



**Security Council**

Distr.  
GENERAL

S/AC.26/2003/15  
26 June 2003

Original: ENGLISH

---

UNITED NATIONS  
COMPENSATION COMMISSION  
GOVERNING COUNCIL

REPORT AND RECOMMENDATIONS MADE BY THE PANEL OF COMMISSIONERS  
CONCERNING PART THREE OF THE THIRD INSTALMENT OF "F3" CLAIMS

## CONTENTS

	<u>Paragraphs</u>	<u>Page</u>
Glossary.....		6
Introduction.....	1-4	14
I. OVERVIEW OF PART THREE OF THE THIRD INSTALMENT CLAIMS	5-7	15
II. PROCEDURAL HISTORY .....	8-15	18
A. The nature and purpose of the proceedings .....	9-10	18
B. The procedural history of the claims .....	11-15	18
III. THE LEGAL FRAMEWORK.....	16-24	20
A. Applicable law .....	17-19	20
B. The directness requirement.....	20-23	20
C. Mitigation .....	24	21
IV. VERIFICATION AND VALUATION .....	25-51	22
A. The importance of evidence.....	26-31	22
B. The procedures adopted by the Panel to verify and value the “F3” claims .	32-38	23
C. Evidential status of the reports of the claimants’ accountants.....	39-41	24
D. Materiality .....	42-47	24
E. Reporting on the verification and valuation of the “F3” claims .....	48-51	25
V. INTRODUCTION TO THE THIRD INSTALMENT PART THREE CLAIMS .....	52	27
VI. INTRODUCTION TO THE KUWAIT INVESTMENT AUTHORITY CLAIM.....		28
VII. THE KUWAIT INVESTMENT AUTHORITY CLAIM – BUSINESS TRANSACTION OR COURSE OF DEALING – USD 56,101,387,423 .....	53-483	29
A. Introduction .....	53-61	29
B. The Portfolio Loss - USD 54,778,087,423 .....	62-77	30
C. The Borrowing Costs - USD 1,323,300,000.....	78-85	33
D. Procedural history of the Portfolio Loss and the Borrowing Costs claims .....	86-90	34
E. Statement of the Panel’s principal findings with respect to the issues raised by the Portfolio Loss and the Borrowing Costs claims .....	91-181	35

1. Compensation for the losses of the Government of Kuwait may properly be sought in a series of claims filed with the Commission	95-99	36
2. The Portfolio Loss and the Borrowing Costs claims have not been resolved in the review of the claims of the Receiving Entities	100-102	37
3. The Portfolio Loss and the Borrowing Costs claims are direct losses only to the extent that they arise in funding underlying direct losses .....	103-114	38
4. Financing losses arising from expenditure on underlying losses that are excluded from compensation by a decision of the Governing Council.....	115	40
5. Evidence of the extent of direct financing losses is required by the Panel.....	116-121	40
6. Direct financing losses - working example .....	122-127	41
7. Direct financing losses may include losses arising from funding the full replacement cost.....	128-137	42
8. Direct financing losses include losses arising from funding "involuntary betterment" .....	138-149	44
9. The periods during which direct financing losses were sustained ..	150-158	46
10. Direct financing losses arise in funding various loss types.....	159-161	47
11. The Portfolio Loss and the Borrowing Costs and claims for interest in underlying claims overlap .....	162-177	48
12. The measure of the direct financing losses .....	178-181	51
F. Analysis of Kuwait's and Iraq's submissions to the Panel and the Panel's further findings .....	182-376	52
1. Introduction .....	182	52
2. Objections raised by Iraq and Kuwait at the oral proceedings .....	183-186	52
3. Main issues considered by the Panel.....	187-376	52
(a) The directness requirement .....	188-222	53
(b) Losses sustained in funding expenditure on items that panels of Commissioners have not found to be direct losses..	223-235	60
(c) Evidence of the extent of direct financing losses .....	236-251	62
(d) Direct financing losses - funding the full replacement cost....	252-275	65
(e) The concepts of "voluntary betterment" and "involuntary betterment" .....	276-295	69

(f) The periods during which direct funding losses were sustained.....	296-308	73
(g) The interaction of the Portfolio Loss and the Borrowing Costs claims and claims for interest in underlying claims .....	309-370	75
(h) Identity of the Receiving Entities and compensation for the Government's direct financing losses .....	371-376	87
G. Quantification of the direct financing losses .....	377-483	88
1. Background .....	377-379	88
2. Verification and valuation of the direct financing losses.....	380-390	89
3. Receiving Entities that received funds for the funding of direct losses during the expenditure period .....	391-393	90
4. Direct financing losses arising from loss of Government revenue .	394-401	92
5. The verification and valuation programmes followed by the Panel in quantifying the direct financing losses.....	402-442	94
6. The measure of the direct financing losses .....	443-473	100
7. Quantification of the funding gap for each year of the expenditure period .....	474-480	105
8. Conclusions and recommendations .....	481-483	107
VIII. THE KUWAIT INVESTMENT AUTHORITY CLAIM – INCOME PRODUCING PROPERTY – USD 6,226,436.....	484-497	108
IX. THE KUWAIT INVESTMENT AUTHORITY CLAIM – PAYMENT OR RELIEF TO OTHERS – USD 3,461,998 .....	498-520	110
X. THE KUWAIT INVESTMENT AUTHORITY CLAIM – OTHER LOSSES: FUNDS ADVANCED TO IRAQ (ADVANCES – USD 6,050,535,000 – CENTRAL BANK OF IRAQ DEPOSITS – USD 1,093,884,421) .....	521-548	114
XI. THE KUWAIT INVESTMENT AUTHORITY CLAIM – INTEREST – USD 23,473,853,424 .....	549-556	119
XII. THE SUPPLEMENTAL INTEREST CLAIM – USD 9,605,117,360 .....	557-566	121
XIII. MISCELLANEOUS (“POW CLAIM”).....	567-570	123
XIV. SUMMARY OF RECOMMENDATIONS.....	571-572	124
<u>Annex</u>		
Presentation of the working example .....		140

List of tables

	<u>Page</u>
Table 1. Summary of the third instalment part three claims resolved by the Panel.....	16
Table 2. Summary table for Kuwait Investment Authority .....	28
Table 3. Asserted amounts liquidated.....	30
Table 4. Amended asserted amounts liquidated.....	31
Table 5. Borrowing Costs schedule, as per statement of claim.....	34
Table 6. Borrowing Costs schedule, as amended.....	34
Table 7. Working example .....	42
Table 8. Summary of losses arising in the working example .....	79
Table 9. List of Receiving Entities .....	91
Table 10. Loss of profits claims giving rise to a funding gap.....	93
Table 11. Other loss of profits or related claims .....	94
Table 12. Amounts of the funding gap as at the end of each financial year.....	106
Table 13. Summary table for the Supplemental Interest Claim .....	121
Table 14. Summary of the principal claim amount and the Panel's recommendation for each third instalment part three claim.....	124

## GLOSSARY

“Actual Performance Method”	Method used to estimate the lost investment returns on the Portfolio Loss, as defined, using the actual and estimated performance of the FGF, as defined
“adjustment”	Deduction made by a panel, as defined, in determining an award
“Amounts Liquidated”	Amounts generated from the sale of assets from the FGF, as defined, by KIA, as defined
“betterment adjustment”	An adjustment, as defined, made by a panel to reflect improvement in repaired or replaced property, as compared with lost, damaged or destroyed property
“Borrowing Costs”	Interest and transaction costs on the Funds Borrowed, as defined
“‘C’ Panel”	The Panel of Commissioners reviewing the category “C” claims, as defined
“category ‘A’ claims”	Individual claims for departure from Iraq or Kuwait
“category ‘C’ claims”	Individual claims for damages of amounts up to USD 100,000
“category ‘D’ claims”	Individual claims for damages of amounts above USD 100,000
“category ‘E’ claims”	Claims submitted by corporations, other private legal entities and public-sector enterprises
“category ‘F’ claims”	Claims submitted by Governments and international organizations

“claimant”	Any party filing a claim with the Commission, as defined
“Commission” or “UNCC”	United Nations Compensation Commission
“credit facilities”	The group of loans described in paragraph 79 of this report
“‘D1’ Panel”	The first of the two panels of Commissioners reviewing the category “D” claims, as defined
“direct loss”	A loss that, as a matter of objective assessment, would have been expected as a normal and natural consequence of Iraq’s invasion and occupation of Kuwait. See paragraph 23 of this report
“direct financing losses”	Losses arising when funding the sums that some Government Ministries and other Receiving Entities, as defined, expended in funding repairs and replacements to Government and Receiving Entities’ property lost, damaged or destroyed as a direct result of Iraq’s invasion and occupation of Kuwait
“direct funding requirement”	Amount of funds required to repair and replace Government and Receiving Entities’ property lost, damaged or destroyed as a direct result of Iraq’s invasion and occupation of Kuwait
“‘E1’ Panel”	The Panel of Commissioners appointed to review the “E1” claims, as defined
“‘E1’ claims”	Category “E”, energy sector claims submitted by corporations, other private legal entities and public sector enterprises

“‘E2’ claims	Category “E” claims filed on behalf of corporations and other business entities not incorporated in Kuwait, excluding oil sector, construction/engineering and export guarantee and insurance claims
“‘E2’ and ‘E2A’ Panels”	The two Panels of Commissioners appointed to review the “E2” claims, as defined
“‘E4’ claims”	Kuwaiti private sector corporate category “E” claims, excluding oil sector claims
“‘E4’ Panel”	The first of the two panels of Commissioners appointed to review the “E4” claims, as defined
“emergency period”	The period from 27 February to 31 May 1991, as used by the Government of Kuwait, as defined, to denote the period during which reconstruction and repair work commenced
“expenditure period”	Period of time from August 1990 to June 1994
“expert consultants”	The expert accounting and loss adjusting consultants assisting the Panel. See paragraph 11 of this report
“‘F1’ claims”	Category “F” claims for losses related to departure and evacuation costs or damage to physical property, and claims filed by international organizations
“‘F1’ Panel”	The Panel of Commissioners appointed to review the “F1” claims, as defined
“‘F3’ claims”	Kuwaiti Government claims, with the exception of claims reviewed by the “F1” Panel and those that the Commission has classified as environmental claims

“FGF”	See “Future Generations Fund”
“First ‘F3’ Report”	“Report and recommendations made by the Panel of Commissioners concerning the first instalment of ‘F3’ claims” (S/AC.26/1999/24)
“first instalment claims”	Those claims considered by the Panel in the First “F3” Report
“forced investment period”	Period of time extending from the date of expenditure for the replacement of any asset, until the normal replacement date, as defined, or the date of receipt of compensation from the Commission
“funding gap”	The excess of the direct funding requirement, as defined, over the amount of compensation awarded in respect of a direct loss, as defined
“Funds Borrowed” or “borrowings”	Amounts borrowed on the international money markets by KIA, as defined
“Funds Raised”	Amounts generated by the liquidations and borrowings, as defined
“Future Generations Fund” (“FGF”)	Fund that is intended to serve as a resource for the future of Kuwait and its people when Kuwait’s oil revenues are no longer sufficient to meet Kuwait’s needs
General Reserve Fund (“GRF”)	Source of funds to operate the Government of Kuwait, as defined. The funding for and spending under the Government’s budget, including contributions to the FGF, as defined, pass through the General Reserve Fund
“Governing Council decision”	A decision of the Governing Council of the Commission

“Government of Kuwait” or “Government”	Government of the State of Kuwait
“Government of Iraq” or “Iraq”	Government of the Republic of Iraq
“involuntary betterment”	Betterment, as defined, that could not reasonably have been avoided
“KERP”	Kuwait Emergency and Recovery Program, a procurement programme set up in December 1990 and managed by the Council of Ministers
“KIA”	Kuwait Investment Authority
“KIO”	Kuwait Investment Office
“level of materiality”	Level above which the amounts claimed carry a greater risk of significant overstatement. See section IV.D of this report and paragraphs 383 to 386 of this report. See further paragraph 49(h) of this report
“liberation”	The liberation on 26 February 1991 of Kuwait from the occupation of Iraq’s forces
“Liquidated Assets”	Assets sold from the FGF, as defined, by KIA, as defined
“liquidation period”	Period of time from August 1990 to December 1993, during which liquidations, as defined, took place
“liquidations”	The sale of assets from the FGF, as defined, by KIA, as defined
“lost investment returns”	Lost income and capital appreciation that KIA would have received on the Liquidated Assets, as defined

“Market Indices Method”	Method used to estimate the lost investment returns on the Portfolio Loss, as defined, using the Morgan Stanley Capital International World Index for equities and the Salomon Brothers World Government Bond Index for bonds
“Ministry of Finance” or “MoF”	Ministry of Finance of the Government of Kuwait, as defined
“normal replacement date”	Date at which the replacement of damaged or destroyed property would have normally taken place, absent the invasion and occupation of Kuwait
“occupation period”	The period from 2 August 1990 to 26 February 1991, as used by the Government of Kuwait, as defined, to denote the period during which Kuwait was occupied by Iraq
“oral proceedings”	Oral proceedings held in Geneva on 12-13 September 2001 in relation to the KIA claim
“panel”	A Panel of Commissioners appointed to review the claims filed with the Commission
“PAAC”	Public Authority for the Assessment of Compensation for Damages Resulting from Iraqi Aggression
“Portfolio Loss”	Loss of investment income from the Liquidated Assets, as defined
“principal claim amount”	See paragraph 5 of this report
“Receiving Entity” or “Receiving Entities”	Entity or entities being the recipient(s) of the Funds Raised, as defined

“Recommended Amounts”	Amounts recommended for compensation by the panels, as defined, in respect of the claims filed with the Commission
“relief paid to employees”	See section IX of this report
“Rules”	The Commission’s Provisional Rules for Claims Procedure, a text of which is annexed to Governing Council decision 10 (S/AC.26/1992/10) of 26 June 1992
“Second ‘F3’ Report”	“Report and recommendations made by the Panel of Commissioners concerning the second instalment of ‘F3’ claims” (S/AC.26/2001/7)
“second instalment claims”	Those claims considered by the Panel in the Second “F3” Report
“secretariat”	The secretariat of the Commission
“Security Council resolution”	Resolution adopted by the Security Council of the United Nations
“Supplemental Interest Claim” or the “SI claim”	The claim filed with the Commission entitled “Government of the State of Kuwait, re Supplemental Interest Claim”
“third instalment claims”	See paragraph 3 of this report
“third instalment part three claims”	See paragraph 4 of this report
“underlying claim”	Claim submitted by a Receiving Entity, as defined
“underlying expenditure”	Sum expended by a Receiving Entity, as defined
“UNROP”	United Nations Return of Property programme

“USD”

United States dollar

“voluntary betterment”

Betterment, as defined, that could reasonably  
have been avoided

### Introduction

1. At its twenty-eighth and thirty-third sessions, held from 29 June to 1 July 1998 and 28 to 30 September 1999, respectively, the Governing Council of the United Nations Compensation Commission (the “Commission”) appointed a Panel of Commissioners (the “Panel”) comprising Messrs L. Yves Fortier (Chairman), Andrew Jacovides and Reiner Soll to review the second, and subsequent, instalments of those claims filed by the Government of the State of Kuwait (the “Government of Kuwait”), known as the “F3’ claims”.
2. The “F3” claims comprise all of the Government of Kuwait’s claims, other than those reviewed by the “F1” Panel and those that the Commission has classified as environmental claims. The “F3” claims have been presented by the Government of Kuwait on behalf of its various Ministries and other entities. There are 63 such claims. Each claim seeks compensation for direct loss, damage or injury alleged to be a result of Iraq’s invasion and occupation of Kuwait.<sup>1</sup>
3. The third instalment of the “F3” claims, comprising 21 claims (the “third instalment claims”), was submitted to the Panel on 14 September 2000, in accordance with article 32 of the Provisional Rules for Claims Procedure (the “Rules”).<sup>2</sup> The Panel advised the Executive Secretary on 13 June 2001 that it would split the third instalment claims into three parts.<sup>3</sup> The Panel completed its report regarding part one of the third instalment claims on 12 October 2001, and that report was approved by the Governing Council by its decision 153 (S/AC.26/Dec.153 (2002)) on 13 March 2002. The Panel completed its report regarding part two of the third instalment claims on 14 December 2001, and that report was approved by the Governing Council by its decision 164 (S/AC.26/Dec.164 (2002)) on 20 June 2002.
4. This report contains the Panel’s recommendations to the Governing Council on the third instalment part three claims, which comprise the claim filed by the Kuwait Investment Authority (“KIA” and the “KIA claim” respectively) and the claim filed entitled “Government of the State of Kuwait, re Supplemental Interest Claim” (the “SI claim”). This report is issued under article 38(e) of the Rules.

## I. OVERVIEW OF PART THREE OF THE THIRD INSTALMENT CLAIMS

5. The KIA claim and the SI claim seek compensation for losses totalling 72,860,612,638 United States dollars (USD) plus interest of USD 23,473,853,424. The amount claimed in each claim is set out in table 1 below. The Panel will refer to the total amount claimed in each claim, excluding interest, as the “principal claim amount”. The Panel’s findings in respect of the KIA claim and the SI claim (in sections VI – XII below) include a tabular breakdown of each claim that sets out the amounts claimed, including interest, and the amounts recommended.

Table 1. Summary of the third instalment part three claims resolved by the Panel<sup>f</sup>

<u>Claimant</u>	<u>UNCC claim number</u>	<u>Government claim number</u>	<u>Principal claim amount (USD)<sup>b</sup></u>	<u>Interest (USD)</u>	<u>Amount claimed including interest (USD)</u>
Kuwait Investment Authority	5000158	19	63,255,495,278	23,473,853,424	86,729,348,702
Government of the State of Kuwait, re Supplemental Interest Claim	5000184	65	9,605,117,360 <sup>c</sup>	-	9,605,117,360
<u>Total</u>			72,860,612,638	23,473,853,424	96,334,466,062

---

<sup>a</sup> See paragraphs 567 to 570 below regarding UNCC claim Nos. 5000169 and 5000459 (National Committee for Missing and Prisoner of War's Affairs).

<sup>b</sup> The figures in this column are the starting point of the Panel's review, before any of the adjustments described in this report. They do not include any claims preparation costs.

<sup>c</sup> Plus the daily amounts set out in table 13 below.

6. Having regard to the complexity of the issues raised, the volume of documentation, and the amount of compensation sought, the Panel has classified the third instalment part three claims as “unusually large or complex” within the meaning of article 38(d) of the Rules. In the ordinary course, such classification requires the Panel to complete its review of such claims within a period of 12 months. However, having considered the provisions of paragraph (c) of Governing Council decision 35 (S/AC.26/Dec.35 (1995)) of 13 December 1995,<sup>4</sup> the Panel determined that it would not be able to complete its review of the third instalment part three claims within the 12-month period specified in article 38 (d) of the Rules and advised the Executive Secretary of the Commission accordingly on 13 June and 21 November 2001. The Executive Secretary advised the Governing Council of the Panel’s determination, and the Governing Council duly took note of the Panel’s request, made through the Executive Secretary, for an extension of time.

7. Given the nature of the third instalment part three claims, the Panel determined that the Commission should provide the Government of the Republic of Iraq (the “Government of Iraq” or “Iraq”) with copies of each of the claim files submitted by claimants. These files were forwarded to Iraq under the authority described in paragraph 18 of Governing Council decision 114, and pursuant to Procedural Order No. 1 issued in respect of each claim, on 13 July 2000. Iraq submitted three written responses to the KIA claim and two to the SI claim.<sup>5</sup>

## II. PROCEDURAL HISTORY

8. In undertaking its review of the third instalment part three claims, the Panel has followed the procedures and applied the principles and decisions set out in previous “F3” Reports. The Panel has re-stated the principles and decisions that are relevant to the third instalment part three claims in this and subsequent sections of this report.

### A. The nature and purpose of the proceedings

9. In undertaking its review of the “F3” claims, the Panel has borne in mind:

(a) The status and functions of the Commission;

(b) The Commission’s claims review processes, which are documentary rather than oral, and inquisitorial rather than adversarial; and

(c) The Panel’s function to provide an element of due process in the review of claims filed with the Commission.

10. The Panel has, like other panels, carried out a thorough and detailed factual and legal review of the “F3” claims, performing the investigative role incumbent on the panels in the claims review process.

### B. The procedural history of the claims

11. Prior to the formal submission of the third instalment part three claims to the Panel, the secretariat of the Commission (the “secretariat”) performed a detailed review of these claims and determined, in accordance with articles 14 and 15 of the Rules, that each of the claims complied with the formal and procedural requirements of the Commission. The Panel, as in previous instalments, and given the complex and technical nature of the third instalment part three claims, has made use of independent loss adjusters and accountants as expert consultants (“expert consultants”). The expert consultants are those that assisted the Panel in its review of previous instalments of “F3” claims, and have worked closely with the Panel, preparing for the Panel’s consideration reports covering the verification and valuation issues raised by the claims.

12. Pursuant to article 32 of the Rules, the Panel was provided with claim summaries recording the significant legal and factual issues identified in the claims, the claim files and other information, such as legal briefing notes and research papers, to assist the Panel in its review of the claims.

13. The Executive Secretary of the Commission submitted a report dated 28 April 2000 to the Governing Council in accordance with article 16 of the Rules, which set out, inter alia, the third instalment part three claims and discussed the main factual and legal issues relating to them. A number of Governments, including the Government of Kuwait and the Government of Iraq, submitted additional information and views on the issues raised in response to that report. Each response included a statement of its position regarding the Commission’s procedures and operation and raised

specific issues of law, verification, valuation or fact. The Panel has duly considered these responses and other relevant submissions, and has investigated those issues of fact accompanied by sufficient information to make investigation possible. Details of the responses so investigated, and the Panel's findings in respect of them, are set out when considering the issues raised by the claims in section VII.F below.

14. The Panel directed that technical missions be undertaken to Kuwait and elsewhere, to investigate certain factual and valuation issues and that on-site inspections be carried out. The Panel was represented on such missions by members of the secretariat and the Panel's expert consultants. Seventeen such missions took place from September 2000 to September 2002. The missions included meetings with Government officials, interviews with certain claimant witnesses, inspection of documents and visits to sites of physical damage and reconstruction. The findings of each mission are set out in the relevant sections of this report.

15. In accordance with the provisions of paragraphs 36(a) and 38(d) of the Rules, and paragraph 21 of Governing Council decision 114,<sup>6</sup> the Panel determined that it should hold oral proceedings concerning certain loss types presented in the third instalment part three claims. The oral proceedings took place on 12 - 13 September 2001, during the course of which both the Government of Kuwait and the Government of Iraq made presentations to, and answered questions of the Panel.

### III. THE LEGAL FRAMEWORK

16. The previous “F3” Reports set out the legal principles that the Panel has applied to its review of the “F3” claims.<sup>7</sup> The relevant legal principles that the Panel has applied to the third instalment part three claims are re-stated below.

#### A. Applicable law

17. At paragraphs 16 to 18 of the First “F3” Report, the Panel set out the law generally to be applied by the Panel, as stated in article 31 of the Rules, as follows:

“Security Council resolution 687 (1991) and other relevant Security Council resolutions, the criteria established by the Governing Council for particular categories of claims, and any pertinent decisions of the Governing Council. In addition, where necessary, Commissioners shall apply other relevant rules of international law.”

18. The principal substantive rule applied by the Panel throughout its review of the “F3” claims is set out in paragraph 16 of Security Council resolution 687 (1991). In this paragraph, the Security Council declared Iraq to be liable under international law “for any direct loss, damage, including environmental damage and the depletion of natural resources, or injury to foreign Governments, nationals and corporations, as a result of Iraq’s unlawful invasion and occupation of Kuwait”.

19. The Panel has taken note of certain findings contained in the reports of other panels of Commissioners, which have been approved by the Governing Council, regarding the interpretation of relevant Security Council resolutions and Governing Council decisions, as well as the reports of the Executive Secretary issued pursuant to article 16 of the Rules and the responses to them.

#### B. The directness requirement

20. At paragraphs 19 to 23 of the First “F3” Report, the Panel set out its considerations regarding the directness requirement. The Panel construed the requirements of paragraph 16 of Security Council resolution 687 (1991) as meaning that all loss or damage directly caused by Iraq’s invasion and occupation of Kuwait is in principle compensable and, correspondingly, that any loss or damage not so caused is not compensable. The Panel also took into account the Governing Council’s guidance on the interpretation of these requirements, notably as set out in Governing Council decision 7 (S/AC.26/1991/7/Rev.1) of 17 March 1992 and Governing Council decision 15 (S/AC.26/1992/15) of 4 January 1993.

21. The Panel noted that paragraph 34 of Governing Council decision 7 provides as follows:

“[These] payments are available with respect to any direct loss, damage, or injury to Governments or international organizations as a result of Iraq's unlawful invasion and occupation of Kuwait. This will include any loss suffered as a result of:

- (a) Military operations or threat of military action by either side during the period 2 August 1990 to 2 March 1991;
- (b) Departure of persons from or their inability to leave Iraq or Kuwait (or a decision not to return) during that period;
- (c) Actions by officials, employees or agents of the Government of Iraq or its controlled entities during that period in connection with the invasion or occupation;
- (d) The breakdown of civil order in Kuwait or Iraq during that period; or
- (e) Hostage-taking or other illegal detention.”

22. The Panel further noted that paragraph 6 of Governing Council decision 15 confirms that there “will be other situations where evidence can be produced showing claims are for direct loss, damage or injury as a result of Iraq’s unlawful invasion and occupation of Kuwait”, in relation to which claimants will have to prove that a loss is “direct”, and that paragraph 3 of Governing Council decision 15 emphasises that for any alleged loss or damage to be compensable, the “causal link must be direct”.

23. The Panel found that there is ample authority in international law, including the reports of other panels,<sup>8</sup> to support the view that a “direct loss” in these circumstances is one which, as a matter of objective assessment, would have been expected as a normal and natural consequence of Iraq’s invasion and occupation of Kuwait. This is the test of causation that the Panel has applied to all the “F3” claims, including the third instalment part three claims.

### C. Mitigation

24. In assessing the third instalment part three claims, the Panel has, continuing the approach set out in the First “F3” Report, considered the duty of the injured party to take all reasonable measures to avoid, diminish or mitigate the damage resulting from Iraq’s invasion and occupation of Kuwait,<sup>9</sup> and, as first set out in paragraph 24 of the First “F3” Report, finds that the reasonable costs of so doing are themselves compensable.

#### IV. VERIFICATION AND VALUATION

25. Paragraphs 103 to 125 of the First “F3” Report set out the principles that the Panel has applied to its review of the “F3” claims and the evidence submitted in support of them. Those principles are re-stated below.

##### A. The importance of evidence

26. The Rules direct that each claim must be supported by sufficient evidence. Thus, article 35(1) of the Rules prescribes that:

“Each claimant is responsible for submitting documents and other evidence which demonstrate satisfactorily that a particular claim or group of claims is eligible for compensation pursuant to Security Council resolution 687 (1991). Each panel will determine the admissibility, relevance, materiality and weight of any documents and other evidence submitted.”

27. In relation specifically to governmental claims, article 35(3) of the Rules provides that:

“... such claims must be supported by documentary and other appropriate evidence sufficient to demonstrate the circumstances and amount of the claimed loss”.

28. Pursuant to these provisions, each claimant has submitted a considerable body of documentary and other evidence in support of its claim. Some of this material was filed with the statement of claim itself substantial further material has been provided in response to questions raised by the Panel and still other material has been submitted to the Commission and reviewed (in some cases during on-site inspections) in Kuwait and elsewhere.

29. The evidence submitted by the claimants, including that additionally requested by the Panel, comprises, in most cases, a sample of the documents available. The size of the sample has been determined by reference to the nature of the loss and the character and quantity of the evidence available.

30. The Panel has addressed a number of specific requests to KIA and other Government and other entities for additional information and documents in their possession. These requests took the form of notifications issued by the secretariat under article 34 of the Rules (“article 34 notifications”), procedural orders, and other requests issued pursuant to procedural orders, of which some 23 were issued in respect of the third instalment part three claims (six article 34 notifications and 17 procedural orders). The responses to each such order or request, and their accompanying documents, have been duly considered by the Panel and its expert consultants.

31. The Panel has noted the claimants’ general assertions that physical damage and destruction during Iraq’s invasion and occupation of Kuwait included the destruction of a large number of documentary records, although the degree of destruction varied from claimant to claimant. As a result, certain elements of the claims when originally filed were supported only by witness statements or by

reports without underlying primary documentation. The Panel, in the observance of due process and by the issue of procedural orders to claimants, has on occasion requested further evidence from the claimants in order to ascertain the degree of destruction of records with a view to assessing the evidence as a whole.

B. The procedures adopted by the Panel to verify and value the “F3” claims

32. The principal tasks of the Panel are to assess the evidence with a view to determining whether the loss or damage claimed has in fact occurred and, in the light of that determination, to assess the amount of compensation to be recommended in respect thereof.

33. In carrying out these tasks, one of the prime objectives of the Panel is to ensure consistency in the examination of the material and the resulting recommendations. This cannot be achieved other than by a systematic approach rigorously pursued in accordance with the requirements of the Rules.<sup>10</sup> For this purpose the Panel has established three series of steps.

34. The first is a general verification and valuation programme applicable to all claims. This programme sets out procedures for the verification and valuation of the claims, including an initial assessment of the character and probative value of all the evidence originally submitted in support of each claim.

35. The second series of steps comprises specific verification and valuation programmes. These programmes set out more detailed procedures for certain loss types, namely, contract, real property and tangible property losses. They include the identification of particular documents needed to establish the existence and terms of contracts and the title and character of real and tangible property as well as those needed to value the losses claimed.

36. The third series of steps comprises supplemental verification and valuation programmes. These programmes set out further detailed procedures for each loss element and were designed at an early stage of the review of a claim to meet its particular character. The programmes identify any additional evidence and other information beyond that originally submitted by the claimant that the Panel considers necessary for a proper review of the claim. This step has not been carried out if the loss element under review falls below the level of materiality that is described below.

37. In applying these programmes the Panel has systematically scrutinized the evidence according to its type, date,<sup>11</sup> quality and quantity and has made consistent adjustments to reflect the extent to which the evidence is not sufficient.

38. Any attempt by the Panel to set out in detail in relation to the individual claims before it the precise manner in which it has found that the evidence is sufficient or not sufficient would involve it in a complex exposition of a very large volume of material and would not be feasible within the confines of a panel report. Moreover, the weighing of evidence is not an exact science but necessarily involves some exercise of judgement or discretion by the Panel.<sup>12</sup> The Panel has, therefore, normally not gone beyond a statement of its conclusions in each case.

C. Evidential status of the reports of the claimants' accountants

39. Each "F3" claim contains an accountant's report, in all cases commissioned by the Government of Kuwait.<sup>13</sup>

40. The accountant's reports include descriptions of the losses claimed, summaries of the valuation methodologies adopted and schedules showing the derivation of the amounts claimed.

41. The Panel notes that all of the reports have been commissioned by the Government of Kuwait for the purpose of the submission of its claims to the Commission. They do not, therefore, constitute original or primary evidence, in contrast to, for example, written contracts, receipts and invoices. As such, the Panel has treated these accountant's reports as supporting documents and not as primary evidence of the matters of fact asserted in them.

D. Materiality

42. The first level of breakdown of the "F3" claims is a "loss type" (that is, the level of breakdown appearing on Form F). Within certain loss types, the claimants have further subdivided the losses into categories to which the Panel will refer as "loss elements". For example, "loss of revenue" is a loss element within the "business transaction or course of dealing" loss type. The Panel has approached its review of the claims and their supporting evidence by reference to loss elements as opposed to the more general loss types.

43. The sheer bulk of the claims before the Panel obliged it to focus on those parts of the claims that carry a greater risk of significant overstatement. The line between these parts and others is called the "level of materiality", with those parts of the claims above the level of materiality being called "material" and those below it "not material".

44. The Panel has set the level of materiality at USD 500,000 for each of the "F3" claims, with the exception of the "business transaction or course of dealing" claim filed by KIA. The level of materiality that the Panel has adopted for that part of KIA's claim is explained at paragraph 384 below.

45. The Panel reduced the level of materiality in the following cases:

(a) Where it was necessary to ensure the examination in sufficient detail of at least 80 per cent of the total value of any loss element across the "F3" claims, the level of materiality was reduced accordingly, but not below USD 100,000;

(b) For claims with a value below USD 5,000,000 (excluding interest, claims preparation costs and any other part of the claim that the Panel found not to be a direct loss) the level of materiality was reduced to 10 per cent of the total value of the claim, but not below USD 100,000; and

(c) In exceptional instances in which the Panel found it appropriate to do so.

46. The Panel determined that the use of these materiality levels would ensure a detailed review of over 99 per cent of the principal claim amount of the “F3” claims. The Panel considered this to be a necessary and therefore suitable approach to achieving its objective: that is, properly to review the “F3” claims within the time allotted for that task. In reporting on the verification and valuation of the third instalment part three claims, the Panel has confirmed, by way of note to the relevant claim or part thereof, whether some or all parts of the claims fall below the level of materiality adopted by the Panel.

47. While the general and (where relevant) specific verification and valuation programmes have been carried out in the review of all loss elements, a supplemental verification and valuation programme has been designed and followed only for material loss elements. Further, so far as the non-material loss elements are concerned, the Panel has not requested any documentation other than that originally submitted by the claimant. In assessing the sufficiency of the evidence submitted in support of these loss elements, the Panel has regard to the fact that the claimant has not been requested to submit additional evidence and that to conclude that the evidence submitted is insufficient may unfairly penalize the claimant concerned. The Panel therefore assesses the sufficiency of the evidence in support of these loss elements in two stages; first, by applying the criteria described at paragraphs 34 to 38 above, in the usual manner, and, second, by adjusting its conclusions to reflect the average sufficiency of all the evidence submitted in support of the claim concerned and/or the relevant loss element, as appropriate.

#### E. Reporting on the verification and valuation of the “F3” claims

48. As in previous instalments of “F3” claims, the expert consultants have provided the Panel with comprehensive reports on the results of the verification and valuation programmes for the third instalment part three claims, indicating their opinions as to the extent that each is supported by the evidence and the value to be given to each. The Panel has considered these reports in detail prior to reaching its conclusions and recommendations. These are set out in section V below. The Panel is satisfied that each of the recommendations made is reasonable in all the circumstances.

