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CHAPTER V

RESPONSIBILITY OF STATES FOR INTERNATIONALLY WRONGFUL ACTS

Addendum

E. Text of the draft articles on Responsibility of States for internationally wrongful acts (*continued*)

2. Text of the draft articles with commentaries thereto (*continued*)

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CHAPTER II

REPARATION FOR INJURY

Chapter II deals with the forms of reparation for injury, spelling out in further detail the general principle stated in article 31, and in particular seeking to establish more clearly the relations between the different forms of reparation, viz., restitution, compensation and satisfaction, as well as the role of interest and the question of taking into account any contribution to the injury which may have been made by the victim.

Article 34

Forms of reparation

> Full reparation for the injury caused by the internationally wrongful act shall take the form of restitution, compensation and satisfaction, either singly or in combination, in accordance with the provisions of this Chapter.

Commentary

(1) Article 34 introduces Chapter II by setting out the forms of reparation which separately or in combination will discharge the obligation to make full reparation for the injury caused by the internationally wrongful act. Since the notion of "injury" and the necessary causal link between the wrongful act and the injury are defined in the statement of the general obligation to make full reparation in article 31,[1] article 34 need do no more than refer to "[f]ull reparation for the injury caused".

(2) In the *Factory at Chorzów* case, the injury was a material one and the Permanent Court dealt only with two forms of reparation, restitution and compensation.[2] In certain cases, satisfaction may be called for as an additional form of reparation. Thus full reparation may take the form of restitution, compensation and satisfaction, as required by the circumstances. Article 34 also makes it clear that full reparation may only be achieved in particular cases by the combination of different forms of reparation. For example, re-establishment of the situation which existed before the breach may not be sufficient for full reparation because the wrongful act has caused additional material damage (e.g., injury flowing from the loss of the use of

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[1] See commentary to article 31, paras. (5)-(14).

[2] *Factory at Chorzów, Merits, 1928, P.C.I.J. Series A, No. 17*, p. 47.

property wrongfully seized). Wiping out all the consequences of the wrongful act may thus require some or all forms of reparation to be provided, depending on the type and extent of the injury that has been caused.

(3) The primary obligation breached may also play an important role with respect to the form and extent of reparation. In particular, in cases of restitution not involving the return of persons, property or territory of the injured State, the notion of reverting to the *status quo ante* has to be applied having regard to the respective rights and competences of the States concerned. This may be the case, for example, where what is involved is a procedural obligation conditioning the exercise of the substantive powers of a State. Restitution in such cases should not give the injured State more than it would have been entitled to if the obligation had been performed.[3]

(4) The provision of each of the forms of reparation described in article 34 is subject to the conditions laid down in the articles which follow it in Chapter II. This limitation is indicated by the phrase "in accordance with the provisions of the present Chapter". It may also be affected by any valid election that may be made by the injured State as between different forms of reparation. For example, in most circumstances the injured State is entitled to elect to receive compensation rather than restitution. This element of choice is reflected in article 43.

(5) Concerns have sometimes been expressed that the principle of full reparation may lead to disproportionate and even crippling requirements so far as the responsible State is concerned. The issue is whether the principle of proportionality should be articulated as an aspect of the obligation to make full reparation. In these Articles, proportionality is addressed in the context of each form of reparation, taking into account its specific character. Thus restitution is excluded if it would involve a burden out of all proportion to the benefit gained by the injured State or other party.[4] Compensation is limited to damage actually suffered as a result of the internationally

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[3] Thus in the *LaGrand* case, the Court indicated that a breach of the notification requirement in art. 36 of the Vienna Convention on Consular Relations (24 April 1963, *U.N.T.S.*, vol. 596, p. 261), leading to a severe penalty or prolonged detention, would require reconsideration of the fairness of the conviction "by taking account of the violation of rights set forth in the Convention": *LaGrand (Germany v. United States of America), Merits,* judgment of 27 June 2001, para. 125. This would be a form of restitution which took into account the limited character of the rights in issue.

[4] See article 35 (b) and commentary.

wrongful act, and excludes damage which is indirect, consequential or remote.[5] Satisfaction must "not be out of proportion to the injury".[6] Thus each of the forms of reparation takes such considerations into account.

(6) The forms of reparation dealt with in Chapter II represent ways of giving effect to the underlying obligation of reparation set out in article 30 (b). There are not, as it were, separate secondary obligations of restitution, compensation and satisfaction. Some flexibility is shown in practice in terms of the appropriateness of requiring one form of reparation rather than another, subject to the requirement of full reparation for the breach in accordance with article 30 (b).[7] To the extent that one form of reparation is dispensed with or is unavailable in the circumstances, others, especially compensation, will be correspondingly more important.

Article 35

Restitution

A State responsible for an internationally wrongful act is under an obligation to make restitution, that is, to re-establish the situation which existed before the wrongful act was committed, provided and to the extent that restitution:

(a) is not materially impossible;

(b) does not involve a burden out of all proportion to the benefit deriving from restitution instead of compensation.

Commentary

(1) In accordance with article 34, restitution is the first of the forms of reparation available to a State injured by an internationally wrongful act. Restitution involves the re-establishment as far as possible of the situation which existed prior to the commission of the internationally wrongful

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[5] See article 30 (b) and commentary.

[6] See article 37 (3) and commentary.

[7] E.g., *Mélanie Lachenal*, *R.I.A.A.*, vol. XIII, p. 116 (1954), at pp. 130-131, where compensation was accepted in lieu of restitution originally decided upon, the Franco-Italian Conciliation Commission having agreed that restitution would require difficult internal procedures. See also commentary to article 35, para. (4).

act, to the extent that any changes that have occurred in that situation may be traced to that act. In its simplest form, this involves such conduct as the release of persons wrongly detained or the return of property wrongly seized. In other cases, restitution may be a more complex act.

(2) The concept of restitution is not uniformly defined. According to one definition, restitution consists in re-establishing the *status quo ante*, i.e. the situation that existed prior to the occurrence of the wrongful act. Under another definition, restitution is the establishment or re-establishment of the situation that would have existed if the wrongful act had not been committed. The former definition is the narrower one; it does not extend to the compensation which may be due to the injured party for loss suffered, for example for loss of the use of goods wrongfully detained but subsequently returned. The latter definition absorbs into the concept of restitution other elements of full reparation and tends to conflate restitution as a form of reparation and the underlying obligation of reparation itself. Article 35 adopts the narrower definition which has the advantage of focusing on the assessment of a factual situation and of not requiring a hypothetical inquiry into what the situation would have been if the wrongful act had not been committed.

(3) Nonetheless, because restitution most closely conforms to the general principle that the responsible State is bound to wipe out the legal and material consequences of its wrongful act by re-establishing the situation that would exist if that act had not been committed, it comes first among the forms of reparation. The primacy of restitution was confirmed by the Permanent Court in the *Factory at Chorzów* case when it said that the responsible State was under "the obligation to restore the undertaking and, if this be not possible, to pay its value at the time of the indemnification, which value is designed to take the place of restitution which has become impossible".[8] The Court went on to add that "the impossibility, on which the Parties are agreed, of restoring the Chorzów factory could therefore have no other effect but that of substituting payment of the value of the undertaking for restitution".[9] It can be seen in operation in the cases where tribunals have considered compensation only after concluding that, for one reason or

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[8] *Factory at Chorzów, Merits, 1928, P.C.I.J. Series A, No. 17*, p. 48.

[9] Ibid.

another, restitution could not be effected.[10] Despite the difficulties restitution may encounter in practice, States have often insisted upon claiming it in preference to compensation. Indeed in certain cases, especially those involving the application of peremptory norms, restitution may be required as an aspect of compliance with the primary obligation.

(4) On the other hand there are often situations where restitution is not available or where its value to the injured State is so reduced that other forms of reparation take priority. Questions of election as between different forms of reparation are dealt with in the context of Part Three.[11] But quite apart from valid election by the injured State or other entity, the possibility of restitution may be practically excluded, e.g. because the property in question has been destroyed or fundamentally changed in character or the situation cannot be restored to the *status quo ante* for some reason. Indeed in some cases tribunals have inferred from the terms of the *compromis* or the positions of the parties what amounts to a discretion to award compensation rather than restitution. For example, in the *Walter Fletcher Smith* case, the arbitrator, while maintaining that restitution should be appropriate in principle, interpreted the *compromis* as giving him a discretion to award compensation and did so in "the best interests of the parties and of the public".[12] In the *Aminoil* arbitration, the parties agreed that restoration of the *status quo ante* following the annulment of the concession by Kuwaiti decree would be impracticable.[13]

(5) Restitution may take the form of material restoration or return of territory, persons or property, or the reversal of some juridical act, or some combination of them. Examples of

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[10] See, e.g., *British Claims in the Spanish Zone of Morocco*, *R.I.A.A.*, vol. II, p. 615 (1925), at pp. 621-625, 651-742; *Religious Property expropriated by Portugal*, *R.I.A.A.*, vol. I, p. 7 (1920); *Walter Fletcher Smith*, *R.I.A.A.*, vol. II, p. 913 (1927), at p. 918; *Heirs of Lebas de Courmont*, *R.I.A.A.*, vol. XIII, p. 761 (1957), at p. 764.

[11] See articles 43, 45 and commentaries.

[12] *R.I.A.A.*, vol. II, p. 915 (1929), at p. 918. In the *Greek Telephone Company* case, the arbitral tribunal, while ordering restitution, asserted that the responsible State could provide compensation instead "for important State reasons". See J.G. Welter and S.M. Schwebel, "Some little known cases on concessions", *B.Y.I.L.,* vol. 40 (1964), p. 216, at p. 221.

[13] *Government of Kuwait v. American Independent Oil Company,* (1982) *I.L.R.,* vol. 66, p. 529, at p. 533.

material restitution include the release of detained individuals, the handing over to a State of an individual arrested in its territory,[14] the restitution of ships,[15] or other types of property[16] including documents, works of art, share certificates, etc.[17] The term "juridical restitution" is sometimes used where restitution requires or involves the modification of a legal situation either within the legal system of the responsible State or in its legal relations with the injured State. Such cases include the revocation, annulment or amendment of a constitutional or legislative provision enacted in violation of a rule of international law,[18] the rescinding or reconsideration of an administrative or judicial measure unlawfully adopted in respect of the person or property of a foreigner[19] or a requirement that steps be taken (to the extent allowed by international law) for the termination of a treaty.[20] In some cases, both material and juridical restitution may be

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[14] Examples of material restitution involving persons include the "*Trent*" (1861) and "*Florida*" (1864) incidents, both involving the arrest of individuals on board ships: Moore, *Digest,* vol. VII, pp. 768, 1090-1091), and the *Diplomatic and Consular Staff* case in which the International Court ordered Iran to immediately release every detained United States national: *Diplomatic and Consular Staff in Tehran, I.C.J. Reports 1980,* p. 3, at pp. 44-45.

[15] See e.g. the "*Giaffarieh*" incident (1886) which originated in the capture in the Red Sea by an Egyptian warship of four merchant ships from Massawa under Italian registry: *La prassi italiana di diritto internazionale*, 1st series (Dobbs Ferry, Oceana, 1970), vol. II, pp. 901-902.

[16] E.g., *Temple of Preah Vihear, Merits, I.C.J. Reports* 1962, p. 6, at pp. 36-37, where the International Court decided in favour of a Cambodian claim which included restitution of certain objects removed from the area and the temple by Thai authorities. See also the *Hôtel Métropole* case, *R.I.A.A.*, vol. XIII, p. 219 (1950), the *Ottoz* case, *R.I.A.A.*, vol. XIII, p. 240 (1950), the *Hénon* case , *R.I.A.A.*, vol. XIII, p. 249 (1951).

[17] In the *Buzau-Nehoiasi Railway* case, an arbitral tribunal provided for the restitution to a German company of shares in a Romanian railway company: *R.I.A.A.*, vol. III, p. 1839 (1939).

[18] For cases where the existence of a law itself amounts to a breach of an international obligation see commentary to article 12, para. (15).

