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**THE INTERNATIONAL COURT OF JUSTICE AND THE
STANDING OF CORPORATE SHAREHOLDERS
UNDER INTERNATIONAL LAW:
*Elettronica Sicula v. Raytheon (U.S. v. Italy)***

ALEXANDER L. PALENZUELA*

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I. INTRODUCTION

In August 1989, a five-member Chamber of the International Court of Justice rendered a judgment which heralds a significant change in the law governing the espousal of claims by a country on behalf of its nationals. The decision in *Elettronica Sicula* dealt with a claim brought by the United States on behalf of two of its nationals, both shareholders in the stock of an Italian corporation. In admitting the claim, the Chamber failed to apply a rule of international law under which the rights of shareholders are not affected when a corporation is expropriated by a foreign government. The non-application of this rule opens the way for the espousal of claims in similar situations where the property rights of a shareholder in a corporation are jeopardised, rather than simply where his rights vis-à-vis the corporation itself are at issue, and announces a significant departure from prior practice.

Another important point developed in the decision of the Chamber is the requirements of the rule governing the exhaustion of local remedies before a claim may be espoused by a state on behalf of its nationals. Here the court faces the issue squarely, thereby elucidating what must be proved before local remedies can be deemed to have been exhausted.

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II. THE DECISION IN ELETTRONICA SICULA

A. The Facts

The Case Concerning Elettronica Sicula S.p.A. arose from the requisition by the Mayor of Palermo of the Italian corporation Raytheon-Elsi S.p.A., previously known as Elettronica Sicula (ELSI). The only shareholders of ELSI were two corporations, Raytheon Company (Raytheon) and Machlett Laboratories Incorporated (Machlett), both of which were nationals of the United States. Raytheon began purchasing shares of ELSI in 1955, when it purchased 14 per cent of the shares. By 1967, Raytheon owned 99.16 per cent of the shares. The remaining 0.84 per cent of the shares were purchased by Machlett, a wholly-owned subsidiary of Raytheon.¹ The investment, however, proved unsound. The accumulated losses of ELSI exceeded one third of its share capital and Raytheon recapitalised ELSI in the amount of the reduction in equity which Italian law required.² By February 1967, Raytheon had provided over 4,000 million lire in recapitalisation and guaranteed credit, as well as technical expertise, in order to render ELSI self-sufficient and improve its facilities.³ In the meantime, Raytheon and ELSI held meetings with cabinet-level officials of the Italian Government and the Sicilian region, the *Istituto per la Ricostruzione Industriale* (IRI) and the *Ente Siciliano per la Produzione Industriale* (ESPI). The meetings were an attempt to form a "partnership" with an entity of the Italian Government in order to favourably influence industrial planning and perhaps secure benefits under Italian legislation designed to encourage development of the Mezzogiorno region.⁴

As part of the streamlining of ELSI, it was decided to dismiss about 300 employees in June of 1967. In spite of some timely intervention by ESPI in an attempt to have the workers suspended with partial pay, the workers were eventually dismissed in March 1968.⁵ At this point, strikes were organised. There is disagreement between the parties whether the strikes were serious disruptions of the operation of the plant or only sporadic events, as claimed by Raytheon. In any case, there was a general strike on 4 March 1968 to protest the dismissal.

¹ Case Concerning Elettronica Sicula S.p.A. (hereinafter ELSI) (U.S. v. Italy) 1989 I.C.J. 15 reprinted in 28 I.L.M. 1109, 1115 (1989).

² ELSI, 28 I.L.M. at 1115. Article 2446 of the Italian Civil Code required ELSI to reduce its equity, Raytheon then recapitalised ELSI or guaranteed its credit in an amount exceeding 4,000 million lire.

³ ELSI, 28 I.L.M. at 1116.

⁴ *Id.*

⁵ *Id.*

Apparently, it had already become clear to Raytheon and Machlett that a satisfactory arrangement involving the Italian Government could not be reached. The two shareholders had already begun to plan to close and liquidate ELSI in order to minimise their losses. On 2 March 1968, the books of the corporation and some inventory were transferred from Palermo to the company's regional office in Milano. On 7 March 1968, Raytheon formally notified ELSI that it would no longer subscribe to any further stock or guarantee any additional loans.⁶ The officials of Raytheon and ELSI had been advised by their Italian counsel that ELSI had sufficient capital to proceed with an orderly liquidation of the corporation rather than declare bankruptcy immediately.⁷ Alternative plans were developed. Under one plan, the sale value of the corporate assets would be maximised by maintaining the company as a going concern while advertising its sale. From the proceeds of the sale, all creditors would be paid in full. The second plan provided for the contingency of a lower quick-sale value of ELSI. The Financial Controller of Raytheon described the plan as follows:

Ideally, we would first settle with the small creditors, subject, of course to the agreement of the major creditors, in order to minimize the administrative effort during liquidation. Secured and preferred creditors would take priority and would be paid when the assets used for collateral were sold. Major unsecured creditors were to be paid on a pro rata basis from within the funds realized from the sale of assets. Then Raytheon would be called upon to satisfy any guaranteed creditor to the extent not already paid from asset sale proceeds. We calculated that the secured and preferred creditors would receive 100 per cent of their outstanding claims, while the unsecured major creditors who were not covered by Raytheon guarantees would realize about 50 per cent of their claims. The latter creditors were certain banks and Raytheon and its subsidiaries. We were confident that an orderly liquidation of this type would be acceptable to the creditors as it was much more favourable than could be expected through bankruptcy.⁸

There is conflicting evidence as to whether ELSI would have been allowed, under Italian Law to proceed with a voluntary liquidation.⁹ In any

⁶ *Id.*

⁷ Under Articles 2447 & 2448 of the Italian Civil Code if the capital stock of ELSI dropped below 1,000,000 lire the corporation did not take action to restore the capital stock it would be dissolved as a matter of law. *Id.* at 1117.

⁸ *ELSI*, 28 I.L.M. at 1118.

⁹ Italy contended that under Article 2450 of the Italian Civil Code a liquidator has to be appointed by the shareholders or the Tribunal and if ELSI was insolvent the only way to avoid bankruptcy was to request the tribunal to be allowed judicial settlement (*concordato preventivo*). The United States contended that private settlement (*concordato stragiudiziale*) could be had even where 100 per cent of the creditors could not be paid. *ELSI*, 28 I.L.M. at 1115.

case, on 16 March 1968, the Board of Directors of ELSI voted to discontinue the company's activities. On 28 March, this decision was ratified by the shareholders.

Having been unsuccessful at convincing ELSI not to cease operations, on 1 April 1968, the Mayor of Palermo issued the order, effective immediately, requisitioning the plant owned by ELSI and its assets for six months. In his order the Mayor cited the ongoing strikes, public opinion, the workers' families destituted by the dismissals, the importance of ELSI (the second largest firm in a District which had recently been hit by earthquakes), the criticism of the authorities by the local press, and the risk of disturbance of the public order. The requisition order was subject to prolongation and promised a subsequent decree by which indemnification would be paid to ELSI.¹⁰

ELSI protested the order and, on 19 April 1968, brought an administrative appeal to the Prefect of Palermo. The Prefect's decision was not given until 22 August 1969. The requisition was not prolonged beyond six months and ended on 1 October 1968. Meanwhile the Board of Directors of ELSI filed a bankruptcy petition on 26 April 1968, which stated:

Because of the order of requisition, against which the Company has in due time filed an appeal, the Company has lost control of the plant and cannot avail itself of an immediate source of liquid funds; in the meanwhile payments have become due . . . it is acknowledged that it is impossible for the Company to pay such sums with the funds existing or available such impossibility being due to the events of the last few weeks . . .¹¹

The decree of bankruptcy was issued on 16 May 1968, and a trustee in bankruptcy (or *curatore*) was appointed. A creditor's committee was also appointed consisting of two representatives of the employees, two representatives of bank creditors, and a representative of Raytheon Europe International Company (a wholly-owned subsidiary of Raytheon serving as its European management). Raytheon itself and another of its subsidiaries did not file claims in bankruptcy. Their Italian counsel had advised them that the costs of filing would not be justified by what they could expect to receive.¹²

Amid negotiations among Raytheon, the creditors, and the Italian government, auctions were held for the sale of the premises, plant and equipment. On 12 July 1968, the fourth auction resulted in a sale to a subsidiary of IRI, the *Industria Elettronica Telecomunicazione* (ELTEL). The

¹⁰ *ELSI*, 28 I.L.M. at 1120.

¹¹ *Id.* at 1122.

¹² *Id.*

sale was for 4,006 million lire. Raytheon Europe appealed the decision to sell, believing the value to be higher, but this was rejected.¹³

Meanwhile, the Prefect of Palermo returned his decision on the appeal filed by ELSI to the Mayor's requisition order. This was done subsequent to a request by the trustee on 9 July 1969. The prefect decided to uphold the appeal and thereby declared the requisition annulled. The Mayor's appeal from this decision was rejected by the President of Italy upon advice from the Council of State.¹⁴

On 16 June 1970, the trustee brought proceedings in the *Tribunale di Palermo* (Court of Palermo) against the Minister of the Interior of Italy and the Mayor of Palermo for damages resulting from the requisition. The trustee requested 2,062,411,600 lire to cover the real loss of value of the plant as the difference between the book value of ELSI's assets on the day of bankruptcy and the value of the assets after the six-month requisition had elapsed. Also claimed were 2,395,561,600 lire as the loss for the lack of disposability of the plant and equipment over six months. The Court of Palermo denied the trustee's claims. The *Corte di Appello di Palermo* (the Court of Appeal of Palermo) upheld the decision as to the decrease in value of the plant and equipment, yet awarded the trustee compensation for the use and possession of ELSI's assets for the period of the requisition, awarding 114 million lire in "rental payments." The Court of Cassation (Italy's highest Court) upheld the Appeal.¹⁵

The result of the bankruptcy was that secured and preferred creditors were paid in full, unsecured creditors received less than one percent, and there was no surplus for distribution to the shareholders, i.e. Raytheon and Machlett. Raytheon paid 5,787.6 million lire to banks whose loans it had guaranteed. Of the seven banks which had made unguaranteed loans to ELSI, five brought proceedings to recover from Raytheon the amount owed by ELSI, yet after three of these lost in the Court of Cassation, the remaining two dropped their suits.¹⁶

¹³ *Id.* at 1123.

