INTERNATIONAL COURT OF JUSTICE

PLEADINGS, ORAL ARGUMENTS, DOCUMENTS

CASE CONCERNING ELETTRONICA SICULA S.p.A. (ELSI)

(UNITED STATES OF AMERICA *v.* ITALY)

VOLUME II
Counter-Memorial; Reply; Rejoinder

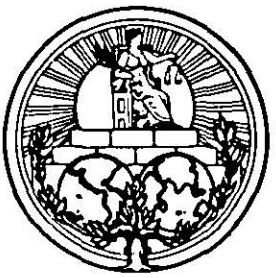
COUR INTERNATIONALE DE JUSTICE

MÉMOIRES, PLAIDOIRIES ET DOCUMENTS

AFFAIRE DE L'ELETTRONICA SICULA S.p.A. (ELSI)

(ÉTATS-UNIS D'AMÉRIQUE c. ITALIE)

VOLUME II
Contre-mémoire; réplique; duplique



REPLY OF THE UNITED STATES OF AMERICA

RÉPLIQUE DES ÉTATS-UNIS D'AMÉRIQUE

PART I. INTRODUCTION

This Reply addresses the numerous unsubstantiated, irrelevant, or incorrect assertions made by the Respondent in its Counter-Memorial, filed 16 November 1987. The Respondent both illegally requisitioned Elettronica-Sicula, S.p.A. ("ELSI"), frustrating Raytheon's and Machlett's planned orderly liquidation of ELSI, and interfered in the subsequent bankruptcy proceedings. Yet the Respondent denies that its acts violated various provisions of the Treaty of Friendship, Commerce and Navigation between the United States and the Italian Republic ("the Treaty"), which entered into force in 1949, and its Supplement, which entered into force in 1961. This Reply is filed in accordance with the Court's Order of 17 November 1987.

From 1956 to 1967, Raytheon and Machlett invested substantial amounts of capital and other assistance in their Italian electronics subsidiary, ELSI, with the expectation that ELSI would become self-sufficient in the Italian market. Despite its reputation for quality products and its sizeable volume of sales, ELSI never became a self-sufficient, let alone profitable, enterprise. Contrary to Italy's assertions, Raytheon and Machlett did nothing to create ELSI's financial problems.

In early 1967, Raytheon and Machlett initiated a comprehensive effort to determine the reasons for ELSI's financial difficulties. They determined that ELSI could survive in the Italian market only with a substantial improvement in its competitive environment: specifically, by partnership with an Italian corporation or substantial co-operation by the Italian Government. In early 1967, Raytheon and Machlett decided that unless they could secure a plan to improve ELSI's competitive environment, they would proceed with an orderly liquidation of ELSI's assets within a year. This decision was communicated to the Respondent.

Although the Respondent made broad proposals for ELSI's continued operation, these proposals required that Raytheon and Machlett make substantial additional investments in ELSI with no prospect of recovering that investment, while continuing to cover ELSI's losses. Raytheon and Machlett reluctantly decided in March of 1968 to proceed with the orderly liquidation as planned. Under that plan, Raytheon and Machlett would advance all funds necessary to allow ELSI to be sold as a going concern.

Instead of allowing Raytheon and Machlett to liquidate ELSI in an orderly fashion, the Respondent, in violation of Italian law, requisitioned ELSI's plant and assets on 1 April 1968 allegedly because the orderly liquidation of ELSI would cause "social unrest". At no time, however, did the Respondent ever resume the operation of the plant or re-employ ELSI's workforce. This unjustified and illegal requisition prevented Raytheon and Machlett from selling ELSI's assets and thus proceeding with the orderly liquidation as planned. Although Raytheon and Machlett immediately took all possible steps to have the requisition rescinded, the Respondent refused to quash the order and indeed told Raytheon that it would continue indefinitely. Since ELSI was deprived of the revenue with which to meet continuing financial obligations, Raytheon and Machlett directed ELSI to file a petition in bankruptcy on 26 April 1968 in accordance with Italian law.

Following the filing of ELSI's petition in bankruptcy, the Respondent continued to exploit the situation in which the requisition had placed ELSI's assets, eventually acquiring ELSI for itself. Only after ELSI had been purchased by the Respondent, the Respondent's administrative and judicial organs ruled that the

Respondent's requisition of ELSI was unlawful as a matter of Italian law. Unfortunately, the Respondent was required by its courts to pay only a small fraction of the compensation it should have paid to remedy the damage the Respondent caused. Accordingly, Raytheon and Machlett incurred substantial losses as a direct result of the Respondent's actions.

These actions of the Respondent violated several provisions of the Treaty. The Treaty violations in this case are clear from the ordinary meaning of the articles cited by the United States. The Respondent's broad assertions about the application of the Treaty and what interests it protects are unfounded; the Treaty provisions cited by the United States protect United States shareholders of companies incorporated in Italy. The requisition and other conduct by the Respondent were both arbitrary and discriminatory, prevented Raytheon and Machlett from managing and controlling an Italian corporation whose shares they had lawfully acquired, and resulted in the impairment of their legally acquired rights and interests — in violation of Articles III and VII of the Treaty and Article I of the Supplement. In addition, the requisition constituted a taking of Raytheon's and Machlett's interests in property without due process and without adequate compensation, in violation of Article V of the Treaty. The Respondent also failed to comply with the obligation under Article V to afford protection and security, by the unwarranted delay in ruling on the challenge to the requisition order and by failing to afford protection to ELSI's plant and premises. These violations, singly and in combination, entitle the United States to receive full compensation for the damages suffered by Raytheon and Machlett.

Italy does not contest the jurisdiction of this Court. Italy does assert that the claims of the United States are inadmissible because local remedies, in the form of a suit in Italian courts based on the Treaty, were not exhausted. The principle that local remedies be exhausted was followed in this case. All reasonable steps were taken to obtain compensation from the Respondent for the unlawful requisition of ELSI. Further resort to Italian courts on the basis of the Treaty is unavailable or unreasonable. In any event, the Respondent is estopped from insisting on such action at this time. Consequently these claims are properly before the Court.

PART II. STATEMENT OF FACTS

CHAPTER I

THE DECISION TO LIQUIDATE ELSI

Section 1. ELSI Received Extensive Financial and Managerial Assistance from Raytheon and Machlett but Could not Become Economically Self-sufficient

By 1967 ELSI had become a respected manufacturer of sophisticated electronic components and equipment with a modern, fully equipped plant in Palermo, a reputation for quality products, and a significant volume of sales and export earnings[1]. It had been Raytheon's and Machlett's expectation from the outset that ELSI would gain access to Italian markets, develop new products, and continue to become more efficient in its operations. ELSI, however, was never able to achieve the financial self-sufficiency that Raytheon and Machlett had anticipated[2].

John Clare, chairman of the Board of Directors of ELSI, and other qualified technical experts under his supervision, prepared an in-depth study of ELSI's potential for survival in the Italian market[3]. They determined that ELSI could operate effectively in Italy only with the addition of an Italian partner, infusion of capital, introduction of new products, and greater access to Italian Markets[4]. These conclusions, previously communicated to the Respondent, were summarized in a report which was distributed to senior officials of the Italian Government, the Sicilian Government, IRI[5], Italian banks, and other members of the Italian establishment[6].

The Counter-Memorial presents additional factors that allegedly contributed to ELSI's inability to become financially self-sufficient, including ELSI's geographic location, the quality and prices of ELSI's products, and the obsolescence of some of ELSI's production lines[7]. The Respondent itself engaged in sustained efforts to attract commerce to the Mezzogiorno region by publicized incentives[8];

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[1] For a discussion of ELSI's product lines and markets, *see* Memorial, **I**, p. 47.

[2] For a discussion of ELSI's financial performance, *see* Memorial, **I**, p. 47; Affidavit of Arthur Schene, Former Vice President-Controller of Raytheon Company, 17 Apr. 1987 (Ann. 13).

[3] In 1967 Raytheon and Machlett designated John Clare, Raytheon Vice President and General Manager of its European management subsidiary, Raytheon Europe International Company, to be ELSI's chairman. They also appointed several other highly qualified persons to assist ELSI. Memorial, **I**, p. 48.

[4] Memorial, **I**, pp. 48-49; Affidavit of John D. Clare, Former Chairman, Raytheon Europe International Company, 10 Jan. 1987, para. 18 (Ann. 15).

[5] Istituto per la Ricostruzione Industriale ("IRI") is a holding company owned and controlled by the Respondent. It has extensive and wide-ranging commercial and banking interests dominating, among other things, the telecommunications, electronics, and engineering markets. Memorial, **I**, p. 49. IRI's actions are thus attributable to the Respondent. Memorial, **I**, p. 85.

[6] Memorial, Ann. 15, para. 20; Memorial, "Project for the Financing and Reorganisation of the Company", 1967 Report prepared by Raytheon-ELSI, S.p.A. (Ann. 22).

[7] Counter-Memorial, *supra*, pp. 4-5.

[8] Memorial, **I**, p. 43.

thus it is ironic that Respondent now attempts to question Raytheon's and Machlett's decision to invest in the region. Despite numerous inquiries to, and promises of, appropriate Italian authorities, these benefits never materialized[1]. Receipt of these benefits would have improved ELSI's financial condition and enhanced its attractiveness to prospective buyers.

Further, ELSI had developed a reputation for the manufacture of high quality and highly sophisticated electronics[2]. In preparation for the introduction of color television in Europe, ELSI had constructed a modern, up-to-date facility for color television research and development pending the decision by Italy and other European countries as to the type of television system they would adopt[3]. In addition, by 1967 ELSI had already moved from production of germanium transistors, which had become technologically obsolete, to the production of silicon rectifiers[4].

Of course, the reasons for ELSI's financial problems are not relevant to the dispute before this Court and were merely presented as background information in the United States Memorial. Whatever the reasons for ELSI's inability to become a profitable enterprise, Raytheon and Machlett were still entitled to put ELSI through an orderly liquidation under their own control. The critical question is whether the Respondent wrongfully requisitioned the plant, prevented its orderly liquidation, permitted the plant to be occupied, and subsequently manipulated the bankruptcy process to its own advantage.

Section 2. Raytheon's and Machlett's Good Faith Efforts to Negotiate a Solution to ELSI's Problems Were Frustrated by the Respondent

Beginning in early 1967 Raytheon made it clear to the Respondent that ELSI could not operate effectively in Italy and that Raytheon would not make additional capital contributions to keep ELSI operating without greater co-operation by the Respondent. In approximately 70 meetings with cabinet level officials of the national and Sicilian Governments, John Clare and other Raytheon officials presented numerous specific proposals for Government partnership in ELSI and Government support for ELSI's development of new products and markets[5].

Raytheon proposed that ELSI find an Italian partner. IRI, for example, dominated the Italian electronics industry at this time and controlled important segments of it, such as the manufacture of telephone components[6]. At first, the Respondent made encouraging statements, but the Respondent was unwilling in

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[1] The Respondent's argument that ELSI's distance from its suppliers of glass tubes in northern Italy is relevant, if at all, only to one of ELSI's product lines, cathode ray tubes. Of course, the transportation subsidy would have removed any disadvantage in this regard, had the Respondent put this program into effect as it had promised. Memorial, I, pp. 48-49; 52. The Respondent's argument with respect to semiconductors is also misplaced as transportation costs of these items is negligible relative to total cost.

[2] Memorial, I, p. 47.

[3] Respondent's suggestion that ELSI's products lacked reliable markets is also misplaced. Counter-Memorial, *supra*, p. 4. ELSI was poised to enter the market for color television. Furthermore, ELSI's sales to Nato, while irregular by nature, were hardly "dwindling to nothing". *See* Memorial, Ann. 22, App. B4. Nonetheless, ELSI recognized that military sales could not form an exclusive operating basis and for that reason sought to develop new products and markets. Memorial, Ann. 22, I, pp. 205-206.

[4] Memorial, Ann. 22, I, p. 208.

[5] Memorial, I, p. 49.

[6] Memorial, I, pp. 49-50; Affidavit of Charles F. Adams, Finance Committee Chairman and Director of Raytheon Company, 17 Apr. 1987, para. 30 (Ann. 9); *see* Ann. 15, para. 31.

the end to agree to a concrete, viable solution to ELSI's problems[1]. Under the Respondent's proposals, Raytheon and Machlett would continue to bear the operating losses of ELSI without itself committing to take specific actions to improve ELSI's ability to compete. Raytheon, however, could not agree to incur continuing losses or to defer any longer its plan for the orderly liquidation of ELSI.

Section 3. As Is Permitted Under Italian Law, Raytheon and Machlett Decided to Place ELSI through an Orderly Liquidation Rather than through Bankruptcy Proceedings

Under Italian law, shareholders are entitled to liquidate a company's assets voluntarily, by their own resolution[2]. Therefore on 28 March 1968, having decided that the orderly liquidation of ELSI's assets was prudent in view of ELSI's financial situation, Raytheon and Machlett voted in accordance with Italian law to proceed with the plan for orderly liquidation prepared by ELSI's management.

ELSI's management made preparations to sell ELSI as a going concern, with an established name and reputation, customer and supplier relationships, and the necessary patent and trademark licenses. ELSI would maintain a limited operation to complete work-in-process, and ELSI's management took all possible steps to maintain good relationships with ELSI's customers and suppliers. Raytheon and Machlett planned to offer ELSI's six product lines either as a total package or individually to maximize the realizable price[3], and made it known that they were willing to enter into technical assistance agreements with the ultimate purchasers of ELSI.

Raytheon also made the commitment to advance any funds to provide the necessary liquidity for the orderly liquidation. Raytheon established a $1.25 million line of credit to cover payment of the small creditors, and ELSI began making payments to them in March of 1968[4]. In addition, Raytheon was willing to pay all creditors whose claims were not satisfied by the sale of ELSI's assets[5].

It was clear to Raytheon and Machlett that an orderly liquidation would generate far greater revenue from the sale of ELSI's assets than would a bankruptcy process. In the first place, Raytheon would have used its knowledge of

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[1] Respondent initially made encouraging statements that IRI would agree to participation in ELSI. *See*, e.g., Minutes of Meeting with Hon. Vincenzo Carollo, President of the Sicilian Region (20 Feb. 1968) (the alleged discrepancies in the minutes to this meeting are refuted in the letter from Timothy E. Ramish, Deputy-Agent of the United States, to the Registrar of the Court, dated 13 Jan. 1988). Respondent's encouragement never materialized in a specific or written proposal for ELSI's future operations. *See*, e.g., Memorial, Ann. 15, Exhibit G, I, p. 181.

[2] Article 2448, n. 5, of the Italian Civil Code provides that a joint stock company may be dissolved by resolution of the shareholders at a meeting called by the directors. M. Beltramo, G. Longo, and J. Merryman (trans.), *The Italian Civil Code* (1969), p. 611. *See also Statement by Professor Franco Bonelli*, 2 Mar. 1988 (Ann. 1 to this Reply).

[3] Each product line could be sold as a separate package, including the respective technology, contracts, customer and supplier bases, and established name and reputation to buyers elsewhere in Italy, Europe or Japan. *See* Affidavit of Joseph A. Scopelliti, Memorial, para. 12 (Ann. 17).

[4] Memorial, Ann. 15, para. 53.

[5] *Ibid.*, Ann. 13, para. 18. Although the Respondent fails to so distinguish, Counter-Memorial, *supra*, p. 10, Raytheon's and Machlett's commitment to fund the orderly liquidation in order to maximize the return on its investment must be distinguished from Raytheon's and Machlett's refusal to continue to capitalize ELSI with no prospect of a return on their investment.

the electronics industry to locate buyers on a worldwide basis and to negotiate the terms for the sale of ELSI's six product lines, maximizing the return for both creditors and shareholders. Further, Raytheon and Machlett would have realized the substantial value of ELSI's intangible assets, including the technical assistance agreements that could be negotiated with each purchaser. Finally, with Raytheon and Machlett in control of ELSI's liquidation, Raytheon could ensure that the plant, equipment, and inventory would be well-maintained and protected.

A trustee in bankruptcy, by contrast, lacked the commercial and technical expertise and the financial incentive to market ELSI or its product lines effectively on a worldwide basis to appropriate buyers[1]. Further, the bankruptcy process did not afford a vehicle for the marketing and sale of the intangible value of ELSI as a going concern, including the premium that would be placed on Raytheon's willingness to enter technical assistance and license agreements with the ultimate purchasers. Moreover, Raytheon and Machlett recognized that the bankruptcy process would not result in the sale of ELSI's assets quickly. Deterioration in the assets caused by delay in the sale would, of course, diminish the return to ELSI's creditors and shareholders. Finally, Raytheon and Machlett sought to avoid the substantial administrative costs associated with the bankruptcy process, costs which would not have been incurred under the orderly liquidation.

Sale of ELSI's assets on a going concern basis[2] would have been sufficient to pay all of ELSI's liabilities in full, including amounts owed to Raytheon, and return 391 million lire to Raytheon and Machlett as a small return on their large investments they had made in ELSI[3]. Of course, Raytheon had good reason to believe that the bank creditors would settle their unsecured, unguaranteed claims at no more than 50 per cent[4].