49. In explaining in any given case why a claim or part thereof has been reduced or rejected, the Panel has sometimes used one or more of the following shorthand expressions, the weight of which will necessarily vary from case to case:

(a) “Enhancement” is used where the Government, in replacing damaged or lost items, has obtained an asset that is better than the one previously used, but has failed to give adequate credit for the improvement;

(b) “Inadequate accounting for depreciation” is used where the Government has not properly considered the age or the remaining useful life of the asset as at the date of the loss or has used an inappropriate rate of depreciation;

(c) “Inadequate accounting for residual value” is used where an amount is likely to be received from the disposal of an asset at the end of its useful life, and that amount is not adequately taken into account;

(d) “Inadequate procurement process” is used where the Government has failed to use an appropriate procurement process to ensure that the loss is kept to a minimum. In many cases, the appropriate procurement process would involve resort to competitive tendering, but such procedures may not be appropriate in the context of urgent or emergency repair work, for example;

(e) “Incorrect valuation of KERP assets” means that the amount claimed has been reduced because the assessment of residual value applied by the claimant to assets received pursuant to the Kuwait Emergency and Recovery Program (“KERP”)<sup>14</sup> is incorrect;

(f) “Insufficient evidence” is used where the Panel considers that the claim must be reduced or rejected because it is not supported by sufficient evidence;

(g) “Method of valuation” means that the amount claimed has been reduced because the valuation method used by the Government is not appropriate under the circumstances of the loss or the Panel has used an alternative method of valuation (such as the use of book value rather than the use of depreciated replacement cost);

(h) “Overstatement” is used where an error of fact or of calculation is discovered; and

(i) “Saved expenses” is used where the Government has not incurred expenses that it would ordinarily have incurred had Iraq’s invasion and occupation of Kuwait not occurred, or has incurred reduced expenses as a result of the invasion and occupation, and the claim has not been correspondingly reduced.<sup>15</sup>

50. In common with its past practice, the Panel has reported only those adjustments that fall above a de minimis level, which the Panel has established as 1 per cent of the total adjustments made by the Panel (for each claim or part thereof).

51. The Panel has reviewed the third instalment part three claims using amounts rounded to the nearest USD 1,000. Therefore, all recommended compensation amounts are presented in multiples of USD 1,000, except where the Panel recommends payment in full of any claim or part thereof and except as is noted in paragraph 390 below.

## V. INTRODUCTION TO THE THIRD INSTALMENT PART THREE CLAIMS

52. The Panel now turns to consider the third instalment part three claims. In this section, the Panel sets out its consideration of the asserted losses and the issues that they present, gives details of the investigations that it has carried out and of the oral proceedings held regarding the claims, considers the submissions made by Iraq and Kuwait regarding the issues presented by the claims, and presents the Panel's recommendations for compensation in respect of the claims.

## VI. INTRODUCTION TO THE KUWAIT INVESTMENT AUTHORITY CLAIM

Government Claim No. 19, UNCC claim No. 5000158Table 2. Summary table for Kuwait Investment Authority

<u>Loss type/loss element</u>	<u>Amount claimed</u> <u>USD</u>	<u>Amount</u> <u>recommended</u> <u>USD</u>	<u>Paragraph</u> <u>references</u>
<b>Business transaction or course of dealing</b>			
(a) Portfolio loss	54,778,087,423	} <u>1,503,000,000</u>	62-483
(b) Borrowing costs	<u>1,323,300,000</u>		
Sub-total	<u>56,101,387,423</u>	<u>1,503,000,000</u>	
Income-producing property	<u>6,226,436</u>	<u>3,219,000</u>	484-497
<b>Payment or relief to others</b>			
(a) Relief paid to employees	<u>3,461,998</u>	<u>1,385,000</u>	498-520
<b>Other losses: Funds advanced to Iraq</b>			
(a) Advances to Iraq	6,050,535,000	Nil	521-548
(b) Central Bank of Iraq deposits	<u>1,093,884,421</u>	<u>Nil</u>	521-548
Sub-total	<u>7,144,419,421</u>	<u>Nil</u>	
<hr/>			
<u>Total</u>	<u>63,255,495,278</u>	<u>1,507,604,000</u>	
Interest	23,473,853,424 <sup>a</sup>		549-556

<sup>a</sup> See paragraph 65 below.

VII. THE KUWAIT INVESTMENT AUTHORITY CLAIM – BUSINESS TRANSACTION OR COURSE OF DEALING – USD 56,101,387,423

A. Introduction

53. The Kuwait Investment Authority (“KIA”) was constituted in 1982 as an “Independent Public Authority with an autonomous status, ... placed under the overall ... charge of the Minister of Finance”. KIA was responsible for the management, in the name and account of the Government of Kuwait, of Kuwait’s main reserves, comprising its Future Generations Fund (the “FGF”), its General Reserve Fund (“GRF”)<sup>16</sup> and other funds, and of a portfolio of commercial and residential real estate.

54. According to the statement of claim, the FGF, constituted in 1976,<sup>17</sup> was “intended to serve as a resource for the future of Kuwait and its people at such time as Kuwait’s oil revenues are no longer sufficient to meet Kuwait’s needs”. When the FGF was established, 50 per cent of the then existing GRF, was transferred to the FGF. In addition, and pursuant to the law establishing the FGF, 10 per cent of the gross government revenue was to be deposited on an annual basis into the FGF, and withdrawals from the FGF were prohibited except in order to further the purposes for which the FGF was created.<sup>18</sup>

55. The creation of the FGF and the introduction of the above annual level of savings thus formalized a practice that began in 1953, when Kuwait started saving a portion of its oil revenues.

56. From the establishment of the FGF in 1976 until the constitution of KIA in 1982, the Ministry of Finance (“MoF”) managed the FGF, primarily through its Investments Department.

57. The Panel notes that the FGF’s assets were managed in part internally, through an affiliate of KIA in London (the Kuwait Investment Office, or “KIO”), and in part externally through commercial fund managers. In its statement of claim, KIA asserts that before 2 August 1990 it had re-invested all investment income earned on FGF assets into the FGF.

58. As is set out in the statement of claim, “[f]ollowing the liberation of Kuwait on 26 February 1991, the State of Kuwait was faced with the need to raise tens of billions of dollars to finance recovery of the country”. KIA asserts that, pursuant to an Amiri decree,<sup>19</sup> it was asked by MoF to provide the funds required for reconstruction and other activities after liberation.

59. KIA continues that “[d]ue to the invasion and resulting loss of oil revenues and other normal sources of financing, Kuwait needed to liquidate large segments of its equity and bond investment portfolio to finance the repair and replacement of national assets stolen or damaged by Iraq, and to fund the government operations of Kuwait. KIA asserts that it sold assets from the FGF (“Liquidated Assets”, giving rise via “liquidations” to “Amounts Liquidated”) and borrowed money on the international money markets (via “borrowings”, giving rise to “Funds Borrowed”) to provide funds for the reconstruction of Kuwait’s infrastructure and to support the Kuwaiti people. The legal restrictions prohibiting withdrawals from the FGF were suspended for this purpose. The Panel will refer to the amounts generated by the liquidations and borrowings together as the “Funds Raised”.

60. KIA asserts that it suffered a consequent loss of investment income from the Liquidated Assets (the "Portfolio Loss") and that it incurred interest and transaction costs on the Funds Borrowed (the "Borrowing Costs"). KIA seeks compensation for the Portfolio Loss and the Borrowing Costs, but not for the Amounts Liquidated nor for the Funds Borrowed. As to the latter, KIA notes that the "principal amount borrowed is not claimed in this statement of claim, as it is appropriate for those funds to be claimed by those various political subdivisions of Kuwait which utilized them to undo the damage resulting from the war". KIA also notes that "the claim does not include the expenditure of the proceeds of [the] liquidation exercise. Those principal amounts were claimed under the Government organisations to which the proceeds were provided or on whose behalf they were expended [footnote omitted]". The political sub-divisions and Government organizations that received the Funds Raised include "F3" and other categories of claimants before the Commission, to each of which the Panel will refer as a "Receiving Entity".

61. The compensation sought by KIA under this loss type is presented in the statement of claim separately as the Portfolio Loss and the Borrowing Costs. The Panel finds it appropriate to set out in some detail the circumstances in which the Portfolio Loss and the Borrowing Costs arose. Following the manner of presentation of the claim, those facts will be described separately.

B. The Portfolio Loss - USD 54,778,087,423

62. In its statement of claim, KIA asserted that between August 1990 and the end of 1993,<sup>20</sup> to which period the Panel will refer as the "liquidation period", it liquidated USD 50,679,700,000 from the FGF.<sup>21</sup> The total annual amount of liquidations, as per the statement of claim, arose as follows:

Table 3. Asserted amounts liquidated

<u>Year ended</u>	<u>Total liquidations (USD)</u>
31 December 1990	9,317,400,000
31 December 1991	31,454,600,000
31 December 1992	6,042,700,000
31 December 1993	3,865,000,000
Total	50,679,700,000

63. KIA further asserted that it lost investment income on the Liquidated Assets estimated at USD 30,590,984,875 in the period up to 30 April 1999, and originally claimed that amount as the Portfolio Loss.

64. The evidence submitted to the Panel discloses that KIA raised a proportion of the Funds Raised using derivative transactions. The terms and conditions of these transactions varied, depending on the financial institution concerned, market conditions at the time, and whether equities or bonds were involved. The essence of each transaction was that KIA used its holdings of quoted securities to raise funds, making payments of interest and any other costs to the institutions concerned, either as payments, or by way of deduction from the sales proceeds.<sup>22</sup> Eventually, all of the relevant securities

were sold. The Panel notes that the effect of the use of derivatives was that liquidations were effected later than would otherwise have been the case, and that KIA paid a cost for delaying the relevant liquidations.

65. In a supplemental statement of claim filed on 11 May 1998, KIA re-stated the Portfolio Loss at its estimated value as at 1 January 1998, increasing the amount claimed from USD 30,590,984,875 to USD 54,778,087,423 and extending the period in respect of which that loss was claimed until 30 June 2003.<sup>23</sup> KIA did not, however, seek to extend the liquidation period in that submission.

66. In a subsequent submission, KIA amended the asserted amounts liquidated, presented in millions of USD, and adjusted for the derivative transactions, as follows:

Table 4. Amended asserted amounts liquidated

<u>Year or period ended</u>	<u>Total liquidations (USD)</u>
31 December 1990	7,986,000,000
31 December 1991	22,217,000,000
31 December 1992	6,037,000,000
31 December 1993	5,055,000,000
31 December 1994	2,793,000,000
31 December 1995	14,000,000
31 December 1996	626,000,000
31 December 1997	2,540,000,00
31 December 1998	600,000,000
Total	47,868,000,000

67. The Panel notes that losses arising from liquidations effected after 31 December 1993 are not included in KIA's calculations of its claim.

68. KIA seeks compensation in the amount of USD 54,778,087,423 for what KIA terms "loss of use of the investments", "opportunity losses" or "loss of profits", that it would have received on the assets that were liquidated from the FGF from 2 August 1990 until 31 December 1993. The Panel will refer to the losses as "lost investment returns", which term includes lost investment income and capital appreciation.<sup>24</sup>

69. KIA asserts that the liquidations were effected as the need for funds arose, and that each transaction was initiated by a written request sent by MoF to KIA to raise a stated amount of funds, for the benefit of a designated governmental department, authority, or state-owned company (each of which the Panel includes in its definition of a Receiving Entity).

70. The Liquidated Assets comprised quoted securities (equities and bonds) managed either by KIA's external fund managers or by KIO's internal fund managers.<sup>25</sup> The fund managers were

requested to raise funds in a particular amount but were not instructed as to which assets to liquidate. Accordingly, when external fund managers received instructions to raise a given amount of funds, the fund managers were able to include in the sums raised any investment income that had accrued to the relevant fund but had not yet been re-invested.

71. KIA also states that the investment income that accrued on the FGF holdings managed internally by KIO was not re-invested in the FGF during each year of the liquidation period. The investment income was therefore treated as equivalent to a liquidation in each relevant year, in that the income received was combined with proceeds from liquidations and was used to meet requests for funds from MoF. Accordingly, the amounts concerned are included in the Liquidated Assets for each year.

72. KIA has calculated the amount of the Liquidated Assets for each year set out in table 4 above, in the following manner. As to those liquidations carried out by external fund managers, KIA has derived the Amounts Liquidated from its review of the funding requests referred to in paragraph 70 above. As to those carried out by internal fund managers, the equivalent amounts are derived from the net realizations during each year (i.e. total asset sales less investment purchases over those years), together with the investment returns that were not re-invested.

73. As the Liquidated Assets comprised both equities and bonds, KIA estimated the ratio of equities to bonds liquidated based upon the ratio of equities to bonds in the FGF on a year-on-year basis. KIA thus estimated the amounts of bonds and equities liquidated in each year of the liquidation period, and, in its claim as originally filed, estimated the lost investment returns thereon up to 30 April 1999 using the Morgan Stanley Capital International World Index for equities and the Salomon Brothers World Government Bond Index for bonds (the "Market Indices Method").

74. The Panel recalls that, prior to Iraq's invasion and occupation of Kuwait, investment income was re-invested in the FGF, but notes that the calculation of the Portfolio Loss does not include the lost investment returns on income that would have been reinvested and would have accrued further yields, had it not been for Iraq's invasion. In other words, the calculation of the loss is effected on a simple and not a compound basis.

75. The updated statement of claim described in paragraph 65 above calculated the lost investment returns for 1994 to 1997 by using the published results of the Morgan Stanley and Salomon Brothers indices and the lost investment returns thereafter were calculated by reference to KIA's anticipated performance of these indices.

76. In January 2001, in response to Procedural Order No. 19, issued on 5 December 2000, KIA provided evidence of the estimated lost investment returns based on the actual and estimated performance of the FGF (that is, the FGF remaining after the liquidations) for the Amounts Liquidated up to December 1993 over the years from 1990 to 2003 (the "Actual Performance Method").<sup>26</sup> Although the Actual Performance Method gives a higher lost rate of investment returns than the Market Indices Method, KIA has not sought to increase the amount claimed from that set out in its updated statement of claim.

77. In Procedural Order No. 64, issued on 13 July 2002, the Panel requested KIA to re-state the Portfolio Loss as at 30 June 2002 (or as at a date as close to the date of this report upon which they could reasonably be stated). The response to that procedural order, re-stating the loss at USD 47,122,000,000 using the Actual Performance Method, was received on 28 August 2002. The asserted Amounts Liquidated presented in table 4 above are those submitted in the response to Procedural Order 64.

C. The Borrowing Costs - USD 1,323,300,000

78. KIA asserts that, as an alternative to continuing liquidation of its investments and in order to decrease the cost of raising the funds to be used for the reconstruction of the country, and acting on behalf of MoF, it entered into four loan transactions to raise funds for the reconstruction of Kuwait. KIA asserts that these four transactions were the first international loans the Government of Kuwait had ever sought.

79. The loans included the following facilities:

(a) A syndicated floating interest loan for USD 5.5 billion (known as the “Jumbo Loan”), entered into on 12 December 1991;

(b) A short-term bridge facility in 1992 for USD 100 million from Citicorp (the “Bridge Loan”). KIA asserts that this facility was “retired” on 17 February 1993 (by which time longer term, and larger, loans had been arranged);

(c) Two facilities with the United States Export Import Bank (the “Exim Financing”), entered into in late 1992, in the sum of USD 400 million; and

(d) A medium-term credit facility with the Export Development Corporation of Canada (the “EDC Financing”) in the sum of USD 500 million, entered into in 1993.

The Panel will refer to the series of loans described above as the “credit facilities”.

80. KIA asserts that, in order to reduce uncertainty associated with its interest payments under the Jumbo Loan, it entered into a number of swap agreements pursuant to which almost half of the loan was converted to a fixed rate loan.

81. KIA seeks compensation for the transaction expenses associated with each form of financing and for the interest paid on each form of financing (including the swap costs associated with the Jumbo Loan); that is, the “sum of the actual and anticipated interest, swaps cost and transaction costs” (the “Borrowing Costs”). Details of the Borrowing Costs as at the date of preparation of the claim (22 March 1994) are as follows:

Table 5. Borrowing Costs schedule, as per statement of claim

<u>Credit facility</u>	<u>Interest (USD)</u> <u>(including swap costs)</u>	<u>Transaction costs (USD)</u>	<u>Total costs (USD)</u>
Jumbo Loan	1,079,857,564	31,761,199	1,111,618,763
Bridge Loan	1,993,412	115,000	2,108,412
Exim Financing	51,462,133	6,386,569	57,848,702
EDC Financing	2,629,442	Nil	2,629,442
<u>Total</u>	1,135,942,551	38,262,768	1,174,205,319

82. On 11 May 1998, in the supplemental statement of claim referred to in paragraph 65, KIA increased the Borrowing Costs claim to USD 1,411,896,530, though without any further indication of the components of that cost.

83. In January 2001, in response to Procedural Order No. 19, KIA further amended its claim for Borrowing Costs and reduced it to USD 1,323,300,000, noting that this amount represented actual as opposed to estimated losses. Details of the amended amounts are as follows:

Table 6. Borrowing Costs schedule, as amended

<u>Credit facility</u>	<u>Interest (USD)</u> <u>(including swap costs)</u>	<u>Transaction costs (USD)</u>	<u>Total costs (USD)</u>
Jumbo Loan	1,211,700,000	31,400,000	1,243,100,000
Bridge Loan	2,000,000	100,000	2,100,000
Exim Financing	67,300,000	6,400,000	73,700,000
EDC Financing	4,300,000	100,000	4,400,000
<u>Total</u>	1,285,300,000	38,000,000	1,323,300,000

84. The Panel notes that the Jumbo Loan was repaid in seven equal quarterly instalments of USD 785.7 million made between June 1995 and December 1996. The other borrowings were also repaid in instalments between 1993 and 1999.

85. As was the case with respect to the Portfolio Loss, the Borrowing Costs claim is restricted to USD 1,323,300,000 as set out above, and KIA does not seek compensation for the relevant Funds Raised in this claim.

#### D. Procedural history of the Portfolio Loss and the Borrowing Costs claims

86. Following its classification of the KIA claim as “unusually large or complex” under the Rules, the Panel addressed a series of requests for further evidence and information to KIA in various

procedural orders. The Panel has also considered KIA's responses to other requests for information set out in article 34 notifications.

87. In response to one such request, in November 2000, KIA advised that significant further information, relating to the Amounts Liquidated and lost investment returns thereon, would be available to the Commission. In particular, evidence previously unavailable to the Commission so as to demonstrate the actual performance of the FGF for the years 1990 and thereafter would be available, so as to support the amounts claimed in the Portfolio Loss.

88. The Panel notes that KIA did not seek to increase the amount claimed by the submission of such evidence. Nonetheless, the Panel considered that the supplemental evidence filed properly formed part of the claim file in respect of this head of claim and, accordingly, the Panel provided such evidence to Iraq, inviting Iraq to respond further to the claim. Iraq provided a further response to the claim on 14 August 2001.<sup>27</sup> The Panel has also requested KIA to update its evidence so as to reflect the losses on or around 30 June 2002, as noted in paragraph 77 above.

89. The oral proceedings held on 12 - 13 September 2001 concerned (*inter alia*) the Portfolio Loss and the Borrowing Costs claims. The Panel addressed a series of questions on the issues raised by those losses in Procedural Order No. 52 issued on 21 May 2001. The Panel also invited the participants to present written summaries of the submissions that they intended to make at the proceedings, and any expert or opinion evidence that they wished to submit in response to Procedural Order No. 52. The Panel will set out the main submissions of each of the participants made in their responses to Procedural Order No. 52 and at the oral proceedings in section VII.F.

90. In the following section, the Panel considers the main issues presented by the Portfolio Loss and the Borrowing Costs claims.

E. Statement of the Panel's principal findings with respect to the issues raised by the Portfolio Loss and the Borrowing Costs claims

91. The Portfolio Loss and the Borrowing Costs claimed by KIA raise numerous complex legal and factual issues. For the convenience of the reader, the Panel has presented its main findings in this section of its report.

92. The main findings appear under the following headings:

(a) Compensation for the losses of the Government of Kuwait may properly be sought in a series of claims filed with the Commission;

(b) The Portfolio Loss and the Borrowing Costs claims have not been resolved in the review of the claims of the Receiving Entities;

(c) The Portfolio Loss and the Borrowing Costs claims are direct losses only to the extent that they arise in funding underlying direct losses;

(d) Financing losses arising from expenditure on underlying losses that are excluded from compensation by a decision of the Governing Council;

(e) Evidence of the extent of direct financing losses is required by the Panel;

(f) Direct financing losses - working example;

(g) Direct financing losses may include losses arising from funding the full replacement cost;

(h) Direct financing losses include losses arising from funding “involuntary betterment”;

(i) The periods during which direct financing losses were sustained;

(j) Direct financing losses arise in funding various loss types;

(k) The Portfolio Loss and the Borrowing Costs and claims for interest in underlying claims overlap; and

(l) The measure of the direct financing losses.

93. The sections that follow the above-captioned sections will address certain issues considered by the Panel in more detail, setting out the submissions of the Governments of Iraq and Kuwait, and the Panel’s findings and, where relevant, will refer to relevant legal authorities upon which the Panel has based its findings.

94. The Panel notes that the main issues raised by the Portfolio Loss and the Borrowing Costs claims are sufficiently similar for the Panel to consider those issues together. For ease of comprehension, the Panel will generally set out its findings only with respect to the Portfolio Loss claim. Nonetheless, those findings apply equally to the Borrowing Costs claim.

1. Compensation for the losses of the Government of Kuwait may properly be sought in a series of claims filed with the Commission

95. According to Governing Council decision 7, paragraph 30, “each Government will submit claims of its own and those of its political subdivisions, or any agency, ministry, instrumentality, or entity controlled by it”. The Portfolio Loss and the Borrowing Costs claims seek compensation for losses that have arisen, in large part, in the provision of funds to Receiving Entities to put right loss and damage that those entities had suffered. The Receiving Entities comprise Government ministries and other agencies of the Government, which have filed claims with the Commission in category “F”, and public sector corporations, in most cases wholly-owned by the Government, which have submitted claims in category “E”.

96. So far as the Receiving Entities that are “F3” claimants are concerned, the Panel has concluded that the claimants form part of the Government, and their losses are accordingly the Government’s losses. The Panel recalls that KIA was established to manage the investment of the FGF in the name

and account of the Government. The Panel has therefore concluded that the Portfolio Loss and the Borrowing Costs are losses sustained by the Government.

97. The Panel notes that there are 62 “F3” claims aside from that filed by KIA, and that in several cases, a claimant Ministry has filed more than one claim. The Panel also recalls that the “F3” claimants are described in the respective statements of claim as “political subdivisions” of the Government of Kuwait, following the wording of Governing Council decision 7, paragraph 30, and elsewhere in the claims as government organizations.

98. The Panel considers all the “F3” claims, including the claim filed by KIA, which were all filed together,<sup>28</sup> as claims that seek compensation for the losses sustained by the Government. The Panel also considers that the Government’s losses may properly be claimed in one or more claims.

99. The Panel notes that the Receiving Entities that have filed claims in subcategories “E1”, “E4”, “F1” and “F4” are either part of the Government, or were ordinarily funded as part of the Government budget. Accordingly, the Panel finds that any of the Government’s losses that arise from funding the losses of such Receiving Entities are to be considered in the same way as those losses that arose from the funding of losses claimed by “F3” claimants.

2. The Portfolio Loss and the Borrowing Costs claims have not been resolved in the review of the claims of the Receiving Entities

100. As the losses of the Government may properly be claimed in one or more claims, the Panel finds that its, or any panel’s, recommendations made in respect of any one claim will dispose of another claim only if the claims rejected or in respect of which recommendations for compensation are made are, in fact, duplicate claims.

101. The Panel considers the interaction between the Portfolio Loss and the Borrowing Costs claims and the claims for interest filed by the Receiving Entities, and the extent to which they are duplicate claims, in section VII.E.11 below.

102. The Panel finds that there are no claims filed by the Receiving Entities that duplicate the Portfolio Loss and the Borrowing Costs claims, leaving aside the question of claims for interest referred to in the preceding paragraph, with the exception of one head of claim filed by the Kuwait Airways Corporation (“KAC”).<sup>29</sup> KAC’s claim included a claim for financing costs related to the purchase of 11 replacement aircraft, which is reported in the “Report and recommendations made by the Panel of Commissioners concerning the fifteenth instalment of ‘E4’ claims” (S/AC.26/2002/16) (the “Fifteenth ‘E4’ Report”). The “E4” Panel of Commissioners did not recommend any compensation in respect of those financing costs, and the Panel finds that the determination of the “E4” Panel resolves the Portfolio Loss and Borrowing Costs claims to the extent that they are referable to the funding of the purchase of the 11 replacement aircraft.

3. The Portfolio Loss and the Borrowing Costs claims are direct losses only to the extent that they arise in funding underlying direct losses

103. The Panel now turns to the question of whether the Portfolio Loss is compensable as “direct loss, damage, ... as a result of Iraq’s unlawful invasion and occupation of Kuwait” within the meaning of Security Council resolution 687 (1991), paragraph 16. The Panel has considered whether the losses claimed would have been expected as a “normal and natural consequence” of Iraq’s invasion and occupation of Kuwait.<sup>30</sup>

104. At the outset, the Panel recalls that, as set out at paragraph 29 of the First “F3” Report, it is satisfied that the evidence submitted in support of the “F3” claims for property losses is sufficient to demonstrate that the losses were direct, falling within the provisions of paragraph 34 of Governing Council decision 7 and those of paragraph 13 of Governing Council decision 9 (S/AC.26/1992/9) of 6 March 1992.<sup>31</sup> The Panel has found, during its review of the “F3” claims, that the Government and “F3” Receiving Entities suffered direct, and compensable, loss and damage.<sup>32</sup> The Panel also notes that other panels, in their reviews of other categories of claims filed with the Commission, have found that other Receiving Entities have also suffered direct, and compensable, loss and damage. The Panel will refer to the claims for such loss and damage as the “underlying claims”.<sup>33</sup>

105. The Government asserts that the Funds Raised were required “for the direct support and recovery of Kuwait and its people during and after the occupation of Kuwait by Iraq, including the reconstruction of Kuwait’s civil infrastructure”. The Government also asserts that “[t]he cause of all the FGF liquidations and international borrowings was the deprivation of Kuwait’s oil revenues and the extraordinary expenses associated with the invasion, for both of which Iraq bears sole responsibility” and, accordingly, that the liquidations and borrowings and their consequent costs and losses were a “normal and natural consequence” of Iraq’s invasion and occupation of Kuwait. The Government further states that “[u]nlike a private party who has been injured by a wrongful act, the State of Kuwait did not have the option of waiting for payment of reparations by the wrongdoer”.

106. In consideration of all of the above, the Panel finds that it is a normal and natural consequence of Iraq’s invasion and occupation of Kuwait that the Government would raise and spend funds from all resources at its disposal as soon as the Government was able to do so, so as to put right the loss and damage that itself arose as a direct result of that invasion and occupation.

107. The Panel therefore finds that:

(a) The use or diversion of Kuwait’s resources to fund the costs of putting right loss and damage arising directly from Iraq’s invasion and occupation of Kuwait is to be regarded as a “normal and natural” consequence of that invasion and occupation; and

(b) The Portfolio Loss and the Borrowing Costs losses arising as a consequence thereof are “direct losses” and so are, in principle, compensable.<sup>34</sup>

108. The Panel notes that KIA's claim seeks compensation for the Portfolio Loss arising from liquidations that were effected from 2 August 1990 to 31 December 1993 (which period the Panel refers to as the liquidation period). The Panel notes, however, that the expenditure that gives rise to the direct financing losses will not take place immediately upon liquidation. The Panel finds, therefore, that a relevant item of expenditure that was disbursed within a reasonable period after a relevant liquidation was effected should be taken as giving rise to direct financing losses, and that a reasonable average period in these circumstances is a period of six months. Accordingly, the Panel has identified the direct financing losses as being the losses incurred in funding relevant expenditure that took place up to and including 30 June 1994 (the "expenditure period"). Thus the expenditure period is the period from 2 August 1990 to 30 June 1994.

109. The Panel further notes that the Portfolio Loss and the Borrowing Costs claims seek compensation for losses that arise from expenditure that was not confined to what the Panel, and other panels, have previously found to be direct losses. The Panel will address the elements of the Portfolio Loss and the Borrowing Costs claims that arise from such greater expenditure in the following sections.

110. The Panel now turns to consider the proportion of the Portfolio Loss and the Borrowing Costs claims that arises from the funding of expenditure on items that have not previously been found to constitute direct losses (in the sense that no award of compensation has been made by the Commission in respect of the relevant underlying claims).<sup>35</sup>

111. The Panel considers that there are three main such categories of expenditure:

- (a) Expenditure on unidentified items;
- (b) Expenditure on losses that have not been claimed before the Commission; and
- (c) Expenditure on losses not yet adjudicated by the Commission.

112. As to expenditure on unidentified items, the Panel finds that the lost investment returns on, or the Borrowing Costs in respect of, those amounts whose ultimate application has not been established<sup>36</sup> cannot be shown to be losses (nor, therefore, to be direct losses). Accordingly, the Panel does not recommend compensation for any losses that arise as a result of funding these losses.

113. As to expenditure on underlying losses that were not claimed before the Commission, the Panel requested KIA in Procedural Order No. 37 issued on 23 February 2001 to provide details of any expenditure on any such losses recorded in the Government's financial statements. In its response, KIA advised that there are no unclaimed losses in respect of which it can furnish the sufficient evidence required to demonstrate such losses, other than losses that would be excluded under Governing Council decision 11 (S/AC.26/1992/11) of 26 June 1992 and Governing Council decision 19 (S/AC.26/Dec.19 (1994)) of 24 March 1994 (for which the Government had not sought compensation). Accordingly, the Panel does not recommend compensation for any losses that arise as a result of funding any unclaimed losses.

114. The Panel notes that losses not yet adjudicated by the Commission<sup>37</sup> represent less than 1 per cent of the amounts claimed in all the underlying claims. The Panel considers this amount as de minimis in the context of the total underlying claims. Accordingly, the Panel will treat such losses as non-material<sup>38</sup> in its review. The Panel's recommendations set out in paragraph 483 below include a recommendation in respect of such unadjudicated losses, calculated on the basis of the average recommendation for those losses in respect of which the Panel makes its recommendations in this report.

4. Financing losses arising from expenditure on underlying losses that are excluded from compensation by a decision of the Governing Council

115. Certain losses are excluded from compensation by Governing Council decision 19. This decision provides that "[t]he Governing Council confirms that the costs of the Allied Coalition Forces, including those of military operations against Iraq, are not eligible for compensation". The Panel construes that text to mean that the decision encompasses the costs incurred by the Allied Coalition Forces, of which Kuwait was a member, including any losses sustained in funding the costs of the Allied Coalition Forces.<sup>39</sup> Accordingly, the Panel does not recommend compensation for any losses that may have arisen as a result of funding these costs.

5. Evidence of the extent of direct financing losses is required by the Panel

116. The Panel recalls that claimants must prove both the fact and the extent of each loss, as required by article 35 of the Rules.

117. In the context of the Portfolio Loss and the Borrowing Costs claims, the Panel finds that the Government must demonstrate, on the basis of the application of the Funds Raised, the amount of funds required (the "direct funding requirement"), and the extent to which funds were expended on funding the losses giving rise to that requirement. The Panel finds that the mere assertion that a need for funds arose as a direct result of Iraq's invasion and occupation of Kuwait does not provide sufficient evidence as required under the Rules.

118. The evidence originally submitted to the Commission in support of Portfolio Loss and the Borrowing Costs claims addressed the Amounts Liquidated and the Funds Borrowed and the losses of investment returns and interest and other charges paid on the various borrowings. However, this evidence did not address the uses to which the Funds Raised were put, and so did not provide evidence of a direct funding requirement. The Panel finds, however, that the evidence as to the direct funding requirement is provided in the underlying claims and the Panel's, or other panels', reports to the Governing Council concerning the underlying claims.<sup>40</sup>

119. Accordingly, the Panel had before it evidence of the direct funding requirement, but not of the extent to which the Funds Raised were expended on funding the losses for which compensation was sought in the underlying claims.

120. The Panel therefore requested detailed information and evidence as to expenditure on direct losses during the expenditure period from the Government Receiving Entities. The information and evidence received in response to those requests demonstrate that a significant proportion of the Portfolio Loss and the Borrowing Costs indeed arises from the funding of direct losses. The Panel finds, therefore, that those elements of the losses claimed by KIA are direct financing losses and are therefore, in principle, compensable.

121. Such evidence also discloses that not all of the Amounts Liquidated and the Funds Borrowed were expended on putting right loss and damage that the Panel, or other panels, have found to be direct (and, in principle, compensable) losses. The Panel does not recommend any compensation to be paid in respect of the elements of the Portfolio Loss and the Borrowing Costs claims that arose from the funding of expenditure beyond the funding of direct losses.

#### 6. Direct financing losses - working example

122. The Panel now turns to examine in more detail what is meant by “direct financing losses”. The Panel finds it convenient to set out its further findings by reference to a working example, which represents a hypothetical “F3” claim, and to which the reader will be referred throughout this and the following sections of this report. The working example refers to a hypothetical building belonging to the Government, which was occupied by a Government Ministry (the “Ministry”) but destroyed during Iraq’s invasion and occupation of Kuwait. The Panel will refer to the loss of the building as the “underlying loss”. The amounts selected for the working example are purely theoretical and do not relate to any claim filed.

123. The working example assumes that:

(a) The Ministry submitted a claim to the Commission seeking the sum of 300 as compensation for the underlying loss, plus interest on that loss at 5 per cent per annum (the “underlying claim”). The Ministry valued the underlying loss as the depreciated replacement cost of its new building, calculated on the basis that the destroyed building was 16 years old at the time of its destruction and had an anticipated total useful life of 40 years;

(b) The Panel, considering that the destroyed building would have had an anticipated useful life of 30 and not 40 years, applied a further adjustment of 67 for depreciation. The Commission, upon the Panel’s recommendation, awarded the sum of 233 as compensation for the underlying claim; and

(c) The Panel notes that the claim for interest on the loss of the building will be addressed by the Governing Council under its decision 16 (S/AC.26/1992/16) of 4 January 1993 in due course.