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ Under Article 2362 of the Italian Civil Code a sole shareholder is rendered liable for the debts of the company. Raytheon was never in this position having taken care to leave 0.14 per cent of the shares in the hands of Machlett, a wholly-owned subsidiary of Raytheon. *ELSI*, 28 I.L.M. at 1124. This situation led Brigitte Stern to argue that if Raytheon can benefit by the limited liability of being a stockholder, the same should apply for the negative consequence of not being able to claim a wrong when the company itself suffers a wrong. In Stern's words the distinction should be "for better or for worse." Brigitte Stern, *La protection diplomatique des investisseurs internationaux: De Barcelona Traction à Elettronica Sicula ou les glissements progressifs de l'analyse*, 4 JOURNAL DU DROIT INTERNATIONAL [J.D.I.] 897 (1990).

On 7 February 1974, the United States pressed the claim of Raytheon and Machlett through diplomatic channels. When Italy denied the claim on 13 June 1978, suit was eventually brought before the International Court of Justice.¹⁷

B. The Chamber's Reasoning

1. The Admissibility of the Claim

In its opinion, the Chamber first addressed the matter of jurisdiction, which in this case was not disputed.¹⁸ Under Article 36(1) of the Statute of the Court, jurisdiction can be established by treaty.¹⁹ Article XXVI of the Treaty of Friendship, Commerce and Navigation (FCN Treaty) between the United States and the Republic of Italy provides that any dispute between the High Contracting Parties, which they cannot resolve by diplomacy, shall be submitted to the International Court of Justice, unless the Parties can agree to some other means of settlement.²⁰

Although jurisdiction was not questioned, Italy objected to the admissibility of the claim in its Counter-Memorial, alleging that the corporations on whose behalf the United States brought the claim had failed to exhaust local remedies. The United States responded by arguing that the rule was not applicable to a dispute arising under Article XXVI of the FCN Treaty, yet the Chamber rejected this argument. The Chamber refused to find that such an important principle of customary international law could be set aside in the Treaty without any express language to that effect. The Chamber also rejected the argument of the United States that its own rights under the FCN Treaty had

¹⁷ *ELSI*, 28 I.L.M. at 1124.

¹⁸ Under Article 26 of the Statute of the ICJ, the Court may form a Chamber. Under Article 17 of the Rules of the Court, the President consults with the parties as to their consent in the formation and composition of the Chamber, but the ultimate authority rests with the ICJ. Rules of the International Court of Justice, Art. 17, reprinted in DOCUMENTS ON THE INTERNATIONAL COURT OF JUSTICE (S. Rosenne 2d ed. 1979). In the *ELSI* case the composition of the Chamber was as follows: Judge Roberto Ago (Italy), Judge Sir Robert Jennings (United Kingdom), Judge Shigeru Oda (Japan), Judge Stephen Schwebel (United States), and President Nagendra Singh (India) who was replaced upon his death in December 1988 by President José María Ruda (Argentina). Furthermore, under the Statute of the ICJ, a judgement given by a Chamber has the same effect as one given by the entire ICJ. Statute of the International Court of Justice (hereinafter Statute of the ICJ), June 26, 1945, Art. 27, 59 Stat. 1055, T.S. No. (933). See generally Murphy, *The ELSI Case: An Investment Dispute at the International Court of Justice*, 16 YALE J. INT'L L. 391, 406, 411 (1991).

¹⁹ Article 36 (1) of the Statute of the ICJ provides that the jurisdiction of the Court comprises all cases which the parties refer to it, and all matters specially provided for in the Charter of the United Nations, or in Treaties and Conventions in force. Statute of the ICJ, *supra* note 18, Art. 36 (1).

²⁰ Treaty of Friendship, Commerce and Navigation, Feb. 2, 1948, United States-Italy, 63 Stat. 2255, T.I.A.S. No. 1965 (entered into force July 26, 1949), Supplemented by agreement of Sept. 26, 1951 (entered into force on March 2, 1961) Agreement Supplementing the Treaty of Friendship, Commerce and Navigation, Sept. 26 1951, United States-Italy, 12 U.S.T. 131, T.I.A.S. No. 4685.

been violated and that the rule applicable to the espousal of claims was not controlling. Citing the *Interhandel* case, the Chamber reasoned that the matter "which colours and pervades" the claim by the United States was the damage done to its nationals.²¹ Furthermore, the argument that Italy was estopped from arguing that local remedies had not been exhausted was rejected. While allowing that it may be enough in other situations, the Chamber refused to find that Italy's failure to mention exhaustion of local remedies in the diplomatic exchanges preceding the pleadings was sufficient to constitute an estoppel.

