Deutsche Bank AG v Sri Lanka, ICSID Case No. ARB/09/02, Award

Summary: The Claimant created a specific derivative instrument allowing Sri Lanka's state-owned enterprise to hedge against oil price increases and variations. The state-owned enterprise failed to make monthly payments as required. The Claimant terminated their agreement and commenced ICSID proceedings on basis of breach of the Germany-Sri Lanka BIT.

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

DEUTSCHE BANK AG

v.

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

AWARD

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

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

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

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

134. According to Claimant, Deutsche Bank's rights under the Hedging Agreement are definitely an "*asset*" and they comprise both "*claims to money*" and "*claims to performance*" within Article 1(1)(c). Claimant submits that no tribunal has read the circular language "*associated with an investment*" in the restrictive way Sri Lanka intends. For its position, Claimant refers *inter alia* to *CSOB v. Slovak Republic*, where the Arbitral Tribunal was faced with a similar language under Article (1)(c) of the Czech Republic-Slovakia BIT and had no difficulty finding that "*terms as broad as "asset" and "monetary receivables or claims" clearly encompass loans*"[63]. Claimant also refers to the *Alpha Projekt Holding v. Ukraine* case[64] in which the Arbitral Tribunal decided that loan agreements can be considered an investment.

135. Finally, Claimant submits that even if the words "*and associated with an investment*" had to receive the meaning given by Respondent, they only apply to "*claims to performance*" and not to "*claims to money*".

II. Territorial nexus with Sri Lanka

136. Claimant submits that the jurisdictional provisions in Articles 1 and 11 of the Treaty do not contain any territoriality requirement. Claimant accepts that some territorial nexus with Sri Lanka was required in order to engage the substantive protections of the Treaty but Claimant considers this to be a merits issue to be determined when considering the actions of the relevant authorities in relation to the investment and that there was no independent requirement for any investment to be physically located in Sri Lanka.

137. Claimant further submits that in any event, it is clear that the Hedging Agreement satisfied any territoriality requirement, and that Sri Lanka's suggestion that the Agreement cannot be located in its territory because the Central Bank "*did not and cannot regulate the seller of the product, DB London*" is incorrect.

138. According to Claimant, there are several arguments for its position: First, Claimant submits that in most treaty disputes, where the investment in question is a State contract, the host State will not be able to regulate the foreign counterparty *per se* but merely its activities in furtherance of the contract.

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

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

139. Secondly, Claimant asserts that the legal parties to the Hedging Agreement were CPC and Deutsche Bank AG and not Deutsche Bank London. The Central Bank is able and did in fact regulate Deutsche Bank AG through its Colombo branch in relation to the contract. The Central Bank assumed regulatory jurisdiction over Deutsche Bank AG's contract and the fact that it was achieved via its jurisdiction over Deutsche Bank AG's branch in Colombo is of no importance. Claimant refers in this respect to the testimony of Mr. Silva and Mr. Rodrigo[65].

140. Thirdly, according to Claimant, Sri Lanka overlooked the fact that the Hedging Agreement could not have been concluded without Deutsche Bank Colombo. The minutes of the Study Group make this clear. Mr. Karunaratne, member of the Study Group, confirmed in his evidence that a local presence was indeed a requirement of the Central Bank. He made clear that CPC would not have concluded the Hedging Agreement if Deutsche Bank did not have a presence in Colombo, and it is precisely for this reason that it did not conclude an agreement with Merrill Lynch. All five banks which concluded Hedging Agreements with CPC had a local presence.

141. In Claimant's view, Mr. Karunaratne also confirmed that in relation to the Hedging Agreement, he only dealt with Mr. Serasundera, that all meetings took place at CPC's office and that he had no contact with Deutsche Bank London[66]. Further, Mr. Serasundera spent more than 50% of his time over almost a two-year period working on various aspects of the Hedging Agreement including overseeing the necessary internal approvals, satisfying documentary requirements, obtaining quotes, liaising with CPC, and providing market updates to CPC almost daily[67]. Claimant concludes that but for the existence and involvement of Deutsche Bank Colombo, the Hedging Agreement could not have been concluded and that Deutsche Bank Colombo played an indispensable role in relation to the investment. According to Claimant, this was sufficient to establish the required territorial nexus with Sri Lanka.