[19] E.g., the *Martini* case, *R.I.A.A.*, vol. II, p. 973 (1930).

[20] In the *Bryan-Chamorro Treaty* case (*Costa Rica v. Nicaragua*), the Central American Court of Justice decided that "the Government of Nicaragua, by availing itself of measures possible under the authority of international law, is under the obligation to re-establish and maintain the legal status that existed prior to the Bryan-Chamorro Treaty between the litigant republics in so far as relates to matters considered in this action..." *A.J.I.L.*, vol. 11 (1917), p. 674, at pp. 683, 696.

involved.[21] In others, an international court or tribunal can, by determining the legal position with binding force for the parties, award what amounts to restitution under another form.[22] The term "restitution" in article 35 thus has a broad meaning, encompassing any action that needs to be taken by the responsible State to restore the situation resulting from its internationally wrongful act.

(6) Restitution, as the first of the forms of reparation, is of particular importance where the obligation breached is of a continuing character, and even more so where it arises under a peremptory norm of general international law. In the case, for example, of unlawful annexation of a State, the withdrawal of the occupying State's forces and the annulment of any decree of annexation may be seen as involving cessation rather than restitution.[23] Even so, ancillary measures (the return of persons or property seized in the course of the invasion) will be required as an aspect either of cessation or restitution.

(7) What may be required in terms of restitution will often depend on the content of the primary obligation which has been breached. In cases not involving the return of persons, property or territory of the injured State, the notion of restoring the *status quo ante* has to be applied having regard to the respective rights and competences of the States concerned.

(8) The obligation to make restitution is not unlimited. In particular, under article 35 restitution is required "provided and to the extent that" it is neither materially impossible nor

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[21] Thus the Permanent Court held that Czechoslovakia was "bound to restore to the Royal Hungarian Peter Pázmány University of Budapest the immovable property claimed by it, freed from any measure of transfer, compulsory administration, or sequestration, and in the condition in which it was before the application of the measures in question": *Appeal from a judgement of the Hungaro-Czechoslovak Mixed Arbitral Tribunal (The Peter Pázmány University), 1933, P.C.I.J., Series A/B, No. 61,* p. 208, at p. 249.

[22] In the *Legal Status of Eastern Greenland* case, the Permanent Court decided "that the declaration of occupation promulgated by the Norwegian Government on July 10th, 1931, and any steps taken in this respect by that Government, constitute a violation of the existing legal situation and are accordingly unlawful and invalid.": *1933, P.C.I.J., Series A/B, No. 53,* p. 22, at p. 75. In *Free Zones of Upper Savoy and the District of Gex* the Permanent Court decided that France "must withdraw its customs line in accordance with the provisions of the said treaties and instruments… and that this regime must continue in force so long as it has not been modified by agreement between the Parties": *1932, P.C.I.J.*, *Series A/B, No. 46,* p. 96, at p.172. See also F.A. Mann, "The consequences of an international wrong in international and municipal law", *B.Y.I.L.*, vol. 48 (1976-77), p. 1 at pp. 5-8.

[23] See above, commentary to article 30, para. (8).

wholly disproportionate. The phrase "provided and to the extent that" makes it clear that restitution may be only partially excluded, in which cases the responsible State will be obliged to make restitution to the extent that this is neither impossible nor disproportionate.

(9) Under article 35 (a), restitution is not required if it is "materially impossible". This would apply where property to be restored has been permanently lost or destroyed, or has deteriorated to such an extent as to be valueless. On the other hand, restitution is not impossible merely on grounds of legal or practical difficulties, even though the responsible State may have to make special efforts to overcome these. Under article 32 the wrongdoing State may not invoke the provisions of its internal law as justification for the failure to provide full reparation, and the mere fact of political or administrative obstacles to restitution do not amount to impossibility.

(10) Material impossibility is not limited to cases where the object in question has been destroyed, but can cover more complex situations. In the *Forests of Central Rhodope* case, the claimant was entitled to only a share in the forestry operations and no claims had been brought by the other participants. The forests were not in the same condition as at the time of their wrongful taking, and detailed inquiries would be necessary to determine their condition. Since the taking, third parties had acquired rights to them. For a combination of these reasons, restitution was denied.[24] The case supports a broad understanding of the impossibility of granting restitution, but it concerned questions of property rights within the legal system of the responsible State.[25] The position may be different where the rights and obligations in issue arise directly on the international plane. In that context restitution plays a particularly important role.

(11) In certain cases, the position of third parties may have to be taken into account in considering whether restitution is materially possible. This was true in the *Forests of Central Rhodope* case.[26] But whether the position of a third party will preclude restitution will depend on

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[24] *R.I.A.A.*, vol. III, p. 1405 (1933), at p. 1432.

[25] For questions of restitution in the context of State contract arbitration see *Texaco Overseas Petroleum Company and California Asiatic Oil Company v. Government of the Libyan Arab Republic*, (1977) *I.L.R.*, vol. 53, p. 389, at pp. 507-8, para. 109; *BP Exploration Company (Libya) Ltd. v. Government of the Libyan Arab Republic*, (1974) *I.L.R.*, vol. 53, p. 297, at p. 354; *Libyan American Oil Company (LIAMCO) v. Government of the Libyan Arab Republic*, (1977) *I.L.R.*, vol. 62, p. 140, at p. 200.

[26] *R.I.A.A.*, vol. III, p. 1405 (1933), at p. 1432.

the circumstances, including whether the third party at the time of entering into the transaction or assuming the disputed rights was acting in good faith and without notice of the claim to restitution.

(12) A second exception, dealt with in article 35 (b), involves those cases where the benefit to be gained from restitution is wholly disproportionate to its cost to the responsible State. Specifically, restitution may not be required if it would "involve a burden out of all proportion to the benefit deriving from restitution instead of compensation". This applies only where there is a grave disproportionality between the burden which restitution would impose on the responsible State and the benefit which would be gained, either by the injured State or by any victim of the breach. It is thus based on considerations of equity and reasonableness,[27] although with a preference for the position of the injured State in any case where the balancing process does not indicate a clear preference for compensation as compared with restitution. The balance will invariably favour the injured State in any case where the failure to provide restitution would jeopardize its political independence or economic stability.

Article 36

Compensation

1. The State responsible for an internationally wrongful act is under an obligation to compensate for the damage caused thereby, insofar as such damage is not made good by restitution.

2. The compensation shall cover any financially assessable damage including loss of profits insofar as it is established.

Commentary

(1) Article 36 deals with compensation for damage caused by an internationally wrongful act, to the extent that such damage is not made good by restitution. The notion of "damage" is defined inclusively in article 31 (2) as any damage whether material or moral.[28] Article 36 (2) develops this definition by specifying that compensation shall cover any financially assessable damage including loss of profits so far as this is established in the given case. The qualification

[27] See, e.g., J.H.W. Verzijl, *International Law in Historical Perspective* (Leyden, Sijthoff, 1973), part VI, p. 744, and the position taken by the Deutsche Gesellschaft für Völkerrecht, in *Yearbook... 1969*, vol. II, p. 155.

[28] See commentary to article 31, paras. (5), (6), (10).

"financially assessable" is intended to exclude compensation for what is sometimes referred to as "moral damage" to a State, i.e., the affront or injury caused by a violation of rights not associated with actual damage to property or persons: this is the subject matter of satisfaction, dealt with in article 37.

(2) Of the various forms of reparation, compensation is perhaps the most commonly sought in international practice. In the *Gabčíkovo-Nagymaros Project* case, the Court declared: "[i]t is a well-established rule of international law that an injured State is entitled to obtain compensation from the State which has committed an internationally wrongful act for the damage caused by it".[29] It is equally well-established that an international court or tribunal which has jurisdiction with respect to a claim of State responsibility has, as an aspect of that jurisdiction, the power to award compensation for damage suffered.[30]

(3) Compensation has a distinct function compared with both satisfaction and restitution. Its relationship with restitution is clarified by the final phrase of article 36 ("insofar as such damage is not made good by restitution"). Restitution, despite its primacy as a matter of legal principle, is frequently unavailable or inadequate. It may be partially or entirely ruled out either on the basis of the exceptions expressed in article 35, or because the injured State prefers compensation or for other reasons. Even where restitution is made, it may be insufficient to ensure full reparation. The role of compensation is to fill in any gaps so as to ensure full reparation for damage suffered.[31] As the Umpire said in the "*Lusitania*" case:

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[29] *Gabčíkovo-Nagymaros Project (Hungary/Slovakia)*, *I.C.J. Reports 1997,* p. 7, at p. 81, para. 152. See also the statement by the Permanent Court of International Justice in the *Factory at Chorzów* case, declaring that it is "a principle of international law that the reparation of a wrong may consist of an indemnity": *Factory at Chorzów, Merits*, *1928, P.C.I.J., Series A, No. 17,* p. 47.

[30] *Factory at Chorzów, Jurisdiction*, *1927, P.C.I.J., Series A, No. 9*, p. 21; *Fisheries Jurisdiction, Merits, (Federal Republic of Germany v. Iceland)*, *I.C.J. Reports 1974,* p. 175, at pp. 203-205, paras. 71-76; *Military and Paramilitary Activities in and against Nicaragua (Nicaragua v. United States), Merits, I.C.J. Reports 1986*, p. 14, at p. 142.

[31] *Factory at Chorzów, Merits*, *1928, P.C.I.J., Series A, No. 17*, pp. 47-8.

> "The fundamental concept of 'damages' is ... reparation for a *loss* suffered, a judicially ascertained *compensation* for wrong. The remedy should be commensurate with the loss, so that the injured party may be made whole."[32]

Likewise the role of compensation was articulated by the Permanent Court in the following terms:

> "Restitution in kind, or, if this is not possible payment of a sum corresponding to the value which a restitution in kind would bear; the award if need be, of damages for the loss sustained which would not be covered by restitution in kind or payment in place of it - such are the principles which should serve to determine the amount due for an act contrary to international law."[33]

Entitlement to compensation for such losses is supported by extensive case law, State practice and the writings of jurists.

(4) As compared with satisfaction, the function of compensation is to address the actual losses incurred as a result of the internationally wrongful act. Thus compensation generally consists of a monetary payment, though it may sometimes take the form, as agreed, of other forms of value. It is true that monetary payments may be called for by way of satisfaction under article 37, but they perform a function distinct from that of compensation. Monetary compensation is intended to offset, as far as may be, the damage suffered by the injured State as a result of the breach. Satisfaction is concerned with non-material injury, specifically non-material injury to the State, on which a monetary value can be put only in a highly approximate and notional way.[34]

(5) Consistently with other provisions of Part Two, article 36 is expressed as an obligation of the responsible State to provide reparation for the consequences flowing from the commission of

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[32] *R.I.A.A.*, vol. VII, p. 32 (1923), at p. 39 (emphasis in original).

[33] *Factory at Chorzów, Merits*, *1928, P.C.I.J., Series A, No. 17,* p. 47, cited and applied *inter alia* by the International Tribunal for the Law of the Sea in *The M/V "Saiga" (No. 2) (Saint Vincent and the Grenadines v. Guinea)*, judgment of 1 July 1999, para. 170. See also *Papamichalopoulos v. Greece (Art. 50), E.C.H.R., Series A, No. 330-B* (1995), at para. 36 (European Court of Human Rights); *Velásquez Rodríguez*, *Inter-Am.Ct.H.R., Series C, No. 4* (1989), at pp. 26-27, 30-31 (Inter-American Court of Human Rights); *Tippetts, Abbett, McCarthy, Stratton v. TAMS-AFFA Consulting Engineers of Iran and Others*, (1984) 6 *Iran-U.S.C.T.R.* 219, at p. 225.

[34] See commentary to article 35, para. (3).

an internationally wrongful act.[35] The scope of this obligation is delimited by the phrase "any financially assessable damage", that is, any damage which is capable of being evaluated in financial terms. Financially assessable damage encompasses both damage suffered by the State itself (to its property or personnel or in respect of expenditures reasonably incurred to remedy or mitigate damage flowing from an internationally wrongful act) as well as damage suffered by nationals, whether persons or companies, on whose behalf the State is claiming within the framework of diplomatic protection.

