

# The *ELSI* Case: An Investment Dispute at the International Court of Justice

Sean D. Murphy<sup>†</sup>

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<sup>†</sup> Attorney/Adviser, United States Department of State. The author appeared on behalf of the United States before the International Court of Justice in the Case Concerning Elettronica Sicula S.p.A. (*ELSI*) (U.S. v. Italy), 1989 I.C.J. 15. The views expressed in this article, however, are those of the author and do not necessarily reflect the views of the United States government.

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I. INTRODUCTION

International trade and investment breed prosperity. Prosperity, in turn, fosters peaceful relations. Through legal regimes that encourage and strengthen trade and investment, international law contributes greatly to the "creation of conditions of stability and well-being which are necessary for peaceful and friendly relations among nations."<sup>1</sup> For the United States, bilateral treaties have held center stage in setting legal standards for the establishment and protection of United States investments overseas, including those that take the form of foreign incorporated businesses. One measure of the effectiveness of these legal standards is their success at resolving international investment disputes when they arise. Without enforceable legal protections, the prospective investor has a lower expectation of security in the investment and is therefore less inclined to conduct business abroad. Consequently, a legal regime that fails to protect overseas investment carries a cost in foregone welfare and ultimately lessens opportunities for nations to forge strong and lasting economic ties.

In the *Case Concerning Elettronica Sicula S.p.A. (ELSI)*,<sup>2</sup> the International Court of Justice (ICJ) reviewed and rejected a claim by the United States that the Italian government had interfered with the investment of a United States corporation in Italy, in violation of the Treaty of Friendship, Commerce and Navigation (FCN Treaty) between the two countries.<sup>3</sup> The United States established that the Italian government requisitioned an Italian subsidiary of a United States corporation in violation of Italian law; that the subsidiary subsequently went bankrupt; and that the Italian government purchased the subsidiary for its own use. Nevertheless, the United States failed to persuade a chamber of the ICJ<sup>4</sup> that Italy's actions constituted an unlawful interference

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1. U.N. CHARTER art. 55.

2. *Case Concerning Elettronica Sicula S.p.A. (ELSI) (U.S. v. Italy)*, 1989 I.C.J. 15, *reprinted in* 28 I.L.M. 1109 [hereinafter *Judgment*].

3. Treaty of Friendship, Commerce and Navigation, Feb. 2, 1948, United States-Italy, 63 Stat. 2255, T.I.A.S. No. 1965 [hereinafter U.S.-Italy FCN Treaty]. The United States-Italy Treaty of Friendship, Commerce and Navigation and its Protocol entered into force July 26, 1949. It was supplemented by an agreement on September 26, 1951 that did not enter into force until March 2, 1961. Agreement Supplementing the Treaty of Friendship, Commerce and Navigation, Sept. 26, 1951, United States-Italy, 12 U.S.T. 131, T.I.A.S. No. 4685 [hereinafter *Supplement*].

4. A judgment given by a chamber has the same effect as one rendered by the entire ICJ. Statute of the International Court of Justice, June 26, 1945, art. 27, 59 Stat. 1055, T.S. No. 993 [hereinafter *Statute of the Court*].

with management and control, an unlawful impairment of investment rights, a wrongful taking of property, or an unlawful failure to provide protection and security of property.

This article argues that despite the Chamber's factual findings, the *ELSI* case has neither undermined the legal rules that apply to transnational investment, nor shown that the ICJ is an inappropriate forum for the resolution of investment disputes. The Chamber did not reject the United States interpretation of the relevant provisions of the FCN Treaty, but rather focused on the failure of the United States to prove a particular factual predicate -- that "but for" the actions of the Italian government, the parent could have placed the subsidiary through an orderly liquidation, rather than see its investment in the Italian subsidiary lost. In fact, the Chamber affirmed several key understandings of the operation of the FCN Treaty and essentially rejected narrow interpretations advanced by Italy and by one of the concurring judges. Although the *ELSI* dispute turned on a treaty and not customary rules of international law, the ICJ apparently retreated from its prior decision in the *Barcelona Traction* case,<sup>5</sup> which restricted states' standing under customary international law to espouse the claims of its nationals who own shares in a foreign corporation. On the other hand, certain aspects of the *ELSI* decision are troubling or, at best, ambiguous, casting some doubt on the ability of bilateral treaties to protect investments adequately.

Part I briefly reviews the historical development of bilateral trade and investment treaties, with an eye to the current generation of such treaties emerging to foster economic relations with developing nations and with states of the former Eastern Bloc. Part II sets forth the facts of the *ELSI* dispute, from the initial investment in the 1950s, to the requisition of the company in 1968, to the ultimate presentation of the dispute to the Chamber in 1987. Part III reviews the parties' arguments and assesses the Chamber's decision on the applicability of the local remedies rule to disputes arising under a bilateral treaty. Part IV discusses the contentions of the United States and Italy concerning Italy's alleged violations of the bilateral treaty between them and evaluates the Chamber's conclusion that no violations had occurred. Although the Chamber did not reach the issue of reparations, Part V of the article reviews and assesses the parties' arguments as to the appropriate types and levels of compensation due for violations of bilateral investment treaties. Part VI discusses certain important procedural aspects of the case: the use of single-phase proceedings, the decision to submit the case to a Chamber of the ICJ, and the treatment of experts and witnesses. Part VII explores some of the implications of the *ELSI* case for bilateral investment disputes, for the law of

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5. Case Concerning the Barcelona Traction, Light and Power Company, Ltd. (New Application: 1962) (Belg. v. Spain), 1970 I.C.J. 3 (Second Phase).

state responsibility generally, and for the relationship of the United States to the ICJ after its withdrawal from the general, compulsory jurisdiction following the ICJ's decision on jurisdiction in the case that Nicaragua brought against the United States.<sup>6</sup>

## II. BILATERAL TREATIES FOR TRADE AND INVESTMENT

Since the early part of this century, transnational corporate entities have become increasingly significant players in international affairs. Investment by United States companies abroad has grown enormously since the Second World War, as has foreign investment in the United States.<sup>7</sup> Notwithstanding the unevenness of political and economic reform, the current political transformation of the Soviet Union and the Eastern Bloc countries seems to presage a new wave of western investment in those nations. In the past, to encourage and promote transnational trade and investment, the United States has actively sought to create legal regimes to govern the treatment of United States investments abroad. To do so, the United States has relied on bilateral treaties for the protection of persons and companies doing business abroad, in part because such treaties allow the parties to create a regime tailored to their particular economic relationship.<sup>8</sup>

The first of these bilateral treaties of amity or friendship focused on the rights of persons engaged in commerce and navigation, and on certain aspects of consular affairs.<sup>9</sup> Prior to the Second World War, some bilateral treaties

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6. See *infra* note 22; see also *infra* notes 231-33 and accompanying text.

7. In 1950, the value of United States direct investment abroad was \$11.8 billion, with \$1.7 billion in Western Europe (figures not indexed for inflation). By 1989, the value of United States direct investment abroad had increased to \$373.4 billion, with \$176.7 billion in Western Europe. During the same period, total direct investment in the United States by foreign investors increased from \$3.1 billion in 1950 to \$400.8 billion in 1989. BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, HISTORICAL STATISTICS OF THE UNITED STATES: COLONIAL TIMES TO 1970, at 869 (1975); *Foreign Direct Investment in the United States: Detail for Position and Balance of Payments Flows, 1989*, SURV. OF CURRENT BUS., Aug. 1990, at 41, 64. "Direct investment," as defined by the Department of Commerce, represents "private enterprises in one country owned or controlled by investors in another country or in the management of which foreign investors have an important role." See BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES: 1990, at 797 (110th ed. 1989).

8. Agreements between governments are not the sole means of protecting overseas investment. Individuals and companies can and do negotiate contracts directly with foreign governments. To be effective, these contracts should be "internationalized" (i.e., not made subject to host country law) and should provide for third-party dispute resolution. See Greenwood, *State Contracts in International Law - The Libyan Oil Arbitrations*, 53 BRIT. Y.B. INT'L L. 27 (1982). The disadvantage of such contracts is that disputes under them do not involve the investor's own government as squarely as do disputes arising under a bilateral treaty.

9. The first such treaty concluded by the United States was with its Revolutionary War ally, France. On February 6, 1778, the United States and France signed, along with a Treaty of Alliance, a Treaty of Amity and Commerce. Treaty of Amity and Commerce, Feb. 6, 1778, United States-France, 8 Stat. 12, T.S. No. 83. This Treaty, and subsequent ones made with the Netherlands in 1782 (Treaty of Amity and Commerce, Oct. 8, 1782, United States-Netherlands, 8 Stat. 32, T.S. No. 249), with Sweden in 1783 (Treaty of Amity and Commerce, April 3, 1783, United States-Sweden, 8 Stat. 60, T.S. No. 346), and

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of trade and commerce began establishing protections not just for natural persons but also for corporations doing business abroad.<sup>10</sup> After the Second World War, when the United States was the principal exporter of investment capital, the treaty of friendship, commerce and navigation (FCN) became a hallmark of efforts to rebuild Europe and the Far East through promotion of corporate investment.

Thus, although these treaties are by their terms reciprocal, they were negotiated in a context where the United States sought to send nationals and corporations into other countries to do business.<sup>11</sup> In this environment, the United States desired a stable international legal framework to regularize trade relations and to facilitate and protect investments in foreign countries. United States investors generally wished to avoid exposing their investments to the vicissitudes of host-country laws, particularly since those laws often worked to the disadvantage of foreigners.<sup>12</sup> Moreover, they felt that customary international law failed to provide sufficiently clear rules or adequate standards for the protection of investments, and that it lacked a dispute resolution mechanism other than the one available through host-country courts.<sup>13</sup> Consequently, the United States employed the FCN treaty device to ensure to its nationals investing abroad the following key rights under international law: 1) to make an investment; 2) to manage and control the investment; 3) to be free from

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with Prussia in 1785 (Treaty of Amity and Commerce, Sept. 10, 1785, United States-Prussia, 8 Stat. 84, T.S. No. 292), were concluded even before the United States Constitutional Convention.

10. Only with the 1911 Treaty of Amity with Japan did United States treaties begin to concern themselves with companies rather than natural persons. See Walker, *Provisions on Companies in United States Commercial Treaties*, 50 AM. J. INT'L L. 373, 373-80 (1956).

11. In the immediate postwar era, the relative economic strength of the United States far surpassed that of its allies. For instance, in the period preceding negotiations of the FCN Treaty with Italy, United States exports to Italy had grown from \$185 million in the early 1920s to \$327 million in 1946, while imports from Italy had decreased from \$79 million in the early 1920s to \$69 million in 1946. *Proposed Treaty of Friendship, Commerce, and Navigation Between the United States and the Italian Republic: Hearing Before a Subcomm. of the Senate Comm. on Foreign Relations*, 80th Cong., 2d Sess. 29-30 (1948). A major goal in negotiating these postwar treaties was to complement existing United States efforts to strengthen the free nations of the world against external aggression through the creation of a favorable climate for trade and investment by United States citizens. Norton, *Doing Business and U.S. Commercial Treaties: The Case with the Member States of the EEC*, 5 CASE W. RES. J. INT'L L. 4, 11-12 (1972). Moreover, contemporaries generally believed that United States law already accorded high levels of protection for investment and private property, so that these treaties did not really confer any improved treatment on a foreign investor in the United States. Thus, while protections granted by these treaties were clearly mutual, few doubted at the time that both sides sought primarily to encourage United States investment abroad. During the Senate Hearing on the Treaty of Friendship, Commerce and Navigation with China, Senator Thomas observed that "mutuality of the general treaty, while it holds in law, is in reality not very much of a mutual affair; it is something definitely to our advantage." Mr. Blaisdell of the Department of Commerce responded that "there is no question about that at all." *Friendship, Commerce, and Navigation with China: Hearing Before a Subcomm. of the Senate Comm. on Foreign Relations*, 80th Cong., 2d Sess. 37 (1948).

12. Walker, *Treaties for the Encouragement and Protection of Foreign Investment: Present United States Practice*, 5 AM. J. COMP. L. 229, 230 (1956).

13. Wilson, *Property-Protection Provisions in United States Commercial Treaties*, 45 AM. J. INT'L L. 83, 104-05 (1951).

laws that are arbitrary or less favorable than those under which host country nationals or other foreigners operate; 4) to withdraw the investment freely; and 5) to receive compensation in the event of expropriation. On the other side of the negotiating table, the host country desired to improve trade relations and to encourage investment in its capital-starved postwar economy.<sup>14</sup> Of course, the reciprocity of the treaty remained in place even though over time the initial economic disparities between the two countries often changed significantly.

In the decade following the Allied victory, the United States negotiated numerous FCN treaties with foreign governments. Most of these agreements remain in force today.<sup>15</sup> One of them, the FCN Treaty with Italy,<sup>16</sup> served as the basis for the legal claims in the *ELSI* case. Consequently, the outcome of the *ELSI* case is extremely significant to all investment disputes that might arise under the postwar FCN treaties of the United States, as well as those arising under similar treaties of other countries.

The *ELSI* decision will not have much significance with respect to international trade disputes, because the drafters of the FCN treaties did not intend the treaties to be significant elements of the international trade system. Before

14. Norton, *supra* note 11, at 11-15.

15. See Treaty of Friendship, Commerce and Navigation, Nov. 28, 1956, United States-Korea, 8 U.S.T. 2217, T.I.A.S. No. 3947 [hereinafter U.S.-Korea FCN Treaty]; Treaty of Friendship, Commerce and Navigation, March 27, 1956, United States-Netherlands, 8 U.S.T. 2043, T.I.A.S. No. 3942 [hereinafter U.S.-Netherlands FCN Treaty]; Treaty of Friendship, Commerce and Navigation, Jan. 21, 1956, United States-Nicaragua, 9 U.S.T. 449, T.I.A.S. No. 4024; Treaty of Amity, Economic Relations, and Consular Rights, Aug. 15, 1955, United States-Iran, 8 U.S.T. 899, T.I.A.S. No. 3853; Treaty of Friendship, Commerce and Navigation, Oct. 29, 1954, United States-West Germany, 7 U.S.T. 1839, T.I.A.S. No. 3593 [hereinafter U.S.-West Germany FCN Treaty]; Treaty of Friendship, Commerce and Navigation, April 2, 1953, United States-Japan, 4 U.S.T. 2063, T.I.A.S. No. 2863 [hereinafter U.S.-Japan FCN Treaty]; Treaty of Friendship, Commerce and Navigation, Oct. 1, 1951, United States-Denmark, 12 U.S.T. 908, T.I.A.S. No. 4797 [hereinafter U.S.-Denmark FCN Treaty]; Agreement Supplementing the Treaty of Friendship, Commerce and Navigation, Sept. 26, 1951, United States-Italy, 12 U.S.T. 131, T.I.A.S. No. 4685; Treaty of Amity and Economic Relations, Sept. 7, 1951, United States-Ethiopia, 4 U.S.T. 2134, T.I.A.S. No. 2864; Treaty of Friendship, Commerce and Navigation, Aug. 23, 1951, United States-Israel, 5 U.S.T. 550, T.I.A.S. No. 2948; Treaty of Friendship, Commerce and Navigation, Aug. 3, 1951, United States-Greece, 5 U.S.T. 1829, T.I.A.S. No. 3057 [hereinafter U.S.-Greece FCN Treaty]; Treaty of Friendship, Commerce and Navigation, Jan. 21, 1950, United States-Ireland, 1 U.S.T. 785, T.I.A.S. No. 2155; Treaty of Friendship, Commerce and Navigation, Feb. 2, 1948, United States-Italy, 63 Stat. 2255, T.I.A.S. No. 1965; Treaty of Friendship, Commerce and Navigation, Nov. 4, 1946, United States-China, 63 Stat. 1299, T.I.A.S. No. 1871. See generally Walker, *The Post-War Commercial Treaty Program of the United States*, 73 POL. SCI. Q. 57 (1956); Wilson, *A Decade of New Commercial Treaties*, 50 AM. J. INT'L L. 927 (1956).

The United States concluded additional FCN treaties in the late 1950s and the 1960s. See Treaty of Amity and Economic Relations, Feb. 8, 1966, United States-Togo, 18 U.S.T. 1, T.I.A.S. No. 6193; Treaty of Friendship, Establishment and Navigation, Feb. 23, 1962, United States-Luxembourg, 14 U.S.T. 251, T.I.A.S. No. 5306 [hereinafter U.S.-Luxembourg FCN Treaty]; Treaty of Amity and Economic Relations, April 3, 1961, United States-Vietnam, 12 U.S.T. 1703, T.I.A.S. No. 4890; Treaty of Friendship, Establishment and Navigation, Feb. 21, 1961, United States-Belgium, 14 U.S.T. 1284, T.I.A.S. No. 5432 [hereinafter U.S.-Belgium FCN Treaty]; Treaty of Establishment, Nov. 25, 1959, United States-France, 11 U.S.T. 2398, T.I.A.S. No. 4625 [hereinafter U.S.-France FCN Treaty]; Treaty of Friendship and Commerce, Nov. 12, 1959, United States-Pakistan, 12 U.S.T. 110, T.I.A.S. No. 4683.

16. U.S.-Italy FCN Treaty, *supra* note 3.

the creation of the postwar FCN treaties, the United States recognized the need to use mutual reduction of trade barriers to lift the country out of the Great Depression. Accordingly, the Trade Agreement Act of 1934 authorized the negotiation of bilateral trade agreements to facilitate foreign commerce.<sup>17</sup> These reciprocal trade agreements dealt with schedules of tariff reductions on a most-favored-nation basis and with the binding of rates on special articles. Although the postwar FCN treaties set forth general standards of treatment for trading partners, the United States did not rely on them as principal instruments of its foreign trade policy. Currently, the General Agreement on Tariffs and Trade<sup>18</sup> dominates this field.

In the investment field, however, United States foreign policy is embodied in the FCN treaties and the new bilateral investment treaties (BITs) devoted exclusively to overseas investments. The United States BITs arose from efforts in the 1980s to improve on United States investment relations with certain lesser developed countries. Several BITs have come into force in only the past two years.<sup>19</sup> In all likelihood, the inevitable economic integration of the East and West over the next several years will rely in part on an expanding network

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17. Act to Amend the Tariff Act of 1930, ch. 474, 48 Stat. 943 (1934). The initial legislation limited the authority of the president to enter into these trade agreements to three years. *Id.* § 2(b). However, Congress authorized extensions in 1937, 1940, and 1943. During the Roosevelt Administration, the United States concluded bilateral trade agreements with 27 countries. 6 A. LOWENFELD, PUBLIC CONTROLS ON INTERNATIONAL TRADE 108 (2d ed. 1983).

18. General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. (5)A3, (6)1365, T.I.A.S. No. 1700, 55 U.N.T.S. 194.

19. The United States has signed BITs with numerous countries. *See, e.g.*, Treaty Concerning the Reciprocal Encouragement and Protection of Investment, May 2, 1986, United States-Grenada, *reprinted in* INVESTMENT LAWS OF THE WORLD (INVESTMENT TREATIES), Booklet 1986-a, at 7 (Int'l Centre for Settlement of Inv. Disputes comp. 1987) [hereinafter ICSID INVESTMENT LAWS] (entered into force Mar. 3, 1989); Treaty Concerning the Reciprocal Encouragement and Protection of Investment, Mar. 12, 1986, United States-Bangladesh, *reprinted in* ICSID INVESTMENT LAWS, *supra*, Booklet 1986, at 21 (entered into force July 25, 1989); Treaty Concerning the Reciprocal Encouragement and Protection of Investment, Feb. 26, 1986, United States-Cameroon, *reprinted in* ICSID INVESTMENT LAWS, *supra*, Booklet 1986, at 1 (entered into force Apr. 6, 1989); Treaty Concerning the Reciprocal Encouragement and Protection of Investments, Dec. 3, 1985, United States-Turkey, *reprinted in* ICSID INVESTMENT LAWS, *supra*, Booklet 1985, at 53 (entered into force May 18, 1990); Treaty Concerning the Encouragement and Reciprocal Protection of Investments, July 22, 1985, United States-Morocco, *reprinted in* ICSID INVESTMENT LAWS, *supra*, Booklet 1985, at 39; Treaty Concerning the Reciprocal Encouragement and Protection of Investment, Aug. 3, 1984, United States-Zaire, *reprinted in* ICSID INVESTMENT LAWS, *supra*, Booklet 1984, at 1 (entered into force July 28, 1989); Treaty Concerning the Reciprocal Encouragement and Protection of Investment, Dec. 6, 1983, United States-Senegal, *reprinted in* ICSID INVESTMENT LAWS, *supra*, Booklet 1983, at 99 (entered into force Oct. 25, 1990) [hereinafter U.S.-Senegal Treaty]; Treaty Concerning the Protection and Treatment of Investment, Oct. 27, 1982, United States-Panama, *reprinted in* ICSID INVESTMENT LAWS, *supra*, Booklet 1982, at 87; Treaty Concerning the Reciprocal Encouragement and Protection of Investments, Sept. 29, 1982, United States-Egypt, *reprinted in* ICSID INVESTMENT LAWS, *supra*, Booklet 1982, at 65.