124. The Panel summarizes the working example in the following table which, for ease of reference, is also reprinted in the annex to this report:

Table 7. Working example

<u>Parameters</u>	<u>Valuation comments</u>
Age of the destroyed building at the time of its destruction	16 years
Original cost of construction	500
Useful life anticipated by claimant	40 years
Book value at the time of its destruction	300
The amount spent on replacing the destroyed building with an identical building (no inflation assumed)	500
Underlying claim as asserted	300 + 5 per cent interest per annum <sup>a</sup>
Depreciated cost of replacement building (500-200)	300
Panel's depreciation adjustment for an anticipated useful life of 30 and not 40 years	(67)
Award of compensation, as recommended by the Panel	233

---

<sup>a</sup> The interest element will be addressed under Governing Council decision 16 (the text of which is set out in paragraph 168 below).

125. In the working example, the Government (through a funding entity, which was also part of the Government) raised the sum of 500, on a date after 2 August 1990, by liquidating assets from the FGF. It transferred the Liquidated Amount to the Ministry (which consequently became a Receiving Entity). The Panel will refer to the reconstruction cost incurred in respect of the building as the "replacement cost". The working example also assumes that the Receiving Entity indeed spent the sum of 500 in reconstructing the destroyed building, and that the Government received no additional income or revenue from the use of the new building.<sup>41</sup>

126. The funding entity, in the working example, has submitted a claim seeking compensation for the lost investment returns on the sum of 500.

127. Similarly, KIA, in its claim, is seeking compensation for the lost investment returns, which arise, inter alia, from funding the sums that a variety of Government ministries and other Receiving Entities expended in funding repairs and replacements to Government and Receiving Entities' property.

7. Direct financing losses may include losses arising from funding the full replacement cost

128. The Panel notes that the full replacement cost of the building in the working example is not claimed by the Receiving Entity, and less than the full replacement cost was awarded by way of compensation for its loss.

129. This situation arises in relation to many claims filed before the Commission, and arises because assets are depreciated for accounting purposes, using percentage deductions from the original

acquisition cost, to reflect their use, their declining value and thereby their estimated remaining useful life. When submitting claims for such assets, claimants have generally sought compensation for the depreciated replacement cost of the assets, by taking the percentage depreciation applied to the lost, damaged or destroyed asset as set out in the relevant accounting records, and deducting that same percentage from the full replacement cost.

130. The Panel, in common with other panels, has sometimes made a further adjustment to the depreciated replacement cost claimed, as is the case in the working example, if the Panel considered that the depreciation deducted by the claimant was understated (that is, if the claimants had overestimated the remaining useful life or value of the lost, damaged or destroyed assets). That adjustment, as is the case for any claimant's adjustments for depreciation, reflects an incidental gain that accrued to the claimant, in that a building that was not new has been replaced by a new building.

131. With reference to the working example, the Panel notes that the sum of 500, the full replacement cost, may be separated into the following elements:

Replacement cost	500		
(Depreciation applied by claimant)	(200)	}	(total depreciation = 267)
(Further depreciation applied by Panel)	<u>(67)</u>		
Compensation awarded	233		

132. Nonetheless, the Panel recognizes that the Ministry was unable to avoid incurring the full replacement cost (500) when reconstructing the building,<sup>42</sup> as the new building was identical to that destroyed, and the costs additional to the destroyed building's book value arise only because the reconstructed building is new. The Panel notes that it is impossible to reconstruct a 16 year-old building. When reconstructing the building, and in seeking to put itself as close to the position that it was in prior to the destruction of the building, the Ministry was effectively forced to fund, or invest in, the full replacement cost. That full replacement cost comprises both the amount of compensation awarded for the loss of the destroyed building (the sum of 233) and the amounts adjusted from the full replacement cost for depreciation (the sum of 267). The Panel will refer to this replacement cost (the sum of 500) as the direct funding requirement.

133. The Panel finds it appropriate at this juncture to recall the aim of compensation, which is to put the claimant back in the position in which it would have been had it not suffered those losses, following the principle established in the case of the Chorzów factory,<sup>43</sup> so far as is reasonably possible. In that case, the Permanent Court of International Justice stated as follows:

“The essential principle contained in the actual notion of an illegal act – a principle which seems to be established by international practice and in particular by the decisions of arbitral tribunals – is that reparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed.”

134. With reference to the working example, the Panel finds that, in order to put itself back to its pre-invasion position, the Ministry had to fund the loss of the building, or was forced to invest in a new building, to the extent of the full replacement cost (the sum of 500). (The Ministry also suffered the loss of use of the destroyed building until the date upon which it was replaced, but this loss does not give rise to the financing losses claimed.)

135. The direct funding requirement, therefore, is the amount expended in funding the entire forced investment in reconstructing the destroyed building (the sum of 500 in the working example) and exceeds the amount that would be required to fund the amount of compensation of 233 awarded in the working example. The costs of funding this excess, being the amount adjusted from the full replacement cost for depreciation (267), form part of the direct financing losses. Nonetheless, such costs will not be compensated in the underlying claim. The Panel will therefore refer to the amount of the uncompensated excess as the “funding gap”.

136. Accordingly, the total award or awards (including interest in relevant cases) by the Commission that would provide the best measure of compensation for the losses sustained as a result of the destruction of the building is or are:

(a) The full replacement cost of the building, 500, less appropriate adjustments for betterment (in the working example, the 267 depreciation adjustments) - that is, an award of 233;

(b) An amount for the financing losses arising from the forced investment in reconstructing the destroyed building – that is, funding the full replacement cost of 500 (the subject of the funding entity claim); and

(c) An award of compensation for the loss of use of the building for the period from the date of its destruction until the date upon which the replacement building is available to the Ministry.

137. The Panel will address the manner in which compensation will be awarded for the direct financing losses and the loss of use of the building, including the interaction between such losses and claims for interest in underlying claims, in paragraphs 163 to 173 below.<sup>44</sup>

8. Direct financing losses include losses arising from funding “involuntary betterment”

138. In the case of the working example, and as described above, the Panel has found that the Ministry could not avoid any of the “betterment” (in this case, depreciation) that was deducted from the full replacement cost, and therefore could not avoid incurring the full replacement cost. For this reason, the Panel has found that the direct financing losses comprised the cost of funding the full replacement cost.

139. Many of the assets that are the subject of the underlying claims were not new at the time of Iraq’s invasion of Kuwait. In some such cases, claimants were unable to avoid replacing old, lost or destroyed assets with new assets, either because second-hand equivalent assets were not available, or because the assets concerned were real property, which must be rebuilt as new. In some cases, identical assets were no longer for sale at all, as newer models had replaced those previously on the

market. In yet other cases, identical replacements may not have been available, and so claimants may have had to buy property with better performance (“better” as compared with that of the property lost). If so, the Panel considers that the claimant was unable to avoid the betterment involved.

140. In other cases, it may have been possible to replace lost or destroyed property with second-hand items. On the other hand, claimants may have taken a strategic decision to upgrade and improve the destroyed property, and so may have chosen to purchase property with such better performance (the Ministry, in the working example, could have decided to spend an additional 100 to upgrade the air-conditioning system in the replacement building). In such cases, the Panel considers that the claimant was able to avoid the betterment involved.

141. The Panel therefore recognizes two broad classifications of betterment: that which could not reasonably have been avoided (“involuntary betterment”) and that which could reasonably have been avoided (“voluntary betterment”). The Panel will set out its more detailed considerations concerning what may constitute such involuntary betterment and voluntary betterment in paragraphs 276 to 295 below.

142. The Panel finds that financing losses are direct losses to the extent that they are referable to sums expended in funding direct losses that could not reasonably have been avoided.<sup>45</sup>

143. Accordingly, the Panel finds that the lost investment returns on sums expended in funding direct losses are, in principle, compensable to the extent of:

(a) The amount of compensation awarded for such losses; and

(b) An amount equal to involuntary betterment adjusted from the full replacement cost (or other relevant measure of the full value of the loss)<sup>46</sup> either by the claimant or by the relevant Panel in its review of the relevant underlying losses. It is this amount, being the uncompensated excess of the direct funding requirement, that constitutes the funding gap of 267 referred to in paragraph 135 above.

144. The sum of the amount of compensation awarded for the underlying losses and for the direct financing losses as set out in the preceding paragraph will, in the Panel’s consideration, give the best measure of compensation for the losses sustained, as set out in paragraph 136 above.

145. The direct funding requirement referred to in paragraph 117 above therefore includes all those elements of the Funds Raised that would be required to fund the amounts of compensation awarded for relevant underlying losses<sup>47</sup> (the sum of 233 in the working example) and the funding gap (the sum of 267 in the working example). Referring to the working example, the direct funding requirement comprises the entire sum of 500.

146. The Panel further finds that compensation should be awarded for the direct funding requirement only to the extent that the funds so required were in fact spent on funding the relevant direct losses. Referring to the working example, the Ministry did in fact spend the sum of 500 on constructing the

replacement building and so the lost investment returns on the sum of 500 are compensable, for the period described in paragraphs 152 to 158 below.

147. The Panel addresses this issue, and the manner in which compensation will be awarded for direct financing losses, including the interaction between such losses and claims for interest in underlying claims, in section VII.E.11 below.

148. The evidence before the Panel suggests that, in many cases, adjustments have also been made in underlying claims for “voluntary betterment”. An example of such voluntary betterment would be the installation of an upgraded air-conditioning system in the replacement building in the working example. So far as voluntary betterment is concerned, the Panel finds that there is no loss that arises from a decision voluntarily to improve or upgrade assets that also arises from Iraq’s invasion and occupation of Kuwait. The elements of the Portfolio Loss that arise from funding such voluntary betterment do not constitute losses that arose as a direct result of Iraq’s invasion and occupation of Kuwait and accordingly the relevant lost investment returns are not direct losses.<sup>48</sup>

149. The Panel recalls that it has, in common with other panels, made adjustments during the review of the underlying claims for matters that go beyond reflecting incidental gains on the part of claimants, such as overstatement and insufficient evidence. The Panel finds that those adjustments reflect the panels’ assessment that the underlying losses suffered were in some manner overvalued by claimants. Accordingly, the Panel finds that claimants did not suffer a loss with respect to such amounts and, therefore, any lost investment returns arising from the funding of such amounts do not constitute losses that arose as a result of Iraq’s invasion and occupation of Kuwait. Accordingly, the relevant lost investment returns are not direct losses.

#### 9. The periods during which direct financing losses were sustained

##### (a) Liquidation and expenditure periods

150. The Panel has defined the “liquidation period” in paragraph 108 above as being the period during which liquidations that give rise to the Portfolio Loss claim were effected (2 August 1990 to 31 December 1993). The Panel has also defined the “expenditure period” as being the period during which the Funds Raised were expended, which for the reasons set out in paragraph 108 above, extends from 2 August 1990 to 30 June 1994.

##### (b) Claim period

151. The Panel now considers the period of time in respect of which KIA has filed a claim. The losses claimed by KIA are the lost investment returns on the Assets Liquidated during the liquidation period. The Panel notes that KIA first submitted a claim for those losses in respect of the period extending from August 1990 until 30 April 1999 for the Portfolio Loss and 15 December 1999 for the Borrowing Costs. It later extended that period until 30 June 2003 for the Portfolio Loss and to the period of the credit facilities in respect of the Borrowing Costs claim.

(c) Forced investment period

152. The Panel has found that the direct financing losses arise because of a forced early investment in assets purchased to replace those lost, damaged or destroyed as a direct result of Iraq's invasion and occupation of Kuwait.

153. The Panel has considered the date upon which the direct financing losses commence, and finds that that date is the date upon which the liquidations, whose proceeds were spent on underlying direct losses, were effected.<sup>49</sup>

154. The Panel also finds, however, that there is no evidence before it that demonstrates the extent of any loss that may have arisen between the time at which funds were liquidated and the time at which they were spent on reconstruction and other activities of the Government, although the evidence does indicate that the Funds Raised were provided to ministries and spent within a reasonable time from the date upon which they were raised.

155. However, since the Funds Raised were co-mingled with other Government funds, as further discussed in paragraphs 303 to 307 below, the date upon which funds were raised to fund any individual loss cannot be ascertained. Accordingly, the Panel has taken the dates of expenditure on relevant underlying losses during the expenditure period as the starting point of the financing losses sustained in funding direct losses, and recommends compensation for direct financing losses from that date onwards.

156. With reference to the working example, the Panel also finds that the Ministry, even if Iraq had not invaded and occupied Kuwait, would have had to replace the destroyed building at the end of its useful life, 14 years after it was destroyed (the "normal replacement date"). The financial impact of the destruction of the building, therefore, is that the replacement cycle was brought forward or accelerated, in that the building was replaced earlier in the repair or replacement cycle than would otherwise have been the case. Accordingly, the Panel finds that the period of the forced investment (of the sum of 500) lasts from the date upon which the building was reconstructed until the normal replacement date (the "forced investment period").

157. The panel notes that direct financing losses will end if compensation is received from the Commission prior to the normal replacement date.<sup>50</sup>

158. The compensation for direct financing losses will therefore be awarded in respect of the forced investment period.<sup>51</sup> Nonetheless, the Panel recalls that KIA has not sought compensation for losses extending beyond 30 June 2003 and, consequently, the Panel has not made a recommendation for direct financing losses that arise outside the claim period.<sup>52</sup>

10. Direct financing losses arise in funding various loss types

159. The Panel notes that the Portfolio Loss and the Borrowing Costs claims seek compensation (among other things) for financing losses that arise from the use of Funds Raised to fund all types of

losses. The Panel has set out its findings as to the compensability of those financing losses in section VII.E.6 above by reference to a working example in which the Funds Raised were expended on funding a loss of real property.

160. Nonetheless, the Panel's findings apply to all cases of property losses. Accordingly, those findings address all cases of property loss in which adjustments were made for involuntary betterment in the underlying claims, whether the property was real or tangible, and whether it was lost, damaged or destroyed. The Panel recalls that, in paragraph 19 of the Second "F3" Report, the Panel considered the question of accounting for depreciation in claims for repairs to, rather than replacement of, real and tangible property. The Panel observed that the "F3" claims for the costs of repairs as filed made no adjustment for depreciation, because the Government asserts that repairs do not generally extend the useful life of the property repaired. The Panel found, however, that repairs may have extended the useful life of the property repaired, or part thereof, and made adjustments for inadequate accounting for depreciation in relevant repair claims. Direct financing losses in excess of the amounts spent in funding the amount of awards of compensation for underlying losses may arise whenever the Panel or other panels have made adjustments for an extension in the useful life of lost, damaged or destroyed property, or any other adjustments for involuntary betterment.

161. Equally, financing losses may arise from the use of Funds Raised to fund types of losses other than losses of property, such as losses of Government revenue. The Panel finds that the direct financing losses comprise losses that arose from the funding of any direct loss.<sup>53</sup>

#### 11. The Portfolio Loss and the Borrowing Costs and claims for interest in underlying claims overlap

##### (a) Introduction

162. The Panel recalls that it has found that the Government incurred direct financing losses if the losses were sustained in funding underlying losses that were themselves direct.<sup>54</sup> The Panel has also found that the direct funding requirement may exceed the amounts of compensation awarded for the relevant underlying losses, to the extent of adjustments made for depreciation or other relevant involuntary betterment by the claimant and the panels that reviewed the underlying claims. Referring to the working example, the direct funding requirement was the sum of 500, comprising 233 (compensation awarded) and 267 (the amount of depreciation adjusted by the claimant and the Panel, which is the funding gap). As the sum of 500 was in fact disbursed in replacing the building, the direct financing losses comprise the costs of funding 500 for the period described in paragraphs 152 to 158 above.

##### (b) Interaction of the Portfolio Loss and the Borrowing Costs and claims for interest

163. The Panel recalls that its function is to make recommendations of compensation in respect of the "F3" claims, in accordance with the relevant applicable law as set out in paragraphs 17 to 19 above. Governing Council decision 16 is of particular relevance in this context. That decision addresses the loss of use of the principal amounts of awards of compensation, for which the Governing Council will award interest as set out in its decision 16.

164. The Panel recalls that direct financing losses arise not merely because property was lost, damaged or destroyed as a direct result of Iraq's occupation and invasion of Kuwait, but also because Iraq did not pay compensation for such losses at the time they were sustained. The Government therefore funded the losses concerned, for example, by paying repair and reconstruction costs. The lost investment returns, for which KIA seeks compensation in the Portfolio Loss, arise because the Government (through KIA) was not able to retain the relevant Amounts Liquidated in the FGF, but instead had to use them to fund direct losses. The Government has therefore lost the investment returns that the relevant Amounts Liquidated would otherwise have generated. Similarly, the Government has paid interest and incurred costs on the Funds Borrowed.

165. The Panel further notes that each underlying claim seeks interest on its losses. Interest is a sum paid or payable as compensation for the withholding of money, which has been said to be "a standard form of compensation for the loss of use of money", and payable "as compensation for damages suffered due to delay in payment [of compensation]".<sup>55</sup>

166. The Panel has therefore considered whether the claims for interest in the underlying claims and the Portfolio Loss and the Borrowing Costs claims seek compensation for the same, or different, losses. The Panel finds that, had the amounts awarded by way of compensation for the underlying losses been paid on the day upon which the underlying losses were inflicted, the amount of funds the Government required to fund its (direct) losses would have been lower. More precisely, the Government would not have had to fund the principal amounts of the awards of compensation (the sum of 233), because that is the amount for which Iraq has been found liable, and would have had to fund only the amount representing "involuntary betterment" adjusted from the full replacement cost (the sum of 267).

167. The Panel has therefore concluded that, to the extent that the Portfolio Loss and the Borrowing Costs claims seek compensation for losses that have arisen because of a delay in the payment of compensation, they seek compensation for the same loss as is claimed by way of interest on the underlying claims. The Panel finds that to award compensation to the Government for the losses claimed by KIA in respect of the costs incurred in funding the principal amounts of awards of compensation for underlying losses for the period commencing on the date upon which the relevant funds were raised, in addition to an award of interest on those underlying losses during that period, would amount to double compensation for the same loss. Accordingly, the Commission can either award interest on the underlying losses, or the costs incurred in funding the principal amounts of the underlying claims awards (the sum of 233) to KIA for that overlapping period, but not both.

168. The Panel has therefore considered the provisions of Governing Council decision 16, which addresses the question of interest on the Commission's awards of compensation. The Panel sets out the full text of that decision below:

"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.”

169. The Panel considers that Governing Council decision 16 addresses all claims that in fact seek compensation for the “loss of use of the principal amount of the award”,<sup>56</sup> in whatever form they may be presented. In other words, any claim that in fact arises as a result of the delay of payment of compensation falls within the ambit of Governing Council decision 16.<sup>57</sup>

170. The Panel notes that Governing Council decision 16 states that interest “will” be awarded, as calculated by the Governing Council.<sup>58</sup>

171. The Panel construes this part of the decision to mean that all “losses of use of principal amounts” of awards of compensation are and are only to be compensated under Governing Council decision 16, by way of an award of interest on the awards made in respect of underlying claims, “at the appropriate time”. Such losses therefore cannot be the subject of recommendations for compensation by the Panel. Accordingly, to the extent that the Portfolio Loss and the Borrowing Costs claims seek compensation for claims that are in fact claims for the “loss of use of the principal amount” of awards made in respect of underlying losses, i.e. they have arisen because of a delay in the payment of compensation for the underlying losses, the Governing Council will consider them under decision 16, and the Panel may not make recommendations for compensation in respect of such losses.

172. The Panel also notes that Governing Council decision 16 states that interest will be awarded “from the date the loss occurred until the date of payment” [emphasis added].<sup>59</sup>

173. The Panel construes this part of the decision to mean that the Governing Council will award interest for both what is commonly termed “pre-judgment” or “pre-award” interest and also for what is commonly termed “post-judgment” or “post-award” interest.<sup>60, 61</sup> Accordingly, panels’ recommendations of compensation are valued as at the date of the relevant loss, and not as at the date of the relevant award. The Governing Council therefore does not envisage any compensation for losses that have arisen because of a delay in the payment of compensation as part of an award. Any such compensation can be only awarded by the Commission as interest upon an award, under Governing Council decision 16.

(c) Manner in which compensation is to be awarded

174. Referring to the working example, interest will be awarded, under Governing Council decision 16, on the award of compensation to the Ministry (233), in respect of the loss that the Government funded, from the date of loss for the underlying claim until the date of payment, “at a rate sufficient to compensate ... claimants for the loss of use of the principal amount of the award”, though to be paid “after the principal amount of awards”.<sup>62</sup>

175. As to the funding gap, i.e. the uncompensated excess of the direct funding requirement (267), the Panel finds that compensation should be paid to the Government through KIA for the financing

losses sustained in funding the sum of 267. The Panel's findings as to the measure of such losses, and its recommendations for compensation thereof, are set out in paragraphs 178 to 181 and section VII.G.6 below.

176. The Panel notes, therefore, that the effect of its findings and recommendations is that the direct financing losses sustained in respect of the replacement building in the working example, as well as equivalent losses for all underlying claims, are to be paid in part by the award of compensation to KIA (in respect of the financing costs of the funding gap, of 267 in the working example)<sup>63</sup> and in part by the award of interest under Governing Council decision 16 on awards of compensation made in the underlying claims (concerning the financing losses sustained in funding the sum of 233 in the working example).

177. The Panel recalls that direct financing losses arise in respect of the funding of any direct loss. However, the Panel notes that certain underlying losses, such as the costs incurred in funding support payments programmes, were not subject to adjustments for involuntary betterment and accordingly there is no funding gap in such cases. Thus, in such cases, there are no direct financing losses beyond those that will be compensated by the award of interest under Governing Council decision 16, and the Panel does not consider such underlying claims further in this report.

#### 12. The measure of the direct financing losses

178. The Panel finds that direct financing losses are, in principle, claims for loss and damage, and therefore represent heads of claim that do not depend upon the underlying claims, although they are related thereto.

179. In principle, therefore, such losses are to be compensated by the award of a principal amount of damages – that is, on the basis of the losses in fact suffered by the claimant, as demonstrated by the evidence before the Panel, and not, for example, on the basis of a hypothetical cost of money over the relevant period or a general interest rate such as a court rate of interest on damages.<sup>64, 65</sup>

180. The Panel has addressed the elements of such losses that duplicate claims for interest in the preceding section, and by reason of the matters set out in that section, recommends compensation only in respect of those direct financing losses arising from funding the funding gap (such as the sum of 267 in the working example).

181. The Panel finds, in the light of the above, that the measure of loss for the funding gap is the amount of the direct financing losses the Government in fact sustained – that is, the lost investment returns on the relevant Amounts Liquidated and the costs and interest paid on the relevant Funds Borrowed.

F. Analysis of Kuwait's and Iraq's submissions to the Panel and the Panel's further findings

1. Introduction

182. The Panel presents below details of the evidence and submissions presented to it during the course of its review of the Portfolio Loss and the Borrowing Costs claims, its further findings, and relevant authorities relied upon by the Panel in coming to those findings.

2. Objections raised by Iraq and Kuwait at the oral proceedings

183. In its Procedural Order No. 52 convening the oral proceedings, the Panel advised Iraq and Kuwait that prior leave of the Panel would be required to adduce expert or opinion evidence as part of either participant's submissions. Iraq did not make a request for such leave. At the oral proceedings, Kuwait raised objections to certain of Iraq's submissions, asserting that they constituted expert or opinion evidence, and that Iraq had not sought prior leave of the Panel to adduce such evidence. Iraq's submissions to which Kuwait objected concerned (a) the relevance of municipal law to international law; (b) "the quantum of the KIA claim ... in the context of published macro-economic figures of Kuwait"; (c) "the quantum of the interest claims, both of PAAC and KIA"; (d) the quantum of the Portfolio Loss claim; and (e) the mix of liquidations and borrowings undertaken by KIA.

184. When the objections were raised, Iraq argued that the submissions did not constitute opinion or expert evidence, but were merely responses by Iraq to the issues raised in Procedural Order No. 52.

185. The Panel has considered these objections of Kuwait and finds that the relevant submissions did indeed constitute, in part, opinion or expert evidence, for which Iraq had not sought the prior leave of the Panel. Therefore the Panel has not taken into account the relevant parts of the submissions concerned, though the Panel notes that its verification and valuation programmes designed for the review of the Portfolio Loss and the Borrowing Costs claims had in fact included a consideration of the issues raised by Iraq.<sup>66</sup>

186. Iraq also raised a number of procedural and substantive objections during the oral proceedings. Each such objection is considered by the Panel in the following sections, in the context of the issue to which it relates.

3. Main issues considered by the Panel

187. The main issues considered by the Panel comprise:

- (a) The directness requirement;
- (b) Losses sustained in funding expenditure on items that panels of Commissioners have not found to be direct losses;
- (c) Evidence of the extent of direct financing losses;

- (d) Direct financing losses – funding the full replacement cost;
- (e) The concepts of “voluntary betterment” and “involuntary betterment”;
- (f) The periods during which direct financing losses were sustained;
- (g) The interaction of the Portfolio Loss and the Borrowing Costs claims and claims for interest in underlying claims; and
- (h) Identity of the Receiving Entities and compensation for the Government’s direct financing losses.

(a) The directness requirement

188. The Panel invited Iraq and Kuwait to present information and views on the directness requirement in its Procedural Order No. 52 and in questions set out in the first article 34 notification issued to KIA on 26 January 2000. The Panel also requested the participants to address the issue at the oral proceedings on 12 - 13 September 2001 by answering the following question set out in Procedural Order No. 52:

“Upon what basis, if at all, can the Portfolio Loss and the Borrowing Costs (the ‘KIA Claims’) be compensable as ‘direct loss, damage ... as a result of Iraq’s unlawful invasion and occupation of Kuwait’ within the meaning of Security Council Resolution 687, paragraph 16?”

(i) Kuwait’s arguments

189. Kuwait alleges that the Portfolio Loss and Borrowing Costs claims seek compensation for direct losses suffered as a result of the Iraqi invasion and occupation, and asserts that the Portfolio Loss and the Borrowing Costs fall squarely within the Panel’s definition of “direct loss”. Kuwait argues that the Iraqi invasion and occupation “touched off a chain of events” that “forced” KIA to incur the Portfolio Loss and the Borrowing Costs.

190. With respect to the Portfolio Loss, Kuwait further asserts that, prior to Iraq’s invasion and occupation of Kuwait, it had not at any time liquidated any assets from the FGF for the Government to use in the discharge of its expenses<sup>67</sup> and had, up to that date, re-invested all income earned by the FGF.<sup>68</sup>

191. With respect to the Borrowing Costs, Kuwait submits that it had never borrowed money on the international market before 2 August 1990, that it was a term of each loan agreement that all funds borrowed be used on reconstruction, and that it would not have borrowed the funds if Iraq had not invaded Kuwait.

192. Accordingly, considering that the liquidations and borrowings were the direct result of Iraq’s invasion and occupation, Kuwait argues that the loss of investment returns that the amounts liquidated

would have otherwise produced, and the Borrowing Costs, in their entirety, also result directly from Iraq's invasion and occupation of Kuwait.

193. Kuwait further argues that its Portfolio Loss claim was "for loss of income from its investment portfolio liquidated to fund reconstruction", and that:

"The Iraqi invasion was the direct cause of KIA's unprecedented massive national borrowings and portfolio losses, because it was both reasonable and foreseeable that Iraq's mistreatment and displacement of Kuwaiti nationals and Iraq's extensive destruction of Kuwait's infrastructure would necessitate massive borrowings and/or the liquidation of a portion of KIA's portfolio, given that these were the only sources of funds available to Kuwait that were of sufficient magnitude to enable it to support its nationals during the emergency and to undertake billions of dollars of repairs promptly following liberation."

194. Subsequently, in response to the Panel's questions set out in Procedural Order No. 52, and at the oral proceedings, Kuwait submitted that "KIA's loss of profits and payment of borrowing costs are compensable on an independent basis from, and do not depend for compensability upon, the eventual uses of the Funds Raised by other Kuwait government organizations". Kuwait further argued in its response that the amounts claimed by KIA did not include the Funds Raised and used by government organizations for "reconstruction or other governmental activities", that the uses of the Funds Raised could not therefore be relevant, and the claims should be compensable as separate and distinct loss of profits claims. Kuwait stated that "international law consistently recognizes that when property interests are impaired by wrongdoing, compensation is awarded both for the physical injury to the property (part of the damnum emergens or effectively sustained loss) and also for the lost profits (lucrum cessans) if the property was profitably employed. A claim for lost profits is separate and distinct, and not overlapping with, a claim for physical damage to property".

195. Kuwait summarized its submissions on the directness requirement at the oral proceedings in the following terms:

(a) That the cause of all the borrowings and the liquidations was the deprivation of Kuwait's oil revenues and the extraordinary expenses associated with Iraq's invasion and occupation of Kuwait, and that Iraq necessarily knew that its invasion would force Kuwait to turn to other sources of funds to support its population and to restore Kuwait's infrastructure. Accordingly, Kuwait asserted, its losses fall squarely within the Panel's definition of what constitutes direct loss under Security Council resolution 687 (1991);

(b) That the ultimate use of the money raised by KIA was irrelevant to the claim and that "the causation analysis should be at the liquidation stage, not at the spending stage", in that "the proper question should be whether the action of liquidating securities or borrowing money was taken in response to Iraq's wrongdoing. If so, it is a compensable loss, without regard to how the funds were ultimately applied. The costs were expended, the profits were lost, the causation is established;" and

(c) That the “relevant question is whether the liquidations and borrowings took place in order and only to raise the funds reasonably anticipated as needed to deal with the consequences of the invasion. If so, which is indeed the case here, the resultant lost profits and borrowing costs are direct losses”.

196. Kuwait’s submissions also include detailed reviews of cases before a wide range of tribunals and other relevant bodies, in which losses of profits have been awarded following physical damage to property, or other injury, including interruption of businesses, in which property that was profitably employed was damaged or destroyed.

197. Kuwait further argued, in its response to Procedural Order No. 52,<sup>69</sup> that the Panel’s test of causation (which involves the concept of remoteness) did not need to be applied to any consequences that were intended by the author of the relevant wrongful act, because “such consequences are regarded as consequences of the act for which reparation has to be made, irrespective of whether such consequences are normal, or reasonably foreseeable”, and that an aggressor is responsible for any consequences that are presumed to have been in his contemplation. Kuwait referred to this basis of causation as an “intentionality test”.

198. Additionally, Kuwait submitted that the combination of liquidations and borrowings were the result of reasonable and considered judgements by the Government of Kuwait based on the conditions at the time and with substantial advice and input from independent specialists, and that the limited degree of choice as to the amounts that could be raised by borrowings and those that could be raised by liquidations does not change the direct nature of KIA’s losses.

199. Alternatively, Kuwait asserts that the liquidations and borrowings substantially mitigated Kuwait’s losses and the losses sustained as a result are compensable as the costs of such mitigation.

200. In summary, Kuwait asserts that “KIA’s entitlement to full recovery of the significant lost profits and borrowing costs that it incurred as a direct result of Iraqi aggression should not be constrained by a legally unnecessary and factually incomplete analysis of the uses to which the Funds Raised were put”.

(ii) Iraq’s arguments

201. At the oral proceedings, Iraq submitted that “to be considered as a distinct head of damages [in respect of which the Panel has jurisdiction], this funding or financial costs [claim] must first be ... damage, then be ... damage eligible for compensation as defined by the [Commission’s] Rules, [and] be ... distinct damage; namely these costs must not be part of claims already submitted, already awarded or already rejected or already adjusted by the Panel”.

202. Iraq also argued that the claim filed by KIA is “in its nature ... ancillary to a principal claim. It is not an independent head of damages. The compensation [that] is sought for the funding costs, for the financial costs, must be exclusively analysed as a component of interest ... in any event, [KIA] has no principal claim for damages”, that “there are no grounds for adding to the [underlying] claims any

additional claim made by KIA”, and that if Kuwait did not claim in the underlying claims for its financing costs, it omitted a head of loss and “a claimant must include in its claim all heads of damage. He cannot be allowed later to add further heads of damage.” The Panel takes these submissions together to mean that any financing costs can be claimed or awarded only in the underlying claims, and then only as claims for interest which, as Iraq noted, are to be considered by the Governing Council under its decision 16 and are not to be the subject of recommendations for compensation by panels of Commissioners.

203. In response to the Panel’s questions set out above, Iraq submitted at the oral proceedings that the Portfolio Loss and the Borrowing Costs claims are “funding costs, which in our view ... if at all admissible, are ancillary” to the underlying claims and, “[a]s a matter of principle, an ancillary claim for compensation of the loss of use of a principal amount is characterised as a claim for interest. Historically, and by definition, a claim for interest aims at compensating the aggrieved party for its lost profit, lucrum cessans”.<sup>70</sup>

204. Iraq further argued that the claims should not be classified as claims for lost profits, in that a loss of profit “normally [arises as] loss of the profit that would have been made with the asset affected, a hotel for instance, [loss of] which was [an underlying claim]. Here we are not talking about the loss of the hotel, we are talking about the loss which the one who finances the operations would have made with the ... funds which he applies to the reconstruction.”

205. Iraq then considered the effect of characterizing the Portfolio Loss and the Borrowing Costs claims as claims for interest, addressing Kuwait’s submission that the cause of the need for funds was the loss of Kuwait’s oil revenue. Iraq recalled that the loss of the oil revenue was considered by the “E1” Panel and that that panel had awarded approximately USD 15 billion as compensation for that loss. Accordingly, Iraq submitted, “the claim [that] is being made here has been made already, has been determined, and it cannot form the subject of an additional claim ... the entire claim ... must be dismissed on the grounds of double-claiming ...” Similarly, Iraq argued that the Portfolio Loss and the Borrowing Costs claims are also ancillary to the underlying claims, and “[a]ny loss or damage for the events there related, which was not included in these [underlying claims], is foreclosed” and “cannot be assessed independently from the principal one”.

206. Iraq argued, in the alternative, that its liability is limited to direct losses and interest is not such a direct loss. Generally, on the question of claims for interest, Iraq asserts that there is no legal basis to award interest on compensation, either under Security Council resolution 687 (1991) or under international law, in that interest is itself compensation and it is not reasonable to award compensation on compensation.