(6) In addition to the International Court of Justice, international tribunals dealing with issues of compensation include the International Tribunal for the Law of the Sea,[36] the Iran-United States Claims Tribunal,[37] human rights courts and other bodies,[38] and I.C.S.I.D. tribunals under the Washington Convention of 1965.[39] Other compensation claims have been settled by agreement, normally on a without prejudice basis, with the payment of substantial

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[35] For the requirement of a sufficient causal link between the internationally wrongful act and the damage see commentary to article 31, paras. (11)-(13).

[36] E.g., *The M/V "Saiga" (No.2) (Saint Vincent and the Grenadines v. Guinea)*, International Tribunal for the Law of the Sea, judgment of 1 July 1999, paras. 170-177.

[37] The Iran-United States Claims Tribunal has developed a substantial jurisprudence on questions of assessment of damage and the valuation of expropriated property. For reviews of the Tribunal's jurisprudence on these subjects see *inter alia*, G.H. Aldrich, *The Jurisprudence of the Iran-United States Claims Tribunal* (Oxford, Clarendon Press, 1996), chs. 5, 6, 12; C.N. Brower and J.D. Brueschke, *The Iran-United States Claims Tribunal* (The Hague, Nijhoff, 1998), chs. 14-18; M. Pellonpää, "Compensable Claims Before the Tribunal: Expropriation Claims", in R.B. Lillich & D.B. McGraw (eds.), *The Iran-United States Claims Tribunal: Its Contribution to the Law of State Responsibility* (Irvington-on-Hudson, Transnational Publishers, 1998), pp. 185-266; D.P. Stewart, "Compensation and Valuation Issues", ibid., pp. 325-385.

[38] For a review of the practice of such bodies in awarding compensation see D. Shelton, *Remedies in International Human Rights Law* (Oxford, Oxford University Press, 1999), pp. 214-279.

[39] I.C.S.I.D. Tribunals have jurisdiction to award damages or other remedies in cases concerning investments arising between States parties and nationals. Some of these claims involve direct recourse to international law as a basis of claim. See e.g. *Asian Agricultural Products Ltd. v. Republic of Sri Lanka,* (1990) 4 *I.C.S.I.D. Reports* 245.

compensation a term of the agreement.[40] The rules and principles developed by these bodies in assessing compensation can be seen as manifestations of the general principle stated in article 36.

(7) As to the appropriate heads of compensable damage and the principles of assessment to be applied in quantification, these will vary, depending upon the content of particular primary obligations, an evaluation of the respective behaviour of the parties and, more generally, a concern to reach an equitable and acceptable outcome.[41] The following examples illustrate the types of damage that may be compensable and the methods of quantification that may be employed.

(8) Damage to the State as such might arise out of the shooting down of its aircraft or the sinking of its ships, attacks on its diplomatic premises and personnel, damage caused to other public property, the costs incurred in responding to pollution damage, or incidental damage arising, for example, out of the need to pay pensions and medical expenses for officials injured as the result of a wrongful act. Such a list cannot be comprehensive and the categories of compensable injuries suffered by States are not closed.

(9) In the *Corfu Channel* case, the United Kingdom sought compensation in respect of three heads of damage: replacement of the destroyer *Saumarez*, which became a total loss, the damage sustained by the destroyer *Volage*, and the damage resulting from the deaths and injuries of naval personnel. The Court entrusted the assessment to expert enquiry. In respect of the destroyer *Saumarez* the Court found that "the true measure of compensation" was "the replacement cost of the [destroyer] at the time of the loss" and held that the amount of compensation claimed by the United Kingdom Government (£700,087) was justified. For the damage to the destroyer *Volage*, the experts had reached a slightly lower figure than the £93,812 claimed by the United Kingdom, "explained by the necessarily approximate nature of the valuation, especially as regards stores

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[40] See e.g. *Certain Phosphate Lands in Nauru*, *I.C.J. Reports 1992* p. 240, and for the Court's order of discontinuance following the settlement, *I.C.J. Reports 1993*, p. 322; *Passage through the Great Belt (Finland v. Denmark)*, *I.C.J. Reports 1992*, p. 348 (order of discontinuance following settlement); *Aerial Incident of 3 July 1988 (Islamic Republic of Iran v. United States of America)*, *I.C.J. Reports 1996,* p. 9 (order of discontinuance following settlement).

[41] Cf. G.H. Aldrich, *The Jurisprudence of the Iran-United States Claims Tribunal* (Oxford, Clarendon Press, 1996), p. 242. See also B. Graefrath, "Responsibility and damages caused: relationship between responsibility and damages", *Recueil des cours*, vol. 185 (1984-II), p. 101; L. Reitzer, *La réparation comme conséquence de l'acte illicite en droit international* (Paris, Sirey, 1938); C.D. Gray, *Judicial Remedies in International Law* (Oxford, Clarendon Press, 1987), pp. 33-34.

and equipment". In addition to the amounts awarded for the damage to the two destroyers, the Court upheld the United Kingdom's claim for £50,048 representing "the cost of pensions and other grants made by it to victims or their dependants, and for costs of administration, medical treatment, etc."[42]

(10) In the *M/V "Saiga"* case, Saint Vincent and the Grenadines sought compensation from Guinea following the wrongful arrest and detention of a Saint Vincent and the Grenadines' registered vessel, the *Saiga*, and its crew. The International Tribunal for the Law of the Sea awarded compensation of US$ 2,123,357 with interest. The heads of damage compensated included, *inter alia*, damage to the vessel, including costs of repair, losses suffered with respect to charter hire of the vessel, costs related to the detention of the vessel, and damages for the detention of the captain, members of the crew and others on board the vessel. Saint Vincent and the Grenadines had claimed compensation for the violation of its rights in respect of ships flying its flag occasioned by the arrest and detention of the *Saiga*, however, the Tribunal considered that its declaration that Guinea acted wrongfully in arresting the vessel in the circumstances, and in using excessive force, constituted adequate reparation.[43] Claims regarding the loss of registration revenue due to the illegal arrest of the vessel and for the expenses resulting from the time lost by officials in dealing with the arrest and detention of the ship and its crew were also unsuccessful. In respect of the former, the Tribunal held that Saint Vincent and the Grenadines failed to produce supporting evidence. In respect of the latter, the Tribunal considered that such expenses were not recoverable since they were incurred in the exercise of the normal functions of a flag State.[44]

(11) In a number of cases payments have been directly negotiated between injured and injuring States following wrongful attacks on ships causing damage or sinking of the vessel, and

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[42] *Corfu Channel case (Assessment of Compensation)*, *I.C.J. Reports* 1949 p. 244, at p. 249.

[43] *The M/V "Saiga" (No.2) (Saint Vincent and the Grenadines v. Guinea)*, International Tribunal for the Law of the Sea, judgment of 1 July 1999, para. 176.

[44] Ibid., para. 177.

in some cases, loss of life and injury among the crew.[45] Similar payments have been negotiated where damage is caused to aircraft of a State, such as the "full and final settlement" agreed between Iran and the United States following a dispute over the destruction of an Iranian aircraft and the killing of its 290 passengers and crew.[46]

(12) Agreements for the payment of compensation are also frequently negotiated by States following attacks on diplomatic premises, whether in relation to damage to the embassy itself[47] or injury to its personnel.[48] Damage caused to other public property, such as roads and infrastructure, has also been the subject of compensation claims.[49] In many cases these payments have been made on an *ex gratia* or without prejudice basis, without any admission of responsibility.[50]

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[45] See the payment by Cuba to the Bahamas for the sinking by Cuban aircraft on the high seas of a Bahamian vessel, with loss of life among the crew (*R.G.D.I.P.*, vol. 85 (1981), p. 540), the payment of compensation by Israel for an attack in 1967 on the *U.S.S. Liberty*, with loss of life and injury among the crew (*R.G.D.I.P*, vol. 85 (1981), p. 562) and the payment by Iraq of US$ 27 m for the 37 deaths which occurred in May 1987 when Iraqi aircraft severely damaged the *U.S.S. Stark* (*A.J.I.L.*, vol. 83 (1989), p. 561).

[46] *Aerial Incident of 3 July 1988 (Islamic Republic of Iran v. United States of America), I.C.J. Reports* 1996, p. 9 (order of discontinuance following settlement). For the settlement agreement itself, see the General Agreement between Iran and the United States on the Settlement of Certain I.C.J. and Tribunal Cases of 9 February 1996, made an Award on Agreed Terms by order of the Iran-United States Claims Tribunal, 22 February 1996: (1996) 32 *Iran-U.S.C.T.R.* 207, at p. 213.

[47] See e.g. the Agreement of 1 December 1966 between the United Kingdom and Indonesia for the payment by the latter of compensation for, *inter alia*, damage to the British Embassy during mob violence (*United Kingdom Treaty Series*, No. 34 (1967)) and the payment by Pakistan to the United States of compensation for the sacking of the United States' Embassy in Islamabad in 1979: *R.G.D.I.P.*, vol. 85 (1981), p. 880.

[48] See e.g. Claim of Consul *Henry R. Myers* (*United States v. San Salvador*), [1890] *U.S. For. Rels.* pp. 64-65; [1892] *U.S. For. Rels.* pp. 24-43, 44, 49-51; [1893] *U.S. For. Rels.* pp. 174-179, 181-182, 184); Whiteman, *Damages*, vol. I, pp. 80-81.

[49] For examples see Whiteman, *Damages*, vol. I, p. 81.

[50] See e.g. United States-China agreement providing for an *ex gratia* payment of US$ 4.5 million, to be given to the families of those killed and to those injured in the bombing of the Chinese Embassy in Belgrade on 7 May 1999, *A.J.I.L.*, vol. 102 (2000), p. 127.

(13) Another situation in which States may seek compensation for damage suffered by the State as such is where costs are incurred in responding to pollution damage. Following the crash of the Soviet Cosmos-954 satellite on Canadian territory in January 1978, Canada's claim for compensation for expenses incurred in locating, recovering, removing and testing radioactive debris and cleaning up affected areas was based "jointly and separately on (a) the relevant international agreements… and (b) general principles of international law".[51] Canada asserted that it was applying "the relevant criteria established by general principles of international law according to which fair compensation is to be paid, by including in its claim only those costs that are reasonable, proximately caused by the intrusion of the satellite and the deposit of debris and capable of being calculated with a reasonable degree of certainty".[52] The claim was eventually settled in April 1981 when the parties agreed on an *ex gratia* payment of Can. $3 million (about 50 per cent of the amount claimed).[53]

(14) Compensation claims for pollution costs have been dealt with by the United Nations Compensation Commission in the context of assessing Iraq's liability under international law "for any direct loss, damage, including environmental damage and the depletion of natural resources … as a result of Iraq's unlawful invasion and occupation of Kuwait".[54] Decision 7 of the Governing Council of the Commission specifies various heads of damage encompassed by "environmental damage and the depletion of natural resources".[55]

(15) In cases where compensation has been awarded or agreed following an internationally wrongful act that causes or threatens environmental damage, payments have been directed to reimbursing the injured State for expenses reasonably incurred in preventing or remedying

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[51] Canada, Claim against the USSR for Damage Caused by Soviet Cosmos 954, 23 January 1979, *I.L.M.* vol. 18 (1979), p. 899, at p. 905.

[52] Ibid., at p. 906.

[53] Protocol between Canada and the USSR, 2 April 1981, *I.L.M.,* vol. 20 (1981), 689.

[54] SC res. 687 (1991), para. 16.

[55] Decision 7 of 17 March 1992, *Criteria for Additional Categories of Claims*, S/AC.26/1991/7/Rev.1.

pollution, or to providing compensation for a reduction in the value of polluted property.[56] However, environmental damage will often extend beyond that which can be readily quantified in terms of clean-up costs or property devaluation. Damage to such environmental values (biodiversity, amenity, etc – sometimes referred to as "non-use values") is, as a matter of principle, no less real and compensable than damage to property, though it may be difficult to quantify.