These BITs draw on FCN treaty concepts, especially those relating to investment. *See* Gann, *The U.S. Bilateral Investment Treaty Program*, 21 STAN. L. REV. 373 (1985). The United States is not alone in pursuing such treaties. Germany took the lead as early as 1959 and has now signed nearly 70 BITs. *See* Salacuse, *BIT by BIT: The Growth of Bilateral Investment Treaties and Their Impact on Foreign Investment in Developing Countries*, 24 INT'L LAW. 655, 657 (1990).

of BITs.<sup>20</sup> The past two years have seen the emergence of new investment treaties between the West and Eastern European countries; the Soviet Union alone has signed treaties with the United Kingdom, France, Belgium and Luxembourg, and the Federal Republic of Germany.<sup>21</sup>

Yet how effectively do these bilateral treaties foster investment? Do they really create reasonable expectations that investment capital will be protected? Is the next generation of BITs an improvement over the FCN treaties? The degree to which FCN treaties have helped to resolve investment disputes illustrates the success of such treaties in promoting international investment generally. In the post-World War II era, litigants have invoked FCN treaties frequently in domestic cases, but only rarely have governments invoked them in international litigation. Until 1989, the ICJ had considered such treaties in only four cases, but none of these cases actually involved a foreign investment as the primary issue.<sup>22</sup> The *ELSI* case, however, presented the ICJ with an investment dispute arising exclusively from an investment treaty in force between two western economic powers -- the United States and Italy. Consequently, the arguments the parties presented, and the recent decision rejecting the United States claims, will not only have a deep impact on future litigation

20. Changes in the municipal laws of host countries will also play a major role in this economic integration. See, e.g., Gordon, *The Polish Foreign Investment Law of 1990*, 24 INT'L LAW. 335 (1990).

21. Agreement on Trade Relations, June 1, 1990, USSR-United States, 29 I.L.M. 946; Agreement for the Promotion and Reciprocal Protection of Investments, Apr. 6, 1989, USSR-United Kingdom, 29 I.L.M. 366; Treaty Concerning Business and Economic Relations, Mar. 21, 1990, United States-Poland, 29 I.L.M. 1194 [hereinafter U.S.-Poland Treaty]; Agreement for the Promotion and Reciprocal Protection of Investments, July 4, 1989, France-USSR, 29 I.L.M. 317; Treaty on Promotion and Reciprocal Protection of Investments, June 13, 1989, West Germany-USSR, 29 I.L.M. 351; Agreement Concerning the Promotion and Reciprocal Protection of Investments, Feb. 9, 1989, Belgium-Luxembourg-USSR, 29 I.L.M. 299; Treaty Concerning the Promotion and Reciprocal Protection of Investments, Nov. 10, 1989, West Germany-Poland, 29 I.L.M. 333. Bilateral trade agreements have also recently been negotiated between the East and West. Agreement on Trade Relations, Apr. 12, 1990, Czechoslovakia-United States, 29 I.L.M. 902. The European Community has recently become involved by establishing broad principles in this area. See Final Document on the Bonn Conference on Economic Co-operation in Europe, April 11, 1990, Conference on Security and Co-operation in Europe, 29 I.L.M. 1054; Agreement on Trade and Commercial and Economic Cooperation, Dec. 18, 1989, European Economic Community-European Atomic Energy Community-USSR, 29 I.L.M. 918.

22. Case Concerning Diplomatic and Consular Staff in Tehran (U.S. v. Iran), 1980 I.C.J. 1; *Ambatielos Case* (Greece v. U.K.), 1953 I.C.J. 10 (Merits); Case Concerning Rights of Nationals of the United States of America in Morocco (France v. U.S.), 1952 I.C.J. 176. The ICJ relied in part upon the 1956 FCN treaty between the United States and Nicaragua in the Case Concerning Military and Paramilitary Activities in and Against Nicaragua (Nicar. v. U.S.), 1984 I.C.J. 1 (Jurisdiction and Admissibility); 1986 I.C.J. 1 (Judgment). By a vote of 14-2, with the United States and Argentine judges dissenting, the ICJ found that the FCN treaty vested it with jurisdiction insofar as Nicaragua's claims arose under that treaty. Nicaragua had alleged in its Memorial that the mining of Nicaraguan ports and territorial waters, attacks on Nicaraguan airports, and military operations on land violated the FCN treaty. The United States argued unsuccessfully that the ICJ should dismiss the FCN treaty claim because: (1) Nicaragua failed to invoke the FCN treaty in its original Application; (2) the treaty was irrelevant to the real claim advanced by Nicaragua; and (3) Nicaragua's failure to attempt to resolve the dispute by diplomacy did not satisfy the conditions of the treaty's compromissory clause. For an analysis of the jurisdictional decision, see Reisman, *Has the International Court Exceeded Its Jurisdiction?*, 80 AM. J. INT'L L. 128 (1986).

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over bilateral investment treaties, but also will contribute considerably to our understanding of how successfully these treaties operate.

### III. THE FACTUAL BACKGROUND OF THE *ELSI* DISPUTE<sup>23</sup>

#### A. *The Investment*

In 1952, Raytheon Company -- a United States manufacturer of electronics equipment -- entered into a licensing and technical assistance agreement with an Italian company. This relationship eventually led Raytheon to become a partial shareholder in a relatively new company, Elettronica Sicula S.p.A. (ELSI), located in Palermo, Sicily.<sup>24</sup> From 1956 through 1967, Raytheon invested some 7.42 billion lire in ELSI, ultimately acquiring over ninety-nine percent of its shares. In addition, Raytheon guaranteed more than five billion lire worth of loans to ELSI from various Italian banks. In April 1967, Machlett Laboratories, a wholly-owned subsidiary of Raytheon, acquired ELSI's remaining shares.<sup>25</sup>

ELSI manufactured sophisticated electronic components and equipment, based largely on patents, licenses, and technical assistance provided by Raytheon. While ELSI sold its products throughout the world (sales in 1965 and 1966 exceeded eight billion lire), the company never became economically self-sufficient. During fiscal years 1964 through 1966, ELSI earned an operating profit, but this profit was insufficient to offset its debt expenses and accumulated losses. ELSI never paid any dividends to its shareholders.<sup>26</sup>

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23. The material in Part III derives largely from the "Statement of Facts" sections appearing in each of the briefs filed by both parties: Memorial of the United States (U.S. v. Italy), 1989 I.C.J. 15 (Case Concerning Elettronica Sicula S.p.A.) (May 15, 1987) (unpublished) [hereinafter U.S. Memorial]; Counter-Memorial of Italy (U.S. v. Italy), 1989 I.C.J. 15 (Case Concerning Elettronica Sicula S.p.A.) (Nov. 16, 1987) (unpublished) [hereinafter Italian Counter-Memorial]; Reply of the United States (U.S. v. Italy), 1989 I.C.J. 15 (Case Concerning Elettronica Sicula S.p.A.) (March 18, 1988) (unpublished) [hereinafter U.S. Reply]; Rejoinder of Italy (U.S. v. Italy), 1989 I.C.J. 15 (Case Concerning Elettronica Sicula S.p.A.) (July 18, 1988) (unpublished) [hereinafter Italian Rejoinder]. This Part also refers to the Chamber's Judgment of July 20, 1989. See Judgment, *supra* note 2, paras. 13-46. Both sides submitted extensive evidence on the facts of the case; the United States Memorial alone had nearly 100 annexes. Although the parties discussed the possibility of producing an agreed statement of facts for use by the ICJ, they ultimately did not present such a statement.

24. U.S. Memorial, *supra* note 23, at 11.

25. Judgment, *supra* note 2, para. 13; U.S. Memorial, *supra* note 23, at 12-13. The claim pursued by the United States technically involved injuries to both Raytheon Company and its subsidiary, Machlett Laboratories. Hence the United States often referred throughout the pleadings to both Raytheon and Machlett as injured shareholders. This article will refer to both United States companies simply as "Raytheon;" "Raytheon Company" will be used in matters only involving the parent company. A significant effect of Machlett's minority ownership of ELSI was the failure of suits brought by creditors of ELSI to recover from Raytheon Company on unpaid loans to ELSI. The suits foundered on a well-established Italian legal principle that precluded liability for Raytheon Company, since it was not the "sole shareholder" of ELSI. U.S. Memorial, *supra* note 23, at 55-56; Judgment, *supra* note 2, para. 45.

26. Judgment, *supra* note 2, para. 14.

The reasons for ELSI's failure to attain self-sufficiency later engendered considerable disagreement between the United States and Italy. The United States argued before the Chamber that Raytheon undertook extensive efforts to improve ELSI's financial performance by enhancing its administrative efficiency and by upgrading the plant facilities. Nevertheless, according to the United States, the real key to making ELSI successful lay in overcoming an inherent competitive disadvantage vis-à-vis Italian-owned companies by securing an Italian investment partner with economic power and political influence. In doing so, ELSI would gain the support of the national and regional governments, which granted certain benefits to businesses operating in southern Italy. The United States argued that when Raytheon's efforts to obtain such an Italian partner failed, ELSI lost all ability to provide a return.<sup>27</sup>

Italy countered that Raytheon essentially caused ELSI's demise with bad management, including poor product selection, poor choice of location, poor labor relations, and exorbitant charges for technical assistance. Italy further argued that it had given ELSI considerable financial assistance and that the success of non-Italian competitors during this period showed that ELSI's problems did not derive from its foreign ownership. Italy admitted that ELSI had approached it for help, but stated that the financial contributions requested by ELSI exceeded the government's resources.<sup>28</sup>

### B. *The Decision to Liquidate*

By 1968, however, the causes of ELSI's condition were less germane than the rights and obligations of the United States and Italy under the FCN Treaty. Raytheon had decided not to infuse additional capital into ELSI,<sup>29</sup> and since no further capital was forthcoming from an Italian partner, Raytheon developed a plan to close and liquidate ELSI to minimize Raytheon's losses. Under this plan, ELSI would maintain limited operations to complete work-in-progress and to fill existing purchase orders. This action would preserve ELSI as a going concern and make it more attractive to potential purchasers, who would have the chance to acquire ELSI's established name and reputation, its customer and supplier relationships, and the necessary patent and trademark licenses and technical assistance from Raytheon. Raytheon planned at that time to offer ELSI for sale both as a total package and separately by product lines in order to maximize the liquidation price.<sup>30</sup>

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27. U.S. Reply, *supra* note 23, at 9-13; U.S. Memorial, *supra* note 23, at 15-22.

28. Italian Counter-Memorial, *supra* note 23, at 7-17.

29. Judgment, *supra* note 2, para. 17; International Court of Justice Verbatim Record, C 3/CR 89/1, at 44-45 (Feb. 13, 1989).

30. International Court of Justice Verbatim Record, C 3/CR 89/1, at 47-50 (Feb. 13, 1989); International Court of Justice Verbatim Record, C 3/CR 89/2, at 37-48 (Feb. 14, 1989).

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On March 16, 1968, ELSI's Board of Directors voted to cease full-scale production by March 29 and to liquidate ELSI. The company's shareholders voted to affirm this decision on March 28. On March 29, ELSI sent dismissal letters to those employees deemed unnecessary to fulfill the liquidation plan.<sup>31</sup>

### C. *The Requisition by the Italian Government*

On April 1, 1968, the Mayor of Palermo issued an order requisitioning ELSI's plant and related tangible assets for six months.<sup>32</sup> The order was based on an 1865 law that provided Italian administrative authorities with the power to "dispose of private property" for reasons of "grave public necessity."<sup>33</sup> The requisition noted that ELSI's decision to close its plant gave rise "to strikes (both general and sectional)," aggravated the difficulties of the region, which had been "severely tried" by recent earthquakes, and created a "touchy" situation in which "unforeseeable disturbances of public order could take place." The order also stated that ELSI's plan spurred a public reaction that "strongly stigmatized" the action and caused the local press to be "very critical toward the authorities" and to accuse them of "indifference." These conditions, according to the Mayor, created a "grave public necessity and [an] urgency to protect the general economic public interest."<sup>34</sup>

The United States and Italy later disagreed sharply over the reason for the requisition. The United States argued that the requisition was an unlawful, arbitrary act taken by political authorities to appease public opinion. The United States noted that on March 31, 1968, the President of the Sicilian Region had met with ELSI's Managing Director to inform him that the Italian government would not allow ELSI to close, since a closure would produce significant unemployment just before the national elections of May 1968. Furthermore, the United States introduced as evidence several comments made by officials of the Italian government before and after the requisition stating that the government wished to take over ELSI itself rather than allow its liquidation.<sup>35</sup>

The Italian government responded that the United States was accusing it of a grand conspiracy to take over a relatively worthless company. Italy argued that the Mayor of Palermo had acted as he thought necessary, given the labor unrest that could have resulted had the government remained silent. Even if the Mayor had made a mistake in requisitioning the plant, Italy contended, he

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31. Judgment, *supra* note 2, para. 27.

32. Judgment, *supra* note 2, para. 30.

33. Law of Mar. 20, 1865, No. 2248, attachment E, art. 7, *reprinted in* U.S. Memorial, *supra* note 23, annex 34.

34. Requisition Decree, Mayor of the Municipality of Palermo, Apr. 1, 1968, *reprinted in* U.S. Memorial, *supra* note 23, annex 33.

35. U.S. Memorial, *supra* note 23, at 29-35.

nevertheless had still exercised a police power granted to him by Italian law, and therefore had not acted improperly.<sup>36</sup>

On April 2, 1968, ELSI's management surrendered control of the plant and assets to the Mayor of Palermo. Surprisingly, the Mayor did not then keep the plant open and regularly operating. Workers were allowed to enter the plant premises, but production largely remained at a standstill.<sup>37</sup> On April 9, ELSI's management petitioned the Mayor to lift his order, arguing that the requisition was illegal. On April 12, the company again invited the Mayor to revoke his order.<sup>38</sup> When it received no response from the Mayor, ELSI's management appealed the order to the Prefect of Palermo, the Mayor's administrative superior.<sup>39</sup> Again, ELSI's management argued that the requisition was illegal, arbitrary, and *ultra vires*. However, the Prefect did not rule on this appeal for sixteen months.<sup>40</sup>

#### D. The Bankruptcy

On April 25, 1968, ELSI's Board of Directors voted to file a voluntary petition in bankruptcy.<sup>41</sup> The Civil and Criminal Tribunal of Palermo adjudged ELSI bankrupt on May 16, 1968, and designated a trustee to represent the creditors' interests in ELSI's assets.<sup>42</sup> The dispute between the United States and Italy over the reason for the bankruptcy became the focal issue on which the *ELSI* decision turned. The United States argued that Raytheon quickly recognized that it would not be permitted to place ELSI through an orderly liquidation. Without the constant infusion of funds from Raytheon, ELSI could no longer meet its financial obligations as they came due, and unless ELSI's board of directors was willing to incur possible personal liability for ELSI's debts, ELSI had no choice under Italian law but to declare bankruptcy.<sup>43</sup>

Italy argued that immediately prior to the time of the requisition, ELSI's financial condition was so grave that the company should have been placed in bankruptcy under Italian law. Consequently, the requisition did not cause the bankruptcy. Even if the bankruptcy had been related to the requisition, Italy

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36. Italian Counter-Memorial, *supra* note 23, at 25-29.

37. U.S. Memorial, *supra* note 23, at 31-32.

38. Judgment, *supra* note 2, para. 32.

39. Appeal by Raytheon-ELSI S.p.A. to the Prefect of Palermo of Requisition Decree of the Mayor of Palermo, Apr. 19, 1968, *reprinted in* U.S. Memorial, *supra* note 23, annex 36.

40. *See infra* notes 53-54 and accompanying text.

41. Minutes of Meeting of Raytheon-ELSI S.p.A. Board of Directors, Apr. 25, 1968, *reprinted in* U.S. Memorial, *supra* note 23, annex 42.

42. Raytheon-ELSI S.p.A., Judgment of Bankruptcy, Civil and Criminal Tribunal of Palermo, deposited May 16, 1968, *reprinted in* U.S. Memorial, *supra* note 23, annex 44.

43. U.S. Memorial, *supra* note 23, at 35-37.

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argued, *ELSI*'s shareholders did not lose anything since by April 1 the corporation's liabilities exceeded its assets.<sup>44</sup>

The requisition began on April 1 and lasted through September 1968. On July 25, 1968 -- long before the bankruptcy court held any auction of *ELSI*'s assets -- the Italian Minister of Industry, Commerce and Crafts announced to the Parliament that the Italian government intended to take over *ELSI*'s plant through a subsidiary of the government-owned conglomerate, Istituto per la Ricostruzione Industriale (IRI). On November 13, 1968, the government stated that an entity of IRI would acquire *ELSI*'s plant. The following month, IRI formed a new subsidiary, Industria Elettronica Telecomunicazioni S.p.A. (ELTEL), to take over *ELSI*'s plant and assets.<sup>45</sup>

The bankruptcy court began its efforts to liquidate *ELSI* soon after the formation of ELTEL. The first auction of *ELSI*'s plant and equipment occurred on January 18, 1969, with a minimum bid of five billion lire (U.S. \$8,000,000). No buyers appeared at the auction. On March 22, the bankruptcy court held a second auction, adding *ELSI*'s inventory to the assets for sale and setting a minimum bid of approximately 6.2 billion lire (U.S. \$ 9,957,000). Again, no buyers appeared.<sup>46</sup> Shortly after this auction, ELTEL proposed to the trustee that it be allowed to lease and reopen the plant for eighteen months. The trustee recommended this course of action, and the judge agreed to grant ELTEL the lease. In April 1969, ELTEL proposed to the trustee that it be allowed to buy *ELSI*'s work-in-progress -- material left on the production lines -- for 105 million lire (U.S. \$168,000). The bankruptcy court approved the sale.<sup>47</sup> On May 3, the bankruptcy court held the third auction of *ELSI*'s plant, equipment, and inventory for the same price as the first auction. For a third time, no buyers appeared. On May 27, ELTEL offered to buy the remaining plant, equipment, and supplies for four billion lire (U.S. \$6,400,000). With the approval of the creditors' committee, the bankruptcy court scheduled a fourth auction on these terms, and the sale was consummated.<sup>48</sup>

Not surprisingly, the United States and Italy had two very different views of what was going on during the bankruptcy process. The United States asserted that by its acts -- delaying the bankruptcy sale by imposing a six-month requisition, allowing the local work force to occupy the plant, and announcing its intention to take over the plant -- Italy had essentially scared off potential buyers, producing a bankruptcy sale that greatly benefitted Italy's own corporate entity.<sup>49</sup> The United States presented evidence, particularly

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44. Italian Counter-Memorial, *supra* note 23, at 35-37.

45. U.S. Memorial, *supra* note 23, annexes 46, 47, 50.

46. Judgment, *supra* note 2, paras. 38-39.

47. *Id.* at para. 39.

48. *Id.* at para. 40.

49. U.S. Reply, *supra* note 23, at 24-26.

during the oral proceedings, regarding the likelihood of a European company purchasing ELSI's product lines either together or individually.<sup>50</sup> Italy countered that the United States was advancing an absurd conspiracy theory, envisioning a coordinated effort by numerous central and local government officials over a protracted period.<sup>51</sup> Italy contended that the lack of participation in the bankruptcy auctions proved the low value of ELSI, implying that only the Italian government's willingness to purchase ELSI permitted any recovery in the bankruptcy process at all.<sup>52</sup>

### E. Administrative and Judicial Remedies

Forty days after ELTEL purchased ELSI's plant and equipment, the Prefect of Palermo ruled on the appeal of the Mayor's decision to requisition the plant.<sup>53</sup> The Prefect declared the requisition illegal, as it could not have achieved its stated purposes, such as preventing labor unrest by keeping the plant operating. This ruling later formed a cornerstone of the United States case, inasmuch as the principal standards in judging adherence to the treaty obligations discussed below turned in part on whether the Mayor had arbitrarily interfered with property interests. The United States saw the Prefect's decision as an admission of the arbitrary nature of the requisition by an official of the Italian government.

The Mayor appealed the Prefect's decision to both the Italian Council of State and the President of Italy. This appeal was dismissed on the ground that the Mayor lacked standing to appeal a decision of the Prefect.<sup>54</sup> Based on the Prefect's decision, ELSI's trustee brought suit in the Court of Palermo against the local and national Italian governments.<sup>55</sup> The trustee sought damages for the injuries that the requisition caused to ELSI and to its creditors. The alleged injuries arose from the decrease in the value of ELSI's plant and equipment during the requisition period, and from ELSI's inability to dispose of the plant and equipment during that period.

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50. International Court of Justice Verbatim Record, C 3/CR 89/2, at 46-48 (Feb. 14, 1989) (testimony of John Clare).

51. International Court of Justice Verbatim Record, C 3/CR 89/5, at 24-26 (Feb. 20, 1989).

52. Italian Counter-Memorial, *supra* note 23, at 46-49.

53. Judgment of the Prefect of Palermo, Aug. 22, 1969, *reprinted in* U.S. Memorial, *supra* note 23, annex 76.

54. Council of State Opinion Regarding Appeal by the Mayor of Palermo, Nov. 19, 1971, *reprinted in* U.S. Memorial, *supra* note 23, annex 77; Ruling by the President of Italy Dismissing Appeal by Mayor of Palermo, Apr. 22, 1972, *reprinted in* U.S. Memorial, *supra* note 23, annex 78.

55. Lawsuit for Damages filed by the Trustee Against the Minister of the Interior and the Mayor of Palermo, June 16, 1970, *reprinted in* U.S. Memorial, *supra* note 23, annex 79. Raytheon itself never sued in the Italian courts. Its counsel and an Italian constitutional lawyer advised that under Italian law it would have no standing as a shareholder to sue for the injuries caused to the corporation by the acts of the Italian government. International Court of Justice Verbatim Record, C 3/CR 89/3, at 15-16 (Feb. 15, 1989).

