor David A. R. Williams, a national of New Zealand, as arbitrator. Mr. Khan accepted his appointment on 27 May 2009, and Professor Williams accepted his appointment on 28 May 2009.

70. On 29 June 2009, the Secretariat informed the parties that Professor Williams and Mr. Khan had appointed Professor Bernard Hanotiau, a national of Belgium, as the President of the Tribunal. Professor Hanotiau accepted his appointment on 2 July 2009.
71. On 6 July 2009, pursuant to Rule 6(2) of the Rules of Procedure for Arbitration Proceedings (the “ICSID Arbitration Rules”), the ICSID Secretary-General informed the parties that, having received from each arbitrator an acceptance of his appointment, the Arbitral Tribunal was deemed to have been constituted and the proceedings to have begun on that date.
72. By the same letter, Ms. Frauke Nitschke was designated to serve as Secretary of the Tribunal. Between 12 March and 27 July 2012, Ms. Eloïse Obadia served as Secretary of the Tribunal while Ms. Nitschke was on leave.

SECTION II. PROCEDURAL RULES AND AGENDA: MINUTES OF THE FIRST SESSION

73. Following an agreement by the parties and the Tribunal, a first session was held on 9 September 2009 by telephone conference.
74. The session considered various procedural matters regarding the conduct of the arbitration. At the session, the parties expressed agreement that the Tribunal had been properly constituted and stated that they had no objections in this respect. The parties further agreed on a set of rules applicable to this proceeding as well as on a timetable for the filing of written pleadings. The session was recorded and sound recordings were subsequently distributed by the Centre to the parties and the Members of the Tribunal. Summary Minutes of the first session were prepared by the Secretary of the Tribunal and transmitted to the parties following the session.

SECTION III. THE ISSUE OF BIFURCATION

75. In accordance with the timetable agreed upon at the first session, Respondent submitted on 14 December 2009 its Objections to Jurisdiction. As foreseen in the procedural calendar agreed at the first session, Respondent also addressed the issue of bifurcation in its submission, requesting the bifurcation of the proceeding between questions related to the Tribunal’s jurisdiction and those related to the merits of the case.
76. By letter of 18 December 2009, Claimant requested certain clarifications concerning Respondent’s position on jurisdiction as set forth in its 14 December 2009 submission. Respondent answered Claimant’s inquiries by letter of 30 December 2009.

77. Claimant filed its submission on bifurcation on 14 January 2010, objecting to Respondent's request for the bifurcation of the proceeding.
78. On 26 January 2010, Respondent filed its observations on Claimant's submission on bifurcation, to which Claimant replied to on 9 February 2010.
79. Having duly considered the parties' arguments in their written submissions on bifurcation, the Tribunal denied in its Procedural Order of 25 February 2010 Respondent's request for bifurcation of the proceeding, and decided that the procedural calendar under alternative A of Section 14 of the Summary Minutes of the first session was to apply to the remainder of the proceeding. This calendar provided as follows:
- March 29, 2010: Respondent's counter-memorial on the merits;
 - May 10, 2010: Claimant's reply on the merits and counter-memorial on jurisdiction;
 - June 21, 2010: Respondent's rejoinder on the merits;
 - July 26 - 30 (31), 2010 Hearing on jurisdiction and merits in Singapore (5 days and 1 day in reserve).

**SECTION IV. CLAIMANT'S REQUESTS FOR PRODUCTION OF DOCUMENTS:
PROCEDURAL ORDER OF 9 APRIL 2010 AND DECISION OF 9 JUNE 2010**

80. Subsequently, and in accordance with the procedure set forth in the Summary Minutes of the first session, Claimant submitted a request for production of documents to Respondent on 4 March 2010 (with minor clarifications submitted on 5 March 2010). Respondent replied to Claimant's request by letter of 22 March 2010. On 24 March 2010, Claimant amended certain requests and requested Respondent to confirm by 29 March 2010 whether it would accept any additional document requests, failing which the Claimant indicated that it would raise the matter with the Tribunal. Respondent did not answer that letter.
81. On 1 April 2010, Claimant filed a request for production of documents with the Arbitral Tribunal in the form of a *Redfern* Schedule, which set forth the positions of both parties regarding each category of documents requested by Claimant. Respondent filed its observations on Claimant's request by letter of 6 April 2010.
82. In its Procedural Order dated 9 April 2010, the Arbitral Tribunal recorded the parties' agreement on the production by Respondent of certain documents requested by Claimant, and denied Claimant's request for the production of certain other categories of documents.
83. By letter dated 26 May 2010, Claimant informed the Tribunal that Respondent had failed to meet its document production undertakings and obligations as set forth in the Tribunal's Procedural Order of 9 April 2010, and requested the Arbitral Tribunal to order Respondent to (i) produce these documents and to (ii) conduct specific searches of email accounts or in the alternative confirm that such searches had been conducted by Respondent.

84. By letter of 28 May 2010, Sri Lanka responded to Claimant's letter, stating, *inter alia*, that Respondent had agreed to search for printed/hardcopy emails, but had not agreed to conduct an electronic search, which in Respondent's view was not required under the IBA Rules of Evidence which the parties had agreed to be applicable to this proceeding.
85. Claimant objected to Respondent's interpretation of the parties' agreement and the interpretation of the IBA Rules by letter of 1 June 2010.
86. Having taken note of the parties' respective positions and arguments, the Arbitral Tribunal decided on 9 June 2010 as follows:

[...] As pointed out by Claimant, emails are by nature electronic documents, not hardcopy print outs. Consequently, Sri Lanka's agreement to search for emails necessarily amounts to an agreement to conduct a reasonable electronic search for such emails. The Tribunal also agrees that the usual interpretation of the term "Documents" in the IBA Rules of Evidence includes electronic means of storing or recording information and therefore emails.

We therefore invite Sri Lanka to proceed to a reasonable search of emails complying with its undertaking to produce the documents requested [...].

SECTION V. RESPONDENT'S REQUESTS FOR PRODUCTION OF DOCUMENTS: PROCEDURAL ORDERS OF 23 JUNE AND 5 JULY 2010

87. In accordance with the procedure set forth in the Minutes of the first session, Respondent submitted requests for production of documents directly to Claimant on 14 May 2010. By letter of 28 May 2010, Claimant provided its response to these requests directly to Respondent. On 31 May 2010 Respondent submitted a further request for production of additional documents directly to Claimant (the "additional request").
88. Under cover of a letter dated 3 June 2010, Respondent filed its requests for production of documents with the Arbitral Tribunal for decision in the form of a *Redfern* Schedule. On the same day, Claimant provided to the Arbitral Tribunal its position on Respondent's additional document production request of 31 May 2010 in the form of a *Redfern* Schedule listing the position of both parties on Respondent's additional document production request.
89. On 10 June 2010, the Arbitral Tribunal denied Respondent's additional document production request.
90. By letter of 15 June 2010, Respondent informed the Arbitral Tribunal that Claimant had agreed to the production of certain categories of documents identified in Respondent's request of 3 June 2010, and that Respondent no longer pursued a number of its other requests, save for eight categories of documents. On 16 June 2010, Claimant responded to Respondent's letter, clarifying the categories of documents it agreed to produce while recording its objections to certain other requests.

91. In its Procedural Order dated 23 June 2010, the Arbitral Tribunal decided the remaining document production requests by Respondent, granting certain requests while denying others.
92. On 24 June 2010, Respondent renewed its additional document production request, which the Tribunal had decided on 10 June 2010. By letter of 29 June 2010, Claimant requested that the Tribunal reject Respondent's renewed request.
93. Having considered the parties' views and arguments, the Arbitral Tribunal denied in its Procedural Order of 5 July 2010 Respondent's renewed request of 24 June 2010, confirming its 10 June 2010 decision.

SECTION VI. EXCHANGE OF WRITTEN PLEADINGS

94. As mentioned above, Claimant filed a Memorial on the Merits (the "Claimant's Memorial") dated 25 September 2009 together with exhibits, legal authorities and the witness statements of Messrs. Rohan Rodrigo, Sreenivasan Iyer, and Dhakshitha Serasundera. On 14 December 2009, Respondent submitted its Objections to Jurisdiction together with exhibits and legal authorities.
95. On 1 April 2010, Respondent submitted its Counter-Memorial on the Merits together with exhibits, legal authorities, an expert report of Mr. Johannes Benigni of JBC Energy, and witness statements of Messrs. Mohamed Shibly Aziz, Nanayakkara Wasamwakwella Gamage Dhammika Nanayakkara and Ms. Ranee Jayamaha.
96. By letter of 7 May 2010, the Arbitral Tribunal confirmed an amendment to the procedural calendar agreed upon by the parties, according to which Claimant's Reply on the Merits and Counter-Memorial on Jurisdiction was to be filed on or before May 17, 2010; and Respondent's Rejoinder on the Merits was to be filed on or before June 25, 2010.
97. In accordance with the amended timetable, Claimant filed its Reply on the Merits and Counter-Memorial on Jurisdiction together with exhibits, legal authorities, the witness statement of Messrs. Rohan Rodrigo and an expert report of Mr. Richard Grove of Rutter Associates LLP, on May 17, 2010.
98. On 7 July 2010, Respondent filed its Rejoinder on the Merits together with exhibits, legal authorities, an expert report of Mr. Johannes Benigni, and witness statements of Messrs. Ashantha de Mel, Peduru Merenna Lalith Kierthie Karunartne, Lalith Weeratunga, Kosgallana Durage Ranasinghe, Bendarage Don Wasantha Ananda Silva, Nanayakkara Wasamwakwella Gamage Raja Dhammika Nanayakkara, Ranee Jayamaha, and Abdul Hameed Mohamed Fowzie.

SECTION VII. ADJOURNMENT OF THE HEARING

99. By letter of 3 June 2010, Respondent had filed an application for adjournment of the hearing scheduled to commence on 26 July 2010 in Singapore, and requested an extension

until 27 August 2010 to file its Rejoinder on the Merits. Claimant objected to Respondent's application and request for an extension by letter of 4 June 2010. Each party filed a further written submission on the matter on 8 June 2010.

100. Having examined the parties' respective arguments, the Arbitral Tribunal decided on 9 June 2010 that a postponement of the hearing was not justified, and that the hearing as originally scheduled was confirmed. The Arbitral Tribunal further decided to grant Sri Lanka an extension until 7 July 2010 to file its Rejoinder.
101. In preparation of the hearing, the President of the Tribunal held a telephone conference with the parties on 25 June 2010 concerning procedural matters related to the conduct of the oral procedure.
102. Subsequently, by letter of 12 July 2010, both parties requested an adjournment of the hearing originally scheduled to commence on 26 July 2010. The adjournment was confirmed by the Tribunal on the same day.
103. On 12 and 13 July 2010, both parties filed observations regarding the allocation of costs of the adjournment of the hearing. On 14 July 2010, the President of the Tribunal held a telephone conference with the parties regarding the further procedure.
104. Following several rounds of correspondence between the parties and the Arbitral Tribunal regarding (i) the allocation of costs for the adjournment of the hearing, and (ii) the parties' and Tribunal Members' availability for a 10-day hearing (four additional sitting days had been requested by the parties), it was recorded on 16 August 2010 that the first possible dates on which counsel and the Tribunal Members were available was 25 August to 7 September 2011. On 27 August 2010, the Arbitral Tribunal further decided to address questions related to the costs of the adjournment in its award.

SECTION VIII. CLAIMANT'S ADDITIONAL REQUESTS FOR PRODUCTION OF DOCUMENTS: PROCEDURAL ORDER OF 22 DECEMBER 2010

105. On 3 December 2010, Deutsche Bank filed a further request for production of documents with the Arbitral Tribunal for decision. Claimant had submitted its requests directly to Respondent on 3 August 2010, to which Sri Lanka responded by letter of 22 October 2010. Claimant's 3 December 2010 request contained the requested documents and the parties' positions in form of a *Redfern* Schedule.
106. In its Procedural Order of 22 December 2010, the Arbitral Tribunal decided Claimant's document production requests, denying some and granting others.

SECTION IX. RESPONDENT'S REQUEST FOR RECONSIDERATION OF THE TRIBUNAL'S PROCEDURAL ORDER: PROCEDURAL ORDER OF 9 FEBRUARY 2011

107. On 20 January 2011, Respondent requested the Arbitral Tribunal to reconsider certain aspects of the Tribunal's 23 June 2010 Procedural Order.
108. By letter of 26 January 2011, Claimant objected to Respondent's request of 20 January 2011. Respondent filed a reply submission on production of documents on 1 February 2011, to which Claimant responded on 4 February 2011.
109. On 9 February 2011, having considered the parties' respective submissions, the Arbitral Tribunal issued a Procedural Order denying the Respondent's 20 January 2011 request.

SECTION X. CLAIMANT'S FURTHER APPLICATION FOR AN ORDER IN RELATION TO DOCUMENT PRODUCTION: PROCEDURAL ORDER OF 11 APRIL 2011

110. On 16 March 2011, Claimant submitted a request for an order by the Arbitral Tribunal in relation to document production on the basis that Respondent had substantially failed to discharge its document production undertakings and obligations. Respondent submitted its observations on Claimant's request on 25 March 2011. Claimant filed a further written submission on the matter on 29 March 2011, to which Respondent replied on 6 April 2011.
111. Having considered the parties' written submissions, the Arbitral Tribunal issued on 11 April 2011 a Procedural Order denying Claimant's request and accepting Respondent's assurances of reasonable searches for the documents requested by Claimant. At the same time the Arbitral Tribunal noted that it reserved the right to draw adverse inferences should evidence be presented at a later stage in the proceeding disclosing that any of the documents requested did in fact exist.

SECTION XI. THE PARTIES' FURTHER APPLICATIONS FOR INCLUSION OF EVIDENCE: DECISION OF 29 JULY 2011, PROCEDURAL ORDER OF 16 AUGUST 2011 AND PROCEDURAL ORDER OF 20 AUGUST 2011

Claimant's application

112. In accordance with the procedural timetable leading up to the hearing, which had been agreed upon by the parties and confirmed by the Arbitral Tribunal, each party filed further evidence on 20 July 2011. Between 22 and 28 July 2011, the parties filed several rounds of communications regarding the admission of further evidence. The parties were in agreement regarding the inclusion of certain documents into the record, and, on 29 July 2011, the Arbitral Tribunal granted Claimant's application for the inclusion of two further expert opinions.

Respondent's applications

113. By letter of 5 August 2011, Respondent requested the admission of further evidence into the record, which included, *inter alia*, a copy of an English Court Order granting CPC's permission to appeal a judgment rendered on 11 July 2011 in the matter Standard Chartered Bank v. Ceylon Petroleum Corporation ("SCB v. CPC") in the English High Court. A copy of the SCB v. CPC judgment had previously been introduced into the record by the Claimant on 20 July 2011.
114. By the same letter, Respondent requested the admission of an award rendered on 1 August 2011 in an arbitration under the Rules of the London Court of International Arbitration ("LCIA") involving Citibank and CPC (the "*Citibank* award").
115. Claimant objected to Sri Lanka's request regarding the admission of the *Citibank* award on the same day, and the parties exchanged further written submissions on this issue between 8 and 10 August 2011.
116. In accordance with the pre-hearing procedural calendar agreed by the parties, each party filed a roadmap submission on 12 August 2011. By letter of 13 August 2011, Claimant requested the Arbitral Tribunal to take note that Respondent had in its roadmap submission made reference to the *Citibank* award and, should the Tribunal decide that the *Citibank* award be inadmissible in this arbitration, Respondent should be directed to resubmit its roadmap submission without references to the *Citibank* award. By letter of 14 August 2011, Respondent filed observations on Claimant's 13 August 2011 letter.
117. In its Procedural Order of 16 August 2011, the Arbitral Tribunal confirmed that it had refrained from reading the *Citibank* award submitted by Respondent on 5 August 2011. The Tribunal decided that the *Citibank* award would not be admitted into the record of the present arbitration, and that Respondent's summaries thereof would also be excluded. Respondent was further directed to resubmit its roadmap submission within two working days of the Tribunal's Order with all references to the *Citibank* award removed. The Tribunal further admitted all other documents submitted by Respondent on 5 August 2011 into the record.
118. By letter of 17 August 2011, Respondent invited the Arbitral Tribunal to reconsider its decision regarding the inadmissibility of the *Citibank* award. By letter of 18 August 2011, Claimant objected to Respondent's request and reaffirmed its position of the inadmissibility of the *Citibank* award in this arbitration.
119. Having examined the parties' submissions and arguments on the issue, the Tribunal decided in its Procedural Order of 20 August 2011, to reconsider its 16 August 2011 decision and to admit the *Citibank* LCIA award into the record, and further authorized references thereto and summaries thereof in the parties written and oral submissions.

SECTION XII. THE HEARING

120. From 25 August 2011 to 5 September 2011 the Arbitral Tribunal held a Hearing on Jurisdiction and Merits at the Maxwell Chambers in Singapore.
121. In addition to the three Members of the Arbitral Tribunal and the Secretary, the following persons participated in the hearing:

On behalf of Claimant:

Ms. Judith Gill QC, Mr. Matthew Gearing, Mr. Andrew Battisson, Mr. Matthew Hodgson, Mr. Simon Maynard, and Ms. Claire Balchin, of Allen & Overy LLP;
Ms. Dilumi de Alwis, Mr. Meven Bandara of Julius & Creasy.

Ms. Jessie Tan, Mr. Beon Chye Lob, Mr. Joe Longo, Mr. Akash Mohapatra, Mr. Theodore Backhouse, Mr. Stuart Smith, and Mr. Gunnar Hoest.

Providing witness testimony:

Mr. Rohan Rodrigo, Mr. Dhakshitha Serasundera, Mr. Sreenivasan Iyer of Deutsche Bank AG.

Providing expert witness testimony:

Mr. Richard Grove of Rutter Associates LLC.

On behalf of Respondent:

Mr. Mohan Pieris PC, Attorney General of Sri Lanka; Mr. Janak de Silva, Mr. Milinda Gunetilleke, Mr. Rajitha Perera and Ms. Ruwanthi Herat-Gunaratne of the Attorney General's Department of Sri Lanka; Professor James Crawford SC of Matrix Chambers; Mr. Ali Malek QC and Mr. Clive Freedman of 3 Verulam Buildings; Mr. Simon Olleson of Thirteen Old Square; and Ms. Juliette McIntyre of the Lauterpacht Centre for International Law.

Providing witness testimony:

Mr. A. H. M. Fowzie, Senior Minister; Mr. Lalith Weeratunga, Secretary to His Excellency the President of Sri Lanka; Mr. Lalith Karunaratne; Dr. Ranee Jayamaha, Advisor to His Excellency the President of Sri Lanka; Mr. Ananda Silva, Mr. R. D. Nanayakkara and Mr. K. D. Ranasinghe of the Central Bank of Sri Lanka; and Mr. Ashantha de Mel, former Chairman of CPC.

Providing expert witness testimony:

Mr. Johannes Benigni of JBC Energy.

SECTION XIII. POST-HEARING SUBMISSIONS; SUBMISSIONS ON THE JUDICIAL COMMITTEE'S DECISION IN GÉCAMINES AND THE COURT OF APPEAL'S DECISION IN SCB; CLOSURE OF THE PROCEEDINGS

122. At the end of the hearing and following the parties' joint proposal, the Tribunal decided that the parties were to file a first round of post-hearing briefs simultaneously on 25 October 2011, and a second round on 10 November 2011. Each party filed its post-hearing submission in accordance with this calendar.
123. The parties further filed their respective statements of costs on 25 November 2011, and Claimant filed amendments to its submission on 28 November 2011.
124. Under cover of a letter of 11 May 2012, Respondent provided the Tribunal with an update regarding the *SCB v. CPC* hearing before the English Court of Appeal.
125. Under cover of a message of 22 July 2012, Respondent drew the attention of the Tribunal to the decision of the Judicial Committee of the Privy Council, on appeal from the Court of Appeal of Jersey, in *La Générale des Carrières et des Mines (Gécamines) v F.G. Hemisphere Associates LLC* which in Respondent's view was directly relevant to the present case. Claimant filed observations on Respondent's letter on the same day. Following an invitation by the Tribunal, each party filed on 27 July 2012 its observations on the relevance of the *Gécamines* decision to the present case.
126. In its 27 July 2012 submission, Respondent requested leave from the Tribunal for the parties to file written submissions on the English Court of Appeal's decision in the *SCB v. CPC* proceedings (on appeal of the decision of Hamblen J), which had been rendered that day⁶². The Tribunal granted Respondent's request and the parties filed further written submissions on the Court of Appeal's decision on 10 and 24 August 2012, respectively.
127. Pursuant to Arbitration Rule 38(1), the Arbitral Tribunal closed the proceedings on 4 September 2012.

⁶² *Standard Chartered Bank v. Ceylon Petroleum Corporation* [2012] EWCA Civ 1049.

CHAPTER V. JURISDICTION

128. Respondent submits that the Arbitral Tribunal does not have jurisdiction under the BIT and under Article 25(1) of the ICSID Convention. This is disputed by Claimant.
129. The parties have filed very extensive submissions on this issue as well as on the other issues dealt with in the subsequent chapters. The summaries of the parties' arguments set out below are without prejudice of the parties' full arguments as submitted in written pleadings and presented at the hearing, which the Tribunal has taken into full consideration in making its determinations.

SECTION I. CLAIMANT'S POSITION

Sub-Section I. The Treaty

130. The Treaty provides in its Article 1 that for the purposes of this Treaty:
- "1. The term "investments" comprises every kind of asset, in particular: ...
c) claims to money which has been used to create an economic value or claims to any performance having an economic value and associated with an investment;
...".*
131. Article 11 of the Treaty provides that:
- "1. Divergences concerning investments between a Contracting State and a national or company of the other Contracting State should as far as possible be settled amicably between the parties in dispute.
2. If the divergency cannot be settled within six months of the date when it has been raised by one of the parties in dispute, it shall, unless the parties in dispute agree otherwise, be submitted at the request of the national or company of the other Contracting State for settlement under the Convention of 18 March 1965 on the Settlement of Investment Disputes between States and Nationals of Other States.
...".*

I. Investment under Article 1(1) of the Treaty

132. According to Claimant, the Hedging Agreement satisfies the definition of investment under Article 1(1) of the Treaty. This Article provides that the term "*investments*" comprises "*every kind of asset*" before setting out a list of illustrative categories. Claimant submits that the Hedging Agreement is an asset, it is legal property with economic value for Deutsche Bank that booked the Agreement as an asset at fair value in its accounts.
133. Claimant further submits that Article 1(1)(c) is simply an illustration of the reference to "*every kind of asset*". According to Claimant, the wording of Article 1(1)(c) cannot be read, as alleged by Respondent, as requiring the receivables or claims to performance to be

associated with a separate investment in order to qualify for protection. Such an interpretation would render Article 1(1)(c) superfluous since it would depend on the existence of an independent investment. Claimant asserts that Sri Lanka has cited no case where a tribunal has read such language restrictively. According to Claimant, an illustrative list of “*assets*” is precisely that and does not imply the exclusion of assets which do not happen to be listed, or that the broad scope of protected investments should be constrained by a narrow and restrictive construction of those listed.

134. According to Claimant, Deutsche Bank’s rights under the Hedging Agreement are definitely an “*asset*” and they comprise both “*claims to money*” and “*claims to performance*” within Article 1(1)(c). Claimant submits that no tribunal has read the circular language “*associated with an investment*” in the restrictive way Sri Lanka intends. For its position, Claimant refers *inter alia* to *CSOB v. Slovak Republic*, where the Arbitral Tribunal was faced with a similar language under Article (1)(c) of the Czech Republic-Slovakia BIT and had no difficulty finding that “*terms as broad as “asset” and “monetary receivables or claims” clearly encompass loans*”⁶³. Claimant also refers to the *Alpha Projekt Holding v. Ukraine* case⁶⁴ in which the Arbitral Tribunal decided that loan agreements can be considered an investment.
135. Finally, Claimant submits that even if the words “*and associated with an investment*” had to receive the meaning given by Respondent, they only apply to “*claims to performance*” and not to “*claims to money*”.

II. Territorial nexus with Sri Lanka

136. Claimant submits that the jurisdictional provisions in Articles 1 and 11 of the Treaty do not contain any territoriality requirement. Claimant accepts that some territorial nexus with Sri Lanka was required in order to engage the substantive protections of the Treaty but Claimant considers this to be a merits issue to be determined when considering the actions of the relevant authorities in relation to the investment and that there was no independent requirement for any investment to be physically located in Sri Lanka.
137. Claimant further submits that in any event, it is clear that the Hedging Agreement satisfied any territoriality requirement, and that Sri Lanka’s suggestion that the Agreement cannot be located in its territory because the Central Bank “*did not and cannot regulate the seller of the product, DB London*” is incorrect.
138. According to Claimant, there are several arguments for its position: First, Claimant submits that in most treaty disputes, where the investment in question is a State contract, the host State will not be able to regulate the foreign counterparty *per se* but merely its activities in furtherance of the contract.

⁶³ *Československa obchodní banka, a.s. (CSOB) v. Slovak Republic* (ICSID Case No. ARB/97/4), Decision on Jurisdiction, 24 May 1999, para. 77 [hereinafter “*CSOB v. Slovak Republic*”].

⁶⁴ *Alpha Projekt Holding GmbH v. Ukraine* (ICSID Case No. ARB/07/16), Award, 8 November 2010, para. 273 [hereinafter “*Alpha v. Ukraine*”].

139. Secondly, Claimant asserts that the legal parties to the Hedging Agreement were CPC and Deutsche Bank AG and not Deutsche Bank London. The Central Bank is able and did in fact regulate Deutsche Bank AG through its Colombo branch in relation to the contract. The Central Bank assumed regulatory jurisdiction over Deutsche Bank AG's contract and the fact that it was achieved via its jurisdiction over Deutsche Bank AG's branch in Colombo is of no importance. Claimant refers in this respect to the testimony of Mr. Silva and Mr. Rodrigo⁶⁵.
140. Thirdly, according to Claimant, Sri Lanka overlooked the fact that the Hedging Agreement could not have been concluded without Deutsche Bank Colombo. The minutes of the Study Group make this clear. Mr. Karunaratne, member of the Study Group, confirmed in his evidence that a local presence was indeed a requirement of the Central Bank. He made clear that CPC would not have concluded the Hedging Agreement if Deutsche Bank did not have a presence in Colombo, and it is precisely for this reason that it did not conclude an agreement with Merrill Lynch. All five banks which concluded Hedging Agreements with CPC had a local presence.
141. In Claimant's view, Mr. Karunaratne also confirmed that in relation to the Hedging Agreement, he only dealt with Mr. Serasundera, that all meetings took place at CPC's office and that he had no contact with Deutsche Bank London⁶⁶. Further, Mr. Serasundera spent more than 50% of his time over almost a two-year period working on various aspects of the Hedging Agreement including overseeing the necessary internal approvals, satisfying documentary requirements, obtaining quotes, liaising with CPC, and providing market updates to CPC almost daily⁶⁷. Claimant concludes that but for the existence and involvement of Deutsche Bank Colombo, the Hedging Agreement could not have been concluded and that Deutsche Bank Colombo played an indispensable role in relation to the investment. According to Claimant, this was sufficient to establish the required territorial nexus with Sri Lanka.
142. Claimant also insists on the global nature of Deutsche Bank's operations which is reflected in the presence of many branches and the centralisation of some of the functions in certain centers, such as Singapore where all credit decisions are made with regard to Sri Lankan clients. According to Claimant, the majority of the day-to-day interaction of Mr. Serasundera in relation to the Hedging Agreement was with Mr. Wong, Mr. Ng, Mr. Mazumder and Mr. Iyer, all of whom are based in Asia⁶⁸. In Claimant's view, the global

⁶⁵ Hearing on Jurisdiction and the Merits, Transcript Day 5, p. 108, line 19 to p. 109, line 19 and Day 2, p. 124, lines 14 to 18 [hereinafter referred to as "Transcript Day [#], p. [#], line [#]"].

⁶⁶ Transcript Day 4, p. 86, line 4, to p. 87, line 3. Reference is also made to Mr. Iyer's evidence, Transcript Day 3, p. 7, lines 13 to 16.

⁶⁷ Second Witness Statement of Rohan Sylvester Rodrigo, 14 May 2010, para. 74; Transcript Day 2, p. 136, line 5 to p. 137, line 9, and p. 161, line 14 to p. 162, line 6.

⁶⁸ Witness Statement of Dhakshitha Serasundera, 23 September 2009, para. 12 [hereinafter "Serasundera Witness Statement"].

nature of Deutsche Bank is also reflected in the fact that accounts are prepared for Deutsche Bank AG as a whole and not for separate branches.

143. Claimant finally submits that the nature of any territoriality requirement must depend on the investment at issue. In the case of financial instruments, Claimant asserts that it is well established that the territorial nexus exists where the purpose of the transaction is achieved in the host State. *Abaclat* confirmed this approach, holding that in the case of financial instruments: “*the relevant criteria should be where and/or to the benefit of whom the funds are ultimately used, and not the place where the funds were paid out or transferred*”⁶⁹. Since the parties agreed that the reduction of volatility is the purpose of the hedging transaction⁷⁰, and since the Hedging Agreement immediately reduced CPC’s exposure to volatility by 9.04%, the defining feature of the Agreement occurred in Sri Lanka. Moreover, according to Claimant, all other benefits of the Agreement such as the improvement of CPC’s cash flow also occurred in Sri Lanka and all payments by Deutsche Bank to CPC in order to offset the problem caused by high oil prices were required to be made in Sri Lanka; let alone the fact that in this case, the territorial nexus also included substantial activities on the ground in Sri Lanka.

Sub-Section II. **Article 25(1) of the ICSID Convention**

144. Article 25(1) of the ICSID Convention provides that

“[t]he jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State (or any constituent subdivision or agency of the Contracting State designated to the Centre by that State) and the national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre”.

Claimant accepts the existence of a “*double-barrel test*” but only to a very limited extent. It submits that it cannot have been the parties’ intention that Article 25(1) of the Convention would restrict the broad definition of “*investments*” chosen in Article 1(1) of the Treaty so as to frustrate the bringing of any claim.

145. Claimant further submits that the *Salini*⁷¹ characteristics have been discredited and are not a jurisdictional requirement but that in any case, they are satisfied here.

I. Contribution

146. Claimant submits that the Hedging Agreement undoubtedly involved a contribution to Sri Lanka for multiple reasons. First, it involved a binding commitment by Deutsche Bank to

⁶⁹ *Abaclat and others. v. Argentine Republic* (ICSID Case No. ARB/07/5), Decision on Jurisdiction and Admissibility, 4 August 2011, para. 374 [hereinafter “*Abaclat v. Argentina*”].

⁷⁰ Respondent’s Post-Hearing Brief, paras. 66 (a) and 66(b); 25 October 2011 [hereinafter “Respondent’s Post-Hearing Brief”].

⁷¹ Claimant’s Memorial, para. 35, section 3.5.

pay up to USD 2.5 million. Secondly, according to Claimant, at prevailing prices, the Hedging Agreement gave CPC and Sri Lanka access to oil at substantially below spot and forward-curve prices.

147. Thirdly, Claimant points out that the Hedging Agreement provided a 9.04% reduction in CPC's exposure to volatility in relation to the 100,000 barrels hedged. Claimant further submits that the serious negative consequence of un-hedged exposure to oil price volatility for developing countries have been confirmed by the World Bank and the International Monetary Fund ("IMF"). In Claimant's view, it cannot be disputed that the reduction in exposure to volatility of oil prices immediately upon conclusion of the Hedging Agreement was a benefit both to CPC and the Sri Lankan economy. In Claimant's view, Mr. Grove's calculation, which had not been challenged by Sri Lanka, is that the Hedging Agreement reduced CPC's exposure to volatility by 9.04% immediately upon its conclusion in relation to the 100,000 barrels hedged⁷². According to Claimant and contrary to what Sri Lanka seemed to suggest, this reduction was not dependent on any subsequent movement in oil prices, it was a measurable economic benefit which accrued to CPC at the moment the Hedging Agreement was signed⁷³.
148. Fourth, Claimant asserts that the Hedging Agreement provided cash flow benefits. The structure of the Hedging Agreement ensured that CPC would not bear the full cost of oil prices whilst they remained above USD 112.50 in respect of the 100,000 barrels hedged.
149. Fifth, Claimant submits that the Hedging Agreement required Deutsche Bank to extend a substantial credit line to CPC. The amount of this credit line was calculated by Deutsche Bank at USD 25 million on the date the Hedging Agreement was concluded as reflected in the record and confirmed both by Mr. Iyer⁷⁴ and Mr. Grove⁷⁵. Claimant disputes Sri Lanka's contention in its Closing Submission that "*there was no provision of credit in any sense of the word on 8 July 2008*"⁷⁶. In Claimant's view, there is no support for this point of view. To the contrary, Claimant submits that Mr. Nanayakkara also confirmed that Deutsche Bank assumed a credit risk under the Hedging Agreement⁷⁷. According to Claimant, it was for this reason that Credit Risk Management approval was required for conclusion of the Hedging Agreement just as it would have been if Deutsche Bank had extended a loan to CPC.
150. Finally, Claimant submits that the extension of credit had real and tangible benefits to CPC. If CPC had not dealt directly with Deutsche Bank, but instead had obtained derivatives from an exchange, it would have been required to make an upfront margin

⁷² Claimant's Reply; Richard Grove Expert Report, pp. 38 to 40 [hereinafter "Grove Report"].

⁷³ Grove Report, *supra* note 72, pp. 38 to 40.

⁷⁴ Transcript Day 3, p. 5, lines 15 to 19.

⁷⁵ Transcript Day 5, p. 176, lines 12 to 18.

⁷⁶ Transcript Day 8, p. 210, lines 8 to 11.

⁷⁷ Transcript Day 3, p. 205, line 19 to p. 206, line 2.

deposit and faced further margin calls if the trade moved against CPC. According to Claimant, this was confirmed by Mr. Karunaratne⁷⁸ and admitted by the CPC Board⁷⁹.