207. Iraq concluded that “[a] loss which is not directly caused by the events for which Iraq is held liable, but results from the unavailability of the principal compensation at the time when the loss arose ... according to decision 16 of the Governing Council, must be treated as interest”. Iraq continued that the Governing Council must apply international law, and that in international and comparative law, “a trend may be observed according to which, as a matter of principle, interest on a principal award by an

international tribunal is intended to compensate losses caused by the delay in the availability of the principal, starting [at] the time of the award and possibly [at] the time of the loss”.

208. Iraq further submitted that the notions of fault or intention were not relevant to the question of directness before the Panel, in that the liability of Iraq could not exceed compensation for material damage for which it bore responsibility, and introducing notions of fault and intention may lead to punitive damages. Further, Iraq argued that “[i]nsofar as the word ‘direct’ may alter otherwise applicable rules in Security Council Resolution 687 (1991), it seems intended to have a limited effect regarding the scope of Iraq’s responsibility. The word seems to reflect a wish that the Commission’s jurisdiction be delimited in ways that recognise the enormity of the potential claims and the finite future resources available to pay them.”

209. Furthermore, Iraq argued that the effect of paragraph 19 of Security Council resolution 687 (1991)<sup>71</sup> requires the Commission to limit the amount of compensation to be borne by Iraq. At the oral proceedings, Iraq further argued that “the nature of this claim is one for war damages, where the resources to pay for it are limited, where distribution has to take place and where the history of settling war damages, in particular, after World War II shows that there was never full compensation in the case of war damages. Why? Because there was the intention of the international community to avoid stigmatising a state and excluding a state permanently from the community of states, and the intention to reintegrate states and not to put an excessive burden upon a state, and that international law imposes “limitations [on] full compensation with regard to war damages claims.”

210. Iraq concluded that international law limits the compensation that is to be paid in respect of war damages to take into account any “excess burden for the population of a particular state”, and that “[t]he practice has been lump sum agreements reflecting only partial satisfaction of the claims. [The practice] means also [that] interest on the principal amounts that were included in [the relevant] claims ... was never fully paid.” Accordingly, “special circumstances ... prevail in the case of the settlement of claims after war or similar events of large scale damage. Before the UNCC, in view of such circumstances, ... the losses resulting from delay in the settlement of the principal should not be compensated.”

211. At the oral proceedings, on the question of the test of directness, Iraq argued that “[t]he intentions of a state, if they can be conceived and identified at all, are not considered as an element in determining liability” and that Security Council resolution 687 (1991) does not mention “any qualified or increased liability”.

212. Although relying on its primary submissions set out above, Iraq also argued that, before considering whether the action of liquidating funds or borrowing was caused by the acts of Iraq, the existence of a loss had to be established. Iraq submitted that “it is ... apparent that any alleged need for funds cannot be considered compensable without determining the purpose for which the funds were needed” and that “[i]t is only to the extent to which the need for funds arises from expenditures for which Iraq is liable that one may even consider the possibility of liability. To the extent to which

the funds are needed for other purposes, there is no reason why Iraq should be held responsible [for any resultant losses]”. Iraq argued that “Kuwait has failed to establish this link”.

213. Iraq continued that “[t]he liquidation itself does not cause a loss. Normally ... the proceeds of the liquidation and of the borrowing are reinvested in similar or different assets. Accepting that the investor proceeds rationally, reasonably, the new investment, at least in the eyes of the investor, is equivalent; otherwise he would not apply the proceeds to it. It is only if and to the extent to which proceeds of liquidation and borrowing are invested in assets of a lower value that conceivably a loss could occur.” Iraq concluded that “[c]onsequently, it is not the decision to liquidate but the decision to invest in unproductive or less productive assets [that] constitutes the loss, if any.”

214. In consequence, Iraq argued that “in order to determine whether a loss exists and whether a loss exists in the present case, one must identify the expenditures which were made, the investments which were made with liquidation proceeds”.

215. Iraq submitted that there was no evidence of loss before the Panel, because Kuwait had not filed evidence as to the application of the Funds Raised, as it is required to under established principles of international law and under article 35 of the Rules and paragraph 5 of decision 15. Iraq concluded that since Kuwait had not produced evidence as to the use of the proceeds of the liquidations or borrowings, it “had failed to show that any loss occurred at all. There is [no] question of directness of loss; there is no loss shown”. Additionally, Iraq argued, Kuwait had acknowledged that the Funds Raised were put to a variety of uses, including the costs of the Allied Coalition Forces and normal Government activities.

(iii) The Panel’s findings

216. The Panel is satisfied that Kuwait would neither have liquidated any of the Amounts Liquidated nor have borrowed any of the Funds Borrowed had Iraq not invaded and occupied Kuwait. The Panel is also satisfied that Kuwait liquidated and borrowed the amounts asserted, and that KIA sustained losses in at least the amended amounts claimed. However, the Panel has concluded that these facts alone are insufficient to demonstrate that the Portfolio Loss and the Borrowing Costs are direct losses.<sup>72</sup>

217. The Panel has taken into account KIA’s statement that the Funds Raised were required “for the direct support and recovery of Kuwait and its people during and after the occupation of Kuwait by Iraq, including the reconstruction of Kuwait’s civil infrastructure”. Although the Panel accepts that there was a general requirement for funds for such purpose, and therefore that the cause of Kuwait’s raising funds through liquidations from the FGF and borrowing on the international capital market was Iraq’s invasion and occupation of Kuwait, the Panel does not accept that it necessarily follows that every liquidation and borrowing subsequently undertaken was itself a direct result of that invasion and occupation. Further, the Panel does not find that the facts set out in the preceding paragraph provide sufficient evidence of the extent of the losses asserted as required by the provisions of article 35(3) of the Rules and paragraph 37 of decision 7.

218. Accordingly, the Panel finds that it is not the need for funds that gives rise to a loss. A loss arises only when funds are spent so as to meet that need. The Panel therefore accepts Iraq's submission that evidence as to the use of the Funds Raised must be identified for the Panel to determine whether liquidations and borrowings were caused, and directly caused, by Iraq's invasion and occupation of Kuwait. For this reason, the Panel does not accept Kuwait's submissions that the causation analysis should be undertaken only at the stage at which the funds were raised and that an intentionality test, rather than the Panel's test of causation, should be applied to the question of directness.

219. The Panel finds that a direct loss in fact has been demonstrated, in respect of any liquidation or borrowing, only to the extent that the funds raised are shown to have been expended in funding a loss that was itself a direct loss.

220. Accordingly, the Panel has concluded that:

(a) The use or diversion of Kuwait's resources to fund the costs of putting right loss and damage arising directly from Iraq's invasion and occupation of Kuwait is to be regarded as a "normal and natural" consequence of the invasion and occupation;

(b) That such use must be demonstrated by reference to expenditure on such loss and damage;

(c) Losses that are shown to have arisen as a consequence of such expenditure are themselves direct losses, falling squarely within the types of loss contemplated by Articles 31 and 35 of the ILC Articles, and the principles established in the Chorzów case,<sup>73</sup> and so are compensable, subject to verification and valuation. The Panel recalls that it has termed such losses "direct financing losses"; and

(d) Conversely, the use of the Funds Raised beyond funding losses that are themselves direct losses has not been shown to be a loss in fact, and such use in any event is not to be regarded as a "normal and natural" consequence of the invasion and occupation. Accordingly, any losses that flow from such use are not themselves direct losses.<sup>74</sup>

221. The Panel finds that direct financing losses are damages that flow naturally from the wrongful act - Iraq's invasion and occupation of Kuwait - and therefore should be assessed as such damages, that is, on the basis of the losses in fact sustained unless and to the extent that relevant Security Council resolutions and Governing Council decisions provide otherwise. So far as direct losses funded by the proceeds of liquidations are concerned, the loss is to be valued as the loss of profits that the resources diverted to funding such losses would otherwise have earned (and the Portfolio Loss claim may to such extent be classified as a claim for lost profits, or lucrum cessans). By analogy, the Borrowing Costs are to be valued as the interest and costs paid to the lenders of the credit facilities (and the Borrowing Costs claim may to such extent be classified as a claim for loss sustained, or damnum emergens).<sup>75</sup> The claims are, subject to the amounts set out in paragraphs 364(b) and 364(c)(i) and (iii) below, "distinct sources of loss and causes of action". Nonetheless, the Panel

accepts Iraq's submission that the claims are not claims for losses of profit in the sense of losses flowing from an interruption of business.

222. However, the Panel does not accept Iraq's submission that the Portfolio Loss and the Borrowing Costs claims are merely claims for interest, and discusses the interaction of those claims and claims for interest filed with the Commission in section VII.F.3(g) below.

(b) Losses sustained in funding expenditure on items that panels of Commissioners have not found to be direct losses

223. The Panel now turns to consider the losses for which the Portfolio Loss and the Borrowing Costs claims seek compensation that have arisen other than as the result of funding direct losses. The Panel defines direct losses for this purpose as losses that have been found to be direct losses by the Commission (and in respect of which the Commission has made awards of compensation).<sup>76, 77</sup>

224. The Panel requested Iraq and Kuwait to address the issue at the oral proceedings by answering the following question:

“The funds raised by the liquidations from the Future Generations Fund (“FGF”) and through borrowings and credit facilities (the “Funds Raised”) may have been used in the following ways:

- a. to fund the reconstruction of damaged property or other losses, or to replace lost income, for which claims have been filed with the UNCC and for which the UNCC has awarded compensation; or
- b. to fund losses or expenditure, that may have been extraordinary in nature, but for which no claim has been filed with the [Commission], or that the [Commission] has found or will or would find not to be direct losses.

Upon what basis, if at all, can those parts of the Portfolio Loss and the Borrowing Costs referable to Funds Raised that fall within sub-paragraph (b) be eligible for compensation?”

(i) Kuwait's arguments

225. Kuwait's primary submission is that the Portfolio Loss and Borrowing Costs claims are independent of the uses to which the Funds Raised were put. Kuwait submitted in its response to Procedural Order No. 52 that “[a]ll losses ‘referable to the Funds Raised’” are direct losses or “consequences for which reparation has to be made”, because KIA's claims are a distinct source of loss and cause of action.

226. In response to the above question, Kuwait also submitted that “[i]n any event, most of the Funds Raised were used for expenditures that represent ‘direct losses’” and that “[t]he total of ‘direct losses’ to which the Funds Raised were directed extends beyond the ‘F3’ claims, to include the attached and independent budget entities that are ‘E’ claimants and the ‘out of pocket’ expenses being considered

by the 'F4' Panel." Finally, Kuwait noted that the Government "also had extraordinary expenses for which it did not claim compensation but which were 'direct losses' (e.g. free distribution of food, waiver of utility charges, forgiveness of debt, the payment of a grant to each Kuwaiti who remained in Kuwait during Iraq's occupation and payments to the social security fund)".

227. As for the Funds Raised that were spent on the activities of the Allied Coalition Forces, Kuwait asserted during the oral proceedings that the costs of funding military expenditures, even if the underlying expenditures are not themselves compensable under Governing Council decision 19, are themselves direct losses and compensable.

228. As for the Funds Raised that were spent on funding normal activities of the Government after liberation, Kuwait asserted that such expenditure "does not alter the compensability of the KIA Portfolio Losses and Borrowing Costs. The need to use any of the Funds Raised for such purposes was directly caused by the Iraqi aggression even though the expenses were not 'extraordinary' ... Iraq purposely deprived the State of Kuwait of the source of funds, payments for crude oil, that normally would have been available to pay for these activities." [Footnote omitted]

(ii) Iraq's arguments

229. In responding to the question of the Panel set out above, Iraq relied on its primary submissions that "[i]t is only to the extent to which the need for funds arises from expenditures for which Iraq is liable that one may even consider the question of liability" and that evidence to establish the link between the Funds Raised and relevant expenditures must be established. Further, Iraq submitted that the claims were for "loss of use of money", and may be compensable only as ancillary claims to the principal amounts awarded.

230. Iraq further argued that losses arising from the use of funds to fund loss and expenditure in respect of which compensation has been awarded by the Commission may be compensated by an award of interest, but that no direct losses arise from the use of funds to fund "other expenditures for which no claim has been filed or which have been rejected ... or have been subject to adjustments".

231. Iraq further submitted that Amounts Liquidated in 1990 and in early 1991 were expended at a time when "it was not possible to start the process of reconstruction", and accordingly argued that such funds "were used to meet the expenditure of the allied forces, which are not subject to compensation in accordance with decision No. 19 of the UNCC Governing Council".

232. Iraq accepted that "it is likely that some of the expenditures, some of the funds raised were reinvested in funding the compensable part of [Kuwait's] claims before [the "F3" Panel]", but argued that, in return, Kuwait received the benefit of a claim against Iraq "in the same amount" and therefore suffered no loss following the award of compensation for such loss.

(iii) The Panel's findings

233. The Panel has found that financing losses are themselves direct losses only to the extent that the relevant Funds Raised are shown to have been disbursed in funding direct losses, as set out in paragraph 220 above. It follows, therefore, that the lost investment returns on, or the Borrowing Costs in respect of, those amounts whose ultimate application cannot be established cannot be shown to be direct losses.<sup>78</sup>

234. The Panel notes that Kuwait may have suffered losses for which it has not claimed compensation and has also concluded, during the course of its review, that certain heads of loss claimed in some "F3" claims may have been sustained in amounts greater than those claimed, even after allowing for adjustments for involuntary betterment. The Panel finds that direct financing losses can arise only to the extent that the Panel, or other panels, find or have found that expenditure was disbursed on funding direct losses. There can therefore be no direct financing losses without a determination that there were direct underlying losses, and a determination of the extent of such direct underlying losses. Such a determination requires both the existence and extent of the losses to be demonstrated by sufficient evidence, under article 35 of the Rules.

235. Having considered all the evidence before it, the Panel has concluded that there is insufficient evidence to support the existence or extent of any direct underlying loss beyond those set out in claims in respect of which the Panel, or other panels, have made recommendations for compensation. That is, the Panel is unable to quantify any understatement in any underlying claim that has been found to be direct, or to quantify any loss that has not been claimed before the Commission.<sup>79</sup> The Panel has therefore not recommended compensation for direct financing losses other than those arising in claims in respect of which the Panel, or other panels, have made recommendations for compensation.

(c) Evidence of the extent of direct financing losses

(i) Kuwait's arguments

236. Kuwait's arguments, as set out in the preceding section, also addressed the question of the extent of the direct financing losses.

(ii) Iraq's arguments

237. At the oral proceedings, Iraq submitted, recalling the evidentiary requirements set out in the Rules and in paragraph 37 of Governing Council decision 7, that Kuwait "must prove how the proceeds were invested, how they were spent" in order to demonstrate the existence and extent of any financing loss. Iraq noted that, up to that date, Kuwait had "not produce[d] any evidence on the use of the proceeds, [and] it failed to show any loss occurred at all".

238. Iraq further considered Kuwait's submission that it was not possible to produce the evidence as to the disbursement of the funds, paraphrasing Kuwait's reasons in the following terms. First, because "the evidence is confidential and [KIA] is prevented by law to produce it, and second, [KIA] argues that it would be practically impossible to trace the disbursements from their origin to final use for

reconstruction”. Iraq rejected those reasons, asserting that KIA’s own statutes allow “expressly that information may be provided ... Article 8 of the statute [states that] information may be disclosed with the written permission of the chairman of the board of directors” and that in the context of billions of dollars, it was not credible “that KIA or Kuwait did not keep any recording, any record, any trace at all of the investments which were covered by these enormous proceeds of the international borrowings or the portfolio investments”.

239. Iraq also considered Kuwait’s submission that “a wrongdoer should bear the risk of uncertainty”, conceding that “[p]erhaps that may be right, but ... the events in Kuwait did not affect KIA. KIA had its records in London” (KIA’s operations continued in London during the occupation period), and “whatever uncertainty that Kuwait and the KIA may raise with respect to the management of the KIA’s assets is something that had nothing to do with the events in Kuwait”.

240. Iraq further asserts that saved expenses, being expenses assumed by Iraq during the occupation period, should be deducted from KIA’s claims.

241. During the oral proceedings, Iraq further argued that the Panel should not have regard to a supplemental statement of claim and other documents in support thereof that KIA filed in May 1998, in which the amount of compensation claimed for the Portfolio Loss and the Borrowing Costs claims was increased, because “[t]he Governing Council has determined that, with the exception of environmental claims, after 1st January 1997 no category F claims will be accepted under any circumstances and that, after 11th May 1998, unsolicited supplements to previously filed claims in category F will not be admitted”.

242. Iraq also argued that the Panel should not consider “further evidence and information submitted by Kuwait” during the course of the Panel’s review of the claim (as requested, *inter alia*, by Procedural Order No. 19 and Procedural Order No. 52), if the claimant was thereby being provided with “the opportunity, the possibility to re-state its original claim to better fit Resolution 687”, because “no adjudicating body may substitute its own claim to the claim as originally stated by the claimant party and ... [it] cannot transform the claim”.

243. Iraq argued that if the Panel were to “consider the possibility of treating the claim not as it was made – that is to say, as one for a separate and independent loss – but merely as ancillary to the [underlying claims] ... it would be a total transformation of the claim [that] Kuwait was invited to make”. Iraq submitted “that transforming and improving an original claim is not admissible ... [it] would not be ... in harmony with the fundamental principles of international adjudication”.

(iii) The Panel’s findings

244. The Panel finds that the Government will have established that the Portfolio Loss and the Borrowing Costs claims seek compensation for direct financing losses by demonstrating that the Funds Raised were applied in putting right or funding losses that are themselves direct losses. It is implicit in the Panel’s findings that the application of any of the Funds Raised on funding losses in respect of which the Commission has awarded compensation gives rise to direct financing losses.

245. While noting that Kuwait relied upon its primary submission that the uses to which the Funds Raised were put was not relevant in order to consider whether the Portfolio Loss and the Borrowing Costs claims are direct losses, the Panel has sought information from KIA and the Receiving Entities so as to establish the amounts the Government spent on funding direct losses. The Panel issued a series of article 34 notifications and procedural orders to such end.

246. It is inherent in the Panel's findings that the Panel has concluded that the losses for which compensation is sought by KIA are linked with the losses for which compensation was sought in the underlying claims, because those claims demonstrate the need for funds asserted by Kuwait.<sup>80</sup>

247. Indeed, that nexus between the various losses of the Government is acknowledged by KIA in its statement of claim, in which KIA acknowledges that the Funds Raised themselves could have been claimed by KIA. They were not so claimed because KIA accepted that it was appropriate for them to be claimed by the Receiving Entities.<sup>81</sup>

248. The Panel does not accept Iraq's submission that the Panel is, by its consideration of the evidence submitted in the underlying claims and the request for KIA to file evidence as to expenditure direct on underlying losses, transforming the claim or permitting KIA to re-formulate its claim. The Panel notes that, in its statement of claim, KIA asserted that the Government was "forced to liquidate a substantial portion of its invested assets and to borrow billions of dollars in order to generate the tens of billions of dollars needed to support the people and Government of Kuwait during and after the occupation and to pay for the recovery of Kuwait". The destination of the funds raised is further clarified in the claim and supplemental statement of claim in the following terms: "[t]he true cost of repairing and rebuilding Kuwait is not only the sums paid to the contractors and for materials, but also includes the interest payments and lost future investment income caused by the need for Kuwait to spend the amounts saved for future generations". The Panel, in requesting evidence as to expenditure on underlying direct losses from KIA, has put KIA to proof of the assertions as to the funds liquidated for the support of the people and Government of Kuwait made in the original statement of claim filed.<sup>82</sup>

249. As to Iraq's general submission that it should have no regard to the supplemental information and evidence submitted by KIA in response to the Panel's procedural orders, the Panel notes that, under articles 35(4) and 36(b) of the Rules, it may require claimants and others to submit further evidence and information. The Panel does not therefore accept this submission. The Panel also notes that KIA's supplemental statement of claim and supporting documents were filed in a timely fashion and may therefore be considered by the Panel.

250. The Panel has therefore considered all the evidence filed in support of the claim, including the evidence of the use of the Funds Raised that KIA and the Receiving Entities submitted, and the evidence submitted to the Commission in support of the underlying claims, in making its determinations of the extent of the losses that are direct losses and the amounts of compensation that it recommends.

251. Having considered all such evidence, the Panel finds that the Government has demonstrated that there was a need for funds to fund direct losses, that it spent part of the Funds Raised in funding such direct losses, and that it incurred direct financing losses as a result. The Panel's findings as to the extent of the losses sustained, and the Panel's recommendations in respect of them, are set out in section VII G below.

(d) Direct financing losses – funding the full replacement cost

252. The Panel now turns to consider the extent to which the direct financing losses are themselves compensable.

253. The Panel recognises that, so far as claims concerning property are concerned, assets that were lost or destroyed may have been replaced with what may be described as “better” assets and that replacing lost or destroyed assets with “better” assets may have been voluntary or involuntary on the part of the claimants, depending on the claimants' decisions as to repairs and reconstruction.<sup>83</sup>

254. The Panel notes that claimants have, in many cases, submitted claims for amounts less than the full replacement cost of lost or destroyed assets, so as to reflect the “betterment”, or incidental gain, that the claimants accrued when the assets were replaced.<sup>84</sup>

255. When making its recommendations in respect of the underlying claims, the Panel (as have other panels) has made recommendations that exclude from compensation its estimate of the entire amount by which assets replacing those lost or destroyed are “better” than the assets lost or destroyed. Those adjustments may be additional to those made by the claimants. The amount of compensation recommended will therefore have been less than the full replacement cost of many assets.

256. The Panel therefore considers in this section all such adjustments, whether made by the claimants or by the Panel.

257. The Panel requested Iraq and Kuwait to address the following issue at the oral proceedings:

“When recommending compensation for direct losses, a Panel of Commissioners may recommend or have recommended the award of an amount (the Recommended Amount) lower than the amount claimed. In such cases, the difference between the amount claimed and the Recommended Amount is represented by adjustments. Upon what basis, if at all, can compensation be recommended for the KIA Claims referable to the difference between the amount claimed and the Recommended Amount for any direct loss (i.e. the adjustments)?”<sup>85</sup>

(i) Kuwait's arguments

258. Kuwait submitted in its response to Procedural Order No. 52 that it is entitled to the Portfolio Loss and the Borrowing Costs referable to the Funds Raised that “correspond in amounts to the amounts that were claimed, but not awarded, in other Kuwait claims”, again relying on its primary

submission that the Portfolio Loss and the Borrowing Costs claims are separate and independent distinct losses and so payable without reference to the ultimate use of the Funds Raised.

259. Kuwait argued that there is a “consistent body of law that disregards incidental or collateral gains to the victim in calculating damage awards, particularly when there is intentional misconduct”, and that, in the light of the relevant authorities, “justice compels that KIA be awarded its lost profits derived from liquidations corresponding to the amounts of other claims that were subjected to those adjustments. KIA’s lost profits must be awarded to prevent “double deductions” in circumstances in which the initial deductions were already generous to Iraq.<sup>86</sup> KIA relies on various municipal authorities for its proposition quoting, in particular, the following passage in a decision of the English Courts: “[We do not] accept that the plaintiffs must give credit under the heading of ‘betterment’ for the fact that their new factory is modern in design and materials. To do so would be the equivalent of forcing the plaintiffs to invest their money in the modernising of their plant, which might be highly inconvenient for them.”<sup>87</sup>

260. Kuwait further argued that the “incidental benefit” adjustments made by the Panel were not required by international law and so should not limit KIA’s right to compensation for its loss of profits.<sup>88</sup>

261. Finally, Kuwait also submitted that the adjustments may have been for reasons “not relevant to the actual loss suffered by liquidating investments and borrowing money”.

(ii) Iraq’s arguments

262. In its response to Procedural Order No. 52, Iraq argued that the amounts claimed in other “F3” claims were overstated and therefore were not awarded in full by the Commission. Iraq concluded that “those amounts should be deducted from the sums claimed by the [KIA]”.

263. In response to the Panel’s specific question, Iraq submitted that “[t]o the extent to which claimed amounts were adjusted, they concerned losses for which Iraq is not liable. If the Panel found that Iraq was not liable for the [amount] of the adjustments, it is quite obvious to [Iraq] that there is no basis for holding Iraq liable for the loss that may have been caused to the Government by using KIA funds for making payments of this size. However ... Kuwait argues that it should be compensated through the KIA claim for losses it failed to recover through the awards previously made on the claims that had been decided. This kind of argument is obviously ill-conceived. It amounts in substance to re-opening issues [that have] been finally decided.”

264. Iraq continued that “[e]ither the amounts recommended by the Panel are below the loss actually suffered by Kuwait ... because one or more claims were assessed by the Panel at an amount below the actual loss ... we are facing final decisions of the Panel and in the [Commission’s] system, there is no possibility to [appeal] against these decisions.” Further, Iraq argues that “a claimant must include in its claim all heads of damage. He cannot be allowed later to add further heads of damage”, nor can Kuwait thereafter correct previous understatements.

265. On the question of adjustments, Iraq argued that “[a] decisive issue is whether Iraq has been held liable for the principal or not. Claims with respect to funding of expenditures can be considered for compensation only if, and to extent to which, the expenditure itself is found to be compensable.”

266. Iraq continued that “if the claimant gets only the depreciated value, there may be financing costs because he must rebuild at a higher cost and must refinance the increased construction costs. So there may be a refinement there in favour of the claimant, but ... this is not compensable because it is the damage for which he can claim interest.” Iraq further argued that “[n]ormally the new asset is more expensive but ... for computers, prices go down”.

267. Iraq agreed that adjustments should be made to reflect betterment, noting that if a claimant replaces assets “in a manner which gives him a value above the loss ... he is not in the same position as he would have been without the damage; he is better off. In such a situation the deduction is perfectly justified.” Iraq, however, did “concede that there may be exceptional cases where the claimant had no choice but to make the better situation and has no use for it, but in such a situation the claimant would first have to show that there is absolutely no alternative ... In such circumstances, Iraq argued, “the claimant would [then] have to show the difference, which is unusable”.

(iii) The Panel’s findings

268. The Panel recalls that the aim of compensation for direct losses suffered is to put the claimant back in the position in which he would have been had he not suffered those losses, so far as is reasonably possible.<sup>89</sup>

269. The Panel notes that there is precedent in international law for reducing awards of compensation to reflect incidental gains, such as those adjustments made by the Panel in the underlying claims. In 1923, an international tribunal, the Mixed Arbitral Tribunal established by Yugoslavia and Germany, held that the claimants should be awarded compensation for the loss of furniture, and “allowed the claimants an amount sufficient to replace the furniture ... at the ‘present rates’, taking into account both the depreciation and the increase in prices of furniture, and deducting the storage charges, the costs of custody, and the cartage avoided by the owners”.<sup>90</sup>

270. The Panel notes that the objections to making adjustments for any “betterment” have been maintained in various municipal authorities, a succinct example of which follows:

“...if a plaintiff, who is entitled to be compensated on the basis of the cost of replacement, is obliged to submit to a deduction from that compensation for incidental and unavoidable enhancement, he or she will not be fully compensated for the loss suffered. The plaintiff will be obliged, if the difference is paid for out of his or her own pocket, whether borrowed or already possessed, to submit to ‘some loss or burden’, to quote from Dr Lushington [in *Re The Gazelle*]. Widgery LJ in *Harbutt’s ‘Plasticine’* called it ‘forcing the plaintiffs to invest their money in the modernizing of their plant which might be highly inconvenient for them’”.<sup>91</sup>

271. The Panel finds that such objections can be met by making awards of compensation in the manner suggested by an author, S.D. Waddams, who writes:

“It commonly occurs that a plaintiff, in making good damage to property, will not be able to restore herself to her pre-loss position without improving it. If the plaintiff’s ten-year old roof is damaged, she will not be able to purchase a replacement ten-year old roof. The only reasonable course will be to replace with a new roof. If roofs have a life of twenty years, and the defendant is compelled to pay the full cost of the replacement, the plaintiff will be in a better position after satisfaction of the judgment than if the damage had not occurred in the first place. It would seem, therefore, that the damages should be reduced by the value of the improvement if the plaintiff’s position has improved [footnote omitted].”<sup>92</sup>

272. The contrary argument, that it is the defendant’s wrong that has caused the need for replacement, and that the plaintiff should not be compelled to invest money in a replacement that the plaintiff might not have chosen to make, does not appear to be conclusive. The fact that the defendant is a wrongdoer is not a reason for overcompensation. The argument that the plaintiff is forced to make an unwanted investment can be met by increasing the damages by the amount of any loss suffered by the plaintiff in making such an investment.

273. In another municipal case, the above principle was applied in the following terms:

“As part of its damages the trial judge allowed the plaintiff interest on the money which it was required to spend prematurely for betterment. The judgment of this court [in an earlier case]... authorized the making of such an award. The general principle is that the plaintiff should have deducted from his award the amount by which his property is improved (betterment) but is compensated to the extent he has had to put out money prematurely to obtain that betterment ... In our opinion, the proper approach in assessing this head of damages is to award to the plaintiff for damages for loss of interest, an amount, the present value of which... [will produce] for the plaintiff the interest to which he would have been entitled on the premature expenditure of his funds.”<sup>93</sup>

274. The Panel notes that the cost of disbursing money prematurely is to be compensated by an award of damages. In the above case, the Court also awarded pre-judgment interest on those damages.<sup>94</sup>

275. Having considered all these decisions, the Panel finds as follows:

(a) It is appropriate to make adjustments for depreciation, enhancement and other adjustments reflecting any incidental gain that has accrued to a claimant, and the sum of the amounts adjusted for these matters is the amount of the incidental gain;<sup>95</sup>

(b) The losses sustained in funding direct losses are themselves direct losses both as regards the funding of awards of compensation made and as regards the funding of the amount of any incidental

gain that was involuntarily incurred. The Panel recalls that the amount of such incidental gain is the excess of the amount required to fund the direct loss over the amount of compensation awarded in respect of the relevant underlying loss, which the Panel has defined as the “funding gap”; and

(c) Such losses should be awarded as claims for damages (that is, on the basis of the losses in fact suffered by the claimant), subject to the amounts set out in paragraphs 364(b) and 364(c)(i) and (iii) below.

(e) The concepts of “voluntary betterment” and “involuntary betterment”

276. The Panel now turns to consider how an incidental gain that was involuntarily, as opposed to voluntarily, incurred is to be identified and the extent to which compensation should be paid for the financing losses sustained in funding that amount (the funding gap).

277. The Panel recalls that: “[i]n explaining in any given case why a claim or part thereof has been reduced or rejected, the Panel has sometimes used one or more of the following shorthand expressions, the weight of which will necessarily vary from case to case...”.<sup>96</sup> Those shorthand expressions are defined in paragraph 49 above and are:

- (a) “Amounts claimed in excess of those allowed under the UNROP agreement”;
- (b) “Economies of re-creation”;
- (c) “Enhancement”;
- (d) “Inadequate accounting for depreciation”;
- (e) “Inadequate accounting for residual value”;
- (f) “Inadequate accounting for UNROP returned property”;
- (g) “Inadequate procurement process”;
- (h) “Incorrect valuation of KERP assets”;<sup>97</sup>
- (i) “Insufficient evidence”;
- (j) “Method of valuation”;
- (k) “Overstatement”; and
- (l) “Saved expenses”.

278. The Panel requested Iraq and Kuwait to respond to the following question at the oral proceedings:

“When recommending compensation for direct losses, a Panel of Commissioners may recommend or have recommended the award of an amount (the ‘Recommended Amount’) lower than the amount claimed. In such cases, the difference between the amount claimed and the Recommended Amount is represented by adjustments. If compensation can be recommended for the KIA claims referable to the difference between the amount claimed and the Recommended Amount for any direct loss (i.e. the adjustments), in respect of which adjustments, and on what basis or bases?”

(i) Kuwait’s arguments

279. Kuwait’s primary submissions are that the Portfolio Loss and the Borrowing Costs claims are “separate and independent direct” losses and thus payable without reference to the ultimate use of the Funds Raised and, in the alternative, that KIA is entitled to the Portfolio Loss and the Borrowing Costs referable to the Funds Raised that “correspond in amounts to the amounts that were claimed, but not awarded, in other Kuwait claims”.

280. In responding to the Panel’s question, however, Kuwait submitted that “most of the adjustments ... were made for reasons that do not under any circumstances implicate the compensability of the direct losses suffered by KIA”. Kuwait continued that “KIA suffered its proven loss of portfolio profits in order for Kuwait to pay, among other expenses, the full amount of asset replacements” and “... absent Iraq’s aggression, KIA would not have had any liquidations associated with such (FGF) replacements and would not have had any lost profits”.

281. More specifically, Kuwait argued that:

(a) “Adjustments for ‘enhancement’, ‘inadequate accounting for depreciation’ and ‘inadequate accounting for residual value’ represent discretionary deductions to losses ... and do not represent findings that the losses claimed were not suffered, in the amounts claimed, as a foreseeable result of Iraq’s aggression”;<sup>98</sup>

(b) “Adjustments for ‘inadequate procurement process’, ‘insufficient proof [evidence]’ and ‘methods of valuation’ also represent discretionary valuation deductions that do not rest on findings that the amounts claimed were not incurred or spent, or are not essentially compensable. The procurement and proof adjustments represent choices by the Panel, faced with some uncertainty ... based on the possibility that the losses could have been mitigated further or proven with more specificity. The ‘method of valuation’ adjustments represent choices by the Panel, faced with uncertainty as to alternative loss valuation methods”; and

(c) “Adjustments for ‘saved expenses’ and ‘compensation received from other sources’ generally do reflect the presence of a perceived financial offset to the amount expended by Kuwait.” However, KIA is entitled to compensation for “all its lost profits, including specifically the profits attributable to liquidations whose amounts correspond to the amounts of these financially based adjustments”. This is particularly so in the case of claims for relief paid to employees, where the

adjustments made did not represent “offsets to Kuwait’s expenditures”, but were rather “alleged savings and receipt of other funds ... by the employees”.

282. Kuwait did not address specifically the Panel’s adjustments made for “economies of recreation” or for “overstatement”.<sup>99</sup>

283. Kuwait also submitted that the costs of funding the adjustments could not be compensated through an award of Governing Council decision 16, because the amounts of the adjustments are not contained in any Recommended Amount for which interest could possibly be granted pursuant to that decision.