Having found the rule to be applicable, the Chamber elaborated on the extent to which local remedies had to be exhausted. Italy's argument, that the failure of Raytheon and Machlett to argue a violation of the FCN Treaty and its Supplementary Agreement in Italian domestic courts resulted in a failure to exhaust all remedies available to them, was rejected. Even though enabling legislation had been passed to execute the FCN Treaty under Italian law, the Chamber held that "it is sufficient that the essence of the claim has been brought before the competent tribunal and pursued as far as permitted by local law and procedure and without success."²² Italy therefor failed to satisfy the burden of showing that the stockholders had failed to pursue a reasonable local remedy.²³

2. The FCN Treaty and the Supplementary Agreement

Having found the claim admissible, the Chamber proceeded to address the merits. In its final submission to the Court the United States argued that Italy had violated Article III(2), Article V(1) & (3), Article V (2) and Article VII of the FCN Treaty of 1948 as well as Article I of the Supplementary agreement of 1951. The Chamber addressed these alleged violations while first recognising that the issue presented required the determination of elaborate questions of mixed law and fact. Among these the Chamber would have to decide the meaning and effect of the FCN Treaty and the Supplementary Agreement; the legal status of the requisition order and the legal and practical significance of the financial position of ELSI and its effect on plans for an orderly liquidation. All three of these determinations would be subject to different interpretations as the concurring and dissenting opinions show.

²¹ For a discussion of whether a treaty violation can be considered a direct injury to a State when it is intended to protect a State's nationals, *See: Interhandel Case (Switz. v. U.S.)*, 1959 I.C.J. 6, 27.

²² *ELSI*, 28 I.L.M. at 1127.

²³ Italy argued that Raytheon and Machlett could have proceeded under Article 2043 of the Italian Civil Code (the equivalent of a tort provision) to argue that the requisition was in violation on the FCN Treaty and its Supplementary Agreement for which implementing legislation had been enacted. *ELSI*, 28 I.L.M. at 1127.

a. The Right to Control and Manage.

Article III, paragraph 2, sentence 1 of the FCN Treaty provides that "[t]he nationals, corporations and associations of either High Contracting Party shall be permitted . . . to organize, control and manage corporations and associations of such other High Contracting Party for engaging in commercial . . . activities." In responding to the claim that Italy violated this provision, the Chamber held that the provision does not provide a warranty that the management and control of a company will not be interfered with. The Chamber recognised that public emergencies could justify interference with such rights. In this case however, the Chamber noted that the Prefect of Palermo had found that the requisition was unjustified under local law and therefor the requisition order could be seen as a *prima facie* violation of Article III. The Chamber continued its inquiry, however, and asked whether the financial position of ELSI on the eve of the requisition meant that, as a practical matter, and under Italian law, ELSI would be able to proceed with an orderly liquidation.

Although the Chamber recognised that there was evidence that Raytheon was prepared to supply cash flow and other assistance to effect an orderly liquidation it eventually held that there was insufficient evidence to establish causation. The doubts of the Chamber were as follows: the banks would not agree to give the company time to effect an orderly liquidation; it was speculative to assume the banks would agree to only 50 per cent of what was owed to them, especially since the employees of ELSI, who were preferential creditors, had not been paid; the liquidation plan involved an inequality among creditors to which there might have been some objection; ELSI could not have counted on undisturbed access to the plant in order to sell it due to the occupation by workers on strike; ELSI knew the Sicilian government was opposed to the dismissal of workers and would take steps to prevent it and, finally, under Italian law there was some question as to whether ELSI would have been forced to declare bankruptcy, even if the requisition had not occurred. The Chamber concluded in effect that the requisition was not the cause of the forced bankruptcy of ELSI and therefor the requisition did not deprive the shareholders of their right to manage and control ELSI.

As a result, the Chamber concluded that Article III, paragraph 2 of the FCN Treaty was not violated. As will be seen below, the determination that the requisition did not cause the bankruptcy determination was fatal to the case of the United States. Having rejected causation, the Chamber was more easily able to deal with the other alleged violations of the FCN and the Supplementary Agreement.

b. Security for Persons and Property.

Article V, paragraph 1 of the FCN provides that "[t]he nationals 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." Article V, paragraph 3 provides that the protection and security of paragraph 1 shall be no less than that given to the nationals of the other High Contracting party or those of a third party. "Moreover, in all matters relating to the taking of privately owned enterprises into public ownership" the same standards will apply.

Without deciding whether the property to be protected extended to include the plant and assets of ELSI, the Chamber did apply the term to the entity of ELSI itself as property of the foreign shareholders. Nevertheless, the Chamber found that there was no violation of Article V since, although there was some occupation of the property by workers after the requisition, no damage to the plant had been caused thereby. The Chamber then reiterated its finding that Article V could not be considered a warranty that property will never be occupied or disturbed and that, in the circumstances, although the Prefect and the court of Appeals of Palermo found the requisition to be unlawful, this did not fall below the standards set forth in Article V, i.e. those of international law or national law. In effect, the issue was reduced to a question of whether the United States' nationals had been treated less well than Italian nationals. The Chamber answered this question in the negative.