151. Claimant further considers that Sri Lanka's allegation that there was no contribution by Deutsche Bank because "*if the risks faced by CPC were to arise, there would be no contribution of any kind by DB London*", is without merit. According to Claimant, immediately on conclusion of the Hedging Agreement, with oil prices levels of close to USD 140 per barrel, Deutsche Bank relieved CPC of the risk that it would continue to pay the full market price of oil whilst prices remained at such elevated levels. In Claimant's view, the Hedging Agreement provided CPC with an assurance that for a period of twelve months it would be protected by up to USD 10 per barrel and an overall USD 2.5 million for 100,000 barrels of oil whilst prices remained above USD 112.50. The obligations assumed by Deutsche Bank which so reduced CPC's risk were Deutsche Bank's contribution in this regard.
152. Claimant also submits that Sri Lanka wrongly attempts to equate a "*contribution*" by Deutsche Bank to actual payments to CPC under the Hedging Agreement. The investment must be assessed at its inception and not with hindsight. Moreover, there is no requirement for a cross border flow of capital in Article 25 of the ICSID Convention. According to Claimant, the key point is that the conclusion of the Hedging Agreement gave CPC immediate protection and without payment of a premium. The parties agree in this regard that the date the Hedging Agreement was concluded is the relevant date to determine whether there was an investment.
153. According to Claimant, Sri Lanka's suggestion that the Agreement would result "*in either a contribution or a return*" but not both, proceeds from the same flawed logic which confuses subsequent payment by Deutsche Bank with its contribution on Day 1. In Claimant's view, it is also incorrect that Deutsche Bank's return was conditional upon market prices falling such that CPC made payments to Deutsche Bank. Claimant asserts that the Agreement, like all derivatives concluded by banks, had a positive mark to market value for Deutsche Bank immediately upon its conclusion as a result of the bid-offer spread regardless of future movements in the market prices.
154. Claimant also disputes Sri Lanka's allegation that the Hedging Agreement did not provide CPC immediate access to oil at below market rate. In Claimant's view, hedging contracts by their nature directly correspond to an underlying physical exposure held by the hedger. Claimant submits that in CPC's case, this exposure was the purchase of 100,000 barrels of crude oil at market rate. The Hedging Agreement, whose payment terms were derived from market prices, had the effect of offsetting and discounting the actual price paid by CPC. That this was achieved by separate contracts is irrelevant according to the Claimant.

⁷⁸ Transcript Day 4, p. 78, lines 5 to 12; Core 3/72; Core 3/73.

⁷⁹ Core 5/219, p. 170.

155. Finally, Claimant disputes Sri Lanka’s position that derivative agreements which, by their nature, involve uncertain pay-outs which are linked to movements in market prices, may never fall within Article 25(1) of the ICSID Convention. According to Claimant, the substantial benefits of such agreements, and oil-hedging contracts in particular, to developing States have been emphasized repeatedly by the IMF, the World Bank and others and that the United States Model BIT specifically identifies derivatives as investments. Deutsche Bank however points out that the Tribunal need not find that all derivatives constitute an investment. Claimant submits that the Hedging Agreement was a unique contract, negotiated over some two years in order to further national policy. It was concluded with substantial governmental involvement and oversight and for a specific significant duration and was carried out on credit rather than payment of a premium or margin.

II. Duration

156. Claimant submits that Deutsche Bank worked towards delivering the Hedging Agreement from August 2006, almost two years before its conclusion and the Agreement commitment was for twelve months. In Claimant’s view, it is immaterial that under certain circumstances, it might terminate before then. This will almost invariably be the case where an investment is a contract.

157. Claimant objects to Sri Lanka’s submission that the Hedging Agreement was unilaterally terminable by Deutsche Bank. According to Claimant, this is not correct. The Agreement provides for termination only in the event of a few specifically identified “*additional termination events*”.

158. According to Claimant, the fact that the Hedging Agreement was terminated by Deutsche Bank after 125 days is irrelevant. The relevant date to determine the existence of an investment is when the agreement is concluded. The Agreement involved a commitment for twelve months and this is sufficient.

159. In any case Claimant submits that the drafters of the ICSID Convention specifically rejected the imposition of a minimum duration. Claimant further argues that both ICSID and non-ICSID tribunals have confirmed that a minimum duration should not be imposed⁸⁰ and found that twelve months is a sufficiently long term commitment to be an investment⁸¹.

⁸⁰ *Malaysian Historical Salvors Sdn, BHD v. Malaysia* (ICSID Case No. ARB/05/10), Decision on Annulment, 16 April 2009, para. 71 [hereinafter “*MHS v. Malaysia-Annulment*”]; *Romak SA v. Republic of Uzbekistan* (PCA Case No. AA280), Award, 26 November 2009, para. 225. [hereinafter “*Romak v. Uzbekistan*”]

⁸¹ *Petrobart Ltd. v. Kyrgyz Republic* (SCC Arb. No. 126/2003), Award, 29 March 2005.

III. Risk

160. Claimant submits that the Hedging Agreement involved various risks for Deutsche Bank: credit risk, market risk, liquidity risk, operations risk, legal risk and political risk⁸².
161. According to Claimant, Sri Lanka had no answer to the fact that Deutsche Bank faced a substantial risk that it would pay up to USD 2.5 million to CPC.

IV. Contribution to economic development

162. According to Claimant, contribution to the economic development of the host State is not a jurisdictional condition. It has been discredited and has not been adopted by a recent tribunal. Indeed, whether a given transaction makes a positive contribution to economic development introduces unacceptable subjectivism and is a matter on which economists may often disagree.
163. In any event, Claimant argues that this criterion would clearly be satisfied in the present case. The hedging program was designed and implemented in the national interest and the Sri Lankan authorities, well aware of the terms of the transactions being concluded by CPC, repeatedly attested to their benefits to CPC and the national economy.

V. Expectation of regular profit or return

164. Claimant submits that the criterion of profit and return does not constitute a jurisdictional requirement. This was confirmed by the Tribunal in *Malaysian Historical Salvors v. Malaysia*⁸³. In any case, insofar as it is relevant, it should be more accurately stated as an expectation of profit or return. For example, the Tribunal in *Biwater Gauff*⁸⁴ found that, although the business was never in fact profitable, the criterion was nonetheless satisfied as “*BGT intended the project to be profitable albeit with a relatively low rate of return*”.
165. Claimant argues that Deutsche Bank concluded the Hedging Agreement with an intention to make a profit. It had an immediate “mark to market” value for Deutsche Bank in the form of a bid-offer spread⁸⁵.

VI. There is no “Ordinary commercial transaction” test

166. Contrary to what Sri Lanka alleges, Claimant submits that the Hedging Agreement is not a sale of goods. It is a financial product along with many other financial instruments such as

⁸² Transcript Day 3, p. 205, line 19 to p. 206, line 2.

⁸³ *MHS v. Malaysia*-Annulment, *supra* note 80, para. 17.

⁸⁴ *Biwater Gauff (Tanzania) Limited v. United Republic of Tanzania* (ICSID Case No. ARB/05/22), Award, 24 July 2008, para. 320 [hereinafter “*Biwater v. Tanzania*”].

⁸⁵ Grove Report, *supra* note 72, p. 45 section 6.2.

bonds and loans. Claimant argues that the *Fedax*⁸⁶, *CSOB*⁸⁷, *Abaclat*⁸⁸ and *Alpha Projektholding*⁸⁹ Tribunals have all qualified loans and bonds as investments.

167. According to Claimant, there is good reason for a simple sale of goods not to be considered an investment. There is no duration of any significance. Such sales are typically supported by letters of credit or upfront payments such that there is little or no risk associated with the sale. The only contribution is the transfer of title to goods against full and immediate payment at market rate. There are therefore good reasons why a simple sale of goods is not considered an investment which do not depend on any alleged “ordinary commercial transaction” test. However, Claimant argues that where a sales agreement includes special features such as a bespoke product or the provision of a credit line, it is difficult to see why it should not be considered an investment⁹⁰.
168. Deutsche Bank insists that there is no “ordinary commercial transaction” test, suggesting an exclusion of activity which is normal or routine for the investor. Such a reference is in Claimant’s view imprecise and would be unworkable. The international government bond market is worth many trillions of dollars, with such bonds being traded in high volumes on a daily basis, but this, so Claimant submits, has not prevented tribunals concluding that bonds are an investment. Similarly, granting loans is a normal activity for banks, but this has not prevented loans from constituting an investment.
169. In any event Claimant argues the Hedging Agreement was in no sense an “ordinary commercial transaction”. The hedging program was negotiated over a period of two years at the instigation and with the approval of the very highest authorities in Sri Lanka to further the national interest.
170. Finally, Claimant submits that Sri Lanka may not rely on Professor Abi-Saab’s opinion in the recent *Abaclat* case⁹¹. The facts of *Abaclat* were different since the bonds were purchased on the secondary market and there was no activity by the investors in the host State nor any direct dealings with Argentina. In Claimant’s view, the same concerns do not arise in this case where substantial and indeed indispensable activities were carried out in Sri Lanka. Deutsche Bank dealt directly with both CPC and the Central Bank in relation to the conclusion of the Hedging Agreement.

⁸⁶ *Fedax N.V. v. Republic of Venezuela* (ICSID Case No. ARB/96/3), Award, 9 March 1998 [hereinafter “*Fedax v. Venezuela – Award*”].

⁸⁷ *CSOB v. Slovak Republic*, *supra* note 63, para. 77 (1999).

⁸⁸ *Abaclat v. Argentina*, *supra* note 69, para. 374 (2011).

⁸⁹ *Alpha v. Ukraine*, *supra* note 64, para. 273 (2010).

⁹⁰ *Pantehniki SA Contractors & Engineers v. Republic of Albania* (ICSID Case No. ARB/07/21), Award, 30 July 2009, para. 44 [hereinafter “*Pantehniki v. Albania*”].

⁹¹ *Abaclat v. Argentina*, *supra* note 69, Dissenting Opinion of Georges Abi-Saab, 28 October 2011, para. 104.

VII. The Hedging Agreement is not a “Contingent Liability”

171. Claimant denies Sri Lanka’s argument that the Hedging Agreement cannot amount to an investment as it involves a purely contingent future liability. According to Claimant, none of the cases on which Sri Lanka relies is authority for Sri Lanka’s position. Furthermore, it is clear to Claimant that as a matter of accounting practice as well as ordinary construction, the Hedging Agreement was not a contingent liability: it created immediate rights and obligations and created value from the outset.
172. According to Claimant, Respondent stretches beyond recognition the notion of “Contingent Liability”. The term has a specific meaning as a matter of accounting treatment. International Accounting Standards (“IAS”), in particular IAS 37, defines “Contingent Liabilities” in the following terms:
- “A possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or
a present obligation that arises from past events but is not recognized because:
(i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
(ii) the amount of the obligation cannot be measured with sufficient reliability”.*
173. The Hedging Agreement is according to Claimant not considered as a “Contingent Liability” in financial practice. Derivatives fall within the scope of IAS 39: “[t]he basic principle in IAS 39 is that all derivatives are carried at fair value with gains and losses in the income statement”⁹². Claimant submits that the IMF also confirms that
- “[c]ontingent assets and liabilities are contractual financial arrangements between institutional units that do not give rise to unconditional requirements either to make payments or to provide other objects of value. They are not recognised as financial assets or liabilities prior to the condition(s) being fulfilled. ... Although the value of future payments arising from equity, financial derivatives ... are recognised as financial assets rather than as contingent assets. ... [T]he liability exists, but the amounts payable depend on subsequent events”⁹³.*
174. Claimant points out that this position is consistent with Deutsche Bank’s internal treatment of the Hedging Agreement⁹⁴. CPC’s Annual Report 2007 does not include the hedging arrangements in its list of “Contingent Liabilities”⁹⁵. They are listed in the profit and loss account.

⁹² PriceWaterhouse Coopers, International Financial Reporting Standards “IAS 39 – Achieving hedge accounting in practice”, p. 7. December 2005.

⁹³ IMF, Balance of Payments and International Investment Position Manual, 6th Ed., p. 82, para. 5.10/5.11.

⁹⁴ Rodrigo First Witness Statement, *supra* note 27, para. 48.

⁹⁵ Exhibit C-247.

Sub-Section III. **Is the Hedging Agreement valid? Did CPC have the capacity to enter into it?**

175. This third issue involves two separate sub-issues:

- on the one hand, is Sri Lanka entitled to dispute the validity of the Hedging Agreement given its active involvement and knowledge of the hedging program and the public credit and financial benefits it took from it until the day where it had to make payments to Deutsche Bank?
- On the other hand, is the Hedging Agreement void because it was outside CPC statutory authority?

I. Is Sri Lanka entitled to dispute the validity of the Hedging Agreement?

(A) *Sri Lanka's denial of the validity of the Hedging Agreement is unconscionable in light of its involvement and knowledge of CPC's hedging program*

176. According to Deutsche Bank, Sri Lanka initiated and promoted CPC's hedging program for its own national interest; it was kept fully informed of it including the features it now complains of; it took public credit as well as substantial benefits from such agreements; and it deliberately chose to intervene only when the unexpected fall in oil prices reversed the flow of payments to CPC.

1) *The hedging program was initiated by Sri Lanka in the national interest*

177. Claimant submits that the hedging program was initiated by the Central Bank in a national interest and implemented in accordance with Cabinet approval. Following the discontinuance of the Government's subsidies, it became imperative to consider alternative strategies which led to the Central Bank's interest in oil hedging⁹⁶.

178. As stated above, in late July / early August 2006, the Central Bank invited Deutsche Bank and other banks to make presentations on hedging and later called for quotes from the banks directly⁹⁷. The Central Bank was the driving force behind the hedging program, promoting it to the public, the Cabinet and the President⁹⁸. The hedging program was said to be in the national interest, *i.e.*, to safeguard Sri Lanka's balance of payments position and foreign reserves, to address macroeconomic imbalances associated with rising oil prices and to reduce the risk of social instability⁹⁹.

⁹⁶ Witness Statement of Kosagallana Durage Ranasinghe, 7 June 2010, paras. 7-8 [hereinafter "Ranasinghe Witness Statement"].

⁹⁷ Core 1/21; 2/29.

⁹⁸ Core 2/27; 2/32; 2/34 and 2/35.

⁹⁹ Core 2/35 p. 2 and 2/49 pp. 2, 3.

179. By October 2006, the Central Bank was confident that there was sufficient expertise and knowledge within the Bank and other Government institutions to implement this type of scheme¹⁰⁰. According to Mr. Karunaratne, the Central Bank had decided that CPC would be required to hedge even before the Study Group was set up in October 2008 and regardless of CPC's own opinion¹⁰¹. This view was shared by Mr. de Mel and Minister Fowzie who confirmed that the Central Bank was "responsible"¹⁰².

2) *Sri Lanka was kept fully informed of CPC's hedging program*

180. Deutsche Bank submits that Sri Lanka was kept fully informed of the details of CPC's hedging program from the very start. The first agreement concluded by CPC with the Standard Chartered Bank on 7 February 2007 was a seagull or three-way collar with a USD 2 per barrel cap for a three-month period¹⁰³. In response to a request from the Ministry of Petroleum¹⁰⁴, CPC provided a draft Cabinet Memorandum setting out the terms of the transaction, including the USD 2 seagull¹⁰⁵. Minister Fowzie has recognised in his witness statement that he was aware that CPC was entering into agreements with a cap on the upside¹⁰⁶.

181. According to Claimant, the full details of the first agreement were published in a joint press release by CPC and SCB in February 2007¹⁰⁷. On 20 February 2007, Dr. Thenuwara, Assistant Governor of Central Bank, Study Group Member and Observer to the CPC Board, spoke at a press conference where the terms of the trade were explained¹⁰⁸. Mr. Ranasinghe confirmed during his testimony that he saw the press release and it was clear from this that CPC had capped the upside (potential payments were limited to USD 900,000) to USD 2 per barrel without limiting the downside (payments by CPC to SCB were in theory up to USD 30,375,000)¹⁰⁹. Mr. Ranasinghe also confirmed that the reference in the Central Bank's Annual Report 2006 to the conclusion of zero cost collars "with a ceiling price" refers to this cap on the upside¹¹⁰.

¹⁰⁰ Core 2/36.

¹⁰¹ Transcript Day 4, p. 50, line 25 to p. 51, line 15.

¹⁰² Transcript Day 7, p. 57, lines 7 to 16, and Day 5, p. 15, lines 3 to 15.

¹⁰³ See paragraph 326 below for a discussion of the meaning of these terms.

¹⁰⁴ Core 3/91.

¹⁰⁵ Core 3/93.

¹⁰⁶ Witness Statement of Minister Abdul Hameed Mohamed Fowzie, 7 July 2010, para. 18 [hereinafter "Fowzie Witness Statement"].

¹⁰⁷ Core 3/86.

¹⁰⁸ Core 3/87.

¹⁰⁹ Transcript Day 5, p. 71, lines 13 to 23, and p. 74, lines 15 to 22.

¹¹⁰ Transcript Day 5, p. 78, lines 9 to 20.

182. Claimant recalls that shortly before the conclusion of the first transaction, Governor Cabraal referred to the need to accept a cap on the upside as a “*trade-off we had to work out for pricing reasons*”¹¹¹. Consequently in Claimant’s view, both the Ministry of Petroleum and the Central Bank were aware that CPC was capping its upside. According to Claimant, this was the feature that Sri Lanka put forward to argue that the Hedging Agreement was speculative and *ultra vires* while at the time, there was no criticism nor any suggestion that it might be so¹¹².
183. Claimant further points out that the Sri Lankan authorities continued to receive updates regarding the agreements which were concluded. As an example, Dr. Thenuwara actively discussed hedging at the CPC Board Meeting on 20 August 2007 where Board Paper No. 30 was approved¹¹³. Ms. Wijetunge, Additional Secretary to the Ministry of Petroleum and Study Group Member, and Mr. Perera, Chairman of the Board of Investment, were also present. The Board Paper referred to CPC’s first two trades with Citibank which included Seagull and TPF features. The trades were also leveraged. Claimant submits that no objection was made by any attendee¹¹⁴.
184. Claimant also emphasizes that Mr. de Mel testified that as a matter of practice, he kept Minister Fowzie informed of the basic details following the conclusion of CPC’s trades, including the Hedging Agreement itself¹¹⁵.
185. Deutsche Bank further submits that full details of CPC’s two trades with Peoples’ Bank were sent directly to the Central Bank on 18 August and 10 October 2008¹¹⁶. The trades included, like the Hedging Agreement, Seagull and TPF features and an additional feature: the use of leverage on the downside. According to Claimant, there is no evidence of any objection by the Central Bank.

3) *Sri Lanka took public credit and financial benefits from the Hedging Agreements*

186. Deutsche Bank submits that despite this knowledge of CPC’s hedging program, the Sri Lankan authorities raised no complaints at the time that such agreements might be *ultra vires* and invalid. To the contrary, they took the credit but also the financial benefits from such agreement throughout 2007 and much of 2008, during which time CPC received payments of tens of millions of dollars from the Bank, including the USD 21.9 million for January-September 2008 alone¹¹⁷.

¹¹¹ Core 3/77.

¹¹² Transcript Day 4, p. 65, lines 9 to 20.

¹¹³ Core 3/107.

¹¹⁴ Transcript Day 4, p. 71, line 12 to p. 72, line 20.

¹¹⁵ Transcript Day 5, p. 44, line 19 to p. 45, line 1, and p. 45, lines 11 to 17.

¹¹⁶ Core 4/148; Core 5/171.

¹¹⁷ Core 4/165, p. 121; Core 5/245, p. 2817.

187. According to Claimant, Governor Cabraal was keen to assert the Central Bank’s “*instrumental*” role in the hedging program¹¹⁸ and to comment on CPC’s Hedging Agreement in press¹¹⁹. The Assistant Governor of the Central Bank, Dr. Thenuwara, took centre stage at the first press conference¹²⁰. The Central Bank continued to report on the success of hedging in its Annual Reports¹²¹.
188. Claimant submits that Minister Fowzie was happy to take credit for the success of the program. For example, at a press conference on 20 April 2007, he was photographed receiving a mock check for USD 300,000 from SCB¹²². He was also frequently quoted in the press in relation to the hedging program and its benefits to CPC and Sri Lanka¹²³.
189. Claimant further recalls that at another press conference on 30 May 2008, SCB presented another mock check to CPC for USD 2.8 million¹²⁴ and Minister Fowzie declared at this occasion that hedging “*has helped the country face the challenge of balancing fuel prices amidst sky-rocketing rates in the world’s markets*”¹²⁵.
190. According to Claimant, the Government was also keen to promote its role in the success of the hedging program. In a presentation to investors in October 2008, CPC’s hedging gains of Rs. 1.9 billion in the first half of 2008 were referred to under the heading “*Government taking pro-active approach to increasing the flexibility of the expenditure base*”¹²⁶.

4) *Sri Lanka intervened only when payments by CPC were required*

191. Deutsche Bank submits that it is only after the sudden fall in world oil prices in September 2008 that the Sri Lankan attitude changed abruptly. Mr. de Mel admitted this during the hearing¹²⁷ and Minister Fowzie also stated to Parliament on 3 December 2008 that “[h]ad the price increase gone up to US Dollars 200 as predicted by dealers [the] world over, nobody would have complained”¹²⁸.

¹¹⁸ Core 2/62.

¹¹⁹ Core 3/77.

¹²⁰ Core 3/87.

¹²¹ Annual Report 2006, Core 2/56, p. 47, and Annual Report 2007, Core 3/121, p. 58.

¹²² Core 3/98.

¹²³ Core 3/77; C-88; C-86; C-87; C-122; C-70; C-362.

¹²⁴ C-348; C-359.

¹²⁵ C-362.

¹²⁶ Core 4/166, p. 72.

¹²⁷ Transcript Day 5, p. 17, lines 4 to 20.

¹²⁸ Core 5/245, p. 2817.

192. Deutsche Bank further submits that at the time, none of the relevant actors considered that there had been any wrongdoing by CPC or the banks. Claimant recalls that at the 20 and 24 November 2008 meetings, the CPC Board noted that the program was conducted in accordance with the instructions of the Cabinet and that the Central Bank had approved payments under the agreements¹²⁹. According to Claimant, Minister Fowzie also insisted that the program had been carried out as originally intended, “*on the advice of the Governor of the Central Bank and the approval of the Cabinet*”. He added that the losses resulted from “*totally unforeseeable events*” and cautioned Parliament not to be “*misled by the mountain of prejudice built around this issue*”¹³⁰. Claimant submits further that Mr. de Mel and Mr. Karunaratne as well as Minister Fowzie have also confirmed in their Supreme Court affidavits in 2009 that there had not been wrongdoing in relation to the hedging program¹³¹.

(B) *Sri Lanka may not deny the validity of the Hedging Agreement as a matter of international law*

193. On the basis of the above, Deutsche Bank alleges that there are three separate reasons why Sri Lanka may not rely on the alleged invalidity of the Hedging Agreement as a matter of international law:

- First, the alleged illegality is attributable to CPC which, on Sri Lanka’s case, acted beyond its capacity, and is not attributable to Deutsche Bank;
- Second, CPC is a State entity and Sri Lanka may not rely on the alleged illegality of the acts of a State entity under its own national law, particularly so when the facts giving rise to the alleged illegality were well-known to the State;
- Finally, in light of a) Sri Lanka’s direction and knowledge of the hedging program including the terms of the Hedging Agreement; b) the benefits Sri Lanka derived from such agreements including the latter; and c) the representations made to Deutsche Bank by CPC and the Central Bank, Sri Lanka is estopped from denying the validity of the Hedging Agreement.

1) *The alleged illegality is attributable to CPC and not to Deutsche Bank*

194. According to Deutsche Bank, a distinction has to be made between alleged unlawfulness of the investment for which the investor is responsible and that which is attributable to another entity. According to Claimant, in this case, the alleged invalidity was the responsibility of CPC. Sri Lanka may not therefore invoke this alleged invalidity. Deutsche Bank relies for its analysis on *Inmaris v. Ukraine*¹³² and on *Abaclat v. Argentina*¹³³.

¹²⁹ Core 5/219 ; Core 5/227.

¹³⁰ Core 5/245, pp. 2817-2818.

¹³¹ Core 6/281; Core 6/308; Core 6/309.

¹³² *Inmaris Perestroika Sailing Maritime Services GMBH and others v. Ukraine* (ICSID Case No. ARB/08/8), Decision on Jurisdiction, 8 March 2010 [hereinafter “*Inmaris v. Ukraine*”].

2) *Sri Lanka may not rely on a breach of domestic law by it is own State entity*

195. Secondly, Deutsche Bank submits that Sri Lanka is a State entity and may not therefore rely on the alleged illegality of the acts of CPC under its national law, particularly so when the facts giving rise to the alleged illegality were well-known to the State. For this proposition, Claimant relies on *Kardassopoulos v. Georgia* in which the Tribunal decided that Georgia was not permitted to assert that its State-owned enterprises violated Georgian law by exceeding their authority and that therefore the investment was entitled to protection under the BIT regardless of whether it was void as a matter of Georgian law¹³⁴; as well as on *Metalclad v. Mexico*¹³⁵ and *Inmaris v. Ukraine*¹³⁶.

3) *Sri Lanka is estopped from denying the validity of the Hedging Agreement*

196. According to Deutsche Bank, Sri Lanka is estopped from denying the validity of the Hedging Agreement given its active involvement and knowledge of the hedging program and its decision to terminate only when payments by CPC were required and given Deutsche Bank's reliance on Sri Lanka's promotion and knowledge in concluding the Hedging Agreement. Deutsche Bank relies for this conclusion on *Kardassopoulos v. Georgia*¹³⁷, *Southern Pacific Properties v. Egypt*¹³⁸ and *Inmaris v. Ukraine*¹³⁹.

197. Deutsche Bank also founds its estoppel's argument on Article 4(v) of the Term Sheet and the Confirmation Letter in which CPC expressly represented to Claimant that the purpose of the Agreement was to hedge its liabilities and not speculation and that the Hedging Agreement complied with all applicable law and regulations.

II. Is the Hedging Agreement void because it was outside CPC's statutory authority?

198. According to Deutsche Bank, the proper enquiry is whether CPC had capacity to enter into the Hedging Agreement in accordance with its objects and powers under the CPC Act. It

¹³³ *Abaclat v. Argentina*, *supra* note 69, para. 33 (2011).

¹³⁴ *Ioannis Kardassopoulos v. Georgia* (ICSID Case No. ARB/05/18), Decision on Jurisdiction, 6 July 2007, para. 182 [hereinafter "*Kardassopoulos v. Georgia*"].

¹³⁵ *Metalclad Corp. v. United Mexican States* (ICSID Case No. ARB(AF)/97/1), Award, 30 August 2000 [hereinafter "*Metalclad v. Mexico*"].

¹³⁶ *Inmaris v. Ukraine*, *supra* note 132, para. 140 (2010).

¹³⁷ *Kardassopoulos v. Georgia*, *supra* note 134, paras. 185-194 (2007).

¹³⁸ *Id.* para. 193 quoting *Southern Pacific Properties (Middle East) Limited v. Arab Republic of Egypt* (ICSID Case No. ARB/84/3).

¹³⁹ *Inmaris v. Ukraine*, *supra* note 132, para. 140 (2010).

was both incidental and conducive to CPC's business. And even if the hedging/speculation distinction is relevant, the Hedging Agreement was a hedge and therefore fully valid.

(A) *The Hedging Agreement was both "incidental" and "conductive" to CPC's business*

199. The parties agree that CPC's capacity is a matter of Sri Lankan law¹⁴⁰.
200. Deutsche Bank submits that CPC's objects are broadly defined by Section 5(c) of the CPC Act to include "any such other business as may be incidental or conducive" to the carrying on of CPC's business as "an importer, exporter, seller, supplier or distributor of petroleum".
201. On the other hand, Section 6(l) entitles the CPC Board to determine which transactions are so conducive to CPC's business. It enables CPC "to enter into any agreements with any bank ... that may seem to the Board to be conducive for the purposes of the corporation".
202. Deutsche Bank submits in this respect that contrary to Sri Lanka's position, Sections 5 and 6 of the CPC Act are very closely linked because the powers of a corporation are intimately bound up with its objects. It quotes Anthony Amerasinghe's statement that an act will be conducive to CPC's business: "... if the Directors honestly formed the view that it can be advantageously combined with other objects, even though the Directors are mistaken and in fact the business in question cannot be carried on as the Directors believe"¹⁴¹. For Deutsche Bank, it is not correct to say that the Act must be objectively conducive to CPC's business. Claimant submits that Section 6 refers to the power of the Board to enter into agreements with any bank that may seem to the Board to be conducive for the purposes of the corporation.
203. Deutsche Bank also relies on *Bell Houses Ltd. v. City Wall Properties Ltd.*¹⁴² where the Directors were granted the power to determine what it is advantageous to the company. The Court held that

"[p]rovided they form their view honestly, the business is with the plaintiff company's objects and powers... It may be that the directors take the wrong view and in fact the business in question cannot be carried on as the directors believe. But it matters not how mistaken the directors may be".

In the same vein, in *Den Norske Creditbank v. The Sarawak Economic Development Corporation*¹⁴³, the Court considered that a guarantee provided by respondent to claimant

¹⁴⁰ Respondent's Rejoinder on the Merits, para. 368 (c) [hereinafter "Respondent's Rejoinder"].

¹⁴¹ Anthony Amerasinghe, *Public Corporations in Ceylon (Lake House Investments)*, Colombo (1971), p. 38 and 40.

¹⁴² *Bell Houses Ltd. v. City Wall Properties Ltd.* [1966] 2 Q.B. 656, 690-C [hereinafter "*Bell Houses v. City*"].

was within the statutory powers of the corporation, that the latter had capacity to enter into the guarantee so long as it considered it incidental or conducive to its objects.

204. Claimant further submits that it does not mean that the directors have the power to do anything they choose such as gambling on horses or orange juice futures. Rather, in Claimant's view, the directors have the right to decide whether in their good faith opinion an act may be capable of hedging its liabilities or reducing a risk it faces and as such be incidental or conducive to CPC's oil business. Whether it was so in fact is immaterial.
205. According to Claimant, the evidence reveals that the CPC Board did believe that the Hedging Agreement was capable of being conducive to CPC oil business as an oil importer. As a result CPC was capable of entering into hedging agreements such as the Hedging Agreement and delegated authority to Mr. de Mel and Mr. Karunaratne to do so¹⁴⁴. The Hedging Agreement was entered into pursuant to and within the scope of the Board authority¹⁴⁵. Therefore, in Claimant's view, CPC was not acting beyond its capacity when entering into the Agreement.
206. Deutsche Bank submits that it is common ground that it was within CPC's capacity to enter into derivative transactions for the purposes of hedging¹⁴⁶. Sri Lanka has also accepted on numerous occasions that the Hedging Agreement reduced volatility of oil prices to some extent¹⁴⁷. According to Claimant, there can therefore be no doubt that the Hedging Agreement hedged CPC's exposure to volatility and reduced its risk. It was in Claimant's view reasonable for the Board of CPC to conclude that the Hedging Agreement was capable of falling within CPC's objects and for that reason it cannot be deemed *ultra vires*.
207. Deutsche Bank finally objects to Sri Lanka's allegation that the Hedging Agreement was *ultra vires* as it was not "*necessary*" to the attainment of CPC's objects¹⁴⁸. Claimant points out that it is only under Section 6(q) where the "*necessary*" requirement appears. Under Section 6(l), the necessary requirement is not present, the directors must only believe that an action is capable of being conducive to CPC's business. According to Claimant, the test is subjective and not objective.

¹⁴³ *Den Norske Creditbank v. The Sarawak Economic Development Corporation*, The Lloyd's Rep. 616, 620 [hereinafter "*Den Norske v. SEDC*"].

¹⁴⁴ Core 3/95.

¹⁴⁵ Transcript Day 4, p. 167, lines 15 to 17, and p. 176, line 18 to p. 177, line 8.

¹⁴⁶ Respondent's Post-Hearing Brief, para. 63 [hereinafter "*Respondent's Post-Hearing Brief*"].

¹⁴⁷ *Id.* paras. 67 (b), 67(c), 67(f), 68, 69.

¹⁴⁸ *Id.* para. 84.

(B) ***The Hedging Agreement was a real hedge and did not amount to speculation***

208. Deutsche Bank submits that the issue of CPC's capacity to enter into the Hedging Agreement has been raised as a positive defense by Sri Lanka to avoid the implications of the validity of the Hedging Agreement. Claimant argues that Sri Lanka has therefore the burden of proving that by entering into the Agreement, CPC was acting *ultra vires*.
209. As noted above, Sri Lanka's primary position is that the hedging/speculation distinction is irrelevant. However, Sri Lanka contends that even if it were relevant, the Hedging Agreement was not a hedge. Deutsche Bank disagrees with this conclusion.
210. Claimant submits that it is common ground that hedging is about managing risk where the hedger has an underlying position and seeks to reduce the risk or uncertainty of that position¹⁴⁹. As an oil importer, it is also common ground that CPC had an underlying exposure to which the Hedging Agreement related¹⁵⁰.
211. According to Deutsche Bank, a transaction either reduces risk and uncertainty or it does not. The extent to which a hedger may be able to reduce risk through hedging depends on the position of the market at the time and the resources it has available. Claimant submits Sri Lanka, however, seeks to impute a further condition that a reduction in risk does not prevent a transaction from being speculative unless it is "meaningful". In Claimant's view, Respondent's expert Mr. Benigni was unable in cross-examination to offer any explanation for this proposition¹⁵¹. Claimant argues that the definition of a Hedging Agreement in International Accounting Standards No. 39 does not contain a *de minimis* or effectiveness test as Mr. Benigni sought to infer. Moreover, as the expert accepted, the imposition of a meaningful test would result in the classification of a transaction being dependent on the financial position of the hedger¹⁵². What would be a hedge one day could be speculation the next, a position which would in Claimant's view create substantial uncertainty and would be unworkable in practice.
212. Deutsche Bank submits that when the Hedging Agreement was concluded, oil prices were already more than USD 57 above the USD 80 per barrel described by the Study Group as unbearable¹⁵³. The risks CPC faced were sustained high prices and the volatility of expenditure for oil. This was underlined by the Study Group report. Claimant points out that CPC faced a huge oil bill irrespective of whether prices remained high or increased, putting pressure on Sri Lanka's foreign exchange reserves and the exchange rate¹⁵⁴.