Section 4. At no Time Prior to 1 April 1968 Was It Required by Italian Law that ELSI Be Placed in Bankruptcy

Prior to the requisition, ELSI was never in jeopardy of bankruptcy or compulsory dissolution. Italian law would have required ELSI to file a petition in bankruptcy if it was impossible for ELSI to fulfill regularly its financial obligations[5]. Alternatively, ELSI could have been considered dissolved as a matter of Italian law only if its capital were depleted below a statutory minimum amount (at the relevant time the statutory minimum amount was one million lire)[6].

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[1] Reply, Ann. I, para. 2.

[2] In this case, book value is the closest available approximation of going concern value. *See infra*, Part VI, Chapter III.

[3] Memorial, I, pp. 52, 108.

[4] *Ibid.*, I, p. 52. Willingness of the banks to settle their claims with ELSI at 40 to 50 per cent of their value is further evidenced by the banks' agreement to settle for 50 per cent or less of their claims in the fall of 1968. Counter-Memorial, *supra*, p. 24; *see also* Reply, Ann. I, para. 3.

[5] Reply, Ann. I, para. 4; Italian Bankruptcy Act, Art. 5 (Ann. 1).

[6] Article 2447 of the Italian Civil Code states:

> "If, by reason of the loss . . . [exceeding] over one-third of the capital, [the capital] falls below the minimum established by Article 2327, the directors (2380) shall without delay call the meeting (2365) to decide on the reduction of the capital and the concurrent increase thereof to an amount not less than said minimum, or on the reorganization of the company."

Italian Civil Code, op. cit., pp. 610-611; *see also*, Reply, Ann. I, para. 5.

ELSI never contravened these laws. Until ELSI was deprived of its revenue by the requisition, ELSI consistently met and was in a position to meet all of its financial obligations[1]. ELSI's capital, even after taking into account losses, was always well above the statutory minimum[2]. Thus, contrary to the Respondent's unsubstantiated assertions, ELSI had no obligation to file a petition in bankruptcy, nor was it subject to compulsory dissolution. Raytheon and Machlett were fully entitled to proceed with the orderly liquidation of ELSI's assets under Italian law.

The Respondent also maintains that ELSI was in violation of Article 2446 of the Italian Civil Code with respect to the size of its losses and in violation of the Italian Bankruptcy Act due to its bookkeeping practices. These assertions, like many of those found in the Counter-Memorial, are irrelevant to the claims before this Court. In the interest of accuracy, however, it must be noted that ELSI was fully in compliance with Italian law, both with regard to capitalization requirements[3] and with regard to bookkeeping practices[4].

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[1] In addition, the Respondent seems to overlook the fact that the book value of ELSI's assets was consistently greater than ELSI's liabilities. *See* Counter-Memorial, *supra*, p. 15; Memorial, Ann. 13, Schedule B1; Reply, Ann. 1, para. 5.

[2] Memorial, I, p. 53, n. 2; Reply, Ann. 1, para. 5.

[3] Article 2446 of the Italian Civil Code provides that when a company's losses exceed one-third of its capital, the shareholders — after a one-year grace period from the date they are or should be aware of such losses (typically at the time they review the balance sheets) — must either reduce the company's capital in proportion to the losses to correct the imbalance or make alternative arrangements for the disposition of the company. *Italian Civil Code, op. cit.*, p. 610. Following the review of the balance sheets for the fiscal year ending 30 September 1966, ELSI reduced the value of its stock, thereby diminishing its losses. Raytheon and Machlett invested an additional 2,500 million lire in ELSI, thereby bringing the company's capital to 4,000 million lire. Memorial, Ann. 13, Schedule B1. Notwithstanding these efforts, ELSI's losses once again exceeded one-third of its capital in the fiscal year ending 30 September 1967. This time, however, ELSI's shareholders voted within the one-year grace period, to liquidate the company rather than adjust its capital. *See* Memorial, Ann. 32. This decision was in complete compliance with Article 2446. Reply, Ann. 1, para. 6.

[4] There is also no merit to the Respondent's assertion that ELSI's books were not properly kept. Counter-Memorial, *supra*, p. 8. From the time Raytheon acquired a majority interest in ELSI, Coopers and Lybrand, an internationally respected accounting firm, audited ELSI's books. To allow time for its foreign operations to close their year-end books and to transmit their accounting data to Raytheon, Raytheon's foreign operations typically closed their books three months prior to Raytheon's consolidated report of December of each year. Under this system, Coopers and Lybrand audited ELSI's books and prepared a year-end report for the year ending 30 September 1967. The books for the period through 31 December 1967, were kept on a normal basis at Palermo and a complete management report for that period, consistent with the closing of 30 September 1967, was transmitted to Raytheon in the first quarter of 1968. The balance sheet at 31 March 1968 was prepared on a basis consistent with the valuations in the Coopers and Lybrand audit report of 30 September 1967 and a conservative extrapolation to 31 March 1968. Memorial, Ann. 13, I, p. 133. Any abnormal delay in the preparation of ELSI's books was due solely to earthquakes in Sicily and strikes at the plant in early 1968; these were brief and unavoidable interruptions in ELSI's bookkeeping operations and did not constitute violations of Italian law. Reply, Ann. 1, para. 7.

CHAPTER II

THE REQUISITION AND RESULTING BANKRUPTCY

Section 1. Rather than Allow Raytheon and Machlett to Place ELSI through a Lawful, Orderly Liquidation, the Respondent Requisitioned ELSI

By March of 1968, Raytheon's and Machlett's plan for the orderly liquidation was in place and the first steps of implementing it had begun. Raytheon and Machlett had extended the line of credit for payment of the small creditors and was engaged in discussions with the Italian banks for settlement of the large unsecured, unguaranteed debts.

One event alone prevented the orderly liquidation of ELSI's assets: the unlawful requisition by the Respondent of ELSI's plant and equipment on 1 April 1968. The requisition deprived ELSI of control of the plant and physical assets. It prevented Raytheon and Machlett from proceeding with the sale of ELSI's assets and prohibited ELSI's management from continuing as planned with limited production and sale of inventory at full value to waiting customers[1].

As discussed in Part V, below, the requisition was a deliberate act by the Respondent to prevent Raytheon and Machlett from proceeding with the orderly liquidation of ELSI's assets. The requisition was purportedly for the purpose of protecting "the economic public interest" that was threatened by the proposed liquidation[2]. However, during the requisition the Respondent never re-opened the plant, otherwise resumed production, or re-employed the plant's workers[3].

Raytheon immediately tried to get the requisition rescinded[4]. On 9 April Raytheon petitioned the Mayor to lift the requisition order, but received no response[4]. On 19 April Raytheon appealed the requisition to the Prefect of Palermo, and again received no response[4]. Determined not to foreclose any possibility of re-opening the plant, officers of Raytheon and ELSI continued to meet with Italian officials even after the requisition of ELSI. The Respondent, however, was still unwilling to come forward with any real proposals to improve ELSI's competitive position[5]. The Counter-Memorial seeks to portray the Re-

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[1] Memorial, I, pp. 52-53. Although the requisition deprived Raytheon and Machlett of management of ELSI's operations, Raytheon and Machlett directed Mr. Rico Merluzzo to remain in the plant to protect the security of the plant. Mr. Merluzzo remained in the plant until ELSI was forced to file its petition in bankruptcy. Memorial, Affidavit of Rico A. Merluzzo, Former Director of Planning, Raytheon-ELSI, S.p.A., 17 Apr. 1987 (Ann. 21).

[2] Memorial, Requisition Decree, Mayor of the Municipality of Palermo, 1 Apr. 1968 (Ann. 33); Minutes of Meeting in Palermo between Messrs. Joseph Oppenheim, Howard Hensleigh, Stanley Hillyer, and President Carollo of Sicily, 19/20 Apr. 1968 (Ann. 37); Memorandum from the President of the Sicilian Region, 20 Apr. 1968 (Ann. 38).

[3] Memorial, Ann. 21, para. 19.

[4] Memorial, I, p. 55.

[5] In April of 1968 Italy proposed to lift the requisition order following the establishment of a special management team of officials from ELSI, the Sicilian Region, and IRI to liquidate ELSI. However, this plan required Raytheon to make additional capital contributions to fund ELSI's continued operation, an option Raytheon and Machlett had determined they could no longer pursue. In the summer of 1968 the Sicilian Region also proposed a plan that would have required Raytheon and Machlett to advance all costs of ELSI's operations without any commitment on the part of the Respondent as to the exact arrangements the Respondent would make for the sale of ELSI's assets.

spondent as eager to enter into a negotiated settlement by these proposals[1], but these proposals are irrelevant to the question whether the requisition and subsequent interference with the bankruptcy process violate the Treaty. In addition, the Respondent's admitted use of the requisition to coerce Raytheon and Machlett into carrying indefinitely operating losses of ELSI is precisely the type of governmental action which the Treaty condemns.

Although the requisition was on its face limited to six months, the President of the Sicilian Region stated to ELSI's stockholders on 19 April, and confirmed in writing on 20 April, that the requisition would continue as long as necessary to achieve the Respondent's objectives regarding ELSI[2]. With regard to Raytheon's and Machlett's ability to sell ELSI, President Carollo stated that:

> "Nobody in Italy shall purchase, that is to say IRI shall not purchase neither for a low nor for a high price, the Region shall not purchase, private enterprise shall not purchase. Let me add that the Region and IRI and anybody else who has any possibility to influence the market will refuse in the most absolute manner to favor any sale while the plant is closed . . . In the event that the plant shall be kept closed, waiting for Italian buyers who will never materialize, the requisition shall be maintained at least until the courts will have resolved the case. Months shall go by[3]."

Hence ELSI was deprived of income from the sale of its assets and was therefore no longer able to meet its financial obligations as they became due. Without any hope for a change in this situation by the Respondent, Raytheon and Machlett certainly could no longer advance funds to ELSI for its continued operations. ELSI therefore was required under Italian law to file a petition in bankruptcy on 26 April 1968. The bankruptcy petition explicitly and accurately stated that the reason for the bankruptcy was the requisition of the plant on 1 April 1968[4].

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[1] Counter-Memorial, *supra*, p. 22. The Respondent also speculates that the failure to reach an agreement between Raytheon and the Respondent was "an attempt [by Raytheon] to force the hand of the banks, which had previously seemed reluctant to accept a negotiated solution". Counter-Memorial, *supra*, p. 23. This unsubstantiated assertion must be rejected. Had the Respondent and IRI at any point made a concrete offer to acquire ELSI as a going concern or share ownership with Raytheon and Machlett, Raytheon and Machlett would have acceded to the plan. The failure to reach agreement was due not to the reluctance of Raytheon to reach a negotiated solution to ELSI's problem. Raytheon had worked for more than a year for just such a resolution. Failure instead was due to the Respondent's inability — or unwillingness — to commit to such a solution. *See generally* Memorial, Ann. 22. Indeed, the Respondent's unsubstantiated assertion that it "did everything it could" to help ELSI must be rejected for similar reasons. Counter-Memorial, *supra*, p. 22.

[2] *See generally*, Memorial, Anns. 37, 38. The continued negotiations with the Respondent and the fact that the appeal of the requisition was brought on 19 April — only 18 days after the requisition — did not indicate that Raytheon considered the requisition "to be little more than a temporary nuisance". Counter-Memorial, *supra*, p. 22. On the contrary until the oral and written statements by the President of the Sicilian Region, Raytheon believed that the order would soon be quashed. Although Raytheon and Machlett had been frustrated by the Respondent's refusal to engage in meaningful cooperation, until 19 April there were no indications that the Respondent would sanction the continuance of illegal actions in its treatment of ELSI.

[3] Memorial, Ann. 38.

[4] Memorial, I, p. 57.

Section 2. By Its Acts Subsequent to the Requisition, the Respondent Also Interfered with the Bankruptcy Process to Its Own Advantage

Following the filing of ELSI's petition in bankruptcy, the Respondent continued to exploit the situation in which the requisition had placed ELSI, thereby substantially aggravating the financial injury to Raytheon and Machlett. As a legal matter, the requisition prevented the Trustee once he was appointed on 16 May by the bankruptcy court from selling the plant and assets or otherwise protecting the property. Moreover, following the filing of the bankruptcy petition the Respondent allowed the local workforce to occupy the plant, which undoubtedly discouraged prospective buyers and certainly made it difficult to show to interested buyers the company's plant and other assets[1]. Even after the requisition period ended, the bankruptcy court's lease of the plant by IRI[2] had the same effect. The Respondent proceeded to obtain ELSI's work-in-process for a price below the value assigned by even the judicial valuator[3].

In addition, the Respondent repeatedly and publicly announced its intention to take over ELSI's plant through one of IRI's subsidiaries[4]. Given the extensive power and dominance of the Respondent in the commercial environment of Italy, there can be little doubt that these announcements deterred other buyers from bidding on ELSI's assets when the four auctions were held by the bankruptcy court[5]. Notwithstanding its announced intentions, however, Elettronica Telecomunicazioni, S.p.A. ("ELTEL"), the IRI subsidiary created to take over ELSI, boycotted the first three bankruptcy auctions, seeking to buy only some of the assets at a lower price. Through a series of manoeuvers which had the effect of controlling the sale of ELSI's assets, the Respondent, through ELTEL, systematically acquired ELSI's operations on a piecemeal basis, at the expense of ELSI's shareholders and creditors[6]. Taking advantage of the situation which it had created, IRI's subsidiary, Italtel, S.p.A., now uses ELSI's plant to manufacture telephone equipment — one of the new products proposed by ELSI in its 1967 Report to Italian officials[7].

On 11 August 1969, more than 16 months after the appeal was filed, but only 40 days after ELTEL had completed its acquisition of ELSI's assets, the Prefect ruled that the requisition was illegal under Italian law.

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[1] The occupation should be distinguished from the pre-requisition strikes and sporadic sit-ins, a point which the Respondent confuses. Counter-Memorial, *supra*, pp. 8, 11, 14. First, the strikes were directed at the Respondent, to persuade it to take action with respect to ELSI. Memorial, Ann. 21, para. 22. They were limited to brief interruptions of production operations and did not result in the closure of the plant for an indefinite amount of time. Only after Mr. Merluzzo left the premises following the filing of the bankruptcy petition did the workers actually occupy the plant for a sustained period.

[2] Memorial, I, pp. 60-61.

[3] *Ibid.*, p. 62.

[4] *Ibid.*, Anns. 37, 38, 46.

[5] That IRI's announcement was at the direction of the Respondent is confirmed in the Counter-Memorial, *supra*, p. 25.

[6] For a complete discussion of the bankruptcy process and ELTEL's systematic methods acquiring ELSI at a price favorable to itself, *see* Memorial, I, pp. 58-63.

[7] *Ibid.*, p. 63.

PART III. JURISDICTION

Jurisdiction in this case is based on Article 36 (1) of the Statute of the Court, as read in conjunction with Article XXVI of the 1948 Treaty of Friendship, Commerce and Navigation (the "Treaty") between the United States and Italy[1]. Although acceptance by the Respondent of the Court's jurisdiction on this basis is not necessary, the Respondent "fully recognizes" the Court's jurisdiction over this dispute as it relates to the interpretation and application of the FCN Treaty and its Supplement[2].

The Respondent declines to object to the Court's jurisdiction. Since Rule 79 of the Rules of the Court requires that any objection to the jurisdiction of the Court be made within the time-limit fixed for the delivery of the Counter-Memorial, the Respondent is now barred from raising an objection. The Counter-Memorial speculates, however, that jurisdiction with respect to Articles V (1) and (3) of the Treaty is in doubt because the United States has not put forward these provisions previously in diplomatic negotiations, in accordance with Article XXVI[3]. The Respondent's view appears based on the fact that while these provisions were discussed throughout the Memorandum of Law accompanying the 1974 Claim, they were not specifically cited in the Memorandum's "Summary of Legal Arguments".

The Respondent's view is wholly unjustified. The United States has repeatedly raised with the Respondent since 1972 the legal claims now before this Court. Each Treaty claim argued before this Court was presented to the Respondent in the Legal Memorandum submitted to the Respondent in 1974[4]. Since the Respondent has consistently refused to pay compensation for the damages suffered by the United States, the dispute has not been satisfactorily adjusted by diplomacy and is now properly before this Court pursuant to Article XXVI of the Treaty.

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[1] Memorial, **I**, p. 68.

[2] Counter-Memorial, *supra*, p. 26.

[3] Article XXVI of the Treaty states that disputes "which the High Contracting Parties shall not satisfactorily adjust by diplomacy" may be submitted to the Court.

[4] The claim presented to the Respondent in 1972 and again in 1974 appears in Volume I of the "Unnumbered Documents" annex to the Counter-Memorial. The Memorandum of Law in Support of the Claim of Raytheon Company and the Machlett Laboratories, Inc. Against the Government of Italy in Connection with Raytheon-ELSI S.p.A. appears as Volume 2 of the 1972/1974 claim. *See supra*, pp. 236, 245 (Art. III (2)); pp. 236, 246 (Art. V (1)); pp. 236, 241, 264, and 276 (Art. V (2)); pp. 245, 247 and 264 (Art. V (3)); pp. 236, 248 and 277 (Art. VII); pp. 237, 277 (Treaty Protocol, para. 2); pp. 236, 239, 264, 277 (Treaty Supplement, Art. I); pp. 237, 277 (Treaty Supplement, Art. V).

PART IV. ADMISSIBILITY OF THE CLAIMS

The Respondent contends that the United States claim is inadmissible because Raytheon and Machlett failed to exhaust available remedies in Italian courts. Raytheon and Machlett, however, have exhausted in Italy all remedies available under Italian law. Consequently the United States claim is admissible before this Court.

