

This case summary was prepared in the course of research for S Ripinsky with K Williams, Damages in International Investment Law (BIICL, 2008)

Case summary

Asian Agricultural Products Ltd v Sri Lanka

Year of the award: 1990

Forum: ICSID

Applicable investment treaty: Sri Lanka – United Kingdom BIT (1980)

| Arbitrators | Timeline of the dispute |
|--|--|
| Dr. Ahmed Sadek El-Kosheri – President | 8 July 1987 – request for arbitration |
| Prof. Berthold Goldman | 5 January 1988 – arbitral tribunal constituted |
| Dr. Samuel Asante | 27 June 1990 – arbitral award |

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I. Executive Summary

The claimant, a Hong Kong corporation AAPL, owned 48.2% of Serendib, a Sri Lankan joint venture company that was formed to cultivate and export shrimp to Japan. Serendib made only two shipments of shrimp when in January 1987 its principal facility, a shrimp farm, was destroyed as a result of counter-insurgency operation of the Sri-Lankan Security Forces. As a result, Serendib went out of business and thus AAPL's investment was lost.

In July 1987 AAPL brought a dispute before an ICSID Tribunal claiming violations by Sri Lanka of the 1980 Sri Lanka-UK BIT (extended to Hong Kong) and requesting US\$ 8 million in compensation. The Tribunal declined AAPL's claim under the general "full protection and security" standard but found merit in its claim under a specific BIT article providing for compensation for losses suffered by foreign investors as a consequence of an armed conflict or insurrection. This BIT article did not contain a specific standard of compensation; the Tribunal held that the full value of the lost investment had to be compensated.

To determine the full value of the investment, the Tribunal estimated the reasonable price a willing purchaser would have offered for the AAPL's shareholding in Serendib on the date preceding the destruction of the shrimp farm. When making this assessment, the Tribunal declined to take into account Serendib's goodwill and future profitability as not proven by the claimant. Essentially, to estimate the "reasonable price", the Tribunal determined the value of Serendib's physical assets decreased by the amount of Serendib's liabilities on the relevant date. The Tribunal awarded US\$ 460,000 in compensation plus simple interest at the rate of 10% from the date of the arbitration request up to the date of the actual payment.

The Tribunal took its decision by a 2-1 majority. One arbitrator, in his dissenting opinion, declined Sri Lankan liability and rejected AAPL's claim for damages.

II. Factual Background and Claims of the Investor

Asian Agricultural Products Ltd ("AAPL") was a Hong Kong corporation that established a joint venture in Sri Lanka in 1983 – Serendib Seafoods Ltd ("Serendib"). AAPL held a 48.2% share in Serendib.

The purpose of Serendib was to cultivate and export shrimp to Japan. Serendib commenced operations in 1986 from its principal facility, a shrimp farm located in eastern Sri Lanka, an area which had come under control of Tamil insurgents in 1986 during a major insurrection. In January 1987, during the counter-insurgency operation conducted by the Sri-Lankan Security Forces, Serendib's farm was destroyed (measure at issue). From the commencement of its operations in 1986 until the destruction of its facilities, Serendib operated at a loss and had completed only two shipments of shrimp to Japan.

AAPL brought a dispute before an ICSID Tribunal claiming violations of the 1980 Sri Lanka-UK BIT (extended to Hong Kong). AAPL contended that Sri Lanka had failed to comply with its general BIT obligation to accord “full protection and security” to foreign investments. In the alternative, AAPL argued that it was entitled to special BIT protection against losses incurred as a consequence of an insurrection. Reflecting 48.2% shareholding in Serendib, AAPL claimed 48.2% of the physical, intangible and financial assets destroyed and the future profits of Serendib. In total, AAPL claimed US\$ 8 million as compensation for the destruction of its investment.

III. Findings on Merits¹

The BIT contained a general provision embodying the “full protection and security” standard (Article 2), as well as a special clause with rules on compensation for losses suffered due to war or other armed conflict, insurrection, etc. (Article 4)

AAPL claimed that Article 2 effectively established a standard of “strict liability” which rendered Sri Lanka liable for any destruction of the investment (without any need to prove that the damages suffered were attributable to the State or its agents), and that Article 4 did not apply by virtue of the BIT’s MFN clause, given that the subsequent Sri Lanka-Switzerland BIT did not contain a special provision on losses sustained during an armed conflict and thus accorded better treatment to Swiss investors. However, AAPL submitted an alternative claim under Article 4. The apparent logic for this strategy was that, in Claimant’s estimate, it would have been harder for him to meet the burden of proof under specific Article 4 than under more general Article 2.

A. Full Protection and Security (Article 2)

The Tribunal found that the “full protection and security” standard could not be interpreted as creating “strict liability” and that it did not render Sri Lanka liable for any destruction of investments, without the need to prove that the damages suffered were attributable to the State or its agents, and to establish State’s responsibility for not acting with “due diligence”. (paras 45-53) The Tribunal also rejected AAPL’s invocation of the MFN clause, as it was not satisfied that the Sri Lanka-Switzerland BIT contained rules more favourable than those provided under the Sri Lanka-UK BIT. (para.54)

For these reasons, the Tribunal dismissed the AAPL’s claim under Article 2.