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The District Court of Palermo denied the trustee's claim for compensation.<sup>56</sup> On appeal, however, the Court of Appeal of Palermo awarded compensation of 114 million lire (U.S. \$171,000) for the lost use and possession of ELSI's plant and assets during the six-month requisition period.<sup>57</sup> Often referred to by the United States as a "rental" payment, this compensation made no provision for the decline in value due to the inability to dispose of ELSI's plant and equipment during the requisition period. The Supreme Court of Appeals, the highest competent Italian court, upheld this decision on appeal.<sup>58</sup>

### F. *Intervention by the United States*

As the appeals were reaching their unsuccessful conclusion, Raytheon sought help from the United States government in "espousing" the claim as an injury to the United States under international law.<sup>59</sup> On February 7, 1974, the United States presented Italy with a diplomatic note advancing a claim "based upon the illegal actions and interferences by Italian authorities contrary to treaty provisions, Italian law, and international law which precluded an orderly liquidation under the laws of Italy of ELSI, S.p.A."<sup>60</sup> Although some limited discussions took place between United States and Italian officials from 1974 to 1978, Italy did not respond formally to this diplomatic note until the summer of 1978. By an *aide-mémoire* of June 13, 1978, Italy rejected the claim as groundless, stating, "the records show that the order of seizure, even though unlawful, did not cause damage to the shareholders."<sup>61</sup> The United States continued its efforts to resolve the claim through diplomatic communications, including unsuccessful discussions held during a May 1979 meeting in

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56. Judgment of the Court of Palermo, decided Feb. 2, 1973, *reprinted in* U.S. Memorial, *supra* note 23, annex 80.

57. Judgment of the Court of Appeals of Palermo, registered Jan. 24, 1974, *reprinted in* U.S. Memorial, *supra* note 23, annex 81.

58. Judgment of the Supreme Court of Appeals of Italy, Apr. 26, 1975, *reprinted in* U.S. Memorial, *supra* note 23, annex 82.

59. "Espousal" is a term of art used to describe the diplomatic protection afforded by a government to its nationals for injuries inflicted by foreign governments contrary to accepted principles of international law. The United States espouses a claim when the executive branch, usually through diplomatic channels, makes the United States national's grievance the subject of a formal claim for reparation, to be paid to the United States by the foreign government responsible for the injury. The decision to espouse is wholly within the discretion of the executive branch and is not subject to judicial review. *See generally* 8 M. WHITEMAN, DIGEST OF INTERNATIONAL LAW 1216-33 (1967).

60. Accompanying the diplomatic note were five volumes of materials: Statement of Facts, Memorandum of Law, Opinions Referred to in the Memorandum of Law, and two volumes of exhibits. The Italian government appended to its Counter-Memorial three volumes of "Unnumbered Documents," which put forth the United States original diplomatic claim. Italy apparently did so in order to show that the claim advanced before the Chamber differed from that advanced in 1974. The diplomatic claim did differ significantly (e.g., the 1974 claim argued that Italy had violated customary rules of international law), but ultimately the Chamber did not find such differences to be relevant.

61. International Court of Justice Verbatim Record, C 3/CR 89/3, at 19 (Feb. 15, 1989).

Rome between United States Secretary of State Vance and Italian Foreign Minister Forlani. Ultimately, the United States determined to resolve the dispute through a third-party dispute settlement mechanism. From 1981 to 1985, the United States presented diplomatic notes to Italy seeking to submit the claim to binding arbitration.<sup>62</sup>

In 1985, the parties met in Rome and agreed that instead of arbitration, the United States would submit the dispute to the ICJ. On October 7, 1985, the United States announced that it had agreed with Italy to bring the dispute before "a special chamber as provided by the Court's Statute and rules of procedure, subject to mutually satisfactory resolution of implementing arrangements."<sup>63</sup> On February 6, 1987, the United States filed its application instituting proceedings before the ICJ. The parties subsequently filed two rounds of pleadings: the United States Memorial (May 15, 1987), the Italian Counter-Memorial (November 16, 1987), the United States Reply (March 19, 1988), and the Italian Rejoinder (July 18, 1988). Upon considering the views of the parties, the ICJ formed a Chamber of five judges to hear the case: Judge Roberto Ago (Italy), Judge Sir Robert Jennings (United Kingdom), Judge Shigeru Oda (Japan), Judge Steven Schwebel (United States), and President Nagendra Singh (India), who was replaced by President José María Ruda (Argentina) upon Judge Singh's death in December 1988.<sup>64</sup> The Chamber held a hearing in The Hague from February 13 to March 3, 1989.

#### IV. JURISDICTION OF THE ICJ AND ADMISSIBILITY OF THE CLAIM

The jurisdictional bases of the ICJ appear in article 36 of the Statute of the Court. The "Optional Clause" of article 36(2) allows states to accept in advance the jurisdiction of the ICJ as compulsory *ipso facto* and without special agreement. The jurisdiction of the ICJ in the *ELSI* case arose under article 36(1) of the Statute, which provides that the "jurisdiction of the court comprises all cases which the parties refer to it and all matters specially provided for in the Charter of the United Nations or in treaties and conventions in force."<sup>65</sup> The United States brought its case based exclusively on its 1948 FCN Treaty with Italy. Article XXVI of that Treaty contains a compromissory clause that permits either party to submit to the ICJ any dispute that the parties "shall not

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62. Application of the United States (U.S. v. Italy), 1989 I.C.J. 15 (Case Concerning Elettronica Sicula S.p.A. (ELSI)) attachment 2 (Feb. 6, 1987) (unpublished).

63. *U.S.-Italy Agree to Submit Dispute to I.C.J.*, DEP'T ST. BULL., Jan. 1986, at 69.

64. For the orders establishing the Chamber and replacing Judge Singh, see Case Concerning Elettronica Sicula S.p.A. (ELSI) (U.S. v. Italy), 1987 I.C.J. 3 (Mar. 2, 1987) (order constituting Chamber); Case Concerning Elettronica Sicula S.p.A. (ELSI) (U.S. v. Italy), 1988 I.C.J. 158 (Dec. 20, 1988) (order replacing Singh, J.). Formation of the Chamber was pursuant to rule 26 of the ICJ's rules. See *infra* notes 205-05 and accompanying text.

65. Statute of the Court, *supra* note 4, art. 36(1).

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satisfactorily adjust by diplomacy."<sup>66</sup> Although in its written pleadings Italy seemed to invite the Chamber to find that certain provisions of the Treaty had not been raised in diplomatic negotiations between the parties, at the oral proceedings Italy conceded the jurisdiction of the ICJ over the claim.<sup>67</sup>

Italy, however, argued vigorously that Raytheon's failure to exhaust available remedies in Italian courts rendered the claim inadmissible. Italy first raised the issue in its Counter-Memorial, citing the ICJ's statement in the *Interhandel* case:

The rule that local remedies must be exhausted before international proceedings may be instituted is a well-established rule of customary international law; the rule has been generally observed in cases in which a State has adopted the cause of its national whose rights are claimed to have been disregarded in another State in violation of international law. Before resort may be had to an international court in such a situation, it has been considered necessary that the State where the violation occurred should have an opportunity to redress it by its own means, within the framework of its own domestic legal system.<sup>68</sup>

Italy argued that its domestic courts never had the opportunity to rule upon the alleged treaty violations presented by the United States. Raytheon had never sued on the basis of the FCN Treaty in Italian courts. In fact, it had never sued in Italian courts at all.<sup>69</sup> Italy contended that Raytheon had ample opportunity to sue on the FCN Treaty in Italian courts, since enabling legislation passed by the Italian Parliament had incorporated the FCN Treaty into Italian domestic law.<sup>70</sup>

The United States produced an array of arguments opposing the application of the local remedies rule to the United States claim, but the Chamber rejected all of them. First, the United States argued that since the compromissory clause of the FCN Treaty did not explicitly require a party to exhaust local remedies before submitting a claim to the ICJ, the rule should not be read into the Treaty. The United States contended that the meaning of article XXVI was

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66. Article XXVI of the United States-Italy FCN Treaty states in full:

Any dispute between the High Contracting Parties as to the interpretation or the application of this Treaty, which the High Contracting Parties shall not satisfactorily adjust by diplomacy, shall be submitted to the International Court of Justice, unless the High Contracting Parties shall agree to settlement by some other pacific means.

U.S.-Italy FCN Treaty, *supra* note 3, art. XXVI. A compromissory clause of a treaty provides that disputes arising under the treaty may be resolved upon the application of either party to a specified arbitral or judicial body. See Charney, *Compromissory Clauses and the Jurisdiction of the International Court of Justice*, 81 AM. J. INT'L L. 855 (1987). In light of the United States withdrawal from the compulsory jurisdiction of the ICJ, compromissory clauses in treaties are now the only mechanisms that subject the United States to the jurisdiction of the ICJ. For a discussion of the United States withdrawal from compulsory jurisdiction, see *infra* notes 232-33 and accompanying text.

67. International Court of Justice Verbatim Record, C 3/CR 89/5, at 10 (Feb. 20, 1989).

68. *Interhandel* Case (Switz. v. U.S.), 1959 I.C.J. 6, 27 (Preliminary Objections). See generally 1978 DIGEST OF U.S. PRACTICE IN INTERNATIONAL LAW 1208-17.

69. Raytheon had been advised by its Italian counsel that it would have no standing under Italian law as a shareholder to sue for an injury to *ELSI*. See *supra* note 55 and accompanying text.

70. For the implementing orders (*ordini di esecuzione*) cited by Italy, see Italian Counter-Memorial, *supra* note 23, at 70.

unambiguous: in appropriate circumstances, disputes about the interpretation or application of the Treaty may be submitted to the ICJ. Had the drafters of the Treaty meant something different, then they would have expressly specified it. In support of this assertion, the United States contrasted the FCN Treaty with the 1948 Economic Cooperation Agreement between Italy and the United States, which entered into force the same year as the FCN Treaty and whose compromissory clause expressly incorporated the local remedies rule.<sup>71</sup>

The Chamber rejected this argument by announcing that where an international treaty is silent about an important rule of customary international law, then that rule applies. The Chamber was "unable to accept that an important principle of customary international law should be held to have been tacitly dispensed with, in the absence of any words making clear an intention to do so."<sup>72</sup> The Chamber cited no authority for this proposition, despite the rather far-reaching implications of this assertion. The Chamber's decision implies that all treaties that are silent on important principles of customary law subsume those principles, even though nothing in the Vienna Convention on the Law of Treaties supports this proposition.<sup>73</sup> Indeed, the Vienna Convention, in its articles relating to the interpretation of treaties, advocates treaty interpretation based on the ordinary meaning of the terms of the treaty in their context and in light of the object and purpose of the treaty.<sup>74</sup> Where the terms of the treaty are ambiguous, the parties may rely on supplementary texts. The Vienna Convention does not, however, support the incorporation of unexpressed customary rules of international law. Moreover, the Chamber's approach does not square with the ICJ's own very textual "plain meaning" approach used in its more significant advisory opinions on the interpretation of treaties.<sup>75</sup>

As a practical matter, the Chamber's position is quite sound. Treaties often contain gaps that can and should be filled by traditional rules that have evolved based on the interaction of nations. In effect, the United States may have made a concession to this view by arguing that the customary international law principles expressed in the Vienna Convention are relevant at all, since that treaty is not yet in force between the parties. However, it is one thing to use customary international law to interpret ambiguous terms of an international

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71. Economic Cooperation Agreement, June 28, 1948, United States-Italy, art. X(3), 62 Stat. 2421, T.I.A.S. No. 1789.

72. Judgment, *supra* note 2, para. 50.

73. Vienna Convention on the Law of Treaties, 8 I.L.M. 679 (1969), reprinted in 63 AM. J. INT'L L. 875 (1969).

74. *Id.* at arts. 31-32. Although the United States has not ratified the Vienna Convention on the Law of Treaties, it nevertheless asserted that the Convention's articles relating to treaty interpretation codify established principles of customary international law. U.S. Memorial, *supra* note 23, at 79.

75. See, e.g., Competence of the General Assembly for the Admission of a State to the United Nations, 1950 I.C.J. 4; Conditions of Admission of a State to Membership in the United Nations, 1948 I.C.J. 57. For a discussion of the ICJ's textual approach, see *Report of the International Law Commission to the General Assembly*, [1966] 2 Y.B. INT'L L. COMM'N 220-21.

convention; it is quite another to use such law to read substantive rules into a convention when those rules do not otherwise present themselves. In the *ELSI* case, the local remedies rule ultimately did not defeat the jurisdictional issue. Had it done so, though, a rule of customary international law would have frustrated an otherwise clear treaty provision (article XXVI) specifically establishing jurisdiction.

Second, the United States argued that the relief it sought did not represent a claim that was "espoused" on behalf of one of its nationals. Although it was clear that Italy's allegedly unlawful activities affected two United States companies (Raytheon Company and Machlett), the United States contended that it, as a party to the FCN Treaty, actually suffered the injury. The United States had based the claim exclusively on Italy's alleged violations of obligations it owed to the United States under the Treaty. In invoking the compromissory clause, the United States sought two forms of redress for injury to itself: a declaratory judgment stating that Italy had committed violations of the Treaty and an award of reparation for those violations. Because the claim arose from a direct injury to the United States, the United States argued that the local remedies rule did not apply.<sup>76</sup>

The Chamber rejected this approach by reviewing several statements made by the United States that clearly pointed to a classic case of espousal. The Chamber observed that the parties described the dispute at the diplomatic level as a "claim of the Government of the United States of America on behalf of Raytheon Company and Machlett Laboratories, Incorporated." Furthermore, during the oral proceedings, the United States Agent had asserted that "the United States seeks reparation for injuries suffered by Raytheon and Machlett."<sup>77</sup> The Chamber also noted that the ICJ had rejected a similar argument made by Switzerland in the *Interhandel* case, in which the Swiss government had contended that the principal submission was one of a "direct breach of international law."<sup>78</sup> Putting these points together, the Chamber was unable "to find a dispute over alleged violation of the FCN Treaty resulting in direct injury to the United States, that is both distinct from, and independent of, the dispute over the alleged violation in respect of Raytheon and Machlett."<sup>79</sup>

Third, the United States argued that estoppel prevented Italy from asserting that Raytheon and Machlett were required to exhaust local remedies. When

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76. The local remedies rule is commonly said to apply to situations where there has been injury in the first instance to the nationals of the state, not to the state itself. *Interhandel Case (Switz. v. U.S.)*, 1959 I.C.J. 6, 27. Thus, the protection afforded by a state's espousal of a national's claim is said to be based only on an "indirect" injury to the state. Violation of a treaty obligation between two states appears to be a direct injury, unless the content of the treaty provision at issue reveals an intention to protect nationals.

77. Judgment, *supra* note 2, para. 51.

78. *Id.* at para. 52.

79. *Id.* at para. 51.

the United States presented its diplomatic claim to Italy in 1974, it stated that local remedies had been exhausted.<sup>80</sup> Italy failed to respond to the United States diplomatic note for four years, and when it did respond, it did not raise the local remedies issue. The parties exchanged further diplomatic notes without any mention of available local remedies that had not been exhausted. Not until the suit came before the ICJ did Italy suggest that further local remedies existed. The United States argued that this conduct by Italy discouraged further resort to local remedies and caused the United States to rely in good faith on Italy's acceptance of the proposition that the dispute concerned only the merits of the claim.

The Chamber rejected this argument as well. First, it noted the difficulty of "drawing any such conclusion from the exchanges of correspondence when the matter was still being pursued on the diplomatic level."<sup>81</sup> It also found that "there are obvious difficulties in constructing an estoppel from a mere failure to mention a matter at a particular point in somewhat desultory diplomatic exchanges."<sup>82</sup> The Chamber's reasoning seems to hinge on the idea that diplomatic exchanges are somehow inherently less trustworthy for the purpose of creating an estoppel. While diplomatic exchanges are often sporadic on any given issue, they do constitute the method by which nations communicate with each other. Moreover, in certain types of diplomatic exchanges, such as those involving the assertion of a diplomatic claim, the claimant state relies on the diplomatic response to advise its nationals on how they should proceed and to assess the types of evidence that may be needed to sustain the claim. The goal of fostering global dispute resolution would presumably favor a system that encourages accurate, timely, and dependable statements in such exchanges. A state's silence in the face of another state's explicit assertion that an "important principle of international law"<sup>83</sup> (to use the Chamber's words) has been violated would seem a highly appropriate case for invoking the principle of estoppel.

In previous cases, the ICJ has recognized the doctrine of estoppel as a principle that prevents one state from acting inconsistently with its prior conduct, whether or not that conduct was silence.<sup>84</sup> Judge Alfaro, in his

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80. In its Diplomatic Note No. 51 of Feb. 7, 1974, the United States asserted that "[i]t is clear from the legal opinion submitted with the claim that the appeal taken to the Prefect of Palermo was the only legal remedy available to Raytheon Company and Machlett Laboratories, Incorporated to obtain redress." Italian Counter-Memorial, *supra* note 23, Unnumbered Documents, at 3. The legal opinions referred to were those of Mr. Giuseppe Bisconti and Mr. Antonio La Pergola, two Italian law experts retained by Raytheon.

81. Judgment, *supra* note 2, para. 54.

82. *Id.*

83. Judgment, *supra* note 2, para. 50.

84. The doctrine of estoppel is a generally recognized principle in international practice derived from notions of good faith and consistency. It does not comprise the more technical features found in municipal laws. See generally B. CHENG, GENERAL PRINCIPLES OF LAW AS APPLIED BY INTERNATIONAL COURTS AND TRIBUNALS 141-58 (1953); H. LAUTERPACHT, THE DEVELOPMENT OF INTERNATIONAL LAW BY THE INTERNATIONAL COURT 168-72 (1961); Bowett, *Estoppel Before International Tribunals and Its Relation to Acquiescence*, 33 BRIT. Y.B. INT'L L. 176, 201 (1957); MacGibbon, *Estoppel in International Law*,

separate opinion in the *Temple of Preah Vihear* case, noted that inconsistency in conduct is especially impermissible when the dispute arises from bilateral treaty relations.<sup>85</sup> As recently as its judgment on jurisdiction in the *Nicaragua* case, the ICJ has reaffirmed this principle.<sup>86</sup> Although the principle of estoppel may have been inapplicable on the facts of *ELSI*, the Chamber's failure to provide further reasoning for rejecting the principle leaves the observer with the sense that the ICJ in general may apply the estoppel doctrine when necessary to reach a desired result, but will otherwise ignore it. Such use of the doctrine disrupts the parties' expectations and can tarnish the integrity of the ICJ. As always, "the persuasive character of [ICJ] judgments and advisory opinions depends on the fullness and cogency of the reasoning offered."<sup>87</sup>

Finally, the United States argued that if the local remedies rule were to apply, then Italy would bear the burden of showing that Raytheon and *ELSI* had not exhausted local remedies. According to the United States, Italy had failed to meet this burden. In addition, Italy had not taken advantage of numerous opportunities within its own legal system to pay compensation for the injury caused by its actions. Prior to the bankruptcy, *ELSI* had made efforts to persuade the Mayor of Palermo to rescind the requisition order. Furthermore, during the bankruptcy proceedings, the trustee had appealed to the Italian courts the decisions of the bankruptcy judge allowing the Italian government to lease the plant and eventually to buy the plant, equipment, and supplies. Finally, after the sale of the plant, equipment, and supplies, the trustee brought a suit for damages against the Italian government based on the Prefect's ruling that the requisition was unlawful. The United States argued that if the local remedies rule existed primarily to provide the host government the opportunity to correct its error through internal procedures, Italy had ample opportunity in this case to have pursued such an option.<sup>88</sup>

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7 INT'L & COMP. L.Q. 468-513 (1958). Unfortunately, the principle has not achieved particular coherence in international law. In practice, its parameters are far from uniform.

85. Case Concerning the Temple of Preah Vihear (Cambodia v. Thailand), 1962 I.C.J. 6, 39. Several of the dissenting and separate opinions in this case show that the cursory application of the principle of estoppel disturbed certain judges. *See id.* at 62-65 (Fitzmaurice, J., separate opinion); *id.* at 101, 142-44 (Spender, J., dissenting).

86. The ICJ stated that "estoppel may be inferred from the conduct, declarations and the like made by a State which ... [has] caused another State or States, in reliance on such conduct, detrimentally to change position or suffer some prejudice." Case Concerning Military and Paramilitary Activities in and against Nicaragua (Nicar. v. U.S.), 1984 I.C.J. 392, 415.

87. 1 G. SCHWARTZENBERGER, INTERNATIONAL LAW 30 (3rd ed. 1957).

88. International Court of Justice Verbatim Record, C 3/CR 89/2, at 81-96 (Feb. 14, 1989); International Court of Justice Verbatim Record, C 3/CR 89/3, at 26-27 (Feb. 15, 1989).

Arguing for or against application of the local remedies rule presents the difficult task of establishing its purpose. Arguably, the rule serves several purposes: 1) it provides the defendant state the opportunity to redress the injury by its own means, within the framework of its domestic legal system; 2) it clarifies the facts and local law applicable to the case prior to elevating the case to an international tribunal, which typically is limited in its fact-finding abilities; and 3) it helps avoid excessive recourse to international adjudication to alleviate friction between nations.