(16) Within the field of diplomatic protection, a good deal of guidance is available as to appropriate compensation standards and methods of valuation, especially as concerns personal injury and takings of, or damage to, tangible property. It is well-established that a State may seek compensation in respect of personal injuries suffered by its officials or nationals, over and above any direct injury it may itself have suffered in relation to the same event. Compensable personal injury encompasses not only associated material losses, such as loss of earnings and earning capacity, medical expenses and the like, but also non-material damage suffered by the individual (sometimes, though not universally, referred to as "moral damage" in national legal systems). Non-material damage is generally understood to encompass loss of loved ones, pain and suffering as well as the affront to sensibilities associated with an intrusion on the person, home or private life. No less than material injury sustained by the injured State, non-material damage is financially assessable and may be the subject of a claim of compensation, as stressed in the *"Lusitania"* case.[57] The Umpire considered that international law provides compensation for mental suffering, injury to feelings, humiliation, shame, degradation, loss of social position or injury to credit and reputation, such injuries being "very real, and the mere fact that they are difficult to measure or estimate by money standards makes them none the less real and affords no reason why the injured person should not be compensated…"[58]

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[56] See the decision of the arbitral tribunal in the *Trail Smelter Arbitration*, *R.I.A.A.*, vol. III, p. 1907 (1938, 1941), which provided compensation to the United States for damage to land and property caused by sulphur dioxide emissions from a smelter across the border in Canada. Compensation was assessed on the basis of the reduction in value of the affected land.

[57] *R.I.A.A.*, vol. VII, p. 32 (1923). International tribunals have frequently granted pecuniary compensation for moral injury to private parties. E.g. *Chevreau (France v. United Kingdom), R.I.A.A.*, vol. II, p. 1113 (1923); *A.J.I.L.*, vol. 27, 1933, p. 153; *Gage*, *R.I.A.A.*, vol. X, p. 226 (1903); *Di Caro*, *R.I.A.A.*, vol. X, p. 597 (1903); *Heirs of Jean Maninat, R.I.A.A.*, vol. X, p. 55 (1903).

[58] *R.I.A.A.*, vol. VII, p. 32 (1923), at p. 40.

(17) International courts and tribunals have undertaken the assessment of compensation for personal injury on numerous occasions. For example, in the *M/V "Saiga"* case, [59] the Tribunal held that Saint Vincent and the Grenadines' entitlement to compensation included damages for injury the crew, their unlawful arrest, detention and other forms of ill-treatment.

(18) Historically compensation for personal injury suffered by nationals or officials of a State arose mainly in the context of mixed claims commissions dealing with State responsibility for injury to aliens. Claims commissions awarded compensation for personal injury both in cases of wrongful death and deprivation of liberty. Where claims were made in respect of wrongful death, damages were generally based on an evaluation of the losses of the surviving heirs or successors, calculated in accordance with the well-known formula of Umpire Parker in the *"Lusitania"* case, estimating:

> "the amounts (a) which the decedent, had he not been killed, would probably have contributed to the claimant, add thereto (b) the pecuniary value to such claimant of the deceased's personal services in claimant's care, education, or supervision, and also add (c) reasonable compensation for such mental suffering or shock, if any, caused by the violent severing of family ties, as the claimant may actually have sustained by reason of such death. The sum of these estimates, reduced to its present cash value will generally represent the loss sustained by claimant."[60]

In cases of deprivation of liberty, arbitrators sometimes awarded a set amount for each day spent in detention.[61] Awards were often increased when abusive conditions of confinement accompanied the wrongful arrest and imprisonment, resulting in particularly serious physical or psychological injury.[62]

(19) Compensation for personal injury has also been dealt with by human rights bodies, in particular the European and Inter-American Court of Human Rights. Awards of compensation

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[59] *The M/V "Saiga" (No.2) (Saint Vincent and the Grenadines v. Guinea)*, International Tribunal for the Law of the Sea, judgment of 1 July 1999.

[60] *R.I.A.A.*, vol. VII, p. 32 (1923), at p. 35.

[61] E.g. *Topaze*, *R.I.A.A.*, vol. IX, p. 387 (1903), at p. 389; *Faulkner*, *R.I.A.A.*, vol. IV, p. 67 (1926), at p. 71.

[62] E.g. *William McNeil*, *R.I.A.A.*, vol. V, p. 164 (1931), at p. 168.

encompass material losses (lost earnings, pensions, medical expenses etc.) and non-material damage (pain and suffering, mental anguish, humiliation, loss of enjoyment of life and loss of companionship or consortium), the latter usually quantified on the basis of an equitable assessment. Hitherto, amounts of compensation or damages awarded or recommended by these bodies have been modest.[63] Nonetheless, the decisions of human rights bodies on compensation draw on principles of reparation under general international law.[64]

(20) In addition to a large number of lump-sum compensation agreements covering multiple claims,[65] property claims of nationals arising out of an internationally wrongful act, have been adjudicated by a wide range of *ad hoc* and standing tribunals and commissions, with reported cases spanning two centuries. Given the diversity of adjudicating bodies, the awards exhibit considerable variability.[66] Nevertheless, they provide useful principles to guide the determination of compensation under this head of damage.

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[63] See the review by D. Shelton, *Remedies in International Human Rights Law* (Oxford, Clarendon Press, 1999), chs. 8, 9; A. Randelzhofer & C. Tomuschat (eds.), *State Responsibility and the Individual. Reparation in Instances of Grave Violations of Human Rights*, (The Hague, Nijhoff, 1999); R. Pisillo Mazzeschi, "La riparazione per violazione dei diritti umani nel diritto internazionale e nella Convenzione Europea", *La Comunità Internazionale*, vol. 53 (1998), p. 215.

[64] See e.g. the decision of the Inter-American Court in the *Velásquez Rodríguez, Inter-Am.Ct.H.R., Series C, No. 4* (1989) at pp. 26-27, 30-1. Cf. also *Papamichalopoulos v. Greece (Article 50)*, *E.C.H.R., Series A, No. 330-B* (1995), at para. 36.

[65] See e.g. R. B. Lillich & B. H. Weston, *International Claims: Their Settlement by Lump Sum Agreements* (Charlottesville, University Press of Virginia, 1975); B. H. Weston, R.B. Lillich and D.J. Bederman, *International Claims: Their Settlement by Lump Sum Agreements, 1975-1995* (Ardsley, N.Y., Transnational Publishers, 1999).

[66] Controversy has persisted in relation to expropriation cases, particularly over standards of compensation applicable in light of the distinction between lawful expropriation of property by the State on the one hand, and unlawful takings on the other, a distinction clearly drawn by the Permanent Court in *Factory at Chorzów, Merits*, *1928, P.C.I.J., Series A, No. 17* p. 47. In a number of cases tribunals have employed the distinction to rule in favour of compensation for lost profits in cases of unlawful takings (see e.g. the observations of the arbitrator in *Libyan American Oil Company (LIAMCO) v. Government of Libya*, (1982) *I.L.R.,* vol. 62, p. 141, at pp. 202-203; and also the *Aminoil* arbitration: *Government of Kuwait v. American Independent Oil Company,* (1982) *I.L.R.,* vol. 66, p. 529, at p. 600, para. 138; and *Amoco International Finance Corporation v. Government of the Islamic Republic of Iran,* (1987) 15 *Iran-U.S.C.T.R.* 189, at p. 246, para. 192). Not all cases, however, have drawn a distinction between the applicable compensation principles based on the lawfulness or unlawfulness of the taking.

(21) The reference point for valuation purposes is the loss suffered by the claimant whose property rights have been infringed. This loss is usually assessed by reference to specific heads of damage relating to (i) compensation for capital value, (ii) compensation for loss of profits, and (iii) incidental expenses.

(22) Compensation reflecting the capital value of property taken or destroyed as the result of an internationally wrongful act is generally assessed on the basis of the "fair market value" of the property lost.[67] The method used to assess "fair market value", however, depends on the nature of the asset concerned. Where the property in question or comparable property is freely traded on an open market, value is more readily determined. In such cases, the choice and application of asset-based valuation methods based on market data and the physical properties of the assets is relatively unproblematic, apart from evidentiary difficulties associated with long outstanding claims.[68] Where the property interests in question are unique or unusual, for example, art works

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See e.g. the decision of the Iran-United States Tribunal in *Phillips Petroleum Co. Iran v. Government of the Islamic Republic of Iran*, (1989) 21 *Iran-U.S.C.T.R.* 79, at p. 122, para. 110. See also *Starrett Housing Corp. v. Government of the Islamic Republic of Iran*, (1987) 16 *Iran-U.S.C.T.R.* 79 where the Tribunal made no distinction in terms of the lawfulness of the taking and its award included compensation for lost profits.

[67] See *American International Group, Inc. v. Government of the Islamic Republic of Iran*, which stated that, under general international law, "the valuation should be made on the basis of the fair market value of the shares": (1983) 4 *Iran-U.S.C.T.R.* 96, at p.106. In *Starrett Housing Corp. v. Government of the Islamic Republic of Iran*, the Tribunal accepted its expert's concept of fair market value "as the price that a willing buyer would pay to a willing seller in circumstances in which each had good information, each desired to maximize his financial gain, and neither was under duress or threat": (1987) 16 *Iran-U.S.C.T.R.* 79, at pp.119-120. See also the *World Bank Guidelines on the Treatment of Foreign Direct Investment*, which state in paragraph 3 of Part IV that compensation "will be deemed adequate if it is based on the fair market value of the taken asset as such value is determined immediately before the time at which the taking occurred or the decision to take the asset became publicly known": World Bank, *Legal Framework for the Treatment of Foreign Investment*, 2 vols., (Washington, I.B.R.D., 1992), vol. II, p. 41. Likewise, according to Article 13 (1) of the Energy Charter Treaty, *I.L.M.,* vol. 33 (1994), p. 360, compensation for expropriation "shall amount to the fair market value of the Investment expropriated at the time immediately before the Expropriation…"

[68] Particularly in the case of lump sum settlements, agreements have been concluded decades after the claims arose. See e.g. the U.S.S.R.-U.K. Agreement of 15 July 1986 concerning claims dating back to 1917 and the China-U.K. Agreement of 5 June 1987 in respect of claims arising in 1949. In such cases, the choice of valuation method was sometimes determined by availability of evidence.

or other cultural property,[69] or are not the subject of frequent or recent market transactions, the determination of value is more difficult. This may be true, for example, in respect of certain business entities in the nature of a going concern, especially if shares are not regularly traded.[70]

(23) Decisions of various *ad hoc* tribunals since 1945 have been dominated by claims in respect of nationalised business entities. The preferred approach in these cases has been to examine the assets of the business, making allowance for goodwill and profitability as appropriate. This method has the advantage of grounding compensation as much as possible in some objective assessment of value linked to the tangible asset backing of the business. The value of goodwill and other indicators of profitability may be uncertain, unless derived from information provided by a recent sale or acceptable arms-length offer. Yet, for profitable business entities where the whole is greater than the sum of the parts, compensation would be incomplete without paying due regard to such factors.[71]

(24) An alternative valuation method for capital loss is the determination of net book value, i.e., the difference between the total assets of the business and total liabilities as shown on its books. Its advantages are that the figures can be determined by reference to market costs, they are normally drawn from a contemporaneous record, and they are based on data generated for some other purpose than supporting the claim. Accordingly, net book value (or some variant of this method) has been employed to assess the value of businesses. The limitations of the method lie in the reliance on historical figures, the use of accounting principles which tend to undervalue assets, especially in periods of inflation, and the fact that the purpose for which the figures were

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[69] See Report and Recommendations Made by the Panel of Commissioners concerning Part Two of the First Instalment of Individual Claims for Damages above US$100,000, 12 March 1998, S/AC.26/1998/3, paras. 48-49, where the U.N.C.C. considered a compensation claim in relation to the taking of the claimant's Islamic art collection by Iraqi military personnel.

