

International Centre for
the Settlement of Investment Disputes
(ICSID)

June 27, 1990

In the Matter of Arbitration between

ASIAN AGRICULTURAL PRODUCTS LTD.
(AAPL)

v.

REPUBLIC OF SRI LANKA
CASE No. ARB/87/3

FINAL AWARD

President : Dr. Ahmed Sadek EL-KOSHERI
Members of the Tribunal : Professor Berthold GOLDMAN, and
: Dr. Samuel K.B. ASANTE
Secretary of the Tribunal : Mr. Bertrand P. MARCHAIS

In Case No. ARB/87/3,

Between Asian Agricultural Products Ltd. (AAPL),
represented by:
Dr. Heribert Golsong, as Counsel
[of the law firm of Fulbright & Jaworski]
And
The Republic of Sri Lanka
represented by:
[Messrs. William Rand, Robert Hornick, Paul Friedland and Evan
Gray of the law firm of Coudert Brothers, as Counsel; and Messrs.
M.S Aziz and A. Rohan Perera, as Agents]

THE TRIBUNAL

Composed as above,
After deliberation,
Made the following Award:

1. On July 8, 1987, the International Centre for the Settlement of Investment Disputes (hereinafter called "the Centre" or "ICSID") received a Request for Arbitration from Asian Agricultural Products Ltd. (Hereinafter called "AAPL" or "the claimant"), a Hong Kong corporation.

The Request stated that AAPL wished to institute arbitration proceedings against the Democratic Socialist Republic of Sri Lanka (hereinafter called "Sri Lanka" or "the Respondent") under the terms of the ICSID Convention to which Sri Lanka is a contracting Party, and in reliance upon Article 8.(1) of the Agreement between the Government of the United Kingdom of Great Britain and Northern-Ireland and the Government of Sri Lanka for the Promotion and Protection of Investments of February 13, 1980 (hereinafter called "the Bilateral Investment Treaty") which entered into force on December 18, and was extended to Hong Kong by virtue of an Exchange of Notes with effect as of January 14, 1981.

2. Article 8.(1) of the Bilateral Investment Treaty, invoked as expressing Sri Lanka's consent to ICSID Arbitration, reads as follows:

Each contracting Party hereby consents to submit to the International Centre for the Settlement of Investment Disputes (...) for settlement by conciliation or arbitration under the Convention on the settlement of Investment Dispute between States and Nationals of the Other States opened for signature at Washington on 18 March, 1965 any legal disputes arising between that Contracting Party and national or company of the other Contracting Party concerning an investment of the latter in the territory of the former.

3. The Claimant indicated in the Request for Arbitration that a dispute arose directly out of an officially approved investment by AAPL in Sri Lanka that took place in 1983 under the form of participating in the equity capital of SERENDIB SEA-FOODS LTD. (hereinafter called "the Company" or "Serendib") a Sri Lankan public company established for the purpose of undertaking shrimp culture in Sri Lanka.

According to the Claimant, the Company's farm, which was its main producing center, was destroyed on January 28, 1987, during a military operation conducted by the security forces of Sri Lanka against installations reported to be used by local rebels. As a direct consequence of said action, AAPL alleged having suffered a total loss of its investment, and claimed from the Government of Sri Lanka compensation for the damages incurred as a result thereof. The claims submitted on March 9, 1987, remained outstanding without reply for more than the three months period provided for in Article 8.(3) of the Bilateral Investment Treaty to reach an amicable settlement, and hence AAPL became entitled to institute the ICSID arbitration proceedings.

4. On July 9, 1987, the Secretary General of ICSID sent an acknowledgment of the Request to AAPL and transmitted a copy of the Request to Sri Lanka. On July 20, 1987, the Secretary General registered the Request in the Arbitration Register and notified the Parties accordingly.

5. On September 30, 1987, the Centre received a communication from AAPL to the effect that Professor Berthold Goldman has been appointed as member

of the Tribunal in conformity with Rule 5.(1) of the Arbitration Rules. He accepted his appointment as arbitrator on October 8, 1987.

The Republic of Sri Lanka appointed Dr. Samuel K. B. Asante by a letter dated October 20, 1987. He accepted his appointment on October 28, 1987.

Dr. Ahmed S. EL-Kosheri was appointed as the third arbitrator and President of the Tribunal on December 24, 1987, by the Chairman of the Administrative Council of ICSID in consultation with the Parties. He accepted his appointment on January 4, 1988.

Accordingly, the Tribunal became constituted as of January 5, 1988, and the declaration provided for under Arbitration Rule 6 was signed by each arbitrator.

6. At the first session of the Tribunal, held on February 23, 1988 at the Offices of the World Bank in Washington, D.C., the Parties declared that they were satisfied that the Tribunal had been properly constituted in accordance with the provisions of Section 2, Chapter IV of the Convention and of Chapter I of the Arbitration Rules (Minutes of said Session, Item I,(c)).

The Parties and the Tribunal established the framework within which the pleadings have to take place, comprising two consecutive rounds of written submissions followed by oral hearings to be electronically recorded without requiring the production of verbatim transcripts (Items 10-12 of the Minutes).

It was also agreed upon in that First Session that the Arbitration Rules in effect after September 26, 1984, shall apply (Item 2); that the language of the proceeding would be English (Item 8); and that the place of the proceedings will be Washington, D.C. at the seat of the Centre (Item 9).

7. The Claimant's Memorial, submitted on April 13, 1988, focused mainly on the "bases for the claim", consisting of:

- (i) - the unconditional obligation of "full protection and security" provided for in Article 2 of the Bilateral Investment Treaty;
- (ii) - the more specific and clearly defined obligation stated in Article 4(2) of that Treaty requiring adequate compensation of the destruction of the Claimant's property under circumstances not justified by combat action or necessities of the situation; and
- (iii) - finally, the Claimant indicated that the Government's liability extends to cover "damage caused under customary rules of international law on State responsibility" (lines 9 and 10 on page 6 of the Claimant's Memorial).

The remedy required was expressed by the Claimant in terms of evaluating "the market value of the undertaking on the basis of discounted cash flow (DCF) theory", in order to establish the "going concern value" of Serendib Seafoods Ltd on January 28, 1978, the date of the destruction of its property.

8. The Respondent's Counter-Memorial, submitted on June 18, 1988, placed the emphasis on different aspects; mainly to illustrate that the Serendib venture "was a failure from the outset", and its "fitful efforts to restructure was overtaken in

January 1987, by the civil war between Tamil separatists and the Sri Lankan Government". Thus, the large majority of AAPL's claimed damages should be denied since they are based on "the illusion of expected profitability."

Moreover, according to the Respondent's account of the facts, the destruction of Serendib's property was due to intense combat action between the Tamil rebels known as the "Tigers", who were allegedly operating out of Serendib's farm and reported by Governmental sources as having violently resisted the counter-insurgency operation conducted by the Special Task Force (STF), and which aimed to drive the Tiger rebels out of the area,

Equally, with regard to the relevant dispositions of the Bilateral Investment Treaty, the Respondent's Counter-Memorial gave the Treaty an interpretation different from that advanced by the Claimant. Particularly, the expression "full protection and security" used in Article 2 has to be construed as simply incorporating the standard which requires "due diligence" on the part of the States, and does not impose strict liability. As to Article 4.(2), the Government's liability thereunder would not arise except in case the Claimant succeeds in providing the proof that the counter-insurgency actions were not reasonably necessary or that the governmental security forces caused excessive destruction during their combat against the Tamil rebels.

9. The Claimant's Reply to the Respondent's Counter-Memorial was duly submitted on August 18, 1988. The first part of the Reply contained an elaboration of the factual aspects of the case from the Claimant's point of view, especially those related to the events of January 28, 1987. According to Claimant, there was no "battle" at the farm site, but rather "a murderous over-reaction by the STF which led to the destruction and civilian deaths".

Furthermore, no access to the farm was permitted before February 10, 1987, either by the Batticaloa Citizens's Committee for National Harmony or by Serendib's staff, in order that "all evidence of the brutal actions in area could be obliterated".

In the second part of the Reply, the Claimant started by indicating that the Sri Lanka/U.K. Bilateral Investment Treaty "should be considered tantamount to" an agreement between the two Parties as to the applicable rules of law, within the context of Article 42 of the ICSID Convention. Nevertheless, it has to be understood that the Treaty itself is not limited to the explicit statement of certain substantive rules, but renders applicable additional rules incorporated therein, either by reference or by implication. Moreover, the Claimant's Reply states that the "rules of customary international law", as well as the "Law of Sri Lanka as the host country", may be regarded as supplementary "alternative source of applicable law" (p. 29 of the Reply).

With regard to the specific issue of the Standard of Liability under the general pattern followed by Bilateral Investment Treaties, the basic argument developed by the Claimant amounts to an assertion that the traditional "due diligence" criterion applicable under the *minimum standard* of customary international law had been replaced by a new type of "strict or absolute liability not mitigated by concepts of due diligence" (p. 54 of the *Claimant's Reply*).

In case the strict liability argument based on Article 2 and on the most-favoured nation clause contained in the Bilateral Investment Treaty, would not be assisted by the Tribunal, the Claimant presented "as an *alternative submission* only" another argument based on Article 4.(2) (p. 56 of the *Claimant's Reply*), and ultimately on article 4.(1) "which remains the fall-back provision in cases of war destruction" (*Ibid*, p. 57).

Under this alternative argument, the applicability of Article 4.(2) cannot be avoided except in case Sri Lanka would succeed in carrying out its *onus probandi* by providing convincing proof that the destruction of January 28, 1987 was caused "in combat action", and was required by "the necessity of the situation".

At the end of the Claimant's reply, AAPL's submissions were formulated as requesting the Tribunal to:

1. Determine the liability of the Government of Sri Lanka to compensate AAPL for the unlawful requisition and destruction of its investments;
2. Award to AAPL restitution or adequate compensation in the amount of freely transferable U.S. Dollars of not less than \$ 8,067,368 (eight million sixty-seven thousand three hundred sixty-eight) on account of the requisition and destruction of its investment, increased by the additional costs, including all direct and indirect costs of the present proceedings, as well as interest at commercial rates;
3. Order the Respondent to assume the guarantee which AAPL had accepted for the loan by EAB/Deutsche Bank to SSL, or to pay in escrow the additional amount of U.S. \$ 888,000 (eight hundred-eighty thousand), representing the principal of the outstanding loan amount to be paid by AAPL if and when Deutsche Bank prevails in a call on the guarantor for the guarantee subscribed on September 15, 1984;
4. Deny the Counter-claim by the Respondent for costs and attorneys-fees.

10. On October 20, 1988 the Government of Sri Lanka submitted its Rejoinder mainly devoted to emphasizing two issues: (i)—on the one hand, the incorrectness of AAPL's construction of the interrelation between Article 2.(2) and Article 4.(2) of the Sri Lanka/U.K. Bilateral Investment Treaty; and (ii)—on the other hand, the refutation of AAPL's claimed damages.

According to the Respondent's Rejoinder, Article 4.(2) is not an exemption from the rule contained in Article 2.(2), since both articles "share a common standard of liability (that of governmental negligence)", but "the two provisions concern damages arising in distinct situations and caused by distinct parties" (p. 6 of the *Rejoinder*). Moreover, Article 4.(2) could not be considered superseded by operation of Article 3 (the most-favoured-nation clause) as a result of the subsequent conclusion of the Sri Lanka/Switzerland Investment Treaty. In the Respondent's own words, such convention "meets the same problem as AAPL's absolute liability theory; because Article 4 of the Treaty creates potential liability, and does not limit liability, its exclusion from a subsequent treaty could not increase U.K. investor's rights under the Treaty" (p. 10 of the *Rejoinder*).

The Respondent's propositions concerning the claimed damages are composed of three elements:

- (a) - Serendib's desperate financial situation as reflected in the Memorandum of Understanding dated December 22, 1986 could hardly become reversed to evidence future expected profitability;
- (b) - the inclusion of assets and other elements which were never touched by the destruction, such as the hatchery on the west coast;
- (c) - the speculative nature of the projections concerning any possible future profitability.

The Respondent's position on the various legal and factual issues led to the following conclusions:

- (i) - that the STF operation on January 28, 1987, was a legitimate exercise of sovereignty;
- (ii) - that any damage which occurred at the Serendib shrimp farm on that date was either necessary under the circumstances or not caused by the Government;
- (iii) - that AAPL's financial loss due to destruction of assets remains unproven; and
- (iv) - that AAPL suffered *no* loss of any reasonably foreseeable future profits (p. 39 of the *Rejoinder*).

11. The oral phase of the proceedings took place from April 17 to April 20, 1989 at the seat of the Centre in Washington, D.C.

As indicated in the Summary Minutes of the Hearing of the Arbitral Tribunal, oral presentations were made by counsels to both Parties, and counsel to each party was given the opportunity to respond to the presentation made by the other.

The Tribunal heard also an oral presentation from Mr. Deva Rodrigo, advisor to the Claimant, and Mr. Victor Santiapillai, Managing Director of Serendib Seafoods Ltd., appeared before the Tribunal as witness called by AAPL. After giving his evidence, he was examined, and cross-examined by Counsel to each Party, and responded to the questions put to him by the members of the Arbitral Tribunal.

Before declaring the hearing adjourned on April 20, 1989, the Tribunal requested the Parties to submit certain additional documents and information, together with their respective comments thereon.

12. In compliance with the Tribunal's oral order fixing the dates for filing the requested submissions, the first exchange took place on May 22, 1989, and the second exchange on May 29, 1989.

13. The Arbitral Tribunal having met for deliberation in Paris on Monday 26 and Tuesday 27 June 1989, and having considered the various issues pending before it, felt necessary to request further clarifications from both Parties about certain important points deemed not sufficiently pleaded during the previous hearing. A procedural Order was issued consequently on June 27, 1989, inviting both Parties to provide the Arbitral Tribunal with their considered points of view, together with all supporting documents, on the following:

(A) - Within the context of Article 4.1 of the Sri Lanka/United Kingdom Bilateral Agreement of February 13th, 1980, for the Promotion and Protection of Investments, is there any existing precedent or established practice concerning restitution, indemnification, compensation or other settlement allocated to Sri Lanka nationals and companies, or to nationals and companies of any Third State in the circumstances specified in said Article 4.(1)? If so how was the quantum calculated?