The United States emphasized that Raytheon had done as much as one could reasonably expect. Raytheon had consulted two Italian legal experts (one admittedly Raytheon's regular Italian counsel, the other a professor who was later appointed Chief Justice of the Italian Constitutional Court) as to whether further local remedies existed. Both had replied in the negative. The United States argued further that in at least one Court of Rome case, the Attorney General of Rome had stated that a litigant could not bring a suit in Italian courts based on provisions of the FCN Treaty.<sup>89</sup>

The United States argument on this issue faced significant factual problems. Raytheon, the United States national whose claim had been espoused by the United States, had never actually sought Italian judicial and administrative remedies. Rather, it was ELSI itself (an Italian company) and the bankruptcy trustee (an Italian national appointed by the Italian bankruptcy judge) that took recourse to the Italian courts.<sup>90</sup> Furthermore, none of these actions required Italian administrative or judicial authorities to review the lawfulness of Italy's actions under the terms of the FCN Treaty, even though -- as the Italian government emphasized -- it (and similar treaties) had been previously actionable in Italian courts. Finally, the United States position brought with it the unenviable task of distinguishing the ICJ's earlier ruling in the *Interhandel* case, denying Switzerland's claim on behalf of a Swiss company for failure to satisfy the local remedies rule.<sup>91</sup>

Despite these problems, the Chamber accepted the general position of the United States by enunciating a "rule of reason" for the admissibility of claims. First, the Chamber found that since the injury to Raytheon allegedly arose from actions taken against the locally incorporated company, ELSI was initially the appropriate party to pursue local remedies. When ELSI lost the ability to do so after bankruptcy, the bankruptcy trustee became the appropriate party

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89. Brief of the Attorney General of Rome, *Talenti v. Presidenza del Consiglio dei Ministri* (Court of Rome) (1987) (No. 32266/83), cited in International Court of Justice Verbatim Record, C 3/CR 89/2, at 88 (Feb. 14, 1989). Copies of the brief and the ensuing judgment were submitted during the hearing.

90. As under United States law, the Italian bankruptcy trustee acted in a fiduciary capacity on behalf of all the creditors of ELSI, including Raytheon. But Raytheon was an unsecured creditor with far less at stake than the preferred and secured creditors. They, unlike Raytheon, ultimately received substantial proceeds from the bankruptcy auction. U.S. Memorial, *supra* note 23, at 151. Indeed, Raytheon did not even file claims with the bankruptcy court because it did not believe that the likelihood of receiving any proceeds justified the filing costs. *Id.* at 56. Thus, the *ELSI* litigation raised the issue of whether the trustee, in representing the creditors, was acting sufficiently on "behalf" of Raytheon, with respect to Raytheon's loans to ELSI, for purposes of satisfying Raytheon's obligation to exhaust local remedies. The dispute also presented the issue of whether the trustee was acting on "behalf" of Raytheon with respect to Raytheon's *shareholder* interests in ELSI. The United States contended that the trustee's suit was not and could not have been brought under Italian law on behalf of ELSI's shareholders, as opposed to ELSI's creditors. *Id.* at 53 n.11. Most of Raytheon's claims were for the loss of property and shareholder investment, not for the unsecured loans.

91. *Interhandel Case (Switz. v. U.S.)*, 1959 I.C.J. 6, 27-29. Significantly, Judge Armand-Ugon argued in his dissent that the local remedies rule does not apply where the injury at issue is a breach of an international agreement. *Id.* at 89 (Armand-Ugon, J., dissenting).

to seek redress. Thus the Chamber agreed that the injured foreign national need not always be the entity that pursues satisfaction in local courts.<sup>92</sup>

Second, the Chamber found that although neither *ELSI* nor the trustee had pled the FCN Treaty before the Italian courts, that did not prove that they had not exhausted local remedies. Since the trustee did not view the dispute as one arising under international law, the Chamber found it "not surprising" that he had not invoked the FCN Treaty.<sup>93</sup> The Chamber recognized that the local remedies rule simply cannot require an injured party to bring before the local courts proceedings identical to those brought before an international tribunal, given the differences in form, procedure, and applicable law. "[F]or an international claim to be admissible, it is sufficient if the essence of the claim has been brought before the competent tribunals and pursued as far as permitted by local law and procedures, and without success."<sup>94</sup>

Third, the decision obtained from the Prefect and then pursued by the trustee through the entire Italian judicial system was, in substance, essentially the same claim brought before the Chamber by the United States.<sup>95</sup> The similarity between the municipal and international claims did not prove that *ELSI* and the trustee had exhausted their local remedies, but it did shift the burden to "Italy to demonstrate that there was nevertheless some local remedy that had not been tried; or at least, not exhausted."<sup>96</sup> Although the Chamber did not explicitly formulate its approach as such, the reasoning of the opinion suggests that an applicant, upon showing a *prima facie* resort to local remedies, creates a presumption of exhaustion that the respondent may then rebut.<sup>97</sup>

The Chamber found that Italy did not demonstrate the availability to Raytheon or *ELSI* of any adequate remedy that had not been exhausted.<sup>98</sup> In

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92. Judgment, *supra* note 2, para. 56.

93. *Id.* at para. 59.

94. *Id.*

95. The Chamber stated that:

[t]he arguments were different, because the municipal court was applying Italian law, whereas this Chamber applies international law; and, of course, the parties were different. Yet it would seem that the municipal courts had been fully seized of the matter which is the substance of the Applicant's claim before the Chamber. For both claims turn on the allegation that the requisition, by frustrating the orderly liquidation, triggered the bankruptcy, and so caused the alleged losses.

*Id.* at para. 58.

96. *Id.* at para. 59.

97. Uncertainty about who must show that the claimant has or has not exhausted local remedies may arise from the debate over whether the local remedies rule constitutes a rule essentially procedural in nature or a substantive element of the claimed violation. If it is a procedural rule, exhaustion is a condition precedent to the claimant state's exercise of the right of diplomatic protection of its injured national, and the respondent state must show that the injured party has not fulfilled this condition. If on the other hand it is a substantive rule, exhaustion is a condition precedent to the accrual of international liability, and the claimant state must prove exhaustion in order to prevail on its claim. See T. HAESLER, *THE EXHAUSTION OF LOCAL REMEDIES IN THE CASE LAW OF INTERNATIONAL COURTS AND TRIBUNALS* 23-27 (1968); Fawcett, *The Exhaustion of Local Remedies: Substance or Procedure?*, 31 *BRIT. Y.B. INT'L L.* 452, 454 (1954).

98. Judgment, *supra* note 2, paras. 56-63.

response to Italy's argument that Raytheon should have sued based on an Italian Civil Code provision providing for compensation for wrongful acts,<sup>99</sup> the Chamber found that Italy had not shown that Italian courts would consider violations of the FCN Treaty to be wrongful acts. Italy had cited various cases from its highest court in which litigants, for the benefit of United States nationals, had relied on provisions of the FCN Treaty and other treaties.<sup>100</sup> However, none of these decisions awarded relief based on the Italian Civil Code provision in question. Rather, Italy's highest court had given these treaty provisions effect in conjunction with municipal legislation or with other treaties, through the application of the most-favored-nation clause. In none of the cases cited by Italy did the FCN Treaty provisions at issue in *ELSI* form the basis for establishing the wrongfulness of the Italian government's conduct.

The Chamber also found it relevant that neither of the two Italian experts retained by Raytheon at the time considered the possibility of an action under the Italian Civil Code in conjunction with the FCN Treaty.<sup>101</sup> Thus, an international tribunal's decision on whether a foreign national failed to pursue a viable local remedy may depend in part on the views of jurists familiar with the local law, even if they are employed by the foreign national. In this case, Italian jurists in 1971 did not consider viable the potential remedy advanced by Italy during the proceedings. Since the Chamber could not, given these facts, deduce whether Raytheon would have prevailed in an action based on the Italian Civil Code in the early 1970s, the Chamber found that Italy had failed to discharge its burden of showing Raytheon's failure to exhaust local remedies. Consequently, the Chamber deemed the claim admissible.

On balance, the *ELSI* decision should strengthen the ICJ's article 36(1) jurisdiction to hear cases referred to it pursuant to compromissory clauses in bilateral and multilateral treaties, which constitute the principal source of the ICJ's jurisdiction in contentious cases. In light of *ELSI*, these clauses may become more attractive to states who wish to settle their disputes by using a chamber of judges without lengthy proceedings. The Chamber's application of the exhaustion of local remedies rule to article XXVI of the FCN Treaty, despite the silence of the compromissory clause, ensures that foreign nationals will pursue their claims as far as reasonably possible in the local courts of the

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99. Italy referred to article 2043 of the Italian Civil Code, which provides that "[a]ny act committed either wilfully or through fault which causes wrongful damages to another person implies that the wrongdoer is under an obligation to pay compensation for those damages." Italian Rejoinder, *supra* note 23, annex 16.

100. Judgment of Dec. 6, 1983, Corte cass., Italy, 1984 COMMISSIONE TRIBUTARIA CENTRALE 1143, reprinted in Italian Rejoinder, *supra* note 23, annex 12; Judgment of Jan. 14, 1976, Corte cass., Italy, 1976 Foro It. I 2463, reprinted in Italian Rejoinder, *supra* note 23, annex 4; Judgment of May 21, 1973, Corte cass., Italy, 1973, Foro It. I 2443, reprinted in Italian Rejoinder, *supra* note 23, annex 5; Judgment of July 30, 1960, Corte cass., Italy, 14 RIVISTA DI DIRITTI INTERNAZIONALE 117 (1961), reprinted in Italian Rejoinder, *supra* note 23, annex 11.

101. Judgment, *supra* note 2, para. 62.

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host state before the case reaches an international tribunal. This rule, by providing the host state an opportunity to redress the wrong and by giving both parties a chance to refine the issues of fact and law, ensures that parties will bring such disputes to the ICJ only when they have failed to resolve a clearly defined "dispute."

The Chamber's willingness to retain some flexibility in the application of the local remedies rule, and to place the burden on the defending state to show that the injured party failed to take advantage of further viable local remedies, will encourage states to bring before the ICJ claims on behalf of their nationals, so long as the efforts to obtain local redress appear thorough and the local claim resembles the type of claim brought internationally. The Chamber, however, could have been more formalistic in its approach. For instance, it could have created a rule requiring a state seeking to espouse the claims of its national to prove without question that it has conducted an exhaustive investigation of all conceivable remedies in the host state and that its national has pursued all of those remedies unsuccessfully. Such a rule would make espousal a very dubious project. On the other hand, the Chamber in its more relaxed approach to the local remedies rule has not overreached its jurisdiction. The door remains open for a respondent state to establish that the foreign national has not pursued available viable remedies. For example, the United States could have met this standard in the *Interhandel* case since, at the time the ICJ heard the case, a suit by the Interhandel Company was still active in United States courts.<sup>102</sup>

The impact of the Chamber's "rule of reason" approach to the local remedies rule could well extend beyond the postwar FCN treaties, for several other treaties have the same or similar compromissory clauses. According to the Yearbook of the ICJ, nearly 250 separate treaties now provide in their texts for the resolution of disputes by the ICJ.<sup>103</sup> Although the United States terminated its acceptance of compulsory jurisdiction under article 36(2), the United States remains subject to the jurisdiction of the ICJ under the compromissory clauses of some seventy treaties.<sup>104</sup> While not all claims brought under these treaties would necessarily be on behalf of nationals, many of these treaties are designed to protect the rights of nationals, and consequently the local remedies rule is relevant. For example, the economic cooperation agreements negotiated during the same period as the FCN treaties generally provide for submission to the ICJ of claims espoused on behalf of nationals for damages arising from

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102. *Interhandel Case (Switz. v. U.S.)*, 1959 I.C.J. 6, 27-28.

103. 1988-1989 I.C.J.Y.B. 96-113 (1989). Even more treaties provide for resolution of disputes by the Permanent Court of International Justice. While some of these treaties are no longer in force, most of them carry over to the International Court of Justice. See Morrison, *Treaties as a Source of Jurisdiction, Especially in U.S. Practice*, in *THE INTERNATIONAL COURT OF JUSTICE AT A CROSSROADS* 58, 58-59 (L. Damrosch ed. 1987).

104. Morrison, *supra* note 103, at 58 apps.

host government acts affecting property or interests of the foreign national, including contracts or concessions. Furthermore, the United States is a party to approximately thirty multilateral conventions (concerning subjects as diverse as intellectual property, narcotics, terrorism, aviation, and pollution) that assign jurisdiction to the ICJ.<sup>105</sup>

#### V. THE FRIENDSHIP, COMMERCE AND NAVIGATION TREATY

Having ruled that the United States claim was admissible, the Chamber turned to the centerpiece of the litigation: the application of the facts of the case to the provisions of the FCN Treaty. Based on interrelated provisions of the Treaty, the United States argued that Italy had failed to provide Raytheon four types of protection: 1) protection of management and control pursuant to articles III and VII of the Treaty and article I of the Treaty Supplement; 2) protection and security of the plant and premises, pursuant to article V of the Treaty; 3) protection against the wrongful taking of property, pursuant to article V of the Treaty and article I of the Protocol; and 4) protection from arbitrary measures affecting property rights and interest, pursuant to article I of the Supplement. These four protections are common to all the FCN treaties negotiated by the United States and appear as well in the more recent bilateral investment treaties. Before discussing in turn each protection, as argued by the parties and decided by the Chamber, it is helpful to make several general points.

In assessing the treaty provisions in light of the object and purpose of the FCN Treaty, the United States and Italy differed as to whether or not an overall purpose of the FCN Treaty was to encourage investment. Both parties reviewed extensively the legislative history of the Treaty to support their views.<sup>106</sup> The Chamber, however, avoided lengthy comment on this debate, noting simply that "a purpose of the Supplementary Agreement, which is to 'constitute an integral part' of the FCN Treaty, was to give 'added encouragement to investments of the one country in useful undertakings in the other country.'"<sup>107</sup>

The United States argued broadly that various acts of Italy, such as the requisition of the plant, the failure to prevent the occupation of the plant, the

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105. *Id.* at app. 4. The Convention on the Settlement of Investment Disputes between States and Nationals of Other States, Mar. 18, 1965, art. 64, 17 U.S.T. 1270, T.I.A.S. No. 6090, 575 U.N.T.S. 159, provides for recourse to the ICJ as well, but only for interpretation of the Convention itself.

106. Each party submitted and referred to various forms of the other's legislative history, such as congressional reports and majority and minority parliamentary reports. *See, e.g.*, U.S. Memorial, *supra* note 23, annexes 3, 4, 85, 88, 89, 90; Italian Counter-Memorial, *supra* note 23, at 3-17. Although the Chamber ignored this legislative history in its opinion, Judge Schwebel referred to it extensively in his dissent. Case Concerning Elettronica Sicula S.p.A. (ELSI) (U.S. v Italy), 1989 I.C.J. 15, 97-100 (Schwebel, J., dissenting).

107. Judgment, *supra* note 2, para. 64.

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delay in the Prefect's ruling, and the interference with the bankruptcy process, individually and collectively constituted treaty violations. The Chamber, however, focused upon the requisition of the plant and treated the other acts as ancillary. The Chamber found that the requisition of the plant was the "core" or "essence" of the claim, because this was the act that frustrated Raytheon's ability to place ELSI through an orderly liquidation.<sup>108</sup> This winnowing approach certainly simplified the Chamber's task, but it also de-emphasized those actions that, standing alone, also supported legitimate claims.

As a general matter, Italy argued that the United States claim must fail because the rights, interests, and property implicated belonged not to Raytheon but to ELSI, which, as an Italian corporation, was not a beneficiary under the FCN Treaty.<sup>109</sup> Italy's approach suggested that unless Raytheon could show direct injury to the ownership of shares, then the claim based on the protection granted by the Treaty would necessarily fail. Italy invoked the ICJ's prior ruling in *Barcelona Traction* to argue that international law does not generally provide a remedy to the shareholders of a corporation for acts committed against the corporation and that, if shareholders do have a remedy, it should be interpreted "restrictively and rigorously."<sup>110</sup>

The United States criticized Italy's reading of the *Barcelona Traction* case as inappropriate for several reasons.<sup>111</sup> First, that case was decided on the basis of customary rules of law and did not involve the interpretation of a treaty between the parties. Indeed, the ICJ in *Barcelona Traction* said that it might have reached a different result if there had been a treaty.<sup>112</sup> The United States argued that certain provisions in the FCN Treaty did protect shareholders against acts that compromised their rights to use and dispose of their property, even if that property takes the form of a local corporation.

In addition, the United States argued, *Barcelona Traction* concerned the allocation of the right of diplomatic protection between two potential claimant

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108. *Id.* at paras. 66, 77.

109. Italian Rejoinder, *supra* note 23, at 124. In fact, throughout the written and oral pleadings, Italy emphasized that the FCN Treaty gives virtually no protection to corporate subsidiaries.

110. *Id.* at 126-28.

111. International Court of Justice Verbatim Record, C 3/CR 89/3, at 66-68 (Feb. 15, 1989). In the Case Concerning the *Barcelona Traction, Light and Power Company, Ltd.* (New Application: 1962) (Belg. v. Spain), 1970 I.C.J. 3 (Second Phase), the issue was whether Belgium had standing to submit a claim on behalf of its nationals, who were shareholders in *Barcelona Traction*, a company formed under Canadian law and having its registered office in Canada. The claim sought damages for wrongs allegedly done in Spain to *Barcelona Traction* and two of its subsidiaries by the Spanish government. These wrongs allegedly led to the bankruptcy of the subsidiaries (as in *ELSI*) and of *Barcelona Traction* itself. The ICJ held that Belgium did not have standing to bring a claim on behalf of the shareholders because their claims arose not from an infringement of their "direct" rights, but rather from acts directed against the corporate entity. The *Barcelona Traction* decision has not been free from criticism. See, e.g., Lillich, *The Rigidity of Barcelona*, 65 AM. J. INT'L L. 522 (1971). The relevance to *ELSI* is clear: the ICJ in *Barcelona Traction* indicated that a corporate entity has an independent existence from its shareholders, and that the right to redress for the infringement of corporate rights belongs to the entity alone, through its management.

112. See *Barcelona Traction*, 1970 I.C.J. 3, paras. 87, 90.

states (Belgium and Canada), not the right of one state to espouse the claims of its nationals. The ICJ specifically stated in *Barcelona Traction* that the distinction between the corporation and its shareholders would be less significant if the case involved only one potential claimant state invoking the responsibility of one defendant state.<sup>113</sup> In other words, the ICJ in *Barcelona Traction* addressed only Belgium's standing to bring a claim on behalf of its shareholders, not Canada's ability to espouse *Barcelona Traction's* claims for injuries to its subsidiaries in Spain.

Most importantly, the United States contended that even customary international law, in light of the *Barcelona Traction* decision, provides protection for foreign shareholders who are deprived of their rights as shareholders. Although the United States did not rely on customary international law in *ELSI*, it did frame its case in terms of a deprivation of shareholders' rights. Therefore, application of *Barcelona Traction* would not block the United States claims in *ELSI*.

In perhaps the most significant aspect of the entire decision, the Chamber rejected Italy's argument that the FCN Treaty does not protect the foreign parent corporation from acts taken against its locally incorporated subsidiary. Unfortunately, the Chamber did not squarely address the issue within the context of *Barcelona Traction*. Nevertheless, the Chamber clearly chose not to follow the "traditional view," advanced by Italy, of recognizing a sharp distinction between shareholder and corporate rights -- a distinction that figured prominently in *Barcelona Traction*. Instead, the Chamber looked to the general structure of the FCN Treaty, to the specific language of its provisions, and in some cases to the practical application of these provisions, in order to disregard the corporate form and to provide broad protection for the rights of shareholders.

As noted above, it was only in the beginning of this century that bilateral commerce and friendship treaties extended to artificial persons, such as corporations, protections previously granted only to individuals.<sup>114</sup> Beginning with the 1923 Treaty of Friendship, Commerce, and Consular Rights with Germany,<sup>115</sup> the United States concluded twelve general commercial treaties during the interwar period, all of which contained provisions that applied to artificial persons. Ultimately, the protections afforded to companies expanded to include the same benefits of national, most-favored-nation, and other preferential standards of treatment. Yet this extension of rights was not in itself sufficient to guarantee protection for companies that chose to operate through subsidiaries incorporated in the host country rather than through branches of

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113. *See id.* at paras. 81, 89-90.

114. *See supra* note 10 and accompanying text.

115. Treaty of Friendship, Commerce, and Consular Rights, Dec. 8, 1923, United States-Germany, 44 Stat. 2132, *reprinted in* 20 AM. J. INT'L L. 4 (Supp. 1926).

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entities incorporated in the home country. Normally a state provides diplomatic protection abroad only to entities that are juridically identified with that state, leaving locally incorporated subsidiaries of foreign corporations in need of special protection against the host government. The drafters of the postwar FCN treaties recognized this problem and sought to de-emphasize the corporate form. The FCN Treaty at issue in *ELSI* achieved this goal by creating rights such as the right to "organize, control and manage"<sup>116</sup> -- rights that do not fit the rigid distinction normally drawn between shareholders and the corporation -- to make economic interests rather than legal relationship the operative basis for protection.<sup>117</sup>

The Chamber in *ELSI* could have interpreted the FCN Treaty provisions protecting shareholders and their locally incorporated subsidiaries in the same way that it has interpreted other treaty provisions containing broad principles, i.e., by construing them narrowly, as somehow derogating from rules of customary international law. Indeed, the Chamber in *ELSI* could have turned to the *Barcelona Traction* decision to support a formalistic approach holding: that the Italian government had never committed any acts against Raytheon; that it had acted only against *ELSI*; and that while the Treaty may protect *ELSI*, the United States did not raise claims on behalf of *ELSI*.