As an added claim under Article V, paragraphs 1 and 3, the United States alleged that the sixteen-month delay on the part of the Prefect in ruling on the administrative appeal of the requisition order the bankruptcy could have been avoided. Although the Chamber found the delay to be overly long, it did not find the requisition order to have been the cause of the bankruptcy of ELSI. Furthermore, it was argued that the delay did not rise to the level of a denial of justice under international law and that there was insufficient evidence of an Italian national standard providing for shorter delays.

c. Takings of Property

Article V, paragraph 2 of the FCN Treaty provides that "[t]he property of nationals, corporations and associations of either High Contracting Party shall not be taken without due process of law and without the prompt payment of just and effective compensation." Here there was argument between the parties whether the more expansive meaning of the English word "taking" or the more restrictive sense of the Italian word "espropriazione" should be applied. The Chamber determined that, even according to the broader term, there was no taking requiring compensation. Relying on the same finding of a lack of causation and the admission of the United States that there was no collusion on the part of the Italian Government, the requisition for a limited period, which the Chamber found did not trigger the bankruptcy, did not amount to a taking. The Chamber did say in obiter dictum, however, that if the duration of the

requisition had been prolonged, and the decision of the administrative remedy had been different, the requisition may well have amounted to a taking.²⁴

d. Protection from Arbitrary Measures

Article I of the Supplementary Agreement provides that "[t]he 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 . . ." Here again the Chamber found that the United States failed to establish causation in that the requisition was not shown to be part of a conspiracy by the Italian Government to acquire the assets of ELSI through the ultimate purchase at auction by ELTEL at a low price. The argument by the United States that requisition was found to be unlawful by Italian municipal courts was deemed insufficient by the Chamber to prove the act was also arbitrary. It reasoned that to equate unlawfulness with arbitrariness would deprive the former term of any independent meaning. As a result, the Chamber looked to the bases for the decision by the Mayor of Palermo and held that his concern with local public pressures was enough to overcome any argument that the requisition order was arbitrary under Italian law. Furthermore, the Chamber refused to find the requisition arbitrary under international law. The judges emphasised the fact that the Mayor's decision was subject to appeal and that it was made under Italian law. Although the municipal courts found that the requisition could not accomplish its stated purpose of keeping the ELSI plant open, it was, nevertheless, an exercise of the Mayor's powers under Italian law, and therefore, not arbitrary under international law.²⁵

e. Right to Acquire, Own or Dispose of Immovable Property or Interests.

Article VII of the FCN provides that "[t]he nationals, corporations and associations of either High Contracting Party shall be permitted to acquire, own and dispose of immovable property or interests therein within the territories of the other High Contracting Party" Here there was disagreement between the parties whether the Article applied at all to Raytheon and Machlett. Italy argued that the shareholders property rights (*diritti reali*) were limited to

²⁴ Here, Stern objects that the Chamber isn't restraining itself to deciding only the issues necessary to the solution of the case before it. Stern, *supra* note 16, at 918.

²⁵ The Chamber defines arbitrariness as "not so much something opposed to a rule of law as something opposed to the rule of law" . . . It is a wilful disregard of due process of law, an act which shocks or at least surprises, a sense of judicial propriety." *ELSI*, 28 I.L.M. at 1142. In its analysis, however, the Chamber seems to say that if the act is subjected to judicial or administrative procedure, and the municipal fora find that the act is not arbitrary, then it cannot be so under international law. The danger of this rule is noted in Murphy, *supra* note 18 at 433.: "[t]his interpretation renders a previously useful standard of protection much less effective." As a result of the tension which would have one equate arbitrariness with unlawfulness, (something which the Chamber refused to do), Murphy recommends that future agreements use a standard of reasonableness rather than arbitrariness, since the former would be easier to satisfy. *Id.* at 435.

ownership of the shares in ELSI. The United States argued, and the Chamber agreed, that the phrase "immovable property or interests therein" was broad enough to include the ownership of property held through a subsidiary. The Chamber, however, found Article VII inapplicable to the facts of the case. The protections of the Article were held to be qualified by a proviso which the Chamber interpreted as requiring that the United States make a showing that Raytheon and Machlett were treated in a way less favourable than that in which an Italian corporation would have been treated. Indeed, the Chamber acknowledged that requisitions of Italian companies had occurred with some frequency. Adopting an alternative meaning of the claim by the United States, the Chamber concluded that Italy would have to meet the requirements of the law of the state in which the shareholder corporations were domiciled (in this case Delaware and Connecticut). Although it was determined that Italy had failed to meet these requirements, the Chamber returned to its previous finding that the precarious financial state of ELSI, and not the requisition, was the cause of the inexorable bankruptcy.²⁶ The claims of the United States for compensation occasioned by the inability of ELSI to implement its plan for orderly liquidation were therefor rejected by a vote of four to one.