In the *Interhandel* case[1] this Court stated that in cases involving injury to a foreign national, the principle of exhaustion of local remedies provides that the respondent State be given the opportunity to redress the injury within its internal system. The Court explained that:

> "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[2]."

In this case, the Respondent was accorded every opportunity within its own legal system to pay compensation for the injury caused by its actions. Subsequent to the requisition, Raytheon and Machlett directed ELSI officials to petition formally the Mayor to lift his order. When this produced no result, Raytheon and Machlett directed ELSI officials to appeal the Mayor's order to the Prefect of Palermo. While the decision by the Prefect was pending, Raytheon and Machlett directed its representative on the creditors' committee to appeal decisions of the bankruptcy judge, such as the decisions to lease the plant to ELTEL and to sell the plant, equipment, and supplies to ELTEL. Unfortunately these appeals were denied by Italian courts[3].

Eventually the Prefect declared the requisition to be unlawful[4]. When the Mayor appealed the Prefect's decision to the Italian Council of State and the President of Italy, the appeal was dismissed and the Prefect's decision upheld[5].

Raytheon's and Machlett's interests as creditors of ELSI were represented in the bankruptcy process by the Trustee, Giuseppe Siracusa. Following the decision of the Prefect that the requisition was illegal, the Trustee brought suit against the Respondent seeking damages for the unlawful requisition. After extensive consideration of the facts and law underlying the injury to ELSI, the Court of Palermo refused to award damages[6]. Subsequently the Court of Appeals of Palermo reversed the lower court in part and found that damages were due for the six-month "use" of the plant, but not for the injury caused in preventing Raytheon and Machlett from placing ELSI through an orderly requisition[7]. The

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[1] *Interhandel* case, *Preliminary Objections, I.C.J. Reports 1959*, p. 27 ("*Interhandel* case").

[2] *Interhandel* case, p. 27; *see also Ambatielos* claim, 12 *Reports of International Arbitral Awards*, pp. 118-120 (1956) ("*Ambatielos* claim"); *Finnish Shipowners* case, 3 *Reports of International Arbitral Awards*, pp. 1503-1504 (1934).

[3] Memorial, Decree of the Civil and Criminal Tribunal of Palermo, 9 May 1969 (Ann. 64); Transcript of Bankruptcy Hearing, Civil and Criminal Court of Palermo, 13 July 1969 (Ann. 74).

[4] Memorial, I, p. 55.

[5] *Ibid.*, p. 64.

[6] *Ibid.*, Judgment of the Court of Palermo, Decided 2 Feb. 1973, Filed 29 Mar. 1973, Registered 4 Apr. 1973, I, pp. 375-376 (Ann. 80).

[7] *Ibid.*, Judgment of the Court of Appeals of Palermo, registered 24 Jan. 1974, I, p. 382 (Ann. 81).

Supreme Court of Appeals, after extensive consideration as to the facts and law of the case, upheld the decision of the Court of Appeals of Palermo[1].

The Respondent asserts that after all these efforts to seek redress from the Respondent, Raytheon and Machlett should also have brought suit in Italian courts based on the Treaty[2]. The Respondent, however, does not describe the statutory basis on which such a suit could be brought, undoubtedly because there is no basis for a suit under Italian law for compensation based on Respondent's violation of the Treaty. Raytheon and Machlett should not be required to pursue an unavailable local remedy prior to presentation of their claim by the United States before this Court.

Treaties only can have effect within Italy if they are incorporated into an Italian legislative act[3]. Even then, the treaty is only effective as a matter of Italian law for those provisions which are complete in their essential elements; those provisions which lack completeness remain ineffective[4]. Although the Treaty and Supplement at issue here were incorporated into Italian legislative acts[5], the provisions argued before this Court are not complete enough to permit a suit for compensation by a United States national against the Government of Italy in Italian courts[6]. Indeed, although there is provision in Article V for indemnification by the Government of Italy of those individuals or corporations who have been deprived of their property, that Article is still not sufficiently complete. For example, there is no indication whether such indemnification would be viewed as "diritto soggettivo" (subjective right), and therefore enforceable in the ordinary courts, or "interesse legittimo" (legal interest), and therefore enforceable in the administrative courts. The other articles of the Treaty pleaded by the United States are similarly not enforceable[7]. Further, since Raytheon's and Machlett's claims are those of shareholders, Italian law would prevent a suit seeking compensation based on the illegal requisition because Italian law reserves such a right to ELSI alone, despite the existence of the Treaty[8]. As stated by Elio Fazzalari, an esteemed Professor of Civil Procedure at the University of Rome, "The Respondent's claim is groundless[9]".

Professor Antonio La Pergola, then Professor of Law at the University of Bologna and subsequently President of the Italian Constitutional Court, considered in 1971 whether Raytheon could sue based on the Treaty and concluded that further local remedies were not available. Professor La Pergola stated that:

> ". . . I feel that I have to conclude that in the situation at hand all the requirements appear to be satisfied for international protection of the shareholders of the Raytheon-El.Si. S.p.A. who are United States citizens, without

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[1] Memorial, Judgment of the Supreme Court of Appeals, 26 Apr. 1975 (Ann. 82). The Supreme Court of Appeals is not capable of reviewing *de novo* the facts as found by the lower courts.

[2] Counter-Memorial, *supra*, p. 26.

[3] "Implementation of Treaties and Community Law", V *Italian Yearbook of International Law*, p. 265 (1980-1981).

[4] "Implementation of the Peace Treaty With Italy", II *Italian Yearbook of International Law*, pp. 364-365 (1976).

[5] Counter-Memorial, *supra*, p. 26.

[6] Statement by Professor Elio Fazzalari, University of Rome, 29 Feb. 1988, p. 404, *infra* (Ann. 2 to this Reply).

[7] *Ibid.*, p. 403, *infra*.

[8] *Ibid.*, pp. 403-404, *infra*.

[9] *Ibid.*, p. 403, *infra*.

> the need to pursue internal remedies prior to the possible initiation of a claim against the Italian Government[1]."

The only Italian case cited by the Respondent in support of its argument is the 1961 case of *The Durst Manufacturing Co.* v. *Banca Commerciale Italiana*[2]. *Durst*, however, merely holds that another provision of the Treaty — the "access to justice" clause — relieves a party who files a petition for review by the Italian Supreme Court of the need for an authentication of the signature of the Italian consul in New York by the Minister of Foreign Affairs. There were no damages awarded in that case and it did not involve the Government of Italy.

Even if the Court believes that there was some possibility that a suit by Raytheon and Machlett in Italian courts based on the Treaty would have succeeded, the principle of exhaustion of local remedies does not require an injured national to pursue a highly speculative and unlikely means of redress. The principle is satisfied if there is no effective local remedy "as a matter of reasonable possibility"[3]. Indeed, the burden is on the Respondent to prove the existence of a further remedy in Italian courts[4]. In this case, local counsel advised Raytheon that a suit based on the Treaty could not succeed[5]. Further, the Supreme Court of Appeals in Italy had already decided the amount of compensation owed by the Respondent for its unlawful actions[6]. Therefore, obtaining compensation through a suit based on the Treaty was so unlikely that it could not be considered a remedy available as a matter of reasonable possibility.

In any event, the Respondent is estopped from asserting that there exists any requirement to further exhaust local remedies[7]. Although for 15 years the Respon-

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[1] Letter from Antonio La Pergola, Professor at the University of Bologna, to Raytheon Company, 9 Dec. 1971 (Ann. 3 to this Reply). Raytheon also sought the advice of its Italian counsel, Giuseppe Bisconti, who informed Raytheon on 6 Nov. 1971 that "there is no remedy under Italian law available to the shareholders of ELSI in relation to the damage suffered by them as a consequence of the requisition by the Mayor of Palermo and the subsequent events". Letter from Avv. Giuseppe Bisconti, Studio Legale Bisconti, Rome, to Raytheon Company, 6 Nov. 1971 (Ann. 4 to this Reply).

[2] 64 *Rivista di Diritto Internazionale* (1961), pp. 117-118.

[3] *Norwegian Loans* case, *I.C.J. Reports 1957*, p. 39 (separate opinion of Judge Lauterpacht); *Barcelona Traction* case, *Second Phase*, *I.C.J. Reports 1970*, pp. 144-145, and 284 (separate opinion of Judge Gros).

[4] *Ambatielos* claim, p. 119.

[5] Reply, Ann. 3.

[6] Memorial, Ann. 82. Although the opinion of the Supreme Court is not binding outside the case in which it is rendered, it is highly persuasive authority in subsequent cases in Italian courts. The *Italian Civil Code*, *op. cit.*, ix. No effective local remedy exists if further appeals to the courts are on issues previously decided by the highest court. *Panevezys* v. *Saldutiskis Railway*, *P.C.I.J., Series A/B, No. 76*; *X* v. *Austria*, 30 *International Law Reports*, p. 268.

[7] Estoppel is a general principle of international law which this Court has previously employed to qualify the rights of parties before the Court. E.g., *Arbitral Award Made by the King of Spain on 23 December 1906*, *I.C.J. Reports 1960*, p. 192, pp. 213-214 (where Nicaragua was not permitted to challenge the validity of an arbitral award in part because it had failed to raise any question with regard to the validity of the award over several years); H. Lauterpacht, *The Development of International Law by the International Court*, pp. 168-172 (1961) ("[Estoppel] may fairly be regarded as a general principle of law which, once more, is merely an affirmation of the moral duty to act in good faith"). As for the application of estoppel in the case of a bilateral treaty, a member of this Court has stated:

> "The primary foundation of [estoppel] is the good faith that must prevail in international relations, inasmuch as inconsistency of conduct or opinion on the part of a State to the prejudice of another is incompatible with good faith. Again I submit that such inconsistency is especially inadmissible when the dispute arises from bilateral treaty relations". *Temple of Preah Vihear* case, *I.C.J. Reports 1962*, pp. 40, 42 (separate opinion of Judge Alfaro).

dent entertained diplomatic representations by the United States on the basis of the Treaty (including the formal presentation of a diplomatic claim in 1974), at no time until the filing of its Counter-Memorial did the Respondent suggest or request that Raytheon and Machlett enter Italian courts and sue on the basis of the Treaty. Instead the Respondent made statements that it was willing to go to arbitration with the United States[1], which discouraged further resort to Italian courts. The United States has relied on the Respondent's representations in good faith to the United States' detriment because — assuming for the sake of argument that an action based on the Treaty could be brought — the statute of limitations on that action has now expired[2]. Therefore, the Respondent is now estopped from asserting that there should have been further resort to local remedies by Raytheon and Machlett.

For cogent discussions of the issue of estoppel, *see* Bowett, "Estoppel Before International Tribunals and Its Relation to Acquiescence", 33 *British Year Book of International Law*, p. 176 (1957); MacGibbon, "Estoppel in International Law", 7 *International and Comparative Law Quarterly*, p. 468 (1958).

[1] In response to the claim espoused by the United States in 1974 on the basis of the Treaty and customary international law, the Respondent did not protest that local remedies had not been exhausted, but instead stated that "the claim is juridically groundless, both from the international and internal point of view". Aide-Mémoire of 1978 from the Italian Ministry of Foreign Affairs to the United States. For a summary of the diplomatic efforts made to resolve this dispute, *see* I, Application Instituting Proceedings Submitted by the Government of the United States of America, Attachment 2.

[2] The normal time period for filing of a suit in Italian courts seeking compensation for damages arising from unlawful acts is five years from the date on which the act occurred. *Italian Civil Code*, *op. cit.*, Art. 2947.

PART V. THE CLAIMS OF THE UNITED STATES

CHAPTER I

INTRODUCTION

Respondent's Counter-Memorial attempts to obscure the violations of the Treaty by asserting inaccurate generalities about the Treaty and by attributing to the United States arguments that the United States does not make. The protections of the Treaty and the violations of it by the Respondent, however, are quite clear from the ordinary meaning of each article invoked by the United States.

The United States has shown that the Respondent, through the actions of its agents and officials, violated its legal obligations under the Treaty by: (1) unlawfully requisitioning the ELSI plant on 1 April 1968; (2) allowing ELSI workers to occupy the plant; (3) unreasonably delaying ruling on the lawfulness of the requisition for 18 months until immediately after the ELSI plant, equipment, and work-in-process had all been acquired by ELTEL; and (4) interfering with the ELSI bankruptcy proceedings, which allowed the Respondents to realize its previously expressed intention of acquiring ELSI, for a price far less than its fair market value.

All of these actions, singly and in combination, violated Articles III, V, and VII of the 1949 Treaty and Article I of its 1961 Supplement, which by its terms is an integral part of the Treaty. The protections provided under the Treaty relating to this dispute fall into four categories:

(a) protection from interference with Raytheon's and Machlett's management and control of ELSI;
(b) protection from impairment of Raytheon's and Machlett's investment rights;
(c) protection from the wrongful taking of Raytheon's and Machlett's property; and
(d) protection and security for Raytheon's and Machlett's investment.

Before addressing these four areas of protection under the Treaty, however, three general assertions by the Respondent in the Counter-Memorial must be addressed as a preliminary matter.

First, a specific object and purpose of this Treaty was to encourage investment by corporations of one Party in the territory of the other Party[1]. The United States does not argue that the *sole* purpose of the Treaty is to encourage investment[2], but certainly the articles advanced before this Court show that both

[1] As noted in the Memorial, when the Respondent debated the merits of the Treaty, one factor that weighed in its favor was the "urgent need" of its economy for foreign capital. Memorial, I, p. 69.

[2] The Respondent itself agrees that the encouragement of investment was one of the aims of the Treaty. Counter-Memorial, *supra*, p. 31. Some other treaties of Friendship, Commerce, and Navigation ("FCN") entered into by the United States subsequent to this Treaty contain within their preamble a reference to the promotion of investment, but the object and purpose of all of these treaties are seen in their substantive provisions, which

Parties were concerned with the property and interests therein of each Party's corporations in the territory of the other. The 1961 Supplement, which constitutes "an integral part" of the Treaty[1], states in its preamble that the United States and Italy were "desirous of giving *added* encouragement to investments of one country in useful undertakings in the other country"[2]. The use of the word "added" shows that the original Treaty envisioned protection of investment[3]. To accept the Respondent's implied argument that the Treaty does not provide protection for United States investments in Italy would eviscerate large sections of the Treaty.

The emergence in recent years of bilateral investment treaties ("BITs") between the United States and developing countries is not relevant when interpreting this Treaty's protections for investments. BITs specifically address just investment issues rather than establish a comprehensive network governing both investments and other matters[4]. There is no reason why a later series of treaties with other countries dealing specifically with investment should weaken the provisions of this Treaty with Italy, which deals with investment and other matters.

Second, the Respondent incorrectly asserts that the only standards operating under this Treaty are a national treatment standard and a most-favored-nation standard. The ordinary meaning of the Treaty articles at issue in this dispute belies the Respondent's assertion. For instance, Article I of the Supplement establishes an unqualified rule prohibiting arbitrary and discriminatory conduct that prevents effective control and management by United States corporations of their subsidiaries in Italy or impairs their investments in those subsidiaries. Article V of the Treaty establishes an unqualified rule that property of United States corporations shall not be taken without due process of law and without just

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are largely identical and which all provide investment protections for corporations. Of course treaties create neither rights nor duties for third States. *See* 1969 Vienna Convention on the Law of Treaties, Art. 34.

[1] Treaty Supplement, Art. IX. The Vienna Convention on the Law of Treaties, Art. 31 (3), also provides that any subsequent agreement between the parties shall be taken into account when interpreting the Treaty.

[2] Treaty Supplement, Preamble (emphasis added). As stated in the ratification bill passed in Italy, "The supplemental Agreement . . . is designed above all to foster investment in Italy using private capital from the United States which is the most important, perhaps even the only, country today which has such resources at its disposal". Counter-Memorial, Ann. 9, *supra*, p. 114. (Materials from the Italian internal ratification proceedings are cited in this Reply to demonstrate that the two parties had a common understanding of the meaning and purpose of the Treaty. Standing alone, such internal ratification proceedings cannot, of course, bind another party.)

This Court has previously used the preamble of a treaty to establish its object and purpose. Case concerning *Rights of Nationals of the United States, Judgment, I.C.J. Reports 1952*, p. 24.

[3] Application of the Treaty provisions will not accentuate an "imbalance" between the Parties. Counter-Memorial, *supra*, p. 32. Even if it can be said that United States investments in Italy predominate the two Parties' economic relationship, the Respondent agreed to this Treaty not just to protect the ability of Italians to invest in the United States, but to secure for the Italian economy the benefits of United States capital in Italy. In this sense, the Italian "gain" under the Treaty predominates that of the United States. Whether one Party benefits at any given time more than the other Party is irrelevant to the agreement of each Party to abide by the provisions of the Treaty.