¹⁴⁹ Transcript Day 6, p. 120, lines 7 to 13.

¹⁵⁰ Transcript Day 6, p. 150, line 17 to p. 151, line 25.

¹⁵¹ Transcript Day 6, p. 176, line 9 to p. 177, line 7.

¹⁵² Transcript Day 6, p. 181, lines 3 to 10.

¹⁵³ Exhibit C-53; Core 2/49, p. 3.

¹⁵⁴ Core 2/49.

213. Claimant argues that the protection provided by the Hedging Agreement must be assessed on the date it was entered into and not in light of subsequent price movements¹⁵⁵. Further, Claimant submits that the transaction must be considered as a whole. To do otherwise would preclude any transaction from being a hedge, as there will always be a downside obligation which, when viewed in isolation, will increase risks¹⁵⁶. According to Claimant, the reality is that the Hedging Agreement reduced CPC's exposure to volatility in oil prices¹⁵⁷ and this was recognized by Mr. Benigni¹⁵⁸. Claimant concludes that a transaction which reduces the risks associated with volatility to an existing underlying exposure constitutes a hedge.
214. The Hedging Agreement provided protection against both sustained high prices and rising prices, giving a USD 10 per barrel protection to CPC on oil prices above USD 122.50 per barrel and up to USD 10 per barrel between USD 112.5 and USD 122.5. Claimant argues that it is not correct that the Agreement gave no protection against rising prices. As the English High Court in *SCB v. CPC* held, the correct comparison is with the situation had the Hedging Agreement not been concluded¹⁵⁹. If oil prices had risen to USD 180, CPC would have paid USD 170 with the Hedging Agreement; without the Hedging Agreement, it would have paid in full. According to Claimant, the Hedging Agreement was therefore clearly hedging and not speculation.
215. In relation to the English Court of Appeal decision in *SCB v CPC*, issued in July 2012, in which the Court of Appeal upheld the High Court decision of Hamblen J., Claimant notes that the Court of Appeal found it unnecessary to determine whether the transactions at issue were speculation or hedging as it regardless fell within CPC's capacity as set out in Sections 5 and 6 of the CPC Act. Claimant submits that this is the proper enquiry, but in any case the Hedging Agreement was not speculative, as demonstrated by the evidence presented by the Claimant during the arbitration.

SECTION II. RESPONDENT'S POSITION

216. Sri Lanka considers that the Hedging Agreement was not valid and therefore develops its arguments on jurisdiction only for the case where the Arbitral Tribunal would find the transaction valid.
217. Deutsche Bank submits that the acts of CPC in entering into the Hedging Agreement are attributable to Sri Lanka. This is disputed by Respondent. It submits that the Arbitral

¹⁵⁵ Second Expert Report of Mr. Johannes Benigni [hereinafter "Benigni Report II"], para. 6; Transcript Day 6, p. 197, lines 19-22.

¹⁵⁶ Transcript Day 6, p. 7, lines 8-19.

¹⁵⁷ Grove Report, *supra* note 72, p. 40, Fig. 6.3.

¹⁵⁸ Transcript Day 6, p. 198, line 25 to p. 201, line 8.

¹⁵⁹ Core 10/355; Core 10/358.

Tribunal does not have jurisdiction under the BIT and under Article 25(1) of the ICSID Convention.

Sub-Section I. **The Treaty**

I. Investment under Article 1(1) of the Treaty

218. Sri Lanka submits that Article 1(1) of the BIT defines “investment” as follows:

*“The term “investments” comprises every kind of asset, in particular: ...
c) claims to money which has been used to create an economic value or claims to any performance having an economic value and associated with an investment ...”.*

219. According to Respondent, it is therefore not enough to have a claim to money, that claim must have been “*used to create an economic value*” or must have derived from “*performance having an economic value*”, and it must be “*associated with an investment*”. Respondent argues that by clear inference, claims to money under a contract are not, as such, investments under the BIT. In this case, the Hedging Agreement was not part of a larger aggregate of activities constituting an “investment”. It was a stand-alone financial product.

220. Sri Lanka also relies on the dissent of Professor Abi-Saab in the recent *Abaclat* decision¹⁶⁰ supporting the position taken by Sri Lanka that the Hedging Agreement does not constitute an investment for the purposes of either the BIT or the ICSID Convention.

II. Territorial nexus with Sri Lanka

221. Sri Lanka points out that the Preamble to the Germany-Sri Lanka BIT expresses the State parties’ intention “*to create favorable conditions for investment by nationals and companies of either State in the territory of the other State...*”. According to Respondent, the territorial link is further established in the main substantive protections of the Treaty, *i.e.*, in its Articles 2(1) and (2), 3(1) and (2), 4(1), (2), (3) and (4), 8(2) and 9.

222. According to Sri Lanka, the territorial nexus requirement is either a predicate to jurisdiction or conditions the scope of application of the various substantive requirements of the BIT. Respondent considers that the better approach is that such a requirement is jurisdictional. Whichever approach is correct, the Tribunal is required to decide the issue whether the Hedging Agreement constitutes an investment “within the territory” to find that it has jurisdiction over the present dispute and as a precondition to any consideration of the merits.

223. According to Respondent, the Agreement was explicitly entered into by Deutsche Bank London and all those involved proceeded on the basis at all times. Respondent argues that the Central Bank of Sri Lanka has no regulatory authority over Deutsche Bank London. Its

¹⁶⁰ *Abaclat v. Argentina*, Dissenting Opinion, *supra* note 91.

investigation was limited to Deutsche Bank Colombo's intermediary role and did not purport to investigate the conduct of Deutsche Bank London.

224. Respondent submits that since the Central Bank did not and cannot regulate the seller of the product, Deutsche Bank London, it cannot be the case that financial products emanating from Deutsche Bank London are located "within the territory" of Sri Lanka for the purposes of the BIT. The purpose of the BIT was not to provide a method of enforcement for transnational debt claims but to protect foreign investment, *i.e.*, inward investment, from regulatory abuse. A commercial transaction with a foreign entity, falling outside the regulatory jurisdiction of the host State, is not covered by the BIT in Respondent's view.
225. Sri Lanka further points out that Deutsche Bank Colombo was not the counterparty to the Hedging Agreement. Deutsche Bank Colombo did not provide the financial product in question. As recognised by Claimant, the Colombo Branch "*does not directly engage in commodities derivative trades such as oil hedging transactions*"¹⁶¹. Respondent recalls that the payments made by CPC to Deutsche Bank were remitted to Deutsche Bank London and not Deutsche Bank Colombo¹⁶². Deutsche Bank Colombo did not receive any commission¹⁶³, did not assume any risk in relation to the Hedging Agreement¹⁶⁴ and did not have any budget for expenditure on either hedging in general or for intermediary role that Deutsche Bank Colombo had undertaken to play¹⁶⁵.
226. Respondent argues that the claimed USD 60 million is owed to Deutsche Bank London not Deutsche Bank Colombo¹⁶⁶ and when a dispute arose over whether CPC should continue to pay out moneys to Deutsche Bank, it was again the Deutsche Bank office in London which was the focus of activity. Respondent submits that nearly every material communication from Deutsche Bank on the subject of the dispute came from London, Singapore, or Hong Kong, not from the branch office in Colombo.
227. Sri Lanka further points out that the Hedging Agreement itself was evidenced by:
- the Term Sheet coming from Deutsche Bank London. It designated "Deutsche Bank AG, London" as "Party A". Business days for the instrument were designated as those recognised in "London, New York"; and
 - the Confirmation Letter coming from Deutsche Bank London. It, too, identified Deutsche Bank London as "Party A". The letter was signed by two officers of the

¹⁶¹ Claimant's Memorial, para. 86.

¹⁶² Claimant's Memorial, para. 193.

¹⁶³ Transcript Day 2, p. 59, line 22.

¹⁶⁴ Transcript Day 2, p. 60, line 25 to p. 61, line 1.

¹⁶⁵ Transcript Day 2, p. 45, line 4 and line 19.

¹⁶⁶ Transcript Day 2, p. 60, line 14.

Deutsche Bank Structured Product Department, based in London, it identified the governing law as English law.

228. Respondent also submits that it was not a requirement that CPC enter into hedging contracts with local banks, as evidenced by the following:

- a) In contrast to the suggestion at the First Study Group Meeting that “*international banks that have local presence be invited to submit indicative proposals and suggestions for oil hedging*”¹⁶⁷, the Study Group report and the Cabinet Decision approving it¹⁶⁸ recommended only that CPC enter into transactions with “reputed banks”; and
- b) CPC entered into the Hedging Agreement with Deutsche Bank London and could have made payments to Deutsche Bank London through any mechanism; there was no requirement to use a local branch¹⁶⁹.

229. In conclusion, it is Respondent’s position that even if the marketing of the Hedging Agreement involved the Colombo office, that did not turn into local “investments” the marketed products. London was the locus of the Agreement and Deutsche Bank handled it throughout from London. The benefits Deutsche Bank suggests “*accrued in Sri Lanka*”¹⁷⁰ do not serve to locate the Hedging Agreement in Sri Lanka.

Sub-Section II. **Article 25(1) of the ICSID Convention**

230. To determine whether the Hedging Agreement constitutes an investment pursuant to Article 25(1) of the ICSID Convention, Sri Lanka relies on the *Salini*¹⁷¹ indicia and concludes that they are not fulfilled in the present case.

I. Contribution

231. According to Respondent, Deutsche Bank made no contribution constituting an investment. As of 8 July 2008, no contribution had been made by Deutsche Bank. On 8 July 2008, CPC and Deutsche Bank London agreed to pay one another an amount of money to be determined depending on the average price of oil, calculated over a month. Each party bore an opposing risk, contingent on price movements in a foreign market. On the terms of the Hedging Agreement, there was no contribution except in circumstances in which the risk faced by Deutsche Bank London materialized. On the other hand, if the risks faced by CPC were to arise, there would be no contribution of any kind by Deutsche Bank London.

¹⁶⁷ Core 2/44.

¹⁶⁸ Core 2/49; Core 2/65; Core 2/70.

¹⁶⁹ Core 10/355.

¹⁷⁰ Claimant’s Outline, paras. 15.7 to 15.8; Transcript, Day 8, p. 62, line 21 to p. 65, line 5.

¹⁷¹ *Salini Costruttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco* (ICSID Case No. ARB/00/4), Decision on Jurisdiction, 23 July 2001, 42 ILM 609 (2003) [hereinafter “*Salini v. Morocco*”].

232. According to Respondent, the Hedging Agreement is to be contrasted to a Government bond (as in *Abaclat*). When a Government bond is issued, a contribution is paid upfront; an amount on which the investor expects to generate a return. The Government counterparty can then use the funds raised by the issue of the bonds to finance its governmental needs. The same applies for promissory notes of the type at issue in *Fedax*¹⁷². On the other hand, the Hedging Agreement results in either contribution or a return. It does not generate one from the other.
233. According to Respondent, the Tribunal should reject each of the ways that Deutsche Bank contends that it made a contribution.
234. In the first place, Sri Lanka disputes Claimant's allegation that the Hedging Agreement provided oil to CPC or access to oil at substantially below spot market rate. Respondent argues that the Hedging Agreement did not provide oil or reduced the purchasing price of oil. It was not for the sale or supply of oil. The transaction was simply a paper instrument, based on the market price of oil, requiring either CPC or Deutsche Bank to pay the other an amount of money each month, to be determined by reference to the price of oil.
235. In the second place, Respondent submits that it is incorrect to say that the Agreement offered to CPC "cash flow benefits". Respondent points out that any contribution was contingent on the price of oil remaining above USD 112.50 and there was therefore no guarantee that Deutsche Bank would in fact have to make any contribution.
236. Third, Respondent also disputes that the Hedging Agreement reduced CPC's exposure to volatile prices. For 100,000 barrels, CPC could have hoped for nothing more than USD 10 per barrel payment, whether the price of oil dropped to USD 122.50 or increased to USD 200, and this was further limited by the target accrual of USD 2.5 million. It was only in the narrow band between USD 112.50 and USD 122.50 that there was any reduction of volatility of benefit to CPC.
237. Fourth, Respondent objects to Claimant's allegation that the Agreement provided in effect a credit line. It considers that its contingent nature bears no relation to a line of credit. The fact that one is exposed to credit risk does not necessarily means that one is extending credit.

II. Duration

238. According to Respondent, the Hedging Agreement was of short duration, pegged to monthly events and unilaterally terminable by Deutsche Bank London and as such is not of the requisite certain duration that is normally to be expected of an investment.
239. Respondent argues that the Agreement might have lasted twelve months at most. However, had the price of oil remained above USD 122.50, the contract would have lasted three months before the Target Profit accrued and the Agreement would have terminated in

¹⁷² *Fedax N.V. v. Venezuela - Award*, *supra* note 86.

accordance with its terms and CPC would receive no further payments. In the end, Respondent recalls that the Hedging Agreement in fact lasted for only 125 days before it was unilaterally terminated by Deutsche Bank London.

III. Risk

240. Respondent argues that risk, in the ordinary investment sense, is the risk of failure by an investor to make a return on its contribution. It is a risk that the venture might not be profitable or that it might cost more than originally anticipated. According to Respondent, risks of this type, with a correlation between contribution and return, were not present in the Hedging Agreement. On the one hand, Deutsche Bank London faced a risk that they would have pay USD 2.5 million. On the other, CPC faced a risk that they would have to pay Deutsche Bank London a virtually unlimited amount.
241. The only identifiable risk was in Respondent's view that of default or non-payment by CPC should the oil price drop. That is a risk faced by any contracting party. It is not an investment risk.

IV. Contribution to economic development

242. According to Respondent, it is insufficient that hedging might be generally in the national interest to constitute contribution to economic development. Sri Lanka was extraneous to the performance of the Hedging Agreement and the single contract in no way contributed to the growth of economic prosperity in Sri Lanka. It was merely a private, neutral and speculative transaction. In any case, Respondent argues that the fact that a transaction is "*seen to further the policy priorities of the purchasing State does not bring about a qualitative change in the economic benefit that all legitimate trade brings in its train*"¹⁷³.

V. Ordinary commercial transaction

243. It is also Respondent's position that the Hedging Agreement was an ordinary commercial transaction which does not constitute an investment for the purposes of the ICSID Convention.
244. Respondent submits that it was a sale, even if the product was intangible. It was made up of a bundle of "put" and "call" options. CPC sold one and bought the other. It is irrelevant that CPC did not in fact make any payment upfront in order to buy its call option. The structure of the particular transaction was such that the price paid for the call option was the granting of the put options to Deutsche Bank.

¹⁷³ *Global Trading Resource Corp. and Globex International, Inc. v. Ukraine* (ICSID Case No. ARB/09/11) Award, 1 December 2010, para. 56.

VI. Purely contingent financial instrument

245. According to Respondent, the value of the hedging products sold by Deutsche Bank was entirely contingent. It was a derivative financial structure, consisting of selected options on the price of oil, the value of which (or the costs of which) to CPC was wholly speculative, depending upon the future price of that underlying commodity as determined by the world market and limited by further contractual terms. It had no association to any underlying asset which might have been characterized as an investment. Respondent submits that contingent future value does not constitute an “investment”.
246. In conclusion of the above, Respondent submits that the Hedging Agreement did not display the characteristics of an investment for the purposes of Article 25 of the ICSID Convention.

Sub-Section III. **Is the Hedging Agreement valid? Did CPC have the capacity to enter into it?**

I. Is Sri Lanka entitled to dispute the validity of the Hedging Agreement?

247. Sri Lanka submits that if an agreement is void, for lack of capacity, it cannot be estopped from arguing its invalidity.
248. In the first place, Sri Lanka considers as misconceived Deutsche Bank’s allegation that Sri Lanka may not rely on a breach of its national law to defeat its international obligations, invoking Article 27 of the Vienna Convention on the Law of Treaties. In this regard, Respondent argues that Article 27 is concerned with the failure to perform an international obligation. The international obligations at issue in the present dispute arise under the BIT. They only apply to a valid investment. In respect of Article 8(2) (containing the Umbrella Clause), the BIT requires that States observe the obligations they have assumed; this in Respondent’s view likewise requires that the obligations in question exist, and therefore that the Hedging Agreement is valid.
249. As such, Sri Lanka does not rely on its domestic law to avoid performance of its international obligations. The question is the preliminary one of whether there is anything on which those international obligations can operate.
250. Secondly, Sri Lanka disagrees that it would be estopped as a matter of international law from relying on CPC’s incapacity to conclude the Hedging Agreement. Deutsche Bank relies principally for its argument as to estoppel on the representations made by Mr. de Mel and Mr. Karunaratne in signing the Term Sheet and Confirmation. To succeed, Deutsche Bank would have to establish that the acts of Mr. de Mel and Mr. Karunaratne in signing the contractual documentation were attributable to Sri Lanka. However, Respondent submits that Deutsche Bank is unable to substantiate that proposition for several reasons.
251. Respondent further submits that neither CPC nor Mr. de Mel and Mr. Karunaratne were organs of Sri Lanka. They were not exercising elements of governmental authority in

signing the relevant contractual documentation and finally, they were not acting on instructions or under the specific and close direction and control of any organ of Sri Lanka in carrying out those specific acts of the type necessary for attribution on that basis as a matter of international law.

252. Sri Lanka submits that in that regard, the evidence of Mr. de Mel was that:
- a) he had not informed the Central Bank and he did not recall having informed the Minister that he was contemplating entering into the Hedging Agreement with Deutsche Bank London¹⁷⁴;
 - b) he had not informed the Central Bank or the Minister of the detailed terms of the Agreement prior to concluding it¹⁷⁵; and
 - c) he had not received any instructions from either the Minister or the Central Bank to enter into the Hedging Agreement¹⁷⁶.
253. The acts of Mr. de Mel and Mr. Karunaratne are not attributable to Sri Lanka for the purposes of international law. No estoppel can therefore arise on that basis.
254. Respondent further argues that as far as the actions of the Cabinet and the Central Bank are concerned, their announcements were made to the world at large, well in advance of the conclusion of the Agreement and were expressly premised on the basis that CPC was required to engage in hedging and not speculation. Respondent recalls that neither the Cabinet nor the Central Bank made any representation that the Hedging Agreement, containing these terms, was within CPC capacity and there is no evidence that anyone from Deutsche Bank believed that they had made any representation.
255. According to Respondent, given that no specific instructions were given to CPC to enter into the Agreement and CPC was clearly not acting under the direction and control of Sri Lanka in doing so, it cannot be contended that Sri Lanka is estopped from raising the question of CPC's capacity to do so. Moreover, Deutsche Bank cannot sensibly suggest that it relied on any representation by CPC. Deutsche Bank were the experts on hedging, not CPC, and any representation by CPC on this point would be inherently unreliable.
256. Finally, Sri Lanka submits that Deutsche Bank's argument of contractual estoppel based on Article 4(v) of the Term Sheet and the Confirmation Letter is hopeless as a matter of English law for the reason that, just as it is not possible for an agent to clothe himself with an authority he does not have, so a corporation cannot create capacity where none exists, simply by making an untrue assertion that it has capacity. In Respondent's view, if the Hedging Agreement was void as outside capacity, it was void for all purposes and cannot serve as the basis for a contractual estoppel.

¹⁷⁴ Transcript Day 5, p. 43, lines 20 to 25, and p. 44, lines 19 to 45.

¹⁷⁵ Transcript Day 5, p. 44, lines 2 to 17.

¹⁷⁶ Transcript Day 5, p. 45, lines 18 to 21.

257. Finally, Sri Lanka objects to Deutsche Bank's suggestion that a defense can be disregarded if the defence is considered to be one upon which it is unconscionable to rely. If a contract is *ultra vires*, it is void *ab initio* and unenforceable. There is no exception for cases where the position adopted by the defendant is considered to be unconscionable.

II. Is the Hedging Agreement void because outside CPC statutory authority?

(A) ***Was the Hedging Agreement "incidental" or "conducive" to CPC's business?***

258. In the first place, Sri Lanka alleges that contrary to the position taken by Deutsche Bank, the burden of proof in relation to capacity is on Deutsche Bank and that any doubt as to whether the Hedging Agreement was within CPC's capacity is to be resolved in favour of Sri Lanka.

259. With respect to the test set out in Section 5 of the CPC Act, Sri Lanka accepts that it was within CPC's capacity to enter into derivative transactions for the purpose of risk management. However, it contends that the Hedging Agreement was not a transaction which managed CPC's risks but amounted to speculation. Such a transaction cannot be conducive or incidental to CPC's business as an oil importer. Indeed, speculative derivative transactions are far removed from CPC's petroleum business. They are not necessary for the attainment of its objects.

260. Respondent points out that CPC's "objects" are set out in Section 5 of the CPC Act. Section 6(l) was one of a number of powers expressly confirmed on CPC and gave CPC power to "*enter into any agreements with any bank... in order to obtain any rights ... that may seem to the Board to be conducive for the purpose of the Corporation*". Deutsche Bank has also relied on Section 6(q) which gave CPC power "*to do all other things which, in the opinion of the Corporation, are necessary to facilitate the proper carrying on of its business*".

261. According to Sri Lanka, Sections 6(l) and 6(q) of the CPC Act are not expressed to be "objects" of CPC. They are ancillary powers which may be exercised in order to pursue the "objects" set out in Section 5. In Respondent's view, ancillary powers tell you what activities a company may carry out in order to pursue the company's objects but it is not sufficient that a transaction falls within an ancillary power.

262. The words at the end of Section 6(l) of the CPC Act "*in order to obtain any rights ... that may seem to the Board to be conducive for the purposes of the Corporation*" do not widen the "objects" of CPC, but set out an additional requirement which must be satisfied. As to Section 6(q), in Respondent's view, the word "necessary" is much stronger than "expedient" or "desirable" and conveys that the step taken must be essential to enable CPC to carry on its business. There is no evidence that CPC considered that the Hedging Agreement was "necessary" or essential to facilitate the proper carrying on of CPC's business.

263. Respondent argues that the fact that CPC's March 2007 Board's resolution authorized Mr. de Mel and Mr. Karunaratne to enter into hedging transactions provides no support for Deutsche Bank's case. The resolution was an authorisation to enter into hedging transactions, not transactions which amounted to speculation.
264. Sri Lanka further considers that Deutsche Bank's reliance for its position on *Bell Houses Ltd. v. Citywall Properties Ltd.*¹⁷⁷ and *Den Norske Creditbank v. Sarawak Economic Development Corporation*¹⁷⁸ is misplaced. None of these decisions is relevant to the present case. On the other hand, Respondent relies on the SCB judgement and particularly its paragraphs 405 to 408. According to Sri Lanka, the judgement contains an authoritative decision that under English law, Section 6 of the CPC Act does not confer on CPC capacity to enter into a speculative oil derivative transaction with a bank.
265. Sri Lanka further submits that even if it is correct that the Study Group Report referred to high oil prices, it referred only to two types of hedging instruments as being "the available options"¹⁷⁹: the cap and the zero cost collar. It referred to the latter as having an upper bound and a lower bound. According to Respondent, there was no mention of any type of hedging instrument in which a) there were more than two levels, b) there was a cap on the upside protection, c) the transaction was structured in such a way as to give an immediate guaranteed return to CPC unless the oil price collapsed and to knock out after three months, and d) the transaction was designed to provide cash for CPC as opposed to protection from high prices.
266. Respondent recalls that recommendation 1 made by the Study Group was that CPC should hedge the purchase of petroleum products. Recommendation 2 was that the hedging instrument was to be zero cost collar. Recommendation 5 gave authority to CPC to change the instrument based on the developments in the market. In the context of Recommendations 1 and 2, Respondent argues that it could therefore only be understood as meaning that CPC should be authorized to change from zero cost collar to cap based on developments in the market. It cannot be read as giving CPC authority to enter into the type of transaction entered into with Deutsche Bank, or to change the objective of hedging. Further, Respondent submits that a plain vanilla zero cost collar could not have been used to provide protection against an existing high price, as it would not be possible to structure a plain vanilla zero cost collar to provide an immediate benefit to CPC unless the oil price fell.

(B) ***Was the Hedging Agreement a transaction which managed CPC's risks or did it amount to speculation?***

267. According to Sri Lanka, the following points are common ground between the parties' two experts, Mr. Grove and Mr. Benigni:

¹⁷⁷ *Bell Houses v. Citywall*, *supra* note 142, p. 656.

¹⁷⁸ *Den Norske v. SEDC*, *supra* note 143, p. 616.

¹⁷⁹ Core 2/49, p. 5.

- a) hedging is concerned with the elimination or reduction of market risk, *i.e.*, volatile and adverse market prices;
- b) the primary purpose of an oil hedging program is to reduce the risks from the volatility of crude oil or oil products;
- c) speculation involves the creation of a new exposure to market risk or an increase in an existing exposure to market risk; and
- d) depending on price movements, a hedging transaction may also provide the benefit of reducing the purchasing costs of an oil consumer or importer, but this is not the goal of a hedging program, and a transaction will not be a hedging transaction if it is designed to reduce purchasing costs but does not reduce volatility.

268. Sri Lanka submits that it was impossible for the Hedging Agreement to provide any reduction in volatility or increase in certainty when the oil price exceeded USD 122.50. In that scenario, the price paid by CPC would simply track the global market price with the discount of USD 10, until the target of USD 2.5 million was reached.
269. According to Respondent, it is correct that there would have been a reduction in volatility of CPC's purchasing costs and increase in certainty when the oil price was below the strike price of USD 112.50. This reduction in volatility arose only as a result of the sale of the put option which was required in order to finance the purchase of the call option which provided the expected USD 2.5 million payoff to CPC. This was of no benefit to CPC. On the contrary, it was a detriment to CPC since it meant that CPC had to make payments to Deutsche Bank and could not benefit from a fall in oil price for the number of barrels covered by the Agreement.
270. Respondent argues that as a consequence, the only range in which it was possible for CPC to benefit from a reduction in volatility was the range between USD 112.50 (the strike price) and USD 122.50 (the level of the seagull). However, in Respondent's view even within this range, there would be a vast number of scenarios in which CPC could not in fact experience any reduction in volatility. If, for example, the oil price fell gradually from USD 137.50 over twelve months, CPC would have received its expected payoff of USD 2.5 million in the first three months and the Hedging Agreement would have knocked out.
271. According to Respondent, CPC could not benefit from a reduction in volatility unless the oil price fell steeply to below USD 122.50, the level of the seagull, and could not benefit any further once the target of USD 2.5 million was reached. But the prediction at that time was that prices would remain fairly stable or increase. Such a potential increase was CPC's, the Central Bank's and the Government's concern.
272. Sri Lanka does not deny that a payoff of USD 2.5 million might have provided a limited benefit to CPC. It considers however that a transaction which might provide a reduction in the volatility of CPC's purchasing costs if the oil price fell by over USD 15 to a price in a relatively narrow USD 10 range could not be a transaction which managed CPC's risk, as confirmed by Mr. Benigni's opinion¹⁸⁰. Respondent further submits that it is appropriate in

¹⁸⁰ Benigni Report II, *supra* note 155, para. 52, and Slide 21; Transcript Day 6, p. 208, lines 8 to 14.

this respect to compare the USD 2.5 million amount with CPC's total annual costs of importing oil. According to Mr. Benigni¹⁸¹, that total annual cost would have been USD 3,756,690,000 if the oil price had increased in line with the forward curve. In the context of the Sri Lankan economy as a whole, USD 2.5 million could not be a significant amount.

273. Sri Lanka also relies on the award rendered by the arbitral tribunal in the *Citibank* arbitration to the effect that a transaction which was designed to provide relief from a prevailing high oil price by way of a discount on the market price was not an exercise in risk management but in speculation¹⁸². It submits that this Tribunal should reach the same decision for a number of reasons.
274. In the first place, Respondent submits that a high market price is something which has already happened. It is not possible to enter into a hedging transaction in order to protect against something which has already taken place. Moreover, Claimant's expert, Mr. Grove, also considered that a transaction will not be a hedging transaction if it is designed to reduce purchasing costs but does not reduce volatility.
275. In the second place, Respondent argues that in order to structure a transaction so that it may mitigate the consequences of an existing high price, it is necessary either to agree to limits which eliminate or greatly reduce the protection from volatility on the upside, or agree to greater risks on the downside (such as leverage). And in order to try to mitigate the consequences of an existing high price with a derivative transaction, it is necessary to pursue a short-term strategy based on trying to predict future price movements correctly. In Respondent's view, this is speculation. The disproportionate losses suffered if the prediction is wrong show clearly that a transaction has been a failure. Respondent submits that a hedging transaction on the other hand can achieve its object whether the oil price rises or falls.
276. Sri Lanka also disputes Claimant's allegation that the reasoning of the *Citibank* Tribunal depended on the fact that the two transactions in dispute were leveraged. It points out to the fact that 5 of the 16 Citibank transactions were not leveraged (Nos. 3 to 7). The *Citibank* Tribunal held that all the Citibank transactions were speculative¹⁸³.
277. Sri Lanka submits that for a risk management transaction to be genuine hedging, the protection it provides must be more than minimal. According to Respondent, if the transaction is structured in such a way that it provides (i) a payoff on the upside with a very high degree of probability if a prediction of future oil price is correct and (ii) a measurable but literally insignificant reduction of risk, it cannot be characterized as anything other than speculation.

¹⁸¹ Benigni Report II, *supra* note 155, para. 11.

¹⁸² Core 11/377, paras. 5.45 to 5.50.

¹⁸³ *Citibank N.A. v. Ceylon Petroleum Corporation*, First Partial Award, LCIA ab# 81215, 31 July 2011, paras. 5.71 to 5.78; 5.106 and 5.107 [hereinafter "*Citibank v. CPC*"].

278. In Respondent's view, this was the case here. As Mr. de Mel explained in his witness statement¹⁸⁴, CPC was prepared to enter into a transaction presenting such asymmetric risks and benefits because it believed that so long as the transaction was still in the money, CPC would be able to exit it without having to make a payment to the bank and CPC would only have to make a payment if the price fell very steeply in a single day. This turned out to be a mistaken belief.
279. Sri Lanka considers that Claimant's reliance on the judgment of Hamblen J. in the SCB action cannot provide support for Deutsche Bank's case since he approached the case on the basis that "*a hedge need not be against volatility*"¹⁸⁵ while it is common ground that this is not correct. Moreover, in numerous passages, the Judge referred to individual elements of the transaction as not necessarily being indicative of speculation while it is common ground that any consideration of the effects of the transaction requires consideration of the totality of its features together, as opposed to considering the individual features one by one¹⁸⁶.
280. Respondent further submits that Hamblen J. was wrong in numerous other respects. He failed to make the distinction between hedging and speculation, finding that it was too difficult to distinguish the two concepts. He further ignored many of the factors relied on by CPC to establish that the transactions were speculative on the basis that they related to the actual or subjective state of mind of those entering into the transactions, which CPC had accepted was not a relevant factor to take into account. The Judge also held that the transactions provided potential benefits to CPC including foreign exchange to mitigate exchange risk and cash flow that its business needed at the time. According to Sri Lanka, it is obvious that if the objective of the transaction was to make money and earn foreign exchange for CPC, then it was definitely speculative.
281. In August 2012, Sri Lanka provided additional submissions on the English Court of Appeal's decisions in the *SCB* case, noting that the result of the case was "surprising". It noted that, while the Court found it unnecessary to make a final determination as to whether the transactions in that case were hedges or speculation, had it been required to do so on balance it would have been inclined to the view expressed by the *Citibank* Tribunal that the transactions were speculative. The Respondent also stated that it understood that CPC would appeal the decision to the United Kingdom Supreme Court and that the correctness or otherwise of the Court of Appeal's decision should be tested in proceedings to which CPC is a party – that is, in the English courts. The Tribunal in this case should therefore delay issuing the Award until after the Supreme Court decision in the *SCB* case.

¹⁸⁴ Witness Statement of Ashanta de Mel, 5 July 2010, paras. 124-125, 134, 144-145 [hereinafter "de Mel Witness Statement"] and Transcript Day 5, pp. 4 to 6, and p. 23, line 23.

¹⁸⁵ Core 10/355, para. 362(6).

¹⁸⁶ Grove Report, *supra* note 72; Transcript Day 6, p.45, lines 19-24; and Benigni Report II, *supra* note 155, p. 171, line 28.

282. In conclusion, Sri Lanka sets forth that the question for the Tribunal is ultimately the following: considering the position at the date the Hedging Agreement was entered into, was it a) a hedging transaction by which CPC obtained protection from the risks which it faced, or b) a transaction structured in such a way as to provide for CPC, with a high degree of probability, a profit of USD 2.5 million by correctly predicting that the oil price would go up, and would in any event not fall to below USD 112.50, in return for CPC exposing itself to the risk of having to make massive payments to Deutsche Bank if the oil price did so fall? Respondent submits that if the latter, the transaction was speculative.

SECTION III. THE TRIBUNAL'S ANALYSIS AND DECISION

283. In order to determine whether it has jurisdiction and whether the claims are admissible, the Tribunal will analyze successively the three issues addressed by the parties:

- whether it has jurisdiction under Articles 1 and 11 of the BIT;
- whether it has jurisdiction under Article 25(1) of the ICSID Convention; and
- whether the Hedging Agreement is valid and in this respect whether CPC had the capacity to enter into it.