(B) - Even if there is no precedent or established practice what are the applicable rules and standards under the Sri Lanka domestic legal system with regard to investment losses suffered by private persons owing to any of the circumstances mentioned in the said Article 4.(1)?

(c) - What are the legal obligations of Sri Lanka under international law with regard to investment losses suffered owing to any of the circumstances mentioned in Article 4.(1) by nationals of companies of Third States, whether these States have or have not concluded Bilateral Investment Agreements with Sri Lanka?

14. In compliance with the Tribunal's Order of June 27, 1989, both Parties submitted their answers to the above-stated questions by September 15, 1989, and Claimant commented on the Memorandum of the Respondent on October 27, 1989.

15. At a later stage, and as a result of consultations undertaken between the members of the Tribunal, a new invitation was addressed on December 26, 1989, to Counsel to both Parties in the following terms:

Taking into consideration that the members of the Tribunal deem appropriate receiving from Counsels of both Parties their reflections and comments about the Decision rendered in July 1989 by the International Court of Justice in the case between the U.S.A. and Italy related to the scope of protection extended to a foreign investor under bilateral treaty;

Therefore, both Counsels are kindly invited to submit within the coming four weeks their comments about the legal reasoning stated in said Decision and the what extent they deem said reasoning relevant in adjudicating the pending Arbitration Case.

Counsel to the Respondent dispatched his comments in a letter dated January 26, 1990, and Counsel to the Claimant expressed his comments in a faxed letter dated January 29, 1990.

16. Subsequent consultations undertaken between the members of the Tribunal indicated that there was no need to convene a new oral hearing, and the Tribunal held its final meeting on March 26-27, 1990.

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17. As a result of said deliberations, the Tribunal is of the opinion that the pending arbitration has to be adjudicated taking into account the following:

I - Concerning the Applicable Law

18. The present case is the first instance in which the Centre has been seized by an arbitration request exclusively based on a treaty provision and not in implementation of a freely negotiated arbitration agreement directly concluded between the Parties among whom the dispute has arisen.

19. Consequently, the Parties in dispute have had no opportunity to exercise their right to choose in advance the applicable law determining the rules governing the various aspects of their eventual disputes.

In more concrete terms, the prior choice-of-law referred to in the first part of Article 42 of the ICSID Convention could hardly be envisaged in the context of an arbitration case directly instituted in implementation of an international obligation undertaken between two States in favour of their respective nationals investing within the territory of the other Contracting State.

20. Under these special circumstances, the choice-of-law process would normally materialize after the emergence of the dispute, by observing and construing the conduct of the Parties throughout the arbitration proceedings.

Effectively, in the present case, both Parties acted in a manner that demonstrates their mutual agreement to consider the provisions of the Sri Lanka/U.K. Bilateral Investment Treaty as being the primary source of the applicable legal rules.

This basic premise relied upon heavily by the Claimant acquired full acceptance from the Respondent, who, not only based his main arguments on the provisions of the Treaty in question, but also invoked Article 157 of the Constitution of Sri Lanka emphasizing that the Treaty became applicable as part of the Sri Lankan Law.

21. Furthermore, it should be noted that the Bilateral Investment Treaty is not a self-contained closed legal system limited to provide for substantive material rules of direct applicability, but it has to be envisaged within a wider juridical context in which rules from other sources are integrated through implied incorporation methods, or by direct reference to certain supplementary rules, whether of international law character or of domestic law nature. Such extension of the applicable legal system resorts clearly from Article 3.(1), Article 3.(2), and Article 4 of the Sri Lanka/U.K. Bilateral Investment Treaty.

22. In fact, the submissions of both Parties (*supra*, § 7, iii, § 10) clearly demonstrate that they are in agreement about admitting the supplementary role of the recourse—regarding certain issues—to general customary international law, other specific international rules rendered applicable in implementation of the most-favored-nation clause, as well as to Sri Lankan domestic legal rules.

23. In spite of the Claimant's hostility to the general applicability of customary international law rules and his reluctance to admit Sri Lankan domestic law as the basic governing law under the last part of Article 42 of the ICSID Convention covering the absence of choice of law by the Parties, AAPL arrived from a practical point of view to a position similar to that adopted by the Respondent throughout the arbitral pro-

ceedings. This is particularly seen from what has been quoted in § 7, iii and § 9 herein-above.

24. Accordingly, the Tribunal is of the opinion that the “false problem” related to the preliminary determination in principle of the applicable law has no relevance within the context of the present arbitration, since both Parties agreed during their respective pleading to invoke primarily the Sri Lanka/U.K. Bilateral Investment Treaty as *lex specialis*, and to apply, within the limits required, the international or domestic legal relevant rules referred to as a supplementary source by virtue of Articles 3 and 4 of the Treaty itself.

II – The legal grounds on which the Respondent’s responsibility could be sustained

25. As indicated herein-above, both Parties invoked the Sri Lanka/U.K. Bilateral Investment Treaty as the primary applicable law. However, each Party construed the Treaty’s relevant provisions in a manner which led to basically different conclusions.

(I). The Claimant’s Case

26. The main point of view relied upon by AAPL to substantiate its submissions can be summarized as follows:

(A) – By providing that the investments of one contracting Party “shall enjoy full protection and security in the territory of the other Contracting Party”, Article 2 of the Treaty went beyond the *minimum standard* of customary international law through the creation of an unconditional obligation to be borne by the host country. According to the Claimant, “the ordinary meaning of the words ‘full protection and security’ points to an acceptance by the host State of strict or absolute liability” (*Reply of Claimant to Respondent’s counter-Memorial, op. cit.*, p. 46);

(B) – Within the “context” of the entire Treaty’s “object and purpose”, and taking into account the “identical or very similar” language used in most of the Bilateral Investment Treaties concluded between Sri Lanka, and Third States, the comparative analysis with the different other patterns followed elsewhere indicates that the term “full protection and security” has to be considered “autonomous in character and independent of any link to customary international law” (*Ibid.*, p. 49);

(C) – By abandoning the “diplomatic protection” theory largely based on the United States’ “Friendship, Commerce and Navigation” (FCN) pattern of indirect protection, the foreign investor “enjoys” under the “Bilateral Investment Treaties” (BIT’s) a different method of direct protection.

According to the Claimant, “the right to protection is vested in the holder of the investment with immediate effect upon the simple coming into force of the treaty”

(*Ibid.*, p. 52). Thus, a deliberate choice is reflected to follow a new pattern in matters of protection different from that which prevailed under traditional International Law.

(D) – In implementation of the most-favoured-nation clause contained in Article 3 of the Sri Lanka/U.K. Bilateral Investment Treaty, and in the light of the fact that the Treaty concluded between Sri Lanka and Switzerland does not provide for a “war clause” or “civil disturbance” exemption from the protection and security standard, the Claimant asserts that: “the standard of treatment under the Swiss Treaty, which is obviously more favourable than the provision of the SL/UK Treaty, applies to British investments. This means that a standard of unmitigated strict liability has to be assured by Sri Lanka in favour of British Investments” (*Ibid.*, P. 56).

27. As an “alternative submission only”, the Claimant envisaged a supplementary argument based on Article 4.(2) of the Sri Lanka/U.K. Bilateral Investment Treaty which could be relied upon in case the Tribunal “unexpectedly” would deem that Article applicable.

The Claimant’s position in this respect was clearly stated at page 57 of his *Reply to the Respondent’s Counter-Memorial*, which reads as follows:

As stated above, Article 4(2) of the SL/UK Treaty provides for an exemption from the strict liability rule of Article 2(2). Article 4(2) provides for restitution and freely transferable compensation if the destruction of property in situation of war or civil disturbances was *not* required by the necessity of the situation. This standard of compensation goes beyond the duty of granting “restitution”, “indemnification”, or “compensation” or “other settlement” provided for by Art 4(1) of the Treaty, which remains the fall-back provision in cases of war destruction.

It is clear from the above quotation that the Claimant invokes Article 4 of the Treaty in its entirety, but considers the present case falling within the scope of the specific rule contained in Article 4.(2), which evidently provides a better type of remedy than due under Article 4.(1).

28. The reasons sustaining that alternative as to the applicability of Article 4.(2) are explained as follows:

(A) – The act complained of was “not caused in combat action”, but amounts to what the Claimant describes as “the wanton destruction of AAPL’s property and the cold-blooded killing of the farm manager and the permanent staff members” which was “clearly not planned pursuant to any combat action” (page 8 of the *Claimant’s Memorial*);

(B) – The property was “requisitioned” by Sri Lankan forces and was “destroyed by those same forces” under circumstances suggesting that the wanton use of force was “not required by the exigencies of the situation” (*Ibid.*, same page 8);

(C) – Moreover, the Claimant ascertains that: “the complete destruction and cold-blooded killings by the Government’s security forces were completely out of proportion to what was necessary to meet the specific exigencies of the situation which actually existed at the SSL facility” (*Ibid.*, p. 9); and

(D) - In reliance upon the language of Article 4.(2), the Claimant is of the opinion that said language: "places the burden on the Respondent to demonstrate that the destruction of Claimant's property was required by the necessity of the situation" (*Ibid.*, p. 11).

Invoking what is considered "a general principle of international judicial and arbitral practice" the Claimant submitted at a later stage that:

the burden of proof shifts from the claimant to the defendant if the former has advanced some evidence which *prima facie* supports his allegation. This is particularly appropriate if the defendant wishes to derive a benefit from an interpretation or rule operating in his favor as does Sri Lanka in this case. It is submitted that rules justifying conduct which would otherwise be unlawful (such as military necessity) fall into the category of norms operating in favor of the defendant for which the defendant carries the *onus probandi* (*Reply to Respondent's Counter-claim*, at p. 58).

29. During the written phase of the procedures, the Claimant deemed sufficient to formulate his claims for "adequate compensation" on the basis of said Article 4.(2) without suggesting what could be the ultimate remedy available if the Tribunal—contrary to his submissions—would arrive to the conclusion that conditions required for the applicability of the paragraph in question are missing in the present case, and accordingly the rules referred to in paragraph (1) of Article 4 constitute the proper legal framework within which the pending issues have to be adjudicated.

The only indications provided for in the Claimant's written pleadings with regard to such alternative are limited to what was previously mentioned in two reported passages:

(i) - the short reference on page 6 of the Claimant's Memorial to the Government's liability "under customary rules of international law on State responsibility" (*supra*, § 7. (iii));

and

(ii) - the closing sentence on page 57 of the Reply to the Respondent's Counter-Memorial containing a precise reference to the remedies "provided for by Article 4.(1) of the Treaty, which remains the fall-back provision in cases of war destruction" (*supra*, § 27 at the end of the quotation).

30. In order to obtain certain necessary clarifications about the Claimant's position a question was put to the Claimant's Counsel by the President of the Tribunal at the Oral Hearing held in Washington D.C. from April 17 to April 20, 1989. According to the transcript of the tape containing Dr. Golsong's Closing Statement on April 20, 1989, the latter responded by saying:

we were told that we had not based our claim on 4(1) which therefore has to be deleted from the discussions. We have in our Memorial and in our Reply generally based our contention on the Bilateral Investment Treaty of the United Kingdom extended to Hong Kong and improved eventually by way of incorporation by reference of most-favoured-nation provisions deriving from other Investment Treaties. And we maintain this position. We have started by saying that 2. para-

graph 2 enshrines an absolute or strict standard of liability and certainly more than due diligence. And that there are some exceptions in the UK Treaty, namely the specific war situation in Article 4 in general, without making a distinction between 4(1) and 4(2). And in any way, if I refer to 4(2), I have implicitly to bring into discussion 4(1). (*Text provided by ICSID's Secretariat, as enclosure to a letter dated April 10, 1990, in response to an earlier request from the President of the Arbitral Tribunal to check the electronically recorded tapes of the hearing.*)

31. At a later stage of the proceedings, the Arbitral Tribunal issued the above-mentioned Order of June 27, 1989 (*supra*, § 130), which invited both Parties to provide the Tribunal with their considered points of view about certain aspects related to Article 4.(1) and the results that could be obtained through its implementation.

By his letter dated September 14, 1989, the Claimant's Counsel provided the Tribunal with answers to the questions put to both Parties without raising any objection to the eventual adjudication of the case under Article 4.(1). Moreover, the last sentence of said letter explicitly emphasized that:

...there can be no doubt that in the present case the provisions of Article 4(1) of the Sri Lanka/UK Agreement are applicable, and being *lex specialis*, supersede any general principle of International Law which otherwise may govern the issues at stake.

(II). *The Respondent's Case*

32. In Sri Lanka's Counter-Memorial, the Respondent adopted arguments aimed to contradict the Claimant's initial submissions. The Government's main arguments at that phase of the proceedings can be summarized as follows:

(A) - "The language 'full protection and security' is common in bilateral investment treaties, and it incorporates, rather than overrides, the customary international legal standard of responsibility. This international legal standard requires due diligence on the part of the States and reasonable justification for any destruction of property, but does not impose strict liability" (*Government's Counter-Memorial*, p. 27);

(B) - The "standards for liability under Articles 2.(2) and 4.(2) are essentially identical. In both instances, a requirement of reasonableness is imposed on Government action. Under the international law standard embodied in Article 2.(2), the Government incurs liability if it fails to act with due diligence. Under Article 4.(2), the Government incurs liability if its actions are not reasonably necessary" (*Ibid.*, p. 28);

(C) - "Article 4.(2) sets forth the standard for compensation in the event the Government is found to have violated its obligations under Article 2.(2). That is, if the Government could have prevented the destruction of the farm through due diligence". In case it has been proven that the Government's lack of due diligence caused "unnecessary destruction, then the Government would both have violated its obligation under 2.(2) and owe restitution or compensation under Article 4.(2)" (*Ibid.*, p. 28-29);

(D) - The burden of proof has to be assumed by the Claimant, by proving "that through due diligence, the Government could have prevented Batticaloa from

falling under terrorist control, thus obviating the need for counter-insurgency action. If AAPL fails to prove that the security action itself was avoidable, then its burden is to prove that the Government caused excessive destruction during the operation of January 28, 1987" (*Ibid.*, p. 29);

(E) - "To the extent there was excessive destruction, the Government of Sri Lanka is ready to compensate AAPL for its proportionate ownership". But, it is questionable "whether the Tribunal may determine that there was excessive destruction, without second-guessing tactical decisions made by commanders during the heat of combat" (*ibid.*, p. 41).