[70] Where share prices provide good evidence of value, they may be utilised, as in *INA Corporation v. Islamic Republic of Iran*, (1985) 8 *Iran-U.S.C.T.R.* 373.

[71] Early claims recognised that that even where a taking of property was lawful, compensation for a going concern called for something more than the value of the property elements of the business. The American Mexican Claims Commission in rejecting a claim for lost profits in the case of a lawful taking stated that payment for property elements would be "augmented by the existence of those elements which constitute a going concern": *Wells Fargo and Company v. Mexico (Decision No. 22-B)*, American Mexican Claims Commission (1926), p. 153. See also Decision No. 9 of the United Nations Compensation Commission Governing Council, S/AC.26/1992/9, para. 16.

produced does not take account of the compensation context and any rules specific to it. The balance sheet may contain an entry for goodwill, but the reliability of such figures depends upon their proximity to the moment of an actual sale.

(25) In cases where a business is not a going concern,[72] so-called "break-up", "liquidation" or "dissolution" value is generally employed. In such cases no provision is made for value over and above the market value of the individual assets. Techniques have been developed to construct, in the absence of actual transactions, hypothetical values representing what a willing buyer and willing seller might agree.[73]

(26) Since 1945, valuation techniques have been developed to factor in different elements of risk and probability.[74] The discounted cash flow (DCF) method has gained some favour, especially in the context of calculations involving income over a limited duration, as in the case of wasting assets. Although developed as a tool for assessing commercial value, it can also be useful in the context of calculating value for compensation purposes.[75] But difficulties can arise in the application of the DCF method to establish capital value in the compensation context. The method analyses a wide range of inherently speculative elements, some of which have a significant impact upon the outcome (e.g. discount rates, currency fluctuations, inflation figures,

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[72] For an example of a business found not to be a going concern see *Phelps Dodge Corp. v. Islamic Republic of Iran*, (1986) 10 *Iran-U.S.C.T.R.* 121 where the enterprise had not been established long enough to demonstrate its viability. In *Sedco v NIOC*, claimant sought dissolution value only: (1986) 10 *Iran-U.S.C.T.R.* 180.

[73] The hypothetical nature of the result is discussed in *Amoco International Finance Corp. v. Islamic Republic of Iran*, (1987) 15 *Iran-U.S.C.T.R.* 189, at pp. 256-7, paras. 220-223.

[74] See for example the detailed methodology developed by the U.N.C.C. for assessing Kuwaiti corporate claims (Report and Recommendations made by the Panel of Commissioners concerning the First Instalment of "E4" Claims, 19 March 1999, S/AC.26/1999/4, paras 32-62) and claims filed on behalf of non-Kuwaiti corporations and other business entities, excluding oil sector, construction/engineering and export guarantee claims (Report and Recommendations made by the Panel of Commissioners concerning the Third Instalment of "E2" Claims, 9 December 1999, S/AC.26/1999/22).

[75] The use of the discounted cash flow method to assess capital value was analysed in some detail in *Amoco International Finance Corp. v. Islamic Republic of Iran*, (1987) 15 *Iran-U.S.C.T.R.* 189; *Starrett Housing Corp. v. Islamic Republic of Iran*, (1987) 16 *Iran-U.S. C.T.R.* 112; *Phillips Petroleum Co. Iran v. Islamic Republic of Iran*, (1989) 21 *Iran-U.S.C.T.R.* 79; and *Ebrahimi (Shahin Shaine) v. Islamic Republic of Iran*, (1994) 30 *Iran-U.S.C.T.R.* 170.

commodity prices, interest rates and other commercial risks). This has led tribunals to adopt a cautious approach to the use of the method. Hence although income-based methods have been accepted in principle, there has been a decided preference for asset-based methods.[76] A particular concern is the risk of double-counting which arises from the relationship between the capital value of an enterprise and its contractually based profits.[77]

(27) Paragraph 2 of article 36 recognizes that in certain cases compensation for loss of profits may be appropriate. International tribunals have included an award for loss of profits in assessing compensation: for example the decisions in the *Cape Horn Pigeon* case[78] and *Sapphire International Petroleums Ltd. v. National Iranian Oil Company*.[79] Loss of profits played a role in the *Factory at Chorzów* case itself, the Permanent Court deciding that the injured party should receive the value of property by way of damages not as it stood at the time of expropriation but at the time of indemnification.[80] Awards for loss of profits have also been made in respect of contract-based lost profits in *Libyan American Oil Company* (*LIAMCO) v. Libya*[81] and in some

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[76] See e.g. *Amoco International Finance Corp. v. Islamic Republic of Iran*, 15 *Iran-U.S.C.T.R.* 189 (1987); *Starrett Housing Corp. v. Islamic Republic of Iran*, 16 *Iran-U.S.C.T.R.* 112 (1987), *Phillips Petroleum Co. Iran v. Islamic Republic of Iran*, 21 *Iran-U.S.C.T.R.* 79 (1989). In the context of claims for lost profits, there is a corresponding preference for claims to be based on past performance rather than forecasts. For example, the United Nations Compensation Commission guidelines on valuation of business losses in Decision 9 (S/AC.26/1992/9, para. 19) state: "The method of a valuation should therefore be one that focuses on past performance rather than on forecasts and projections into the future."

[77] See e.g. *Ebrahimi (Shahin Shaine) v. Islamic Republic of Iran*, (1994) 30 *Iran-U.S.C.T.R.* 170, para. 159.

[78] *United States of America v. Russia*, *R.I.A.A.*, vol. IX, p. 63 (1902), (including compensation for lost profits resulting from the seizure of an American whaler). Similar conclusions were reached in the *Delagoa Bay Railway* case (1900), Martens, *Nouveau Recueil*, 2nd series, vol. XXX, p. 329; Moore, *International Arbitrations*, vol. II, p. 1865 (1900), the *William Lee* case, Moore, *International Arbitrations*, vol. IV, pp. 3405-3407 (1867) and the *Yuille Shortridge and Co.* case *(Great Britain v. Portugal)*, de Lapradelle & Politis, *Recueil des arbitrages internationaux,* vol. II, p. 78 (1861). Contrast the decisions in the *Canada* case *(United States of America v. Brazil)*, Moore, *International Arbitrations*, vol. II, p. 1733 (1870) and the *Lacaze* case, de Lapradelle & Politis, *Recueil des arbitrages internationaux*, vol. II, p. 290.

[79] (1963) *I.L.R.*, vol. 35, p.136, at pp. 187, 189.

[80] *Factory at Chorzów (Merits), 1928, P.C.I.J. Series A, No. 17*,, pp. 47-48, 53.

[81] (1977) *I.L.R.*, vol. 62, p. 140.

I.C.S.I.D. arbitrations.[82] Nevertheless, lost profits have not been as commonly awarded in practice as compensation for accrued losses. Tribunals have been reluctant to provide compensation for claims with inherently speculative elements.[83] When compared with tangible assets, profits (and intangible assets which are income-based) are relatively vulnerable to commercial and political risks, and increasingly so the further into the future projections are made. In cases where lost future profits have been awarded, it has been where an anticipated income stream has attained sufficient attributes to be considered a legally protected interest of sufficient certainty to be compensable.[84] This has normally been achieved by virtue of contractual arrangements or, in some cases, a well-established history of dealings.[85]

(28) Three categories of loss of profits may be distinguished: first, lost profits from income-producing property during a period when there has been no interference with title as

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[82] See, e.g., *Amco Asia Corp. and Others v. Republic of Indonesia*, First Arbitration (1984); Annulment (1986); Resubmitted Case, (1990) 1 *I.C.S.I.D. Reports* 377*; AGIP Spa v. Government of the People's Republic of the Congo*, (1979) 1 *I.C.S.I.D. Reports* 306.

[83] According to the arbitrator in the *Shufeldt (USA/Guatemala)* case, *R.I.A.A*., vol. II, p. 1079 (1930), at p. 1099, "the *lucrum cessans* must be the direct fruit of the contract and not too remote or speculative". See also *Amco Asia Corp. and Others v. Republic of Indonesia*, (1990) 1 *I.C.S.I.D. Reports* 569, at p. 612, para. 178 where it was stated that "non-speculative profits" were recoverable. The U.N.C.C. has also stressed the requirement for claimants to provide "clear and convincing evidence of ongoing and expected profitability" (see Report and Recommendations made by the Panel of Commissioners concerning the First Instalment of "E3" Claims, 17 December 1998 (S/AC.26/1998/13), para. 147). In assessing claims for lost profits on construction contracts, Panels have generally required that the claimant's calculation take into account the risk inherent in the project (ibid., para. 157; Report and Recommendations made by the Panel of Commissioners concerning the Fourth Instalment of "E3" Claims, 30 September 1999 (S/AC.26/1999/14), para. 126).

[84] In considering claims for future profits, the U.N.C.C. Panel dealing with the fourth instalment of "E3" claims expressed the view that in order for such claims to warrant a recommendation, "it is necessary to demonstrate by sufficient documentary and other appropriate evidence a history of successful (i.e. profitable) operation, and a state of affairs which warrants the conclusion that the hypothesis that there would have been future profitable contracts is well founded": Report and Recommendations made by the Panel of Commissioners concerning the Fourth Instalment of "E3" Claims, 30 September 1999, (S/AC.26/1999/14), para.140.

[85] According to Whiteman, "in order to be allowable, prospective profits must not be too speculative, contingent, uncertain, and the like. There must be proof that they were *reasonably* anticipated; and that the profits anticipated were probable and not merely possible": Whiteman, *Damages,* vol. III, p. 1837.

distinct from temporary loss of use; secondly, lost profits from income-producing property between the date of taking of title and adjudication,[86] and thirdly, lost future profits in which profits anticipated after the date of adjudication are awarded.[87]

(29) The first category involves claims for loss of profits due to the temporary loss of use and enjoyment of the income-producing asset.[88] In these cases there is no interference with title and hence in the relevant period the loss compensated is the income to which the claimant was entitled by virtue of undisturbed ownership.

(30) The second category of claims relates to the unlawful taking of income-producing property. In such cases lost profits have been awarded for the period up to the time of adjudication. In the *Factory at Chorzów* case,[89] this took the form of re-invested income, representing profits from the time of taking to the time of adjudication. In the *Norwegian Shipowners* case,[90] lost profits were similarly not awarded for any period beyond the date of adjudication. Once the capital value of income-producing property has been restored through the

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[86] This is most commonly associated with the deprivation of property, as opposed to wrongful termination of a contract or concession. If restitution were awarded, the award of lost profits would be analogous to cases of temporary dispossession. If restitution is not awarded, as in the *Factory at Chorzów (Merits), 1928, P.C.I.J. Series A, No. 17*, p. 47 and *Norwegian Shipowners (Norway/USA), R.I.A.A.*, vol. I, p. 307 (1922), lost profits may be awarded up to the time when compensation is made available as a substitute for restitution.

[87] Awards of lost future profits have been made in the context of a contractually protected income stream, as in the *Amco Asia* case *(Amco Asia Corp. and Others v. Republic of Indonesia*, First Arbitration (1984); Annulment (1986); Resubmitted Case, (1990) 1 *I.C.S.I.D. Reports* 377), rather than on the basis of the taking of income-producing property. In the UN Compensation Commission's Report and Recommendations on the Second Instalment of "E2" Claims (S/AC.26/1999/6), dealing with reduced profits, the Panel found that losses arising from a decline in business were compensable even though tangible property was not affected and the businesses continued to operate throughout the relevant period (ibid., para. 76).

[88] Many of the early cases concern vessels seized and detained. In *The "Montijo"*, an American vessel seized in Panama, the Umpire allowed s sum of money per day for loss of the use of the vessel: Moore, *International Arbitrations*, vol. II, p. 1421 (1875). In *The "Betsey"*, compensation was awarded not only for the value of the cargo seized and detained, but also for demurrage for the period representing loss of use: Moore, *International Adjudications,* vol. V, p. 47, at p. 113 (1794).