Sub-Section I. The Treaty

284. Article 1 of the Treaty¹⁸⁷ provides that the term “*investments*” includes “*every kind of asset*” and gives a list of illustrative categories, preceded by the words “*in particular*”. These categories include “*c) claims to money which have been used to create an economic value or claims to any performance having an economic value and associated with an investment*”.

285. The Arbitral Tribunal considers that the Hedging Agreement is an asset. It is a legal property with an economic value for Deutsche Bank. It is a claim to money which has been used to create an economic value.

286. The Arbitral Tribunal does not agree with Respondent that in order to qualify for protection the claim to money must be associated with a separate investment. The categories enumerated are just an illustrative list of “*assets*”, every kind of which is considered to be an “*investment*”. Defining an investment by reference to an investment would be a circular reasoning. The Tribunal does not see any reason to interpret Article 1(1)(c) in the restrictive way suggested by Respondent. Moreover, even if the terms “*and associated with an investment*” were to receive the meaning proposed by Respondent, the Tribunal considers that they would only apply to “*claims to performance*” and not to “*claims to money*”.

287. The Arbitral Tribunal admits that the existence of a territorial nexus with Sri Lanka is a condition of its jurisdiction.

¹⁸⁷ Quoted *supra*, para. 130.

288. The test to be applied to determine whether such a nexus exists in the case of a financial investment, has been clearly expressed by the majority in the *Abaclat* case¹⁸⁸, as follows:

“374. The Tribunal finds that the determination of the place of the investment firstly depends on the nature of such investment. With regard to an investment of a purely financial nature, the relevant criteria cannot be the same as those applying to an investment consisting of business operations and/or involving manpower and property. With regard to investments of a purely financial nature, the relevant criteria should be where and/or for the benefit of whom the funds are ultimately used, and not the place where the funds were paid out or transferred. Thus, the relevant question is where (sic) the invested funds ultimately made available to the Host State and did they support the latter’s economic development”

289. The *Abaclat* Tribunal further decided that it was not necessary that an investment of a purely financial nature be further linked to a specific economic enterprise or operation taking place in the territory of the host State. It considered that from the moment the Italy-Argentina BIT designated financial instruments as an express kind of investment covered by the BIT, it would have been contrary to the BIT’s wording and aim to attach a further condition to the protection of financial investment instruments.

290. Applying the above test, the majority noted that the funds generated by the bonds issuance process had been ultimately made available to Argentina and had served to finance its economic development. It therefore reached the conclusion that it had jurisdiction over the claims of the bondholders. The third arbitrator dissented on the basis that at the difference of the situations which had confronted the Tribunals in the *Fedax v. Venezuela*, *SGS v. Pakistan* and *SGS v. Philippines* cases, the security entitlements in question were free-standing and totally unhinged, that they were not linked to an underlying specific economic project, operation or activity taking place in Argentina¹⁸⁹.

291. It is the Arbitral Tribunal’s opinion that the territorial nexus condition is fulfilled in the present case. The reality of today’s banking business is that major banks operate all over the world. The fact that one particular subsidiary or branch does the paperwork does not mean that the financial instrument is located in the country concerned. Here, the preliminary engagement took place in Sri Lanka and it is there too that the investment had its impact. The fact that various Deutsche Bank branches all over the world, including Singapore, participated in the preparation and finalization of the investment, does not alter this conclusion. Nor does the fact that the parties selected English law and English jurisdictions in their agreement. It is a reality of modern banking that London is the world’s first financial place. Its courts have great experience in financial transactions and

¹⁸⁸ *Abaclat v. Argentina*, *supra* note 69, paras. 374 *et seq.*, referring to *Fedax N.V. v. Republic of Venezuela* (ICSID Case No. ARB/96/3), Decision of the Tribunal on Objections to Jurisdiction, 11 July 1997, para. 41 [hereinafter “*Fedax v. Venezuela – Jurisdiction*”], and *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, 6 August 2003, paras. 136-140 [hereinafter “*SGS v. Pakistan*”].

¹⁸⁹ Dissenting Opinion of Professor Georges Abi-Saab, *supra* note 91, paras. 107, 108 and 109.

its law in that area offers great security to bankers and investors. It is the reason why, notwithstanding the territory where the investment takes place, parties to financial transactions often select English law and the English courts in their agreements.

292. In the present case, it is undisputed that the funds paid by Deutsche Bank in execution of the Hedging Agreement were made available to Sri Lanka, were linked to an activity taking place in Sri Lanka and served to finance its economy which is oil dependent. The Tribunal therefore decides that the condition of a territorial nexus with Sri Lanka is satisfied.

Sub-Section II. **Article 25(1) of the ICSID Convention**

293. The Tribunal notes that the parties agree that its jurisdiction should be determined not only on the basis of the provisions of the BIT but also by application of Article 25(1) of the ICSID Convention. However, Claimant only accepts the existence of this “double-barrel test” to a very limited extent, considering that it could not have been the Parties’ intention that Article 25(1) would restrict the broad definition of “*investments*” adopted in Article 1(1) of the Treaty so as to frustrate the bringing of any claim.
294. Indeed, as the Arbitral Tribunal has noted in *Biwater v. Tanzania*¹⁹⁰, it is clear from the *travaux préparatoires* of the Convention that several attempts to incorporate a definition of “*investment*” were made but ultimately did not succeed. Since the Convention was not drafted with a strict, objective, definition of “*investment*”, it is doubtful that arbitral tribunals sitting in individual cases should impose one such definition which would be applicable in all cases and for all purposes¹⁹¹. There is therefore no basis for a strict application in every case of the five criteria that were originally suggested by the Arbitral Tribunal in *Fedax v. Venezuela*¹⁹² and restated (notably) in *Salini v. Morocco*¹⁹³, namely (i) a substantial commitment or contribution, (ii) duration; (iii) assumption of risk; (iv) contribution to economic development; (v) regularity of profit and return, in order to determine the Tribunal’s jurisdiction under Article 25(1). These criteria are not fixed or mandatory as a matter of law. They do not appear in the ICSID Convention. If transactions were to be presumed excluded from the ICSID Convention unless each of the five criteria were satisfied, this would entail the risk of arbitrarily excluding certain types of transactions from the scope of the Convention.
295. The development of ICSID case law suggests that only three of the above criteria, namely contribution, risk and duration should be used as the benchmarks of investment, without a separate criterion of contribution to the economic development of the host State and

¹⁹⁰ *Biwater v. Tanzania*, *supra* note 84, para. 312.

¹⁹¹ *Id.* para. 313.

¹⁹² *Fedax v. Venezuela – Jurisdiction*, *supra* note 188.

¹⁹³ *Salini v. Morocco*, *supra* note 171.

without reference to a regularity of profit and return¹⁹⁴. It should also be recalled that the existence of an investment must be assessed at its inception and not with hindsight.

296. The Arbitral Tribunal considers that the three above criteria are fulfilled in this case.
297. In the first place, the Tribunal agrees with Claimant that the Hedging Agreement involved a contribution to Sri Lanka. A contribution can take any form. It is not limited to financial terms but also includes know-how, equipment, personnel and services. In *RFCC v. Morocco*¹⁹⁵, the Tribunal found that the investor had made a “... contribution in cash, kind and labour”¹⁹⁶. And the Tribunal in *Bayindir v. Islamic Republic of Pakistan*¹⁹⁷ held that the investor had “... made a significant contribution, both in terms of know-how, equipment and personnel and in financial terms”¹⁹⁸. In *L.E.S.I. S.p.A. & Astaldi S.p.A. v. People’s Democratic Republic of Algeria*¹⁹⁹, the Tribunal also confirmed that the contributions could “consist of loans, materials, works, services, as long as they have an economic value. In other words, the contractor must have committed some expenditure, in whatever form, in order to pursue an economic objective”²⁰⁰.
298. The record confirms that Deutsche Bank made a substantial contribution in connection with the Hedging Agreement. By concluding the Agreement on 8 July 2008, Deutsche Bank immediately committed to pay USD 2.5 million if CPC’s costs of importing oil remained above USD 112.50 per barrel. The commitment was made in the context of oil prices that were USD 137.52 per barrel when the Agreement was concluded. The immediate effect of the transaction was to allow CPC to purchase oil over the following twelve months at a price substantially below both the current market price and the forward curve. The benefit of the Hedging Agreement to CPC and Sri Lanka was also immediate. It immediately reduced their exposure to oil price volatility and improved the predictability of their cash-flow.
299. Deutsche Bank’s commitment of resources pursuant to the Hedging Agreement continued after its conclusion. Deutsche Bank made payment of USD 35,523.81 to CPC on 19 September 2008 pursuant to the terms of the transaction.

¹⁹⁴ See in particular *Saba Fakes v. Republic of Turkey* (ICSID Case No. ARB/07/20), Award, 14 July 2010 and *Consorzio Groupement L.E.S.I.-Dipenta v. People’s Democratic Republic of Algeria* (ICSID Case No. ARB/03/08), Award, 10 January 2005.

¹⁹⁵ *Consortium R.F.C.C. v. Kingdom of Morocco* (ICSID Case No. ARB/00/6), Decision on Jurisdiction, 16 July 2001.

¹⁹⁶ *Id.* para. 61.

¹⁹⁷ *Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. v. Islamic Republic of Pakistan* (ICSID Case No. ARB/03/29), Decision on Jurisdiction, 14 November 2005.

¹⁹⁸ *Id.* para. 131.

¹⁹⁹ *LESI, S.p.A. and Astaldi, S.p.A. v. People’s Democratic Republic of Algeria* (ICSID Case No. ARB/05/3), Decision on Jurisdiction, 12 July 2006 [hereinafter “*LESI and Astaldi v. Algeria*”].

²⁰⁰ *Id.* para. 73(i).

300. Deutsche Bank also committed resources of substantial economic value to Sri Lanka. Deutsche Bank’s employees engaged in over two years of regular meetings, negotiations and correspondence with CPC and the Central Bank. Furthermore, once it became clear that CPC would be required to make substantial payments pursuant to the Hedging Agreement, Deutsche Bank invested substantial resources in seeking to mitigate the costs to CPC. It organised a number of meetings between the Bank and CPC and examined various alternative structures which might reduce the required payment.
301. As far as risk is concerned, the Arbitral Tribunal takes note of Professor Schreuer’s observation that “*the very existence of the dispute is an indication of risk*”²⁰¹. Moreover, as assessed by the Tribunal in *Kardassopoulos v. Georgia*, “*the risk component is satisfied in light of the political and economic climate prevailing throughout the period of the investment*”²⁰².
302. It cannot be seriously disputed that Deutsche Bank’s investment involved a risk. The bank indeed faced a substantial risk that it would pay up to USD 2.5 million to CPC.
303. With respect to duration, the Tribunal once again agrees with Schreuer that “[duration] is a very flexible term. It could be anything from a couple of months to many years”²⁰³. Further, the Tribunal concurs with the statement made by the Tribunal in *Romak SA v. Republic of Uzbekistan*²⁰⁴, holding that “short-term projects are not deprived of “investment” status solely by virtue of their limited duration. Duration is to be analysed in light of all the circumstances, and of the investor’s overall commitment”. While this Tribunal is aware that *Romak* was not an ICSID case, the analysis equally applies to proceedings under the ICSID Convention. As the ICSID Tribunal noted in *MCI v. Ecuador*, the ‘duration’ characteristic is not necessarily an element that is necessarily required for the existence of an investment, but is to be considered a mere example of a typical characteristic.²⁰⁵
304. The Arbitral Tribunal is persuaded that the duration criterion is satisfied in this case. The Hedging Agreement commitment was for twelve months. Moreover, Deutsche Bank had already spent two years negotiating the Agreement. The fact that it was terminated after 125 days is irrelevant. As pointed out by the Tribunal in *L.E.S.I. S.p.A. and Astaldi S.p.A. v. People’s Democratic Republic of Algeria*, “*the fact that the contract was suspended and then terminated prematurely changes nothing; in order to judge the importance of the*

²⁰¹ The ICSID Convention: A Commentary (2nd Ed.), Article 25, para. 163. See also *Fedax v. Venezuela – Jurisdiction*, *supra* note 188, para. 40.

²⁰² *Kardassopoulos v. Georgia*, *supra* note 134, para. 117.

²⁰³ Panel Discussion, “Are the ICSID Rules Governing Nationality And Investment Working?”, in T.J. Grierson Weiler (ed.), *Investment Treaty Arbitration and International Law* (Huntington, Juris, 2008), 119, 125.

²⁰⁴ *Romak v. Uzbekistan*, *supra* note 80, para. 225.

²⁰⁵ *M.C.I. Power Group, L.C. and New Turbine, Inc. v. Republic of Ecuador* (ICSID Case No. ARB/03/6), Award, 31 July 2007, para. 165.

contribution, it is necessary to focus on the duration that was agreed in the contract, which determines the nature of the contribution”²⁰⁶. In other words, it is the intended duration period that should be considered to determine whether the criterion is satisfied.

305. With respect to the other *Salini* criteria, the Tribunal notes that most of the recent decisions have generally refused – rightly so – to take into consideration “*regularity of profit and return*”. Indeed, some investments can qualify as such although they were loss leaders. Others may indeed be contingent on extraneous events, such as the discovery of natural resources or, as here, the evolution of the oil price on the world market. The criterion should rather be qualified as an expectation that the investment will be profitable. This was undoubtedly the expectation of Deutsche Bank.
306. Finally, the criterion of contribution to economic development has been discredited and has not been adopted recently by any tribunal. It is generally considered that this criterion is unworkable owing to its subjective nature. Indeed, whether or not a commitment of capital or resources ultimately proves to have contributed to the economic development of the host State can often be a matter of appreciation and can generate a wide spectrum of reasonable opinions²⁰⁷. Moreover, some transactions may undoubtedly be qualified as investments, even though they do not result in a significant contribution to economic development in a post hoc evaluation of the claimant’s activities.²⁰⁸ This is for example the case of mergers and acquisitions or of failed construction projects²⁰⁹.
307. What is important is the commitment of the investor and not whether he positively contributed to the economic and social development of the host State. In this respect, the Tribunal has no doubt that the hedging program was designed and implemented in the national interest, as was repeatedly attested to by the Sri Lankan authorities.
308. Finally, the Arbitral Tribunal considers, contrary to Respondent’s submission, that the Hedging Agreement was neither an ordinary commercial transaction nor a contingent liability.
309. As the Tribunal pointed out in the *Pantechniki* case, the same product can be an ordinary sale of goods or an investment depending on the attending facts and circumstances of the case: “[i]t is admittedly hard to accept that the free-on-board sale of a single tractor in country A could be considered an “investment” in country B. But what if there are many tractors and payments are substantially deferred to allow cash-poor buyers time to generate income? Or what if the first tractor is a prototype developed at great expense for

²⁰⁶ *LESI and Astaldi v. Algeria*, *supra* note 199, para. 73(ii).

²⁰⁷ Z. Douglas, *The International Law of Investment Claims* (Cambridge/New York: Cambridge University Press, 2009), p. 164, para. 343.

²⁰⁸ *SGS Société Générale de Surveillance S.A. v. Republic of Paraguay* (ICSID Case No. ARB/07/29), Decision on Jurisdiction, 12 February 2010, para. 107

²⁰⁹ S. Manciaux, “The Notion of Investment: New Controversies” (2008), 9 *The Journal of World Investment and Trade*, p. 16.

*the specificities of country B on the evident promise of amortisation? Why should States not be allowed to consider such transactions as investments to be encouraged by the promise of access to ICSID?”*²¹⁰.

310. In other words, where a sales agreement includes special features such as a bespoke product, it will usually be considered an investment. In the present case, the Hedging Agreement was negotiated over a period of two years, and took into account the recommendations made by the Cabinet Study Group. It was instigated and approved by the highest authorities in Sri Lanka to further the national interest. It is therefore in no sense an ordinary commercial transaction.
311. The Hedging Agreement also does not fall in the definition of contingent liability in IAS 37 but rather in the definition of derivatives in IAS 39. As confirmed by the IMF, contingent assets and liabilities are contractual financial arrangements between institutional units that do not give rise to unconditional requirements either to make payments or to provide other objects of value. They are not recognised as financial assets or liabilities prior to the conditions being fulfilled. On the other hand, the value of future payments arising from equity and financial derivatives are recognised as financial assets rather than as contingent assets. The liability exists, but the amounts payable depend on subsequent events²¹¹.
312. Aside from its decision that the three criteria used as the benchmark of investment are fulfilled in this case, the Tribunal further decides that the other jurisdictional requirements set forth in Article 25(1) of the ICSID Convention and the BIT are also fulfilled, namely:
- (i) Sri Lanka is an ICSID Contracting State since 11 November 1967. Deutsche Bank AG is a judicial person incorporated under the laws of Germany. As a national of Germany, Deutsche Bank AG is a national of an ICSID Contracting State for purposes of Article 25(1) of the Convention.
 - (ii) The parties to the present proceeding disagree about whether Sri Lanka complied with its obligations under the BIT and the Hedging Agreement. Hence, since the Tribunal is of the view that the Hedging Agreement qualifies as an investment for the purposes of Article 25(1) of the ICSID Convention, a legal dispute exists between the parties that arises directly out of an investment.
 - (iii) Deutsche Bank AG and Sri Lanka have consented in writing to ICSID arbitration. Claimant’s consent is contained in the Request for Arbitration. Claimant argues that Respondent’s consent is contained in Article 11 of the BIT. Given that the Tribunal also considers the Hedging Agreement an investment under the BIT, and Respondent does not dispute that the other pre-requisites of Article 11 of the BIT are fulfilled, the Tribunal concludes that the parties have consented in writing to ICSID jurisdiction in accordance with Article 25(1) of the ICSID Convention.

²¹⁰ *Pantechniki v. Albania*, *supra* note 90.

²¹¹ IMF, Balance of Payments and International Investment Position Manual, *supra* note 93.

Sub-Section III. **Is the Hedging Agreement valid? Did CPC have the capacity to enter into it?**

313. The central issue with respect to the validity of the Hedging Agreement is to determine whether the transaction was within or outside of CPC's statutory authority. The parties agree that this issue is a matter of Sri Lankan law.

(A) ***Was the Hedging Agreement "incidental" or "conducive" to CPC's business?***

314. Section 5 of the CPC Act defines the objects of CPC. Section 5(c) extends these objects to "*any such other business as may be incidental or conducive*" to the carrying on of CPC's business as "*an importer, exporter, seller, supplier or distributor of petroleum*".

315. On the other hand, Section 6(1) of the CPC Act defines the powers of the corporation. It entitles the CPC Board to determine which transactions are so conducive to CPC's business. It enables CPC "*to enter into any agreements with any bank ... that may seem to the Board to be conducive for the purposes of the corporation*".

316. Under Section 6, the CPC Board is empowered to determine what, in its best judgement, is incidental and conducive to CPC's business. Provided the Board form their view honestly, a transaction which has been so determined to be incidental and conducive to CPC's business is within the company's objects and powers, even if the directors have taken the wrong view. The transaction will only be considered *ultra vires* if it can be said that no reasonable board could have genuinely considered that the transaction was incidental and conducive to CPC's business.

317. Sri Lanka has acknowledged that CPC had the capacity to enter into a hedging transaction but contends firstly that the Hedging Agreement was *ultra vires* because it did not comply with the Study Group Recommendations and secondly, that it amounted to speculation and therefore CPC had no capacity to enter into it and that the Agreement is consequently void.

318. As to the first argument, the Arbitral Tribunal notes that the Study Group Recommendations were just that: they "*recommended two types of hedging instruments: the Cap and the Zero-Cost Collar*". Moreover, Recommendation 5 gave authority to CPC to change the instrument based on the developments in the market.

319. The Tribunal interprets these Recommendations as having given CPC the broad parameters to comply with. It then belonged to the Board of CPC to study the available instruments and decide what was best in the interest of the company. In the present case, 18 months had elapsed between the adoption of the Recommendations in January 2007 and the conclusion of the Hedging Agreement in July 2008. The market had changed and the price of oil had considerably increased. Taking into consideration Recommendation 5, it was reasonable for CPC to adopt a form of hedging that it considered to be more in conformity with developments in the market.

320. As Mr. Grove has pointed out in his first expert report:

*“in sum, the Hedging Agreement entered into by CPC and Deutsche Bank resembled a Zero-Cost Collar and a Swap, albeit one in which CPC agreed to limit on its potential payments in exchange for a lowering of the rate above which it would receive payments (a benefit to CPC) and a lowering of the rate below which it would be required to make payments (another benefit to CPC). With oil prices at historically high levels and with the forward curve pricing oil at even higher levels in the immediately following months, it was not illogical for CPC to agree to these limits in exchange for these benefits”*²¹².

321. The Arbitral Tribunal is convinced that at the time it took the decision to hedge, the CPC Board formed the *bona fide* view that the Hedging Agreement was capable of falling within the objects of the company, that it was incidental and conducive to CPC’s business.
322. The next question to be determined is whether the Hedging Agreement was a genuine hedge or amounted to speculation. This issue is addressed below.

(B) ***Was the Hedging Agreement a transaction which managed CPC’s risks or did it amount to speculation?***

323. Before analyzing the issue, the Tribunal notes that the Hedging Agreement is *prima facie* a valid hedging transaction. The Tribunal considers that the burden is therefore on the Respondent – as the party asserting that the Agreement is invalid – to demonstrate that CPC was speculating, rather than hedging, when it entered into the Agreement.²¹³ As such, any doubt as to whether CPC had the capacity to enter into the Agreement will fall in favor of the Claimant.
324. The Tribunal has received extensive submissions – both written and oral – from the parties and their respective experts on this matter. At its heart is the ability to distinguish a genuine “hedge” from market speculation. In relation to this distinction it is important to note that there is much that the expert witnesses for both parties agree upon. However, before turning to this in detail, it is useful to revisit the nature of the transaction itself. As noted in paragraph 30 above, the transaction in the present case involved CPC buying a call option at a strike price of USD 112.50 and selling a put option at the same strike price (which has variously been referred to as creating a “zero cost collar”, a “synthetic long position” or a “swap”²¹⁴). CPC also sold a call option with a strike price of USD 122.50, effectively creating a “seagull” or a USD 10 limit on the upside of the transaction. The transaction would terminate if the Claimant paid to CPC a total of USD 2.5 million (effectively a “TPF”). As the market price on 8 July 2008 was USD 137.52, the call option was “in-the-money” as at that date.
325. It is noted that the parties agree that, provided the Hedging Agreement was a hedge and not speculation, then CPC had the capacity to enter into it.²¹⁵ This is the case regardless of

²¹² Grove Report, *supra* note 72, para. 5.3.6.11.

²¹³ Claimant’s First Post-Hearing Brief, para. 54; Transcript Day 8, p. 127, lines 6 to 25.

²¹⁴ Transcript Day 6, p. 149, lines 3 to 5, and p. 155, lines 8 to 9.

²¹⁵ Transcript Day 8, p. 46, line 20 to p. 47, line 23.

whether the call/put options each at USD 112.50 constituted a zero cost collar, a synthetic long position or a swap. Therefore, the Tribunal is not required to decide this point.

326. The above description contains a number of “jargon” terms commonly used by those familiar with derivatives. To explain these terms more fully, the Tribunal quotes below from the English High Court Judgment of Hamblen J in *Standard Chartered Bank v Ceylon Petroleum*²¹⁶ where an explanation of these terms – in particular “zero cost collar”, seagull, TPF (referred to below as TRF) and “in-the-money” – and how each mechanism is structured was helpfully set out by the Judge:

“26. An alternative method is for the customer to purchase a call option, not in consideration of a premium, but by selling a corresponding put option to the bank, giving the bank a right to buy oil at a specified price from the customer if the market price of oil is below the strike price of the put option. A transaction involving the purchase of a call option by the customer in consideration of the sale of a put option is sometimes called a Zero Cost Collar or ZCC.

27. Under a simple ZCC, the customer, a purchaser of physical oil, buys a call option from the bank, that is a right to buy oil if the oil price is higher than the ‘strike price’ of the call option. The strike price of the call option is often referred to as “the ceiling”. The customer does not pay an upfront premium for the call option that it is buying (hence the transaction is, in this sense, “zero-cost”), but pays for it by selling a corresponding put option to the bank. Under the put option, the customer must pay the bank if the oil price falls below the strike price of the put option. The strike price of the put option is often referred to as “the floor”.

28. The effect of a simple ZCC is that:

- (1) If the market price of oil is above the ceiling (i.e. above the strike price of the call option bought by the customer), the bank is required to make a payment to the customer.*
- (2) If the market price of oil is between the ceiling and the floor, neither party is required to make a payment to the other.*
- (3) If the market price of oil is below the floor (i.e. below the strike price of the put option sold by the customer), the customer is required to make a payment to the bank.*

29. The effect of a ZCC is that the customer acquires upside rights exercisable when oil prices are high (and when its costs for physical oil are high) in

²¹⁶ Core 10/355.

consideration for selling downside obligations exercisable by the bank when the oil price is low (but when its costs for physical oil are low). In this way, the customer hedges the risks arising from its physical position

30. Unlike the position where a party purchases a call option in exchange for a premium, it is inherent in a zero-cost structure that the customer accepts an uncertain downside risk. The consideration that the customer provides to the bank is not the payment of a fixed sum by way of premium, but the sale of rights that will require it to make payments to the bank if, but only if, oil prices are low.

31. The parties may modify the precise terms of the upside rights which are bought, and as a result the precise terms of the downside obligations which are sold, or vice versa.

32. Thus, if, for example, the customer wishes to reduce the risk of its downside obligations, by lowering the floor (i.e. the oil price at which it will start making payments to the bank), one means of doing so is by reducing the value of its upside rights that it seeks to purchase. There are a number of ways in which it may seek to do so, including the following:

- (1) It may cap the amount that the bank will have to pay per notional barrel of oil if the oil price is above the strike price of the call option. A ZCC which contains this additional feature is sometimes called a “Seagull” (or “3-way”). The strike price at which the Seagull operates is sometimes called “the cap”. The effect of a Seagull is that, if the market price is between the ceiling and the cap, the customer receives the difference between the ceiling and the market price. If the market price is greater than the cap, it continues to receive payment, but capped at the agreed maximum amount per barrel. A customer may consider a Seagull sensible where, for example, it considers that oil prices are unlikely to rise beyond a particular amount (the level of the cap) or is not willing or able to pay for full protection above that level.*
- (2) Another way is by capping the total amount that the bank will have to pay in respect of the transaction as a whole when the oil price is above the strike price of the call option. In this situation, if and when the total amount (or “target”) is paid to the customer, the structure then terminates or “knocks-out”, and there are no continuing obligations either way. A ZCC that contains this additional feature is sometimes called a “Target Redemption Forward” (or “TRF”).*

33. In each such case, because the customer is buying upside rights by selling downside obligations, a modification to its upside rights will usually require a

modification to the amount of its downside obligations (and vice versa) so that the two packages of rights agreed by the parties continue broadly to be matched.

35. One factor that affects the value of the upside risks concerns the relationship at the trade date between the market price for oil and the strike price for the call option being purchased from the bank.

- (1) It is, for example, possible for a customer to obtain a strike price for the call option that it is buying that is below the market price at the time of the trade. Such a trade is described as being “in the money” or “ITM”.*
- (2) Given that an ITM trade increases the value of the customer’s upside rights, by lowering the price at which the bank will have to make payment to it, it will need to pay for this, either, for example, by capping the amount of its upside (by including, for example, a Seagull or TRF), and/or by increasing the amount of its downside (by including, for example, leverage).*
- (3) By entering into such a trade, the customer may obtain a higher prospect of receiving a (smaller) payment from the bank, in exchange for undertaking a lower risk of having to make a (larger) payment to the bank ...”*

327. Having clarified the nature of the transaction at issue in this case, the Tribunal must now determine whether this transaction was a hedge or speculation. To do this, the Tribunal has considered in detail the evidence provided by the two expert witnesses presented by the parties: Mr. Grove and Mr. Benigni. There are two important aspects of a “hedge” that both Mr. Grove and Mr. Benigni agreed upon:

- a) A hedge must reduce the risk of the hedger.²¹⁷ If a transaction increases risk or exposure, then it is speculation.
- b) The hedger must have an underlying exposure to the physical market relevant to the hedge,²¹⁸ and as a result the hedge manages (*i.e.*, reduce the uncertainty of) that underlying exposure.²¹⁹

328. Returning to the circumstances of this case the first step is to consider whether the Hedging Agreement meets these agreed qualifications. It is clear that, as an oil importer, CPC had a physical position to protect and an underlying exposure or risk to fluctuations in the oil price. It is this exposure that CPC sought to manage through the Hedging Agreement and

²¹⁷ See Transcript Day 6, p. 25, line 17.

²¹⁸ Transcript Day 6, p. 31, lines 3 to 5, and p. 150, lines 12 to 20.

²¹⁹ Transcript Day 6, p. 31, lines 3 to 7, and p. 150, lines 12 to 16.

there is no question that the amount being hedged was always less than CPC's actual physical exposure.²²⁰ As such, the Agreement did not increase or extend CPC's exposure, but is reflective of the already existing exposure.

329. Leaving aside the issue of whether CPC should have sought to reduce its exposure to increasing prices or high prices more generally (this is addressed at paragraph 340 below), the Tribunal is also satisfied that the transaction did in fact reduce CPC's risk or exposure, rather than increase it.
330. Any assessment of whether the Hedging Agreement reduced risk must be made as at the date the transaction was entered into – 8 July 2008 – and cannot take account of the benefit of hindsight. It is clear that, in July 2008, the forward curve was predicting that prices would remain high. Mr. Grove demonstrated convincingly that, based on the forward curve, the transaction resulted in a reduction of risk as the price CPC would pay for oil was reduced if the market price remained above USD 112.50 (as it was expected to do).²²¹ Under cross-examination, Mr. Benigni agreed that, as at 8 July 2008, the most likely outcome of the Hedging Agreement, based on the forward curve at the time, was that CPC would receive a 6% contribution towards the cost of purchasing oil over the relevant 3 month period of the Agreement.²²² The Tribunal considers Mr. Benigni's alternative analysis which considered the transaction in relation to annual imports (without any reference to CPC's overall hedging program) unconvincing and of minimal (if any) relevance.²²³ The Tribunal therefore finds that the Hedging Agreement was risk reducing. Consequently, the two agreed criteria as set out above have been met.
331. The Tribunal now turns to the key areas of disagreement between the experts. Although the experts agreed on the need for a hedging transaction to be risk reducing, they disagreed as to the nature of the reduction required. Mr. Grove contended that a transaction is either risk reducing or it is not:²²⁴ *"I think ... you are either hedging or you are speculating, that there is a bright line, and we can look at a transaction objectively and we can determine objectively whether that transactions reduces risk or increases risk; and if it reduces risk, it's hedging, and if it increases risk it's speculation."*²²⁵ Mr. Grove's contention was that this judgment should be made objectively and that subjective issues, such as the intention of the person entering into the transaction, should not be taken into account.²²⁶

²²⁰ Transcript Day 6, p.151, line21 to p. 152, line 1.

²²¹ First Expert Report of Mr. Johannes Benigni [hereinafter "Benigni Report I"], p. 40; Transcript Day 6, p. 39, lines 1 to 6.

²²² Transcript Day 6, p. 197, line 23 to p. 198, line 1.

²²³ Benigni Report II, *supra* note 155, paras. 9-12.

²²⁴ Transcript Day 6, p. 22, lines 17 to 25.

²²⁵ Transcript Day 6, p. 26, lines 12 to 18.

²²⁶ Transcript Day 6, p. 27, line 3 to p. 28, line 1.

332. Mr. Benigni, on the other hand, contended that something more was required to constitute a genuine hedge – he stated in his second report that “[t]he hedging transaction has to reduce the risk of the hedging party meaningfully”²²⁷ and that the Study Group’s Recommendations “must mean that [they] required CPC to enter into a transaction which meaningfully reduced its risk in the physical market to rising prices” (emphasis added).²²⁸
333. The Tribunal is not convinced by Mr. Benigni’s addition of a “meaningfulness” or “effectiveness” requirement. Although, Mr. Benigni referred during the oral hearing to Article 39 of the International Accounting Standards to justify his “meaningful” (or effectiveness) requirement,²²⁹ the Tribunal can find no reference to any such test in the Accounting Standards, nor has it been referred by the parties or the experts to any literature or authoritative documents which endorse an effectiveness or meaningfulness test.
334. In addition, Mr. Benigni could give no indication as what would constitute a meaningful risk reduction or an effective hedge and admitted that some hedges were “more effective” than others.²³⁰ Instead, he considered that “*the Tribunal will make its own view on putting things in perspective*”²³¹ and that the meaningfulness of a hedge to any given hedger would be different depending on that hedger’s particular circumstances.²³² The Tribunal finds it an extremely unattractive proposition that the difference between a hedge and speculation should be based on such a subjective and ever-changing requirement.
335. It cannot be correct that whether a transaction is a hedge or speculation depends entirely upon the subjective view of the person making the assessment. If this were so, CPC could never be sure whether it had capacity or not to enter into what it considered to be a “hedging” transaction. Moreover, the introduction of an effectiveness analysis could mean, as Claimant’s Counsel pointed out during the Closing oral submissions, that a transaction might be considered a hedge one day and speculation on some other day because the hedger’s position had changed.²³³ This inherent uncertainty is undesirable.
336. We agree with the Claimant that the introduction of a subjective effectiveness test is unworkable. In essence, the hedger would never know if they had entered into a hedge until a court or tribunal had proclaimed as such. Such a position is simply uncommercial. Mr. Grove, on the other hand, stressed the objective nature of assessing the difference between a hedge and speculation. He considered that whether a transaction was a hedge could not depend upon the intention of the party entering into the transaction, but must be assessed using objective economic criteria – as such, he created a simple workable solution

²²⁷ Benigni Report II, *supra* note 155, para 6.

²²⁸ Benigni Report II, *supra* note 155, para 27.

²²⁹ Transcript Day 6, pp. 176 to 178.

²³⁰ Transcript Day 6, p. 178, line 25 to p. 179, line 10.

²³¹ Transcript Day 6, p. 181, lines 3 to 4.