(F) - "By investing in an area which it knew contained a vehement, and potentially violent, separatist presence, AAPL assumed the risk that its investment would be caught up in the Sri Lankan civil war" (*Ibid.*, p. 41).

33. The Government's Rejoinder focused essentially on the arguments developed in the Claimant's Reply, by ascertaining that:

(A) - AAPL's alleged "absolute liability theory" based on Article 2.(2) concerns damages arising in situations and caused by parties other than those concerned by Article 4.(2). In essence, according to the Respondent, Article 2.(2) "establishes the general standard of protection owed to foreign investors against damage caused by third parties"; but Article 4.(2) "applies to damages caused by the Government itself" (*Respondent's Rejoinder*, p. 6);

(B) - Contrary to the Claimant's assertion that Article 4.(2) establishes an "exemption" to the strict liability standard of Article 2.(2), Article 4.(2) "creates rather than limits liability" (*Ibid.*, p. 8);

(C) - There are no "authorities" suggesting that "full protection and security" clauses are "among the innovative provisions of modern BITs", and there is "no historical support for AAPL's absolute liability theory" (*Ibid.*, p. 8-9); and

(D) - "The absence of liability-creating provisions analogous to Article 4 of the Treaty in other Sri Lanka BITs, such as the treaty with Switzerland, means only that under those treaties investment losses due to destruction caused by the Government in response to civil strife, whether necessary or not, are covered by the general "fair and equitable treatment" standard found in virtually every BIT, or that investors are left to their traditional remedies under customary international law" (*Ibid.*, p. 10-11).

34. Finally, it has to be noted that throughout the arbitration proceedings, the Government of Sri Lanka maintained that:

- (i) - the destruction was not attributable to the governmental security forces but caused by the rebels;
- (ii) - there was effectively a "combat" between the Government's Special Task Force (STF) and the Tigers insurgents; and
- (iii) - there is no proof that the destruction of the property was "not required by the necessity of the situation".

Therefore, from the Respondent's point of view the liability provided for in Article 4.(2) can not be sustained due to the absence of all three of its *sine qua non* conditions. Hence, the applicability of Article 4.(1) could have been logically envisaged.

Nevertheless, the Government of Sri Lanka refrained from dwelling upon its interpretation of said Article 4.(1), its scope of application, as well as the extent of the responsibility that may emerge thereunder.

The reasons for such silence became perfectly clear during the oral phase of the arbitral proceedings, since Mr. Hornick, Counsel of the Respondent, indicated during his oral argument on April 19, 1989, that there was no need to elaborate upon Article 4.(1), since in his understanding "AAPL is not claiming" thereunder (*Transcript of the electronic taping provided on April 12, 1990 by ICSID Secretariat upon request from the Tribunal's President*).

35. Only at a later stage, and in response to the Tribunal's Order of June 27th, 1989, the Respondent expressed the Government of Sri Lanka's views on the three issues related to the remedies that could be available under Article 4.(1) of the Sri Lanka/U.K. Bilateral Investment Treaty.

36. With regard to the "applicable rules and standards under the Sri Lankan domestic legal system", the letter dated September 13, 1989, addressed by the Respondent's Counsel in response to the Tribunal's Order stated the following:

1. If a Sri Lankan individual or company wished to make a claim against the Sri Lankan Government for any losses suffered owing to the war, etc., it may file an action in a district court in Sri Lanka for compensation. The action will have to be based on a cause of action arising in delict (tort). The law relating to delict is based on Roman Dutch Law which provides a remedy under *lex aquiliana* principles, namely, for intentional or negligent wrongdoing. There is no special legislation or other basis whereby liability is incurred in the absence of fault. Any person making a claim against the Government would have to file an action in the district court. The prescription ordinance of Sri Lanka, which may be availed of by the Government as any other defendant, states (Sections 9):

No action shall be maintainable for any losses, injury or damage, unless the same shall be commenced within two years from the time when the cause of action shall have arisen.

2. It may also be relevant to note that the State (Liability in Delict) Act of 1969 based on the English Crown Liability in Delict Act permits an individual to file an action against the Government in respect of delicts committed by its officers or agents. Under this Act, vicarious liability attaches to the State for the wrongful acts of its servants.

37. Regarding Sri Lanka's legal obligations under international law, the last part of the Respondent's letter dated September 13, 1989 emphasized that:

with regard to investment losses suffered owing to any of the circumstances mentioned in said Article 4.1 by nationals or companies of third States, whether these States have or have not concluded bilateral investment agreements with Sri Lanka, the government refers to Appendix A of its Counter-Memorial (at 7-8) in which it is explained that Government's obligation in such circumstances un-

der customary international law is to exercise due diligence to protect alien individuals or companies from investment losses (references deleted).

Thus, the mere occurrence of investment losses by an alien, such as AAPL, does not render the Government responsible to compensate the alien for the losses. Rather, the Government is obliged to compensate the alien only in the event the alien demonstrates that the Government failed to act reasonably under the circumstances.

III. *The Tribunal's Findings*

38. From the above-stated summary of the arguments advanced by each of the two Parties to sustain his position, it becomes clear that the only point on which they agree is the applicability of the Sri Lanka/U.K. Bilateral Investment Treaty as the primary source of law. Beyond that preliminary point, the two Parties are in disagreement, since each Party construes the relevant provisions of the Treaty in a manner fundamentally in conflict with the interpretation given by the other Party to the same provisions.

Therefore, the first task of the Tribunal is to rule on the controversies existing in this respect by indicating what constitutes the true construction of the Treaty's relevant provisions in conformity with the sound universally accepted rules of treaty interpretation as established in practice, adequately formulated by *l'Institut de Droit International* in its General Session in 1956, and as codified in Article 31 of the Vienna Convention on the Law of Treaties.

39. The basic rule to be followed by the Tribunal in undertaking its task with regard to the pending controversial interpretation issue has been formulated since 1888 in the Award rendered in the *Van Bokkelen* case (Haiti/USA), where it was stated that:

for the interpretation of treaty language and intention, whenever controversy arises, reference must be made to the law of nations and to international jurisprudence (*Repertory of International Arbitral Jurisprudence*, Volume I: 1794-1918, Edited by; Vincent COUSSIRAT-COUSTÈRE and Pierre Michel EISEMANN, *Nijhoff, Dordrecht/Boston/London*, 1989, § 1015, p. 13).

In essence, the requirement that treaty provisions "must be interpreted according to the Law of Nations, and not according to any municipal code", emerges from the basic premise expressed by Mr. WEBSTER, in the following terms:

When two nations speak to each other, they use the language of nations (Quoted by the Germany/Venezuela Mixed Claims Commission in the *Christem Case*, as reproduced in the *Repertory* referred to herein-above, § 1017, p. 27).

40. The other rules that should guide the Tribunal in adjudicating the interpretation issues raised in the present arbitration case may be formulated as follows:

Rule (A) - "The first general maxim of interpretation is that it is not allowed to interpret what has no need of interpretation. When a deed is worded in a clear and precise terms, when its meaning is evident and leads to no absurd conclusion, there can be no reason for refusing to admit the meaning which such deed nat-

urally presents" (passage from VATTEL'S Chapter on Interpretation of Treaties—Book 2, chapter 17, relied upon in 1890 as expressing "universally recognized law" by the U.S.A./Venezuela Mixed Commission in the *Howland case*, *Repertory*, *op. cit.*, § 1016, p. 16), and the Mixed Commission did not hesitate in declaring: "to attempt interpretation of plain words.... would be violative of Vattel's first rule" (*Ibid.*, p. 26). -*cf.* A. Ch. KISS, *Répertoire de la Pratique Française en Matière de Droit International Public*, Tome I, 1962, p. 399, on p. 402 § 810-Text of Prof. GROS's Pleading in the ICJ on July 15-16, 1952 in the *Morocco case*, and § 811-Text of Prof. BASDEVANT's Pleading in of the PICJ on July 5, 1923 in the *Wimbledon case*; S.BASTID, *Les Traités Dans la Vie Internationale*, 1985, p. 129, footnote no. 1—reproducing the text of the Résolution adopted by *l'Institut de Droit International*, Grenada Session, *Annuaire de l'Institut*, vol. 46, 1956, underlining that the rules adopted are only applicable "lorsqu'il y a lieu d'interpréter un traité" -; and I.M. SINCLAIR, "The Principles of Treaty Interpretation and Their Application By the English Courts", *International and Comparative Law Quarterly*, vol. 12, (1963), p. 536—referring to the decisions pronouncing that if the meaning intended to be expressed is clear the Courts are "not at liberty to go further").

Rule (B) - "In the interpretation of treaties... we ought not to deviate from the common use of the language unless we have very strong reasons for it (...) words are only designed to express the thoughts; thus the true signification of an expression in common use is the idea which custom has affixed to that expression" (another passage from VATTEL relied upon by the U.S.A./Venezuela Mixed Commission in the *Howland case*, *op.cit.*, p. 16—*cf.* Award of the Mexico/U.S.A. Mixed Commission of 1871 in the *William Barron case*, *Ibid.*, § 1023, p. 30, emphasizing that: "interpretation means finding in good faith that meaning of certain words, if they are doubtful, which those who used the words must have desired to convey, according to the usage of speech (*usus loquendi*)"; ALEXANDER's award of 1899 in the *Treaty of Limits* case between Costa Rica and Nicaragua *Ibid.*, § 1025, p. 31, declaring that: "words are to be taken as far as possible in their first and simplest meanings", "in their natural and obvious sense, according to the general use of the same words", "in the usual sense, and not in any extraordinary or unused acceptation"; S. BASTID, *op.cit.*, p. 129, reproducing the Résolution adopted in 1956 by *l'Institut de droit International* according to which: "L'accord des parties s'étant réalisé sur le texte, il y a lieu de prendre le sens naturel et ordinaire de ce texte comme base d'interprétation"; and I.M. SINCLAIR, *op. cit.*, § 537, reporting that: "the Court is bound to construe them (the words) according to their natural and fair meaning").

Rule (C) - In cases where the linguistic interpretation of a given text seems inadequate or the wording thereof is ambiguous, there should be recourse to the integral context of the Treaty in order to provide an interpretation that takes into consideration what is normally called: "le sens général, l'esprit du Traité", or "son écon-

omie générale” (Award rendered in 1914 by the Permanent Court of Arbitration in the *Timor Island* case between the Netherlands and Portugal, *Repertory, op. cit.*, § 1019, p. 28; decision of the Bulgarian/Greek Mixed Arbitration Tribunal rendered in 1927 in the *Sarrapoulos* case, *Repertory, vol. II: 1919-1945*, § 2020, p. 21-22; The 1926 *Paula Mendel* case where the Germany/U.S.A. Mixed Claims Commission disregarded “a literal construction of the language” since it “finds no support in the other provisions of the Treaty as a whole”. Hence, “it cannot stand alone and must fall” *Repertory vol. II, § 2025*, p. 25; and the Decision of the Germany/Venezuela Mixed Claims Commission of 1903 in the *Kummerow* case which stated that: “it is a uniform rule of construction that effect should be given to every clause and sentence of an agreement”, *Repertory, op. cit.*, vol. I, § 1031, p. 38).

Rule (D) - In addition to the “integral context”, “object and intent”, “spirit”, “objectives”, “comprehensive construction of the treaty as a whole”, recourse to the rules and principles of international law has to be considered a necessary factor providing guidance within the process of treaty interpretation. (Resolution of *l’Institut de Droit International, op. cit.*, Article 1.(2) which stipulates: “les termes des dispositions du traité doivent être interprétés dans le contexte entier, selon la bonne foi et à la lumière des principes du droit international”; Paragraph 3.(c), of Article 31 of Vienna convention on the Law of Treaties, containing reference to: “all relevant rule of international law applicable in the relations between the parties”, and the Award rendered in 1928 by the France/Mexico Claims Commission in the *Georges Pinson* case, which stated among “les principes généraux d’interprétation”: “Toute convention internationale doit être réputée s’en référer tacitement au droit international commun, pour toutes les questions qu’elle ne résout pas elle-même en termes exprès et d’une façon différente” *Repertory, op. cit.*, vol. II, § 2023, p. 24).

Rule (E) - Nothing is better settled, as a canon of interpretation in all systems of law, than that a clause must be so interpreted as to give it a meaning rather than so as to deprive it of meaning (Award of the UK/USA Arbitral Tribunal of 1926 in the *Cayuga Indians* case, *Repertory, vol. II, § 2036*, p. 35-36). This is simply an application of the more wider legal principle of “effectiveness” which requires favouring the interpretation that gives to each treaty provision “effet utile”.

Rule (F) - When there is need of interpretation of a treaty it is proper to consider stipulations of earlier or later treaties in relation to subjects similar to those treated in the treaty under consideration” (Award of the Mexico/USA General Claims Commission of 1929 rendered in the *Elton* case, *Repertory, vol. II, § 2033*, p. 35). Thus, establishing the practice followed through comparative law survey of all relevant precedents becomes an extremely useful tool to provide an authoritative interpretation.

41. In the light of the above mentioned canons of interpretation, the relevant provisions of the Sri Lanka/U.K. Bilateral Investment Treaty have to be identified, each provision construed separately, examined within the global context of the Treaty, in order to determine the proper interpretation of each text, as well as its scope of application in relation to the other treaty provisions and with regard to the various general rules and principles of international law not specifically referred to in the Treaty itself.

In more precise terms, all appropriate measures should be undertaken in view of establishing the legal regime created by the Treaty for the protection of those investors covered by the Sri Lanka/U.K. Bilateral Investment Treaty in case their investments suffer destruction owing to activities related to the Government’s counter-insurgency actions.

42. The construction of the Treaty’s comprehensive system governing all aspects related to the extent of the special protection conferred upon the investors in question would permit the evaluation of the Treaty’s effective contribution in this respect; *i.e.* in view of determining with regard to each issue whether the Sri Lanka/U.K. Treaty intended, merely, to consolidate the pre-existing rules of international law, or, on the contrary, it tended to innovate by imposing on the host state a higher standard of international responsibility.

Essentially, said evaluation is required, not as a conceptual doctrinal exercise, but for a practical reason related to the adjudication of the case, since in accordance therewith the following question could be adequately answered: what are the limits within which the classical international law based on the judicial and arbitral precedents could be of relevance in adjudicating the present case?