[89] *Factory at Chorzów (Merits), 1928, P.C.I.J. Series A, No. 17*, p. 47.

[90] *Norwegian Shipowners (Norway/USA), R.I.A.A.*, vol. I, p. 307 (1922).

mechanism of compensation, funds paid by way of compensation can once again be invested to re-establish an income stream. Although the rationale for the award of lost profits in these cases is less clearly articulated, it may be attributed to a recognition of the claimant's continuing beneficial interest in the property up to the moment when potential restitution is converted to a compensation payment.[91]

(31) The third category of claims for loss of profits arises in the context of concessions and other contractually protected interests. Again, in such cases, lost future income has sometimes been awarded.[92] In the case of contracts, it is the future income stream which is compensated, up to the time when the legal recognition of entitlement ends. In some contracts this is immediate, e.g. where the contract is determinable at the instance of the State,[93] or where some other basis for contractual termination exists. Or it may arise from some future date dictated by the terms of the contract itself.

(32) In other cases lost profits have been excluded on the basis that they were not sufficiently established as a legally protected interest. In the *Oscar Chinn* case[94] a monopoly was not

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[91] For the approach of the U.N.C.C. in dealing with loss of profits claims associated with the destruction of businesses following the Iraqi invasion of Kuwait, see Report and Recommendations made by the Panel of Commissioners concerning the First Instalment of "E4" Claims, 19 March 1999, (S/AC.26/1999/4), paras 184-187.

[92] In some cases, lost profits were not awarded beyond the date of adjudication, though for reasons unrelated to the nature of the income-producing property. See e.g., *Robert May (United States v. Guatemala)*, 1900 For. Rel. 648; Whiteman, *Damages*, vol III, pp. 1704, 1860, where the concession had expired. In other cases, circumstances giving rise to *force majeure* had the effect of suspending contractual obligations: see e.g. *Gould Marketing, Inc. v. Ministry of Defence*, (1984) 6 *Iran-U.S.C.T.R.* 272; *Sylvania Technical Systems v. Islamic Republic of Iran*, (1985) 8 *Iran-U.S.C.T.R.* 298. In *Delagoa Bay Railway Co. (Great Britain, United States of America/Portugal)*, Martens, *Nouveau Recueil*, 2nd series, vol. XXX, p. 329; Moore, *International Arbitrations*, vol. II, p. 1865 (1900), and in *Shufeldt (USA/Guatemala)*, *R.I.A.A.*, vol. II, p. 1079 (1930), lost profits were awarded in respect of a concession which had been terminated. In *Sapphire International Petroleum Ltd v. National Iranian Oil Company*, (1963) *I.L.R.*, vol. 35, p. 136; *Libyan American Oil Company (LIAMCO) v. Government of the Libyan Arab Republic*, (1977) *I.L.R.*, vol. 62, p. 140 and *Amco Asia Corp. and Others v. Republic of Indonesia*, First Arbitration (1984); Annulment (1986); Resubmitted Case (1990), 1 *I.C.S.I.D. Reports* 377, awards of lost profits were also sustained on the basis of contractual relationships.

[93] As in *Sylvania Technical Systems v. Islamic Republic of Iran*, (1985) 8 *Iran-U.S.C.T.R.* 298.

[94] *1934, P.C.I.J., Series A/B, No. 63,* p. 65.

accorded the status of an acquired right. In the *Asian Agricultural Products* case,[95] a claim for lost profits by a newly established business was rejected for lack of evidence of established earnings. Claims for lost profits are also subject to the usual range of limitations on the recovery of damages, such as causation, remoteness, evidentiary requirements and accounting principles, which seek to discount speculative elements from projected figures.

(33) If loss of profits are to be awarded, it is inappropriate to award interest under article 38 on the profit-earning capital over the same period of time, simply because the capital sum cannot be simultaneously earning interest and generating profits. The essential aim is to avoid double recovery while ensuring full reparation.

(34) It is well established that incidental expenses are compensable if they were reasonably incurred to repair damage and otherwise mitigate loss arising from the breach.[96] Such expenses may be associated for example with the displacement of staff or the need to store or sell undelivered products at a loss.

Article 37

Satisfaction

1. The State responsible for an internationally wrongful act is under an obligation to give satisfaction for the injury caused by that act insofar as it cannot be made good by restitution or compensation.

2. Satisfaction may consist in an acknowledgement of the breach, an expression of regret, a formal apology or another appropriate modality.

3. Satisfaction shall not be out of proportion to the injury and may not take a form humiliating to the responsible State.

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[95] *Asian Agricultural Products Ltd v. Democratic Socialist Republic of Sri Lanka,* (1990) 4 *I.C.S.I.D. Reports* 245.

[96] Compensation for incidental expenses has been awarded by the United Nations Compensation Commission (Report and Recommendations on the First Instalment of "E2" Claims (S/AC.26/1998/7) where compensation was awarded for evacuation and relief costs (paras. 133, 153 and 249), repatriation (para. 228), termination costs (para. 214), renovation costs (para. 225) and expenses in mitigation (para. 183)) and by the Iran-United States Claims Tribunal (see *General Electric Company v. Islamic Republic of Iran*, (1991) 26 *Iran-U.S.C.T.R.* 148, at pp. 165-167, 168-169, paras. 56-60, 67-69, awarding compensation for items resold at a loss and for storage costs).

Commentary

(1) Satisfaction is the third form of reparation which the responsible State may have to provide in discharge of its obligation to make full reparation for the injury caused by an internationally wrongful act. It is not a standard form of reparation, in the sense that in many cases the injury caused by an internationally wrongful act of a State may be fully repaired by restitution and/or compensation. The rather exceptional character of the remedy of satisfaction, and its relationship to the principle of full reparation, are emphasized by the phrase "insofar as [the injury] cannot be made good by restitution or compensation". It is only in those cases where those two forms have not provided full reparation that satisfaction may be required.

(2) Article 37 is divided into three paragraphs, each dealing with a separate aspect of satisfaction. Paragraph 1 addresses the legal character of satisfaction and the types of injury for which it may be granted. Paragraph 2 describes, in a non-exhaustive fashion, some modalities of satisfaction. Paragraph 3 places limitations on the obligation to give satisfaction, having regard to former practices in cases where unreasonable forms of satisfaction were sometimes demanded.

(3) In accordance with paragraph 1, the injury for which a responsible State is obliged to make full reparation embraces "any damage, whether material or moral, caused by the internationally wrongful act of a State". Material and moral damage resulting from an internationally wrongful act will normally be financially assessable and hence covered by the remedy of compensation. Satisfaction, on the other hand, is the remedy for those injuries, not financially assessable, which amount to an affront to the State. These injuries are frequently of a symbolic character, arising from the very fact of the breach of the obligation, irrespective of its material consequences for the State concerned.

(4) The availability of the remedy of satisfaction for injury of this kind, sometimes described as "non-material injury" ("*préjudice immatériel*"),[97] is well-established in international law. The point was made, for example, by the Tribunal in the *Rainbow Warrior* arbitration:

> "There is a long established practice of States and international Courts and Tribunals of using satisfaction as a remedy or form of reparation (in the wide sense) for the breach of an international obligation. This practice relates

[97] See C. Dominicé, "De la réparation constructive du préjudice immatériel souffert par un État", in *L'ordre juridique international entre tradition et innovation; Recueil d'études* (Paris, P.U.F., 1997) p. 349, at p. 354.

> particularly to the case of moral or legal damage done directly to the State, especially as opposed to the case of damage to persons involving international responsibilities".[98]

State practice also provides many instances of claims for satisfaction in circumstances where the internationally wrongful act of a State causes non-material injury to another State. Examples include situations of insults to the symbols of the State, such as the national flag,[99] violations of sovereignty or territorial integrity,[100] attacks on ships or aircraft,[101] ill treatment of or deliberate attacks on heads of State or Government or diplomatic or consular representatives or other protected persons[102] and violations of the premises of embassies or consulates or of the residences of members of the mission.[103]

(5) Paragraph 2 of article 37 provides that satisfaction may consist in an acknowledgement of the breach, an expression of regret, a formal apology or another appropriate modality. The forms of satisfaction listed in the article are no more than examples. The appropriate form of

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[98] *Rainbow Warrior (New Zealand/France), R.I.A.A.*, vol. XX, p. 217 (1990), at pp. 272-273, para. 122.

[99] Examples are the *Magee* case (1874) (Whiteman, *Damages*, vol. I, p. 64), the *Petit Vaisseau* case (1863) (Whiteman, *Damages*, 2nd series, vol. III, No. 2564) and the case that arose from the insult to the French flag in Berlin in 1920 (C. Eagleton, *The Responsibility of States in International Law* (New York, New York University Press, 1928), pp. 186-187).

[100] As occurred in the *Rainbow Warrior* arbitration, *R.I.A.A.*, vol. XX, p. 217 (1990).

[101] Examples include the attack carried out in 1961 against a Soviet aircraft transporting President Brezhnev by French fighter planes over the international waters of the Mediterranean (*R.G.D.I.P.*, vol. 65 (1961), p. 603); and the sinking of a Bahamian ship in 1980 by a Cuban aircraft (*R.G.D.I.P.*, vol. 84 (1980), pp. 1078-1079.

[102] See F. Przetacznik, "La responsabilité internationale de l'Etat à raison des préjudices de caractère moral et politique causés à un autre Etat", *R.G.D.I.P.*, vol. 78 (1974), p. 951.

[103] Examples include the attack by demonstrators in 1851 on the Spanish Consulate in New Orleans (Moore, *Digest*, vol. VI, p. 811, at p. 812), and the failed attempt of two Egyptian policemen, in 1888, to intrude upon the premises of the Italian Consulate at Alexandria (*La prassi italiana di diritto internazionale*, 2nd series, (Dobbs Ferry, N.Y., Oceana, 1970) vol. III, No. 2558). Also see cases of apologies and expressions of regret following demonstrations in front of the French Embassy in Belgrade in 1961 (*R.G.D.I.P.*, vol. 65 (1961), p. 610), and the fires in the libraries of the United States Information Services in Cairo in 1964 (*R.G.D.I.P.*, vol. 69 (1965), pp. 130-131) and in Karachi in 1965 (*R.G.D.I.P.*, vol. 70 (1966), pp. 165-166).

satisfaction will depend on the circumstances and cannot be prescribed in advance.[104] Many possibilities exist, including due inquiry into the causes of an accident resulting in harm or injury,[105] a trust fund to manage compensation payments in the interests of the beneficiaries, disciplinary or penal action against the individuals whose conduct caused the internationally wrongful act[106] or the award of symbolic damages for non-pecuniary injury.[107] Assurances or guarantees of non-repetition, which are dealt with in the Articles in the context of cessation, may also amount to a form of satisfaction.[108] Paragraph 2 does not attempt to list all the possibilities, but neither is it intended to exclude them. Moreover the order of the modalities of satisfaction in paragraph 2 is not intended to reflect any hierarchy or preference. Paragraph 2 simply gives examples which are not listed in order of appropriateness or seriousness. The appropriate mode, if any, will be determined having regard to the circumstances of each case.

(6) One of the most common modalities of satisfaction provided in the case of moral or non-material injury to the State is a declaration of the wrongfulness of the act by a competent court or tribunal. The utility of declaratory relief as a form of satisfaction in the case of

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[104] In the *Rainbow Warrior* arbitration the Tribunal, while rejecting New Zealand's claims for restitution and/or cessation and declining to award compensation, made various declarations by way of satisfaction, and in addition a recommendation "to assist [the parties] in putting an end to the present unhappy affair". Specifically it recommended that France contribute US$2 million to a fund to be established "to promote close and friendly relations between the citizens of the two countries". See *R.I.A.A.*, vol. XX, p. 217 (1990), at p. 274, paras. 126-127. See further L. Migliorino**,** "Sur la déclaration d'illiceité comme forme de satisfaction: à propos de la sentence arbitrale du 30 avril 1990 dans l'affaire du Rainbow warrior", *R.G.D.I.P.*, vol. 96 (1992), p. 61.