[4] The United States has negotiated BITs with Panama, Senegal, Haiti, Zaire, Morocco, Turkey, Cameroon, Bangladesh, Egypt and Grenada. None of these treaties is yet in force. The BITs draw on concepts of protection which were developed in the FCN treaties subsequent to World War II. Any greater specificity of investment protections in the BITs are attributable to innovations that address concerns particular to investments in developing countries. P. Gann, "The U.S. Bilateral Investment Treaty Program", 21 *Stanford Journal of International Law*, pp. 373-374 (1985).

compensation. Article III of the Treaty also establishes a virtually unqualified rule permitting United States corporations to organize, manage and control Italian corporations, subject only to certain guidelines under Italian law. In Article VII of the Treaty, there is a standard of reciprocity which requires the Respondent to allow United States corporations operating in Italy the same freedom to dispose of their immovable property or interests as is given to Italian corporations in the United States. The operative standard of treatment must be analyzed for each of the articles advanced by the United States.

Third, the Respondent is incorrect in implying that the United States' claim depends upon ELSI being a beneficiary under the Treaty. The Treaty provisions at issue specifically protect the rights, interests, and property of United States corporations such as Raytheon and Machlett, which invested in the Italian economy by means of an Italian subsidiary. The rights, interest, and property affected by the Respondent's actions belonged to Raytheon and Machlett, not ELSI[1]. In the case concerning the *Barcelona Traction, Light, and Power Company, Limited*, the Court recognized that whether particular rights and interests of shareholders are protected as a matter of international law may be governed in a particular case by the rules of an applicable international instrument[2]. The nature of the right, interest, or property at issue in this case is clear from the ordinary meaning of the Treaty provisions that apply within each category of protection. Those categories of protection are now discussed separately in light of the Counter-Memorial.

[1] The argument of the United States before the United States Supreme Court in *Sumitomo Shoji America, Inc.* v. *Avigliano*, cited in the Counter-Memorial, *supra*, p. 36, is not relevant to this case. In *Sumitomo* the United States argued that the United States *subsidiary* of a Japanese corporation was not capable under the particular language of Article VIII (1) of the United States-Japan FCN Treaty to avoid application of United States federal law. That case dealt with language particular to Article VIII (1) of that FCN Treaty. Further, *Sumitomo* did not discuss in any way the right of Japanese corporations to raise claims under that FCN Treaty in United States courts.

[2] *Judgment, Second Phase, I.C.J. Reports 1970*, paras. 54, 61, 62.

CHAPTER II

INTERFERENCE WITH MANAGEMENT AND CONTROL OF ELSI

The Respondent requisitioned the ELSI plant, delayed its decision as to the lawfulness of the requisition, and thwarted the normal bankruptcy process, instead of allowing an orderly liquidation of ELSI. These acts constitute interference with Raytheon's and Machlett's management and control of their subsidiary. Articles III and VII of the Treaty and Article I of the Supplement bar the Respondent from engaging in such interference.

Section 1. Article III of the Treaty

Article III of the Treaty guarantees that United States corporations may participate in corporate enterprises organized under the laws of Italy. Article III (2) creates a broad right for United States corporations to "organize, control and manage" Italian corporations engaged in commerce and manufacturing in conformity with applicable Italian law and regulations[1]. The facts of this case vividly show a denial of this right to control and manage. The respondent, however, tries to avoid application of the ordinary meaning of Article III (2) by making several incorrect assertions.

First, the Respondent contends that the unlawful requisition of the ELSI plant in "no way affected control by the shareholders" over ELSI, but rather "merely concerned the management by [ELSI] of some property belonging to [ELSI][2]". Yet a fundamental right of shareholders in controlling and managing a non-public corporation is the right to decide to liquidate or "wind-up" the business of that corporation. Under Article 17 of the By-Laws of ELSI, the right "of changing the legal nature of the Company, of winding up voluntarily the Company" was reserved exclusively to shareholders owning shares having an aggregate value of 90 per cent of the capital of ELSI[3]. After having made extensive investments in ELSI, Raytheon and Machlett alone had the right and the responsibility to decide to liquidate ELSI in an orderly fashion.

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[1] Art. III (2) of the Treaty states in part:

> "The nationals, corporations and associations of either High Contracting Party *shall be permitted*, in conformity with the applicable laws and regulations within the territories of the other High Contracting Party, *to organize, control and manage corporations* and associations of such other High Contracting Party for *engaging in commercial, manufacturing*, processing, mining, educational, philanthropic, religious and scientific *activities*." (Emphasis added.)

[2] Counter-Memorial, *supra*, p. 42. Contrary to the Respondent's assertion, the United States is not establishing an "autonomous principle of fair treatment". Counter-Memorial, *supra*, p. 35. The United States simply points out that the Treaty as a whole seeks to assure investors that investments will be given fair or equitable treatment. Memorial, I, p. 72. The concern with equitable treatment is expressly stated in the Preamble to the Supplement, which of course constitutes an integral part of the Treaty. *See* Treaty Supplement, Art. IX. The existence of other standards of treatment such as national treatment and most-favored-nation treatment does not preclude application of fair treatment.

[3] *ELSI — Elettronica Sicula S.p.A.*, By-Laws (Articles of Incorporation), Approved by the Shareholders Extraordinary Meeting of 19 July 1961, Art. 17 (Ann. 5 to this Reply).

Second, the fact that the requisition did not transfer ownership of ELSI to the Respondent[1] does not make the requisition any less of an interference with management and control. The requisition deprived any potential buyer of access to ELSI's physical assets, thereby making sale of ELSI as a going concern impossible. When President Carollo of Sicily informed Raytheon orally and in writing that the requisition would be prolonged indefinitely unless Raytheon abandoned its plan to wind up ELSI[2], it was clear that Raytheon and Machlett had completely lost their ability to manage and control ELSI, leaving them only the option of placing ELSI in bankruptcy as required by Italian law[3]. Ultimately the interference by the Respondent in the bankruptcy process even diminished the right of Raytheon and Machlett to receive any of the benefits of a normal bankruptcy sale, thereby forcing Raytheon and Machlett to pay off a greater share of ELSI's guaranteed debts that went unpaid due to the low proceeds from the bankruptcy. Whether or not the requisition involved transfer of title, it obviously involved interference with management and control.

Third, the Respondent seeks to justify its conduct under the first sentence of Article III (2) by asserting that the requisition was based on an Italian law and therefore was in "conformity with the applicable laws and regulations". Yet while that clause permits United States corporations to organize and control Italian corporations only within the guidelines established by local law, it does not call for United States corporations to receive treatment "no less favorable" than that accorded to corporations owned by local nationals, which is the clause used in the Treaty to trigger a national treatment standard[4]. Consequently the "applicable laws and regulations" clause must be interpreted to mean that the way in which management and control may be exercised is subject to regulation under local law, but the right to manage and control may not be abrogated entirely, regardless of the treatment accorded to Italian nationals[5].

Subject only to this constraint, the guarantee of treatment in the first sentence of Article III (2) is unqualified. Unqualified or "absolute" rules are used in FCNs to protect vital rights and privileges of foreign corporations in any situation, whether or not a host government provides the same rights to its own population[6].

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[1] Counter-Memorial, *supra*, p. 42.

[2] Memorial, I, pp. 55-56.

[3] *Ibid.*, pp. 56-57, 73-74.

[4] The "no less favorable" clause appears in various parts of the Treaty where a national treatment standard is intended. The clause also appears in the second sentence of Article III (2), but this sentence applies to corporations controlled by corporations in the other party. Hence, Article III (2) applies a national treatment standard to the rights and privileges *of ELSI* to engage in activities in Italy, but not to the rights of Raytheon and Machlett to control and manage ELSI.

[5] Herman Walker, a highly qualified writer in this area who was intimately involved in the negotiation of many FCNs, noted that the phrase "in conformity with applicable laws and regulations", as it occurs in this Treaty, "is framed in such a manner as to imply that it does not constitute a reservation detracting from the treaty rights; and such phraseology has been omitted from subsequent treaties". H. Walker, "Provisions on Companies in United States Commercial Treaties", 50 *American Journal of International Law*, p. 373, at p. 384, n. 53 (1956). In view of the possible ambiguity of this qualification, however, the Supplementary Agreement provided stronger protection by absolutely prohibiting arbitrary and discriminatory interference, whether or not in accordance with local law. *See infra*, Part V, Chap. II, Sec. 2.

[6] H. Walker, "Modern Treaties of Friendship, Commerce and Navigation", 42 *Minnesota Law Review*, p. 805, at pp. 811, 823 (1958). Mr. Walker states that in these situations foreign nationals are to receive "not only equal protection, but also a certain minimum degree of protection, as under international law, regardless of a Government's possible lapses with respect to its own citizens". H. Walker, "Treaties for the Encouragement and Protection

In any event, the "applicable laws and regulations" clause cannot excuse the Respondent's conduct in this case because the requisition of the plant by the Respondent was *not* in conformity with applicable laws and regulations. The Prefect of Palermo found the requisition to be illegal because it was not directed toward the goal stated by the Mayor of Palermo. The highest Italian court confirmed the Prefect's finding. To be in conformity with applicable laws and regulations, it is not enough that the Mayor of Palermo referenced certain laws when he requisitioned the plant. If mere reference to local laws satisfies Article III (2), then all acts of the Respondent could be excused in this way and the protection of Article III (2) would be rendered meaningless.

Even if the first sentence of Article III (2) is read as providing for treatment no less favorable than is provided to Italian corporations, the presumption must be that this Article was not meant to deprive United States corporations of advantages they would have otherwise enjoyed under international law[1]. Hence Article III (2) includes certain minimum standards of protection under international law, including protection from unlawful interference with management and control[2].

Thus, under either the standard set forth in Article III (2) or even under a national treatment standard, unlawful interference in the management and control of a United States-owned subsidiary violates Article III (2) of the Treaty.

Section 2. Article I of the Supplement

Article I *(a)* of the Supplement guarantees that United States corporations shall not be subject to arbitrary or discriminatory measures in Italy resulting particularly in preventing their effective control and management of enterprises which they have been permitted to establish or acquire in Italy[3]. This provision complements and reinforces the protections accorded to Raytheon and Machlett under Article III by establishing a completely unqualified rule[4] prohibiting inter-

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of Foreign Investment: Present United States Practice", 5 *American Journal of Comparative Law*, p. 229, at p. 232 (1956). Unqualified rules state the law of the treaty itself and may be assessed, as relevant, in accordance with principles of international law.

[1] H. P. Connell, "United States Protection of Private Foreign Investment through Treaties of Friendship, Commerce, and Navigation", 9 *Archiv des Volkerrechts*, p. 256, at p. 266 (1961-1962) (quoting Schwarzenberger at note 49: "Even if the standard of national treatment is laid down in a treaty, the presumption is that it has been the intention of the parties to secure to their nationals in this manner additional advantages, but not to deprive them of such rights as in any case, they would be entitled to enjoy under international customary law or the general principles of law recognized by civilized nations").

[2] When a State admits into its territory foreign investments in the form of juristic persons, that State is bound to extend to them the protection of the law and assumes obligations concerning the treatment to be afforded to them. Such obligations include the obligation to refrain from acts that deprive investors of the right to exercise management and control of their investment. *See*, e.g., *Revere Copper and Brass, Inc.* v. *Overseas Private Investment Corporation*, 56 *International Law Reports*, p. 258, at pp. 290-293, 295 (1980). The unlawful interference with Raytheon's and Machlett's management and control by the Respondent was a breach of its obligations under customary international law as preserved by the Treaty.

[3] Art. I *(a)* of the Supplement states:

> "The nationals, corporations and associations of either High Contracting Party *shall not be subjected to arbitrary or discriminatory measures* within the territories of the other High Contracting Party resulting particularly in: *(a) preventing* their *effective control and management of enterprises* which they have been permitted to establish or acquire therein . . ." (Emphasis added.)

[4] *See supra*, note 6, p. 382, and accompanying text.

ference with control and management by arbitrary and discriminatory conduct, regardless of Italian laws and regulations.

The Counter-Memorial strains to interpret the Respondent's actions as being directed only at ELSI and therefore as having no effect on Raytheon and Machlett's property[1]. Yet Article I *(a)* of the Supplement does not refer to property at all; it refers to control and management of enterprises established or acquired in Italy, which is precisely what is at issue here. Raytheon and Machlett were most certainly "subjected to" measures in Italy "resulting in" the prevention of their effective control and management of ELSI. The Respondent pretends that "the company organs, through which this control and management were performed, were able to function freely also during the period of the requisition"[2]. The "company organs" could still function, but there was nothing left for them to control and manage. This is precisely what Article I *(a)* of the Supplement was designed to prevent[3].

The Counter-Memorial tries to avoid Article I *(a)* by arguing that the requisition was not arbitrary because "arbitrary" means the same as "unreasonable" and the requisition was a reasonable step to take to deal with an emergency. The requisition was *both* arbitrary and unreasonable regardless of the problems of "social unrest" alleged by the Mayor of Palermo and used as the pretext for the requisition[4]. First, both the Prefect of Palermo and the Italian courts declared that the requisition was an unlawful act. An unlawful act is not a reasonable act under any system of legal obligations. Indeed the Prefect himself found that the law was "destitute of any juridical cause which may justify it or make it enforceable" and could not achieve the asserted objective of alleviating social unrest[5]. Second, the subsequent fate of ELSI shows that once the Respondent requisitioned the plant, the Respondent took absolutely no steps to alleviate the "social unrest", such as by reopening the plant. The goal expressed in the requisition order was not obtainable by the act he took and was therefore arbitrary. Third, even if the Respondent's actions were reasonably related to the goal stated, requisitioning a plant for political reasons is not a legally permissible goal under the Treaty. Indeed, the Respondent was completely unresponsive to Raytheon's and Machlett's efforts to stabilize ELSI financially, precipitating the conditions

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[1] Counter-Memorial, *supra*, p. 43. The Respondent's reading of this article runs counter to its asserted acceptance of the rules of interpretation set out in Articles 31 and 32 of the Vienna Convention on the Law of Treaties. Counter-Memorial, *supra*, pp. 30-31. The United States agrees that the rules of the Vienna Convention apply to the interpretation of this Treaty. The ordinary meaning of Article I *(a)* as well as the other provisions cited by the United States establishes the Respondent's wrongful conduct. Further the ordinary meaning of these provisions is the proper meaning within the context of the Treaty as a whole and in light of its object and purpose, which includes the promotion and protection of foreign investment. If reference to supplementary means of interpretation is necessary, in accordance with Article 32, these too confirm the interpretation of the Treaty provisions advanced by the United States.

[2] Counter-Memorial, *supra*, p. 43.

[3] At the time of the ratification of the bill introduced to implement the Supplement, the Respondent noted that "the first part of the [Supplement], which is certainly the most important, refers to the free transfer of capital and income by natural and corporate persons from the two contracting States, and their freedom to manage the companies which these natural or legal persons establish or procure." Counter-Memorial, Ann. 11, *supra*, p. 126.

[4] Counter-Memorial, *supra*, p. 12.

[5] Memorial, Judgment of Prefect of Palermo, 22 Aug. 1969, I, p. 362 (Ann. 76). *See* Memorial, I, p. 64. The Prefect found that the requisition could not possibly have achieved its stated purposes, because the requisition could not result in the re-employment of the workers or in the continued operation of the plant.

which led to the "social unrest". The real purpose of the requisition was not to stem "social unrest", but to wrest control of ELSI's plant, equipment, and assets from its rightful shareholders, Raytheon and Machlett. That purpose was arbitrary.

The existence of Italian laws which in some situations allow the Mayor of Palermo to requisition property does not make reasonable the improper and arbitrary application of those laws. Municipal legal systems, including those of Italy and the United States, and principles of international law, recognize that where the means employed do not fit the expressed goal, or are legally impermissible, then those means are arbitrary and unreasonable[1]. Within the context of the Treaty itself, which has as an objective the promotion of investment, the actions of the Respondent in seizing Raytheon's and Machlett's investment are also unreasonable and arbitrary.

The Respondent contends that the requisition was not discriminatory because requisitions of this kind frequently have been used with regard to plants belonging to Italian-owned companies. The Treaty, however, envisions protection from not just discrimination against foreign companies, but also from discrimination in favor of Government-controlled enterprises[2]. It is not sufficient to point to other requisitions where the Respondent also took over companies that were competitive with its own. Therefore at the time that Raytheon and Machlett invested in ELSI, and at the time this requisition occurred, Italian corporations apparently had never been treated in this fashion, and therefore the requisition may be said to be discriminatory.

Section 3. Article VII of the Treaty

Further protection against interference with management and control is given by Article VII of the Treaty. Article VII states that a United States corporation is entitled to acquire, own, and dispose of its immovable property or interests therein in Italy on terms no less favorable than those accorded to Italian corporations by the state of the United States under which the United States corporation is created[3].

The Respondent contends that since the plant and assets belonged to ELSI, the only property to which Article VII could apply is the shares in ELSI held by Raytheon and Machlett; since Raytheon and Machlett were free to dispose of

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[1] Memorial, I, pp. 77-80.

[2] *See*, e.g., Art. XVIII of the Treaty and para. 2 of the Protocol.