43. Taking the above-mentioned remarks into consideration, the Tribunal agrees with the Parties in considering that there are four fundamental texts in the Sri Lanka/U.K. Bilateral Investment Treaty that should be carefully considered for the purpose of determining the host State’s responsibility for investment losses suffered as a result of property destruction:

First: The general obligation imposed by virtue of Article 2.(2), by which the host State undertook that foreign investments “shall enjoy full protection and security in the territory”, since violation thereof entails a certain degree of international responsibility;

Second: The most-favoured-nation provision contained in Article 3, which may be invoked to increase the host State’s liability in case a higher standard of international protection becomes granted to investments pertaining to nationals of a Third State;

Third: The special provision of Article 4.(1) which envisages the legal consequences of losses suffered by foreign investments “owing to war or other armed conflict, revolution, a state of national emergency, revolt, insurrection or riot” in the territory of the host State; and

Fourth: “without prejudice to” the rules applicable under the previous text (Article 4.(1), the Treaty introduced a more specific rule tailored particularly to cover two

types of “losses”, which are “suffered” in any of the situations enumerated in Article 4.(1). These two categories are:

- (a) requisitioning of their property by its forces or authorities; or
- (b) destruction of their property by its forces or authorities which was not caused in combat action or was not required by the necessity of the situation.

Whenever either case is established, the Treaty provided in the concluding sentence of Article 4.(2) for a certain remedy: “restitution or adequate compensation”, and that the “resulting payments shall be freely transferable”.

44. Accordingly, the treaty envisaged different situations under which protection could be invoked in case of destruction of investments, and different remedies are provided for in order to meet the particularity of each situation.

The various categories of such situations that could be encountered may be classified as follows:

- (i) - Situations in which the foreign investor claims that the destruction of the property was unnecessarily caused by the governmental security forces acting out of combat, and in such case the Treaty provides for a special rule in Article 4.(2), which was tailored particularly to fit the requirements of such serious wrongful action directly attributable to the State organs;
- (ii) - In case the foreign investor fails to establish that the destruction was attributable to the governmental security forces, or in case there was effectively a “combat” during which the property was destroyed under conditions that could hardly permit assessing the unnecessary character of the destruction in a convincing manner, the type of remedy envisaged under Article 4.(2) of the Sri Lanka /U.K. Bilateral Investment Treaty has to be considered excluded. Consequently, the other provisions of the treaty become relevant;
- (iii) - In presence of such situation not possibly governed by Article 4.(2), the search has to be first directed towards investigating the existence of certain rules more favourable to the foreign investor than those provided for under Articles 2.(2) and 4.(1), since the better treatment accorded to investors of the Third State could be extended to apply by virtue of the most-favoured-nation clause stipulated in Article 3 of the Sri Lanka/U.K. Treaty;
- (iv) - In the absence of a more favourable system applicable by virtue of Article 3, the applicable rules become necessarily those governing the liability of the Host State under Article 4.(1) and Article 2.(2), whether taken together or separately as the case may be.

45. The Claimant’s primary submission—as previously explained (*supra*, § 26)—is based on the assumption that the “full protection and security” provision of Article 2.(2) created a “strict liability” which renders the Sri Lankan Government liable for

any destruction of the investment even if caused by persons whose acts are not attributable to the Government and under circumstances beyond the State’s control.

For sustaining said construction introducing a new type of objective absolute responsibility called “without fault”, the Claimant’s main argument relies on the existence in the text of the Treaty of two terms: “enjoy” and “full”, a combination which sustains, according to the Claimant, that the Parties intended to provide the investor with a “guarantee” against all losses suffered due to the destruction of the investment for whatever reason and without any need to establish who was the person that caused said damage. In other words, the Parties substituted the “due diligence” standard of general international law by a new obligation creating an obligation to achieve a result (“obligation de résultat”) providing the foreign investor with a sort of “insurance” against the risk of having his investment destroyed under whatever circumstances.

46. The Tribunal is of the opinion that the Claimant’s construction of Article 2.(2) as explained herein—above cannot be justified under any of the canons of interpretation previously stated (*supra*, § 40).

47. In conformity with Rule (B), the words “shall enjoy full protection and security” have to be construed according to the “common use which custom has affixed” to them, their “*usus loquendi*”, “natural and obvious sense”, and “fair meaning.”

In fact, similar expressions, or even stronger wordings like the “most constant protection”, were utilized since last century in a number of bilateral treaties concluded to encourage the flow of international economic exchanges and to provide the citizens and national companies established on the territory of the other Contracting Party with adequate treatment for them as well as to their property (“*Traité d’Amitié, de Commerce et Navigation*”, concluded between France and Mexico on November 27, 1886—*cf.* A Ch.KISS, *Répertoire de la Pratique Française ...*, *op. cit.*, Tome III, 1965 § 1002, p. 637; The Treaty concluded in 1861 between Italy and Venezuela, the interpretation of which became the central issue in the *Sambiaggio* case adjudicated in 1903 by the Italy/Venezuela Mixed Claims Commission—*U.N. Reports of International Arbitral Awards*, vol. X, p. 512 *ss.*).

48. The arbitral Tribunal is not aware of any case in which the obligation assumed by the host State to provide the nationals of the other Contracting State with “full protection and security” was construed as absolute obligation which guarantees that no damages will be suffered, in the sense that any violation thereof creates automatically a “strict liability” on behalf of the host State.

Sambiaggio case seems to be the only reported case in which such argument was voiced, but without success. The Italian Commissioner AGNOLI, referred in his Report to:

The protection and security...which the Venezuelan Government explicitly *guarantees* by Article 4 of the Treaty of 1861 to Italians residing in Venezuela (*U.N. Reports, op.cit.*, p. 502—underlining added).

The Venezuelan Commissioner ZULOAGA responded by indicating that:

Governments are constituted to *afford* protection, not to *guarantee* it (*Ibid.*, p. 511).

The Umpire RALSTON put an end to the Italian allegation by emphasizing that:

If it had been the contract between Italy and Venezuela, understood and consented by both, that the latter should be held liable for the acts of revolutionists—something in derogation of the general principles of international law—this agreement would naturally have found direct expression in the protocol itself and would not have been left to doubtful interpretation (*Ibid.*, p. 521).

49. In the recent case concerning *Electronica Sicula S.P.A. (ELSI)* between the U.S.A. and Italy adjudicated by a Chamber of the International Court of Justice, the U.S.A. Government invoked Article V.(1) of the Bilateral Treaty which established an obligation to provide “the most constant protection and security”, but without claiming that this obligation constitutes a “guarantee” involving the emergence of a “strict liability” (Section 2—Chapter V of the *U.S.A. Memorial* dated May 15, 1987, where reference is made, on the contrary at page 135 to the : “One well-established aspect of the international standard of treatment... that States must use “due diligence” to prevent wrongful injuries to the person or property of aliens within their territory”).

In its Judgment of July 20, 1989, the ICJ Chamber clearly stated that:

The reference in Article V to the provision of “constant protection and security” cannot be construed as the giving of a warranty that property shall never in any circumstances be occupied or disturbed (*C.I.J., Recueil*, 1989, § 108, p. 65).

Consequently, both the oldest reported arbitral precedent and the latest I.C.J. ruling confirms that the language imposing on the host State an obligation to provide “protection and security” or “full protection and security required by international law” (the other expression included in the same Article V) could not be construed according to the natural and ordinary sense of the words as creating a “strict liability”. The rule remains that:

The State into which an alien has entered ... is not an insurer or a guarantor of his security... It does not, and could hardly be asked to, accept an absolute responsibility for all injuries to foreigners (*Alwyn V. FREEMAN, Responsibility of States for Unlawful Acts of Their Armed Forces*, Sijthoff, Leiden, 1957, p. 14).

This conclusion, arrived at more than three decades ago, still reflects—in the Tribunal’s opinion—the present status of International Law Investment Standards as reflected in “the worldwide BIT network” (*cf.* K.S. GUDGEON, “Valuation of Nationalized Property Under United States and other Bilateral Investment Treaties”. Chapter III, in the *Valuation of Nationalized Property in International Law*, Ed. by Richard B. LILLICH, vol. IV, (1987), p. 120).

50. In the opinion of the present Arbitral Tribunal, the addition of words like “constant” or “full” to strengthen the required standards of “protection and security” could justifiably indicate the Parties’ intention to require within their treaty relationship a standard of “due diligence” higher than the “minimum standard” of general international law. But, the nature of both the obligation and ensuing responsibility remain unchanged, since the added words “constant” or “full” are by themselves not

sufficient to establish that the Parties intended to transform their mutual obligation into a “strict liability”.

51. The Tribunal’s opinion arrived at in applying the established rule, according to which the words contained in a treaty provision have to be given the natural and fair meaning affixed to them by the common usage, is further supported by recourse to the other canons of interpretation.

According to *Rule (C)* (*supra*, § 40), proper interpretation has to take into account the realization of the Treaty’s general spirit and objectives, which is clearly in the present case the encouragement of investments through securing an adequate environment of legal protection. But, in the absence of *travaux préparatoires* in the proper sense, it would be almost impossible to ascertain whether Sri Lanka and the United Kingdom had contemplated during their negotiations the necessity of disregarding the common habitual pattern adopted by the previous treaties, and to establish a “strict liability” in favour of the foreign investor as one of the objectives of their treaty protection. Equally, none among the authors referred to by the Parties claimed in his commentary that the Sri Lanka/U.K. Treaty or similar Bilateral Investment Treaties had the effect of increasing the customary international law standards of protection to the extent of imposing “strict liability” on the host State in cases where the investment suffers losses due to property destruction.

Accordingly, recourse to the spirit of the Treaty and its objectives would not alter the conclusion arrived at by the Tribunal in refusing to consider that the Sri Lanka/U.K. Treaty imposed by Article 2.(2) a “strict liability” in the event of failure to provide “full protection and security”.

52. Moreover, both *Rules (D) and (E)* confirm the Tribunal’s opinion, as Article 2.(2) should not be taken separately out of the Treaty’s global context.

The Claimant’s contention that Article 2.(2) adopted a standard of “strict liability” would lead logically to the inevitable conclusion that Article 4 in its entirety becomes superfluous, in the sense that according to the Claimant’s interpretation the Parties were not serious in adding to their Treaty two provisions which are not susceptible of getting any application in practice. Such an interpretation has to be rejected in application of *Rule (E)* which requires that Article 2.(2) be interpreted in a manner that does not deprive Article 4 from having any meaning or scope of applicability.

Such an unaccepted result could have been easily avoided if the Claimant had not disregarded *Rule (D)* according to which the rules of general international law have to be taken into consideration by necessary implication, and not to be deemed totally excluded as alleged by the Claimant.

In the Tribunal’s opinion the non-reference to international law in Article 2.(2) of the Sri Lanka/U.K. Treaty should not be taken as implying the Parties’ intention to avoid its application under any aspect, including its role as supplementary source providing guidance in the process of interpretation.

The Tribunal's conclusion in this respect, is not only based on *Rule (D)* as previously indicated, but it is supported furthermore by what was expressed by an informed author who stated that:

the U.K. BIT's normally make no international law reference... This drafting device could be argued to cloud reliance on external sources of law and precedent during the life of the treaty, although this is undoubtedly not the intent. (K. Scott GUDGEON, "Valuation of Nationalized Property..." *op.cit.*, at p. 119-120).

53. Finally, it has to be recalled that in reliance upon *Rule (F)* the precedents established by the Arbitral Tribunal in the *Sambiaggio* case (1903) and by the ICJ Chamber in the *Eletronica Sicula* case (1989), both previously referred to (*supra*, § 48-49), are categoric in supporting the Tribunal's refusal to construe the words "full protection and security" as imposing a "strict liability" on the host State for whatever losses suffered due to the destruction of the investment protected under the treaty.

Therefore, and taking into consideration all the reasons stated in the previous paragraphs (*supra*, § 45-52), the Tribunal declares unfounded the Claimant's main plea aiming to consider the Government of Sri Lanka assuming strict liability under Article 2.(2) of the Bilateral Investment Treaty, without any need to prove that the damages suffered were attributable to the State or its agents, and to establish the State's responsibility for not acting with "due diligence".

54. For the same reasons, the Tribunal rejects the Claimant's argument based on the most-favoured-nation clause contained in Article 3 of the Sri Lanka/U.K. Bilateral Investment Treaty.

By invoking the absence in the Sri Lanka/Switzerland Treaty of a text similar to Article 4 providing for a "war clause" or "civil disturbance" exemption from the full protection and security standard, the Claimant based his argument on two implicit assumptions:

- (i) - that the Sri Lanka/Switzerland Treaty provides equally for a "strict liability" standard of protection in case of losses suffered due to property destruction; and
- (ii) - that the rules of general international law are totally excluded and replaced exclusively by the Treaty's "strict liability" standard.

Both assumptions are unfounded, as the Tribunal has no reasons to believe that the Sri Lanka/Switzerland Treaty adopted a "strict liability" standard, and the Tribunal is convinced that, in the absence of a specific rule provided for in the Treaty itself as *lex specialis*, the general international law rules have to assume their role as *lex generalis*.

Accordingly, it is not proven that the Sri Lanka/Switzerland Treaty contains rules more favourable than those provided for under the Sri Lanka/U.K. Treaty, and hence, Article 3 of the latter Treaty cannot be justifiably invoked in the present case.

55. Faced with the task of adjudicating the Claimant's "alternative submission", the Tribunal has to provide an answer to the various arguments raised by both Parties with regard to the interpretation of Article 4, the inter-relation between 4.(1) and 4.(2), their respective scope of application, as well as the burden of proof assumed

by each Party in evidencing the existence or non-existence of the conditions required for the applicability of the rules and standards referred to in both paragraphs of Article 4.

56. In determining the applicability of either paragraph of Article 4, the Tribunal shall be guided by the same rules of interpretation previously prescribed from (A) to (F) (*supra*, § 40).

Nevertheless, in order to handle the legal issues related to evidence, the above-stated canons have to be complemented by taking into consideration the following established international law rules:

Rule (G)- "There exists a general principle of law placing the burden of proof upon the claimant" (Bin CHENG, *General Principles of Law as Applied by International Courts and Tribunals*, Grotius Publications, Cambridge, (1987), p. 327, and the supporting authorities referred to therein).