(ii) Iraq’s arguments

284. Iraq’s response to the question contained in paragraph 257 above, also addressed this issue. Iraq further submitted, in response to a question of the Panel during the oral proceedings, that “[t]he reasons for which ‘adjustments’ were made, is irrelevant in the context of [compensability for funding the adjustments]. [The] decisive issue is whether Iraq has been held liable for the principal or not. Claims with respect to funding of expenditures can be considered for compensation only if, and the extent to which, the expenditure itself is found to be compensable.”

(iii) The Panel’s findings

285. The Panel notes that claimants have adjusted their claims to reflect the notions underpinning the adjustments described above. The references to “adjustments” that follow, therefore, apply to both those made by the claimants and those made by the Panel.

286. The Panel recalls that the adjustments fall into two broad categories – first, those adjustments that reflect uncertainties, overstatements or errors in the amounts claimed, and, secondly, those that reflect “betterment” in the sense in which that term is used in paragraph 253 above.

287. The Panel has made adjustments that reflect uncertainties, overstatements or errors in the amounts claimed because the Panel is not satisfied that the losses claimed have been or should have been sustained in the amounts claimed. The adjustments that fall into this category are those made for “amounts claimed in excess of those allowed under the UNROP agreement”, “economies of recreation”, “inadequate accounting for UNROP returned property”, “inadequate procurement process”, “insufficient evidence”, “method of valuation”, “overstatement” and “saved expenses”. The Panel finds that there is no betterment that arises in connection with amounts adjusted by reason of such matters and, therefore, no financing loss should have been sustained in connection therewith. Accordingly, the Panel finds that any financing losses that in fact arose as a result of funding losses, to the extent of such adjustments, are not themselves direct losses.

288. The Panel now turns to consider whether those adjustments that reflect “betterment” – that is, adjustments for “enhancement”, “inadequate accounting for depreciation”, “inadequate accounting for residual value” and “incorrect valuation of KERP assets” constitute adjustments for “voluntary” or

“involuntary” betterment. Although claimants have used slightly different terms for their own adjustments, the Panel will, for convenience, use the Panel’s shorthand expressions when referring to all adjustments concerned.

289. The Panel finds that adjustments made for “enhancement” may, by definition, include “voluntary” and/or “involuntary” betterment, depending on the facts of the case. The Panel has examined each such case in detail, in order to decide the extent to which the betterment was voluntary or involuntary.

290. The Panel finds that adjustments made for “inadequate accounting for depreciation” by the Panel or for “depreciation” by claimants reflect “involuntary” betterment and therefore that direct financing losses include the losses sustained in funding the amounts by which claims were so reduced.

291. The Panel finds that adjustments made for “inadequate accounting for residual value” and for “incorrect valuation of KERP assets” by the Panel or for “residual value” for KERP purchases are made because compensation awarded for assets purchased for temporary use should be net of the value of the assets when the need for them finishes (the “end date”). The Panel finds that adjustment made for these matters constitute adjustments for involuntary betterment, but that the financing losses do not extend beyond the end date.

292. The Panel also made an adjustment to each of the Government’s claims for relief paid to employees, described in paragraphs 498 to 520 below, as to reflect an average entitlement for the employees concerned. This adjustment does not fall into any of the categories of adjustments described using the shorthand expressions set out in paragraph 277 above.

293. The adjustment made to such claims reflected the Panel’s view that the true measure of relief for lost salaries that the employees could have claimed before the Commission was not the full amount claimed by the Government, because other relief provided by the Government and saved expenses had provided relief for some of the losses sustained by the individual employees. Accordingly, the Panel concluded that the employees’ average financial loss, and hence average entitlement, ascertained as described in paragraphs 505 to 518 below, after such items had been taken into account, did not exceed 40 per cent of the amounts claimed by the Government.

294. The Panel finds, therefore, that the losses claimed in respect of such relief payments should not have been sustained in the amounts claimed. For this reason, the Panel finds that the adjustment made to the amounts claimed for such payments in the calculation of the average entitlement do not give rise to a direct financing loss.

295. Involuntary betterment, i.e. the funding gap, therefore comprises the sum of the amounts that the Panel adjusted in the underlying claims for “inadequate accounting for depreciation” involuntary “enhancement”, and “inadequate accounting for residual value” and for “incorrect valuation of KERP assets”, and equivalent adjustments made by other panels or by claimants in the underlying claims.

(f) The periods during which direct funding losses were sustained

296. The Panel requested Iraq and Kuwait to address the following issue at the oral proceedings: “For what period or periods of time does any [direct financing] loss ... arise?”

(i) Kuwait’s arguments

297. Kuwait submitted in its response to Procedural Order No. 52 that the Portfolio Loss began on the date of each liquidation between 1990 and 1993 and will continue until compensation is received for the Portfolio Loss, although, for reasons of difficulty of accurate valuation, KIA does not seek compensation for losses arising after 30 June 2003. Kuwait also submits that the Borrowing Costs arose “when there were actual payments of borrowing costs”, stating that “the relevant period for calculation of the losses in question begins with the date at which the loss accrued or began to accrue with the liquidation of portfolio investments or borrowing costs. Loss of profits is calculated on a continuing basis until either the cessation of loss or the date of the award, whichever is later.”

298. Kuwait further argued that most of the underlying losses relate to the loss of, or damage to, real and tangible property, and that such losses occurred when the property in question was lost or damaged (i.e. at points between 2 August 1990 and liberation).

299. As to other underlying losses, Kuwait submitted that:

(a) Losses of relief payments occurred at the specific point in time when the relief payments were made;

(b) Losses of humanitarian payments for which no claims were filed occurred when the payments were made (generally soon after liberation); and

(c) Losses related to military expenditures occurred as payments were made (both during the Iraq’s occupation of Kuwait and for a period after liberation);

(d) Losses that are to be “compensated by interest on damages” began “when the underlying vandalism or destruction occurred, or the underlying relief payment was made, and continues until the claimant is made whole for that underlying loss. Although in most situations a claimant will not be made whole until compensation is paid by the wrongdoer (Iraq), it is arguable that for the Kuwait government losses, other than the KIA losses, restoration effectively took place at an earlier date”.

300. Kuwait added that in the calculation of the above losses, “‘pre-judgment interest’ may be awarded in compensation for loss of profit or loss of use that is not provided for in an award of lost profits. In any event, interest is due on such Recommended Amounts from the date of award until date of payment.”

(ii) Iraq’s arguments

301. Iraq argued that “[t]he losses claimed, if they existed, arose at the earliest at the time when the corresponding expenditures were made”.

302. Iraq also submitted that such losses could be compensated only as interest on the underlying losses, and as to the dates of loss for interest purposes, noted that “losses arose after 17 January 1991 not 2 August 1990 [the date selected by KIA]”. Iraq further noted that some losses extend to 2003 and that, therefore, “interest should be calculated from actual dates of loss or the mid point between the date of damage and 2003. To do otherwise is unjustifiable – technically, logically and because it would favour Kuwait over Iraq.”

(iii) The Panel’s findings

303. The Panel finds that the date upon which the losses may commence is the date upon which the Liquidated Assets spent on underlying direct losses were liquidated, or upon which interest and other payments in respect of the relevant funds borrowed were made. However, the evidence before the Panel demonstrates that the Funds Raised were co-mingled with other Government funds and it cannot be determined how the proceeds of any individual liquidation or borrowing were in fact spent.

304. The evidence before the Panel demonstrates that the period of time between funds being raised by KIA and being remitted to MoF was generally short (often, a matter of days). The Panel notes that the Government had use of those funds during this interim period and, indeed, the Government or Receiving Entities continued to have use of them until the Receiving Entities ultimately disbursed funds on repair or reconstruction.

305. The Panel finds that the funds should have been held in an interest-bearing account during any such interim period in order to diminish the Government’s losses and that all returns in fact earned during that period should be brought into account against the Portfolio Loss and the Borrowing Costs claims. Further, the Panel finds that fluctuations in equity and bond values over short periods of time are sufficiently common that the Government may not have sustained any loss at all during such interim periods.

306. The evidence before the Panel does, however, establish when funds were expended in funding direct losses, and therefore establishes the existence of direct financing losses from the dates of such expenditure onwards. The evidence also demonstrates the extent of the direct financing losses from that date onwards.

307. In all the circumstances, therefore, the Panel has concluded that the existence or extent of any direct financing loss that may have arisen between the time at which funds were liquidated or borrowed and the time at which those funds were expended in funding direct losses cannot be established. Accordingly, the Panel recommends compensation from the dates upon which expenditure upon underlying losses was disbursed.

308. The Panel also finds that the loss of use of lost, damaged or destroyed assets that are the subject of the underlying claims will be compensated by award of interest under Governing Council decision

16 for the period from the date of loss for those underlying claims. Such loss of use ceases on the dates upon which the relevant underlying claimants received the Funds Raised.

(g) The interaction of the Portfolio Loss and the Borrowing Costs claims and claims for interest in underlying claims

309. In Procedural Order No. 52 the Panel requested Iraq and Kuwait to address two series of questions concerning this issue at the oral proceedings.

(i) The first series of questions

310. The first series of questions sought responses as to the nature of the loss for which compensation is sought in the Portfolio Loss and the Borrowing Costs claims, and for which compensation is sought in claims for interest on the underlying claims. The questions and the responses of Iraq and Kuwait are summarized below.

311. The Panel's questions sought submissions as to the difference between losses for which compensation is sought in the Portfolio Loss and the Borrowing Costs claims on the one hand and the claims for interest on the underlying claims on the other hand. In particular, the Panel sought submissions as to:

(a) The extent to which either head of claim was for "loss of use of opportunity" of the Funds Raised;

(b) What loss or losses is an award of interest upon an award made in respect of an underlying claim intended to compensate;

(c) For what further or alternative loss or losses the Portfolio Loss and the Borrowing Costs claims seek compensation; and

(d) What loss or losses the Government suffered in addition to those that may be compensated by awards for all underlying claims and interest on those awards.

312. Additionally, the Panel requested Iraq and Kuwait to make submissions as to what loss, in addition to those described above, would an award of interest on an award made in respect of the Portfolio Loss and the Borrowing Costs claims compensate.

a. Kuwait's arguments

313. Kuwait asserts in its statement of claim that the amounts in respect of which it seeks compensation constitute losses "in addition to the damages for the lost, destroyed or confiscated property and for the loss of the use of the property for a period of time (which additional damages are not sought in [KIA's] claim)".

314. Kuwait therefore concludes that, “the claims for Portfolio Losses, the cost of borrowing, and damages for loss of income from its investment portfolio liquidated to fund reconstruction, all of which are expenses to mitigate Kuwait’s damage, do not overlap the claims for interest and losses contained in other claims being made by Kuwait because, as discussed above, Kuwait is entitled to damages in the form of interest to compensate it for the loss of use of its lost or damaged property”. KIA also advises that, should it be held such an overlap exists, Kuwait would give notice of the overlap under Governing Council decision 13 (S/AC.26/1992/13) of 25 September 1992 and withdraw its claim for interest on the non-KIA “F3” claims.

315. Accordingly, Kuwait submitted in its response to Procedural Order No. 52 that its claims are not, or are not merely, for the loss of use or opportunity of the Funds Raised. Nor are they claims for interest on the underlying claims. They are for the loss of money, “whereas claims for interest on the other awards or for the hypothesized loss of use of the Funds Raised are claims for loss of use of money”. KIA argues that a distinction needs to be drawn between “loss of use” and “loss of profits”. It contends that its claim is not merely for a “loss of use of money”, which it associates with interest, but rather a loss of money itself, being a “loss of profit”. It argues that an award of interest on its claim would “compensate solely for the delay in payment, without regard to whether the asset had a profitable use”.

316. Further, Kuwait asserted that a distinction should be drawn “between ‘loss of use or opportunity’ so far as it applies to the funds realised through the Portfolio or expended on Borrowing ... and ‘loss of use or opportunity’ so far as it applies to the principal amount of [an award made in respect of an underlying claim]”.

317. Specifically, Kuwait asserted that the Portfolio Loss is “for lost returns in the form of dividends and capital gains or appreciation from equities” and that such returns are not interest in any sense. The Borrowing Costs include transaction costs that “in no sense can be classified as the payment of interest”. These “undisputed facts confirm that the claims are not merely claims for interest”.

318. In summary, Kuwait asserts in its statement of claim that its claims are not merely claims for interest, in that “[i]t is generally recognized that damages for converted, damaged or destroyed property includes the loss of use of the property. As one authority has written, ‘Interest as damages is sometimes awarded for the loss of the use of land or chattels where a plaintiff has been wrongfully deprived of the use of his property for a period but not permanently. Here interest on the value of the property for the period of deprivation may be given as a substitute for an attempt to measure the rental value of the value of the use of the property.’”<sup>100, 101</sup>

319. Kuwait’s argument in response to the Panel’s questions set out in Procedural Order No. 52 continued in terms that “interest is given on damages awarded, so that one must necessarily start with an award of damages. Interest on damages cannot stand by itself; there must be damages upon which it is payable. This alone is enough to show, and to show incontrovertibly, that awards in relation both to the liquidated Fund and to the borrowings constitute damages and not ... interest. For if what could be awarded here was ... interest then there would be no award of damages, and in the absence of a

damages award ... interest would not be possible. So there would be no damages, no interest, no award at all. This clearly is a nonsense".<sup>102</sup>

320. Accordingly, Kuwait argued that an award of interest is made to compensate for the delay in Iraq's fulfilment of its obligation to pay compensation for the losses compensated in the underlying claims – that is, “for the claimant having been deprived of the damages to which the claimant is entitled by reason of the primary injury for a period of time after those damages are due to be paid”.

321. Kuwait continued that “[b]y an interest award is generally meant that which a court allows on the damages awarded in order to compensate the claimant for being kept out of his money from the date his loss was incurred up to the date of judgement in his action. This may be called pre-judgement interest, or interest on damages. Alternatively, part or even the whole of the damages themselves may be represented by interest. This may be called interest as damages. One critical difference between the two is that, whereas pre-judgement interest tends to be awarded at not too exacting a rate, when interest is awarded as damages the interest is awarded at the generally higher rate which the claimant has foregone on his investment or has incurred on his borrowings.”

322. While noting that the Portfolio Loss claim is made for lost profits, or loss of return on income-producing assets, Kuwait acknowledged at the oral proceedings that the amount of Funds Raised necessarily would have been lower had compensation been paid for the underlying losses at the time at which the losses were sustained.

323. In response to the Panel's questions as set out in paragraph 311 above, Kuwait asserted that it suffered “various losses” in addition to those that may be compensated by awards of compensation in respect of the underlying claims (and interest on these awards), such as: “KIA's lost profits and out-of-pocket borrowing costs”, and losses for which no “F3” claims were filed. KIA argues that “[c]ompensation is due for, amongst other things: (i) ‘direct material loss, such as the destruction of buildings or loss of equipment ... [T]his will be met by [an award in respect of an underlying claim] other than one for KIA claims. The calculation of such [a]mount ought to take into account loss of profit and loss of use, where applicable ... further to Governing Council decision 16’; and (ii) the ‘direct financial losses suffered by KIA (loss of investment returns, borrowing costs), which will be met by [an award of compensation] that takes into account loss of profits and the actual cost of borrowing at the relevant time. International practice recognizes that loss of profits may be ‘substituted’ by interest on the capital diverted from investment, but only where such loss of profit cannot otherwise be determined with reasonable certainty”.

324. Kuwait further submitted that an award of interest on an award made in respect of the Portfolio Loss and the Borrowing Costs would compensate for the delay in Iraq's payment of compensation for the Portfolio Loss and Borrowing Costs.

b. Iraq's arguments

325. At the oral proceedings, Iraq submitted that “[t]he borrowing costs are for alleged costs, while the portfolio loss is for alleged loss of opportunity. However, the latter loss does not relate to the

opportunity for profits through the asset affected by the damaging act but for the opportunity of profit that Kuwait claims it could have made with other assets.” Iraq continued that “[a] loss which is not directly caused by the events for which Iraq is held liable but results from the unavailability of the principal compensation at the time when the loss arose ... according to decision 16 of the Governing Council must be treated as interest. According to decision 16, it is subject to the determination by the Governing Council, which must apply international law.”

326. Iraq further submitted that any further or alternative loss or losses for which the Portfolio Loss and the Borrowing Costs claims seek compensation have not been proven. Iraq acknowledged that the cost of funding compensable losses may be compensable as interest on awards of compensation (though Iraq did not accept that interest should be awarded by the Commission) but argued that in any event interest is limited to the lowest available cost of funding the Recommended Amounts.

327. Iraq also argued that the Government had not suffered any loss(es) in addition to those that may be compensated by the award of compensation in respect of an underlying claim and of interest upon that award, and that any award of interest made, should there be an award of compensation in respect of the Portfolio Loss and the Borrowing Costs claims, would result in overcompensation.

c. The Panel’s findings

328. Kuwait submitted in its response to Procedural Order No. 52 that the Portfolio Loss claim (and by analogy the Borrowing Costs claim) is not a loss of use of money claim, but a loss of money claim. The Panel finds that this characterisation is inaccurate. KIA claims for the lost investment returns, which it calls lost profits, on the Liquidated Amounts. Those losses arise because Kuwait did not have the benefit of the returns on the investments that were liquidated to provide the Funds Raised. Although it is true to say that lost profits and lost investment returns are in fact losses of money, that statement is true only because investment returns and profits are measured in money terms. Similarly, the interest and costs paid to the lender of the credit facilities represent the cost of the Funds Borrowed (i.e. the measure of their use or the cost of borrowing money). The accurate characterisation of the losses is a loss of use of the underlying investments.

329. Iraq argues that the Portfolio Loss and the Borrowing Costs claims can be direct losses only to the extent that they arise in funding awards of compensation and that, even then, they may be compensated only through the mechanism of Governing Council decision 16. Further, Iraq argues, no such interest should be paid as a matter of international law and in order to give effect to certain provisions in Security Council resolutions, because Iraq’s ability to pay and the needs of its people should be taken into account.

330. The Panel finds that the various financing losses and losses of use of property, including loss of use of money, and how they should be compensated, are most easily explored by reference to the working example. The Panel recalls that the working example refers to the loss of a building, which was replaced at a cost of 500, and for which the Ministry was awarded the sum of 233, after adjustments for depreciation were made, as compensation for its loss.

331. As separate claims have been filed by the Ministry and by the funding entity, though both claims seek compensation for the Government's losses, it is necessary to allocate the relevant losses between these claimants.

332. The Ministry's losses arise when the building is destroyed. The losses sustained include the loss of the building and the loss of use of the building. The Panel recalls that restitution of the destroyed building is in fact impossible. Iraq is therefore liable to make reparation, which will take the form of monetary compensation. The Ministry's loss of the building and loss of use of the building end when it is provided with a new building. However, the losses are effectively compensated when the Ministry receives from the funding entity the monetary equivalent of the building, which in the working example (and in many cases) will be before the destroyed building is replaced.<sup>103</sup> At that point, the Ministry's losses are not only compensated by the receipt of and ongoing use of the monetary equivalent of the building, but the Ministry has in fact received an incidental gain, as it has received from the funding entity the monetary equivalent of a new asset to replace its depreciated asset, and it has the use thereof.

333. The funding entity's loss arises when the funds are raised for the Ministry. The funding entity's losses are the loss of the funds (which have been handed over to the Ministry) and the loss of use of the funds (since the funds were previously generating an income).<sup>104</sup> The Panel notes that the funding entity has not sought compensation for the loss of the funds themselves.<sup>105</sup>

334. The Panel summarizes the various losses in the following table which, for ease of reference, is also reprinted in the annex to this report:

Table 8. Summary of losses arising in the working example

	<u>Loss 1</u>	<u>Loss 2</u>	<u>Loss 3</u>
Ministry	Loss of the building from the date of destruction	Loss of use of the building (from the date of destruction until the earlier of the date upon which the building is replaced and the date at which the funding entity provides the monetary equivalent of the building)	
Funding entity	Loss of the funds (on the day they were raised for and handed to the Ministry)		Loss of use of the funds from the day they were raised and transaction costs
Ministry and funding entity = Government	Loss of the building, subsequently replaced by loss of the funds when the building is	Loss of use of the building from the date of destruction until the date at which the	Loss of use of the funds from the day they were raised and transaction costs

	<u>Loss 1</u>	<u>Loss 2</u>	<u>Loss 3</u>
	replaced	funding entity provides the monetary equivalent of the building	
Directness	The loss of the building (or its monetary equivalent, i.e. the funds) is a direct loss	The loss of use of the building is a direct loss	The loss of use of the funds raised is a direct loss

335. It will be seen that the losses sustained by the Ministry and by the funding entity occur over different time periods. If funds could be raised, provided and disbursed instantly, the loss of and loss of use of the building would be replaced at an instant in time by the loss of and loss of use of its monetary equivalent. Those losses are the loss of and loss of use of the entire amount required to replace the depreciated building with a new building.

336. In practice, however, there may be an overlap in time between the loss of the use of the building, which is compensated on the date that the funding entity provides the funds raised, and the loss of and loss of use of the funds raised, given the time taken for the transmission of funds when provided to the Ministry and ultimately disbursed. For the reasons set out in paragraph 305 above, the Panel finds, in cases in which the funds were previously invested in equities and bonds, that such loss of use is extremely difficult to prove.<sup>106</sup> In the instant case, there is no evidence to support the existence and extent of any such loss so far as KIA is concerned.

337. The Panel also notes that the replacement of assets may occur over a period of time, and that periodic payments under relevant contracts may also be required. In such cases, the loss of use of the building and loss of use of some part of the monetary equivalent may also overlap but, as is the case in the preceding paragraph, there is no evidence to support the existence and extent of any such loss so far as KIA and the Government are concerned.

(ii) The second series of questions

338. The second series of questions addressed Governing Council decision 16. The Panel finds it convenient to re-state the text of the decision at this point:

- “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.”

339. The Panel's questions sought submissions on the following issues:

(a) Whether the effect of paragraph 1 of Governing Council decision 16 is that the Governing Council is obliged to award interest on all awards made in respect of underlying claims; and

(b) Whether, if the Panel decides that any portion(s) of the Portfolio Loss or the Borrowing Costs claims is or are equivalent to an award of interest upon an underlying claim, the Panel may recommend the award of compensation for such portions of KIA's claims or whether the Panel must refer the claim to the Governing Council for review under the provisions of Governing Council decision 16.

a. Kuwait's arguments

340. Kuwait submitted at the oral proceedings that Governing Council decision 16 should not be construed as obliging the Governing Council to award interest on all awards made in respect of underlying claims.

341. Kuwait argued that, under Governing Council decision 16, "the concept of granting pre-judgment as well as post-judgment interest has been set and will not be reassessed by the Governing Council". However, the Governing Council "retains the ability and the flexibility to determine that the interest on damages to be granted for the loss of use of the principal amount of a particular award is limited in time or is even non-existent because of a potential overlap with interest on a second award". In this sense, Governing Council decision 16 makes the granting of interest mandatory, "but in practice there may be instances in which no interest will be granted".

342. Kuwait submitted in its response to Procedural Order No. 52 that if the Governing Council perceived an overlap "between a grant of interest on [the] KIA awards and a grant of interest on the Recommended Amounts for other Kuwait claims ... the Council can and should prevent that overlap ... [I]t could determine that, inasmuch as it had made awards for KIA's Portfolio Loss and Borrowing Costs, the 'date of payment' under paragraph 1 of Decision 16 for the awards to other Kuwaiti Government claimants (including attached and independent budget entities) would be the dates when principal amounts of KIA's liquidations from the FGF and its international borrowings equalled those of the other Kuwait awards, rather than the future date of payment by Iraq. This analysis would recognize that these organizations were actually deprived of the use of their assets only for the period before those assets were restored with funds supplied largely by KIA [footnote: – In the strictest economic sense, the other organizations' "loss of use" ended when their assets were restored, not at the somewhat earlier date when KIA had made liquidations and borrowings equal to the amounts needed to restore or rebuild the assets. But because of the difficulties in tracing specific liquidations to specific uses, under Decision 16 the Governing Council could properly use the dates when the funds were available, which is the beginning date for the losses in KIA's Portfolio Loss claim, as a fair and equitable surrogate that guaranteed that Kuwait was not receiving a multiple recovery with respect to interest]. The only interest for later periods that would be necessary under paragraph 1 of Decision 16

to compensate the State of Kuwait for ‘the loss of the principal amount of’ its awards would be interest on the KIA claims ...”

343. Alternatively, the Governing Council could use its power under paragraph 2 of Governing Council decision 16 to compensate the non-KIA claimants for the “loss of use of the principal amount of their awards” only until “KIA had liquidated or borrowed funds adequate to fund those other Kuwait losses”.

344. Under either of the above approaches, Kuwait argued, “there would be absolutely no overlap between the time period for which other Kuwait government organisations receive interest and the time period of the KIA awards. There would be no duplicative or excessive compensation to Kuwait.”

345. Kuwait continued that “[i]f the Panel perceived an equivalence between the Portfolio Loss and the Borrowing Costs and the award of interest upon the non-KIA Recommended Amounts, then it should still award the Portfolio Loss and the Borrowing Costs as Recommended Amounts. International law requires that “any causally connected loss of profits that is proven with reasonable certainty is to be compensated as such”.

346. Kuwait’s argument continued that the question of compensatory interest (i.e. interest from the date of the loss until the date of award) would arise only if it were impossible to award the Portfolio Loss as a principal award (because of difficulties in calculation), and thus, “insofar as the Panel is in a position to award Kuwait an indemnity ensuring full reparation for the [Portfolio Loss], an award of [pre-judgment] interest would be groundless”. Accordingly, the Panel should award the present value of the Portfolio Loss, but “[i]nterest for the period prior to the date of award would be excluded as a matter of logic as well as of law”.

347. Kuwait cited both international law and municipal precedents to the effect that “[i]f loss of profits ... are to be awarded, it would seem inappropriate to award interest on the profit-earning capital over the same period of time, simply because the capital sum cannot be earning interest and notionally employed in earning profits at one and the same time”.

348. In other words, “[w]hether interest requires to be awarded in addition under Governing Council Decision 16 will depend upon whether there has indeed been a loss whereby the claimant has been kept out of his money”. Governing Council decision 16 is a commitment by the Governing Council “to the principle of awarding interest on damages as an addition to the damage awards recommended by the Panels”. It applies only after the assessment of compensation for damages and “[i]t would be totally inconsistent with the letter and purpose of Decision 16 to construe that decision as precluding an award of KIA’s well-proven lost profits based on the availability of interest from the Governing Council. The basic thrust of the Decision is to ensure that claimants will receive a grant of interest in addition to the awards recommended by the various Panels”. Kuwait continued that “[w]here to recover for loss of profits and to recover interest would amount to a double recovery because the two cover the same period of time, it is the loss of profits that is awarded and not interest”.

349. The Governing Council “could theoretically make individualized determinations as to the rate of interest provided on other awards and thereby truly and completely ‘compensate’ Kuwait”. However, this should not mean that Governing Council decision 16 should be interpreted as “precluding an award of KIA’s well-proven lost profits” – to do so would render Governing Council decision 16 inconsistent with Governing Council decision 9 (that allows for the recovery of lost profits).

350. Finally, Kuwait argued that “[t]o interpret Governing Council decision 16 as ... requiring that the Governing Council make individualized determinations of interest for “each award so as to truly and completely ‘compensate’ each claimant for its ‘true’ economic loss would obliterate two primary benefits that the Decision was designed to achieve: (a) the ability to make only a relatively few determinations about interest; and (b) consistent results in the grant of interest”.

351. Kuwait continued that Governing Council decision 16 provides that “interest will be awarded”. “This means that interest should be awarded in all cases.” However, this “interest ... is not intended as compensation for the international wrongful act itself but only for the delay in paying the amount due” and “[w]hatever the nature of the damage, an interest is due. Decision 16 must, therefore, only be addressing interest aimed at compensating for the loss resulting from the late payment of the sums recommended by [the Commission].”

b. Iraq’s arguments

352. Iraq submitted that there was no obligation under paragraph 1 of Governing Council decision 16 for the Governing Council to award interest on all awards made in respect of underlying claims. Iraq further relied on its primary submission that no interest or quasi-interest should be awarded, asserting that “[i]n determining whether it should award interest on principal amounts, the Governing Council will have to take into account not only questions of valuation of losses but also principles of international law, such as those with respect to the settlement of war claims. Consequently, the Governing Council is not obliged to award, and it should not award, interest on all recommended amounts.”

353. On the question of interest itself, Iraq noted that “[i]n modern international law, a trend may be observed according to which, as a matter of principle, interest on a principal [award] by an international tribunal is intended to compensate losses caused by the delay in the availability of the principal, starting with the time of the award and possibly already with the time of the loss”.

354. Further, and in response to the Panel’s question as to whether the Panel may recommend the award of compensation for any portion(s) of the Portfolio Loss and the Borrowing Costs claims that it decides is or are equivalent to an award of interest upon a Recommended Amount, Iraq submitted that “[n]o Panel may recommend the award of any compensation for interest or for claims that are equivalent to interest, i.e. those claims that are ancillary to the recommended amounts. A Panel may not observe powers with respect to ancillary claims by describing them as loss of profit or loss of use rather than interest.” Accordingly, the Governing Council has exclusive jurisdiction over such claims and classification of the Portfolio Loss and the Borrowing Costs claims as “lost profits” cannot confer

such jurisdiction. The Panel must thus refer the claims to the Governing Council for review under its decision 16.

c. The Panel's findings

355. The Panel has decided, with reference to the working example, that the outlay of the sum of 500 was itself a direct result of Iraq's invasion and occupation of Kuwait, and that the financing losses that arose as a consequence are themselves direct losses. The issue, therefore, is whether any or all of such losses are to be compensated under Governing Council decision 16 by the award of interest on the principal amount of an award. The amount funded, the sum of 500, can be divided into the sum of 233, which is the principal amount of the award made to the Ministry, and the sum of 267, which is the funding gap (the amount adjusted from the full replacement cost of the building in respect of depreciation, and in respect of which the Ministry will not receive compensation). The Panel notes that the fundamental concept behind "interest" is generally understood to be that there is an economic value to be placed on the use of money over time. Thus, interest often has been awarded by courts and tribunals, in addition to the principal amount of damages representing the loss incurred by a claimant. The idea behind the allowance of such interest is not to provide a gain or profit, but to compensate the claimant for the loss of use of money over time caused by the delay in payment of the principal amount of the claim.

356. The Panel has set out its main finding, that all "losses of use of principal amounts" of awards of compensation are to be compensated under Governing Council decision 16, by way of an award of interest on the awards made in respect of underlying claims from the date of loss until the date of payment of compensation, in paragraph 171 above. Governing Council decision 16 will cover both pre-judgment or compensatory interest and post-judgment or moratory interest. The Panel has found that it is not necessary for the relevant losses to be presented as claims for "interest". The Panel considers that any claim that arises because of the delay in payment of compensation is a claim that arises in fact because of the loss of use of the principal amount of the award, and Governing Council decision 16 addresses all these claims.

357. Kuwait argued that the Governing Council may not fully compensate the losses claimed by KIA, because the rate or rates of interest that the Governing Council will select in due course when making its award of interest under decision 16 may not be a rate that adequately compensates those losses.<sup>107</sup> The Panel, having considered the terms of decision 16, finds that Kuwait's argument is not one that the Panel can consider when making its recommendations for the compensation of direct financing losses.

358. The Panel must, first, consider the principal amount of the award made to the Ministry, the sum of 233 in the working example. The loss of 233 arises because Kuwait took that sum from the FGF, and applied it in funding the replacement building (in part). Had compensation been paid for the destroyed building on the date of loss, which is the date of destruction of the building, Kuwait would not have had to raise the sum of 233.<sup>108</sup> As compensation of 233 was not paid on that date, Kuwait had to raise the sum of 233 and has suffered, since the sum was raised, loss of use thereof.<sup>109</sup> The loss of use of the principal amount of the award covers both the loss of use of the building (until the date of

replacement) and the loss of use of the monetary equivalent of the building (from the date upon which the funds were raised), since the latter loss replaces the former loss, as explained in paragraph 335 above.<sup>110</sup>

359. The Panel therefore cannot accept Kuwait's submissions that the Portfolio Loss and the Borrowing Costs claims should be the subject of a recommendation of compensation by the Panel to the extent that the Funds Raised were disbursed on funding awards of compensation made to the Receiving Entities, because the loss of use of the principal amount of the award made to the Receiving Entity will be addressed through the mechanism of Governing Council decision 16.

360. The Panel recalls that Kuwait was asked at the oral proceedings whether it accepted the proposition that, had Iraq paid compensation on the date of loss, KIA would have had to liquidate and borrow a lower amount of funds. Kuwait agreed but added that KIA "would still have to liquidate some to make up the difference between the recommended amount and the actual loss", and continued that the fact that Iraq had not paid compensation until a later date did not characterize the relevant part of the KIA claim (unlike the claims of the Receiving Entities) as a claim for interest.

361. Kuwait also submitted that it could not be said that the Ministry's claims and the compensation awarded for them are the underlying award for damages upon which payments of interest would compensate KIA's losses, because each entity suffered separate and distinct losses.

362. The Panel does not accept these submissions because, to the extent that the Portfolio Loss and the Borrowing Costs claims arise because of the delay in payments of compensation to the underlying entities, the losses claimed are for loss of use of the principal amount of the award.

363. The Panel now turns to consider the loss of use of the sum of 267, the amount of the funding gap in the working example (that is, the involuntary betterment adjusted from the replacement cost of the building, or the uncompensated excess of the direct funding requirement). The loss to the Government is the loss that arises from taking the sum of 267 from the FGF, or borrowing the sum of 267, and applying that sum to the purchase of replacement assets or otherwise funding direct losses, and comprises the lost investment returns on the sum of 267, or the loss of the interest and related costs paid to the lenders of the credit facilities for borrowing the sum of 267. The Panel has previously found that this loss of use is a direct loss, and that compensation should be paid for all such losses, as an award of compensation to KIA. As to the sum of 267 itself, the Panel finds that it does not constitute a loss to Kuwait, but an enforced diversion from holding one type of asset to another. It is any difference in the returns on each type of asset that may give rise to a loss – the loss of use described immediately above.