[3] Art. VII of the Treaty states in part:

> "The nationals, corporations and associations of either High Contracting Party shall be permitted to . . . dispose of immovable property or interests therein within the territories of the other High Contracting Party upon the following terms:
>
> . . . . . .
>
> *(b)* in the case of nationals, corporations and associations of the United States of America, the right to acquire, own and dispose of such property upon terms no less favorable than those which are or may hereafter be accorded by the States, territory or possession of the United States of America . . . under the laws of which such corporation or association is created or organized, to . . . corporations . . . of the Italian Republic; provided that the Italian Republic shall not be obligated to accord to nationals, corporations and associations of the United States of America rights in this connection more extensive than those which are or may hereafter be accorded within the territories of such Republic to nationals, corporations and associations of such Republic."

their shares at all times, Article VII was not violated. Even if the protection of Article VII were limited to the shares, the value of Raytheon's and Machlett's shares was essentially reduced to nothing. Prior to the requisition, the shares had a value reflecting ELSI as a going concern, and the shareholders could control and manage fundamental changes in the status of ELSI, such as an orderly liquidation. After the requisition, however, Raytheon and Machlett were only "free" to dispose of their shares by declaring ELSI bankrupt and by paying portions of ELSI's guaranteed debts that would have been paid from proceeds of an orderly liquidation.

Yet Article VII is actually concerned with "immovable property or interests therein". "Interests" in property is a phrase sufficiently broad to include indirect ownership of property rights held through a subsidiary that is not a United States corporation[1]. Raytheon's and Machlett's interests in ELSI's plant, equipment, and work-in-process were obliterated by the unlawful requisition and subsequent treatment in the bankruptcy process. The fact that the requisition period was for six months is irrelevant since Raytheon and Machlett, facing no prospect of an orderly liquidation, were forced to have ELSI declared bankrupt within the first month of the requisition.

The standard of treatment operating in Article VII is one of reciprocity. A national treatment standard is applied only if the reciprocity standard is higher than the standard of national treatment. To establish the reciprocity standard of treatment, the United States has shown that under both Delaware and Connecticut law, corporations may be dissolved and their assets sold pursuant to determinations of their boards of directors and shareholders[2]. If Delaware or Connecticut were to interfere substantially with a parent corporation's right to dissolve its subsidiary, even if for a lawful public use, it would be obligated to pay compensation for that property[3]. The Respondent has not shown that this standard of treatment is higher than that accorded by the Respondent to its own corporations. Unless the Respondent can show that it may illegally requisition a wholly owned subsidiary of an Italian corporation, without paying compensation to that corporation, then the standard of reciprocity applies.

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[1] *Starrett Housing Corp et al.* v. *Islamic Republic of Iran*, Awd. No. 314-24-1, p. 124 (14 Aug. 1987); *Amoco International Finance Corp.* v. *Government of Iran*, Partial Awd. No. 310-56-3, pp. 47-48 (14 July 1987); *Sedco Inc.* v. *National Iranian Oil Company*, Awd. No. 309-129-3, pp. 22-23 n. 9 (7 July 1987) ("The term 'interests in property' clearly is broad enough to encompass property owned indirectly through subsidiary corporations").

[2] Memorial, I, pp. 81-82.

[3] The duty to compensate extends beyond property rights taken solely pursuant to a formal expropriation decree. Memorial, I, p. 82.

CHAPTER III

IMPAIRMENT OF INVESTMENT RIGHTS AND INTERESTS

The previous chapter concerned Treaty provisions that protected investors' rights in managing and controlling their investment. This chapter concerns an equally significant protection against measures that impair the value of that investment. Article I *(b)* of the Supplement provides that United States corporations shall not be subjected to arbitrary and discriminatory measures in Italy which result particularly in impairing either their legally acquired rights and interests in Italian enterprises or their investments[1]. Specifically, the Supplement protects against impairment of rights, interests, and investments "in the form of funds (loans, shares, or otherwise)".

This broad language envisions protection of *all* financial commitments made for the benefit of ELSI, whether in the form of direct capital contributions, loans, loan guarantees, or open accounts[2]. Further, the financial loss incurred by Raytheon in defending the suits brought by Italian banks subsequent to the Respondent's arbitrary measures is also within the scope of the Supplement because that loss represents a burden on or impairment of Raytheon's legally acquired interests in ELSI[3]. The requisition of the plant, which caused Raytheon and Machlett to place ELSI in bankruptcy, and the subsequent acquisition of the plant, assets, and work-in-process of ELSI, clearly impaired investment rights and interests in ELSI. The requisition prevented voluntary liquidation of ELSI and caused it to file for bankruptcy. The impairment continued with the subsequent conduct of Italian officials in a series of concerted actions to acquire for ELTEL the ELSI plant and assets at less than fair market value, leaving Raytheon to pay ELSI's outstanding guaranteed debts and to defend lawsuits brought by ELSI's unsecured, unguaranteed debtors[4].

Once again the Respondent argues that the property of Raytheon and Machlett was not actually affected by the requisition because it was addressed to ELSI[5]. But Article I *(b)* of the Supplement does not protect against just direct seizure of tangible property belonging to United States investors; it prohibits arbitrary and discriminatory measures which "impair" United States corporation's rights and interests in and loans to Italian entities[6]. Clearly Raytheon's and Machlett's rights and interests were impaired. Acceptance of the Respondent's argument would eviscerate the ordinary meaning of this article.

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[1] For a discussion of the arbitrary and discriminatory nature of the Respondent's acts, *see supra*, Part V, Chapter II, Sec. 2.

[2] The Respondent seeks to differentiate between such financial commitments, Counter-Memorial, *supra*, p. 48, but there is no basis in the language of the Treaty for doing so. Loan guarantees represent as much of a financial commitment as any direct loan, especially where, as in this case, the guarantor actually has to pay off the loan. The Respondent itself has recognized that investments which are eligible for protection include equity interests in the form of loan guarantees. *See Operational Regulations of the Multilateral Investment Guarantee Agency*, Art. 1.04 (vi), signed by Italy on 17 Feb. 1986.

[3] Memorial, I, p. 85.

[4] *Ibid.*, at pp. 85-88.

[5] Counter-Memorial, *supra*, p. 43.

[6] The ordinary meaning of "impair" suggests a wide scope of protection. This interpretation comports with the desire of Italy in negotiating the Supplement "to remove any obstacles to the inflow of private American capital . . .". Italian Ann. 9, *supra*, p. 112.

CHAPTER IV

WRONGFUL TAKING OF INTERESTS IN PROPERTY

The Treaty also protects against government taking of property without compensation. Article V (2) of the Treaty provides that property of United States corporations within Italy shall not be taken without due process of law and without the prompt payment of just and effective compensation[1]. Paragraph 1 of the Protocol to the Treaty provides that the provisions of Article V (2) shall "extend to interests held directly or indirectly" by United States corporations. Both the Respondent's act of requisitioning the ELSI plant and its subsequent acts in acquiring the plant, assets and work-in-process singly and in combination constitute takings of property without due process of law or just compensation.

The Respondent agrees that Article V (2) accords protection to United States corporations against the taking of property and agrees that this protection was extended by the Protocol to interests held directly or indirectly by a United States company[2]. Yet despite unambiguous language to the contrary, the Counter-Memorial implies that the standard of protection in the Protocol given to "interests held directly or indirectly" is somehow different than the standard of protection given to property in Article V (2) of the Treaty[3]. This is contrary to the explicit language of the Protocol which states:

> "The provisions of paragraph 2 of Article V, providing for the payment of compensation, shall extend to interests held directly or indirectly by . . . corporations . . . of either High Contracting Party in property which is taken within the territories of the other High Contracting Party."

There is no mention in the Protocol of any different standard of protection from that which exists in Article V; to the contrary, the Protocol "extends" Article V (2). The weakness of the Respondent's interpretation is further made evident in that the Respondent does not even try to establish what this different standard is or whether the standard was met in the treatment of Raytheon and Machlett.

The Counter-Memorial also asserts that Paragraph 1 of the Protocol accords protection "only to rights to property" because the Italian text of the Protocol uses the word "diritti" (which can be translated as "rights") and Vienna Convention Article 33 (4) requires application of the more restrictive meaning[4]. Although "interests" properly reflects the meaning of "diritti" in the Protocol[5], it must be recognized that the Protocol extends Article V to interests (or under the Respon-

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[1] Article V (2) of the Treaty provides that:

> "The *property* of nationals, corporations and associations of either High Contracting Party *shall not be taken* within the territories of the other High Contracting Party without due process of law and *without the prompt payment of just and effective compensation.*" (Emphasis added.)

[2] Counter-Memorial, *supra*, p. 40.

[3] *Ibid.*

[4] *Ibid.*

[5] "Diritti" is also translated as "interests" in other parts of the Treaty, such as Art. VII (1) *(a)*.

dent's interpretation "rights") "held directly or indirectly" by Raytheon and Machlett. Therefore it is clear that indirect rights to property are also protected[1].

The Respondent denies that the requisition of the ELSI plant can be considered an "expropriation" or "taking" of property, since it was simply a "requisition in use" for which the Commune of Palermo received no financial benefit[2]. Yet a "taking" is generally recognized as including not merely outright expropriation of property[3], but also unreasonable interference with its use, enjoyment, or disposal[4]. The requisition of the plant prevented an orderly liquidation of ELSI, thereby causing Raytheon and Machlett to place ELSI in bankruptcy. The Respondent then proceeded through ELTEL to acquire the ELSI plant and assets for less than fair market value. Consequently the Respondent's acts so substantially interfered in the use and disposal of Raytheon's and Machlett's indirect interests in the ELSI property that a taking occurred. This taking gave rise to a right to compensation.

Whether the Commune of Palermo ultimately gained from the action of its Mayor is irrelevant. The Treaty does not require that the Respondent benefit from its taking; it is sufficient that Raytheon and Machlett were deprived of the use and disposal of their interests in ELSI. In any event, the Respondent gained considerably from this requisition because it prevented an orderly liquidation of ELSI and led to ELTEL's acquisition of ELSI's plant, assets, and work-in-process for far less than ELTEL would have had to pay had there been no interference.

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[1] The Respondent's reliance on Article 34 (3) of the Vienna Convention on the Law of Treaties is also misplaced. By its terms Article 33 (4) should not be used unless interpretation in accordance with Articles 31 and 32 does not resolve the difference of meaning. An analysis under Articles 31 and 32 of the meaning of "diritti" shows that the Protocol, placed in context as an extension of Article V, goes beyond the protection accorded in Article V to direct property rights. Therefore the Protocol seeks to protect "interests" in property, not just "rights" in property, since "rights" in property are already protected by Article V. Even if resort to Article 33 (4) of the Vienna Convention is necessary, that Article does not call for application of the most restrictive meaning, but rather the application of the meaning which best reconciles the two texts, having regard to the object and purpose of the Treaty. Both international courts, e.g., *Wemhoff* case [1968], *Pub. Eur. Ct. of Human Rights*, Ser. A (Judgment of 27 June 1968), and even Italian courts, e.g., *Ministero della Difesa* v. *Società Rimorchiatori Napoletani*, Cassazione, 9 Dec. 1974, No. 4106, pp. 307-309, have rejected the approach taken here by the Respondent.

[2] Counter-Memorial, *supra*, pp. 11, 40.

[3] The use of "beni espropriati" in the Italian text of the Treaty should not be read as a restriction on this protection. The Respondent itself recognized that the principle of expropriation was developed in Article V precisely for the purpose of protecting the investment of capital in a broad sense.

> "The advisability and importance of this clause is quite evident because of the peculiar economic and financial structure of our country, in which the accumulation of savings does not correspond to productive needs or to any program of full employment. The influx of foreign capital represents an indispensable supplement for our country."

Memorial, Chamber of Deputies, Parliamentary Proceedings Documents — Bills and Reports, N. 246-A, Page 4, Presented to the Office of the President, 2 Mar. 1949, I, p. 117 (Ann. 3). *See* Counter-Memorial, Ann. 4, *supra*, p. 63.

[4] For an extensive discussion of the concept of "taking" and "expropriation" in international law, *see* Memorial, I, pp. 89-92.

CHAPTER V

FAILURE TO PROVIDE PROTECTION AND SECURITY

A final area of protection under the Treaty denied to Raytheon and Machlett concerned the protection and security of their property. Article V (1) of the Treaty 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[1]. Article V (3) provides that United States corporations shall receive in Italy no less protection and security than that accorded to Italian corporations and other foreign corporations.

The delay in ruling on the challenge to the requisition order until immediately after the ELSI plant, equipment and work-in-process had been acquired by ELTEL was a denial of the level of procedural justice accorded by international law[2]. Normally the legality of the requisition would have been reviewed within 30 days after the date the ruling was sought, which in the case of ELSI was on 19 April 1968[3].

A timely decision by the Prefect could have avoided the need to place ELSI in bankruptcy because while the voluntary petition in bankruptcy was filed on 26 April 1968, ELSI was not in fact declared bankrupt until 16 May 1968. Thus, if the requisition had been rescinded, the bankruptcy could have been avoided by ELSI asking the bankruptcy judge to deny the petition.

The occupation of the plant, which resulted in its deterioration and impeded the Trustee's efforts to dispose of it, occurred with the tacit approval of the local government authorities[4]. It no doubt discouraged potential buyers from inspecting the plant and assets and generally chilled the process of selling ELSI for its full value. Therefore this action also constituted a denial of "constant protection and security", thereby violating Articles V (1) and (3) of the Treaty regardless of whether physical damage actually occurred from the occupation.

The Respondent implies that Article V only protects immovable property and any failure in ruling within a reasonable time or in protecting the plant was not a failure to protect immovable property of Raytheon and Machlett. This construction of Article V is unjustified. Article V (3) states:

> "The . . . corporations . . . of either High Contracting Party shall within the territories of the other High Contracting Party receive protection and

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[1] Art. V (1) of the Treaty states in pertinent part:

> "The nationals of each High Contracting Party *shall receive*, within the territories of the other High Contracting Party, the *most constant protection and security for their* persons and property, and shall enjoy in this respect *the full protection and security required by international law*." (Emphasis added.)

[2] Memorial, I, pp. 99-100.

[3] *Ibid.*, p. 64.

[4] *Ibid.*, pp. 100-101. The Respondent is incorrect that the occupation of the plant by the workers occurred prior to the requisition. Although some brief, intermittent strikes known in Italy as "hiccup" strikes occurred at the plant prior to 1 April 1968, there was no long-term, indefinite control of the plant by the workers. Memorial, Ann. 21, paras. 16-17. Further, the Respondent did not do anything to keep the workers out of the plant nor to "preserve" the value of the plant.

security with respect to the matters enumerated in paragraphs 1 and 2 of this Article."

Articles V (1) and (2) speak of protection and security for "persons" and "property", not "immovable property". Property in its ordinary sense is not confined to immovable property[1], and when the Treaty intends to cover immovable property, such as in Article VII, it expressly says so.

In this case, the property of Raytheon and Machlett in Italy was ELSI itself. The entire entity of ELSI — plant, equipment, receivables, inventories, goodwill, and other intangibles — was at stake when the requisition occurred. The Respondent was obligated to protect ELSI from the deleterious effects of the unlawful requisition. The failure to overturn the Mayor's order, and the failure to provide ELSI with any security from trespass, deprived Raytheon and Machlett of the security and protection for their investment to which they, as 100 per cent owners of ELSI, were entitled.

[1] For instance, under rules of customary international law, takings of property concern expropriation of all rights in the investment, not just in the right to possession of immovable plant and equipment. *See*, e.g., *Revere Copper and Brass, Inc.* v. *Overseas Private Investment Corporation*, 56 *International Law Reports*, pp. 258, 290-293.

PART VI. COMPENSATION

CHAPTER I

THE DUTY TO PAY AND MEASURE OF COMPENSATION

As set forth in the United States Memorial, the United States is entitled to compensation in the full amount of the losses resulting from the wrongful conduct of the Government of Italy[1]. Compensation should be measured in this case by the injuries suffered by Raytheon and Machlett[2].

All of the injuries suffered by Raytheon and Machlett should be included in the measure of compensation. A State may discharge its duty to make reparation by implementing measures designed to re-establish the situation prior to the wrongful act, i.e., *restitutio in integrum*[3]. Where it is not possible to restore the situation that would have existed if the wrongful act had not been committed, or restoration does not fully redress the injury caused by the State's unlawful act, damages should be awarded in lieu of restitution to compensate for all losses or injury caused by a State's wrongful acts[4].

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[1] For a complete discussion of Respondent's obligation to make full compensation, *see* Memorial, I, pp. 102-103.

[2] The Respondent correctly notes that the losses suffered by nationals are not necessarily identical to those suffered by the State. Counter-Memorial, *supra*, p. 47, n. 3. However, international tribunals and commentators have recognized that damage to the national as a result of a violation of a treaty or customary international law may serve as a measure of the compensation to the injured State, particularly where, as in this case, the treaty provision was designed to protect the parties' respective nationals and the violation of the treaty provision caused direct financial loss to the national. *See* Memorial, I, pp. 103-106.

[3] Memorial, I, p. 104.

[4] *Ibid.*, pp. 104-106.

CHAPTER II

THE NATURE OF THE INJURY

Section 1. Raytheon and Machlett Suffered Financial Losses with Respect to Loan Guarantee Payments, Return of Investment and Open Accounts

The requisition directly prevented the orderly liquidation of ELSI. Had the Respondent not interfered with the liquidation, Raytheon and Machlett would have recovered the market value of ELSI as a going concern in 1968. The book value of ELSI — the closest available approximation of going concern value in this case[1] — was 17,053.5 million lire as of 31 March 1968. This amount would have allowed payment of all of ELSI's creditors in full (including Raytheon)[2], payment of all administrative costs, and would have even returned 391 million lire to Raytheon and Machlett as a small return of the large investments they had previously made in ELSI. This amount would have been insufficient to recoup Raytheon's and Machlett's investment in ELSI, since they still would have lost over US$11 million in investments made since 1956.