142. Claimant also insists on the global nature of Deutsche Bank's operations which is reflected in the presence of many branches and the centralisation of some of the functions in certain centers, such as Singapore where all credit decisions are made with regard to Sri Lankan clients. According to Claimant, the majority of the day-to-day interaction of Mr. Serasundera in relation to the Hedging Agreement was with Mr. Wong, Mr. Ng, Mr. Mazumder and Mr. Iyer, all of whom are based in Asia[68]. In Claimant's view, the global

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

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

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

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

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

143. Claimant finally submits that the nature of any territoriality requirement must depend on the investment at issue. In the case of financial instruments, Claimant asserts that it is well established that the territorial nexus exists where the purpose of the transaction is achieved in the host State. *Abaclat* confirmed this approach, holding that in the case of financial instruments: "*the relevant criteria should be where and/or to the benefit of whom the funds are ultimately used, and not the place where the funds were paid out or transferred*"[69]. Since the parties agreed that the reduction of volatility is the purpose of the hedging transaction[70], and since the Hedging Agreement immediately reduced CPC's exposure to volatility by 9.04%, the defining feature of the Agreement occurred in Sri Lanka. Moreover, according to Claimant, all other benefits of the Agreement such as the improvement of CPC's cash flow also occurred in Sri Lanka and all payments by Deutsche Bank to CPC in order to offset the problem caused by high oil prices were required to be made in Sri Lanka; let alone the fact that in this case, the territorial nexus also included substantial activities on the ground in Sri Lanka.

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

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

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

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

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

I. Contribution

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

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

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

[71] Claimant's Memorial, para. 35, section 3.5.

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

Sub-Section I. **The Treaty**

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

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

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

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

220. Sri Lanka also relies on the dissent of Professor Abi-Saab in the recent *Abaclat* decision[160] supporting the position taken by Sri Lanka that the Hedging Agreement does not constitute an investment for the purposes of either the BIT or the ICSID Convention.

II. Territorial nexus with Sri Lanka

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

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

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

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

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

224. Respondent submits that since the Central Bank did not and cannot regulate the seller of the product, Deutsche Bank London, it cannot be the case that financial products emanating from Deutsche Bank London are located "within the territory" of Sri Lanka for the purposes of the BIT. The purpose of the BIT was not to provide a method of enforcement for transnational debt claims but to protect foreign investment, *i.e.*, inward investment, from regulatory abuse. A commercial transaction with a foreign entity, falling outside the regulatory jurisdiction of the host State, is not covered by the BIT in Respondent's view.

225. Sri Lanka further points out that Deutsche Bank Colombo was not the counterparty to the Hedging Agreement. Deutsche Bank Colombo did not provide the financial product in question. As recognised by Claimant, the Colombo Branch "*does not directly engage in commodities derivative trades such as oil hedging transactions*"[161]. Respondent recalls that the payments made by CPC to Deutsche Bank were remitted to Deutsche Bank London and not Deutsche Bank Colombo[162]. Deutsche Bank Colombo did not receive any commission[163], did not assume any risk in relation to the Hedging Agreement[164] and did not have any budget for expenditure on either hedging in general or for intermediary role that Deutsche Bank Colombo had undertaken to play[165].

226. Respondent argues that the claimed USD 60 million is owed to Deutsche Bank London not Deutsche Bank Colombo[166] and when a dispute arose over whether CPC should continue to pay out moneys to Deutsche Bank, it was again the Deutsche Bank office in London which was the focus of activity. Respondent submits that nearly every material communication from Deutsche Bank on the subject of the dispute came from London, Singapore, or Hong Kong, not from the branch office in Colombo.

227. Sri Lanka further points out that the Hedging Agreement itself was evidenced by:

- the Term Sheet coming from Deutsche Bank London. It designated "Deutsche Bank AG, London" as "Party A". Business days for the instrument were designated as those recognised in "London, New York"; and
- the Confirmation Letter coming from Deutsche Bank London. It, too, identified Deutsche Bank London as "Party A". The letter was signed by two officers of the

[161] Claimant's Memorial, para. 86.

[162] Claimant's Memorial, para. 193.

[163] Transcript Day 2, p. 59, line 22.