Rule (H)- "The term *actor* in the principle *onus probandi actori incumbit* is not to be taken to mean the plaintiff from the procedural standpoint, but the real claimant in view of the issues involved" (*Ibid.*, p. 332). Hence, with regard to "proof of individual allegations advanced by the parties in the course of proceedings, the burden of proof rests upon the party alleging the fact" (*Ibid.*, p. 334; and Durward V. SANDIFER, *Evidence before International Tribunals*, University Press of Virginia, Charlottesville, (1975), p. 127, footnote 101).

Rule (I)- "A Party having the burden of proof must not only bring evidence in support of his allegations, but must also convince the Tribunal of their truth, lest they be disregarded for want, or insufficiency, of proof" (CHENG, *op.cit.*, p. 329- 331, with quotations from the supporting authorities).

Rule (J)- "The international responsibility of the State is not to be presumed. The party alleging a violation of international law giving rise to international responsibility has the burden of proving the assertion" (*The Tanager Horses* case (1924); the *Corfu Channel* case (1949), and the *Belgium Claims* case (1930) referred to by CHENG, at p. 305-306).

Rule (K)- "International tribunals are "not bound to adhere to strict judicial rules of evidence". As a general principle "the probative force of the evidence presented is for the Tribunal to determine" (SANDIFER, *op. cit. pp. 9 and 17; Award of 1896* rendered in the *Fabiani* case between France and Venezuela, *Repertory, op. cit.*, Vol; I, p. 412-413; and the 1903 Award rendered in the *Franqui* case by the Spain/Venezuela Mixed Claims Commission, which considered this rule as expressing "the unanimous conviction of the most conspicuous writers upon international law" and relying *inter alia* on Article 15 of the Rules for Arbitration between Nations adopted in 1875 by *l'Institut de Droit International*, and what

MÉRIGNHAC wrote at p. 269 of his *Traité de l'Arbitrage International—U.N. Reports, op.cit.*, Vol. X, p. 751-753).

Rule (L)- In exercising the "free evaluation of evidence" provided for under the previous Rule, the international tribunals "decided the case on the strength of the evidence produced by both parties", and in case a party "adduces some evidence which *prima facie* supports his allegation, the burden of proof shifts to his opponent (SANDIFER, *op. cit.*, pp. 125, 129, 130, 170-173, relying upon the Parker case of 1962 adjudicated by the Mexico/U.S.A. General Claims Commission, *U.N. Reports, op.cit.*, Vol. IV, p. 36-41; the ICJ's *Ambatielos* and *Asylum* cases).

Rule (M)- Finally, "In cases where proof of a fact presents extreme difficulty, a tribunal may thus be satisfied with less conclusive proof, i.e., *prima facie* evidence" (CHENG, *op.cit.* p. 323-325, with quotations from the supporting authorities and cited with approval by SANDIFER, at p. 173).

57. In the light of all the legal Rules from (A) to (M) stated herein above (§ 40 and 56), it becomes clear that Article 4.(2) regulated a specific situation by adopting a standard of responsibility representing a certain degree of particularity, and which becomes applicable only in cases characterized by the cumulative existence of three factors:

- (a) - that the destruction of property not only occurred during hostilities, but more precisely such destruction has been proven to be committed by the governmental forces or authorities themselves;
- (b) - that the destruction was not caused in combat action, since the higher standard of liability ("adequate compensation" payable in "freely transferable" currency) is linked with the assumption of unjustified destruction committed out of combat; and
- (c) - that the destruction was not required by the necessity of the situation, as the existence of a combat would not be sufficient *per se* to alleviate the responsibility of the governmental forces and authorities, once it has been proven that the security forces bypassed the reasonable limits by undertaking unnecessary destruction.

58. Moreover, it has to be noted that the foreign investor who invokes the applicability of said Article 4.(2) assumes a heavy burden of proof, since he has, in conformity with *Rules (G) and (I)*, to establish:

- (i) - that the governmental forces and not the rebels caused the destruction;
- (ii) - that this destruction occurred out of "combat";
- (iii) - that there was no "necessity", in the sense that the destruction could have been reasonably avoided due to its unnecessary character under the prevailing circumstances.

59. Exercizing its discretionary power in evaluating the evidence produced by both Parties during the proceedings of the present case in conformity with the above-stated *Rules (K) and (I)*, the Arbitral Tribunal considers that:

- (a) - There is no doubt that the destruction of the premises which existed in Serendib's Farm took place during the hostilities of January 28, 1987, and the loss of the shrimps harvest occurred during the period in which the governmental security forces occupied the Farm's fields;
- (b) - Nevertheless, there is no convincing evidence produced which sufficiently sustains the Claimant's allegation that the firing which caused the property destruction came from the governmental troops, and no reliable evidence was adduced to prove that the shrimps were lost due to acts committed by the security forces;
- (c) - Equally, no convincing evidence was produced which sufficiently sustains the Respondent's allegation that the firing which caused the destruction of the property came from the insurgents resisting the security forces.

60. Therefore, the Arbitral Tribunal finds that the first condition required under Article 4.(2) cannot be considered fulfilled in the present case, due to the lack of convincing evidence proving that the losses were incurred due to acts committed by the governmental forces.

At the same time, the Tribunal cannot proceed in this respect on the basis of *prima facie* evidence adduced in function of *Rules (H) or (M)* since the existence of a legal condition as important as the attributability of the damage should, in the Tribunal's opinion, be proven in a conclusive manner.

61. Regarding the second condition which excluded from the scope of Article 4.(2) the losses suffered "in combat action", it requires first the determination of what is meant by "combat action" and subsequently whether the investment losses were effectively caused in "combat action".

In implementation of the above-stated *Rule (B)* (*supra*, § 40), the term "combat action" has to be understood according to its natural and fair meaning as commonly used under prevailing circumstances, *i.e.* within the context of guerrilla warfare which characterizes the modern civil wars conducted by insurgents.

Rarely, in contemporary history actions undertaken during civil wars would take the classical form of a regular military confrontation between two opposing armed groups on a battle field where the adversaries engage simultaneously in fighting each other on the spot. In most cases, the opponents in current civil war situations would resort to sporadic surprise attacks as far as possible from their home bases, trying to avoid direct military confrontation through retreat to places where pursuit could be extremely difficult.

Hence, a "combat action" undertaken against insurgents could be envisaged comprising vast areas extending over the several square miles covering all the localities

in which the hit and run operations as well as the governmental counter-insurgency activities could take place.

62. In the light of the fore-mentioned remarks, and taking into consideration the evidence submitted by both Parties throughout the arbitration proceedings, the Tribunal is of the opinion that the operation "Day Break" undertaken on January 28, 1987, against the "Tiger" fighters belonging to the movement known as LLTE, in order to regain control of the Manmunai area, qualifies as "combat action".

Accordingly, the losses caused as a result of said "combat action" are not covered by Article 4.(2) of the Sri Lanka/U.K. Bilateral Investment Treaty, since they fall within the explicitly excluded category.

63. The third and final condition provided for in Article 4.(2) relates to the "necessity of the situation", in the sense that the State responsibility under said disposition can only be engaged if it has been proven that the losses incurred were not due to "the necessity of the situation".

The term in question follows a pattern long established in practice, as a number of arbitral precedents refused to allocate compensation for destructions that took place during hostilities on the assumption that these destructions "were compelled by the imperious necessity of war" (cf. the 1903 Award rendered by the Netherlands/Venezuela Mixed Claims Commission in the *Dania Bembelish* case, *Repertory...op.cit.*, vol. I, § 297-280; and the Special *Ad Hoc* Arbitral Tribunal adjudicating the *Hardman* case between the U.K. and the U.S.A.). The doctrinal authorities approved that reasoning mainly justified by the extreme difficulty, described as "next to impossible", of obtaining the reconstruction in front of the arbitral tribunal of all the conditions under which the "combat action" took place with an adequate reporting of all the accompanying circumstances (cf. RALSTON, *The Law and Procedure of International Tribunals*, (1926), p. 391; and C. EAGLETON, *The Responsibility of States in International Law*, (1928), p. 155).

64. In the present case, neither Party was able to provide reliable evidence explaining with precision the conditions under which the destructions and other losses, mainly of the shrimps crop, took place. Under these circumstances, it would be extremely difficult to determine whether the destruction and losses were caused as an inevitable result of the "necessity of the situation", or, on the contrary, were avoidable if the governmental security forces would have been keen to act with due diligence.

Therefore, the Tribunal deems appropriate to rely on the above-stated *Rule (I)*, according to which "the international responsibility of the State is not to be presumed" (*supra*, § 56).

Consequently, all three conditions necessary for the applicability of Article 4.(2) are proven to be non-existent in the present case, and Article 4.(1) becomes the only part of Article 4 providing remedy that could be available for the Claimant to base his claims thereunder.

65. For the applicability of Article 4.(1), the only condition required is the presence of "losses suffered".

These two key words are so clear that they do not call for interpretation in conformity with VATTEL's *Rule (A)* which renders any attempted departure from the plain meaning of the words a violation of international law rules on treaty interpretation.

Undoubtedly, the term "losses suffered" includes all property destruction which materializes due to any type of hostilities enumerated in the text ("owing to war or other armed conflict, revolution, a state of national emergency, revolt, insurrection or riot in the territory").

Equally, the mere fact that such "losses suffered" do exist is by itself sufficient to render the provision of Article 4.(1) applicable, without any need to prove which side was responsible for said destruction, or to question whether the destruction was necessary or not.

In essence, the scope of applicability of Article 4.(1) is not subject to any legal restrictions. Hence, it extends as *lex generalis* to all situations not covered by the special rule of Article 4.(2), including necessarily cases where no proof has been established to determine whether the governmental forces or the insurgents caused the property destruction.

66. The only difficulty encountered under Article 4.(1) does not relate to its interpretation or conditions of applicability, but to the type of remedy provided for thereunder.

Precisely, Article 4.(1) does not include any substantive rules establishing direct solutions; i.e. material rules providing remedies expressed in fixed and definitive terms. Like conflict-of-law rules, Article 4.(1) contains simply an indirect rule whose function is limited to effecting a reference (*renvoi*) towards other sources which indicate the solution to be followed.

According to the undisputed plain language of Article 4.(1), the investor—already enjoying the "full security" under Article 2.(2) of the Sri Lanka/U.K. Treaty—has to be accorded treatment no less favourable than:

- (i) - that which the host State accords to its own nationals and companies; or
- (ii) - that accorded to nationals and companies of any Third State.

Taking into account the absence of restrictions, whether explicit or implied, and the generality of the text, the "no less favourable treatment" granted thereunder covers all possible cases in which the investments suffer losses owing to events identified as including "a state of national emergency, revolt, insurrection, or riot", with regard to remedies enumerated in the text itself: "restitution, indemnification, compensation or other settlement".

67. Consequently, it could be safely ascertained that the Bilateral Investment Treaty, through the above-stated *renvoi* technique, had not left the host State totally immune from any responsibility in case the foreign investor suffers losses due to the destruction of his investment which occurs during a counter-insurgency action undertaken by the governmental security forces.

In implementation of Article 4.(1), the host State could find itself in such a situation bound to bear a certain degree of responsibility to be determined in implementation of the *renvoi* contained in that Article 4.(1).

Once failure to provide "full protection and security" has been proven (under Article 2.(2) of the Sri Lanka/U.K. Treaty or under a similar provision existing in other bilateral Investment Treaties extending the same standard to nationals of a third State), the host State's responsibility is established, and compensation is due according to the general international law rules and standards previously developed with regard to the State's failure to comply with its "due diligence" obligation under the *minumum standard* of customary international law.

68. It should be noted in this respect that in the Government of Sri Lanka's own words, its international responsibility could be engaged "if it fails to act with due diligence" (*Respondent's Counter-Memorial*, at p. 28, second paragraph).

In the sentence starting at the end of the same page and continued on the following page, it was clearly stated that:

If the government's lack of due diligence caused otherwise unnecessary destruction, then the government would ... have violated its obligation under Article 2.(2)....

The reference to the "lack of due diligence" emerges from the Government's basic assumption, according to which:

the language "full protection and security" is common in bilateral investment treaties, and it incorporates rather than overrides, the customary international legal standard of responsibility. This international legal standard requires due diligence on the part of the states, and reasonable justification for any destruction of property (*Respondent's Counter-Memorial*, at p. 27).

69. Hence, any foreign investor, even if his national State has not concluded with Sri Lanka a Bilateral Investment Treaty containing a provision similar to that of Article 2.(2), would be entitled to a protection which requires "due diligence" from the host State, *i.e.* Sri Lanka. Failure to comply with this obligation imposed by customary international law entails the host State's responsibility.

The Letter of September 13, 1989, containing the Government of Sri Lanka's response to the Tribunal's Order dated June 27, 1989, confirmed that:

The Government's obligation in such circumstances under customary international law is to exercise due diligence to protect alien individuals or companies from investment losses (paragraph (c) of said letter, with reference to authorities stating that: "A state on whose territory an insurrection occurs is not responsible for loss or damage sustained by an alien to his person or property unless it can be shown that the government of this state was negligent in the use of, or in the failure to use, the forces at its disposal for the prevention or suppression of the insurrection").

The Respondent's submission as expressed in the Letter's final paragraph reads as follows:

Thus, the mere occurrence of investment losses by an alien, such as AAPL, does not render the Government responsible to compensate the alien for the losses. Rather, the Government is obliged to compensate the alien only in the event the alien demonstrates that the Government failed to act reasonably under the circumstances.

70. Within the context of the latter alternative, the Tribunal has to envisage whether effectively Sri Lanka's responsibility could be sustained under international law which has to be considered applicable by virtue of the *renvoi* provided for in Article 4.(1), combined with the conventional standard of "full protection and security" stipulated in Article 2.(2), as well as in other Bilateral Investment Treaties concluded by Sri Lanka.

71. But, before turning to undertake that task, the Tribunal has to emphasize that the Respondent referred in the september 13, 1989 Letter to another legal ground available by virtue of the *renvoi* contained in Article 4.(1), which is the State's responsibility under the rules of the domestic legal system.

As indicated in paragraph (B) of said letter, previously quoted in its entirety (*supra*, § 36), the Sri Lankan Law provides, for the person who suffered losses owing to armed hostilities, "a remedy under *lex aquiliana* principles, namely, for intentional or negligent wrongdoing".