[105] E.g. the United States naval inquiry into the causes of the collision between an American submarine and the Japanese fishing vessel, the *Ehime Maru*, in waters off Honolulu: *New York Times*, 8 Feb. 2001, section 1, p.1, col. 6.

[106] Action against the guilty individuals was requested in the case of the killing in 1948, in Palestine, of Count Bernadotte while he was acting in the service of the United Nations (Whiteman, *Digest*, vol. 8, pp. 742-743) and in the case of the killing of two United States officers in Tehran (*R.G.D.I.P.*, vol. 80, p. 257).

[107] See, e.g., *The "I'm Alone"*, *R.I.A.A.*, vol. III, p. 1609 (1935); *Rainbow Warrior*, *R.I.A.A.*, vol. XX, p. 217 (1990).

[108] See commentary to article 30 (b), para. (11).

non-material injury to a State was affirmed by the International Court in the *Corfu Channel* case, where the Court, after finding unlawful a mine-sweeping operation (Operation Retail) carried out by the British Navy after the explosion, said:

> "to ensure respect for international law, of which it is the organ, the Court must declare that the action of the British Navy constituted a violation of Albanian sovereignty. This declaration is in accordance with the request made by Albania through her counsel and is in itself appropriate satisfaction."[109]

This has been followed in many subsequent cases.[110] However, while the making of a declaration by a competent court or tribunal may be treated as a form of satisfaction in a given case, such declarations are not intrinsically associated with the remedy of satisfaction. Any court or tribunal which has jurisdiction over a dispute has the authority to determine the lawfulness of the conduct in question and to make a declaration of its findings, as a necessary part of the process of determining the case. Such a declaration may be a preliminary to a decision on any form of reparation, or it may be the only remedy sought. What the Court did in the *Corfu Channel* case was to use a declaration as a form of satisfaction in a case where Albania had sought no other form. Moreover such a declaration has further advantages: it should be clear and self-contained and will by definition not exceed the scope or limits of satisfaction referred to in paragraph 3 of article 37. A judicial declaration is not listed in paragraph 2 only because it must emanate from a competent third party with jurisdiction over a dispute, and the Articles are not concerned to specify such a party or to deal with issues of judicial jurisdiction. Instead, article 37 specifies the acknowledgement of the breach by the responsible State as a modality of satisfaction.

(7) Another common form of satisfaction is an apology, which may be given verbally or in writing by an appropriate official or even the head of State. Expressions of regret or apologies were required by a third party in the *"I'm Alone"*,[111] *Kellet*[112] and *Rainbow Warrior* cases,[113] and

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[109] *Corfu Channel, Merits, I.C.J. Reports 1949*, p. 4, at p. 35, repeated in the *dispositif* at p. 36.

[110] E.g., *Rainbow Warrior*, *R.I.A.A.*, vol. XX, p. 217 (1990), at p. 273, para. 123.

[111] *R.I.A.A.*, vol. III, p. 1609 (1935).

[112] Moore, *Digest*, vol. V, p. 43 (1897).

[113] *R.I.A.A.*, vol. XX p. 217 (1990).

were offered by the responsible State in the *Consular Relations*[114] and *LaGrand* cases.[115] Requests for, or offers of, an apology are a quite frequent feature of diplomatic practice and the tender of a timely apology, where the circumstances justify it, can do much to resolve a dispute. In other circumstances an apology may not be called for, e.g. where a case is settled on an *ex gratia* basis, or it may be insufficient. In the *LaGrand* case the Court considered that "an apology is not sufficient in this case, as it would not be in other cases where foreign nationals have not been advised without delay of their rights under Article 36, paragraph 1, of the Vienna Convention and have been subjected to prolonged detention or sentenced to severe penalties".[116]

(8) Excessive demands made under the guise of "satisfaction" in the past[117] suggest the need to impose some limit on the measures that can be sought by way of satisfaction to prevent abuses, inconsistent with the principle of the equality of States.[118] In particular, satisfaction is not intended to be punitive in character, nor does it include punitive damages. Paragraph 3 of article 37 places limitations on the obligation to give satisfaction by setting out two criteria: first, the proportionality of satisfaction to the injury; second, the requirement that satisfaction should not be humiliating to the responsible State. It is true that the term "humiliating" is imprecise, but there are certainly historical examples of demands of this kind.

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[114] *Vienna Convention on Consular Relations (Paraguay v. United States), Request for Provisional Measures*, *I.C.J. Reports 1998*, p. 248. For the text of the United States' apology see U.S. Department of State, Text of Statement Released in Asunción, Paraguay; Press Statement by James P. Rubin, Spokesman, November 4, 1998. For the order discontinuing proceedings, see *I.C.J. Reports 1998*, p. 426.

[115] *LaGrand (Germany v. United States of America), Request for Provisional Measures*, *I.C.J. Reports 1999*, p. 9, and *LaGrand (Germany v. United States of America), Merits,* judgment of 27 June 2001.

[116] Ibid., para. 123.

[117] E.g., the joint note presented to the Chinese Government in 1900 following the Boxer uprising and the demand by the Conference of Ambassadors against Greece in the "Tellini" affair in 1923: see C. Eagleton, *The Responsibility of States in International Law* (New York, New York University Press, 1928), pp. 187-188.

[118] The need to prevent the abuse of satisfaction was stressed by early writers such as J.C. Bluntschli, *Das moderne Völkerrecht der civilisierten Staten als Rechtsbuch dargestellt*, (3rd edn.) (Nördlingen, 1878); French trans. by C. Lardy, *Le droit international codifié*, (5th rev. edn.) (Paris, 1895), pp. 268-269.

Article 38

Interest

1. Interest on any principal sum payable under this Chapter shall be payable when necessary to ensure full reparation. The interest rate and mode of calculation shall be set so as to achieve that result.

2. Interest runs from the date when the principal sum should have been paid until the date the obligation to pay is fulfilled.

Commentary

(1) Interest is not an autonomous form of reparation; nor it is a necessary part of compensation in every case. For this reason the term "principal sum" is used in article 38 rather than "compensation". Nevertheless, an award of interest may be required in some cases in order to provide full reparation for the injury caused by an internationally wrongful act, and it is normally the subject of separate treatment in claims for reparation and in the awards of tribunals.

(2) As a general principle, an injured State is entitled to interest on the principal sum representing its loss, if that sum is quantified as at an earlier date than the date of the settlement of, or judgment or award concerning, the claim and to the extent that it is necessary to ensure full reparation.[119] Support for a general rule favouring the award of interest as an aspect of full reparation is found in international jurisprudence.[120] In *The SS "Wimbledon"*, the Permanent Court awarded simple interest at 6 per cent as from the date of judgment, on the basis that interest was only payable "from the moment when the amount of the sum due has been fixed and the obligation to pay has been established".[121]

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[119] Thus interest may not be allowed where the loss is assessed in current value terms as at the date of the award. See the *Lighthouses* arbitration, *R.I.A.A.,* vol. XII, p. 155 (1956), at pp. 252-253.

[120] See, e.g., the awards of interest made in the *Illinois Central Railroad* case, *R.I.A.A.*, vol. IV, p. 134 (1926); the *Lucas* case (1966) *I.L.R.,* vol. 30, p. 220; see also *Administrative Decision No. III* of the United States-German Mixed Claims Commission, *R.I.A.A.*, vol. VII, pp. 66 (1923).

[121] *1923*, *P.C.I.J., Series A, No. 1,* p. 32. The Court accepted the French claim for an interest rate of 6 per cent as fair, having regard to "the present financial conditions of the world and … the conditions prevailing for public loans". The Permanent Court also envisaged interest as payable in the *Factory at Chorzów, Merits*, *1928, P.C.I.J., Series A, No. 17,* p. 17 ("an amount equivalent to interest at 5 per cent per annum from the date of the taking to the date of

(3) Issues of the award of interest have frequently arisen in other tribunals, both in cases where the underlying claim involved injury to private parties and where the injury was to the State itself.[122] The experience of the Iran-United States Claims Tribunal is worth noting. In *Islamic Republic of Iran v. United States of America (Case A-19)*, the Full Tribunal held that its general jurisdiction to deal with claims included the power to award interest, but it declined to lay down uniform standards for the award of interest on the ground that this fell within the jurisdiction of each Chamber and related "to the exercise of the discretion accorded to them in deciding each particular case".[123] On the issue of principle the Tribunal said:

> "Claims for interest are part of the compensation sought and do not constitute a separate cause of action requiring their own independent jurisdictional grant. This Tribunal is required by Article V of the Claims Settlement Declaration to decide claims 'on the basis of respect for law'. In doing so, it has regularly treated interest, where sought, as forming an integral part of the 'claim' which is has a duty to decide. The Tribunal notes that the Chambers have been consistent in awarding interest as 'compensation for damages suffered due to delay in payment'… Indeed, it is customary for arbitral tribunals to award interest as part of an award for damages, notwithstanding the absence of any express reference to interest in the *compromis.* Given that the power to award interest is inherent in the Tribunal's authority to decide claims, the exclusion of such power could only be established by an express provision in the Claims Settlement Declaration. No such provision exists. Consequently, the Tribunal concludes that it is clearly within its power to award interest as compensation for damage suffered."[124]

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payment"). No award was actually made since the amount of compensation was subsequently agreed between the parties.

[122] In *The M/V "Saiga" (No. 2) (Saint Vincent and the Grenadines v. Guinea),* the International Tribunal on the Law of the Sea awarded interest at different rates in respect of different categories of loss: see judgment of 1 July 1999, para. 173.

[123] (1987) 16 *Iran-U.S.C.T.R.* 285, at p. 290. G.H. Aldrich, *The Jurisprudence of the Iran-United States Claims Tribunal* (Oxford, Clarendon Press, 1996) pp. 475-6 points out, the practice of the three Chambers has not been entirely uniform.

[124] (1987) 16 *Iran-U.S.C.T.R.* 285, at pp. 289-90.

The Tribunal has awarded interest at a different and slightly lower rate in respect of intergovernmental claims.[125] It has not awarded interest in certain cases, for example where a lump-sum award was considered as reflecting full compensation, or where other special circumstances pertained.[126]

(4) Decision 16 of the Governing Council of the United Nations Compensation Commission deals with the question of interest. It provides:

> "1. Interest will be awarded from the date the loss occurred until the date of payment, at a rate sufficient to compensate successful claimants for the loss of use of the principal amount of the award.
>
> 2. The methods of calculation and of payment of interest will be considered by the Governing Council at the appropriate time.
>
> 3. Interest will be paid after the principal amount of awards."[127]

This provision combines a decision in principle in favour of interest where necessary to compensate a claimant with flexibility in terms of the application of that principle. At the same time, interest, while a form of compensation, is regarded as a secondary element, subordinated to the principal amount of the claim.

(5) Awards of interest have also been envisaged by human rights courts and tribunals, even though the compensation practice of these bodies is relatively cautious and the claims are almost always unliquidated. This is done, for example, to protect the value of a damages award payable by instalments over time.[128]

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[125] See C.N. Brower & J.D. Brueschke, *The Iran-United States Claims Tribunal* (The Hague, Nijhoff, 1998), pp. 626-7, with references to the cases. The rate adopted was 10 per cent, as compared with 12 per cent for commercial claims.

[126] See the detailed analysis of Chamber Three in *McCollough & Co. Inc. v. Ministry of Post, Telegraph & Telephone & Others,* (1986) 11 *Iran-U.S.C.T.R.* 3, at pp. 26-31.

[127] "Awards of Interest", Decision 16 of 4 January 1993 (S/AC.26/1992/16).

[128] See e.g. *Velásquez Rodriguez (Compensatory Damages) Inter-Am.Ct.H.R., Series C, No. 7* (1990), para. 57. See also *Papamichalopoulos v. Greece (Article 50), E.C.H.R., Series A, No. 330-B* (1995), para. 39 where interest was payable only in respect of the pecuniary damage awarded. See further D. Shelton, *Remedies in International Human Rights Law* (Oxford, Clarendon Press, 1999), pp. 270-2.