²³² Transcript Day 6, p. 181, lines 5 to 10.

²³³ Transcript Day 8, p. 49, lines 8 to 14.

whereby if a transaction was risk reducing (which itself required the hedger to have an underlying physical exposure) then it was a hedge, and if the transaction increased risk it was speculation. The Tribunal finds this so-called “bright line” test preferable.

337. However, even if an effectiveness test were required, the most likely outcome of the Hedging Agreement as at July 2008 was a 6% cost reduction for CPC over the next three months. Such a reduction would surely meet an “effective” or “meaningful” risk reduction test. In his first expert report, Mr. Benigni attempted to demonstrate the lack of “meaningful” risk reduction by presenting a graph which showed the “*proportionality between the loss and gain potential under [the] structure*”.²³⁴ Under cross-examination, Mr. Benigni acknowledged that this graph dealt only with absolute numbers and did not take any account of the probability of those numbers (and in particular of the downside numbers) occurring.²³⁵ Similarly, his graph at Figure 3 of his Second Report only reflected “*potential payments*” in absolute terms, with no reference to the likelihood of those payments occurring.²³⁶ Given that hedging is about the reduction of risk, a graph which does not take into account the probability of the upside occurring as opposed to the downside is of little value to the Tribunal and certainly does not assist in demonstrating that the Hedging Agreement did not create a meaningful reduction in risk. As such, the Tribunal finds that Mr. Benigni’s graphs are unpersuasive.
338. In addition, Mr. Benigni was unable to suggest any serious alternative structures that were realistically available to CPC at the time. The structures he suggested, which involved hedging transactions in February 2007 or February 2008, the payment of significant premiums or protection against only a significant rise in prices, were simply not an option for CPC in July 2008, as Mr. Benigni largely accepted under cross examination.²³⁷ This is particularly so given the constraints imposed on CPC (and in particular on Mr. de Mel) by the Government. These included the requirement that CPC enter into hedging arrangements without delay, that it must not pay any premium for these hedges or make any payments to banks (*i.e.*, the floor price of any zero cost collar instrument (the only instrument whereby no premium was paid) had to be low in order to minimize the risk of making a payment). In addition, evidence of the need to ease the severe cashflow problems faced by CPC is a relevant consideration in relation to these constraints. These restraints only emphasize that an expected 6% cost reduction over three months would be considered meaningful in CPC’s circumstances.
339. The Tribunal is also not convinced by Mr. Benigni’s suggestion that there is something in the combination of factors found in the present transaction (such as the seagull, the TPF and the fact that it was in-the-money) which leads to the conclusion that it was speculation rather than hedging. There is no evidence to support a contention that, just because certain legitimate hedging mechanisms are combined, the transaction loses its classification as a

²³⁴ Benigni Report I, *supra* note 221, Figure 13 (p. 29) and para 39.

²³⁵ Transcript Day 6, p. 155, lines 20 to 24.

²³⁶ Benigni Report II, *supra* note 155, Figure 3 (p. 18); and Transcript Day 6, p. 155, line 25 to p. 156, line 6.

²³⁷ Benigni Report II, *supra* note 155, pp. 26-31; Transcript Day 6, pp. 201-207.

hedge or somehow transforms into a speculation. Mr. Benigni acknowledged during cross-examination that these mechanisms are used in legitimate hedges and that the combination was, to his mind, only indicative – not determinative – of speculation.²³⁸ In the Tribunal’s view, the probability of the upside (and conversely the downside) occurring are critical factors that Mr. Benigni failed to take into account (as demonstrated by his graphs discussed at paragraph 337 above). The introduction of features such as a TPF and a seagull are not unexpected given the constraints on CPC and where the forward curve clearly predicted that the transaction was most likely to result in payments to CPC of USD 2.5 million in the first three months of the transaction.

340. As mentioned briefly above, another important difference between the experts was what each expert considered to be the purpose of the hedge, which in turn was linked to the mandate provided to CPC by the Study Group in its Recommendations.²³⁹ Mr. Benigni considered that CPC should have entered into hedging transactions which protected it against rising oil prices, as opposed to sustained high prices. He opined that, as the Hedging Agreement was an “in-the-money” transaction which provided protection to CPC when the oil price was between USD 112.50 and USD 122.50, but provided no additional protection above USD 122.50, it did not protect against rising prices. As noted above, the market price for oil on the date the transaction was agreed (8 July 2008) was around USD 137.
341. Conversely, Mr. Grove and Claimant considered that protection against sustained high prices (not just an increase in the price) was also part of the mandate provided to CPC by the Study Group in its Recommendations. Mr. Grove pointed out that it was not an increase in prices that was an issue per se (for example, a price increase when prices were low would not necessarily be of concern), but prices that were high for a sustained period.²⁴⁰ He also maintained that protection against the risk of continuing high prices (as well as an increase in the price) was an appropriate reason to hedge, as an exercise in risk management.²⁴¹
342. The Tribunal agrees with Claimant and Mr. Grove that the Recommendations themselves clearly indicate that sustained high prices were of concern to the Sri Lankan Government and that hedging arrangements which reduced the exposure to these high prices were within the mandate of CPC. This is clear from the text of the Recommendations themselves which include statements such as: “*In view of escalation of oil prices... hedging provides insurance cover for very high oil prices ...*”; “*In the case of high oil prices the cost is very severe...* ”; and “*the benefits of protection from high oil prices are greater than the cost of hedging*”.²⁴² The Tribunal also accepts Mr. Grove’s evidence that

²³⁸ Transcript Day 6, pp. 169-173.

²³⁹ Core 2/49.

²⁴⁰ Transcript Day 6, p. 19, lines 4 to 6.

²⁴¹ Transcript Day 6, p. 41, lines 18 to 22.

²⁴² Core 2/49, Background.

the Hedging Agreement did in fact protect against a rise in prices, even though this protection was limited. Therefore, the Tribunal considers that CPC was mandated to hedge in order to protect both against sustained high prices and against rising prices and that the Hedging Agreement therefore fell within this mandate.

343. Additionally, both experts agreed that a reduction in the risk of price volatility was also a legitimate aim of CPC. Mr. Grove demonstrated convincingly with his graphs at figures 5.5 and 6.4 of his Expert Report that volatility was reduced by the Hedging Agreement and Mr. Benigni acknowledged this under cross examination.²⁴³ The Tribunal accepts Mr. Grove's evidence and finds that the Hedging Agreement did indeed reduce CPC's exposure to price volatility in the oil market, which was a legitimate aim of CPC's hedging program.
344. As noted above, Sri Lanka has the burden of proving that the Hedging Agreement – which *prima facie* constitutes an investment – was speculation and therefore outside of CPC's capacity. It has failed to do so. The Tribunal finds that CPC had capacity to enter into the Agreement which constituted a valid hedging transaction.
345. The Tribunal has reached this conclusion on the basis that the Respondent's position that CPC does not have capacity to enter into speculative transactions is correct. There is, nonetheless, an alternative argument that the distinction between hedging and speculation is irrelevant and that all that matters is that the Hedging Agreement was "incidental or conducive" to CPC's business, as required by Section 5 of the CPC Act. In other words, both hedging and speculation may fall within the activities that are conducive or incidental to CPC's business, particularly if the distinction between the two is often blurred. This is the approach taken recently by the English Court of Appeal in *SCB v CPC*, where the Court decided that the transactions in question in that case clearly fell within CPC's capacity as they were incidental or conducive to its business, regardless of whether they were speculation or hedging. This approach has much merit and serves as an alternative basis on which the Tribunal could have reached the same conclusions it has come to above.

Nonetheless, as the Tribunal has decided that the Hedging Agreement constituted a hedge rather than speculation, and as both parties clearly acknowledged that such a hedge is within CPC's capacity, there is no need for the Tribunal to decide definitely whether a speculative transaction would nonetheless have fallen within CPC's capacity, as defined in the CPC Act.

346. Aside from the Court of Appeal decision mentioned briefly in the previous paragraph, during the hearing, and in written submissions, both parties also referred to the LCIA Award in *Citibank v. Ceylon Petroleum Corporation* and the English High Court judgment of Hamblen J in *Standard Chartered Bank v. Ceylon Petroleum*. The Tribunal notes that, aside from quoting relevant definitions from the High Court judgment, this Tribunal has not placed significant reliance on those previous decisions in determining the issues before it in the present case. The financial instruments at issue in those cases were different to the

²⁴³ Transcript Day 6, pp. 198-201.

instrument at issue here and it would be therefore dangerous to apply the conclusions reached in those cases to the present case. Ultimately, the Tribunal considers that it has a duty to reach its decisions based on the specific facts of this transaction and the evidence advanced by the parties and their experts, and has therefore refrained from relying on previous decisions.

(C) **Conclusion**

347. Respondent has not met its burden of proof, *i.e.*, that the hedging transaction was speculation rather than hedging. In the Tribunal's opinion, the CPC Board honestly took the view that the Hedging Agreement was conducive or incidental to CPC's business. Its decision was reasonable and within its powers under Article 6 of the CPC Act. The Agreement is therefore valid. There is no need to further examine Claimant's other arguments and in particular whether Respondent is estopped from invoking the invalidity of the transaction.

Sub-Section IV. **Conclusion on Jurisdiction**

348. The Tribunal has jurisdiction to hear Deutsche Bank's claims. These claims are admissible.

CHAPTER VI. ATTRIBUTION

SECTION I. CLAIMANT'S POSITION

Sub-Section I. **The issue of attribution for a general conduct in relation to the hedging program**

I. Is Sri Lanka responsible for actions of the Cabinet, the Ministry of Petroleum, the Central Bank and the Supreme Court?

349. Article 4 of the International Law Commission's Articles on the Responsibility of States for Internationally Wrongful Acts (the "Articles on State Responsibility" or the "ILC Articles") provides:

"1. The conduct of any State organ shall be considered an act of that State under international law, whether the organ exercises legislative, executive, judicial or any other functions, whatever position it holds in the organization of the State, and whatever its character as an organ of the central Government or a territorial unit of the State.
2. An organ includes any person or entity which has that status in accordance with the internal law of the State".

350. Claimant submits that the actions of each of the Cabinet of Ministers, Ministry of Petroleum (including Minister Fowzie), Central Bank (including its Governor), and the Supreme Court are attributable to Sri Lanka, given that these are organs of the State under Article 4 of the Articles on State Responsibility.

II. Is Sri Lanka responsible for the actions of CPC? Are Articles 4(1) and (2) of the ILC Articles satisfied on the facts? Or alternatively, Article 5 or Article 8?

(A) *Sri Lanka's responsibility under Article 4*

351. According to Deutsche Bank, for an entity to be considered an organ of the State, it must act in "*complete dependence on the State of which it is ultimately merely the instrument*"²⁴⁴. Complete dependence can be demonstrated where the State exercises its control to the extent that the relevant entity lacks any real autonomy²⁴⁵. According to Claimant, this is the case here.
352. In this respect, Claimant recalls that CPC is a 100% State-owned entity established by statute. It is subject to all pervading Government direction and control. The Minister of

²⁴⁴ Application of the Convention on the Prevention and Punishment of the Crime of Genocide (Bosnia and Herzegovina v. Serbia and Montenegro), Judgment of 26 February 2007, at para. 392 [hereinafter "*Bosnia and Herzegovina v. Serbia and Montenegro*"].

²⁴⁵ *Id.* paras. 391 and 392.

Petroleum appoints the entire board. It has immunity for any act which in good faith is done or purports to be done under the CPC Act. Its income and its expenditure are Government-controlled. Its exchange dealings are subject to instructions from the Treasury and the Central Bank. It even acts against its own interests when it is directed to do so by the Government, for example granting discounts to the Ceylon Electricity Board and refusing to charge any interest on the very substantial overdue amounts from the same.

353. Deutsche Bank objects to Sri Lanka's allegation that ILC Article 4 does not apply to CPC because it only relates to the central organs of government and not to other separate entities. Claimant refers to the Commentary to ILC Article 4 that the term "organ" is to have a very broad meaning and is not limited to the organs of the central Government but extends to organs of Government of whatever kind of classification, exercising whatever functions, and at whatever level²⁴⁶.
354. Deutsche Bank also submits that contrary to Sri Lanka's suggestion, nothing turns on CPC's separate legal personality. The term "person or entity" includes in Claimant's view any natural or legal person²⁴⁷.
355. According to Claimant, it is also incorrect to suggest, as Sri Lanka does, that commercial entities cannot be State organs for the purposes of ILC Article 4. The Commentary plainly states that it is irrelevant that the conduct of a State organ may be classified as commercial²⁴⁸. The key requirement relevant to ILC Article 4(1) is control of the entity by the State. According to Deutsche Bank, this is the case here. The facts confirm that Sri Lanka controls CPC.
356. Claimant further submits that ILC Article 4(2) also confirms that CPC is an organ of the State. Where a State's internal law positively identifies an entity to be a State organ, as it is the case here, it is also a State organ for the purposes of Article 4 regardless of the outcome of the ILC Article 4(1) analysis. In Claimant's view, this is clear from the Commentary to ILC Article 4²⁴⁹ and the Sri Lankan case law. In *Dahanayake v. De Silva*, the Sri Lankan Supreme Court confirmed that CPC is:

"a legal hybrid bred by the Government to enable it to engage in commercial business-tailor made to suit its style of business. It is a Government creation clothed with juristic

²⁴⁶ Crawford, J., *The International Law Commission's Articles on State Responsibility*, p. 98, 95 (2002) [hereinafter "Crawford"].

²⁴⁷ *Id.* p. 98. Reference is also made to *Eureko B.V. v. Republic of Poland*, Partial Award on Liability, 19 August 2005, para. 131.

²⁴⁸ Crawford, *supra* note 246, p. 96. Reference is also made to *Noble Ventures Inc. v. Romania* (ICSID Case No. ARB/1/11), Award, 12 October 2005, para. 82; and *Emilio Agustin Maffezini v. Kingdom of Spain*, Decision on Jurisdiction, (ICSID Case No. ARB/97/7) 25 January 2000, para. 77.

²⁴⁹ Crawford, *supra* note 246, p. 42.

personality so as to give it an aura of independence, but in reality it is just a business house doing only the State's business for and on behalf of the State"²⁵⁰.

(B) *Sri Lanka's responsibility under Article 5*

357. Article 5 of the ILC Articles provides that

"[t]he conduct of a person or entity which is not an organ of the State under Article 4 but which is empowered by the law of that State to exercise elements of the governmental authority shall be considered an act of the State under international law, provided the person or entity is acting in that capacity in the particular instance".

358. According to Deutsche Bank, Sri Lanka is also responsible for the conduct of CPC under ILC Article 5.

359. On the one hand, Claimant recalls that the CPC Act empowers CPC to exercise public functions:

- It grants CPC the exclusive right to import, export, sell, supply or distribute petrol, kerosene, diesel oil or furnace oil, which fulfils the public purpose of allowing the Government of Sri Lanka to control petroleum prices (CPC Act, sect. 5 B). In this respect, Claimant points out that Sri Lanka imports over 87% of Sri Lanka's total crude oil and petroleum requirements. Moreover, CPC's expenditure on oil imports is the largest portion of Sri Lanka's total import spending, and at times, is equivalent to more than a quarter of Sri Lanka's export earnings. The fact that CPC no longer has a total monopoly is not determinative. This is merely one factor to be considered in the aggregate with all others;
- CPC is granted powers of compulsory acquisition of property (CPC Act, Part III);
- CPC is directly accountable to the Minister of Petroleum and must follow the Minister's written directions (CPC Act, sect. 7(1)).

360. On the other hand, according to Deutsche Bank, "governmental authority" does not have a prescriptive meaning but depends on "the way [the powers] are conferred on an entity, the purposes for which they are to be exercised and the extent to which the entity is accountable to Government for their exercise"²⁵¹. Claimant submits that in this case, the power to hedge was conferred on CPC directly from the Government by the Cabinet decision. The purposes for which the hedging powers were to be exercised were also governmental: not to generate money for CPC but to shield the public from high and fluctuating oil prices. Further Claimant argues that in the exercise of its hedging powers CPC was accountable to the Government to the fullest extent possible. First, under statute

²⁵⁰ *Dahanayake v. De Silva and others*, [1978] 1 SLR 41, 10 September 1979, paras. 53-54 [hereinafter "*Dahanayake v. De Silva*"].

²⁵¹ Crawford, *supra* note 246, p. 102.

CPC is accountable to the Minister of Petroleum in respect of all or any of its activities. Second, the record clearly shows that the Government supervised the implementation of the hedging program. Thus, all the facts indicate that CPC was primarily exercising governmental authority when carrying out the hedging program.

(C) *Sri Lanka's responsibility under Article 8*

361. Article 8 of the ILC Articles provides that

“[t]he conduct of a person or group of persons shall be considered an act of State under international law if the person or group of persons is in fact acting on the instructions of, or under the direction of or control of, that State in carrying out the conduct”.

362. According to Claimant, even if the Tribunal does not consider CPC to be an organ of the State for the purposes of ILC Articles 4 and 5, Sri Lanka is still responsible for the conduct of CPC in relation to the Hedging Agreement because at all times CPC was acting on its instructions and/or under its direction and control under ILC Article 8. As the words “instructions”, “direction” and “control” are to be read disjunctively, it is only necessary for Deutsche Bank to establish that one of these elements was present.

363. Deutsche Bank submits that the Hedging Agreement was the direct result of the State's instructions. Mr. de Mel testified at the hearing that the *“decision to enter into hedging arrangements based on the zero-cost collar mechanism was a decision of the Cabinet of Ministers based on the recommendations of the Central Bank and a specially appointed study group”*²⁵².

364. Claimant also submits that CPC entered into the Hedging Agreement under Sri Lanka's direction and control. Claimant refers to the Commentary to ILC Article 8, referring to the *Phillips Petroleum Company* case in which, to establish Iran's responsibility for the conduct of the National Iranian Oil Company (NIOC), the Tribunal quoted with approval a passage from *Oil Field of Texas* which stated that it was *“clear that NIOC is one of the instruments by which the Government of Iran conducted and currently conducts the country's national oil policy”*²⁵³. According to Claimant, CPC also meets these criteria. Its purpose is to conduct Sri Lanka's oil policy in the national interest²⁵⁴. The appointments of the members of its board are political appointments, made by the Government²⁵⁵. In Claimant's view, the State is therefore responsible for the conduct of CPC.

365. The ILC Article 8 Commentary also indicates that a State can be responsible for acts when “using its ownership, interest in or control of a corporation specifically in order to achieve

²⁵² Transcript Day 4, p. 166, lines 10 to 20.

²⁵³ Crawford, *supra* note 246, p. 112, referring to *Phillips Petroleum Co. Iran v. Islamic Republic of Iran*, (1989) 21 Iran- U.S.C.T.R., p. 79, n.173.

²⁵⁴ Transcript Day 4, p. 28, lines 15 to 16.

²⁵⁵ Witness Statement of Lalith Karunaratne, 5 July 2010, para. 16 [hereinafter “Karunaratne Witness Statement”].

a particular result”²⁵⁶. It refers to *Foremost Tehran, Inc. v. Islamic Republic of Iran*²⁵⁷ in which the Tribunal held that “[t]he two main indicators of Government control of a corporation are the identity of its shareholders and the composition and behavior of its board of directors”. According to Claimant, these two factors are present here.

366. Moreover, Claimant argues that CPC was established so that a Government control entity could ensure that Sri Lanka’s oil consumption was managed in the interest of the public. In line with this purpose, the Government exercised its control of CPC to achieve a particular result: to alleviate the burden on Sri Lanka’s foreign exchange and reduce the impact of oil price volatility on the macro-economy and vulnerable members of society. It was a directive from the Cabinet and the Minister that obliged CPC to start the hedging program²⁵⁸. Claimant submits that CPC did not have any choice as to whether or not to hedge²⁵⁹. According to Claimant, the State is therefore responsible for acts in relation to the negotiation and conclusion of the Hedging Agreement.

367. Deutsche Bank objects to Sri Lanka’s allegation that it cannot be responsible since there is no evidence that the Government directly instructed a representative of CPC to sign the particular Hedging Agreement. This is contrary to the Commentary to ILC Article 8 which provides that:

*“[s]uch conduct will be attributable to the State only if it directed or controlled the specific operation and the conduct complained of was an integral part of that operation. The principle does not extend to conduct which was only incidentally or peripherally associated with an operation and which escaped from the State’s direction or control”*²⁶⁰.

368. Claimant points out that the hedging program was the specific operation that Sri Lanka directed CPC to engage in. It was a Government decision that was not contemplated or desired by CPC²⁶¹. According to Claimant, the only way in which CPC could carry out this hedging program as instructed was by entering into hedging agreements, including the Hedging Agreement. The latter was therefore an integral part of the hedging operation and cannot sensibly be described as incidental or peripheral to it. Claimant recalls that Mr. de Mel testified at the hearing that no specific instruction to conclude the Hedging Agreement was required because of the Cabinet direction and the Central Bank instructed him to hedge and also as to which banks to use²⁶². Furthermore, Claimant submits that Sri Lanka continued to monitor the hedging program at all times. According to Claimant, the present situation is therefore totally different from those in the *Nicaragua* and *Bosnian Genocide*

²⁵⁶ Crawford, *supra* note 246, pp. 112-113.

²⁵⁷ *Foremost Tehran, Inc. v. Islamic Republic of Iran*, (1986) 10 Iran-U.S.C.T.R., p. 228.

²⁵⁸ Transcript Day 4, p. 164, line 17 to p. 165, line 16.

²⁵⁹ Karunaratne Witness Statement, *supra* note 255, para. 87.

²⁶⁰ Crawford, *supra* note 246, pp. 110-111.

²⁶¹ Transcript Day 4, p. 160, lines 14 to 19.

²⁶² Transcript Day 5, p. 45, line 25 to p. 46, line 5.

cases where there was no evidence of either general or specific instructions from the respondent in either case to commit massacres and where the respondents neither formally or explicitly initiate a program to massacre Bosnian Muslims or Nicaraguan citizens or continued to monitor and interfere with the operations.

(D) *CPC's actions are attributable to Sri Lanka even if they were ultra vires*

369. Deutsche Bank submits that under ILC Article 7, a State cannot avoid responsibility for the conduct of a State organ or an entity exercising governmental authority simply because that entity's "*actions or omissions ought not to have occurred or ought to have taken a different form*". As CPC was acting in its official capacity when it carried out the hedging program, Claimant submits that Sri Lanka is responsible for CPC's conduct under it even if it exceeded its authority or contravened instructions. The Commentary clarifies that conduct will be official if it is "*systematic or recurrent, such that the State knew or ought to have known of it and should have taken steps to prevent it*"²⁶³. Claimant argues that Sri Lanka was kept informed of the hedging program and Minister Fowzie was specifically informed of the conclusion of the Hedging Agreement²⁶⁴. Sri Lanka is therefore responsible for the latter.
370. According to Claimant, the conclusion is the same in relation to ILC Article 8. The Commentary provides that "[w]here a State has authorized an act ... questions can arise as to the State's responsibility for actions going beyond the scope of the authorization". It then provides that the State will not be responsible if the "unauthorized conduct was really incidental to the mission or clearly went beyond it"²⁶⁵. The mission authorized by Sri Lanka was to negotiate and conclude hedging agreements. This conduct was therefore by no means "really incidental" to the mission nor "clearly went beyond" it. Claimant concludes that Sri Lanka is therefore responsible for the Hedging Agreement negotiated and concluded pursuant to CPC's mission.

Sub-Section II. **The issue of attribution by application of the Umbrella Clause of the BIT: Is the Hedging Agreement an obligation of Sri Lanka? Is it so on the basis that the conclusion of the Hedging Agreement was a State action, therefore attributable to Sri Lanka?**

371. Article 8(2) of the Treaty provides that "[e]ach Contracting State shall observe any other obligation it has assumed with regard to investments in its territory by nationals or companies of the other Contracting State" (the "Umbrella clause").
372. According to Claimant, the key issue as regards the Umbrella clause is whether the Hedging Agreement is an obligation of Sri Lanka. The first question to be addressed in this

²⁶³ Crawford, *supra* note 246, p. 108.

²⁶⁴ Transcript Day 4, p. 44, lines 19 to 25.

²⁶⁵ Crawford, *supra* note 246, p. 110.

regard is whether this should be determined by reference to international law principles of attribution or by reference to domestic law.

373. Deutsche Bank submits that whether a State is considered a party to the Hedging Agreement is a question to be considered by reference to international law. Claimant argues that the claim is brought under the Treaty, an international law instrument, based upon the State having assumed an obligation. Deutsche Bank's counterparty under the Hedging Agreement was CPC. According to Claimant, the proper inquiries are therefore whether CPC is part of the State (ILC Article 4) or whether the conclusion of the Hedging Agreement should be considered State action (ILC Articles 5 and 8). In other words, can you attribute to Sri Lanka the entering into of obligations by CPC in respect of the Hedging Agreement? Deutsche Bank submits that this is a question of international law, even if it admits that the case law is mixed on this point.
374. Claimant concludes that for the reasons mentioned above²⁶⁶, CPC's conduct in relation to the Hedging Agreement is attributable to the State. It was part of the hedging program which was instigated, directed, monitored, controlled and later cancelled by the State. CPC entered into the Hedging Agreement to implement a policy dictated by Government in the national interest and the obligations undertaken are therefore to be treated as those of the State. If the Tribunal applies international law, Sri Lanka was a party to the Hedging Agreement.
375. Deutsche Bank submits that the same result is reached even if the Tribunal applied domestic law, *i.e.*, English law, the law governing the Contract. Under English law, according to Claimant, whether a State-owned entity acts as agent of the State is a factual enquiry to be undertaken on a case by case basis. Moreover, Claimant argues that an English court would consider Sri Lankan law to be relevant to its determination because CPC is a Sri Lankan entity, incorporated and governed in accordance with Sri Lankan law. This was the approach taken by the English courts in the matter of *Walker International v. République Populaire du Congo*²⁶⁷ which held that a State-owned oil company should not be considered as separate from the State for the purposes of enforcing a commercial debt. The Court considered evidence of Congolese law as to the status of the State entity.
376. Deutsche Bank further submits that the Sri Lankan cases have been consistent and unequivocal in equating CPC with the State and concluding that CPC enters into agreements on behalf of the State.
377. Finally, in relation to the case of *La Générale des Carrières et des Mines (Gécamines) v F.G. Hemisphere Associates LLC* [2012] UKPC 27 submitted by the Respondent in July 2012 (see paragraph 397 below), the Claimant noted that the decision was fully consistent with its previous submissions on the law and that the Privy Council confirmed that a separate legal entity may be considered part of the State in certain exceptional

²⁶⁶ *Id.*

²⁶⁷ *Walker International Holdings v. République Populaire du Congo*, [2005] EWHC 2813 (Comm) 12 June 2005 [hereinafter "*Walker v. Republic of Congo*"].

circumstances. The Claimant argued that the facts of the present case demonstrated that such exceptional circumstances exist and consequently that CPC's actions should be attributed to the Respondent.

SECTION II. RESPONDENT'S POSITION

Sub-Section I. The issue of attribution for a general conduct in relation to the hedging program

I. Is Sri Lanka responsible for actions of the Cabinet, the Ministry of Petroleum, the Central Bank and the Supreme Court?

378. Claimant points out that Sri Lanka does not dispute that the Cabinet of Ministers, the Ministry of Petroleum, the Central Bank and the Supreme Court are organs of the State under ILC Article 4.

II. Is Sri Lanka responsible for actions of CPC? Are Articles 4(1) and (2) of the ILC Articles satisfied on the facts? Or alternatively, ILC Article 5 or Article 8?

(A) *Sri Lanka's responsibility under ILC Article 4*

379. Sri Lanka submits that CPC cannot be regarded as an "organ" of Sri Lanka for the purposes of ILC Article 4. It is a separate entity, having separate legal personality. State control of other of its activities, or support in particular areas does not affect that conclusion.

380. Sri Lanka refers in particular to the text of ILC Article 4(2) which provides that an entity must be considered an organ where it has that status in accordance with the internal law of the State. Respondent submits that the definition of organs as a matter of domestic law is generally contained in the Constitution or other high-ranking organic laws. CPC, established as a separate entity under its governing statute, does not have that status in Respondent's view.

381. According to Respondent, Claimant relies on the *Bosnian Genocide* case. In answer to the question of whether the acts of genocide were carried out by persons or entities having the status of organs of the Federal Republic of Yugoslavia under its internal law, the Court concluded that there was nothing which could justify an alternative response²⁶⁸. Its reference to the criterion of "*complete dependence on the State of which [it is] ultimately merely the instrument*"²⁶⁹, was in relation to the separate question of whether the conduct of persons and entities, although not having the legal status of State organs, was nevertheless attributable on the basis that they were to be regarded as *de facto* organs

²⁶⁸ *Bosnia and Herzegovina v. Serbia and Montenegro*, *supra* note 244, paras. 386 and 387.

²⁶⁹ *Id.* para. 392.

acting on behalf of the State. According to Sri Lanka, CPC did not constitute a *de facto* organ in the sense envisaged by the Court in *Bosnian Genocide*.

382. Moreover, according to Sri Lanka, Deutsche Bank’s reliance on domestic Sri Lankan cases does not assist it. Respondent argues that the fact that an entity may be assimilated to an organ of the State for certain limited purposes, including the application of fundamental rights guarantees and other quasi constitutional provisions, for instance in relation to eligibility for elections, does not render the entity an “organ” for all purposes, including for the purposes of international law.

(B) Sri Lanka’s responsibility under ILC Article 5

383. Sri Lanka disputes Claimant’s allegation that in entering into the Hedging Agreement, CPC was exercising elements of governmental authority for the purposes of ILC Article 5. The fact that CPC embarked upon hedging as a result of the encouragement of the Central Bank and on the basis of the Cabinet Direction does not mean that everything it did thereafter constitutes action “*in the exercise of governmental authority*”. Respondent argues that the act of entering into the Hedging Agreement can on no view be regarded as such. It is conduct which any private individual or (subject to questions of capacity) corporation is in theory able to perform and implicates no questions of sovereign Government authority. Respondent points out in this respect that no question of sovereign immunity of CPC was raised as a bar to the exercise of jurisdiction by the English Commercial Court in *SCB v. CPC*.

384. Sri Lanka further submits that Deutsche Bank’s interpretation of the Commentary to ILC Article 5 is erroneous. Moreover, Respondent argues that it is wrong to suggest that the power to hedge was conferred on CPC directly from the Government by the Cabinet decision. If CPC had capacity at all to enter into the Hedging Agreement, which is disputed by Respondent, its capacity derived from statute and could not have been widened by a mere decision of the Executive. Deutsche Bank does not in fact assert otherwise, in so far as it relies solely on the terms of the CPC Act in arguing that CPC had capacity.

385. Finally, Sri Lanka disputes Claimant’s suggestion that attribution on the basis of Article 5 constitutes attribution of conduct of an organ. ILC Article 5 expressly applies only to conduct of a person or entity “*which is not an organ of the State under Article 4*”.

(C) Sri Lanka’s responsibility under ILC Article 8

386. Deutsche Bank’s argument that the conduct of CPC in entering into the Hedging Agreement is attributable to Sri Lanka on the basis of ILC Article 8 since it was allegedly acting on the instructions, or under the direction and control of Sri Lanka in doing so, is equally flawed.

387. Respondent points to Claimant’s reliance on the fact that the very choice of instrument, with a low floor price achieved by using the Seagull and TPF features, was chosen in order to lower the floor price. That shows that CPC was not acting in accordance with the

instructions of the Cabinet in entering into the Hedging Agreement. The approach mandated by the Cabinet Study Group was that use should be made of a zero cost collar, with CPC determining “*the upper bound based on market developments*”²⁷⁰, rather than it seeking to drive the floor price down in order to ensure that it received payment.

388. Respondent argues that in any case, the extent of the Directions or instructions from the Central Bank and the Cabinet to CPC was in general terms, to enter into hedging agreements. According to Respondent, there was no direction to enter into complex transactions, with limited potential gains of the type constituted by the Hedging Agreement. Further, Respondent submits that Mr. de Mel’s evidence was clear that he was not acting under the direction or control or instructions of either the Central Bank or the Minister in entering into the Hedging Agreement. He did not inform either of them of its specific terms in advance. Further, he was adamant that he received no instruction to enter into it.
389. Respondent further argues that in order for a specific conduct to be attributable as a matter of international law, it has to be carried out under the “*effective control*” of the State, as evidenced in the decision of the International Court of Justice in *Bosnian Genocide*. Deutsche Bank’s reliance on the Commentary of ILC Article 8 and its reference to use of ownership and control of a corporation “*to achieve a particular result*” is of no assistance given the terms of the Cabinet Study Group Report and the Cabinet Direction. Similarly, Deutsche Bank’s argument that Sri Lanka exercised control over CPC in order to achieve a particular purpose, “*to alleviate the burden on Sri Lanka’s foreign exchange*” is equally flawed. A general direction of this type is insufficient and the evidence is inconsistent with any such specific “*effective*” control by Sri Lanka over CPC in it entering into any of the transactions, including the Hedging Agreement.
390. Respondent also disputes Claimant’s interpretation of the Commentary to ILC Article 8 making reference to two decisions of the *Iran-US Claims* Tribunal and in particular, the *Phillips Petroleum Company* case, as an authority for the proposition that the conduct of Government-controlled entity is attributable to the State under ILC Article 8. The Commentary states that the fact that the State establishes a corporate entity is not a sufficient basis for the attribution to the State of the subsequent conduct of that entity. Since corporate entities are considered to be separate, *prima facie* their conduct in carrying out their activities is not attributable to the State unless they are exercising elements of governmental authority within the meaning of ILC Article 5. It is only when there is evidence that “*the State was using its ownership interest in or control of a corporation specifically in order to achieve a particular result*”, that “*the conduct in question has been attributed to the State*”²⁷¹. According to Sri Lanka, the Commentary negatives the proposition that the mere existence of a board of directors appointed by the Ministry makes all the acts of the company attributable to the State.