Nevertheless, the Tribunal deems appropriate, for procedural considerations, not to delve into the domestic law responsibility, since the Sri Lankan Law was not fully pleaded during the present arbitration proceedings.

III—The Legal and Factual Considerations on which the Respondent's Responsibility is Established

72. It is a generally accepted rule of International Law, clearly stated in international arbitral awards and in the writings of the doctrinal authorities, that :

- (i) - A State on whose territory an insurrection occurs is not responsible for loss or damage sustained by foreign investors unless it can be shown that the Government of that state failed to provide the standard of protection required, either by treaty, or under general customary law, as the case may be; and
- (ii) - Failure to provide the standard of protection required entails the state's international responsibility for losses suffered, regardless of whether the damages occurred during an insurgents' offensive act or resulting from governmental counter-insurgency activities.

73. The long established arbitral case-law was adequately expressed by Max HUBER, the *Rapporteur* in the *Spanish Zone of Morocco* claims (1923), in the following terms:

The principle of non-responsibility in no way excludes the duty to exercise a certain degree of vigilance. If a state is not responsible for the revolutionary events

themselves, it may nevertheless be responsible, for what its authorities do or not to do to ward the consequence, within the limits of possibility. (Translation from the French original text reported by CHENG, in his *general principles...*, *op. cit.*, at p. 229).

Furthermore, the famous arbitrator indicated that the "degree of vigilance" required in proving the necessary protection and security would differ according to the circumstances.

In the absence of any higher standard provided for by Treaty, the general international law standard was stated to reflect the "degree of security reasonably expected". Max HUBER indicated in this respect:

Du moment que la vigilance exercée tombe manifestement au-dessous de ce niveau par rapport aux ressortissants d'un Etat étranger déterminé, ce dernier est en droit de se considérer comme lésé dans des intérêts qui doivent jouir de la protection du droit international (*Rapport, U.N. Recueil des Sentences Arbitrales*, vol. II, p. 634; and in *Repertory...*, *op. cit.*, p. 426).

In implementation of said standard of vigilance "qu'au point de vue du droit international l'Etat est tenu de garantir", HUBER arrived in his award rendered on May 1, 1925 (*Britanic Property* case between Spain and the U.K.) to hold Spain responsible for: "manque de diligence dans la prévention des actes dommageables" (*U.N. Recueil des Sentences...*, *op. cit.*, p. 645), and in the *Melillea-Ziat, Ben Kiran* case he went as far as to declare the authorities responsible for: "négligence qui friserait la complicité" (*Ibid.*, p. 731).

74. Another reputed arbitrator and author, RALSTON acting as Umpire in the *Sambiggo* case between Italy and Venezuela, did not hesitate to declare:

The umpire ... accepts the rule that if in any case of reclamation submitted to him it is alleged and proved that Venezuelan authorities failed to exercise due diligence to prevent damages from being inflicted by revolutionists, that country should be held responsible (*U.N. Recueil des Sentences Arbitrales*, Vol. X, p.534).

75. On various other occasions, the State Responsibility had been admitted for failure to provide the required protection, as witnessed by the following examples:

- In the 1903 *Kummerow* case, the Germany/Venezuela Mixed Claims Commission declared:

substantially all the authorities on international law agree that a nation is responsible for acts of revolutionists under certain conditions such as lack of diligence, or negligence in failing to prevent such acts, when possible, or as far as possible to punish the wrongdoer and make reparation for the injuring (*Repertory, op. cit.*, Vol I, p. 37);

- In Max HUBER's Report of 1925 on "the Individual Claims" (*Spanish Zone of Morocco* cases), he treated the failure to provide the necessary protection and security as an omission or inaction, and considered that:

l'on est fondé à envisager cette inaction comme un manquement à une obligation internationale (*Repertory*, vol. II, p. 430);

- In the 1926 *Home Insurance Company* case, the Mexico/USA General Claim Commission emphasized the importance of the "duty to protect", which required undertaking all "means reasonably necessary to accomplish that end" (*Ibid.*, p. 433).

- In three successive years (1927, 1928, and 1929), the Mexico/USA General Claims Commission declared that the Mexican Government is to be responsible for what could be characterized as "lack of protection" in case this has been proven (the *David Richards* case (1927), the *Oriental Navigation Co.* case (1928), and the *F.M. Smith* case (1929), *Repertory*, vol. II, p. 435-437).

- In the *Victor A. Ermerins* case (1929), the Presiding Commissioner, Dr. SIND-BALLE, in response to the claim that the Mexican authorities failed "to afford protection to the interest of Ermerins", arrived at the conclusion that in the circumstances of that case:

a crime of this nature could not have taken place, if the authorities of the town had properly fulfilled their duty to afford protection to the property of Ermerins (*U.N. reports of International Arbitral Awards*, vol. IV, p. 476-477);

- In both the *Chapman* case and the *Mrs. Mead* case, adjudicated in 1930 by Mexico/USA General Claims Commission, in spite of the insufficiency of the records submitted, the Commission, relied on sworn affidavits and non-official reports introduced as evidence in order "to sustain the charge of lack of protection" (*U.N. Reports, op. cit.*, Vol. IV, p. 639 and p. 656-657);

In the *Dexter Balwin* case (1933), the Panama/USA General Claims commission, condemned the local authorities's failure "to afford protection" (*Repertory*, vol. II, p. 442);

- In the 1937 two cases concerning *Mr. Braumann* and *Frances Healey* against the Republic of Turkey, the Government was declared responsible according to NIELSON's ruling on the basis that "reasonable care to prevent injuries" was not afforded (*Ibid.*, p. 443-444).

76. In the light of all the above-mentioned arbitral precedents, it would be appropriate to consider that adequate protection afforded by the host State authorities constitutes a primary obligation, the failure to comply with which creates international responsibility. Furthermore, "there is an extensive and consistent state practice supporting the duty to exercise due diligence" (BROWNLIE, *System of the Law of Nations, State Responsibility—Part I*, Oxford, 1986, p. 162).

As a doctrinal authority, relied upon by both Parties during the various stages of their respective pleadings in the present case, Professor BROWNLIE stated categorically that:

There is general agreement among writers that the rule of non-responsibility cannot apply where the government concerned has failed to show due diligence (*Principles of Public International Law*, Third Edition, Oxford, 1979, p. 453).

After reviewing all categories of precedents, including more recent international judicial case-law, the learned Oxford University Professor arrived, not only to confirm that international responsibility arises from the mere "failure to exercise due diligence"

in providing the required protection, but also to note “a sliding scale of liability related to the standard of due diligence” (*State Responsibility, op. cit.* p. 162 and p. 168).

In addition, special attention has to be given to the following passages of BROWNLIE’s writings which seem to be of particular relevance to the present case:

- “Unreasonable acts of violence by police officers ... also give rise to responsibility” (*Principles, op. cit.*, p. 447);
- “Substantial negligence to take reasonable precautionary and preventive action” is deemed sufficient ground to create “responsibility for damage to foreign public and private property in the area” (*Ibid.*, p. 452);
- In commenting the ICJ Judgment rendered in the *Cofu* case (1949), the fact that “nothing was attempted to prevent the disaster” was qualified as “grave omission” which involved the international responsibility of Albania (*State Responsibility, op. cit.*, p. 154);
- With regard to the ICJ Judgment rendered in the *Hostages* case (1980), Professor BROWNLIE emphasizes Iran’s failure “to take appropriate steps to ensure the protection” required under the “full protection and security” provision of the Iran/U.S.A. Amity, Navigation and Commerce Treaty (*Ibid.*, p. 157).

77. A number of other contemporary international law authorities noticed the “sliding scale”, from the old “subjective” criteria that takes into consideration the relatively limited existing possibilities of local authorities in a given context, towards an “objective” standard of vigilance in assessing the required degree of protection and security with regard to what should be legitimately expected to be secured for foreign investors by a reasonably well organized modern State.

As expressed by Professor FREEMAN, in his 1957 Lectures at the Hague Academy of International Law:

The “due diligence” is nothing more nor less than the reasonable measures of prevention which a well-administered government could be expected to exercise under similar circumstances (*Responsibility of States...*, *op. cit.*, p. 15-16).

According to modern doctrine, the violation of international law entailing the State’s responsibility has to be considered constituted by “the mere lack or want of diligence”, without any need to establish malice or negligence (*cf.* C.F. AMERASINGHE, *State Responsibility for Injuries to Aliens*, Oxford, (1967), p. 281-282; F.V. GARCIA-AMADOR, *The Changing Law of International Claims*, vol. I, (1987), p. 115,118; M. BEDJAOUI, “Responsibility of States: Fault and Strict Liability”, *Encyclopedia of Public International Law*, vol. 10, (1987), p. 359; and K. ZEMANEK, “Responsibility of States: General Principles”, *Ibid.*, p. 365).

78. In the light of the above-stated international law precedents and authorities, the arbitral Tribunal has to review the evidence submitted by both Parties in the present case in order to establish the proven facts, and to determine whether these facts sustain the Claimant’s allegation that the Respondent Government failed to comply with its obligation under the Sri Lanka/U.K. Bilateral Investment Treaty (particularly the standard provided for in Article 2.(2)), as well as by virtue of the rules governing

State responsibility under general international law (which becomes necessarily applicable by virtue of the *renvoi* contained in Article 4.(1) of the Treaty)).

79. The Claimant’s case on the facts surrounding the events of January 28, 1987, as initially submitted can be summarized as follows:

- (a) - “During the later part of 1986 and into 1987, the Government of Sri Lanka was faced with grave difficulties because of terrorist activities, including terrorist activities in that part of the country which is near Serendib Seafoods, Ltd. farm” (*Claimant’s Memorial*, P. 7);
- (b) - The management of Serendib company had been closely cooperating “with the security authorities in the region”, and “was ready and willing to cooperate with the Government” (*Ibid.*, p. 8-9);
- (c) - The destruction and killing which took place on January 28, 1987 “was caused by special security forces”, under circumstances which “strongly suggest that this incident was a wanton use of force not required by the exigencies of the situation and not planned pursuant to any combat action” (*ibid.*, p. 8);
- (d) - The burning of Serendib’s “office structure, repair shed, store and dormitory”, the opening of the sluice gates to the grow-out ponds, thus destroying the shrimp crop, as well as the execution of “21 staff members of Serendib Staff”, was not needed since “less destructive action—short of wholesale destruction and murder—could surely have been taken by the Sri Lankan special security forces” (*Ibid.*, p. 9 and 10).

In order to substantiate the Claimant’s version of the January 28th, 1987 events, a number of sworn affidavits were submitted with the Claimant’s Memorial, all emanating from the former Serendib employees or relatives of dead former employees, together with copies of two letters addressed by Serendib’s Managing Director to the President of the Republic on February 2, and February 9, 1987 (Exhibits form (F) to (P)).

80. In the Claimant’s Reply to Respondent’s Counter-Memorial, special additional emphasis was put on reiterating that “the destruction and the killings on January 28, 1987 were caused by the STF”, and the following supplemental points were particularly stressed:

- “the Serendib farm was not a terrorist facility”;
- “the STF did not meet with violent resistance from the farm on January 28, 1987”;
- “extensive combat action did not occur at the farm between terrorists and the STF”; and
- “that Respondent has admitted its liability by offering compensation payments to families of the staff members killed by the STF” (*Claimant’s Reply*, p. 72).

Among the documents attached to Claimant’s Reply to the Respondent’s Counter-Memorial, only one Exhibit related to the factual aspects of the events that took place on January 28, 1987, and during the following days was submitted as

"Exhibit 00". The document in question contains a letter addressed to the Managing Director of Serendib Company by the Batticaloa District Citizen's Committee about the results of the visit of the farm that took place on February 10, 1987.

81. Furthermore, the only person who gave testimony in front of the Tribunal during the oral phase of the arbitration proceedings was the Managing Director of Serendib Company, Mr. Victor Santiapillai, whose two letters to the President of the Republic were submitted as evidence by the Claimant according to what has been previously indicated (Claimant's Exhibits (M) and (P)).

Mr. Santiapillai was examined by the Claimant's Counsel and cross-examined by the Respondent's Counsel.

82. The Respondent's case provided a different version of the facts, which can be summarized as follows:

- (a) - "The Government of Sri Lanka was seeking ways to prevent the spread of terrorism and the erosion of Government control in the towns surrounding the shrimp farm" (*Government's Counter-Memorial*, p. 3);
- (b) - "that the Serendib farm was, in the months preceding the operation (of January 28, 1987), used by Tiger rebels as a base of operations and support" (*Ibid.*, p. 4);
- (c) - "That the farm's management cooperated with the Tigers (*Ibid.*, p. 4)
- (d) - "That operating out of the farm (and the surrounding area) the Tigers violently resisted the Special Task Force raid", and "intense combat action occurred at the farm between the Tigers and the special Task Force during the raid" (*Ibid.*, p. 4);
- (e) - "Any destruction of the farm which occurred was caused directly by terrorist action (in particular, mortar fire), and not by the Special Task force" (*ibid.*, p. 41).

83. During the first exchange of the written pleadings, the Respondent's case on the facts concerning the events of January 28, 1987 relied exclusively on three Exhibits submitted with the Counter-Memorial, which contain:

- (i) - Document containing the Report of Assistant Superintendent Nimal Lewke, dated February 2, 1987, and addressed to his superior, Superintendent Karunasena, Commander of the Special Task Force (Exhibit No. 34);
- (ii) - Document dated February 1, 1987, by virtue of which the Operation's Commander Superintendent Karunasena addressed his Report to his superior, Superintendent Sumith Silva, the Coordinating Officer of Batticaloa (Exhibit No. 35); and
- (iii) - Three internal correspondence within the General Intelligence & Security Department of the Ministry of Defense, dated successively February 3, 1987, February 9, 1987, and March 18, 1987, all related to the fate of Serendib's prawns which were in the farm ponds and disappeared after the farm's destruction on January 28, 1987 (Exhibit No. 36).