The Italian government advocated this approach, and Judge Oda clearly adopted it in his concurring opinion.<sup>118</sup> Judge Oda saw the distinction between the rights of a corporation and the rights of its shareholders as fundamental. His view confines shareholders' rights to participating in the distribution of corporate profits and, in the event of liquidation, sharing in the residual property.<sup>119</sup> If a host country interferes with these rights, the shareholders can institute proceedings in the local courts. According to Judge Oda, this fundamental rule governs foreign shareholders' rights in the host country unless a treaty contains express provisions to alter the rule.<sup>120</sup> Reviewing the FCN Treaty, Judge Oda found only three clauses "specifically designed to protect the interests of United States corporations possessing stock or a substantial interest in an Italian corporation or enterprise."<sup>121</sup> Had the United States

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116. U.S.-Italy FCN Treaty, *supra* note 3, art. III(2).

117. For some of the debate at that time, see Jones, *Claims on Behalf of Nationals Who Are Shareholders in Foreign Companies*, 26 BRIT. Y.B. INT'L L. 225 (1949); Kronstein, *The Nationality of International Enterprise*, 52 COLUM. L. REV. 983 (1952).

118. Case Concerning *Elettronica Sicula S.p.A. (ELSI)* (U.S. v. Italy), 1989 I.C.J. 15, 83 (Oda, J., separate opinion).

119. *Id.* at 84. Judge Oda quoted extensively from the *Barcelona Traction* case to support his opinion.

120. *Id.* at 86.

121. Judge Oda identifies these provisions as the following:

(a) "[Italian] [c]orporations ... organized or participated in by ... [United States] corporations ... pursuant to the rights and privileges enumerated in this paragraph, and controlled by such ... corporations ... shall be permitted to exercise the functions for which they are created or organized, in conformity with the applicable laws and regulations, upon terms no less favorable than those now or hereafter accorded to corporations ... that are similarly organized

availed itself of these three provisions, Judge Oda believed, it could have espoused the cause of ELSI against the Italian government, thus indirectly vindicating the interests of its own national, Raytheon. The United States, however, did not do so, and Judge Oda found that the treaty provisions pled by the United States did not protect Raytheon.

The Chamber implicitly rejected both Judge Oda's approach of identifying express treaty provisions protecting locally incorporated subsidiaries and his narrow construction of the provisions protecting shareholders. Since the Chamber did not explicitly address the distinction between the rights of a corporation and the rights of its shareholders, the observer can draw conclusions only from what the Chamber did not say rather than from what was actually said. First, in reviewing the FCN Treaty, the Chamber did not find that some provisions protected shareholders while others protected locally incorporated companies owned by foreign nationals. Second, the Chamber did not limit the protected shareholders' rights to participating in the distribution of corporate profits and to sharing in the residual value of a liquidated company. Had the Chamber done so, then it, like Judge Oda, would have promptly dismissed the case on the ground that the United States had not brought a claim on behalf of the injured party, ELSI. Rather, the Chamber tacitly acknowledged Raytheon's rights to manage and control ELSI and to obtain protection of its other property interests in ELSI. The Chamber also tacitly held that the allegedly unlawful acts of the Italian government, particularly the requisition of ELSI's plant and equipment, could affect these rights.

It is important to recall that the claims in *ELSI* were based on treaty provisions that not only offer broad protection to various types of investment, but that also, through such phrases as "organize, control, and manage," collapse the traditional rigid distinction between a corporation and its shareholders. The Chamber's decision signifies a reluctance to take Judge Oda's narrow approach in the face of such provisions. Instead, the Chamber embraced a more flexible and practical approach requiring a court, in deciding

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or participated in, and controlled, by ... corporations ... of any third country." (Art. III(1), second sentence.)

(b) "[Italian] [c]orporations ... controlled by ... [United States] ... corporations ... and created or organized under the applicable laws and regulations within [Italy] shall be permitted to engage in [commercial, manufacturing] activities therein, in conformity with the applicable laws and regulations, upon terms no less favorable than those now or hereafter accorded to [Italian] corporations ... controlled by ... [Italian] corporations." (Art. III(2), second sentence.)

(c) "[I]n all matters relating to the taking of privately owned enterprises into public ownership and the placing of such enterprises under public control, [Italian] enterprises in which ... [United States] corporations ... have a substantial interest shall be accorded, within [Italy], treatment no less favorable than that which is or may hereafter be accorded to similar enterprises in which ... [Italian] corporations ... have a substantial interest, and no less favorable than that which is or may hereafter be accorded to similar enterprises in which ... [any third country's] corporations ... have a substantial interest." (Art. V(3), second sentence.)

*Id.* at 89-90.

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whether an act violates the right to control and manage, to consider "the meaning and purpose of the Treaty."<sup>122</sup> The FCN Treaty and the other FCN treaties that followed are replete with provisions encouraging private investment. Moreover, the legislative history of the FCN treaties,<sup>123</sup> along with the subsequent practice of nationals and companies operating in states party to these treaties, establishes that the drafters clearly anticipated the use of locally incorporated companies as a key mechanism of investment in host countries. Had the Chamber adopted Judge Oda's approach, it could have undermined this general framework for protecting investments. This danger undoubtedly played a major role in the Chamber's refusal to adopt this approach.

In addition to the general framework of the FCN treaties, the language of the particular treaty provisions at issue most likely influenced the Chamber as well. The Chamber found "undeniable" the proposition that "the requisition of a firm's 'plant and relative equipment' must normally amount to a deprivation" of the "most important part of [a shareholder's] right to control and manage" that company under article III of the Treaty.<sup>124</sup> The Chamber supported its conclusion and brushed aside Italy's assertion that the requisition affected only ELSI's control of its property and not Raytheon's control of ELSI by stating that the "requisition . . . was issued to avoid the closure of ELSI's plant, the dismissal of its work force, and as a consequence, the probable dispersal of the assets, all of which were integral to ELSI's plan for orderly liquidation."<sup>125</sup> Thus, where an act prevents an orderly liquidation of a corporation, the shareholders' right to manage and control is implicated even when the act affects only a part of the corporation's property.

The Chamber also agreed that article VIII of the Treaty, granting foreign nationals the ability to "acquire, own and dispose of immovable property or interests therein," protects foreign shareholders who own immovable property indirectly through a locally incorporated company. The Chamber drew support for this viewpoint from the "general purpose of the FCN Treaty," and also from the language of the provision, which specifically referred not only to property but also to "interests therein." The Chamber rejected Italy's assertions that this right applied only to Raytheon's own property rights in ELSI (i.e., the shares it held). Raytheon alone, as the owner of ELSI, had the right to decide "whether to dispose of the immovable property of the company." An action that took this decision away from Raytheon constituted an injury to

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122. Judgment, *supra* note 2, para. 74.

123. See Case Concerning Elettronica Sicula S.p.A. (ELSI) (U.S. v. Italy), 1989 I.C.J. 15, 97-100 (Schwebel, J., dissenting).

124. Judgment, *supra* note 2, para. 70.

125. *Id.*

Raytheon.<sup>126</sup> The Chamber also felt it important to apply the treaty provision to protect the shareholder who, like Raytheon, is the sole owner of the corporation and therefore fully controls the disposal of its property.<sup>127</sup>

However, the Chamber was less willing to use those provisions of the FCN Treaty that concerned protecting only the "property" of an individual or company, but not the "interests therein,"<sup>128</sup> so as to protect the shareholders of the corporation from acts undertaken against the property of the corporation. The Chamber did not expressly hold that the property protected included not only the shares of home country shareholders, but also the corporation or its assets. Nonetheless, the Chamber proceeded to examine that part of the claim "on the basis . . . that the 'property' to be protected . . . was . . . ELSI itself,"<sup>129</sup> rather than dismiss the claim by asserting that Italy's action affected the "interests" of the shareholder (Raytheon) but not its "rights."<sup>130</sup> Ultimately, however, the Chamber held that it was unnecessary to decide the issue, since the United States had not proven that the requisition and subsequent events deprived Raytheon of any rights it still had in ELSI.<sup>131</sup> But where a provision protecting property extends to "interests held directly or indirectly" in property, the Chamber held that the provision safeguards the rights of shareholders with respect to the assets of the company and their residual value on liquidation.<sup>132</sup> The United States and Italy inserted this extension of protection in the Protocol to the FCN Treaty, and it appears in other FCN treaties as well.<sup>133</sup>

Curiously, one searches in vain for any mention of *Barcelona Traction* in the *ELSI* decision, despite both parties' discussion of *Barcelona Traction* and the apparent relevance of that case to *ELSI*. Possibly the Chamber, feeling that the terms of the Treaty were sufficiently clear to implicate shareholders' rights, saw no need to discuss *Barcelona Traction*. Alternatively, the Chamber may have determined that its holding in *Barcelona Traction* reflected a narrow principle of international law inapplicable to the *ELSI* case, or even that it reflected an inappropriate principle that should be overturned *sub rosa*. The Chamber may even have considered that the principle of *Barcelona Traction*,

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126. *Id.* at para. 132.

127. *Id.*

128. U.S.-Italy FCN Treaty, *supra* note 3, art. V(1), (3).

129. Judgment, *supra* note 2, para. 106.

130. Case Concerning the Barcelona Traction, Light and Power Company, Ltd. (New Application: 1962) (Belg. v. Spain), 1970 I.C.J. 3, para. 44 (Second Phase).

131. Judgment, *supra* note 2, paras. 118-19.

132. *Id.* at para. 118.

133. See, e.g., U.S.-Luxembourg FCN Treaty, *supra* note 15, Protocol, para. 3; U.S.-Belgium FCN Treaty, *supra* note 15, Protocol, para. 4; U.S.-France FCN Treaty, *supra* note 15, Protocol, para. 6; U.S.-Korea FCN Treaty, *supra* note 15, Protocol, para. 4; U.S.-Netherlands FCN Treaty, *supra* note 15, Protocol, para. 6; U.S.-West Germany FCN Treaty, *supra* note 15, Protocol, para. 5; U.S.-Japan FCN Treaty, *supra* note 15, Protocol, para. 2; U.S.-Denmark FCN Treaty, *supra* note 15, Protocol, para. 2; U.S.-Greece FCN Treaty, *supra* note 15, art. VII(3).

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unlike the local remedies rule, was not important enough to warrant reading it into the FCN Treaty. If this was in fact the Chamber's view, it did not suggest any reason for considering such a principle less "important," although the local remedies rule probably has a firmer base in international jurisprudence than the distinction drawn between rights and interests in *Barcelona Traction*.

In the long run, the approach taken in *ELSI* will promote a view of shareholders' rights that extends beyond the receipt of profits and residual proceeds upon liquidation of a corporation to include the exercise of rudimentary control and management over the corporation, at least when it is winding down its operations. The Chamber's flexible approach brings its jurisprudence in line with the latest BITs, which typically accord protection to interests held directly or indirectly. Such a formulation denotes the widest possible protection for investors: protection not only of rights to their stock, but also of associated rights in the corporation itself. Without question, the *ELSI* decision broadens the protections otherwise available to shareholders under *Barcelona Traction*.

### A. *The Right to Manage and Control*

The United States argued that the requisition and subsequent events deprived Raytheon of its rights to manage and control *ELSI*. Article III of the FCN Treaty permits "the nationals, corporations and associations" of either party, "in conformity with the applicable laws and regulations within the territories" of the other party, "to organize, control and manage corporations and associations" of the other party.<sup>134</sup>

In analyzing this provision, the parties focused on whether by requisitioning the plant, Italy had denied Raytheon the right to "control and manage" *ELSI*. Italy argued that the requisition had not affected the shareholders' control over the company (such as the rights to appoint and supervise managers and to approve the financial statements), but rather affected management's control of the company.<sup>135</sup> In particular, Italy claimed that the shareholders retained their ability to manage and control the company because *ELSI* could appeal the requisition order and could be placed in bankruptcy.<sup>136</sup> The United States argued that although the shareholders possess a range of rights to manage and control, Raytheon was entitled to the full extent of these rights, not merely the right to place *ELSI* in bankruptcy.<sup>137</sup> The Chamber agreed that the requisition of a firm's plant and equipment normally amounts to a deprivation of the

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134. U.S.-Italy FCN Treaty, *supra* note 3, art. III(2).

135. Italian Counter-Memorial, *supra* note 23, at 102-03; Italian Rejoinder, *supra* note 23, at 131.

136. Italian Rejoinder, *supra* note 23, at 134-35, 142-43.

137. International Court of Justice Verbatim Record, C 3/CR 89/3, at 47-48 (Feb. 15, 1989).

shareholders' right to control and manage.<sup>138</sup> In rejecting Italy's position, the Chamber found that the Mayor of Palermo requisitioned the plant specifically to avoid the dismissal of the work force, the closure of the plant, and the dispersal of the plant's assets -- all of which were important parts of Raytheon's right to control and manage ELSI.<sup>139</sup>

The parties also focused on the phrase in article III providing the right to control and manage "in conformity with the applicable laws and regulations" of the host country. Italy essentially argued that this phrase provided for a national treatment standard. Under such a standard, since the requisition order was issued by a Mayor who was competent to exercise this power in emergency situations, the requisition was issued pursuant to a law that applied to Italians and non-Italians alike.<sup>140</sup> Therefore, Italy argued, there was no breach of the rights conferred by the FCN Treaty.

The Chamber, however, rejected Italy's interpretation. It agreed with the United States that this clause simply requires the foreign corporation to conform to applicable local laws and regulations such as regulations on corporate organization and registration. The Chamber determined that mere compliance with "the applicable laws and regulations" cannot immunize a host government from the possibility of a breach of the FCN Treaty.<sup>141</sup> This decision provides useful guidance for applying local regulations to a foreign or international entity while at the same time preventing those regulations from undermining the rights to which that entity is entitled under the relevant bilateral treaties.

The Chamber noted that the right to manage and control a company cannot imply a complete bar to host government interference with such shareholders' rights, particularly during public emergencies.<sup>142</sup> In considering the appropriate standard for determining the limits of governmental interference, the Chamber asserted that the legality of such interference under the local law is irrelevant to its legality under the FCN Treaty.<sup>143</sup> Having said this, the Chamber proceeded to place great significance on whether local law justified

138. Judgment, *supra* note 2, para. 70.

139. *Id.*

140. See Italian Rejoinder, *supra* note 23, at 130-32.

141. The Chamber stated that:

in the Chamber's view, the reference to conformity with "the applicable laws and regulations" cannot mean that, if [a host government's] act is in conformity with its municipal laws and regulations, that would of itself exclude any possibility that there was an act in breach of the FCN Treaty.

Judgment, *supra* note 2, para. 71.

142. *Id.* at para. 74 ("Clearly the right cannot be interpreted as a sort of warranty that the normal exercise of control and management shall never be disturbed").

143. The Chamber stated that:

[w]hat is a breach of treaty may be lawful in the municipal law and what is unlawful in the municipal law may be wholly innocent of violation of a treaty provision. Even had the Prefect held the requisition to be entirely justified in Italian law, this would not exclude the possibility that it was a violation of the FCN Treaty.

*Id.* at para. 73.

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the requisition. The Chamber emphasized the finding of the Chamber of Appeal of Palermo that the requisition of ELSI was "a typical case of excess of power, which is of course a defect of lawfulness of an administrative act." Based on this local finding, the Chamber concluded that local authorities had deprived Raytheon of its right to manage and control ELSI and that this deprivation constituted a *prima facie* violation of article III(2) of the FCN Treaty.<sup>144</sup>

Nevertheless, the Chamber then made the crucial determination that Raytheon had already lost the very rights of management and control at issue on account of its financial condition. Upon reviewing the financial status of ELSI leading up to the requisition, the Chamber found that ELSI failed to prove -- as required by law -- that the orderly liquidation plan would have succeeded. The Chamber accepted the United States contention that Raytheon would have bankrolled the orderly liquidation to the extent that additional funds were needed to complete it.<sup>145</sup> Despite this finding, the Chamber indicated six factors that "give rise to some doubt" about the ultimate chances of successfully implementing the plan.<sup>146</sup>

First, ELSI's creditors would have had to agree to wait for payment of their claims until asset sales generated sufficient funds. Second, asset sales may not have realized sufficient funds to pay all the creditors in full, thus requiring the creditors to accept less than full value. Third, since the liquidation plan formulated by ELSI's management envisioned paying the smaller creditors in full, the larger creditors, if they received less than full value, would have had to accept such differential treatment. Fourth, an orderly liquidation would have required unfettered access to the plant in order to show it to prospective buyers.<sup>147</sup> The labor difficulties then in existence cast doubt on ELSI's ability to show the plant. Fifth, the hostility of the local government to ELSI's closure could have taken, in the government's words, "practical form in a legal manner," effectively precluding an orderly liquidation.<sup>148</sup> Finally, the Chamber reviewed the Italian courts' decisions and found that either ELSI was already insolvent by the time of the requisition, or that it was in such desperate financial condition that it was past saving. Although ELSI had not yet defaulted on any of its debts, the Chamber noted that Italian bankruptcy law recognizes insolvency as arising not only when the debtor is in default, but also "by other

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144. The Chamber stated that:

[t]he requisition was thus found not to have been justified in the applicable local law; if therefore, as seems to be case, it deprived Raytheon and Machlett of what were at the moment their most crucial rights to control and manage, it might appear *prima facie* a violation of Article III, paragraph 2.

*Id.* at para. 75.

145. *Id.* at para. 85.

146. *Id.* at paras. 86-101.

147. *Id.* at para. 90.

148. *Id.* at para. 91.

external acts which show that the debtor is no longer in a position regularly to discharge his obligations."<sup>149</sup> For these reasons, the Chamber held that the feasibility of an orderly liquidation plan was a "matter of speculation."<sup>150</sup> ELSI's condition was, according to the Chamber, such that it had already lost the faculty of control and management, and the requisition was not the central cause of the ensuing bankruptcy.

These arguments are superficially plausible. However, none of them is compelling when subjected to greater scrutiny. The Chamber's first three reasons fail to grasp the realities of the bankruptcy process. When faced with an ailing debtor company, creditors invariably prefer an orderly liquidation process to a bankruptcy, since an orderly liquidation process allows for disposal of assets in a manner that maximizes their value. It is not uncommon for such creditors willingly to accept less than full value, knowing that if they precipitate the company's bankruptcy, they might not receive anything. Indeed, ELSI's unsecured creditors eventually received nothing from the bankruptcy process. These factors undercut the persuasiveness of the Chamber's reasoning.

The Chamber's reliance on local labor unrest and the hostility of local authorities is also unsatisfactory. It essentially stated that the local government's inability to control the populace, and the government's disdain for the lawful steps contemplated by ELSI's management, somehow vitiated management's right to conduct the orderly liquidation. Surely the Italian government cannot be excused from its obligations under the FCN Treaty simply because local governments are unable or unwilling to prevent treaty violations. Investment treaties are designed to provide legal protection in extraordinary situations, such as periods of crisis. They become absurd and meaningless if a crisis furnishes an excuse to deny their protection. Moreover, the Chamber itself appears to engage in "speculation" when it suggests that Italian authorities could not have found lawful means to prevent the requisition.

The Chamber's decision rests on more solid ground in holding that ELSI was in such dire financial condition that bankruptcy was inevitable whether the Mayor requisitioned ELSI or not. This may indeed be an issue on which reasonable minds can differ. In reaching this conclusion, the Chamber relied considerably on the opinions of the Italian courts. This reliance is understandable, since ELSI's financial condition was a complex issue imbued with considerations of Italian bankruptcy law and accounting practices.

Even if this last reason were valid, the Chamber fails to explain why ELSI was not entitled even to attempt an orderly liquidation regardless of its financial condition. The fact is that on April 1, 1968, ELSI was not considered bankrupt by either its management or the Italian government. On this same

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149. *Id.* at para. 93.

150. *Id.* at para. 101.

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date, *ELSI*'s management was no longer permitted to try an orderly liquidation due to the requisition. A corporation's shareholders and management generally have the right to control their company and to dispose of corporate assets as they see fit. One stick in the bundle of rights attached to management and control is the right to undertake a risky course of action. Such attempts frequently fail, but at times they are the stuff of great successes. Raytheon, which had formed and dissolved numerous subsidiaries around the world, believed as of April 1, 1968, that an orderly liquidation of *ELSI* could succeed. The requisition, however, eliminated any opportunity to pursue this course of action, thereby curtailing an important shareholders' right -- the right to defy the odds.