By contrast, the Trustee in bankruptcy recovered only 6,373.8 million lire from the sale of ELSI's assets to ELTEL. Raytheon and Machlett, therefore, lost the full value of their open accounts with ELSI[3] and, more importantly, were required to pay all of the guaranteed loans[4], thus incurring some 6,931.4 million lire in losses. The difference between Raytheon's and Machlett's position had they been permitted to proceed with the orderly liquidation (recovery of 391 million lire) and the losses they sustained as the result of the Respondent's interference (net loss of 6,931.4 million lire) is 7,322.4 million lire (US$11,739,200)[5].

Section 2. Raytheon Incurred Substantial Legal Expenses

In addition, as a further direct consequence of the Respondent's actions in violation of the Treaty, Raytheon incurred more than US$939,800 in outside

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[1] *See infra*, Part VI, Chapter III.

[2] The United States has declined to claim compensation based both on sale of ELSI's assets for book value *and* settlement with the large unsecured, unguaranteed creditors. The damages claimed in this case are based on the premise that had Raytheon and Machlett recovered book value or greater, all creditor claims could have been satisfied in full.

[3] That Raytheon and Machlett declined to file a claim for their open accounts with ELSI in the bankruptcy process is irrelevant to the question whether they are entitled to recover the losses associated with the open accounts as a result of the Respondent's violations of the Treaty. However, it should be noted that the principal reason Raytheon did not seek recovery for the open accounts in the bankruptcy process was the inescapable fact that due to the requisition and Respondent's subsequent interference in the bankruptcy process, Raytheon and Machlett would not have recovered sufficient compensation in the bankruptcy process to justify the cost of filing a claim for their open accounts.

[4] The Court should reject the Respondent's assertion that the Respondent is not responsible for payments of the guaranteed loans. First, as demonstrated *supra*, Part V, Chapter III, guaranteed loans are a type of investment specifically protected by the Treaty. Equally important, Raytheon's out-of-pocket expenses associated with payment of the guaranteed loans would not have been incurred but for the Respondent's requisition of ELSI's plant and assets, and are therefore a direct loss compensable under international law. *See* Memorial, I, p. 106.

[5] For a complete discussion of Raytheon's and Machlett's actual financial losses as compared to the planned orderly liquidation, *see* Memorial, I, pp. 106-108.

legal and related expenses in connection with the bankruptcy proceedings, in defending against suits brought by Italian bank creditors in Italian courts, and in pursuing its claim against the Respondent for its actions against ELSI[1]. The Respondent's allegation that the legal expenses incurred by Raytheon were not proximately caused by the infringement of the Treaty must be rejected. As a factual matter, had the Respondent permitted Raytheon and Machlett to proceed with the orderly liquidation plan, Raytheon would not have incurred these costs since the banks would have been paid in full or in settlement.

Furthermore, reimbursement for legals costs arising from an unlawful act is widely recognized by international tribunals[2].

Section 3. Compensation Received by the Trustee for the Unlawful Requisition Was Inadequate

The only "compensation" paid for the requisition was limited to 114 million lire, considered to be the rental value of ELSI during the requisition period. The Court of Appeals of Palermo rejected the claim by the Trustee for the diminution of the value of ELSI's assets and for ELSI's inability to dispose of its plant and assets during the same period[3]. The amount of the judgment was paid to the Trustee who, after deducting costs and expenses, distributed the proceeds to ELSI's creditors[4]. This amount has been taken into account in the calculation of compensation requested in this case.

[1] For a complete discussion of the legal and related expenses incurred by Raytheon, *see* Memorial, I, pp. 109-110. The Counter-Memorial asserts that Raytheon was awarded costs by Italian legal courts, which include "fees corresponding to lawyers tariffs". Counter-Memorial, *supra*, p. 49. Raytheon did receive nominal court costs, but this amount was not sufficient to cover all legal expenses.

[2] Memorial, I, p. 109. *See* M. Whiteman, Vol. III, *Damages in International Law*, pp. 1998, 2005, 2020-2021 (1943), discussing the cases of *Thomas W. Mather (United States* v. *Mexico)* (award included amount for legal expenses incurred by claimants to procure the return of gold seized by Mexican troops) and the *Louisa (United States* v. *Mexico)* (award included amount for legal expenses incurred in prosecution of claim relating to seizure of cargo); L. Sohn and R. Baxter, "Convention on the International Responsibility of States for Injuries to Aliens" ("revised Harvard Draft Convention"), *reprinted in* F. V. Garcia-Amador, L. Sohn and R. Baxter, *Recent Codification of the Law of State Responsibility for Injuries to Aliens*, p. 133 (1974) (Art. 36 states that a "claimant shall be reimbursed for those expenses incurred by him in the local and international prosecution of his claim which are reasonable in amount and the incurrence of which was necessary to obtain reparation on the international plane").

[3] Memorial, Ann. 81.

[4] *Ibid.*, Ann. 26, Attachment.

CHAPTER III

ENTITLEMENT TO THE VALUE OF ELSI AS A GOING CONCERN

The starting point for the calculation of compensation is the value that would have been realized by Raytheon and Machlett by the sale of ELSI as a going concern in the orderly liquidation. Going concern value typically includes the fair market value of the company's assets and the future profits of the company's continued operations. In ELSI's case, however, the actions of the Respondent made it impossible for ELSI to become self-sufficient. Thus, while those familiar with ELSI's operations and its potential for sale determined that the intangible value of ELSI's product lines in an orderly liquidation would command a value[1], it was not then — and is not now — possible to place an exact value on these assets or on the future earnings potential of each line.

The closest remaining approximation of ELSI's going concern value is the book value of the assets as of 31 March 1968: 17,053 million lire. Book value, being merely an accounting tool, does not measure going concern value as such, because it merely values assets at acquisition cost less depreciation. This is so also with respect to any asset, such as land and buildings, which may have appreciated in value. It does not measure the actual market value of the assets or the full intangible value of the company, and therefore understates ELSI's real economic worth[2].

The Respondent does not argue that the United States is not entitled to the value of ELSI as a going concern. Instead, the Respondent argues that book value does not reflect the market value of the assets[3]. First, the balance sheet drawn up as of 31 March 1968 was current within the framework of ELSI's system of financial accounting, was supported by reliable records, and therefore is the valuation that most closely approximates the value of ELSI's assets at that time[4]. Second, while book value does not take into account the deterioration in value of ELSI's assets as a result of the delay caused by the bankruptcy, Raytheon and Machlett are entitled to the value of ELSI at the time of the Respondent's wrongful interference with the orderly liquidation, not at the expiration of, or at any point during the bankruptcy process. It was the Respondent — not Raytheon or Machlett — who caused and interfered with the bankruptcy process and thereby caused the delay in the purchase of ELSI's assets. The Respondent, therefore, is responsible for any decrease in the value of ELSI's assets due to this delay.

The Counter-Memorial also implies that the Court should reject the compensation sought on the basis that it is supported by "documents originating from ELSI or Raytheon or on affidavits of persons closely connected with Raytheon"[5]. Again, this assertion should be rejected. International arbitrations have long accorded probative value to affidavits of interested parties, particularly those that

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[1] Memorial, Ann. 13, para. 15.

[2] Of course, if the Respondent had made available the investment incentives it had promised or had otherwise become involved with ELSI prior to the requisition, ELSI's book value would have been substantially higher.

[3] *See* Counter-Memorial, *supra*, p. 47.

[4] *See supra*, Part II, Chapter I, Sec. 3.

[5] Counter-Memorial, *supra*, p. 47.

are based on personal knowledge and are corroborated by contemporaneous business records, such as those presented in support of this case[1].

The Respondent does not offer an alternative method of valuation. Instead, the Respondent merely questions whether some other measure properly reflects the value of ELSI. As the following discussion demonstrates, neither the quick-sale value, the valuation performed by the judicial valuator, nor the valuation submitted by ELTEL properly establish the market value of ELSI in the spring of 1968.

Consistent with its recognized limited use, ELSI's management created a worst case scenario for the sale of ELSI's assets for purposes of internal corporate planning by ELSI's shareholders. In so doing, they established what is referred to as a "quick-sale" value. This value was calculated by discounting the book value of ELSI's assets in order to identify a worst-case minimum realizable value of ELSI's plant and tangible assets in an orderly liquidation. The quick-sale value was an internal determination of the minimum guaranteed return on the sale constructed for planning purposes. It does not reflect the full value of ELSI's tangible assets or their market value, nor does it take into account the significant intangible value of ELSI's business[2]. In addition, it did not include construction in process, studies in process, deferred costs and other smaller book-value items[3].

The Counter-Memorial erroneously places substantial probative weight on the United States use of the quick-sale value in the 1974 diplomatic claim. Obviously, the use of a quick-sale value in the original claim is not dispositive of the proper measure of ELSI's going concern value. The value was used as a matter of convenience in the diplomatic claim and in the spirit of compromise on which a settlement of the dispute might be based. As this claim has now been brought to the Court for resolution, the United States has a right to the full measure of compensation for injuries imposed by the Respondent.

The valuations performed by the bankruptcy valuator and the valuation submitted by ELTEL should both be rejected as they do not assess the going concern value of ELSI at the time of the requisition. The bankruptcy valuator attempted to value ELSI's assets as of 11 October 1968, more than five months after the time of the Respondent's wrongdoing. Moreover, the valuation which was presented to the bankruptcy judge by ELTEL two days after the third auction, and more than a year after the illegal requisition, clearly under-valued ELSI's plant, machinery and equipment[4]. This valuation also failed to include all of ELSI's assets, such as those in Milan and Rome, and the X-ray, semiconductor, complex components and other product lines. Of course this valuation was prepared by ELTEL's parent company, Siemens S.p.A., itself a member of the IRI group, and therefore cannot be considered an objective assessment of ELSI's true value.

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[1] Sandifer, *Evidence Before International Tribunals*, (1975), pp. 351-355; *see*, e.g., *Gill* case, 5 *Reports of International Arbitral Awards*, pp. 157-159 (1931) (affidavit corroborated by letters from British Minister and employer); *Stacpoole* case, 5 *Reports of International Arbitral Awards*, pp. 95, 96 (affidavit corroborated by distinterested party seven years after loss); *Tracy* case, 5 *Reports of International Arbitral Awards*, pp. 90, 92 (1930) (claimant's affidavit corroborated by affidavit from someone in position to know the facts of loss).

[2] The intangibles include ELSI's reputation as a producer of reliable electronic products, experience and know-how in the electronics industry, its supplier and customer lists and market reputation, patent licenses and other rights to technology supplied by Raytheon and Machlett, the technical assistance agreements that would have been executed by Raytheon and the new purchasers, and the value of existing contracts.

[3] The difference between the 193 million lire quick-sale price and the 217 million lire price established by the court-appointed valuator for work in process is stark evidence of the artificially low value of the quick-sale estimate for purposes of a worst-case scenario.

[4] Counter-Memorial, Vol. 5 (Unnumbered Documents, Vol. III).

CHAPTER IV

THE AWARD OF INTEREST

Compensation awarded should include interest, compounded annually, from the date of the requisition until the date of the award[1]. The circumstances in this case not only call for an award of interest but also require that the rate and calculation of the total amount reflect the commercial realities of the case. Raytheon and Machlett invested in ELSI with the goal of obtaining a return on their investment. These same commercial considerations were paramount in Raytheon's and Machlett's decision to engage in an orderly liquidation of ELSI's assets. The Respondent's requisition of ELSI's assets and interference with the ensuing bankruptcy frustrated Raytheon's and Machlett's investment objective, deprived Raytheon and Machlett of funds to satisfy ELSI's creditors, and caused Raytheon and Machlett to pay ELSI's debts from its own funds. Thus, the Respondent is responsible for the loss of the use of the revenue and funds over time.

The Respondent asks this Court not to award interest because the application to the Court could have been made "many years earlier"[2]. However, the Respondent presents no legal support for the proposition that delay in filing a claim is a bar to an award of interest. The Respondent's argument is also based on a faulty factual premise — that any delay in the filing of the claim is attributable to actions of the United States, Raytheon, or Machlett. The injured parties did not delay in seeking redress for their grievances. The claims asserted in this case were communicated to the Respondent immediately after the requisition and by a diplomatic claim provided to the Respondent in 1972 and formally presented in 1974. Subsequent to the presentation of that claim, the two Governments have been in diplomatic communication in an attempt to reach a negotiated settlement of the dispute. In short, the Respondent can claim no prejudice as a result of the passage of time which would entitle it to a reduction in or absolution from the obligation to pay interest on this claim or to attribute the delay to the claimants. Indeed, Respondent has *benefited* from the value of Raytheon's and Machlett's lost investment in ELSI since the time of the requisition and should now be held accountable for it.

The Respondent's reliance on the *Corfu Channel* case as a basis for denial of an award of interest is misplaced[3]. The question of interest was not before the Court in that case, as the United Kingdom did not assert a claim for interest. Thus, the Respondent has presented no basis for a refusal to award interest in this case.

Interest awarded should be compounded annually[4]. The Respondent bases its opposition to an award of compound interest on the ground that it was not awarded in the case involving *British Property in the Spanish Zone of Morocco*[5]. Although the arbitrator in that case did award simple interest, he went on to

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[1] For a complete discussion of the award of interest, see Memorial, I, pp. 110-115.
[2] Counter-Memorial, *supra*, p. 49.
[3] *Ibid.*
[4] Memorial, I, pp. 114-115.
[5] 2 *Reports of International Arbitral Awards*, p. 650 (1924), cited in the Counter-Memorial, *supra*, p. 49.

recognize that there are situations where compound interest is proper[1]. An award of compound interest is compelling in this case since Raytheon and Machlett have lost the use of their funds for nearly 20 years. If Raytheon and Machlett had not suffered the financial losses they did, these funds would either have generated additional earnings or would have been used to repay debt. These funds therefore would have generated either interest earnings or interest savings, which in turn would have been devoted to profitable use. Each year that compensation is not awarded to Raytheon and Machlett, the injury to them is in fact compounded. Thus, the actual loss to Raytheon and Machlett is most closely approximated by calculating interest at a commercial borrowing rate, compounded annually.

[1] Counter-Memorial, *supra*, p. 49. *See also Case of Antoine Fabiani*, summarized in M. Whiteman, *op. cit.*, at pp. 1785-1789; *American Independent Oil Co.* v. *The Government of the State of Kuwait*, 21 *International Legal Materials*, p. 976, at p. 1042 (1982).

SUBMISSIONS

Accordingly, the United States submits to the Court that it is entitled to a declaration and judgment that:

(a) the claims brought by the United States are admissible before the Court since all reasonable local remedies have been exhausted;

(b) Italy — by engaging in the acts and omissions described above and in the Memorial, which prevented Raytheon and Machlett, United States corporations, from liquidating the assets of their wholly owned Italian corporation ELSI and caused the latter's bankruptcy, and by its subsequent actions and omissions — violated the international legal obligations which it undertook by the Treaty of Friendship, Commerce and Navigation between the two countries, and the Supplement thereto, and in particular, violated:

— Article III (2), in that Italy's actions and omissions prevented Raytheon and Machlett from exercising their right to manage and control an Italian corporation;
— Article (V) (1) and (3), in that Italy's actions and omissions constituted a failure to provide the full protection and security as required by the Treaty and by international law;
— Article V (2), in that Italy's actions and omissions constituted a taking of Raytheon's and Machlett's interests in property without just compensation and due process of law;
— Article VII, in that these actions and omissions denied Raytheon and Machlett the right to dispose of their interests in immovable property on terms no less favorable than an Italian corporation would enjoy on a reciprocal basis;
— Article I of the Supplement, in that the treatment afforded Raytheon and Machlett was both arbitrary and discriminatory, prevented their effective control and management of ELSI, and also impaired their other legally acquired rights and interests;

(c) that, owing to these violations of the Treaty and Supplement, singly and in combination, the United States is entitled to compensation in an amount equal to the full amount of the damage suffered by Raytheon and Machlett as a consequence, including their losses on investment, guaranteed loans, and open accounts, the legal expenses incurred by Raytheon in connection with the bankruptcy, in defending against related litigation and in pursuing its claim, and interest on such amounts computed at the United States prime rate from the date of loss to the date of payment of the award, compounded on an annual basis; and

(d) that Italy accordingly should pay to the United States the amount of US$12,679,000, plus interest, computed as described above and in the Memorial.

18 March 1988.

(Signed) Abraham D. SOFAER,
Agent of the United States
of America.

(Signed) Arnold I. BURNS,
Deputy Attorney General,
Department of Justice.

ANNEXES TO THE REPLY OF THE UNITED STATES OF AMERICA

Annex 1

STATEMENT BY PROFESSOR FRANCO BONELLI, UNIVERSITY OF GENOA, DATED 2 MARCH 1988

My name is Franco Bonelli. I am an attorney and counselor at law duly admitted to practice in all courts in Italy. I graduated *magna cum laude* from the University of Genoa in 1960. I am the senior partner in Studio Legale Bonelli where I specialize in commercial law, particularly bankruptcy law. In my practice I have counselled numerous major private and public companies in bankruptcy law and bankruptcy proceedings. I have held the chair of commercial law at the University of Genoa since 1976 and was a visiting professor at Stanford University in the United States. I am the author of several legal publications on commercial law. I am the founder and editor of *Giurisprudenza Commerciale* and *Diritto del Commercio Internazionale*. I have been involved both as arbitrator and as advocate in various domestic arbitrations of commercial disputes and in international arbitrations under the rules of the Chamber of Commerce in Paris.