(6) In their more recent practice, national compensation commissions and tribunals have also generally allowed for interest in assessing compensation. However in certain cases of partial lump-sum settlements, claims have been expressly limited to the amount of the principal loss, on the basis that with a limited fund to be distributed, claims to principal should take priority.[129] Some national court decisions have also dealt with issues of interest under international law,[130] although more often questions of interest are dealt with as part of the law of the forum.

(7) Although the trend of international decisions and practice is towards greater availability of interest as an aspect of full reparation, an injured State has no automatic entitlement to the payment of interest. The awarding of interest depends on the circumstances of each case; in particular, on whether an award of interest is necessary in order to ensure full reparation. This approach is compatible with the tradition of various legal systems as well as the practice of international tribunals.

(8) An aspect of the question of interest is the possible award of compound interest. The general view of courts and tribunals has been against the award of compound interest, and this is true even of those tribunals which hold claimants to be normally entitled to compensatory interest. For example, the Iran-United States Claims Tribunal has consistently denied claims for compound interest, including in cases where the claimant suffered losses through compound interest charges on indebtedness associated with the claim. In *R.J. Reynolds Tobacco Co. v Government of the Islamic Republic of Iran*, the Tribunal failed to find…

> "any special reasons for departing from international precedents which normally do not allow the awarding of compound interest. As noted by one authority, '[t]here are few rules within the scope of the subject of damages in international law that are better settled than the one that compound interest is not allowable'... Even though the term 'all sums' could be construed to include interest and

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[129] See e.g. the Foreign Compensation (People's Republic of China) Order 1987 (U.K.), s. 10, giving effect to a Settlement Agreement of 5 June 1987: U.K.T.S. No. 37 (1987).

[130] See, e.g., *McKesson Corporation v. Islamic Republic of Iran*, 116 F. Supp. 2d 13 (D.C., D.C., DATE).

> thereby to allow compound interest, the Tribunal, due to the ambiguity of the language, interprets the clause in the light of the international rule just stated, and thus excludes compound interest."[131]

Consistent with this approach the Tribunal has gone behind contractual provisions appearing to provide for compound interest, in order to prevent the claimant gaining a profit "wholly out of proportion to the possible loss that [it] might have incurred by not having the amounts due at its disposal".[132] The preponderance of authority thus continues to support the view expressed by Arbitrator Huber in the *British Claims in the Spanish Zone of Morocco* case:

> "the arbitral case law in matters involving compensation of one State for another for damages suffered by the nationals of one within the territory of the other … is unanimous … in disallowing compound interest. In these circumstances, very strong and quite specific arguments would be called for to grant such interest …"[133]

The same is true for compound interest in respect of State-to-State claims.

(9) Nonetheless several authors have argued for a reconsideration of this principle, on the ground that "compound interest reasonably incurred by the injured party should be recoverable as an item of damage".[134] This view has also been supported by arbitral tribunals in some cases.[135] But given the present state of the authorities it cannot be said that an injured State has any entitlement to compound interest, in the absence of special circumstances which justify some element of compounding as an aspect of full reparation.

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[131] (1984) 7 *Iran-U.S.C.T.R.* 181, at pp. 191-2, citing Whiteman, *Damages,* vol. III, p. 1997.

[132] *Anaconda-Iran, Inc. v. Government of the Islamic Republic of Iran,* (1986) 13 *Iran-U.S.C.T.R.* 199, at p. 235. See also G. Aldrich, *The Jurisprudence of the Iran-United States Claims Tribunal* (Oxford, Clarendon Press, 1996) pp. 477-478.

[133] *R.I.A.A*., vol. II, p. 615 (1924), at p. 650. Cf. the *Aminoil* arbitration, where the interest awarded was compounded for a period without any reason being given. This accounted for more than half of the total final award: *Government of Kuwait v. American Independent Oil Co.,* (1982) *I.L.R.*, vol. 66, p. 519, at p. 613, para. 178 (5).

[134] E.g., F.A. Mann, "Compound Interest as an Item of Damage in International Law", in *Further Studies in International Law* (Oxford, Clarendon Press, 1990) p. 377 at p. 383.

[135] See e.g. *Compañía des Desarrollo de Santa Elena SA v. Republic of Costa Rica*, I.C.S.I.D. Case No. ARB/96/1, final award of 1 February 2000, paras. 103-105.

(10) The actual calculation of interest on any principal sum payable by way of reparation raises a complex of issues concerning the starting date (date of breach,[136] date on which payment should have been made, date of claim or demand), the terminal date (date of settlement agreement or award, date of actual payment) as well as the applicable interest rate (rate current in the respondent State, in the applicant State, international lending rates). There is no uniform approach, internationally, to questions of quantification and assessment of amounts of interest payable.[137] In practice the circumstances of each case and the conduct of the parties strongly affect the outcome. There is wisdom in the Iran-United States Claims Tribunal's observation that such matters, if the parties cannot resolve them, must be left "to the exercise of the discretion accorded to [individual tribunals] in deciding each particular case".[138] On the other hand the present unsettled state of practice makes a general provision on the calculation of interest useful. Accordingly article 38 indicates that the date from which interest is to be calculated is the date when the principal sum should have been paid. Interest runs from that date until the date the obligation to pay is fulfilled. The interest rate and mode of calculation are to be set so as to achieve the result of providing full reparation for the injury suffered as a result of the internationally wrongful act.

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[136] Using the date of the breach as the starting date for calculation of the interest term is problematic as there may be difficulties in determining that date, and many legal systems require a demand for payment by the claimant before interest will run. The date of formal demand was taken as the relevant date in the *Russian Indemnity* case, *R.I.A.A.*, vol. XI, p. 421 (1912), at p. 442, by analogy from the general position in European legal systems. In any event, failure to make a timely claim for payment is relevant in deciding whether to allow interest.

[137] See e.g. J.Y. Gotanda, *Supplemental Damages in Private International Law* (The Hague, Kluwer, 1998), p. 13. It should be noted that a number of Islamic countries, influenced by the *Shari'a*, prohibit payment of interest under their own law or even under their constitution. However, they have developed alternatives to interest in the commercial and international context. For example payment of interest is prohibited by the Iranian Constitution, Principles 43, 49, but the Guardian Council has held that this injunction does not apply to "foreign governments, institutions, companies and persons, who, according to their own principles of faith, do not consider [interest] as being prohibited …" See ibid. pp. 39-40, with references.

[138] *Islamic Republic of Iran v. United States of America (Case No. A19),* (1987) 16 *Iran-US C.T.R.* 285, at p. 290.

(11) Where a sum for loss of profits is included as part of the compensation for the injury caused by a wrongful act, an award of interest will be inappropriate if the injured State would thereby obtain double recovery. A capital sum cannot be earning interest *and* notionally employed in earning profits at one and the same time. However, interest may be due on the profits which would have been earned but which have been withheld from the original owner.

(12) Article 38 does not deal, as such, with post-judgment or moratory interest. It is only concerned with interest that goes to make up the amount that a court or tribunal should award, i.e. compensatory interest. The power of a court or tribunal to award post-judgement interest is better regarded as a matter of its procedure.

Article 39

Contribution to the injury

In the determination of reparation, account shall be taken of the contribution to the injury by wilful or negligent action or omission of the injured State or any person or entity in relation to whom reparation is sought.

Commentary

(1) Article 39 deals with the situation where damage has been caused by an internationally wrongful act of a State, which is accordingly responsible for the damage in accordance with articles 1 and 28, but where the injured State, or the individual victim of the breach, has materially contributed to the damage by some wilful or negligent act or omission. Its focus is on situations which in national law systems are referred to as “contributory negligence”, “comparative fault”, “faute de la victime”, etc.[139]

(2) Article 39 recognizes that the conduct of the injured State or of any person or entity in relation to whom reparation is sought should be taken into account in assessing the form and extent of reparation. This is consonant with the principle that full reparation is due for the injury - but nothing more - arising in consequence of the internationally wrongful act. It is also consistent with fairness as between the responsible State and the victim of the breach.

(3) In the *LaGrand* case, the International Court recognised that the conduct of the claimant State could be relevant in determining the form and amount of reparation. There Germany had

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[139] See C. von Bar, *The Common European Law of Torts* (C.H. Beck, München, 2000), pp. 517-540.

delayed in asserting that there had been a breach and in instituting proceedings. The Court noted "that Germany may be criticised for the manner in which these proceedings were filed and for their timing", and stated that it would have taken this factor, among others, into account "had Germany's submission included a claim for indemnification".[140]

(4) The relevance of the injured State's contribution to the damage in determining the appropriate reparation is widely recognized in the literature[141] and in State practice.[142] While questions of an injured State's contribution to the damage arise most frequently in the context of compensation, the principle may also be relevant to other forms of reparation. For example, if a State-owned ship is unlawfully detained by another State and while under detention sustains damage attributable to the negligence of the captain, the responsible State may be required merely to return the ship in its damaged condition.

(5) Not every action or omission which contributes to the damage suffered is relevant for this purpose. Rather article 39 allows to be taken into account only those actions or omissions which can be considered as wilful or negligent, i.e. which manifest a lack of due care on the part of the victim of the breach for his or her own property or rights.[143] While the notion of a negligent action or omission is not qualified, e.g., by a requirement that the negligence should have

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[140] *LaGrand (Germany v. United States of America), Merits,* judgment of 27 June 2001, paras. 57, 116. For the relevance of delay in terms of loss of the right to invoke responsibility see article 45 (b) and commentary.

[141] See, e.g., B. Graefrath, "Responsibility and Damage Caused", in *Recueil des cours*, vol. 185 (1984-II), p. 95; B. Bollecker-Stern, *Le préjudice dans la théorie de la responsabilité internationale* (Paris, Sirey, 1973), pp. 265-300.

[142] In the *Delagoa Bay Railway (Great Britain, USA/Portugal)* case, the arbitrators noted that: "All the circumstances that can be adduced against the concessionaire company and for the Portuguese Government mitigate the latter's liability and warrant ... a reduction in reparation": ((1900), Martens, *Nouveau Recueil*, 2nd series, vol. XXX, p. 329; Moore, *International Arbitrations*, vol. II, p. 1865 (1900)). In *SS "Wimbledon", 1923, P.C.I.J., Series A, No. 1,* p. 31, a question arose as to whether there had been any contribution to the injury suffered as a result of the ship harbouring at Kiel for some time, following refusal of passage through the Kiel Canal, before taking an alternative course. The Court implicitly acknowledged that the captain's conduct could affect the amount of compensation payable, although it held that the captain had acted reasonably in the circumstances. For other examples see C.D. Gray, *Judicial Remedies in International Law* (Oxford, Clarendon Press, 1987), p. 23.

[143] This terminology is drawn from Article VI (1) of the Convention on International Liability for Damage caused by Space Objects, 29 March 1972, *U.N.T.S.,* vol. 961, p. 187.

reached the level of being "serious" or "gross", the relevance of any negligence to reparation will depend upon the degree to which it has contributed to the damage as well as the other circumstances of the case.[144] The phrase "account shall be taken" indicates that the article deals with factors that are capable of affecting the form or reducing the amount of reparation in an appropriate case.

(6) The wilful or negligent action or omission which contributes to the damage may be that of the injured State or "any person or entity in relation to whom reparation is sought". This phrase is intended to cover not only the situation where a State claims on behalf of one of its nationals in the field of diplomatic protection, but also any other situation in which one State invokes the responsibility of another State in relation to conduct primarily affecting some third party. Under articles 42 and 48, a number of different situations can arise where this may be so. The underlying idea is that the position of the State seeking reparation should not be more favourable, so far as reparation in the interests of another is concerned, than it would be if the person or entity in relation to whom reparation is sought were to bring a claim individually.

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[144] It is possible to envisage situations where the injury in question is entirely attributable to the conduct of the victim and not at all to that of the "responsible" State. Such situations are covered by the general requirement of proximate cause referred to in article 31, rather than by article 39. On questions of mitigation of damage see commentary to article 31 para. (14).