Judge Schwebel, in his dissent, specifically disagreed with the Chamber's conclusion in this matter. He noted that *ELSI*'s advisers in March 1968 believed that *ELSI*'s financial situation was such that it was entitled to engage in an orderly liquidation of its assets.<sup>151</sup> Furthermore, none of the main players apparently considered *ELSI* to be in default, since neither management nor the Italian government took any legal or practical steps at this time to place *ELSI* in bankruptcy.<sup>152</sup> Rather, the intensive negotiations between *ELSI*'s officers and shareholders on one side and Italian officials on the other show that both parties envisioned keeping the plant open. This evidence seriously undercuts the position that *ELSI* was obligated, by reason of its financial position and the requirements of Italian law, to be placed in bankruptcy.<sup>153</sup> Judge Schwebel also pointed to strong evidence of *ELSI*'s solvency in the decision of the Italian Court of Appeal, which apparently did not view *ELSI*'s financial condition as terminating its shareholders' rights to management and control. Indeed, the Court of Appeal awarded what the United States termed "rent" during the period of the requisition.<sup>154</sup> Finally, Judge Schwebel concluded that even if success of the orderly liquidation may have been speculative, the uncertainty of success was relevant only to the quantification of damages. *ELSI*'s entitlement to liquidate assets was independent of its prospects of success.<sup>155</sup>

This last point is especially critical to understanding the Chamber's opinion, which incorrectly predicates the finding of a treaty violation on a definitive showing of damages. The Chamber seems to say that in this instance one cannot separate the underlying right from damages, so that the loss of management and control entails a loss of the ability to direct the company in a manner

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151. Case Concerning *Elettronica Sicula S.p.A. (ELSI)* (U.S. v. Italy), 1989 I.C.J. 15, 101 (Schwebel, J., dissenting).

152. *Id.*

153. *Id.* at 101-02.

154. *Id.* at 103.

155. *Id.* at 108.

that achieves an optimal financial outcome. If there were no real likelihood of a more beneficial financial outcome, according to the Chamber, then Raytheon did not lose an existing power of management and control. The terms of the FCN Treaty, however, do not support this conditional interpretation of management's rights. The ordinary meaning of article II suggests that the issue is not whether Raytheon could have undertaken certain steps that would have succeeded, but whether it was denied the ability to choose a particular course of action. If an act deprives a company of its freedom to choose, then that act constitutes a wrong under the FCN Treaty.

### B. *Protection and Security of Property*

The United States also claimed that the Italian government had denied Raytheon the protection and security of its property guaranteed by the FCN Treaty. By delaying the ruling on the challenge to the requisition order and by permitting workers to occupy the plant after the requisition, the Italian government had allegedly breached article V(1) of the FCN Treaty, which provides that United States corporations shall receive in Italy "the most constant protection and security for their property, and shall enjoy in this respect the full protection and security required by international law."<sup>156</sup> The United States also claimed that Italy had violated article V(3), which guarantees to United States corporations in Italy a degree of protection and security no less than that accorded to Italian corporations and other foreign corporations.<sup>157</sup>

To sustain this argument, the United States introduced evidence that Italian courts generally review challenges to the legality of requisitions within days of the appeal.<sup>158</sup> The United States had greater difficulty, though, in proving that the occupation of the plant by the workers operated to ELSI's detriment. Essentially the United States was reduced to arguing that the occupation on its face prevented the management from performing maintenance on the plant and from showing the plant and assets to potential buyers.

The Chamber in fairly short order determined that the occupation was peaceful and that the United States had not shown that any damage result-

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156. Article V(1) of the Treaty requires each party to provide the nationals of the other party "the most constant protection and security for their persons and property, and ... the full protection and security required by international law." U.S.-Italy FCN Treaty, *supra* note 3, art. V(1).

157. Article V(3) of the Treaty guarantees to "[t]he nationals, corporations and associations" of each party in the territory of the other party:

protection and security with respect to the matters enumerated in paragraphs 1 and 2 of this Article, upon compliance with the applicable laws and regulations, no less than the protection and security which is or may hereafter be accorded to nationals, corporations and associations of [the other party] and no less than that which is or may hereafter be accorded to the nationals, corporations and associations of any third country.

*Id.* at art. V(3).

158. U.S. Memorial, *supra* note 23, annex 26, para. 10.

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ed.<sup>159</sup> Furthermore, the Chamber concluded that an obligation to provide "constant protection and security" cannot be construed as a "warranty" that property will never be occupied or disturbed.<sup>160</sup> The issue was whether the Italian government treated Raytheon worse than Italian nationals. On the facts presented the Chamber found that this was not the case.

The Chamber then turned to the question of whether a delay in an administrative appeal constituted a violation of article V, and interpreted article V(1) and (3) as establishing three necessary standards of protection: the "protection and security" must conform 1) to a minimum international standard; 2) to a national treatment standard; and 3) to a most-favored-nation standard. The Chamber found that the sixteen-month delay did not fall below an international standard, and that the United States did not demonstrate that Italian law provided a more rapid determination of administrative appeals, either for Italian nationals or for foreign nationals. Consequently, the Chamber rejected this claim.<sup>161</sup> The Chamber also attached great significance to the existence of a procedure under Italian law that would have permitted ELSI's shareholders, had they availed themselves of it, to request an expedited administrative decision. The bankruptcy trustee did not make such a request until July 9, 1969, fifteen months after the appeal had been filed.<sup>162</sup>

### C. *Taking of Property*

In addition to these arguments, the United States asserted that the requisition of the plant and the subsequent acts that led to the acquisition of the plant, assets, and work in progress by an entity wholly owned by the Italian government, constituted a taking of property without due process of law and without just and effective compensation in violation of article V(2) of the FCN Treaty.<sup>163</sup> The United States emphasized that a taking of property includes the unreasonable interference with its use, enjoyment, or disposal. Moreover, the United States pointed out that the Protocol to the Treaty provided for the application of article V(2) to "interests held directly or indirectly" by corporations, clearly placing shareholder interests within the scope of the provision.<sup>164</sup>

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159. Judgment, *supra* note 2, para. 107.

160. *Id.* at para. 108.

161. *Id.* at paras. 111-12.

162. *Id.* at paras. 41, 109. Although Raytheon did not control the actions of the bankruptcy trustee, the Chamber most likely regarded the trustee as essentially a surrogate for Raytheon's interests in this matter, on the same reasoning discussed earlier with respect to the local remedies rule. See *supra* notes 90-96 and accompanying text.

163. Article V(2) of the Treaty states that the property of corporations from one party "shall not be taken within the territories of the other [party] without due process of law and without the prompt payment of just and effective compensation." U.S.-Italy FCN Treaty, *supra* note 3, art. V(2).

164. International Court of Justice Verbatim Record, C 3/CR 89/3, at 59-71 (Feb. 15, 1989).

Italy challenged the interpretation of the word "taking" by pointing to the corresponding Italian text where the word *espropriati* appears. Italy argued that *espropriati* has a narrower meaning than "taking," such that the FCN Treaty does not proscribe interference with property. Furthermore, Italy pointed out that the term used in the Italian text of the Protocol was *diritti*, which normally translates into English as "rights," not "interests." Italy contended that this language indicated that the drafters of the Treaty intended the Protocol to be read narrowly as well.<sup>165</sup>

The Chamber viewed the United States claim as one not just for an overt taking, but for a "disguised expropriation."<sup>166</sup> The Chamber essentially ignored the arguments as to the differing translations, finding simply that no taking occurred "because it is simply not possible to say that the ultimate result was the consequence of the acts or omissions of the Italian authorities."<sup>167</sup> Once again, the Chamber supported its conclusion by noting ELSI's precarious financial situation at the time of the requisition and the Italian courts' belief that bankruptcy was inevitable. If ELSI was already under a legal obligation to file for bankruptcy, according to this argument, then the requisition "took" nothing that ELSI had not already lost. Since ELSI was ultimately placed in bankruptcy, the continuing requisition and the failure to overturn the Mayor's order did not deprive ELSI of property interests.<sup>168</sup> As with the right to manage and control, the Chamber again rejected the claims based on the failure of the United States to establish the viability of an orderly liquidation scheme.

The Chamber correctly identified article V(2) as "central to many investment treaties."<sup>169</sup> Because of its significance, the proper standard to be applied in compensation for takings has been debated for years in both the jurisprudence of international tribunals and in academic literature. Unfortunately, the Chamber, by not analyzing the legal scope of article V(2), missed

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165. International Court of Justice Verbatim Record, C 3/CR 89/7, at 26-33 (Feb. 22, 1989).

166. Judgment, *supra* note 2, para. 119. The United States argued essentially that a series of acts or omissions by the Italian authorities that had the end result, whether intended or not and whether the result of collusion or not, of causing United States property in Italy to be ultimately transferred into the ownership of Italy without proper compensation, would violate article V(2) of the FCN Treaty. U.S. Memorial, *supra* note 23, at 110-17.

167. Judgment, *supra* note 2, paras. 116-18.

168. The Chamber stated that:

[e]ven if it were possible to see the requisition as having been designed to bring about bankruptcy, as a step towards disguised expropriation, then, if ELSI was already under an obligation to file a petition of bankruptcy, or in such a financial state that such a petition could not be long delayed, the requisition was an act of supererogation. Furthermore this requisition, independently of the motives which allegedly inspired it, being by its terms for a limited period, and liable to be overturned by administrative appeal, could not, in the Chamber's view, amount to a "taking" contrary to Article V unless it constituted a significant deprivation of Raytheon and Machlett's interest in ELSI's plant; as might have been the case if, while ELSI remained solvent, the requisition had been extended and the hearing of the administrative appeal delayed.

*Id.* at para. 119.

169. *Id.* at para. 113.

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a rare opportunity to render a significant statement with vast implications for foreign investment in general.

Since the Chamber found no "taking," it had no need to undertake an analysis of the language of article V(2). Thus, the United States position regarding the meaning of "just and effective compensation" remained unchallenged. Nor did the Chamber find it necessary to decide whether to construe article V narrowly to prohibit "expropriation" (the literal translation of the Italian provision) but not "takings," which Italy argued was a broader class of actions. The Chamber declined to clarify the difference in scope, if any, between the terms "taking" and "expropriation." However, the Chamber was apparently willing to accept the concept of a "disguised expropriation," as one that occurs not through a formal decree of a host government, but rather through a series of acts or steps that result in a gradual transfer of ownership to the host government.<sup>170</sup> The Chamber's acceptance and use of this concept is consistent with the development of international law,<sup>171</sup> and will serve to fortify the use of the concept to protect property. Furthermore, because it rejected the United States claim based on its failure to prove a sufficient factual predicate, the *ELSI* decision leaves intact the basic rules of international law regarding expropriation of property.

### D. *Arbitrary Measures Affecting Property Rights and Interests*

The final significant area of treaty interpretation addressed by the Chamber centered upon article I of the Supplementary Agreement, which proscribes certain arbitrary and discriminatory measures. Article I protects "the nationals, corporations and associations" of either party from:

[A]rbitrary or discriminatory measures within the territories of the other [party] resulting particularly in: (a) preventing their effective control and management of enterprises which they have been permitted to establish or acquire therein; or, (b) impairing their other legally acquired rights and interests in such enterprises or in the investments which they have made, whether in the form of funds (loans, shares or otherwise), materials, equipment, services, processes, patents, techniques or otherwise.<sup>172</sup>

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170. International jurisprudence has for some time recognized the concept of "disguised expropriation" or "creeping expropriation." See Higgins, *The Taking of Property by the State*, 176 RECUEIL DES COURS 259, 324 (1982).

171. See *Harza Eng'g Co. v. Iran*, 1 Iran-U.S. Claims Trib. Rep. 449, 504 (1981-82) ("[A] taking of property may occur under international law, even in the absence of a formal nationalization or expropriation, if a government has interfered unreasonably with the use of property"); Christie, *What Constitutes a Taking of Property Under International Law?*, 1962 BRIT. Y.B. INT'L L. 307, 309 ("[W]ith the increasing tendency of certain States to conclude bilateral treaties guaranteeing the property of their nationals against expropriation ... the question as to what amounts to expropriation will for the future assume importance in interpretation of these treaties").

172. Supplement, *supra* note 3, art. I.

The United States cited clause (a) to buttress its position that management and control of ELSI should receive the broadest possible protection. The United States further argued that clause (b) extended the basic principles of fair play and nondiscrimination to all forms of governmental action that are injurious to investors, thus prohibiting any arbitrary or discriminatory measures that may impair not only the rights, but also the interests of United States investors in Italian corporations.<sup>173</sup>

In arguing that ELSI's requisition violated article I of the Supplement, the United States focused primarily on the arbitrary nature of the requisition.<sup>174</sup> The United States argued that the prohibition of "arbitrary" measures commits "the respective governments not to injure the investments and related interests of foreign investors by the unreasonable or unfair exercise of government authority."<sup>175</sup> On this basis, the United States characterized the Mayor's requisition order as an action based not on fair and adequate reasons, but rather on a capricious exercise of authority. The United States repeatedly emphasized that the Mayor's superior, the Prefect, and the Italian courts found the requisition "destitute of any juridical cause which may justify it or make it enforceable."<sup>176</sup>

The Italian government accepted that an "arbitrary" measure is one that completely lacks justification, but defined it in a context in which the public authorities have no lawful basis for their exercise of power. In this case, the Mayor of Palermo did have the power under Italian law to requisition ELSI. The anticipated closure of the plant had created serious social and economic problems that were explained in the Mayor's order. Furthermore, the nature of the act could not be viewed as arbitrary, because ELSI had a right to

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173. International Court of Justice Verbatim Record, C 3/CR 89/3, at 49-53 (Feb. 15, 1989).

174. The United States asserted that the Italian government's actions were discriminatory as well as arbitrary. Although the United States produced no evidence that Raytheon, as a foreign corporation, received treatment that differed from that accorded to Italian corporations, the United States argued that "discrimination" included discrimination favoring host government-controlled enterprises. The United States argued that the requisition and subsequent bankruptcy sale to ELTEL, an Italian government-owned entity, constituted an unjustified effort to benefit the Italian government. U.S. Memorial, *supra* note 23, at 89-90; Judgment, *supra* note 2, para. 121. Italy opposed this application of the term "discrimination" to its actions. The Chamber held that the concept of discrimination can include discrimination in favor of the host government's own commercial interest. Nevertheless, the Chamber ultimately found that the evidence did not support the application of such a theory to this case:

[i]t is common ground that the requisition order was not made because of the nationality of the shareholders; there have been many cases of requisition orders made in similar circumstances against wholly Italian-owned companies ... There is no sufficient evidence before the Chamber to support the suggestion that there was a plan to favour IRI at the expense of ELSI, and the claim of "discriminatory measures" in the sense of Article I of the Supplementary Agreement must therefore be rejected.

*Id.* at para. 122.

175. International Court of Justice Verbatim Record, C 3/CR 89/3, at 51 (Feb. 15, 1989).

176. Judgment of the Prefect of Palermo, Aug. 22, 1969, *reprinted in* U.S. Memorial, *supra* note 23, annex 76, at 11.

judicial appeal, which in this case resulted in the setting aside of the Mayor's order.<sup>177</sup>

The Chamber rejected the United States argument that a finding by a local court of an unlawful act necessarily implies that the act is arbitrary. The Chamber also noted that while local court findings may be relevant, the standard of arbitrariness under international law may be quite different.<sup>178</sup> Although the Prefect's decision reversing the Mayor's order noted that the Mayor was acting under the influence of pressure created by the local press, the Chamber did not view this as an indication of arbitrariness.<sup>179</sup> Nor did the Italian courts' determination that the requisition was subject to a "defect of lawfulness" indicate arbitrariness.<sup>180</sup> Citing the ICJ's judgment in the *Asylum* case, the Chamber stated that "arbitrariness is not so much something opposed to a rule of law, as something opposed to *the* rule of law . . . It is a wilful disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety."<sup>181</sup> By this standard, the Chamber failed to find in the decisions of the Prefect or the Italian courts an indication that the requisition was arbitrary. Additionally, in light of the events in Palermo in the spring of 1968, the Chamber did not find the Mayor's act unreasonable or capricious. Rather, the requisition order cited the statutory predicate for the Mayor's power, recited sufficient reasons for exercising that power, and was ultimately appealable within the Italian legal system. The Chamber held that these traits are not the marks of an arbitrary act.<sup>182</sup>

This aspect of the *ELSI* decision is troubling. The Chamber essentially concludes that once a government takes measures against an investment or property under an assertion of lawful state action, provided that an investor receives due process in the local courts, then *ipso facto* the investor has not been treated arbitrarily. This interpretation renders a previously useful standard of protection much less effective. Indeed, under this approach a local government could pass various laws and administrative regulations that arbitrarily impugn the interest of foreign investors. Yet so long as the government provides a judicial forum in which a court applies those laws and regulations, then the measures will not be deemed arbitrary under the FCN Treaty. In his dissent, Judge Schwebel found the Chamber's reasoning unpersuasive. Judge Schwebel, interpreting article I of the Supplement as creating an obligation of result (as opposed to an obligation of conduct), wrote that a failure to correct

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177. International Court of Justice Verbatim Record, C 3/CR 89/7, at 42-43 (Feb. 22, 1989).

178. Judgment, *supra* note 2, para. 124.

179. *Id.* at para. 126.

180. *Id.* at para. 127.

181. *Id.* at para. 128 (*citing Asylum Case (Colom. v. Peru)*, 1950 I.C.J. 266, 284) (emphasis added).

182. *Id.* at para. 129.

an arbitrary measure constitutes a violation of the FCN Treaty regardless of the existence of local remedies.<sup>183</sup>

A close reading of the decisions of the Prefect and the Court of Appeal of Palermo shows that these bodies found the requisition to be arbitrary and capricious because: 1) the legal bases of the Mayor's order were justified only in theory; 2) the order was incapable of achieving its purported purposes; 3) the order did not in fact achieve its purported purposes; 4) the order was designed in part to create an impression that the Mayor was confronting a problem; 5) the order was not simply unlawful, but a "typical case of excess of power;" 6) a paramount purpose of the requisition was to prevent the liquidation of ELSI's assets, regardless of the treaty obligations to the contrary; and 7) the Mayor transgressed his own order by failing to issue a decree for indemnification.<sup>184</sup>

Since the Italian courts found the requisition to be unreasonable and capricious, there should be a presumption that the Chamber would have come to a similar result, both because international law is derived in part from domestic standards of law and because the Italian courts' findings represent an admission of capriciousness by Italy through its state organs. In the factual context of the *ELSI* case, the Chamber's focus on whether due process was accorded to ELSI represents a narrow approach to the term "arbitrary" that may have adverse implications for FCN treaties and similar such treaties. This narrow approach differs from the standard of review used by courts in most systems of law to assess allegedly arbitrary government acts. For instance, in United States jurisprudence, the Administrative Procedure Act<sup>185</sup> derives in part from constitutional guarantees of due process in calling upon courts to hold unlawful "arbitrary" government agency action. Courts interpret the Act as requiring them to "consider whether the [agency] decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment."<sup>186</sup> In Italian jurisprudence, under the law governing regional administrative tribunals, the excess of authority (*eccesso di potere*) provides one of the bases for review by such tribunals of Italian administrative acts.

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183. Case Concerning Elettronica Sicula S.p.A. (*ELSI*) (U.S. v. Italy), 1989 I.C.J. 15, 115-21 (Schwebel, J., dissenting). This analysis of obligation of "conduct" and "result" originates in the I.L.C. Draft Articles on State Responsibility, for which one of the other judges on the Chamber served as Rapporteur. [1977] 2 Y.B. INT'L L. COMM'N (pt. II) 1, 11-30, reprinted in I. BROWNIE, SYSTEM OF THE LAW OF NATIONS STATE RESPONSIBILITY (PART I) 241 app. (1983). Brownlie cautions that this approach should be regarded as a "useful tool of analysis, that is, as a servant and not a master." *Id.*

184. Case Concerning Elettronica Sicula S.p.A. (*ELSI*) (U.S. v. Italy), 1989 I.C.J. 15, 108-15 (Schwebel, J., dissenting).

185. 5 U.S.C. § 706 (1988).

186. *Citizens to Preserve Overton Park v. Volpe*, 401 U.S. 402, 416 (1970); see also *Motor Vehicles Mfr. Assoc. v. State Farm Ins. Co.*, 463 U.S. 29 (1983).

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This excess of power concept includes both misuse of power (*sviamento di potere*) and inequality of treatment (*disparita di trattamento*).<sup>187</sup>

In international jurisprudence, arbitrary actions can be actions that constitute an unreasonable, improperly motivated or unduly unjust or oppressive use of otherwise legitimate government authority. THE RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES defines an "arbitrary act" as "an act that is unfair and unreasonable, and inflicts serious injury to established rights of foreign nations, though falls short of an act that would constitute an expropriation."<sup>188</sup> A variety of otherwise lawful actions that would pass scrutiny within the local court system -- such as expulsion of aliens, arrest, detention, deprivation of nationality, cancellation of contracts, and deprivation of property -- may be prohibited as arbitrary in the international context.<sup>189</sup> Fortunately, most of the other FCN treaties use the terms "unreasonable or discriminatory" to identify measures that impair legally acquired rights or interests.<sup>190</sup> Although the Chamber leaves unclear exactly what type of act it would deem "unreasonable," such an act would undoubtedly be far less offensive than one that "shocks" or even "surprises" judicial propriety. Had the term "unreasonable" appeared in article I of the Supplement of the FCN Treaty, the United States might have prevailed on its claim.

## VI. REPARATION

Having found that Italy did not violate the FCN Treaty, the Chamber did not address the reparation issue. Nevertheless the arguments made by both sides on this issue were quite extensive, and deserve some attention.

### A. *The General Principle*

It is a well-founded principle of international law that a state that has breached its international obligations incurs a duty to make reparations to the

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187. See C. ROSSANO, L'EQUAGLIANZA GIURDICA NELL' ORDINAMENTO COSTITUZIONALE 450 (1966); 1 A. SANDULLI, MANUALE DI DIRITTO AMMINISTRATIVO § 141(e), at 620-24 (1982).

188. RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 712 reporter's note 11 (1986). The black letter rule of the RESTATEMENT (THIRD) sets up different bases of state responsibility for economic injury. Providing an adequate forum to determine the economic claim does not appear to be an element relevant to the basis described as "arbitrary or discriminatory acts or omissions by the state that impair property or other economic interests of a national of another state." *Id.* § 712(3).

189. See *id.* § 712. Several instruments in the area of human rights law support this point. See, e.g., International Covenant on Civil and Political Rights, Dec. 16, 1966, 999 U.N.T.S. 171, arts. 6 (deprivation of life), 9 (arrest or detention), 12 (right to enter one's own country), 17 (interference with "privacy, family, home or correspondence").

190. See, e.g., U.S.-Belgium FCN Treaty, *supra* note 15, art. 4(2); U.S.-Korea FCN Treaty, *supra* note 15, art. VI(3); U.S.-Netherlands FCN Treaty, *supra* note 15, art. VI(3); U.S.-West Germany FCN Treaty, *supra* note 15, art. V(3); U.S.-Japan FCN Treaty, *supra* note 15, art. V(1); U.S.-Denmark FCN Treaty, *supra* note 15, art. VI(4); U.S.-Greece FCN Treaty, *supra* note 15, art. VIII.

injured state.<sup>191</sup> This general principle applies to obligations arising from a treaty, whether or not the treaty explicitly provides for such compensation.<sup>192</sup> Where the injuries arise from treatment of the claimant state's national, these injuries provide the appropriate measure of damages.<sup>193</sup> For this reason, the United States argued that the losses suffered by Raytheon as a result of Italy's treaty violations were the appropriate and convenient measure of the damages due to the United States for the violation of its rights under the FCN Treaty.

In general, Italy did not contest these basic propositions. Italy did, however, argue that an injured state may seek reparation only for the losses that were proximately caused by the unlawful acts.<sup>194</sup> On this theory of "efficient and proximate cause," Italy argued that much of the reparation sought by the United States, such as its claim for legal expenses incurred by Raytheon in defending in the suits filed by its Italian creditors in Italy, was improper. Moreover, Italy argued, even if the requisition itself was unlawful, the United States could not prove a sufficiently strong causal connection with the inability to undertake an orderly liquidation.

Although international law requires some causal connection between the damages sought and the acts of the respondent state, Italy applied too narrow a standard of proximity. The classic statement found in the *Chorzów Factory* case contains a much broader standard: "reparation must, as far as possible, wipe out all the consequences of the illegal acts and re-establish the situation which would, in all probability, have existed if that act had not been committed."<sup>195</sup> International tribunals have accepted related damages, including those legal costs incurred by claimants in seeking to vindicate their claim.<sup>196</sup>

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191. See, e.g., U.S. Diplomatic and Consular Staff in Tehran (U.S. v. Iran), 1980 I.C.J. 3, 41-42 (Judgment); Reparation for Injuries Suffered in the Service of the United Nations, 1949 I.C.J. 174, 184; The Corfu Channel Case (U.K. v. Alb.), 1949 I.C.J. 4, 23-24.

192. See, e.g., *Chorzów Factory Case* (Ger. v. Pol.), 1922 P.C.I.J. (ser. A) No. 9, at 21 (July 26) ("Reparation ... is the indispensable complement of a failure to apply a convention and there is no necessity for this to be stated in the convention itself").

193. *Id.* at 27-28; see also *Forests of Rhodopia*, 7 Ann. Dig. 91; 1 G. SCHWARZENBERGER, INTERNATIONAL LAW 141 (3d ed. 1957).

194. For other examples of damage valuations, see generally *Gov't of Kuwait v. Am. Indep. Oil Co. (AMINOIL)*, 21 I.L.M. 976, para. 165, at 1038-39 (1982); Clagett, *Just Compensation in International Law: The Issues Before the Iran-United States Claims Tribunal*, in 4 THE VALUATION OF NATIONALIZED PROPERTY IN INTERNATIONAL LAW 31, 49 (R. Lillich ed. 1987); McCosker, *Book Value in Nationalization Settlements*, in 2 THE VALUATION OF NATIONALIZED PROPERTY IN INTERNATIONAL LAW 36, 51 (R. Lillich ed. 1973).

195. *Chorzów Factory Case* (Ger. v. Pol.), 1928 P.C.I.J. (ser. A) No. 17, at 47 (Sept. 13).

196. See F. GARCÍA-AMADOR, L. SOHN & R. BAXTER, RECENT CODIFICATION OF THE LAW OF STATE RESPONSIBILITY FOR INJURIES TO ALIENS 133 (1974); 3 M. WHITEMAN, DAMAGES IN INTERNATIONAL LAW 1998, 2005, 2020-21 (1943).

B. *Accounting Valuation Methods*

Typically in cases involving expropriation or loss of property, the parties do not significantly disagree on general principles of valuation. *ELSI* was no exception. Rather, the process of calculating the value of the company served as the primary arena of debate, involving the use of financial and accounting expert witnesses by both sides. In most expropriation or loss of property cases involving corporations, the valuation process employs a going concern approach. Going concern value typically includes the fair market value of the company's assets and the projected future profits of the company's continued operations. Financial experts generally consider this approach superior to a book value approach, since book value is merely an accounting tool and does not measure the actual worth of the company based on its full market value and intangible value (e.g., goodwill).

*ELSI*, by the admission of the United States, was ready to commence an orderly liquidation process. Indeed, the United States claimed damages for the difference between the value that Raytheon would have received in an orderly liquidation and the value actually received from the bankruptcy process. Consequently, the United States argued that the closest approximation of *ELSI*'s going concern value in this particular case was in fact the book value of *ELSI*'s assets as of March 31, 1968.<sup>197</sup>

The Chamber also examined other valuation approaches proposed by Italy. At one point during the planning for the orderly liquidation, Raytheon generated a "quick sale" estimate for *ELSI*. The Italian judicial valuator made an additional valuation in October 1968, while *ELTEL* -- the ultimate purchaser of *ELSI* -- conducted its own valuation. The United States argued that for various reasons all of these alternative appraisals undervalued *ELSI*, either because they represented a worst-case scenario of an orderly liquidation, or because they were developed months after the requisition -- a period during which *ELSI* kept no accounting records and during which *ELSI*'s asset value was deteriorating. The most probative of these valuations, the book value methodology advanced by the United States, was based on *ELSI*'s balance sheet as of March 31, 1968; it was drawn up in accordance with the accounting principles and practices previously approved by *ELSI*'s outside accountant, the firm of Coopers & Lybrand.<sup>198</sup>

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197. Cases before the Iran-United States Claims Tribunal have used book value or original investment value as a proxy when necessary. *See, e.g.,* *Sedco, Inc. v. Nat'l Iranian Oil Co.*, 10 Iran-U.S. Claims Trib. Rep. 180, 182 (1986); *Phelps Dodge Corp. v. Iran*, 10 Iran-U.S. Claims Trib. Rep. 121, 132-33 (1986); *INA Corp. v. Iran*, 8 Iran-U.S. Claims Trib. Rep. 373, 380 (1985). *See also* *Benvenuti et Bonfant v. People's Republic of the Congo*, 21 I.L.M. 740, paras. 4.73-4.79, at 759-60 (1982).

198. International Court of Justice Verbatim Record, C 3/CR 89/4, at 29-30 (Feb. 16, 1989).

*C. Types of Losses Sought*

The United States sought compensation based on the difference between 1) Raytheon's financial position as it should have been absent the Italian government's allegedly wrongful acts, and 2) Raytheon's position as a result of those acts. The losses incurred fell into two categories. The first category included the general financial losses associated with the loss of a small anticipated return of the investment in ELSI, the loss of open accounts, and the payment of loan guarantees. These losses reflected the difference between Raytheon's hypothetical financial position had it been permitted to proceed with the orderly liquidation and its actual position following the sale of ELSI's assets by the trustee in bankruptcy.<sup>199</sup> The second category included certain legal and related expenses forced on Raytheon by the bankruptcy and by lawsuits of ELSI's creditors (many of which were controlled by the Italian government), as well as the expenses incurred by Raytheon in pursuing its claim against Italy. The United States did not seek costs for expenses incurred in bringing the case before the ICJ.<sup>200</sup>

The United States sought interest at a rate of ten percent from the date of the injury until the date of an eventual award. While such interest is generally deemed appropriate for the loss of the use of money,<sup>201</sup> the United States claim sought compound, rather than simple interest. The United States admitted that compound interest has not been uniformly sought or awarded in international investment disputes, but it nevertheless contended that in a commercial dispute it is unquestionably a reasonable rate for purposes of compensation.<sup>202</sup> Raytheon, as a business enterprise, generated earnings and relied on

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199. International Court of Justice Verbatim Record, C 3/CR 89/4, at 11-24 (Feb. 16, 1989).

200. *Id.* at 49-52.

201. *See, e.g.,* McCollough & Co. v. Ministry of Post, Tel. & Tel., Iran-U.S. Claims Trib. Award No. 225-89-3, at 26-28 (1986); Chorzów Factory Case (Ger. v. Pol.) 1928 P.C.I.J. (ser. A) No. 17, at 47 (Sept. 13); Ill. Cent. R.R. Co. v. United Mexican States (U.S. v. Mexico), 4 R. Int'l Arb. Awards 134, 137 (1926); The S.S. "Wimbledon," 1923 P.C.I.J. (ser. A) No. 1, at 33 (Jan. 16); Russian Indemnity Case, Hague Ct. Rep. (Scott), at 297, 313 (1912). The United States sought a rate of 10% because this rate reflected the average United States prime rate over the relevant period of Raytheon's losses. The United States was the proper financial market for computing a reasonable commercial interest rate because Raytheon, a United States company, would most likely have invested or raised funds in United States capital markets.

202. International Court of Justice Verbatim Record, C 3/CR 89/4, at 56-59 (Feb. 16, 1989). The United States cited to F.A. Mann:

it is necessary ... to take account of modern economic conditions. It is a fact of universal experience that those who have a surplus of funds normally invest them to earn compound interest ... On the other hand, many are compelled to borrow from banks and therefore must pay compound interest. This applies, in particular, to business people whose own funds are frequently invested in brick and mortar, machinery and equipment, and whose working capital is obtained by way of loans or overdrafts from banks ...

If, in accordance with the usual formula, damages are intended to afford *restitutio in integrum* (complete compensation for the wrong suffered) such items of damage should not be excluded.

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debt financing. Had Raytheon not suffered the financial losses from *ELSI*'s seizure, those funds would have generated additional earnings or would have been used to repay corporate debt. In either case, those funds would have generated interest earnings or interest savings, which in turn could have been put to profitable use. Italy argued that the United States was not entitled to any interest because of its long delay in bringing a claim before the ICJ. Italy also noted that the vast majority of international case law supports the notion of simple, not compound, interest.<sup>203</sup>

Although the Chamber did not reach the issue of reparation, the parties' arguments presented the Chamber with an array of complicated valuation and accounting issues. One might well ask whether the ICJ is equipped to decide such complex and specialized valuation issues, particularly since the ICJ virtually never renders damage awards. International arbitrators with extensive and specialized experience in arbitrations involving complex accounting valuation methods provide an attractive alternative to the ICJ. Such individuals could bring a wealth of experience to cases like *ELSI*. On the other hand, the members of the ICJ are highly respected and qualified jurists, experienced in the interpretation of treaties and international law. Moreover, they may be more attuned to the political dimensions of disputes between states. If the ICJ is lacking in experience in the commercial area, this simply places a greater burden on the parties to present their case in a cogent, thorough fashion.

## VII. PROCEDURAL ISSUES

The *ELSI* case presented several procedural issues of interest. These issues related to the single-phase nature of the proceedings, the formation of the Chamber, and its treatment of witnesses and experts.

### A. *Single-Phase Proceedings*

Although each side submitted two rounds of written pleadings, both parties decided to brief simultaneously all the issues that the Chamber might consider: jurisdiction, admissibility, merits (i.e., the treaty violations), and reparation. The parties sent letters to the ICJ on November 16, 1987, requesting that the admissibility objection "be heard and determined within the framework of the merits," in accordance with article 79(8) of the Rules of the Court. The Chamber took note of the agreement in its order of November 17, 1987.<sup>204</sup>

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Mann, *Compound Interest as an Item of Damage in International Law*, 21 U.C. DAVIS L. REV. 577, 585 (1988).

203. Italian Rejoinder, *supra* note 23, at 190.

204. Case Concerning *Elektronica Sicula S.p.A. (ELSI)* (U.S. v. Italy), 1987 I.C.J. 185 (Order of Nov. 17).

Thus, the parties intended the case to be a single-phase proceeding regardless of the Chamber's decision on each of the issues.

The single-phase approach permitted the case to be resolved in a reasonably short time, thereby minimizing the effect of a contentious proceeding on the relationship of the parties. The United States filed its application in February 1987, and the Chamber rendered its decision in July 1989. A two-phase or three-phase proceeding would have undoubtedly taken longer, even if each phase was limited to one round of written pleadings. The single-phase method also allowed the United States to present the "big picture," discussing in extensive detail the damages, which were intimately tied to the merits. Indeed, there is something artificial in a case that treats damages as distinct from the injury, particularly in commercial cases where the two are often intertwined.

The single-phase approach also had its disadvantages. Had the ICJ rejected the United States application on admissibility grounds, the parties would have needlessly briefed and argued in detail all the other issues. Nevertheless, the parties presented much needless argument on many elements of the damage claims. In addition, the single-phase proceeding required the Chamber to digest an enormous volume of materials and issues. While the parties may be equipped to assign numerous government and nongovernment lawyers to research and present complicated issues of international and domestic law, as well as accounting valuation methods, the judges of the Chamber must have been under a considerable strain in evaluating all the material before them. Both the parties and the Chamber budgeted three weeks for the oral hearing, leaving each party four days (three hours per day) to argue their initial presentations, and one to two days each to present rebuttal arguments. While this amount of time is perhaps more than adequate for an admissibility phase, a merits phase, or a damages phase separately, the parties were pressed to present all of their arguments at once without extensive detail on any single issue. This time constraint undoubtedly contributed to the Chamber's brief treatment of some of the issues.

In the end, the choice to use single-phase proceedings must be in accord with the objectives sought by the parties. If speedy resolution of the dispute is the primary consideration, then a single-phase method makes sense. If, however, the case is complex and either party wishes the Chamber to focus in depth on each aspect of the case, multiple phases are preferable. In the *ELSI* case, both parties were anxious to put the dispute behind them, but, given the complicated valuation and causation issues, the decision to use single-phase proceedings may have ultimately worked to the detriment of the United States.

B. *Formation of the Chamber*

The decade of the 1980s marked the beginning of a nascent trend in using chambers of the ICJ than the full Court. Article 26 of the Statute of the Court states:

2. The Court may at any time form a chamber for dealing with a particular case. The number of judges to constitute such a chamber shall be determined by the Court with the approval of the parties.

3. Cases shall be heard and determined by the chambers provided for in this Article if the parties so request.<sup>205</sup>

Article 17 of the Rules of the Court sets forth the process for establishing a chamber. Under that article, at any time prior to closure of the written proceedings, a party may request the formation of a chamber. The President of the ICJ determines whether the other party assents and, if so, ascertains the parties' views regarding the composition of the Court. The ICJ then determines, with the approval of the parties, the number of judges forming the panel and then elects the judges.<sup>206</sup>

Until 1982, the full Court, consisting of its fifteen regular judges, supplemented in some cases by *ad hoc* judges, had heard every case decided. In 1982 the United States and Canada set up a chamber for the *Gulf of Maine* case, followed in 1985 by Burkina Faso and Mali in their *Frontier Dispute* case, and in 1987 by El Salvador and Honduras in their *Land, Island, and Maritime Frontier Dispute* case.

The United States filed its application in the *ELSI* case along with a letter to the ICJ requesting the formation of a chamber of five judges to decide the case. Italy accepted this proposal. The ICJ consulted the parties on the composition of the proposed Chamber,<sup>207</sup> and then elected the five preferred judges to the Chamber: President Ruda along with Judges Ago, Jennings, Oda, and Schwebel. This selection, in accordance with the Rules of the Court, gives the parties some control over the number of judges in the chamber. However, while the parties may express their views as to which judges should sit, the ultimate decision rests with the ICJ.

The use of the chamber option was appropriate for the *ELSI* case. The procedure allowed the submission of complex treaty and accounting issues to a small group of judges, most of whom were familiar with western investment

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205. Statute of the Court, *supra* note 4, art. 26.

206. Rules of the International Court of Justice, art. 17, reprinted in DOCUMENTS ON THE INTERNATIONAL COURT OF JUSTICE 215 (S. Rosenne 2d ed. 1979) [hereinafter I.C.J. DOCUMENTS]. See generally Schwebel, *Ad Hoc Chambers of the International Court of Justice*, 81 AM. J. INT'L L. 831 (1987).

207. The ICJ revised its rules in 1978 to allow the President of the Court to consult with the parties regarding composition of the chamber. Normally the ICJ unanimously elects the chamber in accordance with the parties' views. In the *Gulf of Maine* case, however, two judges dissented on the basis that the parties' indication that they would take the dispute elsewhere if their desired composition was not obtained, infringed the ICJ's freedom of choice. Schwebel, *supra* note 206, at 844-45.

practices in the post-World War II era. Although it cannot be said that the choice affected the outcome of the case, the parties undoubtedly felt more comfortable using a smaller group of judges, and the less complicated atmosphere of the Chamber better suited a relatively minor dispute between two long-standing, friendly allies.

### C. *Experts and Witnesses*

Oral proceedings at the ICJ are best characterized as presentational, rather than inquisitorial or adversarial. The parties introduce most evidence during the written pleadings stage in the form of exhibits to the pleadings. At the oral stage, each party usually makes an extensive uninterrupted oral statement over a few days on the law that relates to that evidence. At the end of the presentation, or sometimes at the end of each day of presentation, one or more judges will ask questions that the parties usually answer at some later time.

Typically, the ICJ does not have extensive expert and witness testimony, although increased use of such testimony have become more prevalent over the past several years. As in most international commercial cases, the issues in *ELSI* were heavily fact-based and required both careful attention to relevant rules of Italian law and complex accounting analyses of *ELSI*'s worth on various dates. Consequently, in addition to lengthy pleadings, the United States presented two factual witnesses -- Raytheon's Chairman of the Board and *ELSI*'s Chairman of the Board during the period of *ELSI*'s requisition -- to explain Raytheon's involvement in and ultimate decision to liquidate *ELSI*.<sup>208</sup>

On issues of Italian law, the United States presented two Italian law experts, one to address issues of Italian civil procedure and another to address Italian laws on dissolution and bankruptcy.<sup>209</sup> To address the question of *ELSI*'s 1968 value and the opportunity for an orderly liquidation based on financial records before the Chamber, the United States used a court-appointed Italian accounting expert and an expert accountant from an international accounting firm.<sup>210</sup> The Italian government responded with a single accounting expert who challenged various assertions of the United States accounting expert.<sup>211</sup> Several members of the Italian legal team, however, were them-

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208. International Court of Justice Verbatim Record, C 3/CR 89/1, at 44-52 (Feb. 13, 1989) (testimony of C. Adams); International Court of Justice Verbatim Record, C 3/CR 89/2, at 8-27 (Feb. 14, 1989) (cross-examination of C. Adams); *id.* at 27-30 (Feb. 14, 1989) (questions by the Chamber); *id.* at 31-51 (testimony of J. Clare), 53-61 (cross-examination of J. Clare), 62-66 (questions by the Chamber).

209. International Court of Justice Verbatim Record, C 3/CR 89/2, at 81-97 (Feb. 14, 1989) (presentation of E. Fazzalari); *id.* at 67-80 (presentation of F. Borelli).

210. International Court of Justice Verbatim Record, C 3/CR 89/4, at 25-44 (Feb. 16, 1989) (testimony and cross-examination of T. Lawrence).

211. International Court of Justice Verbatim Record, C 3/CR 89/7, at 64-70 (Feb. 22, 1989) (testimony of A. Hayward).

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selves experts in Italian constitutional, civil, and financial laws, a fact that worked to Italy's advantage.

An interesting aspect of the use of experts and witnesses in *ELSI* was the blurred distinction between "witnesses" and "experts" on one hand and "counsel" and "advisers" on the other. Rule 64 of the Court treats witnesses and experts differently from counsel in that they must make solemn declarations to "speak the truth."<sup>212</sup> The Chamber therefore required the two Raytheon witnesses and the English accountant -- who were not listed as part of the United States delegation -- to make such declarations,<sup>213</sup> and subjected them to cross-examination by counsel for the Italian government. The "legal advisers" appearing on behalf of the United States as experts in Italian civil procedure and bankruptcy law, however, were listed as part of the United States delegation. Thus, they were not required to make such declarations and were not subjected to cross-examination. The accounting "adviser" appearing as part of the Italian delegation made the expert declaration,<sup>214</sup> and the Chamber made him available for cross-examination despite the Italian agent's protest that he was not an expert but an adviser.<sup>215</sup>

An initial conclusion might be that lawyers are not considered "experts" within the meaning of rule 64, but that other professionals who make statements before the ICJ are so considered. The practice in other cases, however, where at times non-lawyers have not been required to make the normal declaration and have not been subject to cross-examination, belies this conclusion. Some confusion arose in *ELSI* when the Italian Agent interrupted one of the Italian law experts appearing on behalf of the United States during his rebuttal presentation on a point of order, arguing that since the expert had made an assertion from his personal knowledge as a lawyer to *ELSI*, he should be treated as a witness. President Ruda decided to treat the Italian lawyer as a witness as to a part of his statement, then, after his presentation was completed, asked him to make the normal declaration for a witness. The Chamber then permitted Italian counsel to cross-examine him on this matter.<sup>216</sup>

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212. Witnesses swear as follows: "I solemnly declare upon my honour and conscience that I will speak the truth, the whole truth and nothing but the truth." Experts swear as follows: "I solemnly declare upon my honour and conscience that I will speak the truth, the whole truth and nothing but the truth, and that my statement will be in accordance with my sincere belief." See Rules of the International Court of Justice, art. 64, reprinted in I.C.J. DOCUMENTS, *supra* note 206, at 245. It is unclear what distinction, if any, is to be drawn between these oaths.