364. The Panel therefore notes that compensation will be provided for the losses sustained in connection with the loss of the building in the working example in the following manner:

(a) For the loss of the building in the working example – by an award of compensation for its depreciated replacement cost, made to the Ministry, of the sum of 233. (This award also compensates the loss of the Funds Raised for the replacement of the building. The Ministry would receive a

windfall if it were to retain such compensation rather than remitting it to the funding entity, because it has already received the monetary equivalent of the building);

(b) For the loss of use of the building from the time of destruction to the time at which the Ministry received the monetary equivalent of the building – by an award of interest on the compensation awarded for the loss of the building, i.e. interest on the sum of 233, from the date of loss until the date at which the Ministry received the funds; and

(c) For the loss of use of the Funds Raised for the replacement building – by three elements of compensation:

(i) First, by the award of interest to the Ministry under decision 16 on the compensation awarded for the loss of the building (interest on the sum of 233, from the date that the funds raised were provided to the Ministry until the date of payment of compensation). The Panel finds that the Ministry would receive a windfall gain if it were to retain this interest, because the Ministry has had use of the monetary equivalent of the building from the date that the funding entity provided the funds for replacement;<sup>111</sup>

(ii) Secondly, by the award of compensation (i.e. an award of principal) to the funding entity for the loss of use of the sum of 267, being the amount of the funding gap (that is, the uncompensated excess of the direct funding requirement or the involuntary betterment adjusted from the replacement cost). Such compensation is to be valued as the losses in fact sustained by the funding entity, from the date that the Ministry disbursed the funds in replacing the building until the date of payment of compensation;

(iii) Thirdly, by the award of interest to the funding entity under decision 16 on the compensation awarded to it for the loss of use of the sum of 267 (from the relevant dates of loss as set out in paragraph 438 below until the date of payment of compensation).

365. The Panel has not recommended any compensation for losses that the funding entity may have sustained between the date upon which the funds were raised and the date upon which the funding entity handed the funds to the Ministry. In the instant case, there is no evidence before the Panel of the existence or extent of any such losses. The Panel recognizes that such losses are in any event difficult to assess, because the funding entity would have been able to deposit, and indeed should have deposited, the Funds Raised, for that period of time, in interest-bearing accounts, and the relevant interest earned should be set against the losses claimed. The interest earned may fully compensate those losses.

366. Similarly, the Panel has not recommended any compensation for any financing losses that may have arisen between the date upon which the funds were handed over to the Ministry and the date upon which the Ministry disbursed them. The Ministry would have been able to deposit, and indeed should have deposited, the Funds Raised, for that period of time, in interest-bearing accounts. Again, the relevant interest earned should be set against the losses claimed (and may fully compensate those

losses). The Panel finds again that there is no evidence before the Panel of the existence or extent of any such losses.

367. Further, the Panel has not recommended any compensation for any financing losses that may have arisen between the date upon which the Ministry disbursed any part of the funds and the date upon which the Ministry received the replacement building. The Panel finds that it is not possible, in the context of this claim, to determine whether any such losses were in fact sustained during that period of time.

368. Therefore, the Panel has not recommended any compensation for any financing losses sustained in funding the funding gap between the date upon which the funds were raised and the date upon which the funds were disbursed by the Ministry.

369. The Panel finds it convenient to set out its conclusions as to the co-existence of the various losses that arise as a result of the destruction of the building in graphical format, which, for ease of reference, is printed in the annex to this report.

370. The Panel also finds that compensation should not be awarded in respect of any loss that may have arisen other than in funding direct losses, or in respect of any loss that may have arisen because the amounts disbursed on direct losses were excessive. "Excessive" in this context refers to amounts that exceeded expenditure that could not reasonably have been avoided in effecting the relevant repairs and replacement.

(h) Identity of the Receiving Entities and compensation for the Government's direct financing losses

371. The effect of the Panel's findings set out above is that compensation for the direct financing losses will be provided to the Government by way of awards either to the Receiving Entities (as interest on their claims under decision 16) or to KIA (as an award made by the Commission following the Panel's recommendations in the present report). At the oral proceedings, Kuwait acknowledged that "the KIA funding could be viewed as ending the other organisation's loss for the delay in receipt of compensation for its other damages".

372. The Panel recalls that, in paragraph 68 of the First "F3" Report, when considering claims for damage to leased premises, the Panel considered that the party who has in fact suffered a loss is the party that should receive compensation for that loss, even if another party should have borne the financial consequences of the loss.

373. To the extent that KIA and the Receiving Entities form part of the Government, the entity that sustained the loss (the Government) will ultimately receive such compensation, whether it is paid as interest to the Receiving Entities or as compensation to KIA, and the notion of an accounting between one and the other is academic.

374. Where the Receiving Entities are not in fact part of the Government, but another legal entity (using the Kuwait Oil Company, ("KOC"), as an example in place of the Ministry in the working

example), the situation is more problematic. The Receiving Entity's claim will have been reviewed by another panel of Commissioners. The accounting between the two entities in such a case is not academic.

375. The Panel noted in the preceding section that the Ministry in the working example would receive a windfall gain if it were to retain the compensation awarded for the loss of the building, and interest awarded on that loss from the date upon which the Ministry was provided with funds from KIA. Similarly, if KOC were to receive an award of interest to the date of payment of compensation by the Commission under Governing Council decision 16, and subsequently did not account for it to KIA, KOC would be overcompensated, and the Government undercompensated for their respective losses. Further, KOC would be overcompensated if it did not account for the principal amount of the award to KIA.

376. The Panel recognizes that this situation should be addressed when the issue of awards of interest under Governing Council decision 16 is considered by the Governing Council, and it is the expectation of the Panel that the submitting entities in respect of the "E1" and "E4" claims would transfer to KIA any relevant awards, including awards of interest that the Governing Council may ultimately make.<sup>112</sup>

#### G. Quantification of the direct financing losses

##### 1. Background

377. The Panel has found, as set out in paragraph 220 above, that the Portfolio Loss and the Borrowing Costs claims are direct losses to the extent that they arise from Amounts Liquidated and Funds Borrowed that were expended in funding direct losses.<sup>113</sup> Sub-sections 2-5 below describe the issues relating to the identification of precisely what constitutes a compensable direct financing loss. Once identified, sub-section 6 addresses the issues relating to the question of how such direct financing losses are to be measured for purposes of awarding compensation.

378. The Panel has also found, as set out in paragraph 179 above, that the measure of the direct financing losses in respect of which the Panel recommends compensation is those losses in fact sustained by the Government. The losses are the lost investment returns on the relevant Amounts Liquidated and the costs and interest paid on the relevant Funds Borrowed.

379. The Panel has assessed the relevant Amounts Liquidated and the costs and interest paid on the relevant Funds Borrowed with reference to the underlying claims. The Panel recalls that the underlying claims are divided into loss types, which are sometimes further divided into loss elements, and then further into one or more levels of subdivisions, any of which may be an individual head of claim. The Panel has reviewed each individual head of claim so as to establish the amount of the direct funding requirement and the direct financing losses sustained for that head of claim. The sum of those individual direct funding requirements and losses comprises the Government's total direct funding requirement and its total direct financing losses. The principles of verification and valuation that the Panel has applied in assessing those direct financing losses are considered in the next section of this report.

## 2. Verification and valuation of the direct financing losses

380. In its review of the Portfolio Loss and the Borrowing Costs claims, the Panel has continued to apply the principles of verification and valuation that it has followed for each “F3” claim. The size and complexity of the Portfolio Loss and the Borrowing Costs claims, however, has required the Panel to refine the application of those principles to certain aspects of the claims. The Panel sets out the two instances in which it has revised the application of its general principles in the following paragraphs.

### (a) The procedures adopted by the Panel to verify and value the direct financing losses

381. The Panel recalls that its review of all “F3” claims commences with its general verification and valuation programme, in which an initial assessment of the character and probative value of all the evidence originally submitted in support of each claim is conducted. The initial assessment conducted for the KIA claim indicated that significant further evidence and information would be required, and that a specific verification and valuation programme should be established for the Portfolio Loss and the Borrowing Costs claims. The Panel therefore established a specific verification and valuation programme for those claims, which set out the steps to be applied to each material head of claim in each underlying claim.<sup>114</sup>

382. The aims of this specific verification and valuation programme are described in section VII.G.2(c) below, and the Panel’s conclusions drawn from the application of this verification and valuation programme follow thereafter.

### (b) Materiality

383. As explained in paragraph 43 above, the Panel focuses on those parts of the claims that carry a greater risk of significant overstatement. The line between these parts and others is called the “level of materiality”.

384. The level of materiality to be applied to all “F3” claims was set by the Panel at USD 500,000. However, the size and complexity of the Portfolio Loss and the Borrowing Costs claims obliged the Panel to reconsider whether the same level was appropriate in this case. The Panel concluded that the level should be revised and, accordingly, set the level for the Portfolio Loss and the Borrowing Costs claims at USD 5,000,000.<sup>115</sup>

385. However, the Panel has reduced the level of materiality in exceptional instances in which the Panel has found it appropriate to do so.

386. The Panel has determined that the use of the materiality level will ensure a detailed review<sup>116</sup> of over 99 per cent of the principal claim amount of the underlying claims. The Panel considers that this approach will achieve its objective: that is, to review adequately those parts of the Portfolio Loss and the Borrowing Costs claims that comprise direct financing losses within the time allotted for the task.

(c) Reporting on the verification and valuation of the direct financing losses

387. The Panel has conducted its review of the direct financing losses with reference to each head of claim, at the lowest level of breakdown, in each underlying claim. However, any attempt by the Panel to set out the precise quantification of the direct funding requirement and the direct financing losses sustained for each such head of claim would require a complex exposition of a very large volume of material, including the forced investment period for each underlying head of claim concerned, and would not be feasible within the constraints of a report of a panel of Commissioners to the Governing Council.

388. The Panel has, therefore, not gone beyond a statement of its findings and recommendations as to the Government's total direct financing losses, which comprise the sum of the direct financing losses sustained in respect of each head of claim. The Panel presents those findings and recommendations as the total amount of the funding gap in each year from 2 August 1990 to 30 June 2003,<sup>117</sup> and the total of the Portfolio Loss and the Borrowing Costs sustained as a result.

389. Further, the assessment of the Portfolio Loss and the Borrowing Costs is not an exact science but necessarily involves some exercise of judgement or discretion by the Panel, and the adoption of certain assumptions. Although the Panel's findings and recommendations cannot therefore be a precise calculation of the direct financing losses sustained, they are nevertheless based on a systematic review of each head of claim and the rigorous application of its specific verification and valuation programme to each head of claim, as well as of the principles applied to all "F3" claims.

390. The Panel recalls that its recommendations for compensation made in respect of each "F3" claim have been rounded to the nearest USD 1,000.<sup>118</sup> The Panel has reviewed each underlying head of claim rounded to the nearest USD 1,000, and has identified the funding gap in respect of each such head of claim rounded to the nearest USD 1,000. Nonetheless, given the matters set out in the preceding paragraph, the Panel finds it appropriate to make its recommendations for compensation in respect of the Portfolio Loss and Borrowing Costs claims presented to the nearest USD 1,000,000.

3. Receiving Entities that received funds for the funding of direct losses during the expenditure period

391. In Procedural Order No. 61 issued on 23 October 2001, the Panel requested KIA to identify all entities that received funds from the Government in the post-invasion period.

392. The Panel finds that the evidence submitted in response to those requests shows that the Government provided funds to the following Receiving Entities (in addition to the "F3" claimants), and that the Government sustained direct financing losses as a result of the provision of Funds Raised to such entities:<sup>119</sup>

Table 9. List of Receiving Entities

<u>Claimant/claims</u>	<u>Panel</u>	<u>UNCC Claim Nos.</u>
Kuwait Oil Company (Well Blowout Control, Physical Assets and related Damage)	"E1"	1798909 4004160
Petrochemical Industries Company (K.S.C.)	"E1"	4003069
Kuwait National Petroleum Company (K.S.C.)	"E1"	4003070
Kuwait Petroleum Corporation (Production and Sales Loss, Loss of Assets, Loss of Fluid)	"E1"	4003197 4003198 4004439
Mobile Telephone Systems Co.	"E4"	4000784
Kuwait Foreign Trading Contracting & Investment Co. S.A.K.	"E4"	4003085
The Industrial Bank of Kuwait K.S.C.	"E4"	4003155
Kuwait Foundation for the Advancement of Sciences	"E4"	4003171
Kuwait Investment Co.	"E4"	4003172
Zakat House	"E4"	4003221
Commercial Bank Of Kuwait S.A.K.	"E4"	4003286
The National Industries Company S.A.K.	"E4"	4003314
Kuwait Cement Co.	"E4"	4003361
Savings and Credit Bank	"E4"	4003565
The Public Authority of Minors Affairs	"E4"	4003901
The Public Institution For Social Security	"E4"	4004111
Kuwait Public Transport Company K.S.C.	"E4"	4004285
Touristic Enterprises Company	"E4"	4004604
Kuwait Aviation Services Company	"E4"	4004710
Kuwait International Fair K.S.C.	"E4"	4005083
Ministry of Foreign Affairs	"F1"	5000015
Kuwait University	"F1"	5000017
PAAC - Public Health Impacts	"F4"	5000403
PAAC - Regional Claims, general	"F4"	5000381

393. The Panel issued Procedural Order No. 65 on 30 September 2002, seeking evidence, inter alia, as to whether the Government provided funds to KAC, for the funding of KAC's direct losses. The Panel finds, on the basis of the evidence submitted in response to that Procedural Order, that the

Government indeed provided funds to KAC during the period 1990-1994. However, in paragraph 164 of the Fifteenth “E4” report, the “E4” Panel found that “insurance recoveries of USD 450 million should be deducted from the total amount of losses suffered by KAC. As the total amount of the insurance recoveries exceeds the total amount of compensable losses suffered by KAC as determined by the [‘E4’] Panel, the [‘E4’] Panel recommends that no award of compensation be made for KAC’s claimed losses”. The “E4” Panel also recommended that no compensation be awarded to KAC in respect of its claim for financing costs sustained in connection with the purchase of new aircraft (see paragraph 143 of the Fifteenth “E4” Report). The Panel finds that the evidence provided in response to Procedural Order No. 65 is insufficient to demonstrate the Government’s funding of any direct loss sustained by KAC beyond that compensated by the receipt of the insurance proceeds. The Panel further finds that the evidence does not establish that the Government has sustained direct financing losses beyond those financing losses claimed before the “E4” Panel and in respect of which no compensation was recommended. Accordingly, the Panel does not recommend compensation for any financing losses that the Government may have sustained as a result of the provision of funds to KAC.

#### 4. Direct financing losses arising from loss of Government revenue

394. The Panel has found, as set out in paragraph 161 above, that the losses sustained in funding all direct losses are themselves direct financing losses.

395. The main part of Government revenue is provided by profits from the oil sector, which is owned by the Government. There are other, smaller, sources of Government revenue. The Panel notes that the loss of such Government revenue has been claimed in underlying claims and, in appropriate cases, awards of compensation have been made. The Panel finds that the loss of the sources of Government revenue, which were found to be direct and compensable losses by this and other panels, gave rise to a need for funds that was itself a direct result of Iraq’s invasion and occupation, in that such revenue would be used to fund ordinary Government expenditure. Accordingly, the costs of replacing such revenue are included within the Government’s direct financing losses.

396. At the oral proceedings, Iraq argued that “[t]o the extent to which a loss was shown to have arisen as a result of the shortage of funds caused by the absence of oil revenue, the loss forms part of the claim for the production and sales loss, which was considered [by the] ‘E1’ Panel and for which some US\$15 billion were awarded to Kuwait”.

397. The Panel notes that the Commission has awarded compensation in respect of those and other direct underlying lost profits claims, and the Governing Council will address the losses sustained by reason of the delay in payment of compensation for those losses under Governing Council decision 16 at the appropriate time.

398. The Panel has therefore considered whether the Government has sustained direct financing losses arising from funding amounts in excess of the awards of compensation made for lost profits in the underlying claims. The Panel notes that the underlying losses are in fact losses of an asset (i.e. cash), and relevant direct financing losses arise because the cash not received needs to be replaced from another source. The Panel finds that the amount of cash that fell to be replaced was the amount

of lost profits sustained by the underlying claimants concerned, together with the amount of the adjustments in respect of depreciation applied. Accordingly, the direct funding requirement that arose as a result of the losses of revenue concerned was both the amount of compensation awarded in respect of the loss of profits and the amounts of depreciation adjusted from the relevant claims.

399. Recalling that the Receiving Entities that have filed loss of profits or equivalent claims in subcategories “E1”, “E4”, “F1” and “F4” are either part of the Government, or were ordinarily funded as part of the Government budget, the Panel finds that the amount of lost cash that the Government funded is the amount of cash foregone by each individual Receiving Entity.

400. The Panel has considered the evidence as to the amount of such cash foregone, submitted in relevant underlying claims, and in response to its Procedural Order No. 61 and Procedural Order No. 65, issued on 23 October 2001 and 30 September 2002 respectively. The Panel finds that the entities that submitted loss of profits or equivalent claims, and in respect of which the Government has sustained direct financing losses in excess of the awards of compensation made in respect of those claims, comprise:<sup>120</sup>

Table 10. Loss of profits claims giving rise to a funding gap

<u>Claimant</u>	<u>Panel</u>	<u>UNCC claim No.</u>
Petrochemical Industries Company (K.S.C.)	“E1”	4003069
Kuwait National Petroleum Company (K.S.C.)	“E1”	4003070
Mobile Telephone Systems Co.	“E4”	4000784
Kuwait Foreign Trading Contracting & Investment Co. S.A.K.	“E4”	4003085
The Industrial Bank of Kuwait K.S.C.	“E4”	4003155
Commercial Bank Of Kuwait S.A.K.	“E4”	4003286
The National Industries Company S.A.K.	“E4”	4003314
Kuwait Cement Co.	“E4”	4003361
Savings and Credit Bank	“E4”	4003565
Kuwait Public Transport Company K.S.C.	“E4”	4004285
Kuwait Aviation Services Company	“E4”	4004710
Kuwait International Fair K.S.C	“E4”	4005083

401. The Panel also finds that the following entities may have sustained losses of profits, but that such losses have not given rise to a funding gap (that is, direct financing losses to the Government in excess of those that will be compensated through the mechanism of Governing Council decision 16).<sup>121</sup> Accordingly, the Panel has not made a recommendation in respect of any financing losses arising in respect of such entities’ losses of profits or equivalent claims:

Table 11. Other loss of profits or related claims

<u>Claimant</u>	<u>Panel</u>	<u>UNCC claim No.</u>
Kuwait Petroleum Corporation (Production and Sales Loss)	“E1”	4003197
Kuwait Foundation for the Advancement of Sciences	“E4”	4003171
Kuwait Investment Co.	“E4”	4003172
Zakat House	“E4”	4003221
The Public Authority of Minors Affairs	“E4”	4003901
The Public Institution For Social Security	“E4”	4004111
Touristic Enterprises Company	“E4”	4004604

5. The verification and valuation programmes followed by the Panel in quantifying the direct financing losses

402. The aim of the verification and valuation programmes followed by the Panel is to identify the following items and thereby allow the Panel to quantify the direct financing losses sustained.

403. The Panel has reviewed the evidence presented in support of those losses and the underlying claims so as to identify the following items:

(a) Evidence of the direct funding requirement;

(b) With regard to that direct funding requirement, the amount of expenditure disbursed, during each year of the expenditure period,<sup>122</sup> on funding the relevant direct losses; and

(c) The period of time during which the direct financing losses were sustained.

404. The measure of the direct financing losses thereby sustained is described in section VII.G.6 below.

(a) Evidence of the direct funding requirement

405. The Panel’s assessment of the direct funding requirement is based upon the Panel’s review of each head of claim at the lowest level of breakdown, which may be a loss type, a loss element or a subdivision thereof.<sup>123</sup>

406. The evidence as to the direct funding requirement is provided in documents and other information submitted in support of the underlying claims and the panels’ reports to the Governing Council in respect of such claims. The Panel notes that it should have regard not only to the evidence submitted in respect of the claim under consideration, but also, under article 36 (a) of the Rules, the Panel may request information from other sources, as necessary. The Panel has duly requested

information from the underlying claim files, and other sources where necessary, so as to establish the direct funding requirement for each head of claim.

407. The direct funding requirement comprises the full cost of replacement or repair in respect of destroyed property, net of all adjustments made for overstatement and other similar adjustments that reflect the Panel's (or other panels') assessment that the losses claimed have been or should have been sustained in the amounts claimed and all adjustments made for voluntary betterment.

408. The direct funding requirement therefore comprises the amounts of compensation awarded in respect of each relevant head of claim in the underlying claims, and the funding gap (that is, amounts equal to the involuntary betterment adjusted in the underlying claims, in cases in which such adjustments were made). The amount of the funding gap is subject to a further qualification, as set out below.

409. The Panel recalls that the underlying claims were adjusted for insufficiency of evidence in many cases, reflecting the Panel's (or other panels') view that the evidence was insufficient so as to exclude the possibility of overstatement in the amounts claimed. The Panel has therefore taken into account the adjustments made for insufficient evidence in the underlying claims when considering the funding gap (and therefore the direct financing losses sustained). The Panel has applied an adjustment equivalent to that made in the underlying claims for insufficient evidence as part of its assessment of the funding gap. Accordingly, the direct funding requirement for each underlying claim is the sum of the amount of compensation awarded in respect of the claim, and an amount equal to the funding gap itself adjusted for insufficient evidence where appropriate.<sup>124</sup>

410. However, noting that the adjustments applied by the Panel for insufficient evidence reflect a risk of overstatement and not an identified overstatement in the underlying claims, the Panel has taken appropriate steps to mitigate the effect of these adjustments.

411. The evidence submitted by Kuwait discloses that there was a small saving in expenses as a result of the reduction in the funds under management following the Liquidations. The Panel finds that the amounts of saved expenses do not reduce KIA's losses to below those awarded and, accordingly, has not adjusted the amounts recommended in respect of direct financing losses in respect of such savings.

412. The Panel recalls that the asserted amended Amounts Liquidated amounted to USD 47,868,000,000, and the Funds Borrowed amounted to USD 6,023,000,000, and finds that the sum of these amounts exceeded the aggregate direct funding requirement for all underlying claims.

(b) The amount of expenditure disbursed, during each year of the expenditure period, on funding the relevant direct losses

(i) Link between evidence of expenditure and the Funds Raised

413. The Panel notes that the direct funding requirement in respect of an element of an underlying claim indicates the maximum amount that the Panel accepts would be necessary in order to fund that underlying loss. Nonetheless, there will be no financing loss sustained unless funds were in fact disbursed on underlying losses. The Panel, in Procedural Order No. 63, issued 22 February 2002 and Procedural Order No. 65, therefore requested KIA and the Receiving Entities to provide, at the head of claim level, evidence of the amounts spent on funding direct losses in the expenditure period (2 August 1990 to 30 June 1994), to the extent that such evidence was not available in the underlying claim files.

414. KIA and the Receiving Entities submitted a considerable body of evidence in response to those Procedural Orders. That evidence, and other information derived from the underlying claims and the Government's accounts and financial statistics, provided the Panel with details of expenditure on heads of claim in the underlying claims during the expenditure period, presented on an annual basis.

415. That evidence, and other evidence before the Panel, does not link individual items of expenditure with individual instances of fund-raising, but demonstrates that the Amounts Liquidated and the Funds Borrowed were mixed with other funds held in Government bank accounts, which were provided to the Receiving Entities in accordance with the Government's relevant procedures. The Panel is satisfied that it cannot now be demonstrated, and nor could it be demonstrated at the time of the expenditure concerned, that the proceeds of any individual liquidation or of any individual credit facility were spent on funding a specific direct loss, such as the replacement of a particular asset. The Panel recalls that Iraq submitted at the oral proceedings that the Panel should not find that any loss was sustained by Kuwait in the absence of such evidence.

416. The Panel finds that the co-mingling of funds in this manner reflects normal practice, and to require Kuwait to have segregated individual amounts liquidated and borrowed and then to have applied them to specific direct losses (losses that would only later be classified as such by the Commission) would be too rigorous and technical an approach, and one that would be unduly onerous upon Kuwait.

417. The Panel has therefore considered whether it may apportion the expenditure on direct losses against the Funds Raised and, if so, in what manner.

418. The Panel has considered the Government's total revenue and expenditure position for the years 1990 to 1994, as set out in the Government's accounts and financial statistics,<sup>125</sup> including the amount of Government expenditure that would and would not have been expected during that period had Iraq not invaded and occupied Kuwait. In all the circumstances, the Panel finds that it is appropriate to conclude that all Government expenditure that would not have been expected had Iraq not invaded and occupied Kuwait was funded using the Funds Raised, and not from usual sources of Government revenue. Such Government expenditure includes the replacement of lost assets of any type in the underlying claims, including losses of cash.

419. Further, the Panel finds that the amount of revenue that accrued to the Government during those years was far lower than that which would have been expected had Iraq not invaded and occupied

Kuwait. The Panel notes that the Government and related entities have submitted underlying claims to the Commission for their lost profits, that these lost profits gave rise to the Government's lost revenue,<sup>126</sup> and that the Commission has awarded approximately USD 16 billion as compensation for those lost profits. The Panel has concluded, having considered the totality of the evidence before it, that the Funds Raised were used, amongst other things, to replace the lost revenue that the Government did not receive during the period.

420. The Panel has noted in paragraph 398 above that the direct funding requirement in respect of lost profits claims includes both the awards of lost profits made by the Commission in respect of the relevant underlying claims and also the amounts of depreciation adjusted in those claims. The Panel has also concluded that the Funds Raised were used to replace the cash losses equivalent to the amounts of depreciation adjusted.<sup>127</sup>

421. The Panel is satisfied, on the basis of all the evidence before it, that the amount of Funds Raised in each year of the liquidation period exceeded the amount of funds spent on funding direct losses in each relevant year of the expenditure period.

422. In all the circumstances, therefore, the Panel is satisfied that all funds expended in funding direct losses in each such relevant year were in fact funds derived from the Funds Raised.

(ii) Expenditure on direct underlying losses in excess of the direct funding requirement

423. The Panel notes that the amounts that the Government and the Receiving Entities asserted in the responses to Procedural Order No. 63 were spent on funding relevant direct losses comprise the full extent of the amounts spent on each compensable head of claim, i.e. in funding the full cost incurred under the relevant replacement or repair contracts or in relevant purchases.<sup>128</sup> Accordingly, the evidence will in some cases relate to expenditure on adjustments that the Panel (or other panels) made for voluntary betterment and for items that indicate that the losses were not, or should not have been, sustained in the amounts claimed in the underlying claims.<sup>129</sup>

424. Referring once again to the working example, it was noted in paragraph 148 above that if the Ministry, when providing the specifications for the replacement building, decided to spend the sum of 100 to upgrade the air-conditioning system from the system in the destroyed building, the sum of 100 would be treated as a voluntary betterment, and no compensation would be awarded for the sum of 100 expended nor for the costs of funding the upgrading of the system. The additional cost would increase the cost of the replacement building from 500 (the cost of the destroyed building) to 600.

425. In the case of the working example with the upgraded air-conditioning system, the total contract price would be the sum of 600. The Panel accepts that the sum of 500 represented unavoidable expenditure in replacing the building, i.e. the sum of 500 rather than the sum of 600 was the direct funding requirement. If the Ministry asserted that during the expenditure period it spent the sum of 400 of the total contract price,<sup>130</sup> the Panel would take the ratio of the direct funding requirement (500) to the total contract price (600) to be the expenditure disbursed in funding direct losses. That is, five

sixths of the expenditure of the sum of 400, i.e. the sum of 333, would be taken to be expenditure disbursed in funding direct losses during the expenditure period.<sup>131</sup>

426. The Panel finds that the expenditure that the Government and the Receiving Entities asserted was disbursed in funding direct losses related to the full cost incurred under the relevant contracts or in relevant purchases. Accordingly, the Panel has applied the ratio of the direct funding requirement to the full cost of repair or replacement to the assertions of expenditure, for each head of claim, so as to derive the amount in fact spent in funding direct losses.<sup>132</sup>

427. The Panel has made such apportionments before considering the sufficiency of the evidence supporting assertions of expenditure.

(iii) The assessment of the sufficiency of the evidence presented in support of expenditure on direct losses

428. The Panel has considered the sufficiency of the evidence presented to the Panel so as to support the assertions as to the amounts spent in funding relevant direct losses in each year of the expenditure period, in accordance with the principles set out in paragraphs 26 to 31 above.

429. The Government and the Receiving Entities provided substantial material in response to the Panel's requests in Procedural Order Nos. 63 and 65; and other material has been submitted to the Commission and reviewed (during on-site inspections) in Kuwait and elsewhere. The Panel, in assessing the admissibility, relevance, materiality and weight of the evidence submitted, has considered the evidence submitted in respect of each head of claim as a whole, taking into account the degree of destruction of records where appropriate, and the fact that the Panel's requests to the Receiving Entities were in many cases made many years after the events at issue, and after those Receiving Entities' own claims had been reviewed by the Commission and its awards of compensation made.

430. In some cases, that evidence was not sufficient so as to demonstrate the fact, the full amount and the year of the expenditure asserted. In such cases, the Panel has made adjustments for insufficient evidence so as to provide for the risk of overstatement in the assertions of the expenditure concerned. The Panel's adjustments for insufficient evidence are lower in cases in which the evidence is insufficient only as regards the timing of expenditure than the Panel's adjustments made in cases in which the evidence is insufficient as regards the amount of the expenditure asserted.

431. The Panel notes that the underlying claims, and the amounts of involuntary betterment adjustments in those claims, may have themselves been adjusted for insufficient evidence. The amount of the Panel's adjustments made in the Portfolio Loss and Borrowing Costs claims reflect the fact that such adjustments are additional adjustments for insufficient evidence.

432. The Panel's findings as to the direct financing losses sustained in funding the funding gap have taken into account all the adjustments made by the Panel and equivalent adjustments made by other panels of Commissioners.

(iv) The application of expenditure in cases of underlying claims in which lost assets have not been replaced with identical assets

433. The evidence before the Panel discloses that, as regards many underlying claims, claimants have replaced lost or destroyed assets with property that is not identical to that lost or destroyed, often for the reasons set out in paragraphs 139 and 140 above. In other cases, the relevant underlying claims were presented on the basis of the historical cost, or book value, of the lost or destroyed assets. In such cases, the Panel is required to consider whether the expenditure asserted in the evidence before the Panel to have been disbursed on replacing what was lost and destroyed was indeed disbursed in replacing those assets.

434. In such cases, the Panel has applied a functionality test. That is, the Panel has considered whether the replacement asset or group of assets provide the same, or substantially the same, function or functions as that or those of the lost or destroyed assets. If the functions are the same or substantially the same, the Panel considers that the expenditure on the replacement assets comprises expenditure disbursed in replacing lost or destroyed assets, and so the relevant losses sustained are direct financing losses. If the functions are not the same, or substantially the same, the Panel considers that the expenditure was not disbursed in funding direct losses, and has not made a recommendation that any financing losses that may have arisen from such expenditure be compensated.

435. The Panel notes that the functionality test must be applied to the circumstances pertaining to each individual Receiving Entity, in that the function of any asset or group of assets must be assessed in the context of the underlying claim at issue, and in the context of a need to replace a large number of assets simultaneously. The Panel has therefore applied the functionality test to individual assets or groups of assets that together provide a particular function or functions, in order to take into account the circumstances of each underlying claim.

436. The Panel also finds that financing losses that arise from the ceding of revenue as payment for replacement of property and from leasing costs<sup>133</sup> and payment for contractual services to replace certain assets or functions are direct financing losses, if, in the circumstances of the underlying claims concerned, it was reasonable to effect replacement of the lost or destroyed assets using such methods. In such cases, the Panel equates the amounts of revenue ceded or leasing or contractual payments made to expenditure in replacing the lost or destroyed assets concerned.

437. The Panel also notes that in some cases, notably vehicles, the underlying claims have been presented on the basis of the market value of the lost or destroyed assets. The Panel has assessed the direct funding requirement in respect of such assets as their market value, taking account of their average age and remaining useful life. The Panel has then considered the expenditure on replacing such assets by reference to its measure of the direct funding requirement.

(c) The period of time during which the direct financing losses were sustained

438. The Panel notes that both Iraq and Kuwait accept that direct financing losses arise on the date upon which funds were raised or expended (referring to funds raised that were disbursed in funding

the relevant direct losses), and not upon the date of the underlying loss or damage. For the reasons set out in paragraphs 365 to 368 above, the Panel has taken the dates of expenditure on relevant underlying losses, or the dates of replacement of lost assets, as the starting point of the financing losses sustained.

439. The Panel recalls that it has found that the direct financing losses arise because of a forced early investment in assets purchased to replace those lost, damaged or destroyed as a direct result of Iraq's invasion and occupation of Kuwait, and that such losses will continue until the normal date of replacement of those assets, or the date of receipt of compensation from the Commission, whichever is the earlier.<sup>134</sup> The losses therefore extend during the forced investment period.<sup>135</sup>

440. The Panel notes that the forced investment period in respect of certain underlying losses requires further amplification, as set out in the following paragraphs.

441. The Panel finds that, so far as assets purchased for temporary use are concerned (such as those set out in the KERP claim),<sup>136</sup> in respect of which there is no normal replacement date, the period of time over which the direct financing losses extend ends on the date upon which the need for the temporary assets ceased (or the date of payment of compensation for the direct financing losses, if sooner), subject in appropriate cases, to a further period so as to allow for the disposal of those assets.<sup>137</sup>

442. So far as losses of cash are concerned,<sup>138</sup> the Panel finds that the end date for each loss is the date of payment of compensation. Accordingly, the Panel finds that the period of time during which the direct financing losses sustained in relation to costs incurred and losses of revenue were sustained ends upon the payment of compensation for those direct financing losses by the Commission.