²⁷⁰ Core 2/49, p. 6.

²⁷¹ Crawford, *supra* note 246, p. 6.

391. Finally, Respondent submits that Deutsche Bank confuses the general hedging program and the Hedging Agreement itself. According to Respondent, there was no instruction given and no direction or control exercised by any Sri Lankan authority over the entering into the latter. In this respect, Claimant's reliance on a passage from the Commentary to ILC Article 8 which refers to the fact that conduct may be attributable if the "*State directed or controlled the specific operation and the conduct complained of was an integral part of that operation*" is misplaced. The specific operation was not the hedging program that Sri Lanka directed CPC to engage in. It was the conclusion of the Hedging Agreement itself.
392. Sri Lanka therefore concludes that it is not responsible for the actions of CPC, either on the basis of ILC Article 4, 5 or 8.

Sub-Section II. **The issue of attribution by application of the Umbrella Clause of the BIT: Is the Hedging Agreement an obligation of Sri Lanka? Is it so on the basis that the conclusion of the Hedging Agreement was a State action, therefore attributable to Sri Lanka?**

393. For Sri Lanka, the answer to the preliminary question as to whether international law or domestic law governs whether Sri Lanka is to be regarded as a party to the Hedging Agreement, is that domestic law is the relevant law to determine this issue.
394. According to Respondent, English law governs the circumstances in which the State is to be regarded as a party to the Hedging Agreement. The circumstances in which English law is prepared to pierce the corporate veil of a State corporation are limited and do not on any view encompass the circumstances of the present case.
395. Respondent argues that in any event, even if Sri Lankan law were in some way relevant, whether or not the Sri Lankan courts have regarded CPC as part of the State for the specific purposes of the Fundamental Rights jurisdiction²⁷² or other quasi constitutional purposes relating to disqualification from standing in elections²⁷³, had no bearing on whether the State was to be regarded as party to a contract entered into by CPC. Quite clearly in Respondent's view, this was not the case and Deutsche Bank has been unable to point to any case in which the State has been held to be liable for contractual obligations undertaken by CPC or any equivalent State entity.
396. According to Respondent, Deutsche Bank's reliance on *Walker v. Republic of Congo*²⁷⁴ is misplaced. It was not a case concerning whether the State was to be regarded as being a party to the contract. Respondent argues that it was concerned with the question as to whether it was possible to pierce the corporate veil in order to enforce the judgement debt resulting from a judgement obtained against a State-owned entity against other assets of

²⁷² *Wickrematunga v. Anurudda Ratwatte and Ors*, [1998] 1 SLR 201, 7 November 1997.

²⁷³ *Dahanayake v. De Silva*, *supra* note 250 (1978).

²⁷⁴ *Walker v. Republic of Congo*, *supra* note 267 (2005).

the State. Respondent submits that that situation is very different from that at issue in the present case.

397. On 22 July 2012, the Respondent drew the attention of the Tribunal to the decision of the Judicial Committee of the Privy Council, on appeal from the Court of Appeal of Jersey, in *La Générale des Carrières et des Mines (Gécamines) v F.G. Hemisphere Associates LLC* [2012] UKPC 27, delivered on 17 July 2012. In additional submissions provided on 27 July 2012, the Respondent submitted that this decision was directly relevant to the present case as it clarified the English law on the assimilation of the state-owned corporation to the State. In particular, the exceptional circumstances required to override the presumption created by the formation of a separate legal entity were emphasised. The Respondent submitted that the factual circumstances broadly paralleled the present case and therefore the Tribunal should find that CPC cannot be assimilated to the Respondent.
398. Finally, Respondent insists on the fact that Deutsche Bank did not at any point regard Sri Lanka as being a party to the Hedging Agreement. Moreover, during the course of the restructuring negotiations, it expressly raised the possibility of the introduction of a Government guarantee of CPC's obligations. The fact that it did so unequivocally demonstrates in Respondent's view that it did not believe that Sri Lanka had any obligations under the Hedging Agreement itself.
399. With respect to international law, Respondent submits that contrary to what Deutsche Bank suggests, the question is not one of State responsibility for a particular transaction but rather whether the conduct of CPC in entering into the Hedging Agreement can be attributed to Sri Lanka. Respondent disputes the allegation that the international law rules of attribution (which are concerned only with whether conduct is to be attributed to the State for the purposes of determining its international responsibility for wrongful acts) should govern this question.
400. Even assuming that the international law rules of attribution of internationally wrongful conduct (which does not normally include the mere conclusion of a contract) were applicable, Sri Lanka refers to its previous developments on ILC Articles 4, 5 and 8 to conclude that there cannot be any responsibility of Respondent on the basis of either ILC Article 4, 5 or 8, for the reasons explained above.

SECTION III. THE TRIBUNAL'S ANALYSIS AND DECISION

401. There are two separate issues to be determined here:
- a) whether the Cabinet of Ministers, the Ministry of Petroleum, the Central Bank and the Supreme Court are organs of the State under Article 4 of the ILC Articles and
 - b) whether CPC is an organ of the State under Article 4 or, alternatively, can its conduct be attributed to the State under Articles 5 or 8 of the ILC Articles.
402. The first issue is the most straight-forward. Both parties agree that the Cabinet of Ministers, the Ministry of Petroleum (including Minister Fowzie), the Central Bank

(including its Governor) and the Supreme Court are organs of the State under ILC Article 4. The Tribunal agrees with this position and therefore that the actions of these bodies/persons are attributable to Sri Lanka. This is important as, as will be seen below, the violations of the Treaty asserted by Deutsche Bank are based principally upon the actions of the Supreme Court and the Central Bank.

403. However, Deutsche Bank also asserts that the actions of CPC violated the Treaty, which is only possible if those actions are attributable to Sri Lanka, being the party with international obligations under the Treaty. In relation to the breaches of Articles 2 and 4 of the Treaty (Fair and Equitable Treatment, Expropriation and Full Protection and Security), this claim is secondary to the conduct of the bodies mentioned in the previous paragraph. However, in relation to alleged violations of Article 8 of the Treaty (the Umbrella clause), the attribution of CPC's actions is a crucial element.
404. As explained further below, because the Tribunal is satisfied that the actions of the Supreme Court and the Central Bank of Sri Lanka establish violations of the Treaty under Articles 2 (fair and equitable treatment) and 4(2) (expropriation) of the Treaty, it is unnecessary for this Tribunal to further decide whether Article 8 was also breached. As such, the primary rationale for deciding whether CPC's actions are attributable to Sri Lanka under either English law (as argued by the Respondent) or under ILC Articles 4, 5 or 8 also slips away.
405. The Tribunal nonetheless makes the following observations on the matter:
- a) The Tribunal finds it compelling that the Supreme Court of Sri Lanka considered CPC to be “*a Government creation clothed with juristic personality so as to give it an aura of independence*” with “*deep and pervasive State control*”²⁷⁵, such that that its business is mainly, if not wholly, controlled by the State. Sri Lanka's suggestion that this finding of the Supreme Court was only relevant to those narrow situations involving “*fundamental rights*” was unconvincing. While it may be unusual for a state enterprise to be considered an organ of the State, this is only the case where the state enterprise is genuinely independent – the fact that it takes the form of a separate legal entity is not decisive.
 - b) State control of CPC is evident. CPC is of course a 100% State-owned entity and it benefits from the protection of immunity from suit. The Minister of Petroleum appoints its directors and may remove them²⁷⁶. CPC has been established by a statute for the purpose of conducting Sri Lanka's oil policy in the national interest²⁷⁷. There is considerable evidence as to the significant control exercised by the Government over CPC's personnel, finances and decision making. In

²⁷⁵ *Dahanayake v. De Silva*, *supra* note 250, paras. 53-54.

²⁷⁶ Core 1/1, CPC Act, ss. 17. 8(4); Karunaratne Witness Statement, *supra* note 255, para. 16, who refers to “political” appointments.

²⁷⁷ Transcript Day 4, p. 28, lines 15-16; CPC Act, s. 66; and Exhibit C-41.

particular, CPC is required to follow any written directions of the Minister of Petroleum²⁷⁸, regardless of whether those directions are in the best interests of CPC.

- c) The Tribunal has also been presented with considerable evidence demonstrating that CPC acted under the direct instruction of Sri Lanka both in (i) negotiating and executing the Hedging Agreement as part of the overall hedging program; and (ii) in refusing to pay the amounts owing following termination of the Hedging Agreement as a direct result of orders CPC received from the Supreme Court and the Central Bank.
- d) A directive from the Cabinet and the Minister obliged CPC to start the hedging program. CPC had to hedge. It did not have any choice. This was confirmed both by Mr. de Mel and Mr. Karunaratne²⁷⁹.
- e) The Tribunal does not consider that the case of *La Générale des Carrières et des Mines v FG Hemisphere Associates LLC* [2012] UKPC 27 on which the parties submitted additional submissions alters any of the above analysis. This was of course a case decided under Jersey law, although it discussed the English law position on attribution. Given that this Tribunal has not found it necessary to make any final determination on attribution in relation to CPC, there is also no need for the Tribunal to come to a firm conclusion as to whether the issue is governed by international law or English law. If English law were to apply, the principles of law set out in the *Gécamines* case are entirely consistent with the approach of the Tribunal above. As stated in *Gécamines*, while separate legal personality is a strong indicator of an entity which is not an organ of the State, there are exceptions. In particular, this is so where the entity has no effective independent existence or where the conduct of the State justifies lifting the corporate veil. Whether either of these exceptions applies is entirely fact-specific and the facts in the *Gécamines* case were obviously different to those before this Tribunal. While there are some similarities on the facts (for example, the ability of the Government to veto certain decisions of the company in each case), the Tribunal considers that the indicators of a lack of true independence in the present case are much stronger than those set out in the *Gécamines* decision. The case therefore does not alter the observations of the Tribunal in this section in relation to CPC's lack of independence from the Respondent.
- f) The above points suggest that CPC's actions would be attributable to the State, either because CPC is an organ of the State under ILC Article 4 or because CPC

²⁷⁸ CPC Act, s. 7(1).

²⁷⁹ Transcript Day 4, p. 166, lines 10 to 20; Transcript Day 5, p. 15, lines 11 to 15, Day 4, p. 165, lines 13 and 14; and Core 5/240; Transcript Day 5, p. 46, lines 4 and 5; Transcript Day 5, p. 8, lines 2 to 9; Transcript Day 4, p. 167, lines 2 to 5; Karunaratne Witness Statement, *supra* note 255, para. 87; Transcript Day 4, p. 164, line 4 to p. 165, line 16.

lacked separate legal existence, and/or acted under the instruction of the State. It is unlikely, however, that CPC's actions would be attributable to Sri Lanka under ILC Article 5 as the specific wrongdoing in the present case (failure to pay the amounts owing under the Hedging Agreement) could not be considered an act of government or sovereign authority.

406. Nonetheless, as noted above, it is unnecessary for the Tribunal to come to any firm conclusions on this matter, as it does not affect the Tribunal's findings on the violations of Articles 2 and 4 of the Treaty, nor does it have any effect on the quantum of the damages claimed by Deutsche Bank.
407. Finally, the Arbitral Tribunal has decided above that Sri Lanka's actions were within its powers and were not *ultra vires*²⁸⁰. There is therefore no issue in this respect. In any case, the Tribunal notes that according to the ILC's commentary²⁸¹, "*where persons or groups have committed acts under the effective control of a State the condition for attribution will still be met even if particular instructions may have been ignored. The conduct will have been committed under the control of the State and it will be attributable to the State in accordance with Article 8*".

²⁸⁰ See para. 347.

²⁸¹ Crawford, *supra* note 246, p 113.

CHAPTER VII. THE MERITS

408. According to Deutsche Bank, Sri Lanka breached Article 2(1), last sentence, Article 4(1) and (2), and Article 8 of the Treaty. This is disputed by Respondent.

SECTION I. FAIR AND EQUITABLE TREATMENT

Sub-Section I. The Standard

I. Claimant's position

409. According to Claimant, Article 2(1) of the Treaty, which provides that “[*Each Contracting State*] shall in any case accord such investments fair and equitable treatment” establishes an autonomous standard of fair and equitable treatment. Claimant argues that it is implausible as a matter of textual interpretation that the Contracting States to a bilateral investment treaty would use the term “*fair and equitable treatment*” where they sought to incorporate the well-known concept of “*minimum standard of treatment in customary international law*”. Unlike other treaties, Article 2(1) of the BIT does not make reference to the customary international law standard.
410. Claimant submits that “*fair and equitable treatment*” has to be interpreted in accordance with Article 31(1) of the Vienna Convention on the Law of Treaties according to which a treaty shall be interpreted in good faith in light of the ordinary meaning of its terms in their context and in light of its object and purpose. Claimant refers to the Oxford Dictionary which defines “*fair*” as “*just, unbiased, equitable, impartial, legitimate*”. The word “*equitable*” means “*characterized by equity or fairness*”. “*Equity*” is defined as fairness, impartiality, even-handed dealing. If one has to interpret the terms in their context and in light of the object and purpose of the Treaty, the Tribunal should also look to the preamble of the German-Sri Lanka BIT recording the intention “*to create favourable conditions for investments*” and “*recognizing that the encouragement and contractual protection of such investments are apt to stimulate private business initiative and to increase the prosperity of both nations*”.
411. Deutsche Bank also submits that a breach of the obligation to provide fair and equitable treatment “*cannot be reached in the abstract; it must depend on the facts of the particular case*”²⁸². It further submits that there can be a violation of the standard even where no *mala fides* is involved, and Claimant approves the definition of the standard in *Waste Management II* (also relied upon by Sri Lanka) prohibiting conduct which is:

“arbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory and exposes the claimant to sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial propriety – as might be the case with

²⁸² *Saluka Investments B.V. v. Czech Republic* (UNCITRAL) 17 March 2006, Partial Award, paras. 303-309 [hereinafter “*Saluka v. Czech Republic*”].

*a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candor in an administrative process. In applying the standard, it is relevant that the treatment is in breach of representations made by the Host State which were reasonably relied on by the claimant*²⁸³.

412. Claimant however submits that the list of proscribed treatment is not exhaustive, for example, it is also established that fair and equitable treatment requires that a State's action in relation to the investor shall be proportionate²⁸⁴.
413. Claimant also disputes Respondent's suggestion that the principle of natural justice does not form part of the standard. In Claimant's view, this is contrary to well established authority. The *Waste Management II* decision itself referred to lack of transparency and candor in the administrative process, and many tribunals have found a breach of due process to violate the FET standard. Claimant argues that due process and the right to be heard have been expressly included in the FET standard in various decisions, including *Saluka v. Czech Republic*²⁸⁵, *Metalclad v. Mexico*²⁸⁶, *Tecmed v. Mexico*²⁸⁷, *International Thunderbird v. Mexico*²⁸⁸ and *Rumeli Telekom v. Kazakhstan*²⁸⁹.

II. Respondent's position

414. According to Respondent, the interpretation of the fair and equitable treatment standard must be resolved primarily on the basis of the ordinary meaning of the terms and by reference to the content of that standard recognized in customary international law.
415. Respondent submits that the threshold for procedural violations of fair and equitable treatment is high. It needs to rise to the level of a "*manifest injustice*" that offends "*judicial*

²⁸³ *Waste Management, Inc. v. United Mexican States*, (ICSID Case No. ARB(AF)/00/3), Award, 30 April 2004, para. 98 [hereinafter "*Waste Management II*"].

²⁸⁴ *EDF (Services) Ltd. v. Romania* (ICSID Case No. ARB/05/13), Award, 8 October 2009, para. 293.

²⁸⁵ *Saluka v. Czech Republic*, *supra* note 282, paras. 303-309 (2006); *Metalclad v. Mexico*, *supra* note 135 (2000).

²⁸⁶ *Metalclad v. Mexico*, *supra* note 135, para. 222 (2000).

²⁸⁷ *Tecnicas Medioambientales Tecmed S.A. v. United Mexican States* (ICSID Case No. ARB(AF)/00/2), Award, 29 May 2003, paras. 161-162 [hereinafter "*Tecmed v. Mexico*"].

²⁸⁸ *International Thunderbird Gaming Corp. v. United Mexican States*, UNCITRAL, Award, 26 January 2006, para. 200 [hereinafter "*Thunderbird v. Mexico*"].

²⁸⁹ *Rumeli Telekom A.S. and Telsim Mobil Telekomunikasyon Hizmetleri v. Republic of Kazakhstan* (ICSID Case No. ARB/05/16), Award, 29 July 2008, para. 618.

propriety”²⁹⁰. In Respondent’s view, it requires “*shock or surprise*” to an impartial tribunal²⁹¹, “*gross denial of justice*” and “*manifest arbitrariness*”²⁹².

416. According to Respondent, the aim of the fair and equitable treatment standard is to ensure the rule of law in the relations between investors and the State in which they invest²⁹³. It allows the Government a wide degree of latitude when it exercises its police powers in the public interest. Respondent argues that the clause does not subject the range of regulatory policies to an exacting proportionality test, nor does it create an international system of judicial review of administrative action. The obligation of fair and equitable treatment is in Respondent’s view not breached where regulatory measures serve a legitimate purpose and are based on legal standards, rather than prejudice or personal preference. Even if, hypothetically, legislation were objectively imperfect, this does not violate fair and equitable treatment. *A fortiori*, imperfect implementation of existing regulation is no breach of the international standard.

III. The Tribunal’s analysis and decision

417. The fair and equitable treatment standard finds different expressions in different treaties. Some treaties, such as the German-Sri Lanka BIT, simply refer to “fair and equitable treatment”. Others include express language treating this standard as an element of the general rules of international law, or this standard alongside the rules of international law.
418. Given the wording of Article 2(2) of the BIT here, the Arbitral Tribunal concludes that the contracting parties ought to be taken to have intended the adoption of an autonomous standard, on the basis, as stated by Christoph Schreuer, that:

*“it is inherently implausible that a treaty would use an expression such as “fair and equitable treatment” to denote a well-known concept such as the “minimum standard of treatment in customary international law”. If the parties to a treaty want to refer to customary international law, it must be presumed that they will refer to it as such rather than using a different expression”*²⁹⁴.

419. On the other hand, the Arbitral Tribunal recognizes that the actual content of the Treaty standard of fair and equitable treatment is not materially different from the content of the

²⁹⁰ *Loewen Group, Inc and Raymond Loewen v. United States of America* (ICSID Case No. ARB(AF)/98/3), Award, 26 June 2003.

²⁹¹ *Mondev International Ltd. v United States* (ICSID Case No. ARB(AF)/99/2), Award, 11 October 2002, 6 ICSID Rep 192 (2004).

²⁹² *Thunderbird v. Mexico*, *supra* note 288, para. 194.

²⁹³ *Elettronica Sicula S.p.A (ELSI), United States v. Italy*, ICJ, Rep. 15, at paras. 101 and 128.

²⁹⁴ C. Schreuer, “Fair and Equitable Treatment in Arbitral Practice”, 6 J. World Investment and Trade 357 (2005), p. 360.

minimum standard of treatment in customary international law, as recognised by numerous arbitral tribunals and commentators²⁹⁵.

420. In this respect, the Tribunal notes that the standard has been rightly – although not exhaustively – defined in the *Waste Management II* case, quoted above²⁹⁶. Accordingly, its components may be distilled as follows:

- protection of legitimate and reasonable expectations which have been relied upon by the investor to make the investment;
- good faith conduct although bad faith on the part of the State is not required for its violation;
- conduct that is transparent, consistent and not discriminatory, that is, not based on unjustifiable distinctions or arbitrary;
- conduct that does not offend judicial propriety, that complies with due process and the right to be heard,

421. It is on the basis of these principles, and taking into consideration all the circumstances of the dispute, that the Arbitral Tribunal must determine whether the conduct of Sri Lanka was consistent with its obligation to ensure fair and equitable treatment of Deutsche Bank’s investment.

Sub-Section II. **Application of the Standard**

I. Claimant’s position

(A) *The violations alleged by Claimant*

422. Claimant invokes various violations of the FET standard by the Supreme Court and the Central Bank.

423. Claimant submits that although from July 2006 Sri Lanka actively encouraged investors such as Deutsche Bank to enter into the market and carry out derivatives trades with Sri Lankan State entities, especially as CPC, once oil prices dropped sharply in November 2008, the Central Bank and the Supreme Court intervened to make it impossible for Deutsche Bank (and other banks) to recover from CPC the moneys owed to it under the Hedging Agreement.

²⁹⁵ E.g., *Saluka v. Czech Republic*, *supra* note 282, para. 291; *Azurix Corp. v. Argentine Republic* (ICSID Case No. ARB/01/12), Award, 14 July 2006, para 361 [hereinafter “*Azurix v. Argentina*”]; *CMS Gas Transmission Company v. Argentine Republic* (ICSID Case No. ARB/01/8), Award, 12 May 2005, 44 ILM 1205 (2005), paras. 282-284 [hereinafter “*CMS v. Argentina*”]; *Occidental v. Ecuador* (UNCITRAL), LCIA Case No. UN3467, Award, 1 July 2004, para 190.

²⁹⁶ *Waste Management II*, *supra* note 283 (2004).

424. Against the backdrop of threatened criminal and regulatory investigations, the Supreme Court issued its first Interim Order in the fundamental rights proceeding on 28 November 2008, suspending all payments to the banks under the hedging transactions.
425. Claimant recalls that on 16 December 2008, the Central Bank sent its Order to Deutsche Bank directing that all payments owed by CPC under the Hedging Agreement were to be suspended and characterized the oil hedging transactions as “*materially affected*” and “*substantially tainted*”. Again, on 6 January 2009, the Central Bank produced an Investigation Report repeating similar allegations. Claimant further points out that the Supreme Court’s Interim Order was lifted on 27 January 2009 but that same day the Central Bank issued a press release confirming that its 16 December Order prohibiting payment remained in full force and effect. According to Claimant, the effect of the above was that payments could not be made under the transactions to any of the banks, even if CPC had wished to make them.
426. Claimant further states that the Central Bank had also continued to make highly critical public statements regarding Deutsche Bank which were unfounded and injurious to the bank’s reputation, for example the Central Bank’s press release dated 27 January 2009 stating that the various hedging transactions entered into between CPC and a number of banks were “*materially affected and substantially tainted*”.
427. In addition, according to Claimant, since the conduct of CPC is attributable to Sri Lanka, the failure of CPC to make payment of USD 60,368,993 following Deutsche Bank’s termination of the Hedging Agreement constitutes a further violation of Sri Lanka’s obligation to afford fair and equitable treatment to Deutsche Bank’s investments.
428. Claimant submits that in and of themselves, the above events are grossly unfair, inequitable and contrary to Deutsche Bank’s legitimate expectations that hedging transactions were supported by Sri Lanka and would be respected.

(B) *The Supreme Court proceedings*

429. As mentioned above, Claimant submits that the Supreme Court proceedings and the Supreme Court’s Interim Order of 28 November 2008 breached the FET Standard on various grounds. This is disputed by Sri Lanka. According to Respondent, the Supreme Court’s Order did not breach the FET standard on the basis that the petitioners challenged the *vires* of the transaction which is credible in light of the *Citibank* award²⁹⁷, and that the Order was only interim and was not made against Deutsche Bank. Claimant contends that both arguments are incorrect.
430. In the first place, a lack of *vires* was not the basis of the Supreme Court’s decision which was as follows:

²⁹⁷ *Citibank N.A. v. Ceylon Petroleum Corporation*, *supra* note 183.

*“[t]he Petitioners have established a strong prima facie case that these transactions have not been entered into lawfully: that they are not “arms-length transactions”; that they are heavily weighted in favor of the Banks; that they are to the detriment of [CPC] and through that to the people of Sri Lanka; that they amount to an abuse of statutory authority which denies the people the equal protection of law”*²⁹⁸.

431. According to Claimant, it is also incorrect to rewrite the Supreme Court’s Order as consistent with the reasoning of the *Citibank* award. Claimant argues that the issues which the *Citibank* Tribunal found determinative, the question of speculation v. hedging and the ambit of a proper risk management policy, were not even placed before the Court. The Supreme Court’s reasoning was essentially that the transactions were unfair or inequitable bargains and not that CPC had exceeded its capacity by engaging in speculative activity.
432. Moreover, the fact that the Supreme Court’s Order was interim is irrelevant in Claimant’s view as the Order prevented the performance of contractual obligations by Deutsche Bank’s counterparty. Even if it was discharged two months later, when the Monetary Board of the Central Bank had issued its own Stop-Payment Order preventing performance of the Hedging Agreement, the Order was not subject to any time limit when issued. Furthermore, the Supreme Court made its Order less than 48 hours after the filing of the petition, based on what appears to have been extremely limited evidence, and without hearing from the banks whose contractual rights were directly affected by the Order.
433. Claimant argues that the practical effect of the Supreme Court’s Order was to leave Deutsche Bank with no alternative but to terminate the Hedging Agreement. The Order prevented payments by CPC but did not excuse Deutsche Bank from its obligation to make payments should oil prices rise. In Claimant’s view, Deutsche Bank was therefore left with a unilateral risk. In addition, Claimant submits that further downward movement in prices would have increased Deutsche Bank’s credit exposure to CPC. Consequently, it had no option but to exercise its right to terminate based on CPC’s breach of contract – by failing to sign and return the ISDA Master Agreement within 90 days – and to crystallize or fix the payments due by CPC under the Hedging Agreement. Claimant submits that this is confirmed by the terms of the letter of termination of 3 December 2008²⁹⁹ and Deutsche Bank’s letter to the President of CPC dated 23 December 2008³⁰⁰.
434. Finally, Claimant also refers to the subsequent public statements of Chief Justice Silva who presided (on a bench of three) over the hearing which in Claimant’s view strongly suggest that the decision was politically motivated. He stated that *“the Government was forced to comply with the hedging agreements. We said we will stop that on a judicial order, just pass on the benefit to the people. The Government said you stop the hedging*

²⁹⁸ Core 5/238, p. 5.

²⁹⁹ Core 5/246.

³⁰⁰ Core 4/273, p. 2.

agreements but we won't pass on the benefit"³⁰¹. Furthermore, referring to the international arbitration proceedings against Sri Lanka and CPC, the Chief Justice commented "[t]here are huge claims and I can't imagine how we are going to meet them. Internationally, we have no defense. This is a difficult fight. But within the country, we would have had a case because there were elements of fraud and corruption"³⁰². Claimant notes in this respect that there had not been any evidence of any fraud nor has Sri Lanka made any such allegation in this proceeding.

(C) ***The Central Bank's investigation and Stop-Payment Order of 16 December 2008***

435. According to Claimant, the investigation conducted by the Central Bank is a clear example of the breach of the fair and equitable treatment standard. Claimant argues that the investigation was flawed both procedurally and substantively.

1) *The investigation was improperly motivated and in bad faith*

436. Claimant submits that at the time of the investigation, the Central Bank and Governor Cabraal were forced to defend their role in relation to the hedging program amid substantial public criticism³⁰³. They openly used the investigation of the banks to deflect such criticism. By placing the blame on the banks and excluding further payment by CPC, the Central Bank and its Governor managed to exculpate themselves and have largely avoided further public criticism.

437. Claimant points out that the Central Bank has offered two alleged motivations for its investigation: 1) foreign exchange concerns because of the substantial payment CPC was required to make in US dollars; and 2) alleged surprise that CPC was required to make large payments following a decline in world oil prices³⁰⁴. According to Claimant, neither motivation is credible.

438. Claimant argues that as to the first, CPC's burden on Sri Lanka's foreign exchange was in fact substantially reduced as a result of the fall in oil prices since the majority of CPC's requirements were unhedged. Mr. de Mel confirmed that CPC's monthly saving was over USD 200 million and that "*the foreign exchange outflow from Sri Lanka was reduced by that amount*"³⁰⁵. As to the second point, the Central Bank was well aware that in the event of a fall in oil prices, CPC would be required to make payment, and this was the cost of hedging.

³⁰¹ Core 7/313, p. 2.

³⁰² *Id.*

³⁰³ Core 6/251.

³⁰⁴ Witness Statement of Ranee Jayamaha, 31 March 2010, para. 45; First Witness Statement of Nanayakkara Wasanwakwella Gamage Raja Dhammika Nanayakkara, 31 March 2010, para. 25 ["Nanayakkara First Witness Statement"].

³⁰⁵ Transcript Day 5, p. 10, lines 15 to 17.

439. Furthermore, Claimant recalls that Governor Cabraal directed Mr. Karunaratne “*to hold the outstanding payments to banks for a while*” in a telephone call on Friday 7 November 2008, a week before the investigation into the banks had even commenced³⁰⁶. Claimant submits that Sri Lanka has offered no explanation for the omission of this highly relevant fact from Mr. Karunaratne’s witness statement³⁰⁷. According to Claimant, Deutsche Bank only became aware of it because it was included in Mr. Karunaratne’s evidence in the SCB claim. Acting on this instruction, Mr. Karunaratne did not make the payment to Citibank which was due that day. On Monday 10 November 2008, following media reports of a “default” by CPC over the weekend, the Governor had a change of mind and instructed CPC to make payment and to follow this up with a press conference which CPC duly did³⁰⁸.
440. Respondent’s submission that only a payment to Citibank was in fact delayed misses the point in Claimant’s view. The instruction was a general one preventing payments to all of the banks. Claimant submits that moreover, in any event, what is significant is that the Governor was making a direction to CPC and before any investigation was commenced. The instruction was given and followed without question which is clear evidence that CPC is not independent of the State.
441. According to Claimant, having been forced by media pressure to reverse his instruction of non-payment to the banks, Governor Cabraal immediately decided to commence an investigation into the hedging transactions. Although it was commenced on Thursday 30 November 2008, Dr. Jayamaha gave evidence that Governor Cabraal informed her of his decision “*a couple of days before the investigation commenced*”³⁰⁹. According to Deutsche Bank, the timeline speaks for itself: the Governor instructed CPC not to make payment to the banks on Friday 7 November, reversed this instruction because of concern that it would be perceived as a default event on Monday 10 November and by Tuesday 11 November decided to commence an investigation. Claimant submits that the Governor had decided that he would need to achieve the desired result, non-payment by CPC, by means of an investigation, to prevent further suggestion of default by CPC which could affect Sri Lanka’s credit rating.
442. Deutsche Bank submits that the outcome of the investigation was clearly a foregone conclusion. In Claimant’s view, this is further made clear by Governor Cabraal’s actions at the meeting with Mr. Rodrigo on 19 November 2008, just four working days after the commencement of the investigation. He stated that the Central Bank had already concluded that Deutsche Bank had not followed proper procedures in relation to the Hedging Agreement and that the Monetary Board (chaired by the Governor) would take actions against Deutsche Bank. He refused to provide any details of the alleged breaches but stated that if Deutsche Bank came up with an “*acceptable solution*” for CPC, the Central Bank

³⁰⁶ Core 8/333, para. 206.

³⁰⁷ Karunaratne Witness Statement, *supra* note 255, para. 214.

³⁰⁸ Core 8/333, para. 207.

³⁰⁹ Transcript Day 4, p. 125, lines 14 to 25.

and the Monetary Board would not pursue the matter any further³¹⁰. According to Claimant, this is an improper conduct for a regulator.

443. Claimant argues that Mr. Rodrigo's account is supported by two contemporaneous emails he sent to update colleagues on the meeting with the Central Bank noting that the Central Bank was "*resorting to strong arm tactics*"³¹¹. It is also consistent with a contemporaneous note prepared by Mr. Haswel of SCB³¹². Mr. Haswel was informed that the alleged failings on the part of the banks included Mr. de Mel's lack of authority and inadequate risk assessments, criticisms which were later made in the Central Bank's report.
444. Deutsche Bank points out that Dr. Jayamaha only belatedly challenged Mr. Rodrigo's account of the meeting in her second witness statement. According to Claimant, her evidence is not credible. During the hearing, she first stated that she could not recall whether or not the Governor had made certain statements at the meeting, before eventually stating that she disagreed with the accounts of Mr. Rodrigo and Mr. Haswel³¹³. Claimant submits that Dr. Jayamaha's account is unsupported by any contemporaneous document and should be rejected.
445. Finally, Deutsche Bank also points out that Governor Cabraal, who had been a central figure in relation to almost every aspect of the case and was involved from the very start in August 2006, has not given evidence to the Tribunal, despite confirmation that he is in good health, working full time³¹⁴ and making regular visits to Singapore.

2) *Lack of transparency and due process*

446. According to Claimant, the suggestion that Mr. Nanayakkara and the Central Bank carried out a serious investigation concerning hundreds of millions of dollars into five banks over a one month period without generating more than the two or three internal documents Sri Lanka has provided, is not credible. In Claimant's view, the absence of any documentary record suggests either that documents have been withheld because they are prejudicial or that no proper investigation was carried out since a proper investigation would surely have produced substantial documentation.
447. Claimant further recalls that Deutsche Bank was not informed of the case against it before the Monetary Board issued its Stop-Payment Order on 16 December 2008. In the Assessment of Compliance, the Central Bank had confined itself to ascertaining compliance with the Directions. However, the scope of the investigation was substantially broadened. Claimant submits that the Investigation Report placed before the Monetary Board on 13 December 2008 (but not sent to Deutsche Bank until 6 January 2009)

³¹⁰ Rodrigo First Witness Statement, *supra* note 27, paras. 101 to 102.

³¹¹ Core 5/14; Core 5/218.

³¹² Core 5/216.

³¹³ Transcript Day 4, p. 138, line 20 to p. 141, line 9.

³¹⁴ Transcript Day 4, p. 104, lines 15 to 25.

contained three new findings against Deutsche Bank of which it received no notice whatsoever and to which it had no opportunity to respond. According to Claimant, this is a clear breach of natural justice.

448. Deutsche Bank further points out that the Investigation Report was prepared in the course of just 24 hours. Claimant argues that the Investigation Report almost completely disregarded Deutsche Bank's responses for reasons which were patently irrational and arbitrary.