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

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

[166] Transcript Day 2, p. 60, line 14.

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

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

a) In contrast to the suggestion at the First Study Group Meeting that "*international banks that have local presence be invited to submit indicative proposals and suggestions for oil hedging*"[167], the Study Group report and the Cabinet Decision approving it[168] recommended only that CPC enter into transactions with "reputed banks"; and
b) CPC entered into the Hedging Agreement with Deutsche Bank London and could have made payments to Deutsche Bank London through any mechanism; there was no requirement to use a local branch[169].

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

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

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

I. Contribution

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

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[167] Core 2/44.

[168] Core 2/49; Core 2/65; Core 2/70.

[169] Core 10/355.

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

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

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

SECTION III. **THE TRIBUNAL'S ANALYSIS AND DECISION**

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

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

Sub-Section I. **The Treaty**

284. Article 1 of the Treaty[187] provides that the term "*investments*" includes "*every kind of asset"* and gives a list of illustrative categories, preceded by the words "*in particular*". These categories include *"c) claims to money which have been used to create an economic value or claims to any performance having an economic value and associated with an investment"*.

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

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

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

[187] Quoted *supra*, para. 130.

288. The test to be applied to determine whether such a nexus exists in the case of a financial investment, has been clearly expressed by the majority in the *Abaclat* case[188], as follows:

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

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

290. Applying the above test, the majority noted that the funds generated by the bonds issuance process had been ultimately made available to Argentina and had served to finance its economic development. It therefore reached the conclusion that it had jurisdiction over the claims of the bondholders. The third arbitrator dissented on the basis that at the difference of the situations which had confronted the Tribunals in the *Fedax v. Venezuela*, *SGS v. Pakistan* and *SGS v. Philippines* cases, the security entitlements in question were free-standing and totally unhinged, that they were not linked to an underlying specific economic project, operation or activity taking place in Argentina[189].

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

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[188] *Abaclat v. Argentina*, *supra* note 69, paras. 374 *et seq.*, referring to *Fedax N.V. v. Republic of Venezuela* (ICSID Case No. ARB/96/3), Decision of the Tribunal on Objections to Jurisdiction, 11 July 1997, para. 41 [hereinafter "*Fedax v. Venezuela – Jurisdiction"*], and *SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan* (ICSID Case No. ARB/01/13), Decision of the Tribunal on Objections to Jurisdiction, 6 August 2003, paras. 136-140 [hereinafter "*SGS v. Pakistan"*].

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

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

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

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

293. The Tribunal notes that the parties agree that its jurisdiction should be determined not only on the basis of the provisions of the BIT but also by application of Article 25(1) of the ICSID Convention. However, Claimant only accepts the existence of this "double-barrel test" to a very limited extent, considering that it could not have been the Parties' intention that Article 25(1) would restrict the broad definition of "*investments*" adopted in Article 1(1) of the Treaty so as to frustrate the bringing of any claim.

294. Indeed, as the Arbitral Tribunal has noted in *Biwater v. Tanzania*[190], it is clear from the *travaux préparatoires* of the Convention that several attempts to incorporate a definition of "*investment*" were made but ultimately did not succeed. Since the Convention was not drafted with a strict, objective, definition of "*investment*", it is doubtful that arbitral tribunals sitting in individual cases should impose one such definition which would be applicable in all cases and for all purposes[191]. There is therefore no basis for a strict application in every case of the five criteria that were originally suggested by the Arbitral Tribunal in *Fedax v. Venezuela*[192] and restated (notably) in *Salini v. Morocco*[193], namely (i) a substantial commitment or contribution, (ii) duration; (iii) assumption of risk; (iv) contribution to economic development; (v) regularity of profit and return, in order to determine the Tribunal's jurisdiction under Article 25(1). These criteria are not fixed or mandatory as a matter of law. They do not appear in the ICSID Convention. If transactions were to be presumed excluded from the ICSID Convention unless each of the five criteria were satisfied, this would entail the risk of arbitrarily excluding certain types of transactions from the scope of the Convention.

295. The development of ICSID case law suggests that only three of the above criteria, namely contribution, risk and duration should be used as the benchmarks of investment, without a separate criterion of contribution to the economic development of the host State and

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

[191] *Id*. para. 313.

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

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