## 6. The measure of the direct financing losses

### (a) Background

443. The Panel recalls that the direct financing losses sustained by the Government are the losses sustained in funding the amounts of compensation awarded in respect of the underlying claims and those amounts adjusted from those awards by claimants and the various panels of Commissioners for involuntary betterment.<sup>139</sup> The measure of such losses is the lost investment returns on the relevant Amounts Liquidated and the costs and interest paid on the relevant Funds Borrowed, as demonstrated by the evidence before the Panel.<sup>140</sup>

444. The Panel further recalls that the direct financing losses are to be compensated in part by an award of interest pursuant to Governing Council decision 16 (in respect of the direct financing losses sustained in funding the awards of compensation made for underlying claims).

445. The balance of the direct financing losses, in respect of which Panel's recommendations for compensation are made, relate to the funding of amounts adjusted from awards made in respect of the underlying claims for involuntary betterment.

446. The Panel now turns to consider the quantification of the direct financing losses, including a consideration of the actions taken by Kuwait in raising the funds concerned.

(b) Simple or compound losses

447. The Panel notes that losses sustained in financing direct losses arise, in reality, as compound losses, because, as Kuwait submitted, “had there not been a loss of investment return in 1990 that lost return would itself have earned a return in 1991 (and so on in subsequent years)”. Similarly, Kuwait has had to fund the interest paid on the borrowings to the providers of the credit facilities (that is, has sustained further financing losses, being the costs of funding the Borrowing Costs claim). KIA has not claimed these compounding elements in the Portfolio Loss and the Borrowing Costs claims but has, however, claimed interest on the Portfolio Loss and the Borrowing Costs claims from 2 August 1990. The Panel finds that the interest claim effectively compounds the Portfolio Loss and the Borrowing Costs claims.

448. The Panel finds therefore that its recommendations for compensation of the direct financing losses should be made on a simple, and not a compound basis. Having considered the matter set out in the preceding paragraphs and the terms of Governing Council decision 16, the Panel notes that the Governing Council will address the question of interest on such losses in due course.

(c) The ratio of liquidations to borrowings

449. The Panel has determined that the financing losses that arise from the Amounts Liquidated, which comprise, in total, some 88 per cent of the Funds Raised, and the Funds Borrowed, which comprise, in total, some 12 per cent of the Funds Raised, are not equal. Losses arising from the Amounts Liquidated are higher per dollar raised than those arising from the Funds Borrowed. The issue therefore arises as to whether the Government fulfilled its duty to take all reasonable measures to mitigate the financing losses resulting from Iraq’s invasion and occupation of Kuwait in raising most of the Funds Raised from liquidations rather than borrowings. Iraq and Kuwait addressed this issue in the response to Procedural Order No. 52 and at the oral proceedings.

(i) Kuwait’s arguments

450. In its response to Procedural Order No. 52, KIA submitted that “[t]he combination of liquidations and borrowings were the result of reasonable, considered judgments that were made at the highest levels of the State of Kuwait (by the Government of Kuwait) based on the conditions at the time and with substantial advice and input from independent specialists”. This combination cannot be second-guessed by Iraq.”

(ii) Iraq’s arguments

451. At the oral proceedings, Iraq argued that to the extent that a compensable loss may exist, it should be limited to the cost of funding the Recommended Amounts at the lowest cost of borrowing to the Government. Iraq added that “Kuwait was bound ... by the general duty to mitigate its loss,

mitigate its costs. That is to say, to choose the least expensive form of raising funds". Iraq continued that "it should ... be examined whether Kuwait's decision to mobilise the funds as it did ... was the best option from an economic point of view. That is to say, whether Kuwait or KIA did not contribute to its own injury by an objectively unreasonable funding policy."

452. Iraq also noted that the total of the Recommended Amounts in the non-KIA "F3" claims could be assumed to be not significantly different from the total Funds Borrowed and, as the conditions of the credit facilities required the Funds Borrowed to be spent on repair and reconstruction, that Kuwait should not only have spent them on funding direct losses but be able to demonstrate that it had done so. Finally, Iraq asserted that Kuwait should have borrowed more, and liquidated less.

(iii) The Panel's findings

453. The Panel recalls the words of Lord Macmillan in the Banco de Portugal case:<sup>141</sup>

"It is often easy after an emergency has passed to criticise the steps which have been taken to meet it, but such criticism does not come well from those who have themselves created the emergency. The law is satisfied if the party placed in a difficult situation by reason of the breach of a duty owed to him has acted reasonably in the adoption of remedial measures and he will not be held disentitled to recover the cost of such measures merely because the party in breach can suggest other measures less burdensome to him might have been taken."

454. The Panel has sought the advice of an expert on the issue of whether KIA's actions in raising the funds were reasonable. Having considered that advice, the Panel is satisfied that, in all the circumstances, KIA's actions in raising the funds to support its population and fund reconstruction efforts were indeed reasonable.

455. The Panel has assessed the amount of funds required to support the people of Kuwait and fund reconstruction efforts. The Panel has also taken into account the fact that the funds required included the funding of all direct underlying losses and not merely funding direct repairs and reconstruction, and that expenditure on repairs and reconstruction and direct losses extended beyond the expenditure period. The Panel finds that the contractual requirements to utilize the Funds Borrowed on repair and reconstruction activities should not be taken to mean that the only permitted use of those funds was in financing property losses to the extent of the awards of principal amounts of compensation by the Commission.

456. Accordingly, the Panel does not accept Iraq's submissions that Kuwait could have satisfied its direct funding requirement through the Funds Borrowed.

457. Further, the Panel does not find that the Government should have raised a higher proportion of the Funds Raised through borrowings, even assuming it were possible for Kuwait to do so, and finds that no adjustment to the amounts found to have been sustained by the Government as direct financing losses is warranted as a result of the funding decisions taken by the Government.

458. The Panel has considered the ratio of total liquidations (that is, totals not limited to the liquidation period) to total borrowings, after excluding the amount of payments the Government made in respect of the military operations of the Allied Coalition Forces (“Operation Desert Storm”) from the Amounts Liquidated. The Panel finds that that ratio is sufficiently close to the ratio of total liquidations to borrowings (including those Operation Desert Storm payments), of 88 per cent to 12 per cent, during the expenditure period, to enable the Panel to assess Kuwait’s direct financing losses on the basis of the ratio of the total Liquidated Amounts to the total Amounts Borrowed in each relevant year.<sup>142</sup>

459. To reflect the fact that the Funds Raised became co-mingled as described in paragraph 303 above, and the matters set out in the preceding paragraph, the Panel has apportioned the losses sustained in funding each direct loss on the basis of the ratio of the total Liquidated Amounts to the total Amounts Borrowed in each year from 1990 to 2003.<sup>143</sup>

(d) Estimation of the lost investment returns in connection with the Portfolio Loss

460. The Panel recalls that KIA has presented the Portfolio Loss claim using both the Market Indices Method and the Actual Performance Method, which are described in paragraphs 73 and 76 above. In Procedural Order No. 52, the Panel requested Iraq and Kuwait to address the issue of the valuation of the Portfolio Loss by answering the following question:

“Should the Portfolio Loss be valued by reference to: (i) the performance of the unliquidated portion of the FGF; or (ii) the average performance of major funds, for example, as measured by world market indices; or (iii) some other measure?”

(i) Kuwait’s arguments

461. Kuwait submitted that the Portfolio Loss should be valued as “the amount that the liquidated FGF funds would have earned during the period between their respective liquidations and the date of the award on this claim” plus “the projected profits through to June 30, 2003 (discounted back to the date of the award) ... These profits (investment income) that KIA would have earned are due to Kuwait ... in order to restore Kuwait to the position in which it would have been but for the Iraqi aggression.” Kuwait asserts that the actual returns on the unliquidated portions of the FGF are the “most appropriate measure of rate of return to be used for valuing the Portfolio Loss”.

(ii) Iraq’s arguments

462. Iraq argued that the Portfolio Loss and the Borrowing Costs claims could be compensable only as claims for interest. As to the amounts claimed Iraq argued that “the claims seek compensation at a rate above that which would be applied in commercial matters. They do so since the claims are not for the lowest borrowing costs available to the State of Kuwait, or to KIA”. Iraq also recalled its earlier submissions that the amounts claimed “exceed the compensation which would have to be paid under international law for the settlement of war damages claims”. As to the rate of interest, which is claimed at 5 per cent per annum in all “F3” claims, Iraq argued that “the 5 per cent interest rate is too

high and would constitute unjust enrichment at the expense of the Iraqi people, in that ... the rate is higher than commercial rates; and constitutes an attempt to make a profit out of reconstruction”.

463. Iraq further asserted that “[a]ccording to general standards applied in the UNCC, past performance is the principal criterion for valuation, but developments after 2 August 1990 may also be taken into consideration. It is not the unliquidated part of the portfolio that should serve as reference since it must be expected that least performing assets were liquidated first and the more valuable assets were kept in the portfolio”.

(iii) The Panel’s findings

464. The Panel has found in paragraph 179 above that the direct financing losses should be valued on the basis of the losses in fact sustained by the Government. So far as the Portfolio Loss is concerned, the losses sustained are the lost investment returns on the relevant Amounts Liquidated.<sup>144</sup> In accordance with the requirement for sufficient evidence as to the extent of the loss set out in article 35 (1) of the Rules, the Panel has therefore sought to estimate the lost investment returns on the relevant Amounts Liquidated taking into consideration all the evidence that KIA presented to the Panel.

465. Having reviewed that evidence, the Panel is satisfied that the estimated lost investment returns, using each of the methods of estimating them, are accurately stated, save as noted in paragraph 470 below and that the evidence submitted by KIA in support of those estimates provides sufficient evidence of these lost investment returns. The Panel further finds that the estimate of the ratio of equities to bonds invested in the FGF at the end of each financial year, derived as set out in paragraph 73 above provides sufficient evidence of those ratios and has adopted each such ratio for the purposes of its review.

466. The evidence of the lost investment returns comprises the estimated losses calculated annually:

(a) Using the Market Indices Method, as the actual returns for the period from 2 August 1990 until 30 June 2002 as set out in the published indices, and the estimated annual return from 1 July 2002 to 30 June 2003. The estimate for the year 1 July 2002 to 30 June 2003 is based on the average performance from 1997 to 2002; and

(b) Using the Actual Performance Method, as the annual overall returns on the investments held in the FGF for the period 2 August 1990 to 31 March 2002, as the published returns for the world market indices for the period 1 April 2002 to 30 June 2002 and as the estimated returns (using the average returns of 1997-2002) for the year from 1 July 2002 to 30 June 2003 (that is, the performance of the amounts remaining in the FGF portfolio after the liquidations had been effected).

467. The Panel notes that any method of deducing lost investment returns for a mixed portfolio of investments can only be an estimate of the losses. The Panel has therefore considered which of the methods of estimating the losses set out above may provide the better estimate, or whether any other method of estimating the losses is to be preferred.

468. The Panel finds that the investment returns earned on the balance of the FGF that remained after the liquidations closely tracked the investment returns using the world market indices for the period 1990 to 2001.<sup>145</sup>

469. Having considered all the evidence before it, the Panel is satisfied that, had there been no liquidations, the percentage investment returns earned on the FGF would not have been significantly different from those in fact earned on the remaining portfolio.

470. Accordingly, the Panel finds that the better estimate of the lost investment returns is provided by the use of Actual Performance Method for the period from 2 August 1990 to 30 June 2002. However, the Panel is unable to accept the estimated returns thereon for the year from 30 June 2002 to 30 June 2003 in the light of the volatility and overall downwards trend of equity and bond markets during the period of the Panel's review of the Portfolio Loss, and has assumed a zero return for the year 30 June 2002 to 30 June 2003.

471. Accordingly, the Panel has based its recommendations as to the lost investment returns on the Amounts Liquidated using the ratio of equities to bonds invested in the FGF, and using the Actual Performance Method for the period from 2 August 1990 to 30 June 2002, in each case as submitted by KIA. The Panel finds that no investment return should be applied for the year 30 June 2002 to 30 June 2003, for the reasons set out in the preceding paragraph.

(e) The Borrowing Costs

472. The Panel finds that, although the amounts of interest and costs paid to the providers of the credit facilities in each year may themselves have been funded through further liquidations from the FGF, the Borrowing Costs losses should be valued as the amounts of interest and costs paid. The Panel is satisfied that the evidence as to the amounts so paid supports the losses asserted by KIA, and those amounts are included in the composite financing rate described in the next section.

(f) Composite financing rate

473. Recalling that the Panel has apportioned the losses sustained in funding each direct loss on the basis of the ratio of the total Liquidated Amounts to the total Amounts Borrowed in each year from 1990 to 2003, the Panel presents its recommendations for compensation for the direct financing losses sustained as the total direct financing losses, calculated on the basis of a composite rate for each such year.<sup>146</sup>

7. Quantification of the funding gap for each year of the expenditure period

474. The Panel recalls that the direct financing losses arise in respect of thousands of individual heads of claim. The Panel cannot set out, within the confines of this report, the forced investment period for each head of claim, nor is there any meaningful average period that can usefully be set out. The length of the forced investment period in respect of which the Panel recommends compensation varies from 1 to 13 years.<sup>147</sup>

475. The Panel notes that the total amount raised to fund direct losses increased between 2 August 1990 and 30 June 1994, as funds were disbursed in putting right direct losses. The Panel recalls that the direct funding requirement in respect of each head of claim ceases on its normal replacement date, and therefore that the costs of funding that direct funding requirement also cease as of that date. Accordingly, the total direct funding requirement was reduced by the amount of the direct funding requirement for any asset as of the normal replacement date for that asset.

476. As a consequence, the Government's overall direct funding requirement increased as funds were raised and disbursed (1990 to 1994) and decreased and continues to decrease as the normal replacement date in respect of individual heads of claim (1991 to 2003) arose or arises.

477. The Panel has made its recommendations for the financing losses sustained based on the total funding gap in fact funded, for each period set out in table 12 below:

Table 12. Amounts of the funding gap as at the end of each financial year

<u>Year or period ended</u>	<u>Amount of funding gap</u>
30 June 1991	USD 376,368,000
30 June 1992	USD 1,076,327,000
30 June 1993	USD 1,786,009,000
30 June 1994	USD 1,940,870,000
30 June 1995	USD 1,784,701,000
30 June 1996	USD 1,639,279,000
30 June 1997	USD 1,587,446,000
30 June 1998	USD 1,567,261,000
30 June 1999	USD 1,379,335,000
30 June 2000	USD 1,321,454,000
30 June 2001	USD 1,208,533,000
30 June 2002	USD 1,156,145,000
30 June 2003	USD 1,118,177,000

478. The Panel notes from the above table that the total direct funding requirement was at its highest in 1994, and declined thereafter. The Panel has recommended compensation for the financing losses arising from the funding gap (that is, the direct funding requirement in excess of awards of compensation made in respect of the underlying claims) only in so far as funds were disbursed in meeting that portion of the direct funding requirement. The Panel has made its recommendations for the financing losses sustained in respect of the total funding gap in fact funded.

479. As to that amount, the Panel notes that although the total of the funding gap in fact funded for each underlying claim amounted to USD 2,226,917,000 during the period 1990 to 1994, the Government was not required to fund that full amount at any one time during the period 2 August

1990 to 30 June 2003. The maximum amount that the Government was required to fund at any one time during that period was USD 1,940,870,000 (in 1994).

480. The Panel notes that KIA seeks compensation for its losses only until 30 June 2003. The Panel finds, therefore, that any losses that arise after that date are not the subject of a claim for compensation and, therefore, the Panel makes no recommendation in respect of any loss that may have continued after that date, even should the normal replacement date for any asset fall after 30 June 2003.

#### 8. Conclusions and recommendations

481. The Panel notes that the total compensation awarded to date by the Commission in respect of the underlying claims is approximately USD 28,574,000,000.<sup>148</sup> The financing losses sustained in funding those direct losses will be compensated through the mechanism of Governing Council decision 16.

482. The Panel recalls that there is no single total amount of the funding gap in respect of which it recommends compensation, but that in each year of the claim period, the Government was required to fund the amounts of the funding gap set out in paragraph 477 above.<sup>149</sup> Applying the composite financing rate described at paragraph 473 above, the Panel finds that the total direct financing losses sustained from 2 August 1990 until 30 June 2003 in funding the funding gap amounted to USD 1,503,000,000.

483. In light of the above, the Panel recommends compensation in the amount of USD 1,503,000,000 out of USD 56,101,387,423 claimed.

VIII. THE KUWAIT INVESTMENT AUTHORITY CLAIM – INCOME PRODUCING PROPERTY –  
USD 6,226,436<sup>150</sup>

484. Prior to Iraq's invasion and occupation of Kuwait, KIA earned revenue from properties managed on its behalf by five real estate management companies (the "Managers"). KIA claims the loss of such revenue for the period from 1 August 1990 to 30 June 1993,<sup>151</sup> calculated as the difference between its estimate of the revenue that would have been earned in the absence of Iraq's invasion and occupation of Kuwait and the revenue in fact earned.

485. In order to have a basis for assessing the extent and nature of revenue that could have been expected to be earned and that which was in fact earned, and to assist it in the consideration of the individual losses of revenue described below, in November 2000 the Panel issued Procedural Order No. 16 to obtain information as to revenue earned by KIA in the period from 1 July 1988 to 30 June 1994. The information thus provided has been taken into consideration by the Panel in reaching the recommendations in paragraph 497 below.

486. The Panel set out its findings in respect of this type of claim at paragraphs 51 to 58 and 433 and 434 of the First "F3" Report. Those findings, and particular conclusions concerning the claim submitted by KIA for revenue losses, are set out below.

487. The Panel has concluded that Iraq's invasion and occupation of Kuwait led to the interruptions in Government services alleged, but that, by reason of the diversity of economic factors bearing upon each case, the determination of any revenue losses suffered has to be made separately for each claim.<sup>152</sup>

488. The Panel notes that acceptance of a loss of revenue as a compensable claim assumes that the revenue-generating activity would have continued at the same general level if Iraq's invasion and occupation of Kuwait had not occurred. It is, of course, true that all revenue collection depends upon some activity by a third party, e.g., a licensee seeking a licence for which he or she must pay. But the fact that the collection of such revenue is predicated upon the action of a third person cannot necessarily be seen as breaking the chain of causation between Iraq's invasion and occupation of Kuwait, on the one hand, and the particular loss of revenue, on the other. This is because the third party's action belongs to a class of conduct the continuation of which in periods of normality can reasonably be expected.

489. In calculating revenue losses, the Panel has again applied the general principle that any incidental benefit or gain on the part of a victim should be offset against his or her losses.

490. This principle involves two considerations: first, that any expenditure which would have been incurred in the generation of the revenue lost, but which has not been so incurred, should be brought into account to reduce the claimed loss; second, where the Panel has identified extraordinary or increased revenues flowing from Iraq's invasion and occupation of Kuwait, such revenues should be accounted for in like manner. The Panel has therefore taken any such extraordinary income into account in connection with the loss of revenue claims.

491. The Panel has also taken account of amounts going to generate revenue in one Ministry or government entity that would have been paid by another. This is because any such loss of revenue by one government entity is an expense saved by the entity that would otherwise have paid it.

492. The Panel notes that the revenue of the Government of Kuwait may have been affected by changes in the population composition of Kuwait after liberation and has considered the impact of such changes where necessary.<sup>153</sup>

493. So far as losses of revenue that are in principle compensable are concerned, the Panel has determined<sup>154</sup> that the time period in respect of which compensation should be paid is that period during which the revenue was affected as a direct result of Iraq's invasion and occupation of Kuwait. The Panel considers the relevant period by reference to historical revenue trends and noted that the period may in some cases extend to several years.

494. The Panel has concluded that the period during which a loss of rental revenue is compensable is also to be determined by reference to various factors such as the nature and extent of damage done to the relevant buildings.<sup>155</sup>

495. The Panel finds that the loss of revenue claimed by KIA is, in principle, compensable, and that the period during which the revenue was affected as a direct result of Iraq's invasion and occupation of Kuwait extended from 2 August 1990 until 1 August 1991.<sup>156</sup> The Panel has therefore made an adjustment to the amount claimed so as to exclude losses of revenue that arose after 1 August 1991.

496. The Panel finds that adjustments should also be made for saved expenses and for insufficient evidence.

497. In light of the above, the Panel recommends compensation in the amount of USD 3,219,000 out of the USD 6,226,436 claimed.

IX. THE KUWAIT INVESTMENT AUTHORITY CLAIM – PAYMENT OR RELIEF TO OTHERS –  
USD 3,461,998

498. KIA seeks compensation in the amount of USD 3,461,998 for relief paid to employees.<sup>157</sup>

499. Thirty-six “F3” claimants, including KIA, seek or have sought compensation for relief payments made to the Kuwaiti and Gulf Cooperation Council (“GCC”) employees of the Government of Kuwait. The payments amounted to the salaries the employees would have earned, but did not receive, in respect of the occupation and emergency periods. Each claimant seeks compensation in respect of its own employees. These employees, some of whom remained in Kuwait during the occupation and emergency periods and some of whom left after Iraq’s invasion and occupation of Kuwait, did not receive their regular salaries during those periods. The Government made the relief payments in a series of lump-sum payments commencing after liberation, and claims the amounts so paid. The total amount of the compensation sought for these payments in all the “F3” claims is USD 2,030 million and the number of employees in respect of whom such claims are made is around 100,000.

500. In paragraphs 31 to 48 of the First “F3” Report, the Panel set out its findings as to the compensability and valuation of the claims for such relief paid to employees. Those findings, and particular conclusions concerning the claim submitted by KIA for relief paid to employees, are set out below.

501. In May 1998, the Government supplemented each of the claims for relief paid to employees by submitting additional information that included the following background:

“In 1991, Kuwait’s Council of Ministers directed, in partial relief for the major losses suffered as a result of Iraq’s invasion and occupation, that Government organizations should pay the salaries that their Kuwaiti and GCC employees would have earned during the seven-month occupation period ... and three-month recovery period.”

502. When reviewing claims for relief paid to employees, the Panel has considered paragraph 36 of Governing Council decision 7, which provides in part as follows:

“[P]ayments are ... available to reimburse payments made or relief provided by Governments or international organizations to others - for example to nationals, residents or employees or to others pursuant to contractual obligations - for losses covered by any of the criteria adopted by the Council.”

503. In paragraph 36 of the First “F3” Report, the Panel found, on the basis of the considerable evidence made available to it during the course of the review of the first instalment claims, that the payments for which the claimants seek compensation were made to compensate for the loss of the employees’ financial support during the occupation and emergency periods. The Panel concluded that such payments constitute payments made or relief provided to others within the meaning of paragraph

36 of Governing Council decision 7 and that they, including the amounts claimed by KIA, are thus in principle compensable.

504. When assessing the amount of compensation to be paid, the Panel bore in mind the number of employees concerned and the impossibility of calculating the actual entitlement of each individual. It therefore proceeded on the basis of calculating the compensation to be recommended in respect of the employees by way of an average individual entitlement (the “entitlement”), using information provided by the claimants and the Government so as to ensure that the entitlement was as representative as possible.

505. The Panel found<sup>158</sup> that the two main factors determining the entitlement were the length of the period for which payment of compensation may be justified and the amount of salary that would have been received by each individual during that period, less appropriate deductions as explained in paragraphs 506 to 516 below.

506. With respect to the first factor, the Panel found that compensation should be recommended based on the period that the employees were reasonably unable to work. Recalling that the positions of the employees were suspended, not terminated, the Panel concluded that it was usually not possible for the employees to resume their positions until the end of the emergency period. The employees in respect of which claims were made in the first, second and parts one and two of the third instalments were thus reasonably unable to work during both the (seven-month) occupation period and the (three-month) emergency period, a total of 10 months.

507. With respect to the second factor, the first step undertaken by the Panel was to compare the monthly amounts ordinarily received by way of salary by the employees and the amounts actually paid retrospectively.<sup>159</sup>

508. The Panel noted that the Government of Kuwait operates a social security system which confers pensions and similar benefits on employees, and which is funded by contributions from employers and employees (the “Social Security Fund”). These contributions are calculated as a percentage of salary and the contributions of the employees, being 5 per cent of gross salary, are deducted at source from the salaries paid to them. As part of the first step described above, the Panel requested the Government to confirm whether the amounts paid to the employees and claimed as relief took into account the employees’ contributions where necessary and whether there had been any loss of benefits to the employees. The Government responded that there had been no loss of benefits, and that some but not all claimants had accounted for the contributions by paying to the employees only their gross salary less the 5 per cent deduction. The Panel took the Government’s response into consideration and reviewed it in the light of the evidence provided in support of each claim. The Panel found that suitable account had been taken in a number of claims. The Panel therefore determined that an adjustment should be made to the amounts claimed in cases in which the Panel was not satisfied that the social security contributions had been adequately accounted for.

509. The evidence shows that the amount claimed by KIA is based upon the employees' salaries after deduction of the social security contribution.

510. In order to ensure that the entitlement accounted for the employees' true losses, as a second step the Panel considered and brought into account the employees' entire financial receipts (including the benefits received from relief programmes) and expenditures over the compensable period.

Furthermore, the Panel applied the general principle that any incidental benefit or gain on the part of a victim should be offset against his or her losses. In other words, "saved" expenses, that is, expenses that the employees would ordinarily have incurred if Iraq's invasion and occupation of Kuwait had not taken place, but did not in fact incur during the period for which compensation is recommended, were deducted from the entitlement.

511. In order to ascertain what other relief payments were made and what expenses the employees might have "saved" during the period, the Panel issued Procedural Order No. 15, issued on 10 November 2000, in respect of all relevant first instalment claims, seeking information in this connection. A comprehensive response was received, which provided a model of the average Government employee covering the amount and nature of his or her income and expenditure and the benefits obtained by him or her through policies implemented by the Government of Kuwait during the period.

512. This response showed that the mean pre-invasion levels of consumption in Kuwait were very high, exceeding the average Government employee's monthly salary.<sup>160</sup> It also described a wide-ranging programme of relief payments.<sup>161</sup> The Panel took this information into account.<sup>162</sup>

513. The Government submitted that only a few employees who left Kuwait could demonstrate that their costs outside Kuwait exceeded the relief received and that these employees have made individual claims before the Commission. With regard to those who did not leave Kuwait, the Panel assumed that any losses in respect of additional costs incurred could similarly have been the subject of claims before the Commission. Accordingly, the Panel assumed that additional living expenses and the relief paid in respect of them did not need to be taken into account when calculating the employees' true losses.

514. In the light of the above considerations, the Panel found that deductions for "compensation received elsewhere for the same loss" should be made in respect of the free food and utility services provided in Kuwait over the period above.<sup>163</sup>

515. The Panel further found, from the model provided by the Government of Kuwait, that the employees who were outside Kuwait during the period under consideration did indeed "save" certain expenses in Kuwait.<sup>164</sup> That is, they did not incur a proportion of ordinary and anticipated living expenses over the period under consideration.

516. On the basis of the matters noted in paragraphs 506 to 515 above, the Panel recommended a deduction of 60 per cent from the amounts claimed. That is, the Panel recommended a total award of 40 per cent of the relief paid to employees and claimed in each of the relevant "F3" claims, subject to

verification of the amounts claimed and the Panel's assessment of the evidence presented.<sup>165</sup> Accordingly, the Panel recommended an award to each respective claimant calculated in this manner.

517. The Panel has applied this percentage award to the claims for relief paid to employees in all instalments, though making certain adjustments to the amount claimed when calculating the award so as to reflect the work performed in respect of which the Government of Kuwait had received the relevant benefit, i.e. in those cases in which such work comprised the performance of the tasks for which the relevant employees were ordinarily employed. (In certain other cases, in which the work did not comprise such tasks, the Panel has recommended that claims for payments made in relation to such extraordinary work be compensated.)

518. The Panel made further adjustments in respect of advance payments of salaries or other payments, to the extent that such payments were not made in mitigation of additional expenses occasioned by Iraq's invasion and occupation of Kuwait.

519. The Panel notes that, during its occupation of Kuwait, Iraq requested employees to exercise their normal functions and that certain employees did work during the occupation period. In calculating the percentage award, the Panel made allowance for a certain level of payments made by Iraq for work carried out during the occupation period.

520. In light of the above, the Panel recommends compensation in the amount of USD 1,385,000 out of the USD 3,461,998 claimed.

X. THE KUWAIT INVESTMENT AUTHORITY CLAIM – OTHER LOSSES: FUNDS ADVANCED TO IRAQ (ADVANCES – USD 6,050,535,000 – CENTRAL BANK OF IRAQ DEPOSITS – USD 1,093,884,421)

521. KIA seeks compensation for funds advanced to Iraq, arising as loans made between 1963 and 1982 and as deposits made with the Central Bank of Iraq between 1983 and 1988. KIA asserts that these loans and deposits were made pursuant to understandings reached at the highest level of the Governments of Kuwait and Iraq. KIA notes that its Loan Department is responsible (among other things) for administering and overseeing the loans and deposits. The specific terms of the loans and deposits were set out in agreements for each such loan and deposit.

522. KIA sets out the diplomatic history of the loans and deposits in the statement of claim. The main stated purpose of the loans, as rolled over, and deposits was to enable Iraq to defray the expenses of its 1980-1988 war with Iran. Kuwait has deferred all demands for payment of the loans and the deposits (including any applicable interest) since the start of that war, though it has not renounced its rights to such repayment. Iraq has, on several occasions, stated that it had no obligation to repay any of the amounts advanced.

523. KIA asserts that the loans were drawn from the GRF and authorized by Amiri Decrees and legislation and were not interest bearing. KIA further asserts that the deposits were authorized by MoF and drawn from funds at the Central Bank of Kuwait, and carried 5 per cent interest per annum.

524. KIA asserts that the majority of the loans (approximately USD 5 billion out of approximately USD 6 billion) were initially scheduled for repayment before 2 August 1990, although many of them had been re-scheduled for repayment after 2 August 1990. Kuwait notes that USD 3,600,000,000 of the loans had been formally re-scheduled prior to Iraq's invasion and occupation of Kuwait and accordingly no payments were formally due until after 2 August 1990. The remaining USD 2,450,535,000 had not been formally rescheduled. Kuwait had not made demands for the repayment of the loans by 2 August 1990, as Iraq had advised that it was unable to repay the amounts, and Kuwait therefore asserts that no sums were formally due as at 2 August 1990.

525. The deposits made between 1983 and 1988 comprised seven deposit agreements under which 21 separate transfers of funds were made. The total amount of funds transferred was USD 815 million. Each deposit had a maturity of one year, and was rolled over on each maturity date, by the issue of a confirmation from the Central Bank of Kuwait to the Central Bank of Iraq, confirming the deposit's renewal, interest rate and the interest that had accumulated over the life of the deposit. Each confirmation was accepted by the Central Bank of Iraq, up until the date of Iraq's invasion of Kuwait. The Central Bank of Iraq also requested renewal of all the outstanding principal and accrued interest on each deposit at the maturity date immediately preceding the date of its invasion. The next maturity dates after Iraq's invasion of Kuwait fell due between October 1990 and July 1991.

526. KIA asserts that on 23 September 1991 it made a formal demand for the return of the funds on deposit at the Central Bank of Iraq, but Iraq has not responded to the demand. KIA does not indicate

whether it has made a demand for the repayment of the loans. KIA states that it has not undertaken any proceedings to recover the loans or deposits, because no alternative forum is available to Kuwait.

527. The oral proceedings held on 12-13 September 2001 also concerned the claim for funds advanced to Iraq. At the oral proceedings, the Panel requested Iraq and Kuwait to respond to the following questions:

(a) “[D]o[es] any of the [loans or deposits] fall within the [Commission’s] jurisdiction or is one or more excluded therefrom because it or they constitute ‘debts and obligations of Iraq arising prior to 2 August 1990’, as set out in paragraph 16 of Security Council resolution 687 (1991); and

(b) [I]s Iraq’s failure to repay any or all such funds a direct result of Iraq’s invasion and occupation of Kuwait, whether because it was a repudiation of the loan and deposit agreements or otherwise?”

528. The Panel considers that the arguments of Kuwait in response to the above questions should be set out in the context of the propositions set out in KIA’s statement of claim. In the statement of claim, Kuwait put forward three main reasons why the loans and deposits should not be excluded from the Commission’s jurisdiction as “debts and obligation of Iraq arising prior to 2 August 1990”.

529. First, Kuwait argued that payment was not due under the loans and deposits, and accordingly the debts and obligations had not arisen prior to 2 August 1990, because “Kuwait had not demanded repayment and Iraq had not indicated that it was financially unable to repay”, and that “Iraq acknowledged its obligation to repay these loans and deposits”, in that “it complained that Kuwait had not forgiven them”. Kuwait continued that the repayment of many of the loans had been officially or formally extended and it was well understood that the remainder had been similarly extended. Kuwait further argued that the phrase “debts and obligations arising prior to 2 August 1990” “cannot be construed so as to include obligations to make future payments under pre-invasion contracts”, for which the Governing Council has held Iraq liable, because to construe the phrase in this manner would remove the Commission’s jurisdiction over almost all contract claims. Accordingly, Kuwait argued that the phrase should be construed as referring only to “claims” arising prior to 2 August 1990.

530. Kuwait further argued that time deposits are not due until the date of maturity and ordinary deposits are not due until demand has been made for their repayment.<sup>166</sup>

531. Kuwait submitted, secondly, that its claim against Iraq in respect of these loans and deposits was not a claim in debt, but a claim for the expropriation of the right to repayment, for which Iraq is liable to pay reparation under customary international law. Kuwait asserted in its statement of claim that Iraq’s invasion “necessarily repudiated its obligation to repay the loans and deposits advanced by Kuwait”, which itself constituted a compensable expropriation or confiscation of Kuwait’s property.

532. Kuwait’s third argument was presented in the following terms. Kuwait noted that the exclusionary language of paragraph 16 of Security Council resolution 687 (1991) “contemplates the existence of ‘normal mechanisms’ to recover pre-invasion debts and obligations, but Kuwait has no

normal mechanisms through which to assert its right against Iraq regarding the loans and deposits". In addition to the lack of diplomatic relations between the countries, Kuwait stated that "there is no legal forum in which Kuwait could take proceedings against Iraq, because Iraq has filed no declaration recognizing the compulsory jurisdiction of the International Court of Justice at The Hague [as it is required to do] under article 36 of that court's statute". Additionally, Kuwait asserts that it may not commence proceedings in Iraq "since Iraq does not recognize Kuwait's existence as a State [and would therefore reject Kuwait as a plaintiff]". Kuwait therefore argues that, as a matter of policy, the Commission should exercise jurisdiction over the loans and deposits.