3) *Inconsistency and breach of legitimate expectations*

449. Claimant further states that the Central Bank was involved in CPC's hedging program from the outset. And though, Mr. Nanayakkara confirmed that his Department did not interview anyone at CPC or the Central Bank during the investigation³¹⁵. He rather decided to form his own views of the nature and purpose of the program, although he had not had any prior involvement with it. He concluded that the "*original intention of the hedging program*" would not have required CPC to make large payments to the banks in the event of substantial falls in market prices³¹⁶, while the downside risks to CPC had been made clear in every significant document produced by the Central Bank.

450. Claimant submits that acting as it did, the Bank Supervision Department acted inconsistently and in breach of Deutsche Bank's legitimate expectation that the Hedging Agreement did not breach Sri Lankan regulations.

4) *The findings of the investigation do not withstand any scrutiny*

451. According to Claimant, the substantive findings of the Central Bank's Investigation are manifestly flawed. In Claimant's view, many of the findings were based on no apparent rule or direction which Deutsche Bank could have known in advance. Some of the findings were highly irregular and Sri Lanka has made little attempt to justify the substantive findings of the Central Bank in its submissions. Moreover, Claimant argues that not one of the adverse findings by the Central Bank is relied upon by Sri Lanka as ground for the alleged unlawfulness of the Hedging Agreement in this proceeding. Sri Lanka's case rests on the alleged speculative nature and *ultra vires* character of the Hedging Agreement. Claimant concludes that it is evident that Sri Lanka considers that there is no merit in the Central Bank's findings.

452. According to Claimant, it is also notable that the Central Bank reached identical conclusions, *verbatim*, with regard to both Deutsche Bank and Commercial Bank³¹⁷.

³¹⁵ Transcript Day 3, p. 79, lines 1 to 18.

³¹⁶ Transcript Day 3, p. 88, line 9 to p. 89, line 4; Nanayakkara First Witness Statement, *supra* note 304, para. 25.

³¹⁷ Exhibit R-75, pp. 35-36; Core 6/280, pp. 25-26.

453. Finally, Claimant argues that the overall conclusion that the Hedging Agreement, and indeed all CPC's hedging agreements, were "*materially affected and substantially tainted*" is highly dubious. Neither concept had any basis in any Sri Lankan law or Central Bank's Regulation³¹⁸.

5) *The Central Bank acted in excess of powers*

454. Claimant further submits that the Stop-Payment Order did not state the power on which it was based. Mr. Nanayakkara stated in his first witness statement that this was under Section 46 of the Banking Act³¹⁹. Claimant argues that Section 46 does not confer the power to suspend contracts entered into by a bank. Rather, it allows the Central Bank to take necessary measures in order to ensure the soundness of the banking system. According to Claimant, Section 46 had never before been used to interfere with a contract as it has been done in this case.

6) *The Central Bank's action was disproportionate*

455. In Claimant's view, its expert, Mr. Grove, had demonstrated that if Deutsche Bank had concluded an instrument without a capped upside such as a plain-vanilla zero cost collar with CPC on 8 July 2008, it would have been required to pay Deutsche Bank an additional USD 26 million³²⁰. According to Claimant, it is therefore entirely disproportionate for the Central Bank to take the draconian step of preventing any payment to Deutsche Bank based on an alleged breach of regulations which in fact resulted in a substantially reduced cost to CPC. Claimant argues that this demonstrates that the motive of the investigation was not concerned with a breach of regulations but a contrived scheme to excuse CPC's payment obligations.

7) *Additional remarks*

456. Claimant disputes Sri Lanka's insistence that the investigation was only concerned with the intermediary role of Deutsche Bank Colombo. According to Claimant, this is contradicted by Respondent's witnesses. The intermediary role which Mr. Rodrigo offered to play in the transaction was expressly limited to ensuring compliance with the Directions. Yet Mr. Silva and Nanayakkara have acknowledged that the findings of the Investigation Report went beyond the Directions³²¹.

457. Deutsche Bank also disputes Sri Lanka's repeated statement that Deutsche Bank should have raised its complaints of mistreatment with the Central Bank during the investigation. It is normal that Deutsche Bank did not consider it appropriate to criticize the conduct of the regulator during the course of the ongoing investigation but confined itself to a robust

³¹⁸ Transcript Day 5, p. 121, line 21 to p. 122, line 22.

³¹⁹ Nanayakkara First Witness Statement, *supra* note 304, para. 42.

³²⁰ Grove Report, *supra* note 72, Fig. 6.7 and 6.1.2.11.

³²¹ Transcript Day 5, p. 109, lines 14 to 19; and Transcript Day 3, p. 164, lines 2 to 12.

rejection of the Central Bank's allegations. Moreover, Deutsche Bank believed that the investigation was ongoing until it received the Investigation Report on 6 January 2009. Claimant states that it was only during the course of these proceedings that it appeared that the report had in fact been finalized on 13 December 2008³²².

458. Finally, Claimant disputes Sri Lanka's allegation that even if there was a breach of the fair and equitable treatment, it did not cause Deutsche Bank's pleaded loss since Deutsche Bank still has the opportunity to file an action before the English Courts. Claimant argues that this is a Treaty case, and that the case law is clear that where a State interferes with a contract by way of a sovereign act, the Treaty is engaged and it is not necessary to show that the contractually chosen forum for resolution of disputes is unavailable. The investigation which was characterized by serious procedural failings, led directly to the Stop-Payment Order which has prevented Deutsche Bank from receiving payment. According to Claimant, the Central Bank's breach of fair and equitable treatment therefore directly caused Deutsche Bank's loss.

II. Respondent's position

459. Sri Lanka submits that the three grounds on which Deutsche Bank claims a breach of the fair and equitable treatment standard, *i.e.*, (i) the Interim Order of the Supreme Court dated 28 November 2008, (ii) the conduct of the Central Bank's investigation, and (iii) the letter from the Central Bank to Deutsche Bank Colombo dated 16 December 2008, have no foundation.

(A) *The Supreme Court Interim Order*

460. According to Sri Lanka, the Interim Order had no effect on Deutsche Bank's contractual rights against CPC and in particular on its right to bring a claim against CPC before the Commercial Court in London or in Sri Lanka.
461. Moreover, Respondent points out that this was only an interim order and Deutsche Bank was not a party to the proceedings and did not seek to be joined. The effect of the Order was only temporarily to prevent payment by CPC.

(B) *The Central Bank's Investigation and Stop-Payment Order of 16 December 2008*

462. Sri Lanka submits in the first place that at the time of the Investigation, Deutsche Bank never formulated any of the complaints that it is alleging today in relation to the Assessment of Compliance and the Investigation Report.
463. Respondent argues that the Investigation was conducted pursuant to Section 29(1) of the Monetary Law Act. It began on 13 November 2008 and concerned Deutsche Bank

³²² Transcript Day 2, p. 148, line 11 to p. 149, line 15.

Colombo's role as the intermediary in the Hedging Agreement. These were the issues examined in the Assessment of Compliance.

464. Respondent further recalls that on 20 November 2008, the Supreme Court ordered the Monetary Board to conduct an investigation³²³. It decided indeed that the petitioner had founded a "*strong, prima facie case*":

"that these transactions had not been entered into lawfully; that they are not "arms-length" transactions; that they are heavily weighted in favour of the Banks; that they are to the detriment of the Ceylon Petroleum Corporation and through that to the people of Sri Lanka; that they amount to an abuse of statutory authority..."

465. According to Respondent, these bases were repeated in the CBSL investigation report and this was confirmed by Mr. Silva³²⁴ and by Mr. Nanayakkara³²⁵.

466. Moreover, according to Respondent, the Assessment of Compliance made clear at the outset that it dealt with the intermediary role played by Deutsche Bank Colombo which in Sri Lanka is registered as Deutsche Bank AG. Respondent submits that the role of an intermediary bank can only be assessed by reference to what it was supposed to do. It is only if Deutsche Bank London in fact complied with the 2005 Directions that Deutsche Bank Colombo could be said to have complied within its undertaking; Respondent submits that an assessment of the actions of Deutsche Bank London was therefore a necessary part of the investigation of Deutsche Bank Colombo's compliance with its undertaking.

467. In Respondent's view, the fact that the investigation was only concerned with the intermediary role of Deutsche Bank Colombo in the Hedging Agreement was confirmed by Mr. Silva³²⁶ and Mr. Nanayakkara³²⁷. Mr. Nanayakkara and Mr. Rodrigo were in agreement with the fact that:

- Deutsche Bank London is regulated in London;
- The Central Bank does not have and does not purport to have any regulatory jurisdiction over Deutsche Bank London, it has no authority over either of the contracting parties;
- The 2005 Directions are not binding on Deutsche Bank London, but
- Deutsche Bank Colombo agreed to play an intermediary role to ensure the compliance of transactions by Deutsche Bank London with those Directions.

³²³ Core 5/238, p. 6.

³²⁴ Transcript Day 5, p. 108, lines 22 to 24.

³²⁵ Transcript Day 3, p. 163, lines 21 to 5, and p. 167, lines 23 to 4, and p. 214, line 10 to p. 215, line 18.

³²⁶ Transcript Day 5, p. 100, line 7.

³²⁷ Transcript Day 3, p. 39, lines 9 to 11, p. 137, line 9, p. 153, lines 1 to 13, p. 208, lines 22 to 25, and p. 209, lines 5 to 9.

468. Respondent further argues that the Central Bank also made clear that Deutsche Bank Colombo was only required to cease its own intermediary role in light of its failure to act in accordance with its undertaking. According to Respondent, there were some 20 other banks through which CPC could have remitted the payment due to Deutsche Bank London³²⁸.
469. Sri Lanka also objects to Claimant's reliance on the Investigation Report sent to Commercial Bank of Ceylon PLC on 12 January 2009³²⁹ and its conclusion that it was "*clear that [the Central Bank] intended to apply the same sanction to all the banks*". Contrary to what Claimant suggests, there are significant and notable differences between the reports, the first notable one being the fact that the Commercial Bank report is ten pages longer than the Deutsche Bank report. Respondent points out that the considerations of the Central Bank were similar for both banks. Both reports were based on the 2005 Directions and the terms of the Supreme Court Interim Order but the conclusions regarding the supervisory concerns were very different. In Respondent's view, they were not arbitrary and the process was not discriminatory.
470. According to Sri Lanka, the Central Bank's investigation had no consequences for Deutsche Bank. The Central Bank imposed no sanction on Deutsche Bank Colombo. Respondent submits that all it did was to ask it to avoid repetition in the future. In Respondent's view, the Central Bank had never challenged Deutsche Bank London's right to claim against CPC. Respondent further points out that even though it was clear that Deutsche Bank did not comply with the terms of the 16 December 2008 letter, it continued to act as if it were the conduit by delivering Deutsche Bank London's demands for payment.
471. According to Sri Lanka, there was nothing in the conduct of the Central Bank which even conceivably gave rise to a violation of the fair and equitable treatment standard. Respondent argues that Deutsche Bank has failed to substantiate its allegations of bad faith or improper purposes on the part of the Central Bank. According to Respondent, the investigation was undertaken *bona fide*, albeit upon short notice, in relation to a matter of concern which suddenly emerged. Deutsche Bank Colombo was at all times apprised of the investigation by the Central Bank. It was given an opportunity to respond to the Assessment of Compliance, an opportunity which Deutsche Bank London took. However, in Respondent's view, Deutsche Bank chose not to respond to the majority of the concerns raised as to the role of Deutsche Bank Colombo and none of the various documents which it has subsequently relied upon were attached to that letter. Deutsche Bank accordingly failed to avail itself of the opportunity to respond to the preliminary findings of the investigation and in any case, Respondent submits that the few points made by Deutsche Bank in its letter were taken into account in the Investigation Report.

³²⁸ Transcript Day 5, p. 118, line 8 to p. 120, line 7.

³²⁹ Exhibit R-75.

472. Finally, Respondent disputes Deutsche Bank's suggestion that the substantive findings of the investigations were manifestly flawed. It further submits that the fact that the Investigation Report was prepared in a day and that the investigation was essentially paperless is not surprising. Respondent submits that the Central Bank was working under extreme pressures. Moreover, if the investigation was paperless, it was in major part due to the fact that Deutsche Bank submitted very little paper for the Central Bank to consider.
473. In any case, Respondent argues that both the Supreme Court Order and the Central Bank's letter of 16 December 2008 had no effect on the rights of Deutsche Bank London under the Hedging Agreement, including its right to claim against CPC before the English courts. Respondent further submits that even if the Tribunal were to conclude that there had been some procedural failings in the course of the Central Bank's investigation which rose to the level of a violation of the fair and equitable treatment standard, which is denied, those failings are not causative of the loss for which Deutsche Bank claims in the present arbitration.

III. Tribunal's analysis and decision

474. The Arbitral Tribunal considers, on the basis of the evidence, that Sri Lanka has breached the fair and equitable treatment principle through the actions of the Supreme Court and the Central Bank, including its Governor.

(A) *The Supreme Court proceedings*

475. As recalled above, on 26 November 2008, two petitioners filed two requests before the Supreme Court of Sri Lanka³³⁰ against the Minister of Petroleum and Petroleum Resources Development, CPC, Mr. de Mel, the Secretary to the Treasury, the Minister of Export Development and International Trade, the Minister of Finance and Finance Planning, the Monetary Board of Sri Lanka and the Attorney General. They alleged that the Hedging Agreement was disastrous, constituted mismanagement by CPC and had been entered into illegally and arbitrarily. They submitted that it violated their fundamental rights and they therefore asked *inter alia* that the Supreme Court grant an interim order suspending and/or preventing CPC making any payment to the SCB, Deutsche Bank, Citibank or any other bank or institution involved in the hedging program until final determination of their application.
476. The Supreme Court issued its Interim Order on 28 November 2008³³¹. In a five page judgment rendered less than 48 hours after the filing of the petition, it granted all the claims formulated by petitioners based on what appears to have been extremely limited evidence and without hearing from the various banks whose contractual rights were directly affected by the Order. It ordered that all payments by CPC to Deutsche Bank and the other banks be suspended; that Mr. de Mel, Chairman of CPC, be suspended for

³³⁰ C-131.

³³¹ Core 5/238.

alleged misconduct; that the President of Sri Lanka consider suspending the Minister of Petroleum for his support of the actions of Mr. de Mel; that the Government directly purchase all petroleum products and distribute them through the available network; that the Secretary of the Treasury review taxes on petroleum products and submit a report to the Supreme Court for the Court to consider the possibility of a formula for the pricing of petroleum products; and that the Monetary Board carry out an investigation as regards the impugned transactions and take action thereon.

477. Founding itself on the allegations of the petitioners with respect to the structure of the different hedging agreements entered into with the various banks, and the amount to be paid by CPC, the Supreme Court decided that the petitioners had established a strong *prima facie* case that the transactions had not been entered into lawfully, that they were not arms length transactions and that they were heavily weighted in favour of the banks, to the detriment of CPC and through that to the people of Sri Lanka³³².
478. The Arbitral Tribunal decides that reaching such a conclusion and issuing the Order as detailed above with its far-reaching consequences, without a proper examination and without giving the banks involved an opportunity to respond, constitutes a breach of the fair and equitable treatment obligation of Article 2(2) of the BIT in form of a due process violation.
479. The Tribunal also relies on the public statements made subsequently by Chief Justice Silva who presided over the hearing. In those public statements the Chief Justice confirmed that the decision was issued for political reasons. He indeed declared that “*the Government was forced to comply with the hedging agreements. We will stop that on a judicial order, just pass on to benefit to the people. The Government said you stop the hedging agreements we won’t pass on the benefit*”³³³. The Chief Justice further recognized that internationally, Sri Lanka had no defence to present in the arbitration proceedings, that it was a difficult fight³³⁴.
480. The Tribunal considers that the fact that the Order of the Supreme Court was interim and was discharged two months later, is irrelevant, particularly given that the Tribunal considers it involved a serious due process violation. Indeed, looking at the situation as a whole, at the time that the Supreme Court’s Order was discharged, the Monetary Board of the Central Bank had put its own Stop-Payment Order in place, preventing performance of the Hedging Agreement.

³³² *Id.* p. 5.

³³³ Core 7/313, p. 2.

³³⁴ Core 6/280, p. 20: “[t]here are huge claims and I can’t imagine how we are going to meet them. Internationally, we have no defence. This is a difficult fight”.

(B) *The Central Bank's investigation and Stop-Payment Order of 16 December 2008*

1) *The investigation was improperly motivated*

481. According to the Central Bank, there were two reasons for its investigation: the fact that the substantial payments CPC was required to make in US dollars raised foreign exchange concerns and an alleged surprise that CPC was required to make large payments following the fall in world oil prices.

482. The Arbitral Tribunal is not convinced that these were the true motivations. On the one hand, Sri Lanka's foreign exchange liability was considerably reduced following the fall in oil prices. Indeed, most of CPC's requirements were unhedged. As far as the existence of large payments is concerned, the Central Bank was well informed that if the oil prices fell, CPC would be required to make payment. This was the cost of hedging. It rather appears that given the substantial public criticism, Governor Cabraal and the Central Bank were forced to defend their role in relation to the hedging program³³⁵.

2) *The Government acted in bad faith*

483. In a telephone call on Friday 7 November 2008, a week before the investigation started, Governor Cabraal directed CPC to hold for a while the outstanding payments to banks³³⁶. The instruction was given and followed without question by Mr. Karunaratne. On Monday 10 November, having been forced by media pressure to reverse his instruction of non-payment – given the risk of a default by CPC which could affect Sri Lanka's credit rating – Governor Cabraal changed his mind and instructed CPC to make payment³³⁷. He then decided on Tuesday 11 November to commence an investigation into the hedging transactions. The Arbitral Tribunal agrees with Claimant that the Governor had obviously decided that the payments to the banks should be stopped and that from the moment he realised he could not achieve this result by way of an order he had to do it by means of an investigation.

484. The fact that the result of the investigation was a foregone conclusion is confirmed by the meeting that Governor Cabraal had with Mr. Rodrigo on 19 November 2008, four working days after the beginning of the investigation. During this meeting, he stated that the Central Bank had concluded that Deutsche Bank had not followed proper procedures in relation to the Hedging Agreement and that the Monetary Board would take action against Deutsche Bank. The record also confirms that the Governor indicated to Mr. Rodrigo that if he could come up with an acceptable solution for CPC, the Central Bank and the Monetary Board

³³⁵ Core 6/251.

³³⁶ Core 8/333, para 206.

³³⁷ *Id.* para. 207.

would not pursue the matter any further³³⁸. All this is evidence that the Governor acted in bad faith.

3) *Lack of transparency and due process*

485. It results from the record that only two or three internal documents were generated during the Central Bank's investigation. This absence of documentary record in a case involving hundreds of millions of dollars and extending over a one month period is hardly credible. But even if it is true that the investigation was paperless, this would confirm that it was seriously flawed since an investigation of this nature would have required evidence to be recorded and assessed by the investigators before any report could be produced and finalized.
486. Mr. Nanayakkara confirmed in his testimony that his department did not interview anyone at CPC or the Central Bank during the investigation although the Central Bank had dealt directly with the banks and had played a key role in the investigation and implementation of the programme³³⁹. While he had not been involved in the program, Mr. Nanayakkara decided to form his own views of its nature and purpose. On this basis, he reached the conclusion that the original intention of the program would not have been to have CPC make large payments to the banks in the event of substantial falls in market prices³⁴⁰. This is however in total contradiction with the fact that the downside risk to CPC had been clearly emphasized in every important document produced by the Central Bank.
487. Moreover, Deutsche Bank was not informed of the case against it before the Monetary Board issues its Stop-Payment Order on 16 December 2008 and it was not offered the possibility to respond to the investigation report. On 5 December 2008, the Central Bank had sent a letter to Mr. Rodrigo containing an Assessment of Compliance concerning compliance with the Directions. The scope of the investigation was subsequently broadened in the final Investigation Report to include issues such as whether the Hedging Agreement was properly authorised by the CPC Board and the Cabinet; the Hedging Agreement was "*weighted in favour of Deutsche Bank*"; and Deutsche Bank violated "*best practices and prudential norms*".
488. Deutsche Bank responded to the Assessment of Compliance at 8:00 pm on 11 December 2008. Thereafter, the final Investigation Report was prepared in the course of just 24 hours. It was indeed submitted to the Monetary Board in the morning of 13 December 2008. It completely disregarded Deutsche Bank's responses. Moreover, it contains three new findings against Claimant of which it received no notice whatsoever and to which it had no opportunity to respond. And it was only sent to Deutsche Bank on 6 January 2009.

³³⁸ Rodrigo First Witness Statement, *supra* note 27, paras 101 and 102. *See also* Core 5/214, 216 and 218.

³³⁹ Transcript Day 3, p. 79, lines 1 to 18.

³⁴⁰ Transcript Day 3, p. 88, line 9 to p. 89, line 4; Nanayakkara First Witness Statement, *supra* note 304, para. 25.

489. Finally, the fact that the Central Bank reached identical conclusions, word for word, with regard to both Deutsche Bank and Commercial Bank, also raises concerns with respect to the legitimacy of the process³⁴¹.

4) *The Central Bank acted in excess of its powers*

490. The Stop-Payment Order does not mention on which legal basis it is issued. Mr. Nanayakkara testified that it was based on Section 46 of the Banking Act³⁴². However, this Section does not confer to the Central Bank the power to suspend a contract entered into by a bank but only to take necessary measures in order to guarantee the soundness of the banking system³⁴³. The Central Bank therefore acted in excess of its powers.

5) *Conclusion*

491. On the basis of the above, the Arbitral Tribunal decides that by acting as it did in relation to the Supreme Court Interim Order, the Central Bank's investigation and the Stop-Payment Order of 16 December 2008, Sri Lanka has breached the fair and equitable treatment standard contained in Article 2(2) of the BIT.

SECTION II. EXPROPRIATION

Sub-Section I. **The standard of indirect expropriation**

I. Claimant's position

492. Article 4(2) of the Treaty creates certain legal rights and obligations in respect of expropriation:

"[i]nvestments by nationals or companies of either Contracting State shall not be expropriated, nationalized or directly or indirectly subjected to any other measure the effects of which would be tantamount to expropriation or nationalization in the territory of the other Contracting State except for the public interest and against compensation".

493. Article 4(2) of the BIT therefore clearly encompasses both direct and indirect expropriation.

494. Claimant argues that indirect expropriation has been said to include:

"not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host State, but also

³⁴¹ Exhibit R-75, pp. 35-36; Core 6/280, pp. 25-26.

³⁴² Nanayakkara First Witness Statement, *supra* note 304, para. 42.

³⁴³ Transcript Day 3, p. 218, line 2 to p. 219, line 15, and Transcript Day 5, p. 93, lines 5 to 12.

covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be expected economic benefit of property even if not necessarily to the obvious benefit of the host State"³⁴⁴.

495. Referring in particular to *Metalclad*³⁴⁵, Claimant submits that modern tribunals almost invariably consider the test for indirect expropriation to be whether the investor has been “substantially deprived” of the economic benefit of its investment.
496. Claimant considers that Sri Lanka’s reliance on paragraph 175 of the award in the Waste Management II case to the effect that “it is necessary to show an effective repudiation of the right, unredressed by any remedies available of the Claimant, which has the effect of preventing its exercise entirely or to a substantial extent”³⁴⁶ is unfounded. The preceding paragraph of the Waste Management II award makes clear that in that case, the Tribunal distinguished between sovereign acts of interference with a contract on the hand, and simple breach of contract on the other. Only in the latter case would an investor need to show a “repudiation” of the contract and that its remedies were foreclosed. Deutsche Bank agrees that a mere breach of contract will not amount to an expropriation and that the counter-party would normally proceed under the dispute provisions of the contract. This was the situation in Waste Management II. There was an alleged breach of contract by an organ of the State in circumstances where the Claimant was also alleged to have breached its obligations in significant respects. The investor could not show that the contract had been repudiated nor that its contractual remedies were in any way affected and therefore there was no expropriation. Claimant submits that this is entirely different to the circumstances Deutsche Bank faces in the present case. CPC was a willing counter-party which considered the Hedging Agreement to be a binding contract and duly made payments to Deutsche Bank as late as 14 November 2008, before the Supreme Court and the Central Bank, exercising sovereign powers, ordered that no further payment should be made. The effect of this was substantially to deprive Deutsche Bank of the economic value of the Hedging Agreement, since it was deprived as a matter of fact and under Sri Lankan law, of payment under the Hedging Agreement.
497. According to Claimant, Sri Lanka’s submissions regarding expropriation follow from a flawed premise. Its argument that because Deutsche Bank remains free to bring a claim against CPC in the English courts, there has been no expropriation, is an attempt to introduce a requirement to exhaust “*available no-treaty remedies*” where none exists. There is no requirement in international investment law or arbitral practice that the contractual forum be unavailable in order to commence a treaty claim arising out of sovereign interference with a contract. In Claimant’s view, it is sufficient that Sri Lanka has prevented Deutsche Bank from receiving payment under the Hedging Agreement either as a matter of fact or under Sri Lankan law.

³⁴⁴ *Metalclad v. Mexico*, *supra* note 135, para. 103 (2000).

³⁴⁵ *Id.*; See also *Pope & Talbot Inc. v. Canada*, Interim Award, 26 June 2000, para. 102.

³⁴⁶ Transcript Day 8, p. 227, line 22 to p. 228, line 3.

498. Finally, Deutsche Bank also disputes Respondent's position that only rights in *rem* are normally susceptible to expropriation. Claimant argues that contractual rights may be expropriated was made clear by the Permanent Court of Arbitration in the *Norwegian Shipowners* case in 1922³⁴⁷, and has since been accepted by an overwhelming number of investment arbitration tribunals.

II. Respondent's position

499. Respondent submits that contractual rights are not generally capable of being expropriated. Only rights in *rem* are capable of expropriation. Respondent admits that there have been arbitral awards affirming the expropriability of particular contract rights but this was only in cases where there was a close connection between the contract and a unique underlying physical asset.

500. Respondent also insists that expropriation is the permanent deprivation of property or conduct equivalent thereto.

501. It further submits that legitimate regulatory measures do not amount to expropriation, that is, general regulations that are commonly accepted as within the police power of States. According to Respondent, all investments are subject to the possibility of *bona fide* regulatory investigation and action in accordance with the law. Respondent argues that property in an asset, tangible or intangible, does not convey any immunity against the operation of the general law; even if the effect of such action is to negate the private law rights which would otherwise have been exercisable, it is covered by the police powers doctrine and does not constitute a compensable expropriation³⁴⁸.

III. The Tribunal's analysis and decision

502. Article 4(2) of the Treaty encompasses not only direct expropriation (*i.e.*, a formal Government taking) but also *de facto* or indirect expropriation, that is, an expropriation resulting from a series of acts which are attributable to the State over a period of time and culminate in the expropriatory taking of the relevant property.

503. Many tribunals in other cases have tested governmental conduct in the context of indirect expropriation claims by reference to the effect of relevant acts, rather than the intention behind them. In general terms, a substantial deprivation of rights, for at least a meaningful period of time, is required. The required level of interference with rights has been variously described as "*unreasonable*"; "*an interference that renders rights so useless that they must be deemed to have been expropriated*"; "*an interference that deprives the investor of fundamental rights of ownership*"; "*an interference that makes rights practically useless*";

³⁴⁷ *Norway v. United States of America* (Norwegian Shipowner's Claims), Award, 13 October 1922, p. 22.

³⁴⁸ *Saluka v. Czech Republic*, *supra* note 282, para. 262 (2006); *S.D. Myers Inc. v. Canada*, UNCITRAL Arbitration (NAFTA), First Partial Award, 13 November 2000, para. 281; *Sedco, Inc. v. National Iranian Oil Company*, (1985) 9 Iran- U.S.C.T.R., p. 248, 275.

“an interference sufficiently restrictive to warrant a conclusion that the property has been “taken””; “an interference that makes any form of exploitation of the property disappear”; “an interference such that the property can no longer be put to reasonable use”³⁴⁹.

504. Equally, whilst accepting that effects of a certain severity must be shown to qualify an act as expropriatory, there is nothing to require that such effects be economic in nature. A distinction must be drawn between (a) interference with rights and (b) economic loss. A substantial interference with rights may well occur without actually causing any economic damage which can be quantified in terms of due compensation. In other words, the fact that the effect of conduct must be considered in deciding whether an indirect expropriation has occurred, does not necessarily import an economic test. The Tribunal also notes that in this case, the Treaty does not include “economic damage” as a requirement for expropriation nor does the Tribunal consider that there is any basis for importing such a standard.
505. In the Tribunal’s view, the absence of economic loss or damage is in the first place a matter of causation and *quantum* – rather than a necessary prerequisite in the cause of action of expropriation itself. Therefore, the suffering of substantive and quantifiable economic loss by the investor is not a precondition for the finding of an expropriation under Article 4(2) of the Treaty.
506. Finally, Respondent’s allegation that only rights *in rem* are normally susceptible of expropriation is unfounded. Contractual rights may be expropriated, a position that has been accepted by numerous investment arbitration tribunals³⁵⁰.

Sub-Section II. **Application of the standard**

I. Claimant’s position

507. According to Deutsche Bank, the Supreme Court’s Interim Order of 28 November 2008 and the Central Bank’s letter of 16 December 2008 amounts to an expropriation of its claim to debt under the Hedging Agreement. An order was issued that no further payment should be made, the effect of which was to deprive Deutsche Bank of the economic value of the Hedging Agreement since it was deprived as a matter of fact and under Sri Lankan law, of payment under the Hedging Agreement.
508. Deutsche Bank disputes Sri Lanka’s argument that the Supreme Court’s Order could not have been expropriatory because although it prevented payment by CPC it was only temporary and that the Central Bank’s interference cannot have been expropriatory because by 16 December 2008 the Hedging Agreement had been terminated and replaced by a right to payment of a debt which remains intact under the governing English law and was unaffected by the Stop-Payment Order.

³⁴⁹ *Per* Y. Fortier and S. Drymer, “Indirect Expropriation in the Law of International Investment: I Know It When I See It, or *Caveat Investor*”, 19 *ICSID Review-FILJ* 293, 305 (2004).

³⁵⁰ Reference is made to the numerous authorities cited by Claimant in its Reply at footnotes 1451 to 1454.

509. Claimant submits that this is both artificial and contrary to international law. In Claimant's view, the State is a single legal entity and is treated as such for State responsibility purposes. The different organs of a State cannot therefore play pass the parcel with an investor, with each arguing either that its interference was only temporary or that by the time it got around to interfering there were insufficient rights left to expropriate.
510. Claimant argues that Deutsche Bank was compelled to exercise its right to terminate the Hedging Agreement because the Supreme Court's Order had left it with a unilateral risk but without the prospect of benefit. At the time of this interference, Deutsche Bank did not have a mere debt but a valuable contract with a counter-party which was willing to perform. It is therefore both unconscionable and incorrect as a matter of law for Sri Lanka to argue that it only interfered with an English law debt.
511. According to Claimant, Sri Lanka's attempt to divorce the actions of the Supreme Court and the Central Bank is all the more inappropriate because these actions were expressly coordinated. Claimant points out that while it is true that the Supreme Court withdrew its Interim Order on 27 January 2009. However, when it did so, the Central Bank immediately issued a press release to confirm that its own orders remained in force such as to assuage market fears that these large payments would now have to be made. The Central Bank simply reinforced and later extended and made permanent the interference begun by the Supreme Court. According to Deutsche Bank, the conduct of the Sri Lankan authorities was not legitimate regulatory actions as suggested by Respondent.
512. As to the relevant date of expropriation, Claimant submits that it is 28 November 2008. It objects to Sri Lanka's argument that the interim nature of the Supreme Court's Order means that it could not be the effective date of expropriation. Deutsche Bank submits that in accordance with the prevailing case law, the determination of the date of indirect expropriation is an exercise conducted with hindsight³⁵¹. Claimant argues that the fact that the Supreme Court's Order was expressed to be interim may have prevented a contemporaneous conclusion that that was the date of expropriation. However, in Claimant's view, it is now clear with hindsight that from 28 November 2008 onwards, the coordinated actions of the Supreme Court and the Central Bank prevented Deutsche Bank from receiving payment under the Hedging Agreement.

II. Respondent's position

513. According to Respondent, neither the Supreme Court's Interim Order nor the Central Bank's letter of 16 December 2008 can be regarded as having amounted to a "taking" of Deutsche Bank's claim against CPC which, to the extent that it is well founded, subsists. Respondent argues that there is nothing which prevents Deutsche Bank from pursuing its claim against CPC to judgement before the English or Sri Lankan courts, subject to any defence raised by CPC as to its lack of capacity. Deutsche Bank's rights in that regard have

³⁵¹ *Compañía del Desarrollo de Santa Elena, SA v. Costa Rica* (ICSID Case No. ARB/96/1), Award, 17 February 2000, paras. 80-81; *Azurix v. Argentina*, *supra* note 295, para. 417.

not been in any way affected and consequently, in Respondent's view, there can have been no expropriation.