C. Judge Oda's Separate Opinion

In his separate opinion, Judge Oda concurred for different reasons. Highlighting the fact that the United States brought the claim as an espousal of the claim of its nationals, the Judge adhered to the rationale in the *Barcelona Traction* decision.²⁷ He reiterated the rule of *Barcelona* that the rights of the shareholders and the right of the corporation are different. Since the claim was not brought on behalf of ELSI, (here it must be recognised that the United States could not espouse the claim of a corporation that is not a national of the United States) it could not be for the damage done to the corporation. He further argued that there was no damage done to the rights of the shareholders. Although their interests were affected, their rights as distinct from those of ELSI were not. Judge Oda phrased his approach as the classical rule whereby the shareholders' rights are limited in relation to the company and its assets, which is a corollary of the shareholders' limited liability. The direct rights (*droits propres*) of the shareholder are not implicated, unless an action is brought for a wrong done by the corporation to the shareholder. Since the shareholder only has rights vis-à-vis the corporation, in an action against a third party such as this, the shareholders lack *jus standi*. Only ELSI could have complained of the loss of control over its assets.

²⁶ The rather convoluted language of the Treaty and the decision are elegantly paraphrased by Stern, "Les sociétés américaines se voient donc accorder par le traité, le traitement le moins favorable dont bénéficient les sociétés italiennes respectivement aux Etats-Unis et en Italie." Stern, *supra* note 16, at 921.

²⁷ Case Concerning *Barcelona Traction, Light, and Power Company, Ltd.* (New Application: 1962) (Belg. v. Spain), 1970 I.C.J. 3 (Second Phase).

Judge Oda refused to find that the FCN Treaty could have changed this rule of international law without some express provision to that end.²⁸ In his analysis of the provisions of the FCN cited by the United States, Judge Oda found that the treaty was worded to grant rights to corporations but not to shareholders. The shareholders rights can be no greater than those under Italian law or under general principles of (international) law. This analysis is also applied to the Supplementary Agreement. The only right which Judge Oda found the treaty expressly granted to the United States' corporations as shareholders, was that of owning up to 100 per cent of an Italian company's stock.²⁹ This right was clearly not infringed even if the value of those stocks and the entitlement of the shareholders to the amounts remaining after dissolution may have been adversely affected by the requisition.

Having found the cited provisions of the FCN inapplicable, Judge Oda turned to other provisions of the Treaty which he termed extraordinary and which could have been used to protect ELSI against the actions by the Italian Government.³⁰ Unfortunately, these were not the provisions relied upon by the other side. Perhaps in response to what could be viewed as his reluctance to expand the rights of shareholders under international law, Judge Oda stated that it is "a great privilege to be able to engage in business in a country other than one's own" so that "foreigners may have to accept a number of restrictions in return for the advantages of doing business through such local companies."³¹ Not only does this argument ignore the very purpose behind the creation of Treaties such as the FCN, but Judge Oda has ignored an opportunity to encourage a change in the law which would favour the continued growth of foreign investment.

Judge Oda in fact found a paradox because he refused to extend his view beyond the rights of the corporation to those of the shareholders. Instead he argued that under the extraordinary provisions of the FCN, which he read as a guarantee to ELSI of most-favoured-nation treatment or national treatment, the United States could have espoused the claim of ELSI itself and thereby protected its shareholders indirectly. This was not done. In the end, he concurred in the result arrived at by the Chamber because he believed that the United States had failed to produce enough evidence to show denial of justice in the Italian courts.

D. Judge Schwebel's Dissenting Opinion

Judge Schwebel began his dissent by supporting the rule of reason applied by the Chamber and the expansive interpretation given the FCN. Judge

²⁸ *ELSI*, 28 I.L.M. at 1147. (Oda's concurring opinion.)

²⁹ *Id.* at 1148.

³⁰ *Id.* at 1148-49.

³¹ *Id.* at 1149.

Schwebel went further, however, and found that Article III of the FCN was violated and that the requisition was an arbitrary act. In essence, he disagreed with the facts and concluded that the requisition order was indeed the cause of the forced bankruptcy. The uncertainties which led the Chamber to find that causation was not established, because the allegation was too speculative, were treated by Judge Schwebel more as a question of the damages to be awarded rather than a matter of causation - having deprived ELSI of the right to liquidate, the requisition interfered with the rights of the corporation.

As to the question of arbitrariness, Judge Schwebel disagreed with the three bases of the Chamber's decision. He read the decisions of the Italian courts as holding that the Prefect *had* acted arbitrarily. He cited to the language stating that since the requisition order did not and could not achieve its intended purpose "it lacked the juridical motivation which might justify it and make it operative." He concluded that this "is not far from stating that the requisition was ill-motivated and hence unreasonable or even capricious."³² Judge Schwebel suggested that just as the Chamber looked to the "meaning and purpose" of the FCN Treaty to determine whether or not certain acts constituted a breach of the right to control and manage, as guaranteed in the treaty, so should the Chamber have done when determining what is arbitrary. The order was intended to prevent the orderly liquidation of ELSI, was contrary to the treaty obligation, and hence, should have been deemed to be arbitrary under international law. He points specifically to the fact that the Mayor did not abide by his own decree and failed to pay compensation.