I have been asked to provide my opinion on whether Elettronica-Sicula, S.p.A. ("ELSI") was entitled in 1968 to proceed with an orderly liquidation under Italian law, whether ELSI was obligated to file a petition in bankruptcy prior to the requisition on 1 April 1968, and whether any delays in ELSI's bookkeeping in early 1968 due to earthquakes in Sicily or strikes at the plant violated Italian law.

The following opinion is based on my experience in Italian bankruptcy law and my review of the Memorial of the United States Government, the Counter-Memorial of the Government of Italy, and the accompanying annexes to each.

Entitlement to an Orderly Liquidation

1. A company is entitled under Article 2448, n. 5, of the Italian Civil Code to engage in an orderly liquidation of its assets upon a resolution of its shareholders to that effect.

   Raytheon and Machlett acted in accordance with this law when they voted on 28 March 1968 to liquidate the plant and assets of ELSI.

2. In Italy it is widely recognized that an orderly liquidation generates a more favorable return to the shareholders than does placing the company into bankruptcy.

   There are two principal reasons for this. First, a trustee in bankruptcy lacks the knowledge of the industry and marketing expertise to locate a buyer and execute the terms of the sale at the greatest return to the shareholders. Second, the trustee does not have the same monetary incentive to maximize the sales price as would the shareholders in an orderly liquidation.

3. In my experience it is common practice for larger bank creditors in Italy to settle claims for 40 or 50 per cent of value, rather than taking the risk of receiving little or nothing in the bankruptcy process.

No Obligation to File a Petition in Bankruptcy

4. Based on my review of ELSI's financial data attached to Annex 13 of the United States Memorial, it is my opinion that ELSI was under no obligation to file a petition in bankruptcy under Italian law. Under Italian law, ELSI would have been obligated to file a petition in bankruptcy only if its liabilities clearly exceeded its assets or if it was impossible for ELSI to fulfil regularly its financial obligations. At no time during its operations, as summarized in Attachment E1 to Annex 13 of the United States Memorial, did ELSI's liabilities exceed the book value of its assets. Moreover, as evidenced by the United States Memorial, ELSI consistently met and was in a position to meet all of its financial obligations.

I have no reason to believe the book value was incorrect since it appears from the United States Memorial that ELSI's balance sheets were audited by the company's auditors and by the accounting firm of Coopers and Lybrand. Therefore, if the book value had been higher than the actual value, the book value would have been diminished by virtue of Articles 2423 and 2425 of the Italian Civil Code.

No Jeopardy of Compulsory Dissolution

5. It is also my opinion that ELSI was never in jeopardy of compulsory dissolution. Under Article 2447 of the Italian Civil Code, ELSI would have been considered dissolved as a matter of law if its capital were depleted below a statutory minimum amount. At the relevant time the statutory minimum was 1,000,000 lire. Attachment B1 to Annex 13 of the United States Memorial demonstrates that ELSI's capital, even after taking into account losses, was always well above the statutory minimum.

Compliance with Article 2446

6. It is my opinion that ELSI was at all times in compliance with Article 2446 of the Italian Civil Code. When a company's losses exceed one-third of its capital, Article 2446 grants the shareholders of a company a one-year grace period from the date they knew or should have known of such losses either to reduce its capital or to take another appropriate action. As Annex 13, Attachment B1, demonstrates, at the fiscal year ending 30 September 1966, ELSI's capital was 4,000 million lire and its losses were 2,007.1 million lire. As the same Annex demonstrates, in 1967 the company devalued the capital stock to 1,500 million lire to reduce the company's losses and invested an additional 2,500 million lire to bring the company's capital back to 4,000 million lire. During the fiscal year ending 30 September 1967, however, ELSI's losses once again exceeded one-third of its capital. This time, the company did not adjust its capital and instead the shareholders voted to proceed with the orderly liquidation of ELSI's assets. This decision was taken within the one-year grace period authorized by Article 2446 and was in all respects in conformity with Italian law.

Delays in ELSI's Bookkeeping

7. Any delays in ELSI's bookkeeping in early 1968 that were due to earthquakes in Sicily or strikes at the plant were merely brief and unavoidable interruptions in ELSI's recordkeeping. In my opinion such delays do not violate Article 216 or 217 or the Italian Bankruptcy Act.

(Signed) Franco BONELLI,
Studio Legale Bonelli,
Genova.

Genoa, 2 March 1988.

DEPARTMENT OF STATE
DIVISION OF LANGUAGE SERVICES
(TRANSLATION)

LS NO. 125453
PH/
Italian.

[Title II

On Bankruptcy

Chapter I

On Declaring Bankruptcy]

5. *State of insolvency.* — The entrepreneur who finds himself in a state of insolvency is declared bankrupt.

The state of insolvency is manifested by defaults or other external facts which would demonstrate that the debtor is no longer in a position to satisfy his own obligations in a regular manner.

Annex 2

STATEMENT BY PROFESSOR ELIO FAZZALARI, UNIVERSITY OF ROME, DATED 29 FEBRUARY 1988

WRITTEN OPINION IN THE CASE CONCERNING ELETTRONICA SICULA S.P.A. BETWEEN UNITED STATES OF AMERICA AND ITALY

My name is Elio Fazzalari. I am an attorney at law practising in Italy and am qualified to appear before the Supreme Court of Cassazione. I have been appointed by the International Chamber of Commerce of Paris as chairman of several international arbitrations.

I graduated in 1944 from the law faculty of Rome University. I have been a professor of civil procedure since 1957. Since 1972, I have taught civil procedure at the Law Faculty of Rome University.

I am a member of the International Association for Comparative Law and a professor on the International Faculty of Comparative Law in Strasbourg.

I am the Director of the procedural law section of *Encyclopedia del Diritto*.

I am the author of several legal publications and treaties of civil procedure.

* * *

I was requested to provide my opinion as to whether Raytheon and Machlett exhausted all local remedies in Italy with respect to their claim before the International Court of Justice involving their subsidiary Elettronica-Sicula, S.p.A.

The following opinion is based on my knowledge of Italian civil law and my review of the Memorial of the United States and of the Government of Italy.

I

In its defence the State of Italy claims that, as a consequence of the execution order of the two treaties between Italy and the United States of America (treaties of 12 July 1949 and 1 September 1960, respectively), the Italian internal law has been integrated with the provisions of the said treaties and therefore Raytheon and Machlett should have and could have requested enforcement of these provisions in an Italian court. On the other hand, the Respondent does not specify which subjective position it assumes may have arisen in the Italian internal law nor which judicial remedies it assumes may belong to Raytheon and Machlett.

Thus, Article V of the treaty, providing an indemnification for an individual dispossessed of his own property, is not self-executing. In fact, in domestic law — to the structure of which it is necessary to make reference, and in our case to Italian law — an indemnification can be recognized either as "diritto soggettivo" (enforceable in an ordinary court) or as "interesse legittimo" (which is a different situation, enforceable in an administrative court): the provision of an indemnification obligation does not imply a determination of which of the two subjective positions an individual has been awarded, and such specific determination must be derived from other provisions of Italian law.

Also the provision of Article I of the Integrative Agreement is not a complete norm; in any case, a claim for damages in an Italian court is subject to the same specification as mentioned above with regard to Article III of the treaty: the

Italian legislator must further specify what kind of indemnification and/or compensation is provided and which court is competent to deal therewith.

Similarly, as Italy has not introduced in Italian law provisions affording United States citizens the additional protections of Articles III and VII, United States citizens in Italian courts may only assert the protection of Italian law as applied to all companies in Italy.

Any claim for the additional protections created by Articles III and VII — as well as those arising from Article I of supplementary agreement and Article V of the treaty — must therefore be raised by the United States at the international level.

II

Having excluded that the treaty has introduced into the internal law claims and judicial remedies stronger and different from those already available in the Italian legal system, we can only repeat that Raytheon and Machlett have exhausted all available remedies for the simple reason that there were no remedies available to them.

In fact, in case of an arbitrary requisition of the assets of a company, the shareholders do not have any claim against the requisition order, because such claim is reserved to the company (in the case in issue ELSI exercised the claim).

Similarly, an action for compensation by the authorities, as a consequence of a judicial declaration of the illegitimacy of the requisition, is reserved to the company which was the object of the requisition and not to its shareholders. And, in any case, if the company has become bankrupt, any judicial action is reserved to the receiver, while the shareholders become creditors of the bankruptcy (in the case in issue, the receiver of ELSI exercised all claims without success).

Rome, 29 February 1988 *(Signed)* Elio FAZZALARI.

Annex 3[1]

LETTER FROM PROFESSOR ANTONIO LA PERGOLA, PROFESSOR AT THE UNIVERSITY OF BOLOGNA, TO RAYTHEON COMPANY, DATED 9 DECEMBER 1971

[Italian text not reproduced]

(Translation)

PROF. ANTONIO LA PERGOLA, ATT'Y.
ORDINARIUS OF THE UNIVERSITY OF BOLOGNA

Bologna, 9 December 1971.

Raytheon Company
Lexington, Massachusetts 02173.

The question posed to me is whether (given all the happenings and circumstances surrounding Raytheon-El.Si. S.p.A. of Palermo and in the event that the United States Government intends to make a claim against the Italian Government for unlawful acts against the US national shareholders of the said company) the prerequisite of exhausting all available local remedies can be considered as fulfilled and an international claim advisable.

To respond to this query, I shall first have to look at the principles of international law to determine at what point an individual and, in particular, the shareholder of a commercial enterprise, can be legitimately backed by the country of which he is a citizen, in the case of injustice suffered in a foreign State. Only then can I proceed to examine whether in this particular case the essential elements for an international claim are given.

1. It is the common opinion of the scholars and of the judicial bodies that each country has the right to protect its citizens against injustice to which they may be subjected by foreign States. However, such protective action must be subject to the prerequisite that the individual has unsuccessfully exhausted the remedies effectively available under the constitution of the State in which the alleged injustice has occurred. Yet the meaning and the scope of application of the local redress rule would be misunderstood if one were to maintain that exhausting the available internal remedies constitutes the only condition that must be satisfied before international protective action can be taken. Whenever the country concerned takes steps to act on behalf of one of its citizens, it is in fact not enough that he has unsuccessfully tried to obtain compensation for damage or injustice suffered in the foreign State; the action taken must be based on a rightful claim that establishes the international responsibility of the foreign State. Therefore, in the case at hand, it would not suffice if the American citizens as shareholders of Raytheon-El.Si. S.p.A. only tried local remedies without at the same time making sure that the other conditions are met which are required by international law, so as to justify a possible claim against the Italian Government. It would be another matter if one intended not to file a claim or complaint, but, rather, to

[1] By a letter of 27 May 1988 from the Deputy-Agent of the United States, this full translation of Professor Pergola's letter was submitted to supersede the partial translation originally submitted. *[Note by the Registry.]*

extend generic diplomatic protection to such subjects at the moment that the application of such broader rights of diplomatic protection — recently last discussed and redefined in the Vienna convention on diplomatic relations of 18 April 1961, but undoubtedly based on general international law — is cleared — with the only and obvious exception that not even generic diplomatic protection can be extended to subjects other than those connected with the State by virtue of citizenship — of the provision for the necessary requisites for proposing international action. These requisites are essentially as follows: *(a)* Citizenship of the individual concerned in the country filing the complaint (nationality of the claim). This is to be understood in the sense that the individual must have had that citizenship status from the time he sustained the damage or injury resulting from an unlawful act of a foreign State, without interruption up to the time at which the State to which he belongs has initiated the claim or fully up to the moment at which the claim is decided upon by the appropriate judicial agencies. Some also feel that parallel to this requirement there should be an effective "genuine link", not just an occasional or even involuntary connection, between the injured party and the State committing the injustice, which could be derived for instance from a contract or from residency in the said State. *(b)* Another requisite is that the State against which a claim is intended is charged with the perpetration of an international violation. This violation must consist in the failure to observe an international rule which binds the State concerned to a specific treatment of the citizens of the other country. In committing the violation, it does not matter whether the rule violated is one of common practice, i.e., consuetudinary rather than statutory in nature. It will doubtless be more difficult to prove the violation of a consuetudinary rule than that of a formal treaty, with the onus of proof being on the State filing the complaint. Proving a possible violation of a contractual rule is presumably facilitated by the existence of a written text on which the court can rely in determining at which point the violation took place, while there is no unanimity on the tenor of the consuetudinary standards to which the State is bound in assuring the rights of foreigners, if one leaves the obligation to adapt the administration and operation of jurisdiction to a minimum level of impartiality and of procedural guarantees out of consideration.

It is immaterial at this point to consider other problematic aspects of the definition of an international violation. I shall limit myself to the observation that doctrine and jurisprudence are in agreement to the effect that a violation fundamentally committed against an individual must be considered as an unlawful act against the State to which the individual belongs *(Mavrommatis Palestine Concessions, P.C.I.J., Series A, No. 2)*. This is a definite point in the law governing claims which cannot be disputed, being based on the premise, under peacetime conditions, that the individual is not an international entity. It follows from this premise that the infraction of an international rule which binds the State to a certain behaviour toward the foreigner constitutes a violation of the rights of the country of which the foreigner is a citizen; that is, of the right to demand that the rule be observed or, in fact, the right to diplomatic protection which each State possesses on behalf of its subjects. It is, therefore, certain that the international complaint is indicated, whether the violation consisted in an act of injustice against the private individual or whether it constitutes a direct violation of the rights of the State filing the complaint, quite apart from any particular behaviour which the perpetrator of the violation may have shown toward citizens of that State. This still does not preclude, when the State takes steps to provide protection of its citizen, the subjection of the claim to certain conditions which, logically, cannot apply in the case where the complaining State claims to have been the

direct victim of the violation. These are exactly the prerequisites for a complaint as I have stated them above, with that of attempted internal remedy being of first priority. It has, in fact, been stated that the remedies in question must have been exhausted by the foreign individual, so long as these are effective remedies which serve to obtain indemnification for the damage and injury sustained, for which purpose it can be assumed that the subject has been required or prepared to submit to the jurisdiction of the territorial State authorities to which extent foreign sovereignty cannot be considered: *Par in parem non habet jurisdictionem.* To this must be added that the proposition of a complaint regarding an injustice suffered by the individual cannot in any way prescind from a substantiation of the damage or injury sustained by the individual protected. It follows that this form of violation is distinguished from that of direct injury committed against the sovereign State, which latter is solely determined by whether there is a threat or agitation aimed at violation of the interests or rights of a State. Therefore, to clearly determine the damage or injury caused by the injustice, one must take into consideration the substance of that particular international rule the violation of which is alleged by the complaining State; the complaint must also indicate in what form, acceptable under international law, the damage and injury claimed by the individual should be remedied.

If one maintains that the requirement of damage and injury to the private subject can be set aside, one would also have to negate any basis for the entire system of rules which govern the initiation of international claims; in fact, the requirement of "nationality of the claim" is based on the concept according to which any violation of the sphere of interest of the individual is tantamount to a violation of the sphere of interest of the State. The very rule which requires the exhaustion of internal domestic remedies presupposes that the individual has sustained a damage which has arisen to him from the violation of a privileged juridical position to which he should be entitled by virtue of the constitution of the territorial State and which damage can be remedied, in accordance with the provisions of such constitution, without delay or denial of justice which, from the perspective of international law, would constitute a form of unlawful act by itself.

2. This is the essential framework of the principles within which the investigation of the specific case in question must be conducted.

It is now necessary to point out how, in applying these principles, one can put into proper perspective the circumstance that the individual on whose behalf the complaint is contemplated, is the shareholder of an Italian company. This element of the case in point can give rise to some doubt relative to the validity of the claim. The scholars and arbitral colleagues are in fact still debating the question of whether protection of the shareholders of a commercial company should be precluded considering the fact that individuals are involved who are organized in juridical entities which, according to most State constitutions, have their own particular personality and nationality, with the result that the shareholders may be citizens of various countries and that one can attribute to the corporation the nationality of a country other than the States to which the shareholders belong. To accept international protection of the shareholder without reservation would therefore involve a lifting of the mantle of personality of the company. This has in fact been advocated before at the Permanent Court at The Hague by an expert Italian jurist, Scialoia, who observed, in the *Canevaro* case, that the right of the Italian Government to protect its own citizens is neither limited nor eliminated by the foreign character of a company, because "if the rights of the company as a legal person are distinguished from those of the shareholders, then they serve in effect only the interests of the business partners". Others point out, however, that the international protection afforded the individual partner or shareholder

can engender serious drawbacks and especially conflicts which may eventually involve different States, each providing international protection for its own citizens who are all shareholders of the same company. The State charged with the unlawful act would in such a case find itself facing as many individual cases as there are countries initiating claims. If the shareholders of the foreign company, on their part, are not individuals but corporations, perhaps even of different nationalities, it could well be that they act together and that cumulative claims are initiated, all against the same State, respectively on behalf of the company in question and of the individual shareholders. In view of such prospects, arbitral jurisprudence has had to proceed with great circumspection, largely guided by considerations of equity, to find the right point of reconciliation between the necessity of not unduly compromising the right of diplomatic protection of each State on the one hand and, on the other hand, the need to avoid a dilatation, beyond reasonable limits, of the international responsibility of the States in which operate commercial corporations constituted of individuals of diverse citizenship.