84. The text of the Respondent's Rejoinder contained no new elaboration on the facts, but its enclosures comprised two additional Exhibits related to the events of January 28, 1987, which are:

- (i) - A sworn affidavit dated October 17, 1988 (Exhibit No. 38) emanating from the same Mr. Karunasena, the author of the report previously submitted as Exhibit No. 35; and
- (ii) - A sworn affidavit dated also October 17, 1988 (Exhibit No. 39), emanating from Mr. Sumith Silva, the area Coordinating Officer to whom Mr. Karunasena's Report has been previously submitted.

85. Exercising its recognized prerogatives with regard to the evaluation of the entire evidence submitted by both Parties taken as a whole, and after careful consideration of all arguments raised during the proceedings related to the factual aspects of the case, the Arbitral Tribunal came to the following conclusions:

- (A) - Both Parties are in agreement about one fact; that the infiltration by the rebels of the area in which Serendib's farm was located took such magnitude that the entire district had been for several months before January 1987 practically out of the Government's control.

Though such admitted situation would have raised logically the question of whether there was during that period failure from the Government's part to provide "full protection and security" according to the objective standard suggested to be applicable, said question remains theoretical since there were no claimed "losses suffered" due to the lack of governmental protection throughout that period.

- (B) - The Respondent never contested the evidence given by Mr. Santiapillai, neither during the written phase of the proceedings, nor when he gave his testimony at the Oral Hearing, about what he expressed in his letter of February 2, 1987, addressed the Sri Lankan President of the Republic by stating:

we maintained very cordial relationship with the senior officers of the security forces in Batticaloa, repeatedly told them that, if they had the slightest reservation about any of our Batticaloa staff they should let us know quietly and we would take action directly to get such persons out of the company.

More importantly, Mr. Santiapillai, indicated that:

On last visit to Batticaloa, (he) met Sumith de Silva, Coordinating Officer for the area, on January 17, 1987, (and) introduced (to him) the new Farm Manager (Mr. Karunargy), who was appointed on 1 January 1987 Farm Manager, after having worked for the Company since its inception.

He added, that during that visit to Mr. Sumith de Silva on January 17, 1987, the latter:

assured me ... that he had no such reservation.

In his Affidavit prepared and sworn in October 1988; *i.e.* after Mr. Santiapillai's letter was produced as evidence by the Claimant in the present case, the same Mr. Sumith de Silva did not contest that the meeting in question took place at the

indicated date (just 10 days before the January 28, 1987 operation), he did not contradict the substance of the reported discussion, and he did not deny the existence of "cordial relationship" as manifested by making "enquiries from government officials" before recruiting staff and readiness to dismiss whoever the authorities have "the slightest reservation" about him.

In the light of said uncontested evidence, the Tribunal is of the opinion that reasonably the Government should have at least tried to use such peaceful available high level channel of communication in order to get any suspect elements excluded from the farm's staff. This would have been essential to minimize the risks of killings and destruction when planning to undertake a vast military counter-insurgency operation in that area for regaining lost control.

The Tribunal notes in this respect that the failure to resort to such precautionary measures acquires more significance when taking into consideration that such measures fall within the normal exercise of governmental inherent powers—as a public authority—entitled to order undesirable persons out from security sensitive areas. The failure became particularly serious when the highest executive officer of the Company reconfirmed just ten days before his willingness to comply with any governmental requests in this respect.

Accordingly, the Tribunal considers that the Respondent through said inaction and omission violated its due diligence obligation which requires undertaking all possible measures that could be reasonably expected to prevent the eventual occurrence of killings and property destructions.

- (c)- There are no reasons to doubt the Respondent's submission regarding the long planned character of the January 28, 1987 operation given the code-name "Day Break" which obtained prior high level clearance. But the Tribunal does not consider the military reports prepared at a later date conclusive evidence with regard to the alleged heavy firing coming "from the direction of the Prawn Farm", or that "the enemy hold up in the Farm" and resisted the security forces during a period over two hours.

The reports of the two officers are contradicted on these specific points by the information contained in the affidavits sworn by Mr. Kirupakara, the casual worker at Serendib farm (Exhibit F), and by Mr. Selbatnamby, the tractor driver at Serendib farm. Both provide more detailed account as eye-witnesses about what effectively happened on the spot with extreme rapidity between 7.45 in the morning, when gunfire came "in the direction of the office" causing the employees to "rush into the Farm office for shelter", and 8.00, when "three officers attached to the STF entered the office". The taking-over of the Farm by the security forces faced no resistance according to these two eye-witnesses, and there were no destructions at that time, as witnessed by the fact that the tractor driver returned later in the day to the Farm with four members of the security forces to take certain equipments from the Farm Office, which implies that it remained non-destroyed till then.

Moreover, it has to be noted that of the officers' reports raise certain issue of credibility with regard to their chronological order, since unexpectedly the commander of the operation, Mr. Karunasena who was observing from a helicopter reported to his superior the Area Coordinating Officer Sumith de Silva on February 1, 1987, before receiving any report from his assistant Mr. Lewke who effectively conducted on the ground the operation of taking over the farm facilities (the latter's report is dated February 2, 1987).

Therefore, the Respondent's version of the events has to be considered lacking convincing evidence with regard to the allegation that the farm became a "terrorist facility" which "violently resisted the Special Task Force" through an "intense combat action" that "occurred at the Farm".

Apparently, the officers' version of the events, which are not substantiated with any credible evidence, and which are contradicted by the Affidavits submitted by eye-witnesses, were intended to cover up their inability to prevent the destruction of the farm.

- (d) - Neither Party succeeded in providing the Tribunal with convincing evidence about: (i)—the circumstances under which the destruction of the premises took place after they came under the control of the governmental forces; (ii)—who are the persons responsible for the effective destruction of the farm premises; (iii)—how was the destruction committed; and (iv)—how the subsequent acts causing the loss of the prawns in ponds took place.

The Respondent could have at least provided the results of investigations conducted in this respect by the competent Sri Lankan authorities, particularly since all the events in question took place during the two weeks period when the farm was under the exclusive control of the security forces.

In final analysis, no conclusive evidence exists sustaining the Claimant's allegation that the special security forces were themselves the actors of said destruction causing the losses suffered.

At the same time no conclusive evidence sustains the Respondent's allegation that the destruction were "caused directly by the terrorist action".

Hence, the adjudication of the State's responsibility has to be undertaken by determining whether the governmental forces were capable, under the prevailing circumstances, to provide adequate protection that could have prevented the destructions from taking place totally or partially.

In this respect, it has been already indicated that the governmental authorities should have undertaken important precautionary measures to get peacefully all suspected persons out of Serendib's farm before launching the attack, either through voluntary cooperation with the Management of the company or by ordering the Company to expel the suspected persons.

The reports of Messrs. Lewke, Karumasena, and Silva, as well as the sworn affidavits of the last two senior officers, provide certain indications that the governmental authorities failed to undertake such measures because they were

considering as suspected guerrilla supporters the entire Management of Serendib Company, starting from the newly appointed farm manager Mr. Karunargy, up to the American Manager, Mr. Bruce Cyr. Even Mr. Santiapillai the Managing Director was accused of "complicity with LLTE as far as the management of the Prawn Farm is concerned" (Paragraph 8, of the Report of the Commandant/STF dated March 18, 1987, *Respondent's Exhibit No. 37*, which referred to "evidence" against the Managing Director to that effect).

If this had been effectively the case, in the opinion of the Tribunal, the legitimate expected course of action against those suspected persons would have been either to institute judicial investigations against them to prove their culpability or innocence, or to undertake the necessary measures in order to get them off the Company's farm. But, as previously explained, nothing of the sort took place. On the contrary, only ten days before the January 28, 1987, operation no complaints were voiced against any of them, including the newly appointed farm manager Mr. Karunargy, during the meeting of Mr. Santiapillai with the Area Coordinating Officer Mr. Sumith de Silva. The mere fact that Mr. Karunargy had been the first person who lost his life during the first hours of the operation "Day Break", under the circumstances described by Mr. Kirupakara in his Affidavit (*Claimant's Exhibit F*) and Mr. Selbathnamny in his Affidavit (*Claimant's Exhibit G*), casts serious doubts about the ability of the security forces which took control over Serendib's farm to provide the required standard of protection in preventing human losses, or a *fortiori* of property destruction, which is by far a less imperative objective.

Therefore, and faced with the impossibility of obtaining conclusive evidence about what effectively caused the destruction of the farm premises during the period in which the entire area was out of bounds under the exclusive control of the governmental security force, the Tribunal considers the State's responsibility established in conformity with the previously stated international law rules of evidence (especially *Rules (L) and (M)*, *supra* § 56).

86. For all the legal and factual considerations contained in the present section of the award, the Tribunal came to the conclusion that the Respondent's responsibility is established under international law.

IV—The Legal Consequences of the Respondent's International Responsibility

(A)—Quantum of the compensation

87. Both Parties are in agreement that whenever the State's responsibility is established, due to failure of its authorities to provide foreign investors with the full protection and security required under the relevant international law rules and standards, the interested party becomes entitled to claim the type of remedy deemed appropriate,

which takes in the present case the form of monetary compensation (*Respondent's Counter-Memorial*, p. 28–29, p. 39, p. 40, p. 42 ss; and *Government's Rejoinder*, p. 11 ss).

88. Both Parties are equally in agreement about the principle, according to which, in case of property destruction, the amount of the compensation due has to be calculated in a manner that adequately reflects the full value of the investment lost as a result of said destruction and the damages incurred as a result thereof.

The basic rule long established in this respect was clearly formulated by Max Huber in the 1925 *Melilla-Ziat, Ben Kim* case in the following words:

Le dommage éventuellement remboursable ne pourrait être que le dommage direct, à savoir la valeur de marchandises détruites ou disparues (*U.N. Reports of International Arbitration Awards*, vol. II, p. 732).

Thus, the task of the Tribunal in the present case has to focus on the determination of the "value" of the Claimant's right which suffered losses due to the destruction that took place on January 28, 1987, and throughout the following days during which Serendib's farm remained under governmental temporary occupation (unjustifiably characterized by the Claimant as *de facto* "requisition", since it has not been proven that the Government used the farm to promote its own military interests and to benefit thereof).

89. Disagreement among the two Parties to the present arbitration emerges only with regard to the following two major points:

- (i) - Which elements have to be taken into consideration in calculating the Claimant's property rights to be compensated; and
- (ii) - What quantum reflects the full value of the elements constituting the Claimant's property right to be compensated.

90. With regard to the first point, the elements enumerated in the Claimant's Memorial included the following:

- (A) - 50% of the physical direct losses sustained by Serendib Company on January 28, 1987, which comprise:
 - (1) - loss of revenue from stocks of shrimp existing by then in the ponds;
 - (2) - value of farm structure and equipment destroyed, damaged or missing;
 - (3) - loss of investment in technical staff training at the farm;
 - (4) - compensation payable to dependents of dead staff members;
 - (5) - pond rehabilitation to resume operations.
- (B) - The "going concern value" of the Claimant's 50% share-holding percentage in Serendib Company on January 28, 1987.
- (C) - 50% of the projected lost profits for a reasonable period of 18 months (*Claimant's Memorial*, p. 14–16).

91. According to the final form submitted by the end of the oral hearing on April 19, 1989, expressing the Claimant's conclusions, the Tribunal was requested to award AAPL compensation that includes the following elements:

- (A) - 48.2% of the value of assets destroyed, comprising

- (1) - physical assets;
 - (2) - financial assets;
 - (3) - intangible assets.
- (B) - 48.2% of Serendib's net projected future earnings.

92. The Respondent's Counter-Memorial, emphasized the following important aspects:

- (i) - AAPL's Claims is "largely based on the illusion of expected profitability" (*Government's Counter-Memorial*, p. 42);
- (ii) - AAPL's claim "is based on blatant double (or triple) counting. AAPL claims entitlement not only to its share of "going concern value" of Serendib, but also to indemnification for physical losses and lost prospective profits. Yet AAPL cannot be entitled to both, because any measurement of the "going concern value" of Serendib on January 28, 1987, includes a valuation of the net book value of both Serendib's assets and its future profitability" (*Ibid.*, p. 43);
- (iii) - "In the event the Tribunal finds the Government liable to AAPL for damage sustained by Serendib, the Tribunal must chose *either* to undertake a going concern valuation *or* to determine damages for "physical loss" and lost prospective profits, but cannot logically award both" (*Ibid.*, p. 43).

93. During the course of the proceedings, the Respondent added another basic objection according to which the percentage of AAPL's share-holding in Serendib is neither 50% as initially claimed, nor 48.2% as subsequently admitted, but a far lesser percentage, since the "preference shares" of the Export Development Board should be taken into consideration as an integral part of Serendib's equity capital.

94. The Parties were invited by the Tribunal to express their considered opinions and conclusions on that issue, by virtue of the Order of April 20, 1989, rendered at the end of the oral hearing, and lengthy exchanges took place in this respect on May 22, and May 29, 1989 as previously indicated (*supra*, § 1.2).

95. In deciding on the issues under consideration which are subject to disagreement among the Parties, the Tribunal has primarily to indicate that AAPL is entitled in the present arbitration case to claim compensation under the Sri Lanka/U.K. Bilateral Investment Treaty, on the legal grounds previously described in Part II of this award due to the fact that the Claimant's "investments" in Sri Lanka "suffered losses" owing to events falling under one or more of the circumstances enumerated by Article 4.(1) of the Treaty ("revolution, state of national emergence, revolt, insurrection", etc....).

The undisputed "investments" effected since 1985 by AAPL in Sri Lanka are in the form of acquiring shares in Serendib Company, which has been incorporated in Sri Lanka under the domestic Companies Law.

Accordingly, the Treaty protection provides no direct coverage with regard to Serendib's physical assets as such ("farm structures and equipment", "shrimp stock in

ponds", cost of "training the technical staff", etc.), or to the intangible assets of Serendib if any ("good will", "future profitability", etc...). The scope of the international law protection granted to the foreign investor in the present case is limited to a single item: the value of his share-holding in the joint-venture entity (Serendib Company).

96. In the absence of a stock market at which the price for Serendib's shares were quoted on January 27, 1987 (the day preceding the events which led to the destruction of the value of AAPL's investment in Serendib's capital), the evaluation of the shares owned by AAPL in Serendib has to be established by the alternative method of determining what was the reasonable price a willing purchaser would have offered to AAPL to acquire its share holding in Serendib.