Judge Schwebel considered the fact that the decision was subject to review, both administratively and judicially, insufficient to render an arbitrary act non-arbitrary. First he cited to the delay involved in the review of the Prefect's order, a delay which he held to have materially prejudiced the shareholders. He argued that, under Articles 20 and 21 of the International Law Commission's Draft Articles of State Responsibility, Italy was under an obligation to achieve a result in conformity with Article 1 of the Supplementary Agreement once the situation which placed it in violation of that provision arose.³³ In his interpretation, Judge Schwebel argued that Italy's obligation was one of result. Italy's conduct in reviewing the Mayor's order was not

³² *ELSI*, at 1143. (Judge Schwebel's dissenting opinion.)

³³ Articles 20 and 21 of the Commission's Draft Articles on State Responsibility provide as follows: "Article 20. There is a breach by a State of an international obligation requiring it to adopt a particular course of conduct when the conduct of that State is not in conformity with that required of it by that obligation. Article 21. 1. There is a breach by a State of an international obligation requiring it to achieve, by means of its own choice, a specified result if, by the conduct adopted, the State does not achieve the result required of it by that obligation. 2. When the conduct of the State has created a situation not in conformity with the result required of it by an international obligation, but the obligation allows that this or an equivalent result may nevertheless be achieved by subsequent conduct of the State, there is a breach of the obligation only if the State also fails by its subsequent conduct to achieve the result required of it by that obligation." II Y.B. INT'L L. COMM'N 11 (1977).

enough. It had an obligation to correct its violation of the Treaty, i.e. to restore ELSI to where it would have been had the requisition not occurred. Although Judge Schwebel recognised the difficulties inherent in attempting to determine just what amount of damages suffered by ELSI were due to the requisition, he believed that since the Italian appeals procedure did not attempt to achieve this result (granting indemnification only for the rental value of the property while it was requisitioned) it could not have corrected the arbitrary act of the Mayor of Palermo.

III. THE IMPLICATIONS FOR THE LAW

A. The Rule on the Admissibility of Claims

The adoption of a "rule of reason" by the Chamber to address the issue of whether local remedies have been exhausted reflects a sensible approach to the problem. The Chamber did not adopt a stricter view which could have required a showing that all possible causes of action under Italian law be pursued or that the parties whose claim was espoused were the parties who actually brought suit in the local courts.

In its approach, the Chamber seemed to support the conclusion that the rule of exhaustion of local remedies is a procedural requirement. Rather than having the burden of proving that local remedies have been exhausted, the claimant need only make a *prima facie* showing of exhaustion of local remedies, and the respondent must then rebut the presumption raised.³⁴ Such an approach favours the admissibility of the claim while assuring that the claimant will have made a real attempt at solving the dispute locally.

The attorney for the United States, Sean D. Murphy, argues that "the Vienna Convention does not support the incorporation of unexpressed rules of customary international law" and that the Chamber strayed from the ICJ's "very textual 'plain meaning' approach"³⁵ in reading a requirement that local remedies be exhausted into the FCN Treaty. Although the FCN Treaty does not explicitly require such a showing, the rule adopted by the Chamber represents a sound approach to preserving a long-standing rule of international law while also protecting the position of the ICJ which, under the rule, will not speak on the treaty until all meaningful municipal and diplomatic attempts at finding a solution have failed.³⁶

³⁴ Murphy, *supra* note 18, at 413.

³⁵ Vienna Convention on the Law of Treaties, 8 I.L.M. 679 (1969), *reprinted in* 63 AM. J. INT'L L. 875 (1969). (While the United States have not ratified the Convention they have asserted that the principles relating to the interpretation codify established principles of customary international law.)

³⁶ Statute of the ICJ, *supra* note 20.

Murphy also argues that the Chamber's reasoning was too facile in rejecting the argument that Italy could be estopped from asserting the failure to exhaust local remedies. He cites to other decision where the court has applied to estoppel even where the conduct upon which such estoppel is based is silence. The danger Murphy underlines here is that the Chamber may have created the impression that estoppel will be applied solely according to the result the Court would like to achieve, thereby undermining the perceptions of the Court's integrity.³⁷

In spite of these criticisms, the decision suggests that the long standing rule of international law, that local remedies must be exhausted will be applied even under treaties where the principle is not specifically dispensed with, and where the respondent nation fails to challenge the claim prior to its reaching the ICJ. Furthermore, in allowing the claim brought by the trustee in bankruptcy to satisfy the rule, the requirements of the rule have been rationalised so that, as long as the matter has been substantially brought up in the municipal courts, not all legal theories need be exhausted nor do the parties involved in the municipal dispute have to be the same parties those whose claim is brought internationally.