B. Losses Sustained Due to an Insurrection (Article 4)

The Tribunal held that Article 4(1) was applicable in this case because it provided for compensation to be paid to investors who suffered losses as a result of property destruction which occurred as a consequence of “war or other armed conflict, revolution, a state of national emergency, revolt, insurrection or riot”.

¹ The Tribunal took its decision by 2-1 majority. One arbitrator, in his dissenting opinion, declined Sri Lankan liability and rejected AAPL’s claim for damages.

In this connection, the Tribunal referred to the following “generally accepted” rules of international law:

- (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 the 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 the insurgents’ offensive act or resulting from governmental counter-insurgency activities.

(para.72)

After considering the facts of the case, the Tribunal held that Sri Lanka failed to exercise the “due diligence” obligation established under customary international law, which requires undertaking all possible measures that are reasonably expected to prevent the eventual occurrence of killings and property destructions. (paras.76, 85(B)) Hence, Sri Lanka was held liable to pay compensation under Article 4(1) of the BIT.

The difficulty was, however, that Article 4(1) only provided for compensation to be paid on no less favourable terms than the host State accorded to its own nationals or to companies or nationals of a third State; the Article did not include any substantive standard of compensation.²

IV. Findings on Damages

A. Law Applicable to the Determination of Damages

The Tribunal only discussed the issue of applicable law generally, and not specifically with regard to the award of damages. However, this issue was addressed in the context of law applicable to the dispute in general. The Tribunal found that in the present case, the parties had acted in a manner that demonstrated their mutual consent to consider the provisions of the Sri Lanka-UK BIT as being the primary source of the applicable legal rules. (para.20) The Tribunal also noted that the BIT was not a self-contained closed legal system but that it pointed, expressly or impliedly, to supplementary rules, both of international law and domestic law nature. (para.21) Therefore, the Tribunal designated the BIT as *lex specialis*, and decided to apply international and domestic relevant legal rules as a supplementary source, when warranted by the BIT. (para.24)

In damages part of the award, the Tribunal frequently referred to general rules of international law (see below). It did not make any references to Sri Lankan law.

² On this, see the “Standard of compensation” section below.

B. Burden of Proof

The Tribunal reiterated a number of general principles on burden of proof under international law, in particular:

- 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, least they be disregarded for want, or insufficiency, of proof;
- 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;
- In exercising the “free evaluation of evidence”, the international tribunals decide the case on the strength of the evidence produced by both parties, and in case a party adduces some evidence which *prima facie* supports its allegation, the burden of proof shifts to his opponent;
- In cases where proof of a fact presents extreme difficulty, a tribunal may be satisfied with less conclusive proof, i.e., *prima facie* evidence.

(para.56)

The Tribunal cited these principles in connection with establishing State responsibility, but having general value and application they also hold true for the assessment of damages.

C. Standard of Compensation

As mentioned above, Article 4(1) did not include any substantive standard of compensation in fixed and definitive terms; it only provided for compensation to be paid on no less favourable terms than the host State accorded to its own nationals or to companies or nationals of a third State. In other words, this Article established both national and MFN treatment as regards compensation, but no substantive rules.

The Tribunal decided therefore that compensation had to be determined according to general rules of international law rules and standards previously developed with regard to a States’ failure to comply with its “due diligence” obligation under the minimum standard of customary international law. (para.67)

The parties and the Tribunal agreed that the amount of compensation should adequately reflect “the full value of the investment lost as a result of said destruction and damages incurred as a result thereof”. (para.88) In the present case, the value of the investment was the value of AAPL’s shareholding in the joint venture (Serendib) on the date immediately preceding the day of its destruction. (para.95)

D. Heads of Damages and Valuation

AAPL’s damages resulted from the destruction of a substantial part of Serendib’s physical assets during the counter-insurgency operation conducted by the Sri-Lankan Security Forces. This caused Serendib’s going out of business (it ceased to be a going concern capable of realizing profits), which in turn led to a complete loss of AAPL’s investment. (para.99)

Reflecting 48.2% shareholding in Serendib, AAPL claimed 48.2% of the

- physical assets destroyed;
- intangible assets destroyed (mainly “goodwill”);
- future profits of Serendib.

1. Approach to the assessment

The Tribunal determined that in the present case, the treaty coverage did not extend to physical or intangible assets as such. The value of the investment was the value of AAPL’s shareholding in the joint venture. (para.95)

The Tribunal stated that to determine the value of the investment (shareholding), a stock market quote of the shares on the relevant date would be appropriate, if the shares were publicly traded. In the absence of a stock market quote, the Tribunal decided to use the alternative method of determining the shareholding value – through estimating the reasonable price a willing purchaser would have offered for the investment in question, i.e. for AAPL’s shareholding in Serendib.