97. Certainly, all the physical assets of Serendib, as well as its intangible assets, have to be taken into consideration in establishing the reasonable value of what the potential purchaser could have been willing to offer on January 27, 1987 for acquiring AAPL's shares in Serendib. But the reasonable price should have reflected also Serendib's global liability at that date; *i.e.* the aggregate amount of the current debts, loans, interests, etc... due to Serendib's creditors.

98. Consequently, the Tribunal is of the opinion that the determination of the percentage of AAPL's share-holding in Serendib's capital is a false problem, since the relevant factor is to establish a comprehensive balance sheet which reflects the result of assessing the global assets of Serendib in comparison with all the outstanding indebtedness thereof at the relevant time.

For the purpose of evaluating the market price of AAPL's shares on January 27, 1987, the result would be ultimately the same whether or not the "preference shares" of Sri Lanka's Export Development Board technically qualify under the domestic companies law as part of Serendib's capital. Assuming that the correct legal interpretation of the Sri Lankan Law would lead to include among Serendib's capital assets the value of the "preference shares" issued in favour of the Export Development Board as a security for the cash money funds already supplied to the Company, Serendib's capital assets would have on one hand, to be considered increased. But on the other hand, the global amount of the Development Board's disbursements together with the accruing interests due on January 27, 1987, should be taken into consideration in reflecting Serendib's global indebtedness.

In other words, in case the "preference shares" of Export Development Board decrease AAPL's percentage of share-holding in Serendib's equity capital, this would not ultimately affect the value of AAPL's share-holding.

In the language of figures, a 48% ordinary share-holding is an equity capital amounting to 21,464,241 Sri Lankan Rupees (*S-L.Rs*) equals 37% share-holding in an entity having a total capital of *S-L.Rs* 28,184,241 (*i.e.* by adding the value of the preferences shares).

At the other side of the equation, assuming 48% of loan liabilities totalling *S-L.Rs* 70,024,000, is the same as acquiring 37% of the global indebtedness amounting to *S-L.Rs* 76,744,000.

99. Taking into consideration the above stated preliminary remarks of general character, the Tribunal is faced with no legal objections in allocating to the Claimant compensation for the damages which were effectively incurred due to the destruction of a substantial part of Serendib's physical assets, thus rendering the legal entity in which AAPL invested out of business since January 28, 1987. In essence, Serendib ceased as of that date to be a "going concern" capable of realizing profits, thus causing AAPL's investment therein to become a total loss.

100. In the light of all the elements of evidence provided by both Parties, including the evaluation Report of *Coopers & Lybrand*, the additional explanation pertaining thereto (filed by AAPL as *Exhibit BB*), the Respondent's objections raised in the *Government's Rejoinder* (p. 17ss), as well as those other issues raised during the Oral Hearing, particularly in cross-examination of the Claimant's advisor Mr. Deva Rodrigo which led to revised evaluation figures submitted by the Claimant before the end of the Oral hearing, the Tribunal considers that the fair evaluation exclusively based on Serendib's tangible assets leads to value AAPL's investment in that company at a total amount of 460,000 U.S. Dollars.

101. Nevertheless, the major part of the Claimant's pleas were directed towards obtaining 5,703,667 U.S. dollars as compensation for a variety of other claimed damages, which include intangible assets, mainly "goodwill", and loss of future profits.

The admissibility of such claims raised serious legal objections from the Respondent, which are expressed in the following two quotations:

- (a) - "International arbitral tribunals are bound to project future on the basis of the past, Serendib's history offers no sound basis for projecting any future profitability" (*Counter-Memorial of the Government*, p. 49);
- (b) - "The loss of crops to be harvested in the future has usually been considered to be too speculative and indefinite to be included as a proper element of damage under international law" (*Ibid.*, p. 50).

102. In the Tribunal's view, it is clearly understood that the evaluation of the "going concern" which is Serendib Company in the present case, has for unique objective the determination of what could be the reasonable market value of the Company's shares under the circumstances prevailing on January 27, 1987. Hence, as a general rule all elements related to subsequent developments should not be taken as such into consideration, and *lucrum cessans* in the proper sense could not be allocated in the present case for which the precedents concerning unlawful expropriation claims or liability for unilateral termination of a State contract are of no relevance.

The only pertinent question in the present case would be to establish whether Serendib have had by then developed a "good will" and a standard of "profitability" that renders a prospective purchaser prepared to pay a certain premium over the value of the tangible assets for the benefit of the Company's "intangible" assets.

Consequently, the projection of future profits in function of the "Discounted Cash Flow Method" (DCF) has to be envisaged simply as a tool to assess the level of

Serendib's future profitability under all relevant circumstances prevailing at the beginning of 1987.

103. In this respect, it would be appropriate to ascertain that "goodwill" requires the prior presence on the market for at least two or three years, which is the minimum period needed in order to establish continuing business connections, and during that period substantial expenses are incurred in supporting the management efforts devoted to create and develop the marketing network of the company's products, particularly in cases like the present one where the Company relies exclusively on one product (shrimps) exportable to a single market (Japan).

The possible existence of a valuable "goodwill" becomes even more difficult to sustain with regard to a company, not only newly formed and with no records of profits, but also incurring losses and under-capitalized.

A reasonable prospective purchaser would, under these circumstances, be at least doubtful about the ability of the Company's balance sheet to cease being in the red, in the sense that the future earnings become effectively sufficient to off-set the past losses as well as to service the loans which exceed in their magnitude the Company's capital assets.

104. Furthermore, according to a well established rule of international law, the assessment of prospective profits requires the proof that:

"they were reasonably anticipated; and that the profits anticipated were probable and not merely possible" (Marjorie M. WHITEMAN, *Damages in International Law*, vol. II, (1937), p. 1837, with reference to extensive supporting precedents disallowing "uncertain" or "speculative" future profits, p. 1836-1849; The 1902 Award rendered in *EL Triunfo* case (EL Salvador/U.S.A.), *Repertory, op.cit.*, vol. I, § 1350, p. 324; The 1903 Award rendered by the Italy/Venezuela Mixed Commission in the *Poggidi* case, *Ibid.* § 1358, p. 328-329; Ignaz SEIDEL-HOHENVELDOERN, "L'Evaluation des Dommages dans les Arbitrages Transnationaux", *Annuaire Français de Droit International*, vol. XXXIII, (1987), p. 17 ss. with ample reference to the numerous decisions rendered by the Iran/USA Claims Tribunal to that effect, and interestingly the Author's reference to the DCF calculations provided by the Expert Accountants of the Parties which contain "élément de conjecture" looking: "guère moins spéculatifs et tout aussi obscurs que les prophéties de Nostradamus" P. 24).

105. The Claimant itself, in the *Reply to the Respondent's Counter-Memorial* (p. 64-68), reproduced a long quotation from the Award rendered on July 14, 1987, by the Chamber presided by the late Michel VIRALLY, in the case *AMOCO International Finance Corporation v. Iran*, which after clearly distinguishing the *lucrum cessans* from the "future prospects" of profitability that constitutes an element to be taken into consideration in evaluating the "going concern", find necessary to emphasize the need to prove that:

the undertaking was a "going concern" which had demonstrated a certain ability to earn revenues and was, therefore to be considered as keeping such ability for the future (§ 203 of the Award as quoted on p. 67 of the *Claimant's Reply*).

The fact that Serendib exported for the first time two shipments to Japan during the same month of January 1987 when its farm was destroyed, does not sufficiently demonstrate in the Tribunal's opinion "a certain ability to earn revenues" in a manner that would justify considering Serendib—by exporting for the first time in its short life—able to keep itself commercially viable as a source of reliable supply on the Japanese market.

106. In the light of the above-stated considerations, and taking into account all the evidence introduced by both Parties with regard to the existence or non-existence of "intangible assets" capable of being evaluated for the purpose of establishing the total appropriate value of Serendib on January 27, 1987, the Tribunal comes to the conclusion that neither the "goodwill" nor the "future profitability" of Serendib could be reasonably established with a sufficient degree of certainty.

107. Without putting into doubt the binding force of the rules requiring that the intangible assets including "goodwill" and "future profitability" of an enterprise have to be reflected in the evaluation of a "going concern", the Tribunal's opinion is established on considering the assumptions upon which the Claimant's projection were based in the present case insufficient in evidencing that Serendib was effectively by January 27, 1987, a "going concern" that acquired a valuable "goodwill" and enjoying a proven "future profitability", particularly in the light of the fact that Serendib had no previous record in conducting business for even one year of production.

108. Therefore, all the amounts of claimed compensation for "intangible assets", as well as for "future earnings" are rejected.

(B)—*The issue of AAPL's Guarantee to the European Asian Bank*

109. Evidently, the present Arbitral Tribunal does not have jurisdiction to adjudicate any controversy or dispute related to the interpretation of AAPL's Guarantee given for the benefit of Serendib in AAPL's capacity as share-holder in Serendib Company, in order to determine whether said Guarantee came to an end or is still operative and capable of creating potential liability on AAPL.

110. Nevertheless, the Tribunal takes into consideration that AAPL as Claimant in the present Arbitration has considered its investment in Serendib a total loss, and submitted in its final conclusions dated April 19, 1989, that:

... AAPL is willing to give up its shares of Serendib Seafoods Ltd, should the Respondent pay adequate compensation.

The Tribunal equally notes that the Respondent Government did not raise any objection, with regard to said offer.

111. Accordingly, the Tribunal deems appropriate to invite the two Parties to envisage, upon reception of the amounts becoming due to the Claimant by virtue of the present Award, to conclude an agreement according to which AAPL undertakes all the necessary steps in order to transfer free of charge all its shares in Serendib

Company to the Government of Sri Lanka or to any other entity the Government may nominate, with the understanding that said transfer of title on the shares entails in exchange the passing of any potential liability under the European Asian Bank Guarantee from AAPL to the new owner of the shares.

(C)—*The allocation Of Interest*

112. The Claimant requested interest at the rate of 10% per annum as of the date of the losses incurred (January 28, 1987), and the Respondent did not raise any objection with regard to, either the principle of entitlement to interests in case the Government's responsibility is sustained by the Tribunal, or to the suggested rate of 10% per annum.

113. In accordance with a long established rule of international law expressed since 1872 by the Arbitral Tribunal which adjudicated the *Alabama* case between the U.K. and U.S.A., "it is just and reasonable to allow interest at a reasonable rate" (*Report, op.cit.*, vol. I, § 1382, p. 343).

In implementation of the above-stated rule, and in view of the Parties' attitude indicated herein-above, the present Tribunal deems appropriate to allocate interest on the amount of U.S. \$460,000 granted to the Claimant as previously stipulated (§ 100), at the rate of 10% per annum.

114. The only pending issue in this respect relates to the date from which that interest starts accruing.

The survey of the literature reveals that, in spite of the persisting controversies with regard to cases involving moratory interests, the case-law elaborated by international arbitral tribunals strongly suggests that in assessing the liability due for losses incurred the interest becomes an integral part of the compensation itself, and should run consequently from the date when the State's international responsibility became engaged (*cf.* R. LILLICH, "Interest in the Law of International Claims", *Essays in Honor of Vade Saario and Toivo Sainio*, (1983), P. 55-56).

115. Therefore, and taking into account that Article 8.(3) of the Sri Lanka/U.K. Bilateral Investment Treaty provides that the foreign investor becomes entitled to file a recourse in front of the Centre only in case agreement with the Host State "cannot be reached within three months", and since the claimant in the present case effectively submitted his Request of Arbitration on the 8th of July, 1987, the Tribunal rules that the 10% per annum rate of interest adopted starts accruing as of July 9th, 1987, and continues to run as a part of the compensation allocated to the Claimant up to the date of the payment of the sum awarded.

(D)—Costs

116. In implementation of Article 61.(2) of ICSID Convention, the Tribunal exercises the discretionary power accorded thereto in the following manner:

- (i) - in assessing the fees and expenses incurred by the Claimant in preparation and presentation of its case, all the amounts figuring in AAPL's final Statement of May 7, 1990 under *Items 1, 4, 5 and 6* in the Section entitled "Statement of expenditure incurred by AAPL and its officers" have to be excluded, since they are not proven necessary "in connection with the proceedings", and the rest which is totalling U.S. \$164,917.20 (One Hundred, Sixty Four Thousands, Nine hundred Seventeen, and Twenty Cents) has to be shared on the basis of two thirds by the Claimant and one third by the Respondent;
- (ii) - the Respondent has to bear all the fees and expenses incurred in preparation and presentation of its case;
- (iii) - the costs of the arbitration, including the arbitrators' fees and the administrative charges of the Centre, have to be shared on the basis of 40% by the Claimant and 60% by the Respondent.

For the above-stated reasons:

THE TRIBUNAL DECIDES AS FOLLOWS:

1. The Republic of Sri Lanka shall pay to Asian Agricultural Products Ltd., the sum of U.S. Dollars FOUR HUNDRED AND SIXTY THOUSAND (U.S. \$ 460,000) with interest on this amount at the rate of ten percent (10%) per annum from July 9, 1987 to the date of effective payment.

2. The Two Parties are invited to envisage adopting a solution that would permit, upon reception of the payment due under the preceding paragraph, to conclude an agreement according to which Asian Agricultural Products Ltd. undertakes all the steps required in order to transfer free of charge all its shares in Serendib SEA-FOODS LTD. to the Government of Sri Lanka or any other entity the Government may nominate, provided that in exchange the new owner of the shares assumes any potential liability under the European Asian Bank Guarantee previously granted by AAPL as shareholder to the benefit of Serendib Company.

3. All other submissions of the Parties are rejected.

4. The Republic of Sri Lanka shall bear the amount of U.S. \$54,972.40 (Fifty Four Thousands Nine Hundred Seventy Two, and Forty Cents) which represents one third of the relevant fees and expenses incurred by Asian Agricultural Products Ltd. for the preparation and presentation of its case.

5. The Republic of Sri Lanka shall bear the fees and expenses it incurred for the preparation and presentation of its case.

6. The Republic of Sri Lanka shall bear sixty percent (60%) of the arbitrators' fees and expenses and the charges of use of the facilities of the Centre, and the remaining forty percent (40%) shall be borne by Asian Agricultural Products Ltd.

Ahmed S. EL-KOSHERI

Berthold GOLDMAN

Signed by both arbitrators forming the majority of the Arbitral Tribunal on 21 June 1990, after taking notice of Dr. ASANTE's Dissenting Opinion dated 15 June 1990.