B. The Non-application of the Rule on Espousal of Claims by Shareholders

Although the Chamber ignored the holding in *Barcelona* in its decision, the case is clearly germane to a discussion of the ELSI decision. Judge Oda relied on *Barcelona* in his concurrence to argue that the facts of the ELSI case put it within the general rule of *Barcelona*. He argued that no matter how the articles of the FCN were construed the claims by the United States that these were violated could not be the basis for the espousal of a claim on behalf of Raytheon and Machlett, since the provision of the FCN creates no rights on behalf of shareholders. Brigitte Stern, who agrees with Judge Oda, presents the hypothetical of when a violation of the FCN would in fact provide the shareholders with a claim. She states that Article III, paragraph 2 of the FCN would have been violated if, for instance, Italy had passed a law preventing foreigners from holding a majority of shares in Italian corporations.³⁸ She notes that, under *Barcelona*, the Chamber, rather than inquiring whether the requisition constituted a taking or not, should have held that since the act was not directed at the shareholders it could not have violated the Treaty.³⁹ Furthermore, she argues that in going beyond the determination that the requisition was not a disguised taking, the Chamber violated a principle of the ICJ to decide strictly the issues before it.⁴⁰

³⁷ Murphy, *supra* note 18, at 411.

³⁸ Stern, *supra* note 16, at 911.

³⁹ *Id.* at 916.

⁴⁰ *Id.* at 918.

The opinion of Barcelona Traction recognises that there are three possible exceptions to the general rule which it laid down: (1) the corporation no longer existed and the shareholders were the only ones left to take up the claim; (2) this is a case where the shareholders must bring the claim because a State cannot protect one of its nationals against itself; and (3) this case is exceptional because it is based on a treaty. Stern argues that the court did not make clear under which of these three exceptions the ELSI decision fell. She admonishes the Chamber for failing to state clearly what the customary law was on each point and how the treaty modified it.⁴¹ She describes the failure of the Chamber to state clearly whether the decision was based on customary international law or on the FCN and why the Chamber failed to distinguish Barcelona Traction as follows: "La Chambre a ainsi procédé comme le font souvent les juridictions - internes ou internationales - lorsqu'elles opèrent un sérieux revirement de jurisprudence, à savoir affirmer les nouveaux principes, mais sans les appliquer - pour des raisons factuelles - au cas d'espèce, pour rendre le changement moins brutal."⁴²

Although Stern has correctly noted the difficulty in reconciling the Chamber's decision with the previous important decision by the ICJ, the fact that the Chamber was not explicit in restricting its decision to the FCN, nor stating clearly which of the three exceptions to Barcelona Traction it fits under, has created ample room for the expansion of the protection of shareholders and investments under principles of customary international law.

IV. CONCLUSION

Read broadly, the decision in the ELSI case extends greater protections to shareholders who have invested abroad as the principles upon which the case was decided become part of customary international law. As Murphy noted in his discussion of obiter dictum in the decision, "[f]rom the earliest decisions of the Permanent Court of International Justice, many elements of the decisions of the ICJ, even though based solely on particular treaties or unnecessary to the ultimate ruling, have nevertheless worked their way into the fabric of customary international law."⁴³ This realisation is especially important when one considers the statement by Sir Robert Y. Jennings that "section 38 of the Statute of the International Court of Justice which ranks decided cases alongside learned commentators as 'subsidiary means for the ascertainment of the law' is out of

⁴¹ *Id.* at 931.

⁴² Thus the Chamber proceeds as often do jurisdictions - domestic or international - when they engage in a serious change in jurisprudence, to know how to affirm the new principles, without applying them - for factual reasons - to the case at hand, in order to render the change less brutal. (Author's translation) *Id.* at 935.

⁴³ Murphy, *supra* note 18, at 448

line with contemporary practice, according to which decided cases are certainly more important than writings."⁴⁴

Whether or not the decision is read to modify the rules of customary international law on the espousal of the claims of shareholders, the rule in the ELSI case will have an effect on the agreements which states have made amongst each other for the protection of the investments of their nationals. As noted above, the language of such agreements may be modified to move away from protecting from arbitrary acts towards a standard of reasonableness, as suggested by Murphy. The language of such agreements may also be modified to expressly include protection for the rights of shareholders. In the case of bilateral investment treaties (BITs), the impact may be less since these treaties protect investments directly as well as their "associated activities," including indirect ownership and interests in assets, and therefore do not generally suffer from the same shortcomings of the FCN.⁴⁵

Even interpreted narrowly, although the United States did not prevail based on the facts, the decision in general heralds greater protection for foreign investment. An interesting question now would be to ask what view the entire ICJ, composed also of judges from the developing countries, would take of the rule in the ELSI case. The Chamber, with the exception of the President, was composed of judges from developed countries. Would the rest of the judges reject the added protections for foreign investment? Or, as Stern notes in her article, since 'removal of the corporate veil' has been used to hold corporations responsible for the acts of their subsidiaries, could the protection to the right to control in ELSI also be interpreted to extend this additional protection into an increased liability?⁴⁶

⁴⁴ See Jennings, *An International Lawyer Takes Stock*, 1 U. MIAMI Y.B. INT'L L. 1, 8 (1991)(*supra* this volume).

⁴⁵ *Id.* at 444-47.

⁴⁶ Standard oil was held responsible for the damages caused by the oil spilled from the Amoco Cadiz, even though a series subsidiaries separated Standard from Transport Co., a Liberian corporation. See Stern, *supra* note 16, at 942-943.