213. International Court of Justice Verbatim Record, C 3/CR 89/1, at 42 (Feb. 13, 1989) (testimony of C. Adams); International Court of Justice Verbatim Record, C 3/CR 89/2, at 30 (Feb. 14, 1989) (testimony of J. Clare); International Court of Justice Verbatim Record, C 3/CR 89/4, at 25 (Feb. 16, 1989) (testimony of T. Lawrence).

214. International Court of Justice Verbatim Record, C 3/CR 89/7, at 64 (Feb. 22, 1989).

215. See *id.* at 70.

216. See International Court of Justice Verbatim Record, C 3/CR 89/9, at 8-21, 52-53, 59 (Feb. 27, 1989).

Whether the ICJ actually sees a probative difference in information presented in the form of a statement by counsel or advisers, as opposed to a statement by an expert or witness, is unclear. What is clear, however, is that the susceptibility of experts to cross-examination engenders a great practical difference. Cross-examination disrupts the flow of a party's presentation and tilts the presentation in the direction sought by the other party. In the *ELSI* case, the use of witnesses who were subject to cross-examination compromised the ability of the United States to present a clear, uninterrupted presentation of the facts.

### VIII. LIFE AFTER *ELSI*

The protection of private property rights in public international law has figured prominently in the jurisprudence of international arbitral tribunals. The *ELSI* decision will undoubtedly serve as a benchmark in future assessments of property protection by such tribunals. Although the case turned on the interpretation of a particular bilateral treaty, that treaty, along with a similar FCN treaty with China, bears a particular significance because it launched an entire class of FCN treaties between the United States and other countries. These treaties in turn prompted comparable treaties between other nations. Furthermore, the protection of investment first sought in these FCN treaties appears in other types of international agreements as well, including recently completed bilateral investment treaties (BITs) with lesser developed countries and those currently being negotiated with the states of Eastern Europe and the Soviet Union. The *ELSI* case will also have a ripple effect on the development of principles of state responsibility generally in that many of the Chamber's statements have implications outside the context of investment treaties. Finally, the *ELSI* case arose at a crucial time in the relationship of the United States to the ICJ in the wake of the *Nicaragua* case. Continued United States support of the ICJ is a welcome sign in fostering the rule of law in international relations.

#### A. Contemporary BITs

In 1981, the United States began a new approach to fostering overseas investment by negotiating a series of BITs (bilateral investment treaties) with developing countries.<sup>217</sup> Although many of the first United States BITs have

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217. See *supra* notes 19-21 and accompanying text. The impetus for this program was the success of several European countries in the 1960s and 1970s in negotiating these treaties which, unlike their predecessor FCN treaties, dealt exclusively with foreign investment. See Gudgeon, *United States Bilateral Investment Treaties: Comments on Their Origins, Purposes, and General Treatment Standards*, 4 INT'L TAX & BUS. LAW. 105 (1986).

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only recently come into force, the United States is now concluding additional BITs with the Eastern European states. Like the FCN treaties, the BITs seek to establish a basic legal framework governing certain economic relations through the establishment of standards of treatment to be accorded to nationals and companies of one country in the territory of another. Unlike the FCN treaties, however, BITs deal exclusively with foreign investment. The preamble typically states that the treaty seeks to "stimulate the flow of private capital and the economic development of the Parties."<sup>218</sup>

The *ELSI* case will have a less direct impact on the development and interpretation of these BITs than on FCN treaties in general. BITs largely avoid the issue of protection of shareholders' rights, since they focus not on protecting the nationals or companies making the investment, but rather on protecting the investment itself. For example, article 1 of the recent United States-Poland Treaty Concerning Business and Economic Relations<sup>219</sup> (United States-Poland BIT) carves out a broad definition of investment that covers "every kind of investment . . . owned or controlled directly or indirectly," including shares of stock or other interests in a company or its assets.<sup>220</sup> By emphasizing protection of the investment, whether owned "directly or indirectly," and by including interests "in the assets thereof," the BITs render irrelevant the debate about the distinction between the rights and the interests of the shareholder. BITs clearly protect a shareholder who has invested in a locally incorporated company from acts that affect the shareholder's shares or profits and from acts that impair other interests in the company.

These BITs protect not only the investment, but "associated activities" as well. This language reflects a concern with both the return on and the corpus of the investment and the general operation and management of the investment. Article I of the United States-Poland BIT broadly defines "associated activities" as all kinds of activities associated with an investment, including control, operation, and disposition of companies, and the disposition of property of all kinds.<sup>221</sup> Thus, while the Chamber in *ELSI* expressed doubts as to whether

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218. U.S.-Poland Treaty, *supra* note 21, at Preamble.

219. U.S.-Poland Treaty, *supra* note 21.

220. Article I of the United States-Poland Treaty defines "investment" as:

every kind of investment, in the territory of one Party owned or controlled directly or indirectly by nationals or companies of the other Party, and includes: (i) tangible and intangible property, including rights, such as mortgages, liens and pledges; (ii) a company or shares of stock or other interests in a company or interests in the assets thereof; (iii) a claim to money or a claim to performance having economic value, and associated with an investment; (iv) intellectual property ... and (v) any right conferred by law or contract, and any licenses and permits pursuant to law.

*Id.* at art. I(1)(b).

221. Article I of the United States-Poland Treaty defines "associated activities" as:

activities associated with an investment, such as the organization, control, operation, maintenance and disposition of companies, branches, agencies, offices, factories or other facilities for the conduct of business; the making, performance and enforcement of contracts; the acquisition, use, protection and disposition of property of all kinds including intellectual property rights; the

the protection and security of property under article V of the FCN Treaty applied to Raytheon, instead of only to *ELSI*, presumably the new provisions of a BIT would remove such doubts. This broad definition nicely complements the Chamber's willingness to recognize the FCN Treaty as protecting investments generally, including those that take the form of a locally incorporated subsidiary.

In other areas, the *ELSI* case will have a more direct impact. BITs incorporate the same types of standards that arose in the *ELSI* case concerning equitable treatment and protection from arbitrary measures. Article II(6) of the United States-Poland BIT protects investments from "arbitrary and discriminatory measures."<sup>222</sup> Obviously the Chamber's interpretation of what constitutes an "arbitrary" measure will be highly relevant in any interpretation of this provision. That interpretation was based on the Chamber's view that the act in question was consciously made in the context of an operating system of law and subject to appropriate remedies of appeal, and was treated as such by the host country's administrative and judicial authorities. Certainly the existence of an operating system of law in countries such as Poland will help avoid arbitrary acts occurring without redress, but the Chamber's narrow definition opens the door to a wide range of actions that nevertheless could occur and that, for whatever reason, are not corrected by the existence of local administrative or judicial oversight. Although it is subject to wide-ranging application, one positive element of the *ELSI* decision may be that any act which surprises an international tribunal's sense of judicial propriety is to be deemed arbitrary. Future BITs may need creative drafting to prohibit arbitrary or unreasonable acts, or to define "arbitrary" as having no relationship to the availability to the injured party of redress in administrative or judicial tribunals.

In the United States-Poland BIT, some clauses will take on particular relevance in the event that an situation similar to what befell *ELSI* were to arise. The Treaty gives special attention to the ability to repatriate liquidated investments, obligating each party to "permit all transfers related to an investment or commercial activity to be made freely and without delay into and out of its territory. These transfers include . . . proceeds from the sale or liquidation of all or any part of an investment."<sup>223</sup> Such provisions represent a welcome amplification of ideas already present in most of the older FCN treaties.

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borrowing of funds; the purchase and issuance of equity shares and other securities; and the purchase of foreign exchange.

*Id.* at art. I(1)(e). The phrase "such as" indicates that this is an illustrative rather than an exhaustive list.  
222. Investments shall:

at all times be accorded fair and equitable treatment, shall enjoy full protection and security and shall in no case be accorded treatment less than that required by international law. Neither party shall in any way impair by arbitrary and discriminatory measures the management, operation, maintenance, use, enjoyment, acquisition, expansion or disposal of investments.

*Id.* at art. II(6).

223. *Id.* at art. V(1).

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The BITs do not provide for the ICJ's jurisdiction in the event of a dispute concerning their interpretation or application. Although they vary in their terms, BITs envision the national or company itself seeking redress directly from the host government for an alleged breach of the rights conferred by the treaty or, failing that, through some form of dispute settlement mechanism, such as arbitration.<sup>224</sup> Additionally, where an intergovernmental dispute arises as to the interpretation or application of the treaty, BITs often provide for submission of the dispute to a three-member arbitral tribunal for a binding decision. For most BITs, the ICJ's only involvement is its ability to appoint arbitrators if either party fails to appoint an arbitrator or if the party-appointed arbitrators fail to appoint the third arbitrator.<sup>225</sup> The BITs, however, call upon the arbitral tribunal to make its decisions in accordance with the provisions of the treaty and the applicable rules of international law,<sup>226</sup> and therefore would require the tribunal to look to cases such as *ELSI* in rendering its award.

### B. *General Principles of International Law*

Because the ICJ rarely ventures into the world of international trade and investment, investors might be tempted to regard the *ELSI* decision as an authoritative source in this area for rules of state responsibility. Even a cursory reading of the case, however, reveals that the Chamber drew far more on the precise treaty language before it than on prior precedent and practice in the general area of state responsibility. Consequently, the implications of the *ELSI* case must begin with the appreciation that the Chamber was not construing and did not purport to construe customary rules of international law in reaching its decision, except in limited situations for the purpose of interpreting the particular language of the FCN Treaty.<sup>227</sup>

Furthermore, much of the treaty analysis consisted of *obiter dictum*. At the end of the day, the Chamber's decision rested predominantly on the factual conclusions that, regardless of the Italian government's acts, the United States had not sufficiently established the feasibility of an orderly liquidation plan for *ELSI*, and that the bankruptcy was inevitable.<sup>228</sup> Therefore, it did not matter which of Raytheon's rights the FCN Treaty obligated the Italian government to protect. At the time in question, nothing, including the requisition, could have further harmed *ELSI* or infringed more on Raytheon's rights in *ELSI*.

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224. See, e.g., U.S.-Senegal Treaty, *supra* note 19, at art. VII.

225. See, e.g., *id.* at art. VIII(4).

226. See, e.g., U.S.-Poland Treaty, *supra* note 21, art. X(2).

227. For instance, the ICJ drew upon its decision in the *Asylum Case* in assessing the meaning of "arbitrary." Judgment, *supra* note 2, para. 28; see also *supra* note 181.

228. Judgment, *supra* note 2, paras. 101, 119, 121, 135.

However, the Chamber's decision did not rely entirely on this factual conclusion. For example, it did not render the interpretations of article V(1) and (2) of the FCN Treaty and of article I of the Supplement unnecessary.

Even given these caveats, the implications of the *ELSI* case will extend beyond the further development and interpretation of the FCN Treaty and comparable treaties to the development of customary international law itself, including principles of state responsibility. From the earliest decisions of the Permanent Court of International Justice, many elements of the decisions of the ICJ, even though based solely on particular treaties or unnecessary to the ultimate ruling, have nevertheless worked their way into the fabric of customary international law. Much of the *ELSI* decision may be *obiter dictum*, but it nevertheless reflects the thinking of esteemed international jurists from a variety of legal backgrounds, acting within the crucible of a real case. Moreover, international law does not draw as sharp a distinction as American common-law jurisprudence between *obiter dictum* and direct holding. In fact, a striking feature of international law is that an ICJ decision itself theoretically does not even make law, because "[t]he decision of the Court has no binding force except between the parties and in respect of that particular case."<sup>229</sup> Nevertheless, the ICJ's judgments do play a large role in the development of international law and influence subsequent state practice.<sup>230</sup> Because the ICJ rules on comparatively few cases in any one particular field, this effect is equally valid for both the holding proper and *obiter dictum*.

### C. *The United States and the ICJ*

In the *Case Concerning Military and Paramilitary Activities in and Against Nicaragua*, the ICJ found on November 26, 1984, that Nicaragua and the United States had validly accepted ICJ compulsory jurisdiction over Nicaragua's claims, and that the 1956 Treaty of Amity between the two countries also vested the ICJ with jurisdiction. The ICJ also found the claims admissible because they were "not about any ongoing armed conflict."<sup>231</sup> On January 18, 1984, the United States announced that it would no longer participate in the proceedings instituted against it by Nicaragua because "[t]he proceedings initiated by Nicaragua in the International Court of Justice are a misuse of the

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229. Statute of the Court, *supra* note 4, art. 59.

230. The impact on customary rules of international law is readily apparent in the influence of: the Fisheries Case (U.K. v. Nor.), 1951 I.C.J. 116 (with respect to territorial sea straight baselines); Reservations to the Convention on the Prevention and Punishment of the Crime of Genocide, 1951 I.C.J. 15 (with respect to reservations to multilateral treaties); and Reparation for Injuries Suffered in the Service of the United Nations, 1949 I.C.J. 174 (with respect to juridical personality of international organizations).

231. *Case Concerning Military and Paramilitary Activities in and Against Nicaragua* (Nicar. v. U.S.), 1984 I.C.J. 392, 434.

court for political purposes."<sup>232</sup> On October 7, 1985, the United States issued a notice terminating its acceptance of compulsory jurisdiction, to which it had adhered from the Court's inception.<sup>233</sup> At the same time, however, the United States announced that it would file an application in the *ELSI* case.<sup>234</sup> This act showed the continued support of the United States for the ICJ, notwithstanding the United States view that the ICJ had incorrectly asserted its jurisdiction in the *Nicaragua* case.

On July 20, 1989, the Chamber rendered its decision against the United States in *ELSI*. One might ask whether the United States would lose faith in its ability to prevail at the ICJ. Since that time, however, the United States has continued to support the ICJ as an institution. First, on September 23, 1989, the United States and the Soviet Union issued a joint statement endorsing a working paper containing proposals for extending the jurisdiction of the ICJ.<sup>235</sup> The joint statement indicated that the two governments had agreed on the desirability of enhancing the ICJ's role in the resolution of international disputes. The two governments had jointly developed proposals that relied on existing treaties in identifying disputes to be brought before the ICJ. However, the proposals limited such disputes to a chamber of judges and excluded from the jurisdiction of the ICJ certain categories of issues of a highly sensitive, national security nature.<sup>236</sup> Although this exclusion might appear as an attempt by the United States to diminish the ICJ's jurisdictional scope, this initiative in fact represents an effort to bring before the ICJ certain states and issues that have not been previously within its jurisdiction.

Second, in May 1989, the Iranian government filed an application against the United States in the *Case Concerning the Aerial Incident of 3 July 1988*.<sup>237</sup> The application alleges that a United States naval vessel violated certain civil aviation conventions in shooting down a civilian airliner. Iran argued that the ICJ had jurisdiction pursuant to the compromissory clauses found in those conventions.<sup>238</sup> At the time of the *ELSI* decision, the United States faced the choice of whether to participate in the proceedings brought by Iran. Although the case clearly implicates sensitive matters relating to the

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232. U.S. Dep't St., *Statement: U.S. Withdrawal from the Proceedings Initiated by Nicaragua in the International Court of Justice*, Jan. 18, 1985, 24 I.L.M. 246.

233. Letter from George P. Shultz, Secretary of State of the United States of America, to Javier Perez de Cuellar, Secretary-General of the United Nations (Oct. 7, 1985) (terminating United States acceptance of compulsory jurisdiction), reprinted in 24 I.L.M. 1742.

234. See *supra* note 63 and accompanying text.

235. DEP'T ST. BULL., Nov. 1989, at 8.

236. U.S. Dep't St., Fact Sheet on International Court of Justice Initiative (Sept. 23, 1989) (on file with author).

237. Application Instituting Proceedings in Case Concerning Aerial Incident of 3 July 1988 (Iran v. U.S.), May 17, 1989, 28 I.L.M. 843.

238. Convention for the Suppression of Unlawful Acts Against the Safety of Civil Aviation, Sept. 23, 1971, art. 14, 24 U.S.T. 565, T.I.A.S. No. 7570, 10 I.L.M. 1151; Convention on International Civil Aviation, Dec. 7, 1944, arts. 84, 86, 61 Stat. 1180, T.I.A.S. No. 1591, 15 U.N.T.S. 295.

lawful use of force, the United States appointed an agent and notified the ICJ that it would participate in the case. This action, too, reflects the United States belief in the viability of the ICJ in fostering the international rule of law, a belief that will strengthen the ICJ as an institution.

#### IX. CONCLUSION

The *ELSI* case presents a classic example of a transnational investment gone sour amidst actions by a host government to maintain its domestic *status quo*. A Chamber of the ICJ ruled against the United States even though the United States established that the Italian government had violated its own law in requisitioning *ELSI* before its parent companies could execute a plan of orderly liquidation. At first glance, the outcome of the case suggests that bilateral treaties designed to prevent interference with such investments do not have much practical effect.

The primary reason, however, that the United States lost the *ELSI* case was its failure to adequately establish an important factual predicate -- that the company's financial position was still sufficiently secure to allow its owners to continue to exercise important rights of management and control before the Italian government requisitioned *ELSI*. The Chamber was simply not able to find on the evidence before it that *ELSI*'s parent could have placed it through an orderly liquidation and that bankruptcy was not inevitable at the time of the requisition. The Chamber did not indicate what further evidence it needed to establish this predicate; it apparently wanted the United States to prove with a high degree of certainty that the Italian government prevented a specific course of events from occurring. Having to find a similarly situated entity that was not subject to any unlawful act and fared better is difficult enough; it seems almost impossible to prove that specific results would have occurred absent the allegedly unlawful act. If *ELSI* had been a healthy concern, rather than on the verge of insolvency, or if other electronics enterprises in Italy at that time had undertaken successful liquidations, the United States could have presented further evidence that might have tipped the balance in its favor.

Fortunately, by and large, the *ELSI* decision did not undercut the essential protections provided by the United States-Italy FCN Treaty and by FCN treaties in general, including those provisions relating to management and control and to expropriation. For instance, the Chamber asserted that where the requisition of a company's plant and equipment is not justifiable under local law, there is a *prima facie* violation of rights to management and control as provided in FCN treaties. Most importantly, in deciding to whom the right of management and control attaches, the Chamber maintained that investors in a locally-incorporated subsidiary have rights under FCN treaties notwithstand-

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ing general legal principles relating to the corporate form, and notwithstanding the ICJ's own ruling in the *Barcelona Traction* case.

In two areas, however, the *ELSI* decision adversely affected substantive FCN treaty rights. First, the Chamber asserted that even where a state's nationals have a right to manage and control a company, including the right to dispose of its assets, clear evidence of a chance of success does not preserve this right. Rather, the claimant must show that an orderly disposition of the assets will in fact succeed. As noted above, this may be possible only where the company can be compared to similarly situated companies that were successfully liquidated. Second, the Chamber considered an arbitrary act to be one that transgresses the rule of law (as opposed to simply a rule of law) in the sense that the host country lacks an internal mechanism to correct the arbitrary act. This very narrow approach to arbitrary acts is inconsistent with standards operating on both international and domestic levels. Unfortunately, the *ELSI* decision will undoubtedly be cited in future cases involving investment treaties.

Many future foreign investments, however, may be subject to treaty regimes that are only now being established. The recent United States-Poland BIT draws upon many of the concepts established in the earlier FCN treaties, but, like all the BITs, approaches the problem of protecting investments in a manner that should vitiate restrictive aspects of the *ELSI* decision with regard to investors rights.

In the end, the Chamber's factual findings were central to the case and deserve close scrutiny. The Chamber believed that it faced a complex situation "of mixed fact and law."<sup>239</sup> While this was true, *ELSI*'s situation does not differ from that of any number of foreign investments that for one reason or another result in major losses. The Chamber showed little sensitivity to the potential for even the most financially distressed company to wind down its operations in a manner more beneficial to its creditors and owners than declaring bankruptcy. Moreover, the Chamber rejected the possibility of an orderly liquidation because it was "speculative." This, however is always the case in assessing what might have happened had an unlawful interference not occurred. Under this standard, one should question the real possibility of preserving and presenting sufficient evidence to an international tribunal for the purpose of vindicating investment treaty rights.

How effectively a bilateral investment treaty promotes foreign investment in a particular country is unclear, since major investments have been made even in the absence of such treaties. There can be little doubt, however, that in such a treaty the host government acknowledges its sovereign interest in attracting foreign investment by creating an environment that benefits foreign

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239. Judgment, *supra* note 2, para. 67.

investors. As the effects of the end of the Cold War play out, the use of the bilateral investment treaty could expedite the economic integration of the Soviet Union and the countries of Eastern Europe with the West. But if the judicial and arbitral bodies specified in these treaties as the fora for dispute resolution do not carefully and effectively resolve issues of fact and law arising under these treaties, the protection these treaties provide will be far weaker than their drafters intended.