514. According to Respondent, Deutsche Bank's reliance on speculation to the effect that potential obstacles may be raised before the Sri Lankan courts on the grounds of, *inter alia*, public policy in order to seek to retard or obstruct the enforcement of any judgement which might be obtained from the English courts, is not relevant. The Tribunal must decide Deutsche Bank's claims on the material before it. It cannot find a breach of the treaty on the basis of speculation as to what might happen in relation to matters occurring in the future. Respondent argues that if such matters were to materialise, they could conceivably give rise to a claim under the treaty. However, at present, they are in Respondent's view entirely premature and speculative.
515. Respondent submits in the first place that the expropriation clause of the Germany-Sri Lanka BIT only protects an existing investment in the territory of Sri Lanka. However, the Hedging Agreement does not constitute an investment in that territory.
516. Moreover, Respondent argues that the Hedging Agreement itself, which lacks any link to any underlying asset, is not capable of being expropriated.
517. Respondent further submits that the decisions taken by the Central Bank as the competent regulator constituted legitimate regulatory actions in line with the law of Sri Lanka and therefore could not amount to expropriation. Claimant could not have had any reasonable or legitimate expectation that the Hedging Agreement would not be subject to domestic financial regulation in accordance with the law.
518. In any case, according to Respondent, the Hedging Agreement was not taken by Sri Lanka. It was terminated by Deutsche Bank itself.
519. Finally, Respondent argues that the alleged debt of Sri Lanka continues to exist and can be sued upon before the High Court in London in accordance with the dispute resolution clause of the Hedging Agreement. Deutsche Bank's attempt in this context, relying on the decision in *Waste Management II*, to argue that a distinction is to be drawn between "simple" breaches of contract and "sovereign" acts is misguided in circumstances in which the contract at issue is governed by a law other than that of the host State. *Waste Management II* was a case in which the contractual rights in question were governed by the law of the host State. According to Respondent, this decision does not find application in the very different circumstances of a case in which the contract is governed by the law of a third State, as a result of and pursuant to which, the "sovereign" acts in question are ineffective to effect any taking of the contractual right.

III. The Tribunal's analysis and decision

520. The Tribunal refers to the developments presented in the section devoted to fair and equitable treatment. Taking these developments into consideration, the Arbitral Tribunal decides that (i) the Supreme Court's Interim Order of 28 November 2008 and (ii) the

Central Bank's letter of 16 December 2008 indeed amount to an expropriation of Claimant's claim to debt under the Hedging Agreement.

521. The Supreme Court's Order prevented payment by CPC to Deutsche Bank. On 16 December 2008, the Monetary Board of the Central Bank sent a letter to Deutsche Bank Colombo and other banks requesting them not to proceed with, or give effect to, the transactions. On 27 January 2009, when the Supreme Court withdrew its Order, the Central Bank issued a press release confirming that the 16 December 2008 Directions to the banks would remain in force. The Central Bank reinforced and later extended and made permanent the interference begun by the Supreme Court. It is clear that from 28 November 2008 onwards, the coordinated actions of the Supreme Court and the Central Bank prevented Deutsche Bank from receiving payment under the Hedging Agreement. They deprived Deutsche Bank of the economic value of the latter. An expropriation of Deutsche Bank's rights consequently took place on 28 November 2008 before it decided to terminate the Hedging Agreement on 3 December 2008. From 28 November 2008 onwards, no payment was permitted pursuant to the Hedging Agreement.
522. The Tribunal does not agree with Sri Lanka that it has an extremely broad discretion to interfere with investments in the exercise of "legitimate regulatory authority". A number of tribunals, including *Tecmed v. Mexico*³⁵², *Azurix v. Argentina*³⁵³, and *LG&E v. Argentina*³⁵⁴ have adopted a proportionality requirement in relation to expropriatory treatment. It prevents the States from taking measures which severely impact an investor unless such measures are justified by a substantial public interest.
523. The present case is a not typical case of regulatory action: the entire value of Deutsche Bank's investment was expropriated for the benefit of Sri Lanka itself. Moreover, as we have determined in the section devoted to fair and equitable treatment, the actions by the Supreme Court and the Central Bank were not legitimate regulatory actions. They involved excess of powers and improper motive as well as serious breaches of due process, transparency and indeed a lack of good faith. It was the Central Bank which encouraged Deutsche Bank to enter hedging agreements with CPC in the first place and which continued to monitor the conclusion of such transactions. Claimant had a legitimate expectation that a validly concluded hedging agreement with CPC would be in force in Sri Lanka and that its contractual rights would not be later interfered by a regulator which was essentially an interested party to the transaction.
524. The Tribunal cannot therefore accept Sri Lanka's excuse that its taking of Deutsche Bank's rights under the Hedging Agreement was the result of a legitimate regulatory action. It was a financially motivated and illegitimate regulatory expropriation by a regulator lacking in independence.

³⁵² *Tecmed v. Mexico*, *supra* note 287, para 122.

³⁵³ *Azurix v. Argentina*, *supra* note 295, para. 311.

³⁵⁴ *LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc. v. Argentine Republic* (ICSID Case No. ARB/02/1), Decision on Liability, 3 October 2006, para. 189.

525. The issue whether Claimant has suffered a damage as a result of the expropriation will be examined in Chapter VIII devoted to the issues of causation and *quantum*.

SECTION III. FULL PROTECTION AND SECURITY

I. Claimant's position

526. Article 4(1) of the Treaty provides that “investments of nationals or companies of either Contracting State shall enjoy full protection and security in the territory of the other Contracting State”.
527. According to Claimant, the full protection and security standard contained in Article 4(1) of the Treaty not only creates a right to protection against physical harm but also extends to guarantees against infringements of the investor's rights by the operation of laws and regulations of the host State³⁵⁵. Claimant submits that arbitral practice supports that conclusion. For example, the Tribunal in *CME Czech Republic B.V. (The Netherlands) v. The Czech Republic*³⁵⁶ defined the standard to mean that:

“the host State is obligated to ensure that neither by amendment of its laws nor by actions of its administrative bodies is the agreed and approved security and protection of the foreign investor's investment withdrawn or devalued”.

528. According to Claimant, CPC's failure to conclude the ISDA Master Agreement and the coordinated efforts of the Central Bank and the Supreme Court to prohibit CPC from paying Deutsche Bank the settlement amount, are a violation of the obligation to ensure full protection and security to Deutsche Bank's investment. The conduct of the Sri Lankan authorities fundamentally undermined the legal security of Deutsche Bank's investment, insofar as it prevented payment under the Hedging Agreement. Such conduct includes the false and unsubstantiated allegations made in the Central Bank's Investigation Report, as well as the public criticism of Deutsche Bank. It also includes the Central Bank's attempt to force Deutsche Bank to settle on favourable terms with CPC. Through these actions, Deutsche Bank was deprived of full protection and security to its investment, and Sri Lanka has therefore breached Article 4(1) of the Treaty.

II. Respondent's position

529. According to Respondent, the full protection and security standard does not duplicate the protection afforded by the FET provision of the Treaty. It has as its primary focus the achievement of normal standards of physical security and protection. The Tribunal in *Saluka v. Czech Republic* determined that the standard applies “essentially when the

³⁵⁵ R. Dolzer and C. Schreuer, *Principles of International Investment Law*, Oxford University Press, 149, 2008.

³⁵⁶ *CME Czech Republic B.V. v. Czech Republic*, Partial Award, 13 September 2001, para. 613.

foreign investment has been affected by civil strife and physical violence". In the words of the Tribunal:

*"the standard obliges the host State to adopt all reasonable measures to protect assets and properties from threats or attacks which may target particularly foreigners or certain groups of foreigners. The practice of arbitral tribunals seems to indicate, however, that the "full security and protection" clause is not meant to cover just any kind of impairment of an investor's investment, but to protect more specifically the physical integrity of an investment against interference by use of force"*³⁵⁷.

530. Moreover, Respondent submits that the full protection and security standard involves a best efforts obligation.
531. According to Respondent, if the full protection and security standard is limited to matters of physical protection and security, then, on the facts of the case, there has been no breach.
532. If, on the other hand, the full protection and security standard is to be held to extend to matters of legal protection and security, it is closely connected to the fair and equitable treatment standard. To the extent that the Tribunal were to conclude that there was no breach of the fair and equitable treatment standard, there would likewise be no breach of the full protection and security standard.
533. Respondent further denies Claimant's allegation that Sri Lanka breached the full protection and security clause through "*CPC's failure to conclude the ISDA Master Agreement*." In this regard, Respondent reiterates its position that CPC and the State are not the same. Acts of CPC are not acts of the State. Moreover, Claimant's assertion that "*CPC's failure to conclude the ISDA Master Agreement*" constitutes a treaty breach is nonsensical. Indeed, CPC's alleged "failure" triggered a termination right, which Deutsche Bank elected to exercise with scarcely any delay. If the ISDA remains valid and in force, which is a matter of English law, then the termination right was never removed – not by CPC's conduct, not by the conduct of the State.
534. For the other allegations of breach, Respondent refers to its development in the context of the fair and equitable treatment clause.

III. The Tribunal's analysis and decision

535. The full protection and security standard has been diversely interpreted by arbitral tribunals. In *Saluka*, the Tribunal decided that the clause is not meant to cover just any kind of impairment of an investment, but to protect more specifically the physical integrity of an investment against interference by use of force³⁵⁸. This seems to be the prevailing interpretation of the clause.

³⁵⁷ *Saluka v. Czech Republic*, *supra* note 282, paras. 483-484 (2006).

³⁵⁸ *Saluka v. Czech Republic*, *supra* note 282, para. 483.

536. On the other hand, in *Azurix v. Argentina*, the Tribunal went further by deciding that: “it is not only a matter of physical security; the stability afforded by a secure environment is as important from an investor’s point of view”³⁵⁹.
537. Finally, Tribunals tend to agree that the full protection and security standard only involves a best efforts obligation, a duty of “*due diligence*”³⁶⁰.
538. The Tribunal considers that, given its decisive findings above that Sri Lanka acted in breach of Articles 2 and 4(2) of the Treaty, it is unnecessary for the Tribunal to further determine whether Sri Lanka has breached the full protection and security provision under Article 4(1) of the Treaty. This is particularly so as any such determination would have no effect on the quantum of damages awarded to the Claimant for breach of Articles 2 and 4(2), as discussed below.

SECTION IV. UMBRELLA CLAUSE

539. The Claimant also submitted that Sri Lanka breached the Umbrella Clause (Article 8) of the Treaty. This claim was based on the attribution of CPC’s conduct to the State under Articles 4, 5 and/or 8 of the ILC Articles on State Responsibility.
540. The Tribunal considers that, given its findings above that Sri Lanka acted in breach of Articles 2 and 4(2) of the Treaty, it is unnecessary for the Tribunal to determine whether Article 8 of the Treaty has also been breached. This is particularly so as any such determination would have no effect on the quantum of damages awarded to the Claimant for breach of Articles 2 and 4(2), as discussed below.

³⁵⁹ *Azurix v. Argentina*, *supra* note 295, para. 408.

³⁶⁰ See for example *American Manufacturing & Trading, Inc. v. Democratic Republic of the Congo* (ICSID Case No. ARB/93/1) Award, 21 February 1997, 36 ILM 1534; and *Wena Hotels Limited v. Arab Republic of Egypt* (ICSID Case No. ARB/98/4), Award, 8 December 2000.

CHAPTER VIII. THE DAMAGES

SECTION I. THE ISSUE OF CAUSATION

541. Since this issue has been raised by Respondent by way of an objection, Respondent's position will be presented first.

Sub-Section I. Respondent's position

542. According to Respondent, the Supreme Court's Interim Order of 28 November 2008 had no effect upon Deutsche Bank London's rights under the Hedging Agreement. This is because the Hedging Agreement was governed by English law, that it was entered into by Deutsche Bank London and that under English law, the Supreme Court's Interim Order did not render performance of the Hedging Agreement illegal. Respondent argues that illegality only arises if an act is unlawful by the law of the place where the act has to be done, *i.e.*, either London or New York. In any event, Respondent submits that under the ISDA Master Agreement, the occurrence of an event giving rise to illegality of performance does not affect the parties' rights. Rather, under Clause 5(b)(i), it constitutes a Termination Event and thus would have given Deutsche Bank the right to terminate the Hedging Agreement (Clauses 6(b)(iv) and (c)). Following such termination (resulting in an Early Termination Date), the ISDA Master Agreement continues in force to enable the Non-defaulting Party to calculate and demand the Settlement Amount (Clause 6(e)). Respondent submits that Deutsche Bank did not invoke these contractual rights, terminating instead on the basis of non-execution of the ISDA Master Agreement.
543. Consequently, in Respondent's view, Deutsche Bank's contractual rights were not cancelled but remained effective and the Supreme Court's Interim Order had no relevant effect upon the rights of Deutsche Bank London. Nor did anyone from Deutsche Bank believe that it did at the time. Moreover, the Order was an Interim Order, was therefore provisional and was in any case terminated after two months on 27 January 2009. Furthermore, Respondent argues that there is no evidence that Deutsche Bank London decided to terminate the Hedging Agreement due to the adoption by the Supreme Court of its Interim Order.
544. Respondent also insists on the fact that even if it is undisputed that branches are not separate legal entities, the case law to which it has referred confirms the principle that for certain purposes, branches are to be treated as such. It is Sri Lanka's position that for the purpose of considering the effect of the actions of the Supreme Court, Deutsche Bank London and Deutsche Bank Colombo are to be treated as separate legal entities.
545. And this, in Respondent's view, is also the case for the actions of the Central Bank. In this respect, Sri Lanka submits that the Central Bank's letter of 16 December 2008 had no effect on Deutsche Bank London's rights under the Hedging Agreement, for the same reasons as those given above in relation to the Supreme Court's Interim Order. And so was Deutsche Bank London's understanding, according to Respondent: following receipt of the letter, Deutsche Bank continued to demand payment from CPC, as previously. There was

no hint in any of the correspondence sent to CPC that Deutsche Bank London thought its contractual rights had been lost or adversely affected as a result of acts taken by the Sri Lankan courts or the Central Bank. Sri Lanka also disputes in this respect Claimant's argument that the exchange control legislation might have prevented payment by CPC.

546. According to Sri Lanka, its position that the Central Bank's letter had no effect on Deutsche Bank London's right is demonstrated by the decision of Hamblen J. in the SCB proceedings that the Central Bank's letter addressed to SCB in near identical terms did not have the effect of rendering performance by CPC illegal in the place of performance and that the transactions entered into by CPC with SCB remained enforceable³⁶¹.
547. Respondent submits that Deutsche Bank remains entitled to bring proceedings before the English courts, in order to enforce its claims against CPC. Respondent argues that neither the Interim Order of the Supreme Court nor the Central Bank's letter had any effect on that right.

Sub-Section II. **Claimant's position**

548. According to Deutsche Bank, Respondent's position is misconceived. Claimant points out that it is well established that a treaty cause of action is not the same as a contractual cause of action. As the Annulment Committee mentioned in *Vivendi v. Argentina*, "[a] State cannot rely on an exclusive jurisdiction clause in a contract to avoid the characterization of its conduct as internally unlawful under a Treaty"³⁶². The existence of a contractual claim does not operate to prevent a party from pursuing a treaty claim. The choice rests with that party.
549. In this respect, a State may be held responsible for its acts in relation to a private transaction even where the party having suffered the resulting loss may also be able to recover against the other party to the transaction. This is the case when a State interferes with a contract and alters the contractual equilibrium by way of a sovereign act. Thus, for example, the Tribunal in *Abaclat v. Argentina* distinguished between "pure contract claims" and those where "... the equilibrium of the contract and the provisions contained therein are unilaterally altered by a sovereign act of the Host State. This applies where the circumstances and/or the behavior of the Host State appear to derive from the exercise of sovereign State power"³⁶³.
550. Claimant submits that in this case, Sri Lanka was not a State counterparty that simply failed to pay. Rather, in Claimant's view, the Supreme Court and the Central Bank interfered by way of sovereign acts with CPC's ability to meet its contractual obligations to Deutsche Bank. Contrary to Sri Lanka's assertions, the requirement that other means of redress be unavailable does not apply. Conversely, the fact that Deutsche Bank's rights

³⁶¹ Core 10/355, paras. 459-470.

³⁶² *Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentine Republic* (ICSID Case No. ARB/97/3), Decision on Annulment, 3 July 2002, para. 103.

³⁶³ *Abaclat v. Argentina*, *supra* note 69, para. 318 (2011).

under the Hedging Agreement may still be valid and in theory enforceable under English law is irrelevant. As confirmed by the Tribunal in *CMS v. Argentina*³⁶⁴, an investor is perfectly free to pursue a separate contractual claim simultaneously with a treaty claim as these are separate causes of action.

551. Claimant considers that Sri Lanka's submissions on these points are also flawed because they rely on its assertion that although Deutsche Bank London and Deutsche Bank Colombo are separate legal entities, they should be treated as though this were not the case for the purposes of this claim. According to Claimant, the case law Respondent relies upon is of no relevance whatsoever.
552. Finally, regardless of whether Deutsche Bank AG or Deutsche Bank London was the proper party to the Hedging Agreement, it is clear in Claimant's view that the intention and effect of the actions of the Sri Lankan authorities was to stop payment under the Hedging Agreement.
553. According to Claimant, the Stop-Payment Order affected all banks equally. The terms of the Order made clear that the Monetary Board had determined that all "*transactions*" were "*materially affected*" and "*substantially tainted*". In light of this, each bank was instructed not to "*proceed with, or give effect to these transactions*".
554. Claimant argues that the Stop-Payment Order also made making or receipt of payment illegal under Sri Lankan law. According to Claimant, it therefore made the performance of the Hedging Agreement unlawful. It is irrelevant in Claimant's view that CPC was not required to make payment in Colombo such that performance of the contract did not technically require an illegal act in the contractual place of performance. According to Claimant, the fact that payment by CPC was unlawful under Sri Lankan law is sufficient. In any event, Claimant submits that all payments by CPC would have had to be made from Sri Lanka since CPC did not hold assets abroad.
555. Consequently, according to Claimant, the actions of the Sri Lankan authorities prevented CPC from making payment to Deutsche Bank as a matter of fact. As a matter of banking practice, the funds could not be transferred to satisfy the Hedging Agreement. Claimant submits that it is not conceivable – contrary to what Sri Lanka alleges – that the Central Bank would prohibit performance of the Agreement by Deutsche Bank Colombo but would be willing for it to be given effect by any other bank. Claimant recalls that Mr. Silva also made clear that payments made to accounts outside the country in connection with the Hedging Agreement are capital in nature and would require permission of the controller of exchange at the Central Bank and this permission would not be granted.

Sub-Section III. **The Tribunal's analysis and decision**

556. The Tribunal disagrees with Respondent that from the moment Deutsche Bank has a debt and the possibility to have it recognised by English courts, it has suffered no damage.

³⁶⁴ *CMS v. Argentina*, *supra* note 295.

557. In the first place, the fact that in the context of an investment, a contract was entered into between an investor and a State-owned company of the host State does not mean that the investor cannot have a valid treaty claim. As clearly formulated by the majority in the *Abaclat* case:

*“a claim is to be considered a pure contract claim where the Host State, party to a specific contract, breaches obligations arising by the sole virtue of such contract. This is not the case where the equilibrium of the contract and the provisions contained therein are unilaterally altered by a sovereign act of the Host State. This applies where the circumstances and/or the behaviour of the Host State appear to derive from its exercise of sovereign State power. Whilst the exercise of such power may have an impact on the contract and its equilibrium, its origin and nature are totally foreign to the contract”*³⁶⁵.

558. The majority in the *Abaclat* case further noted that the Claimants, as owners of a security entitlement, had a potential contract claim against Argentina for payment of the principal amount and interests of such security entitlement. It pointed out, however, that the dispute before that Tribunal did not derive from the mere fact that Argentina failed to perform its payment obligations under the bonds, but from the fact that it had intervened as a sovereign by virtue of its State power to modify its payment obligations towards its creditors in general, encompassing but not limited to the Claimants³⁶⁶.

559. A similar situation arises here. The dispute does not derive from the fact that CPC failed to comply with its payment obligations to Deutsche Bank under the Hedging Agreement, but from the fact that Respondent intervened as a sovereign by virtue of its State power to modify its payment obligations towards Claimant.

560. As in *Abaclat*, the mere fact that Claimant has a potential contract claim against CPC for the payment of its debt does not preclude the pursuit of the BIT arbitration focussing solely on whether Sri Lanka complied with its obligations of protection and promotion of German investments under the Treaty.

561. The Tribunal has decided that through (i) the Supreme Court’s Interim Order, (ii) the Central Bank’s investigation and (iii) the Stop-Payment Order of 16 December 2008, all of which are attributable to the Respondent, Sri Lanka breached the fair and equitable treatment obligation of the Treaty. The Tribunal has further decided that (i) the Supreme Court’s Interim Order and (ii) the Central Bank’s Stop-Payment Order constitute a violation of the expropriation provision of the Treaty. The consequence of these breaches is that Deutsche Bank has not received the amount of approximately sixty million dollars to which it was entitled. It has therefore suffered a damage in that amount and the fact that Claimant has in theory another way to obtain recovery of the amount does not prevent this Tribunal from granting compensation to Claimant.

³⁶⁵ *Abaclat v. Argentina*, *supra* note 69, para. 318.

³⁶⁶ *Id.* paras 319 and 324.

562. As mentioned above, the contract claim and the treaty claim are analytically distinct. An investor may elect to initiate one or the other, or both. In the context of a treaty claim, the analysis is based on the State's compliance with its obligations under the relevant BIT. Once the damage issue is reached, the State may not say to the investor that it does not have any damage because it can still sue on the basis of the contract. As was stated by the Tribunal in *Nykomb Synergetics Technology Holding AB v. Republic of Latvia*, "The risk of double payment is admittedly an effect of the establishment of an arbitration facility also for alleged losses or damages suffered indirectly by an investor.... No definite remedies have been developed at this stage, but clearly the Treaty based right to arbitration is not excluded or limited in cases where there is a possible risk of double payment. This risk of double payment is only likely to be resolved through the further development of the law in this area, such as by the means of new judgements, decisions, guidance or other relevant developments."³⁶⁷ Moreover, there is no "exhaustion of available remedies" condition in the Treaty or the ICSID Convention. If the Tribunal concludes that one or several breaches occurred, it must then consider and quantify any losses arising from those breaches. The responsibility to compensate for a breach of the Treaty is not excused by the existence of a right to claim against CPC in debt in the English Courts. The State and the State entity are in any case protected by the prohibition of double recovery.
563. In any case, it is evident that even if Deutsche Bank were to obtain a judgment from the English courts, CPC would likely be prevented from complying with that judgment as a result of the prohibition on paying its debt to Deutsche Bank.
564. The Tribunal is indeed convinced that the effect of the Stop-Payment Order is that CPC – that does not have any operations outside of Sri Lanka and whose all income is received into bank accounts in Sri Lanka – is prevented from making any payment to Deutsche Bank. Any attempt by CPC to pay the banks outside the country could not be made without the Central Bank's knowledge and without permission from the controller of exchange, which the evidence suggests would not be forthcoming. Moreover, any attempt by the officers of Deutsche Bank AG to call for payment would expose them to a risk of prosecution and would also put at risk the Bank's operations. A breach of the direction of the Monetary Board would entitle it to issue a notice cancelling the Bank's licence under Section 9.1 (e) of the Banking Act.
565. For the foregoing reasons, the Tribunal finds that Deutsche Bank is entitled to compensation for the breaches of the Treaty by the Respondent, as determined by this Tribunal.

³⁶⁷ *Nykomb Synergetics Technology Holding AB v. Republic of Latvia*, Arbitral Award, 16 December 2003, para. 2.4.a.4.

SECTION II. THE RELIEF

Sub-Section I. Claimant's position

566. According to Claimant, the Sri Lankan authorities' breaches of Articles 2(1), 4(1), 4(2) and 8(2) of the BIT, and in particular the Central Bank's Order dated 16 December 2008, have prevented Deutsche Bank from receiving the payments to which it was entitled under the Hedging Agreement. The loss suffered by Deutsche Bank is therefore the amount that it would have received pursuant to the Hedging Agreement if there had been no such breach.
567. Claimant submits that the losses it has suffered are USD 60,368,993, plus interest from 9 December 2008. This represents the amount to which it was entitled in accordance with the terms of the Hedging Agreement following the exercise of its right of termination on 3 December 2008. Alternatively, Claimant submits that if the Tribunal concludes that any of the above breaches was in fact completed by the Supreme Court's Order on 28 November 2008, the amount of its loss should be evaluated at USD 60,846,250³⁶⁸. Deutsche Bank's primary submission however remains that it is entitled to the amount of USD 60,368,993, as calculated following termination.
568. Deutsche Bank requests therefore that the Tribunal provide both a declaration that Sri Lanka has breached various provisions of the Treaty and grant it full compensation, *i.e.*, USD 60,368,993 plus interest at the rate set forth in paragraph 399 of Claimant's Memorial of 25 September 2009 and Exhibit C-185 or alternatively at the rate set forth at paragraph 400 of the same memorial and Exhibit C-187, or alternatively on such other basis as the Tribunal shall determine.

Sub-Section II. Respondent's position

569. Respondent concludes that since there has been no breach of any of the provisions of the BIT, and that since even if there had been one, Deutsche Bank has not suffered the loss claimed as a result, it is not entitled to the damages it claims. Moreover, Claimant's debt claimed under the Hedging Agreement still subsists. A claim may be brought by Deutsche Bank against CPC before the English Courts. Any judgement obtained would be enforceable against CPC in Sri Lanka.
570. As to the *quantum*, Sri Lanka does not as such take issue with the process followed all the way in which Deutsche Bank arrives at the sum of USD 60,368,993 claimed as being the loss amount as of the Early Termination Date. It objects however to the amount of the alternative claim, considering that it does not take account of the three payments made under the Hedging Agreement in September, October and November 2008. According to Respondent, if the Tribunal were to apply the alternative basis, the correct amount on that approach would be USD 54,714,280³⁶⁹.

³⁶⁸ Grove Report, *supra* note 72, para. 7.4.4 and Figure 6.7.

³⁶⁹ Benigni Report II, *supra* note 155, para. 75.

571. Finally, Respondent submits that if the Tribunal would find that there was a breach of the fair and equitable treatment standard due to a procedural failing, but would conclude that Deutsche Bank has suffered no loss, it would be inappropriate for the Tribunal to make a declaration that Sri Lanka has breached the Treaty.

Sub-Section III. The Tribunal's analysis and decision

572. Deutsche Bank has suffered a loss amounting to the sum that it would have received pursuant to the Hedging Agreement if there had not been breaches of the Treaty.

573. The Tribunal further notes that Sri Lanka does not dispute the process followed by Deutsche Bank in calculating its claim of USD 60,368,993, being the loss amount as of the Early Termination Date.

574. It therefore grants Deutsche Bank as compensation for the breaches of the fair and equitable treatment and expropriation provisions of the Treaty that were committed by Sri Lanka the amount of USD 60,368,993 plus interest.

575. Claimant requests the payment of interest as of 9 December 2008, the Early Termination Date. It is so granted. The interest rate to be applied shall be based on a nine-month Libor rate as of 9 December 2008, the Early Termination Date, plus a market-based funding spread based on credit risks associated with Deutsche Bank, based on Deutsche Bank's one year credit default swap rate, of 1.12%. Interest will run until full payment.

CHAPTER IX. THE COSTS

SECTION I. THE PARTIES' SUBMISSIONS

576. On 25 November 2011 (with subsequent amendment on 28 November 2011), Claimant filed its Statement of Costs which amounts to a total cost of USD 7,995,127.36, including legal fees and expenses. Up to that date, Claimant had paid an advance on costs to ICSID and the Tribunal in the amount of USD 494,976.
577. On the same date, Respondent also filed its Statement of Costs which amounts to a total cost of USD 2,822,435.11, including legal fees and expenses. Up to that date, Respondent had paid an advance on costs to ICSID and the Tribunal in the amount of USD 495,000.00.
578. The costs of the arbitration, which includes, *inter alia*, the arbitrators' fees, the expenses of the Tribunal, the Secretariat's administrative fee and the charges for the use of the facilities of the Centre, at the time of the Award, amount to USD 960,928.72.³⁷⁰
579. In their respective submissions, each party has requested that the other party be condemned to pay all costs the requesting party has incurred in defending the claims as well as the costs of the Tribunal and ICSID.
580. The Tribunal also recalls that Claimant requested by letter of 12 July 2010 that the Tribunal order Sri Lanka to bear all costs of the adjournment of the 2010 hearing in accordance with ICSID Arbitration Rule 28(1)(b). On 27 August 2010, the Tribunal decided to deal with this request in its award. Claimant reiterated its request for a cost order in its statement of costs of 25 November 2011, as amended on 28 November 2011.
581. In this respect, Claimant has argued in its 12 July 2010 letter that in light of the numerous new witness statements and other new documentary evidence submitted by Sri Lanka together with its Rejoinder some two and a half weeks prior to the scheduled start date of the 2010 hearing, Claimant did not have sufficient time to test and respond to the new evidence prior to the hearing. Claimant further asserted that Sri Lanka had submitted the new evidence with an intent to derail the timetable for the hearing, given that Respondent's earlier request to postpone the hearing had been denied by the Tribunal on 9 June 2010. In addition, Claimant submitted that Respondent's new evidence made it necessary to increase the required sitting days for oral arguments from six to ten days, hence, according to Claimant, an application for adjournment became unavoidable. In its 15 July 2010 letter, Claimant further submitted that the cost issue should also be decided taking into account Sri Lanka's responses to its document production obligations, which Claimant considered defective.

³⁷⁰ This amount excludes costs incurred during the dispatch of the Award (e.g., costs related to courier services, binding, and photocopying). The ICSID Secretariat will provide the parties with a detailed Financial Statement as soon all invoices are received and the account is final. The balance remaining in the case account will be reimbursed to the parties in proportion to the payments that they advanced to ICSID.

582. Sri Lanka, by letter of 13 July 2010, responded that the adjournment of the hearing was agreed to by both parties and therefore it should not be ordered to bear the costs of the adjournment. Sri Lanka further rejected the allegation that it intended to derail the procedural timetable, arguing that the procedural schedule as agreed by the parties at the first session had been overly optimistic in light of the complexity of the present case. Respondent further stated that all evidence submitted with its Rejoinder was filed in response to Claimant's Reply, was relevant to its legal position, and in principle admissible.

SECTION II. THE TRIBUNAL'S ANALYSIS AND DECISION

583. Pursuant to Article 61(2) of the ICSID Convention, the Tribunal has the discretion in the absence of prior agreement between the parties to decide the allocation of the costs and the legal fees and expenses between the parties.

584. Article 61(2) of the ICSID Convention indeed provides that:

“(2) In the case of arbitration proceedings the Tribunal shall, except as the parties otherwise agree, assess the expenses incurred by the parties in connection with the proceedings, and shall decide how and by whom those expenses, the fees and expenses of the members of the Tribunal and the charges for the use of the facilities of the Centre shall be paid. Such decision shall form part of the award”.

585. With regard to the request for allocation of costs regarding the adjournment of the hearing, the Tribunal is mindful of the fact that Respondent first applied for an adjournment in June 2010, and that Respondent submitted a considerable amount of new evidence with its Rejoinder. At the same time, the Tribunal notes that the Rejoinder was filed in accordance with the procedural schedule as determined by the Tribunal in its Procedural Order of 9 June 2010. The Tribunal wishes to reiterate that it regretted the parties' agreement for an adjournment so close to the actual hearing date, as this prolonged this proceeding by some 13 months, given that the scheduling of a 10-day hearing with such short notice proved to be difficult in light of the busy agendas of tribunal members and counsel alike.

586. The Tribunal has also taken note that, unlike in other cases in which a similar situation arose,³⁷¹ Claimant in this case did not substantiate in its cost submission of 25 November 2011, as amended on 28 November 2011, any specific costs incurred in preparation of the adjourned hearing, or any other costs associated with the adjournment.

587. The Tribunal further notes that the ICSID Secretariat was able to negotiate a waiver of cancellation fees for the hearing venue in Singapore, as well as for support services (e.g., interpreters and court reporters). Hence, the only actual costs that arose in connection with the adjournment were non-refundable transportation costs for Members of the Tribunal, amounting to USD 12,872.91 (USD 8,568.71 and USD 4,304.20).

³⁷¹ See *Chevron Bangladesh Block Twelve, Ltd. and Chevron Bangladesh Blocks Thirteen and Fourteen, Ltd. v. People's Republic of Bangladesh* (ICSID Case No. ARB/06/10), Award, 17 May 2010, paras. 252, 263.

588. With regard to the claims, the Claimant has been the successful party. The Respondent's jurisdictional challenges have failed as have its attempts to resist findings against it on the merits. Moreover, breaches by the Respondent were egregious and it acted in bad faith.
589. The Tribunal further notes that the Respondent's claim for costs including legal fees and expenses is far less than that of the Claimant. This notwithstanding, the parties' costs appear to be reasonable in the circumstances.
590. Taking the above into consideration and exercising its discretion, the Tribunal decides to grant to the Claimant a full recovery of its costs, legal fees and expenses. The advances to ICSID shall be borne by the parties in equal parts, as will the costs of the arbitration.

CHAPTER X. SUMMARY OF FINDINGS AND FORMAL AWARD

591. For all of the foregoing reasons and rejecting all contentions to the contrary, a majority of this Tribunal finds, orders and awards as follows:
- a) The Tribunal has jurisdiction over all the claims presented in this arbitration; the claims are all admissible;
 - b) Respondent has violated Articles 2 and 4(2) of the Treaty;
 - c) Respondent shall pay as compensation to Deutsche Bank the sum of USD 60,368,993 plus interest based on a nine-month Libor rate as of 9 December 2008, the Early Termination Date, plus a market-based funding spread based on credit risks associated with Deutsche Bank, based on Deutsche Bank's one year credit default of rate, of 1.12%; interest will run until full payment;
 - d) Respondent shall forthwith pay to Claimant the sum of USD 7,995,127.36 being the reasonable legal fees and expenses of Claimant. The costs of the arbitration referred to in paragraph 578 shall be borne equally by the parties.
 - e) The Tribunal dismisses all other claims.

The Arbitral Tribunal:



Mr. Makhdoom Ali Khan
Arbitrator

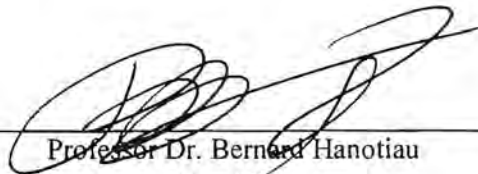
Date: 17 October 2012



Professor David A.R. Williams QC
Arbitrator

Date: 24 October 2012

(Subject to the attached Dissenting
Opinion in accordance with Article
48(4) of the ICSID Convention)



Professor Dr. Bernard Hanotiau
President

Date: 26 October 2012