The Tribunal stated that the value of shareholding should take into account both physical and intangible assets. However, this figure (the “reasonable price”) should also reflect Serendib’s global liability on that date, i.e. the aggregate amount of current debts, loans, interest, etc. due to Serendib’s creditors. (para.97) The Tribunal suggested that to estimate the value of the shareholding one had to establish a comprehensive balance sheet which reflected the result of assessing the global assets of Serendib in comparison with all the outstanding indebtedness thereof at the relevant time. (para.98) The Tribunal did not identify the method which should be applied to determine the value of Serendib’s physical assets.

2. Goodwill and lost profits

In Tribunal’s view, the goodwill and future profits per se were not be compensated in this case, even if proven. In accordance with the “reasonable price” approach previously adopted, the Tribunal decided that “goodwill” and “profitability” had to be taken into account only to the extent that, if proven, they could add a certain premium to the price that the prospective purchaser would be prepared to pay for AAPL’s shares.³ (para.102)

Regarding the “goodwill”, the Tribunal stated that at least two-three years were required to establish continuing business connections. Furthermore, during that period substantial expenses were to be incurred in supporting the management efforts devoted to create and develop the marketing network of the company’s products. Serendib was a newly formed company with no record of profits. Moreover, it was also incurring losses and under-capitalized. In the Tribunal’s view, the possession of a valuable “goodwill” by such a company was very doubtful (para.103)

³ In this respect the Tribunal expressly distinguished this case from precedent concerning unlawful expropriation claims and liability for unilateral termination of State contracts.

Regarding lost profits, the Tribunal recalled a “well-established rule of international law”, according to which lost profits had to be “reasonably anticipated; and that the profits anticipated were probable and not merely possible.” (para.104) The Tribunal decided that the mere two shipments of shrimp exported by Serendib to Japan, did not sufficiently demonstrate its ability to earn revenues.

The Tribunal concluded that neither goodwill, nor future profitability of Serendib could be reasonably established with a sufficient degree of certainty, particularly in light of the fact that Serendib had no previous record in conducting business for even one year of production. (para.107) Therefore, the Tribunal did not take these elements into account when determining the amount of compensation.

3. Assessment

With only Serendib’s tangible assets taken into account, the Tribunal estimated the value of AAPL’s shareholding to be US\$ 460,000. The Tribunal did not indicate how it arrived at this figure⁴ but apparently, it represents 48.2% of the value of Serendib’s tangible assets less 48.2% of Serendib’s global liabilities.

E. Interest

AAPL requested interest at the rate of 10% per annum as of the date of the losses incurred. Sri Lanka did not raise any objections in this regard. The Tribunal recalled the rules “long established” by international arbitral tribunals, according to which (1) it was “just and reasonable to allow interest at a reasonable rate”, and (2) interest should run “from the date when the State’s international responsibility became engaged”. (paras.113-114)

The Tribunal considered an interest rate of 10% to be reasonable. As for the relevant starting date for calculation of interest, the Tribunal awarded interest from the date of AAPL’s request for arbitration (up to the date of the actual payment). (para.115) Apparently, in the Tribunal’s view, this was the date when Sri Lankan international responsibility became engaged.

The Tribunal did not mention that interest had to be compounded, therefore, one has to assume that it awarded simple interest.

F. Costs

The Tribunal ruled that Sri Lanka had to bear its own legal costs and make a one-third contribution towards the costs of AAPL. The costs of the Tribunal had to be borne in a ratio of 40% by AAPL and 60% by Sri Lanka.

V. Implications / Initial Analysis

⁴ As said above, the Tribunal did not indicate a method it used to estimate the value of Serendib’s physical assets.

- The Tribunal referred to the **standard of compensation under customary international law**: the compensation should cover the loss suffered as a result of the measure at issue (in this case – full value of the lost investment and all damages incurred).
- Where stock **market quotes** are available, they represent the value of a shareholding.
- In the absence of the stock market price, an alternative method of establishing the value would be the determination of a **reasonable price** that a willing purchaser would have offered for the investment in question. However, the Tribunal did not specify, how to determine such a reasonable price and specifically, which valuation methods it used to evaluate Serendib's assets.
- **Assets v. liabilities.** When determining the value of a shareholding in the absence of the stock market price, a tribunal must take into account not only the share of assets that the shareholding represents, but also a corresponding share of the company's liabilities (debts, interest) on the relevant date.
- **Goodwill and lost profits.** The Tribunal adopted quite an unusual approach to recoverability of goodwill and lost profits. Despite holding that all damages caused by the measure at issue should be compensated, it held that goodwill and lost profits as such were not recoverable (existing precedents on expropriation that pointed to the contrary were said to be irrelevant) but, if proven, these elements should be taken into account (alongside physical assets) when determining a reasonable price a buyer would be willing to pay for the shareholding on the relevant date. The Tribunal did not indicate how to take into account these elements.
- **Goodwill.** The Tribunal formulated “minimum criteria” for a company to acquire a valuable goodwill (2-3 years of operation, substantial expenses and management efforts to develop the marketing network of the company’s products).
- **Interest.** The Tribunal determined, on the basis of its analysis of international law, that interest should run from the date when the State’s international responsibility became engaged. The Tribunal stated that the relevant date was the date of request for arbitration (not the date when the damage was inflicted).