In a timely comment, Judge Bagge, arbiter in a few prominent controversies connected with the protection of shareholders, writes on this subject that the rules of intervention are semijuridical and semipolitical in nature, portending that they will not be applied along criteria rigorous and inflexible enough to prejudice good relations between the sovereign States but rather in a way as to enhance these relations. However, the jurisprudential precedents which to me seem relevant are few in number and relate predominantly to claims of the United States and Great Britain. These two countries have in fact found it necessary to protect, with a certain frequency, the property interests of their citizens abroad, and in particular those of shareholders. Protection has been exercised at an earlier time through the interposition of good offices and without official intervention, and from the *Delagoa Bay* case (1889) (in Moore, *Digest of International Law*, 1906, Vol. VI) with the institution of formal claims. I feel I can determine from the decision in that case and from subsequent jurisprudential findings several most essential principles which, as I see them, are today commonly accepted and which in all cases appear to me to be the most appropriate ones for the requirements of *juris aequi* from which the right of international claims cannot diverge, especially in this delicate area.

(a) The company, as an entity distinct from individual partners or shareholders, must have the nationality of the State against which the claim is directed. This serves to preclude that the company as such can be protected by the State intervening for the protection of the shareholders, so that the latter, if deprived of the assistance of the State of which they are citizens, would be stripped of any possible international protection (*Delagoa Bay* case, cited; *Tlahualilo* case, in Hackworth, *Digest of International Law*, Vol. V, 1943).

(b) The company must be defunct or in the state of liquidation or bankruptcy and such situation must be understood to be ascribable to an international violation (*Baasch and Roner Kunhardt* case in Ralstin, *Venezuelan Arbitrations of 1903* (1904); *El Triunfo* case, in Moore, *Digest of International Law* (1906), Vol. VI; *Romano-Americana* case, in Hackworth, *Digest*, cited).

The reason for this requirement is twofold. First of all, the company must be unable to claim injury of its own rights by the territorial State in any way other than through a liquidator or receiver, and that, consequently, the individual shareholders find themselves unable to assure normal functioning of corporate offices for protection in the case of any possible violation of their rights which may indirectly result from any damage inflicted on the company. Therefore, in this case as well, international tutelage and diplomatic protection are the only

possible ways to safeguard the rights of the shareholder and to obtain indemnification for the damage sustained by him. One must further consider that, given that the company is dissolved or defunct or in a state equivalent to dissolution or extinction, the right of the shareholders to simply partake of the profits of the company ceases to exist and is replaced by the right to a distribution/share in any assets consisting of the company's remaining net value. Even in the application of these principles on the part of international jurisprudence, one is debating which rights can be immediately and directly considered as far as the shareholders themselves are concerned; while it is ruled out that the category of subjective positions on the part of the shareholders includes the standard or inherent rights conferred on the shareholders governing the organization of the company or a right to remedy for mismanagement, the right to obtain a quota proportional to the equity in the company in the case of liquidation constitutes — according to the most national juridical statutes — a direct proprietary right or one directly pertaining to the shareholder as an individual;

(c) Provided that one can establish that, with the company ceasing regular operation, the shareholder has suffered damages resulting from a violation of the rights attributed to him, the State of which the shareholder is a citizen can lodge a complaint against the State responsible for the violation.

If all of the elements indicated by me appear in the case in point, then direct protection of the shareholder is to be considered admissible, without regard to the existence of the company as an independent subject with its own rights. It follows — and this is a rather important consequence — that the claim is not subject to prior exhaustion of internal remedies since the shareholder, in his capacity as such, has no remedy to pursue within the territorial State to obtain indemnification for the damages suffered by him. For the purpose of admissibility of the international claim, a case in which no effective remedies exist is in fact equivalent to one in which the available remedies have been unsuccessfully exhausted.

The preceding considerations permit sufficiently precise consideration of the aspects relevant to the solution of the questions posed to me in the case here at hand.

Indeed, keeping in mind what I have already had the opportunity to observe with regard to the first requirement for the initiation of a claim on the part of the State to which the shareholders belong — the perpetration of an international violation — reference can be made to the provisions of Article 1 of the supplementary agreement, worked out in Washington on 26 September 1951, to the treaty on commerce and navigation of 2 February 1948, and in particular to the clause relating to the illicit character of any arbitrary or discriminatory measure resulting in an obstruction of the effective control and administration of enterprises founded or acquired by citizens or juridical persons of one of the opposing parties, or in prejudice to their rights and interests relative to business enterprises and investments (including in particular shareholdings). The international obligation of the opposing parties to refrain from discriminatory or arbitrary measures against citizens of the other State is also designed to provide a possibility for securing, under normal conditions, capital and other special goods required for the economic development of ventures derived from investments by citizens of the two countries, besides obtaining the benefit of special assistance in fiscal, customs and tariff matters (in which connection reference is made to Article 5 of the said agreement, with specific regard to the provisions established by the Italian legislation, effective as of the time the Treaty or supplements thereto went into effect) offered for investments for the purpose of the industrialization of the Mezzogiorno (Southern Italy).

With the international rules thus established against which the conduct of the Italian Government must be measured for determining the possible existence of an international violation — and I personally do not consider it possible nor practical to refer, for this purpose, to any other norm, consuetudinary or contractual — the problem faced is that of ascertaining whether the factual situation presented to me by Raytheon Company clearly contains the elements necessary for the conclusion that the obligations arising from the said norm have been violated.

Within the framework of the actions directly or indirectly attributable to the Italian Government, of the formal steps taken, and of all the other circumstances which have brought about the state of extreme hardship in which the American shareholders of Raytheon-El.Si. S.p.A. have come to find themselves, one fact emerges clearly and merits special attention. As a consequence of all the events which have resulted from various corporate actions and which are also described in the report submitted to the appropriate Judge by the bankruptcy liquidator of Raytheon-El.Si. S.p.A. on 28 October 1968, Raytheon El.Si. S.p.A. — after the shareholders had an opportunity for various recoveries either through the conferment of large sums of risk capital or through direct financing or financing guaranteed by them to the company, in view of the losses incurred due to the plant's location — was forced to adopt a program of reorganization of its productive structure which then yielded favourable results and in turn helped to reduce the administrative losses.

This program — designed to assure, through increased productivity of the plant, greater competitiveness of its products — entailed sacrifices for part of the labour force employed, sacrifices which, of course, did not meet with favourable reception on the part of the unions.

Other difficulties, stemming from the situation concerning certain product lines of the operation, prompted the management of Raytheon-El.Si. S.p.A. to decide on the cessation of the industrial activities and, later, of the commercial activities, and to propose to the shareholders the liquidation of the company for the purpose of an orderly and well-planned sale of the company in its entirety. As a result of this decision of the corporate management which was made public, the Mayor of Palermo, in his capacity of a government official, and with the tacit approval of the Central Government per provision of 1 April 1968, ordered the requisitioning of the plant and of all its equipment for a duration of 6 months, successively extended.

Raytheon-El.Si. S.p.A. promptly reacted to this measure through the means available under the Italian constitution. Meanwhile, however, being deprived of the availability of all the material constituting its assets, the company was irremediably obstructed and prejudiced in the planned orderly liquidation of the operation. As a result, with substantial debts falling due which the company was unable to pay for want of liquidity thus brought about, it was forced to file for a declaration of bankruptcy. The bankruptcy was declared by verdict 7 of 16 May 1968.

That the requisition order was illegal has been recognized by the Prefect of Palermo in the execution of his controlling powers over the actions of the Mayor as a government official. The Prefect has confirmed that the situation of financial difficulty which was followed by the declaration of bankruptcy of the company, is a direct result of the fact that the firm was deprived of the availability of the property through the intervention of the government authority.

However, as a matter of interest, it does not seem necessary to determine whether the Mayor's action was unlawful since on the basis of the Italian constitution this is a question which at this point concerns the bankruptcy office

(given the fact that in Italy it is exclusively within the power of the liquidator of the bankrupt company to support or resist any legal action on the basis of which it is possible to definitively establish the contrariety of this action violates the standards of internal law).

On the premise that the company is at this point deprived of any possibility to take action for the protection of the rights which are specifically due to them due to the state of bankruptcy in which it finds itself, it is now a matter of determining whether the shareholders have suffered any violation of their rights as a result of the conduct of the Italian State that may have been contrary to the obligations internationally accepted by Italy according to the specific provisions of the friendship treaty. There seems to be no doubt that the action by the Mayor of Palermo interfered first of all with the implementation and materialization of the liquidation of the business operation of Raytheon-El.Si. S.p.A. after the completion of which it would have been possible to determine whether the shareholders after payment of the corporate debt, would have been able to obtain reimbursement, in full or in part, of the respective amounts paid by them and possibly the allocation of a quota — proportional to their investments out of the residual net assets of the company.

Aside from the direct causal connection existing between the requisition and the state of payment difficulties, culminating in the bankruptcy of the company (at the expense of the corporate creditors in whose collective and objective interest the receiver is empowered to take the most opportune remedial steps), the conduct of the Italian State agency has directly and definitively obstructed any possibility to provide for the liquidation of the corporate assets by a sale, under terms acceptable to the company, of the property requisitioned, as well as by any suitable agreement the company could have worked out with the corporate creditors with whom, in fact, it had already arrived at preliminary agreements, and which would also have left open the possibility of recovering, if only in part, the large amounts which the shareholders had committed to the business.

Now, the act of making it impossible to liquidate the company and to conduct the activities which normally lead to the sale of corporate property, has directly cut into the clear and specific rights of the shareholders. Therefore, the conduct of the Italian State which has brought about this prejudicial situation vis-à-vis the rights and interests of the American shareholders and the negative impact on their investments in the form of stock participation, is certainly contrary not only to the express provisions of the above-mentioned international rule but also to the very raison d'être of the latter which is designed to assure an obligation to the effective and efficacious recognition of the need to safeguard such rights and interests. The conduct of the State assumes in fact an arbitrary and discriminatory character in relation to all the principles of international law, and most of all to the principle of good faith, which offer us a constant interpretative criterion for treaties: It is clear that the terms arbitrary and discriminatory, used in the Treaty, need not clash with the notion of illicitness — especially if that is related to the significance commonly attributed to it in the jurisprudence of State constitutions — in the sense that arbitrary or even discriminatory can refer to a conduct which is not formally illicit but still contrary to international rules. At the border line there may be an act or conduct on the part of the State devoid of any form of control or accountability, taking place within the parameters of internal law, where one can correctly define as arbitrary a given measure alone for the fact that it exceeds the limits of most essential reasonableness and good faith (which are the purpose of the treaty) even though there is not technically an abuse or excess in the exercise of the largely discretionary powers of the public agency. This definition is particularly indicated in that, in the case at hand, the arbitrary

nature of the measure taken by the Mayor of Palermo as a government official is only the most obvious aspect of the picture in which are contained many other facts directly or indirectly chargeable to the Italian State. These facts which, even taken individually, are undoubtedly symptomatic of a tendency to treat the American shareholders of Raytheon El.Si. S.p.A. if not in a hostile, but certainly not a favourable, manner, and in their sum total they assume clear relevance for the purpose of expressing a judgment on the contrariety of the Italian conduct relative to the obligations under the Treaty. Among the facts brought to my attention are the following:

Massive intervention by the President of the Region (of Sicily) prior to the declaration of bankruptcy of the company, openly aimed at obstructing the liquidation plan worked out by the company; the great publicity given by the Italian Government, via radio and television, to the intention of a company of the State-controlled IRI group to proceed with the takeover of the plant, with the effect of discouraging any potential private buyer and of making impossible the sale which later took place at a price substantially below the estimated value; the behaviour of the IRI credit banks towards the American shareholders in pursuing drastic legal action in the Italian courts for the purpose of creating an onerous situation for them.

Based on all these elements I believe that one may be justifiably convinced of the arbitrary nature of the Italian Government's conduct, consequently constituting an international violation.

As I have stated earlier, that it is necessary for making the initiation of a claim legitimate to also meet other requirements, but in our case one cannot really doubt that these are met. The fact is that the shareholders are American nationals which satisfies the requirement of the nationality of the claim. They have further established, through their interest and investments in an Italian corporation, a genuine link with the territorial State.

On the other hand, the company is undoubtedly of Italian nationality. Since the company belongs to the country which committed the violation, another one of the elements is given in that the individual shareholder can be protected by the country of which he is a citizen. The company is furthermore in a state of bankruptcy which is, *inter alia*, a direct result of the requisition order. The bankruptcy status prevents any direct initiative by the company to put itself back into the situation in which it would have found itself had it not been for the illicit action. On the basis of the principles confirmed by international jurisprudence, this constitutes another element permitting immediate protection of the shareholders by the State of which they are citizens. Hence, the question of exhausting internal remedies does not apply since these remedies, in this situation, would not have been directly available to the shareholders. The latter have suffered a specific injury of their interests since the illegal conduct of the State made the liquidation impossible. Such conduct is by itself abstractly apt to cause damage or injury, even if concrete quantification of such damage is an argumentative point not part of the problem posed to me.

For the reasons developed above, I feel that I have to conclude that in the situation at hand all the requirements appear to be satisfied for international protection of the shareholders of the Raytheon-El.Si. S.p.A. who are United States citizens, without the need to pursue internal remedies prior to the possible initiation of a claim against the Italian Government.

(Signed) Prof. Antonio LA PERGOLA,
LL.M. (Harvard).

Annex 4

LETTER FROM AVV. GIUSEPPE BISCONTI, STUDIO LEGALE BISCONTI, ROME, TO RAYTHEON COMPANY, DATED 6 NOVEMBER 1971

6 November 1971.

Gentlemen,

You have requested an opinion as to what remedies are available under Italian law to the shareholders of Raytheon ELSI S.p.A. (hereinafter referred to as "ELSI") in relation to the damages suffered by said shareholders as a consequence of the requisition by the Mayor of Palermo of ELSI's assets on 2 April 1968 and of subsequent events.

I have acted as Italian counsel to Raytheon Company, a shareholder in ELSI, in relation to various matters since 1962. I have also acted as Italian counsel to Raytheon Company in relation to ELSI matters continuously since March 1968. As such counsel, I am fully familiar with the events concerning ELSI that occurred since the resolution of ELSI's Board of Directors of 16 March 1968 to cease production and undertake an orderly liquidation of ELSI and specifically with the events represented by the aforementioned requisition, the subsequent action by the Italian Government, the bankruptcy of ELSI and its developments to date and the pending litigation instituted by the Italian creditor banks against Raytheon Company. Under Italian law the following remedies are available:

1. Remedies against the requisition. The Mayor of Palermo in making the requisition acted as an official of the National Government. Under Italian law, an appeal against the requisition order can be taken to the Prefect. Such appeal was promptly taken by ELSI. As an effect of the bankruptcy of ELSI which occurred subsequent to and as a consequence of the requisition of ELSI's assets by the Mayor, the right to pursue the appeal vested solely in the curator of ELSI's bankruptcy. The remedy as such was a remedy available to ELSI as a company and prior to the bankruptcy there was under Italian law no remedy available to the shareholders of ELSI. The requisition was made by the Mayor acting as an official of the National Government and there is no remedy under Italian law against the National Government other than the aforementioned appeal.

2. Under Italian law as an effect of the bankruptcy ELSI and its management were deprived of the right to take any action in ELSI's name and such right has vested in the curator. Under Italian law the curator exercises any such rights in the interests of ELSI's creditors and not of the shareholders. Subsequent to the bankruptcy of the company, there is no possibility under Italian law for the company itself nor for the shareholders to exercise any rights or action which the company might have had prior to the bankruptcy. Following the decision by the Prefect of Palermo of 22 August 1969 which ruled that the requisition by the Mayor was illegal, the curator of ELSI brought suit against the Italian Government and the Mayor of Palermo to recover damages on behalf of ELSI's creditors. No such action would be available under Italian law to ELSI's shareholders.

3. As stated above, the shareholders of ELSI have no direct action against the Italian Government under Italian law in relation to the damages suffered by them as a consequence of the requisition and subsequent events. In my opinion, the

shareholders would not have a cause of action even under Article 2043 of the Italian Civil Code, because: *(a)* the requisition was directed against ELSI and not the shareholders even though the latter eventually suffered damages; and *(b)* Italian law provides for a specific remedy against the requisition which is the aforementioned appeal to the Prefect. I know of no judicial decision in which Article 2043 of the Italian Civil Code was applied in similar circumstances. It is my opinion that the shareholders of ELSI would have no remedy or no effective remedy under Article 2043 of the Italian Civil Code.

4. By way of conclusion, there is no remedy under Italian law available to the shareholders of ELSI in relation to the damage suffered by them as a consequence of the requisition by the Mayor of Palermo and the subsequent events. In my opinion there can be no question as to whether the shareholders have exhausted all (nonexistent) local remedies.

(Signed) Avv. Giuseppe BISCONTI.

Annex 5

ELSI — ELETTRONICA SICULA S.P.A. BY-LAWS (ARTICLES OF INCORPORATION) APPROVED BY THE SHAREHOLDERS' EXTRAORDINARY MEETING OF 19 JULY 1961

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