533. At the oral proceedings, Kuwait developed its second argument that as a matter of international law, "expropriation occurs when a government takes intangible rights under an agreement, including the right to repayment of a loan".

534. Kuwait further argued that the losses were direct losses because it was a normal and natural consequence of the annexation of Kuwait by Iraq and would lead to "Kuwait's repayment rights ... becoming [unavailable to KIA]". Kuwait further argued that the "intentionality test" (described in paragraph 197 above) should also be applied to Iraq's actions, and that "the explicit purpose of the invasion was the annexation of Kuwait, the immediate and necessary consequence of which would be the disappearance of the liabilities of Iraq to Kuwait".

535. In its response dated 20 January 2001 to Procedural Order No. 1 and to the KIA claim, the Government of Iraq stated that:

"All the sums that the Authority or Government of Kuwait paid to [the] Government of Iraq during the period 1980 to 1982 are, in effect, not loans, but cash contributions of [the] Government of Kuwait for bearing some expenses of the war with Iran, against Iraq bearing alone defence of the Gulf regimes ... Therefore, these loans which [the] Government of Kuwait is alleging ... are not loans nor assistances to Iraq, but they are contributions of [the] Government of Kuwait in bearing a small portion of [the] expenses of the Iraqi-Iranian war."

536. At the oral proceedings Iraq developed further this argument, noting that the funds were paid to Iraq long before 2 August 1990. Accordingly, "any repayment obligation that Iraq may have contracted thus arose prior to that date. The fact that some of the loans matured thereafter does not change that principle. The claim falls under the exception of paragraph 16 of Security Council resolution 687 (1991). In any event, the status of the funds has not been affected by the events of 2 August 1990. Any effect that may have occurred has been wiped out by decision 55 of the Revolutionary Command Council. Iraq accepts that the status of the funds remains in, or if that were necessary, [is] restored to the position prior to 2 August 1990." Iraq continued that Kuwait might not treat the loans as "annulled" by the events following 2 August 1990, because the repayment request of September 1991 is evidence that Kuwait considered the loans extant as at that date.

537. The Panel has considered the arguments of Iraq and Kuwait on the question of the exclusion from compensation of the "debts and obligations of Iraq arising prior to 2 August 1990" contained in

paragraph 16 of Security Council resolution 687 (1991). The Panel notes the statements of the “E2” Panel, in their first instalment report, that “the only avenues for recovery of ‘debts and obligations of Iraq arising prior to 2 August 1990’ are ‘normal mechanisms’, and not the Commission”.<sup>167</sup>

538. The Panel has therefore considered whether or not the loans and deposits should be considered to have “arisen” prior to August 1990, in the light of the decisions of the “E2” Panel on the questions of Iraq’s national debt and rescheduled debts.<sup>168</sup>

539. On the question of Iraq’s national debt, the “E2” Panel found that “the old debts of Iraq certainly include the debts that already existed as of the end of the conflict with the Islamic Republic of Iran, i.e., in August 1988. But these same debts, as described, also distorted the entire economy of Iraq with the consequence that some old debts may appear to be new as of 2 August 1990. In some instances, old and overdue debts were rescheduled. The rescheduling of such old debts perhaps renewed them under applicable law, but did not make them new debts in the sense of Security Council resolution 687 (1991).”

540. On the question of rescheduled loans, the “E2” Panel, in paragraph 24 of their fifth instalment report,<sup>169</sup> recalled that the rescheduling of debts went to the heart of what the Security Council described in Security Council resolution 687 (1991) as the debt of Iraq “arising prior to 2 August 1990”. Correspondingly, the “E2” Panel noted that the Security Council did not intend that the Compensation Fund be used for the payment of creditors unpaid long before Iraq’s invasion and occupation of Kuwait. The “E2” Panel concluded that the rescheduling of old and overdue debts, regardless of their status under municipal law, did not render them “new” debts for purposes of the “arising prior to” clause and that this reasoning likewise applies to rescheduled loans. The Panel agrees with the findings of the “E2” Panel, and finds that the rescheduling of the loans and deposits does not render those loans and deposits “new debts” as at 2 August 1990.

541. Applying the principles set out above, the Panel finds that, to the extent that Kuwait seeks compensation for debts and obligations of Iraq under the contractual documents relating to the loans and deposits, such claims fall outside its jurisdiction in that the funds were advanced, and the obligation or debt of Iraq therefore arose, before Iraq’s invasion and occupation of Kuwait.

542. The Panel also notes that evidence submitted to it indicates that the relationship between Kuwait and Iraq, so far as the loans and deposits are concerned, goes beyond an ordinary debtor/creditor relationship. Indeed, some of the evidence before the Panel indicates that although the loans were formally described as loans, there may not have been a full expectation that they would be repaid. The Panel finds, however, that there is no evidence to support any liability of Iraq to repay the loans and deposits beyond the obligations set out in the relevant agreements.

543. The Panel has therefore considered the alternative argument of Kuwait, that Iraq’s invasion and occupation of Kuwait repudiated the loan and deposit agreements, and so expropriated the funds loaned and deposited, giving rise to a liability that arose at the earliest on 2 August 1990. Kuwait asserts that “... it is clear in international law that there can be liability for the anticipatory repudiation

of a contractual obligation like Iraq's duty to repay these loans and deposits", but cites no authority for the proposition.

544. The Panel has taken into account paragraph 17 of Security Council resolution 687 (1991), in which the Security Council "[d]ecides that all Iraqi statements made since 2 August 1990 repudiating its foreign debt are null and void, and demands that Iraq adhere scrupulously to all of its obligations concerning servicing and repayment of its foreign debt".<sup>170</sup>

545. The Panel has concluded that even if Iraq's invasion, occupation and purported annexation of Kuwait and subsequent actions were to have constituted a repudiation of the loan and deposit agreements, any repudiation has itself been declared null and void by the Security Council and was rescinded by decree No. 55 of the Revolutionary Command Council, issued on 5 March 1991. Accordingly, the Panel does not accept Kuwait's submissions that the loans and deposit agreements were repudiated, that the loans and deposits were thereby expropriated, and that a liability for such expropriation arose on or after 2 August 1990.

546. The Panel finds therefore that the loans and deposits constituted "debts and obligations of Iraq arising prior to 2 August 1990", as set out in paragraph 16 of Security Council resolution 687 (1991).

547. As to Kuwait's third argument, the Panel accepts that the reference to "normal mechanisms" in paragraph 16 of Security Council resolution 687 (1991) is a phrase that has little application to the situation as between Iraq and Kuwait. Nonetheless, the Panel construes that reference to apply to mechanisms outside the Commission. The extent to which those mechanisms may, or may not, exist as a matter of practice gives rise to policy issues that the Panel may not take into account in assessing the liability of Iraq for direct losses under Security Council resolution 687 (1991).

548. Accordingly, the Panel does not recommend any compensation in respect of this head of claim.

## XI. THE KUWAIT INVESTMENT AUTHORITY CLAIM – INTEREST – USD 23,473,853,424

549. The Government seeks interest on the principal claim amount in respect of each “F3” claim, including the Portfolio Loss and the Borrowing Costs claims, and the other claims filed by KIA set out in this report. The Governing Council in its decision 16, as noted in paragraph 168 above, has stated that it will address the methods of calculation and payment of interest at an appropriate time.<sup>171</sup>

550. As noted in paragraphs 98 to 102 of the First “F3” Report, and in subsequent “F3” reports, the Panel has noted that, in the light of Governing Council decision 16, the Panel has to determine only the date from which interest is to run on the “F3” claims. The Panel also set out in previous “F3” reports its consideration of how for the purposes of calculating interest, the date of a specific loss is to be determined. The Panel has found that, in the context of the enormous number of individual claim items, within several loss types, a specific determination for each claim item is impractical. The Panel has, therefore, concluded that for this purpose all losses should be deemed to have occurred on one single date, save in exceptional cases.

551. The Government of Kuwait itself identified two possible dates at two different stages of the proceedings for the majority of “F3” claims. The Government first selected, in its “Summary report of Government claims” submitted in July 1994, 26 February 1991 as the relevant date for most of the “F3” claims.<sup>172</sup>

552. So far as the Portfolio Loss is concerned, interest was calculated in the original statement of claim from the end of each calendar year of the liquidation period (that is, from 31 December 1990, 31 December 1991, 31 December 1992 and 31 December 1993) until 1 May 1994. 1 May 1994 was the date upon which the claim was compiled. As to the Borrowing Costs claim, the date selected in the original statement of claim was the mid-point between the date of the last draw-down on the loans and 1 May 1994.

553. In a subsequent submission, however, filed in May 1998, the Government amended its first submissions to provide that interest should accrue from 2 August 1990 for all “F3” claims, including the Portfolio Loss and the Borrowing Costs claims, being the date on which Iraq invaded Kuwait.

554. Having regard to the varying dates of loss and the need to select one date for interest purposes, the Panel has determined that, in all the circumstances, the date of loss for calculation of interest for “F3” claims is 26 February 1991, save in exceptional cases.<sup>173</sup> The relevant date of loss for interest purposes for the income-producing property and payment or relief to others claims reported in sections VIII and IX above is therefore 26 February 1991.

555. The Panel finds that the date of loss for calculation of interest for the Portfolio Loss and the Borrowing Costs claims should be the mid-point of the period during which the losses claimed were sustained, for the reasons set out by the “E2A” Panel of Commissioners:

“With respect to claims for decline in business leading to loss of profits or claims for increased costs, the Panel notes that such losses in this instalment were suffered over

extended periods of time, and that such losses were generally spread over the period of loss. Given these circumstances, the Panel selects the mid-point of the relevant compensable period (including, as the case may be, relevant primary or secondary periods) during which the particular loss occurred as the date of loss.”<sup>174</sup>

556. However, the Panel finds that such mid-point in the context of the Portfolio Loss and the Borrowing Costs claims should be weighted in accordance with the cumulative value of the direct financing losses. The Panel determines this date to be 31 December 1995.

## XII. THE SUPPLEMENTAL INTEREST CLAIM

Government Claim No. 61, UNCC claim No. 5000184Table 13. Summary table for the Supplemental Interest Claim

<u>Loss type/loss element</u>	<u>Amount claimed</u> <u>USD</u>	<u>Amount</u> <u>recommended</u> <u>USD</u>	<u>Paragraph</u> <u>references</u>
Interest	9,605,117,360 <sup>a, b</sup>	Nil	557 - 566

<sup>a</sup> Plus daily interest of USD 7,487,225 from 30 September 1995 onwards.

<sup>b</sup> This amount reflects withdrawals of parts of claims for interest made in the underlying “F3” claims.

557. In September 1995, the Government of Kuwait filed an aggregate claim for additional interest on the amounts sought in the 63 Government claims categorized as “F3” claims and in the two Government claims reviewed by the “F1” Panel in the “Report and recommendations made by the Panel of Commissioners concerning part two of the first instalment of claims by Governments and international organizations (category ‘F’ claims)” (the “Second ‘F1’ Report”).<sup>175</sup> The Government originally valued its additional loss at USD 9,631,772,814 up to and including 30 September 1995, and estimated the daily interest accruing after 30 September 1995 at USD 7,487,225.<sup>176</sup>

558. In most of the Government’s claims as originally filed,<sup>177</sup> a claim for interest was calculated for the period from 26 February 1991 to 1 May 1994. The claimants each noted that one start date was selected to facilitate the calculation of interest (recognizing that to identify the date of actual loss for each loss element would not have been practical), and to recognize the fact that most Government losses “occurred near the end of the occupation or during liberation”. The end date of 1 May 1994 was selected, as “it was a date by which the Commission would not yet have processed and ruled on any of the government claims”.

559. Having noted that both the category “A” and the “C” Panels had recommended that interest be paid on all compensable damages from 2 August 1990 since “all compensable damages may be deemed to have been caused by Iraq’s unlawful invasion of Kuwait, which commenced on 2 August 1990”, the Government submitted in the Supplemental Interest Claim that interest on the category “F” claims should also run from 2 August 1990.

560. Having also noted that the Government’s claims had not yet been reviewed by the Commission, the Government used 30 September 1995, the date upon which the Supplemental Interest Claim was filed, as an end date for the purpose of the calculation of the interest, and presented a separate claim for daily interest thereafter, “until the date of payment of the Commission’s award”.

561. The Government therefore computed its additional loss by calculating interest for the period of 2 August 1990 to 30 September 1995 for each of the claims and by subtracting the interest already claimed within each of the Government claims. A simple rate of 5 per cent was used. The Government of Kuwait argued that “the best measure of the cost of money to the state of Kuwait ... is the rate which the State of Kuwait had to pay for its USD 5.5 billion borrowing from a syndicate of banks just after the liberation of Kuwait”.

562. The Panel first considered the provisions of Governing Council decision 16, which addresses the question of interest on the Commission’s awards of compensation, in paragraphs 98 to 102 of the First “F3” Report. The Panel construed the effects of Governing Council decision 16 to mean that the Governing Council will address the methods of calculation and payment of interest in the future, and therefore that the Panel has to determine only the date from which interest is to run.

563. The Panel duly selected 26 February 1991 as the date from which interest is to run for all “F3” claims, for the reasons set out in paragraphs 99 to 101 of the First “F3” Report. The Panel noted an exception to that determination in paragraph 344 of that report.

564. In paragraph 76 of the Second “F1” Report, the “F1” Panel selected 16 November 1990 as the date of loss for the purpose of interest calculation for the two Government claims before it.

565. The Panel finds that:

(a) The claim for interest for the period 2 August 1990 to 26 February 1991 relates to a period before any date that the Panel has selected for “F3” claims as the dates of loss for the purposes of calculation of interest under Governing Council decision 16;

(b) The claim for interest for the period 2 August 1990 to 16 November 1990 relates to a period before the date that the “F1” Panel has selected for the relevant “F1” claims as the date of loss for the purposes of calculation of interest under Governing Council decision 16;

(c) The Supplemental Interest Claim seeks compensation for losses that, to the extent that they may be direct losses and that they arise after the dates selected by the relevant panels as the dates of loss for the purposes of the calculation of interest, fall within Governing Council decision 16; and

(d) The Panel has previously made the sole determination it has to make in respect of claims for interest on “F3” claims, which is the determination of the dates of loss for the purposes of calculation of interest under Governing Council decision 16.

566. In light of the above, the Panel does not recommend any compensation in respect of the Supplemental Interest Claim.

### XIII. MISCELLANEOUS (“POW CLAIM”)

567. In paragraphs 326 to 344 of the First “F3” Report, the Panel considered the National Committee for Missing and Prisoner of War’s Affairs (the “COM Committee”) claim (UNCC claim No. 5000169). The COM Committee was created in May 1991 to care for the affairs of the individuals still missing after the liberation of Kuwait, 625 of whom the COM Committee believes were taken prisoner by Iraq, and 595 of whom remained missing as of 1 February 1996 (the “Missing”). The COM Committee in its claim sought compensation for payment or relief to others and public service expenditures, together with interest.

568. One element of the claim was made in respect of the cost of the salaries of those of the individuals referred to above who were Government employees. The costs arise because the COM Committee continues to pay the individuals’ salaries into trust accounts for them. The Panel found that it was unable to consider that claim, because, as the Panel set out in paragraph 339 of the First “F3” Report:

“Under paragraph 1(b) of [Governing Council] decision 12 [(S/AC.26/1992/12)], ‘claims of individuals ... who have been detained in Iraq’ may be submitted within one year of the detainee’s release or death (as legally determined by the detainee’s Government), but not later than the time limit set out in paragraph 2 of the decision. The claims of the Missing cannot yet be filed under paragraph 1(b) of [Governing Council] decision 12 because the Missing have not yet been released and their death has not been legally determined by the Government of Kuwait. Therefore, the Missing have not suffered a loss within the ‘criteria adopted by the Council’.”

569. The Panel notes that, as at the date of signature of this report, it has no further evidence before it that demonstrates that the Missing have been released, nor has the Government legally determined that they are deceased.

570. Accordingly, the Panel remains unable to consider the claim for the cost of the salaries described above. The Panel has therefore directed the secretariat to remit the claim to the Registrar of the Commission for further consideration in due course, noting, as it did in paragraph 340 of the First “F3” Report, that the Missing can file claims for their losses under paragraph 2 of Governing Council decision 12 (or claims can be filed on their behalf), even after the Panel has completed its review of the “F3” claims.<sup>178</sup>

## XIV. SUMMARY OF RECOMMENDATIONS

571. The following is a summary showing, for each third instalment part three claim, the principal claim amount and the Panel's recommended award.

Table 14. Summary of the principal claim amount and the Panel's recommendation for each third instalment part three claim<sup>179</sup>

<u>Claimant</u>	<u>UNCC claim No.</u>	<u>Principal claim amount (USD)</u>	<u>Recommendation (USD)</u>
Kuwait Investment Authority	5000158	63,255,495,278	1,507,604,000
Supplemental Interest Claim	5000184	9,605,117,360 <sup>a</sup>	Nil
<u>Total</u>		72,860,612,638	1,507,604,000

<sup>a</sup> Plus the daily amounts set out in table 13 above.

572. The Panel respectfully submits this report, pursuant to article 38(e) of the Rules, through the Executive Secretary to the Governing Council.

Geneva, 18 December 2002

(Signed) L. Yves Fortier, Q.C.  
Chairman

(Signed) Andrew Jacovides  
Commissioner

(Signed) Reiner Soll  
Commissioner

Notes

<sup>1</sup> The Panel's previous reports and recommendations to the Governing Council in respect of the "F3" claims can be found in the "Report and recommendations made by the Panel of Commissioners concerning the first instalment of 'F3' claims" (S/AC.26/1999/24) (the "First 'F3' Report"), the "Report and recommendations made by the Panel of Commissioners concerning the second instalment of 'F3' claims" (S/AC.26/2001/7) (the "Second 'F3' Report"), the "Report and recommendations made by the Panel of Commissioners concerning part one of the third instalment of 'F3' claims" (S/AC.26/2002/8) (the "Third 'F3' Report Part One"), and the "Report and recommendations made by the Panel of Commissioners concerning part two of the third instalment of 'F3' claims" (S/AC.26/2002/19) (the "Third 'F3' Report Part Two"). The Panel refers to the "F3" claims reported in these reports as the "first instalment claims", the "second instalment claims", the "third instalment part one claims" and the "third instalment part two claims" respectively.

<sup>2</sup> A text of which is annexed to Governing Council decision 10 (S/AC.26/1992/10) of 26 June 1992.

<sup>3</sup> The Panel notes that paragraphs 12 and 21 of Governing Council decision 114 (S/AC.26/Dec.114 (2000)) of 7 December 2000, provide that certain claims as described therein should be the subject of oral proceedings and of a separate report containing the Panel's recommendations into each such claim. The Panel therefore split the third instalment claims into parts so as to comply with the provisions of Governing Council decision 114. The Panel grouped the claims into such parts according to the issues that they raise.

<sup>4</sup> Governing Council decision 35 provides that "[w]ith respect to claims requiring additional proceedings under articles 36 and 38(d), the panel shall determine whether it requires time in excess of that available under article 38(d) to complete its review of the claims and the report and recommendations to the Governing Council. If the panel determines that such excess time is required, this determination shall be considered a request to the Governing Council for additional time pursuant to article 39. The Governing Council hereby approves up to six additional months in that event. A panel that avails itself of such additional time shall so inform the Governing Council through the Executive Secretary."

<sup>5</sup> See further paragraphs 87 to 88 of this report.

<sup>6</sup> The later of which was approved during the course of the Panel's review of the third instalment claims.

<sup>7</sup> See note 1 above.

<sup>8</sup> Notably, "Report and recommendations made by the Panel of Commissioners concerning the first instalment of individual claims for damages up to US\$100,000 (category 'C' claims)" (S/AC.26/1994/3), at part II, section D.

<sup>9</sup> Paragraph 9 of Governing Council decision 15 states that: "The duty to mitigate applies to all claims."

<sup>10</sup> See, in particular, articles 35, 37 and 38 of the Rules.

<sup>11</sup> The Panel has considered the three periods during which a document may have come into existence: prior to Iraq's invasion of Kuwait; during the occupation and emergency periods; and thereafter. The Panel accepts that the number and quality of documents, which may be expected to exist, will vary according to each such period.

<sup>12</sup> The discretion is conferred by articles 35(3) and 38 of the Rules.

<sup>13</sup> A number of “F3” claims, though none of the third instalment part three claims, also contains an engineer’s report. The Panel does not consider the terms of those reports further in this report.

<sup>14</sup> The KERP programme is described in paragraph 52 of the Second “F3” Report, as “a procurement programme set up in December 1990 and managed by the Council of Ministers. KERP was initially operated from an office in Washington, D.C., United States of America and later moved to Dammam, Saudi Arabia. The purpose of KERP was to procure supplies of medicine, food, water, fire-fighting equipment, bomb disposal equipment, transportation vehicles and other goods and related services that the Government anticipated would be required following the liberation of Kuwait. The repair of some damaged facilities was also undertaken pursuant to KERP. The contracts for the vast majority of KERP’s procurements of goods and services were entered into before liberation. The remainder was entered into during the emergency period or shortly thereafter.” KERP handed property to various other Government entities, and the Panel considered whether adequate account had been taken of the residual value of that property. In appropriate cases, the Panel made adjustments for “incorrect valuation of KERP assets”, as further described on the Second and subsequent “F3” Reports.

<sup>15</sup> Where it can be established that expenses were saved as a result of damage to or destruction of assets, adjustments should be made to reflect this.

<sup>16</sup> The GRF is a source of funds to operate the Government. The funding for and spending under the Government’s budget, including contributions to the FGF, pass through the General Reserve Fund.

<sup>17</sup> Pursuant to Law No. 106 of 1976 of Kuwait (the “FGF Law”).

<sup>18</sup> Pursuant to the FGF Law. See further paragraph 58 of this report regarding the suspension of such prohibition.

<sup>19</sup> During the period of Iraq’s occupation of Kuwait, an Amiri decree was issued that required all of Kuwait’s resources to be available to liberate Kuwait and bring about the recovery of Kuwait.

<sup>20</sup> The liquidations continued until the end of 1996 but the losses thereon are not claimed.

<sup>21</sup> The Panel notes that the borrowings, described in the next section, were also undertaken in the same period.

<sup>22</sup> The Panel notes that the sums raised using such derivatives transactions are not part of the borrowings. They are part of the Liquidated Amounts.

<sup>23</sup> The Panel notes that this supplement was filed in timely fashion and that the increase in the amount claimed was permitted under the Rules.

<sup>24</sup> The Panel notes that there may be no capital appreciation during certain periods.

<sup>25</sup> KIA has not claimed for any losses arising from disposals of unquoted securities or assets other than securities.

<sup>26</sup> The Panel considers the submission of such evidence and its evaluation of the losses in paragraphs 464 to 471 of this report.

<sup>27</sup> See also paragraph 7 of this report.

<sup>28</sup> With the exception of the SI claim, which was filed in September 1995.

<sup>29</sup> See paragraph 393 of this report concerning the claim filed by the Kuwait Airways Corporation, UNCC claim No. 4004694.

<sup>30</sup> See paragraph 23 of this report.

<sup>31</sup> The Panel also took into account the “Report of the Secretary-General on the scope and nature of the damage inflicted on the Kuwaiti infrastructure during the Iraqi occupation” (S/22535), which sets out in detail (at paragraph 370 and following) the level of damage and destruction found after liberation. The report noted that the damage, while generally minor from a structural point of view, included significant damage to walls and installations. It also noted widespread vandalism and looting of equipment and furnishings.

<sup>32</sup> See previous “F3” reports.

<sup>33</sup> The Panel notes that such underlying claims have been filed in subcategories “E1”, “E4”, “F1” and “F4” as well as the “F3” claims.

<sup>34</sup> The Panel notes that some tribunals have awarded compensation for the financial burden assumed by the injured party in putting right the wrong suffered. In one case concerning an oil spill, for example, the Government of France financed the cleanup of its shores soiled by an oil spill and the United States Court of Appeals for the Seventh Circuit held that “[v]ictims who finance their own cleanup lend to themselves; forced to devote money to a project not of their own choosing (money they otherwise could have lent out at the market rate of interest), they are entitled to compensation for the ‘hire’ of this capital.” (Oil Spill by the Amoco Cadiz off the Coast of France on March 16, 1978, 954F. 2d 1279 at 1331 (United States Court of Appeals for the Seventh Circuit 1992)).

<sup>35</sup> See paragraph 115 of this report for a discussion of the items excluded from compensation by a decision of the Governing Council.

<sup>36</sup> Notably because the Panel does not have evidence as to the ultimate application of the relevant Funds Raised.

<sup>37</sup> The claims concerned are:

<u>Claimant</u>	<u>Panel</u>	<u>UNCC claim No.</u>
Kuwait Aviation Fuelling	“E1”	4003067
Kuwait Oil Tanker Co	“E1”	4003068
Kuwait Foreign Petroleum Exploration	“E1”	4003086
Kuwait Drilling Co	“E1”	4003178
Kuwait Santa Fe	“E1”	4004159
Kuwait Petroleum Corp (claims preparation cost)	“E1”	4004232
Kuwait Real Estate	“E4”	4005047
Kuwait Ports Authority	“E4”	4003566

The Panel notes that the Government has submitted over 30 claims in respect of environmental losses, which the Commission has classified as category “F4” claims, and which remain to be reviewed by the Commission. The Panel finds that there was no expenditure on the losses in such claims disbursed during the expenditure period beyond that that will be compensated through the mechanism of Governing Council decision 16 and accordingly does not consider such claims further in this report. The “F4” claims that the Commission has resolved are set out in table 9 of this report.

<sup>38</sup> See paragraphs 43 to 45.

<sup>39</sup> The Panel found in paragraph 15 of the Second “F3” Report and paragraph 67 of the Third “F3” Report Part Two that the exclusion from compensation so far as Kuwait is concerned extends to the costs to the Government of its preparation for, participation in, or provision of support in relation to, the activities of the Allied Coalition Forces and their military response to Iraq’s invasion and occupation of Kuwait.

<sup>40</sup> The Panel considers the extent to which the Government may have received a return on the Funds Raised that should be brought into account when considering the amount of such losses in paragraph 411 of this report.

<sup>41</sup> By “additional” in this context, the Panel means income or revenue beyond that that would have been earned absent Iraq’s invasion and occupation of Kuwait.

<sup>42</sup> The Panel has found in all relevant cases that the replacement of the destroyed building was a reasonable and foreseeable course of action.

<sup>43</sup> Case concerning the Factory at Chorzów (Germany v. Poland), Judgment No. 13, 1928, Permanent Court of International Justice, Series A, No. 17, p. 47.

<sup>44</sup> In particular, the Panel will consider the time periods over which such losses may extend and the extent to which they may duplicate the claims for interest in the underlying losses claimed. The Panel recalls that claims for interest will be considered by the Governing Council under its decision 16, the terms of which are set out in paragraph 168 of this report.

<sup>45</sup> That is, the Panel finds that sums expended to the extent of awards of compensation and to the extent of involuntary betterment could not reasonably have been avoided and the losses incurred in funding both those sums are therefore, in principle, compensable.

<sup>46</sup> By which term the Panel means the amount of the loss before adjustments for involuntary betterment, but after any other adjustments.

<sup>47</sup> “Relevant” underlying losses are those funded by the Funds Raised.

<sup>48</sup> The voluntary betterment is that which was identified in the underlying claims.

<sup>49</sup> Or, in the case of the Funds Borrowed, upon which payments of the Borrowing Costs were made.

<sup>50</sup> The Panel notes that such dates will be the date of payment of the award in respect of those direct financing losses for which the Panel recommends compensation, and the date of payment of interest for those direct financing losses that will be compensated through the mechanism of Governing Council decision 16.

<sup>51</sup> Such losses may cease before the normal replacement date if compensation is in fact awarded and paid before that date. See further paragraphs 438 to 442 of this report.

<sup>52</sup> The Panel addresses the issue of direct financing losses that will be compensated through awards of interest, which may extend beyond the claim period, in paragraph 364(c) of this report.

<sup>53</sup> Subject to the matters set out in paragraphs 148 and 149 of this report. See also section VII.E.11 of this report.

<sup>54</sup> Subject to the question of the interaction between the Portfolio Loss and Borrowing Costs claims and claims for interest in the underlying claims, considered in paragraphs 163 to 177 and section VII.F.3.(g) of this report.

<sup>55</sup> See McCullough & Co, Inc. v. Ministry of Post, Tel. & Tel., 11 Iran-U.S. Cl. Trib. Rep. at 29 cited in John Y. Gotanda, Supplemental Damages in Private International Law at 13 (1998). See also Dan B. Dobbs, Handbook on the Law of Remedies section 3.5 at 164 (1973) and Sylvania Technical System v. Iran, 8 Iran-U.S. Cl. Trib. Rep. at 320.

<sup>56</sup> The loss of use of the principal amount of the award encompasses the loss of use of the building.

<sup>57</sup> Interest pursuant to Governing Council decision 16 will be paid irrespective of whether claimants in fact presented claims for interest.

<sup>58</sup> The provision is therefore to be contrasted with some other tribunals, which have interest provisions to the effect that interest “may” be awarded. The Panel construes these other provisions to mean that the relevant principal award may encompass financing losses, such that there is no need to award interest on the underlying loss.

<sup>59</sup> Similarly, article 38(2) of the Articles on the Responsibility of States for Internationally Wrongful Acts (International Law Commission, A/CN.4/L.602/Rev.1) (the “ILC Articles”) provides that “[i]nterest runs from the date when the principal sum should have been paid until the date the obligation to pay is fulfilled.”

<sup>60</sup> Also known as pre-award or compensatory interest, and post-award or moratory interest, respectively. The latter is frequently awarded at a statutory rate.

<sup>61</sup> The relevant provisions of some tribunals state that interest from the date of loss until the date of an award is to be part of the award itself, and that interest on the award, which may be required in some jurisdictions, is payable on the award.

<sup>62</sup> The Panel notes that a Receiving Entity’s loss ends upon the receipt of funds from KIA, and that KIA’s losses commence when those funds are raised. See further paragraph 335 of this report.

<sup>63</sup> Interest pursuant to Governing Council decision 16 will also be awarded on the KIA award.

<sup>64</sup> In the case of the losses claimed by KIA and the claims for interest in the underlying claims, and in so far as they arise from the funding of principal amounts of awards in the underlying claims, the Panel has found that both the claims for interest in the underlying claims and the Portfolio Loss and the Borrowing Costs claims seek compensation (among other things in the case of the Portfolio Loss and the Borrowing Costs claims) for losses that arise because of the delay in payment of compensation in respect of the underlying losses. The Panel’s detailed discussion of these issues is set out in section VII.F.3(g) of this report.

The Panel has further found that all claims that seek compensation for losses that arise because of the delay in payment of compensation do not fall within the Panel's jurisdiction, and will be considered by the Governing Council in the application of decision 16 at the appropriate time. Accordingly, the Panel has excluded all direct financing losses claimed within the Portfolio Loss and the Borrowing Costs claims that arise from the delay in payment of compensation for the underlying claims from the Panel's recommendations for compensation in respect of the Government's direct financing losses.

<sup>65</sup> Claims for interest on losses are normally compensated by reference to standard rates of interest. The Panel notes that claims for interest are not separate and distinct heads of claim.

<sup>66</sup> The Panel's verification and valuation programmes are described in sections IV.B and VII.G of this report.

<sup>67</sup> The Panel notes that investments held in a particular fund are regularly bought and sold, but any such transactions do not constitute relevant liquidations for the purposes of this report.

<sup>68</sup> See paragraphs 70 and 71 of this report.

<sup>69</sup> Citing Professor Bin Cheng, *General Principles of Law as applied by International Courts and Tribunals*, London, 1953.

<sup>70</sup> Iraq cites, *inter alia*, "Sylvania Technical System v. Iran, 1985, *op. cit.*", in support of this statement.

<sup>71</sup> Paragraph 19 of that resolution sets out that the mechanism for determining the appropriate level of Iraq's contribution to the Commission's compensation fund will "tak[e] into account the requirements of the people of Iraq, Iraq's payment capacity as assessed in conjunction with the international financial institutions taking into consideration external debt service, and the needs of the Iraqi economy".

<sup>72</sup> The Panel notes that the "but for" test of causation has been rejected by other panels of Commissioners, including the category "C" Panel of Commissioners considering the Egyptian Workers' Claim. In paragraph 214 of the Egyptian Workers Report S/AC.26/1995/R.20/Rev.1 that Panel said "For a direct link to exist, the Panel initially holds that it is not sufficient that a loss would not have occurred had the invasion and occupation not taken place. With such a 'but for' test, sometimes also referred to as factual causation, any loss that could be traced back through a causal chain to the invasion and occupation would be compensable. This would be a wider standard than the one laid down in resolution 687 according to which only losses resulting directly from the invasion and occupation are compensable, and a 'but for' test could at best serve as a rule of exclusion."

<sup>73</sup> Cited at paragraph 133 of this report.

<sup>74</sup> Indeed, no loss arising from such use of funds can be presumed. It is only by examining the application of the Funds Raised that it can be seen that the Funds Raised were not re-invested in assets capable of generating investment returns equivalent to those that would have been earned had they remained in the FGF.

<sup>75</sup> The Panel refers the reader to section VII.F.3(g) of this report, in which the Panel considers the extent to which the Portfolio Loss and the Borrowing Costs claims are claims for late payment of compensation and fall within the claims to be considered by the Governing Council under its decision 16.

<sup>76</sup> The Panel addresses the issue of amounts spent in funding direct losses that may exceed the amounts of compensation awarded by the Commission in respect of such losses in section VII.F.3(d) of this report.

<sup>77</sup> The Panel notes that the funding of direct losses includes the use of some of the Amounts Liquidated and/or the Funds Borrowed to replace Government revenue, the loss of which has been claimed before the Commission and in respect of which the Commission has made awards of compensation.

<sup>78</sup> Notably because the Panel does not have evidence as to the ultimate application of the relevant Funds Raised.

<sup>79</sup> The Panel addresses claims that have been filed with the Commission, but not yet reviewed by a panel of Commissioners, in paragraph 114 of this report.

<sup>80</sup> See paragraph 58 of this report.

<sup>81</sup> The Panel notes that the evidence before it does not demonstrate that all the Funds Raised were in fact expended on the losses in respect of which the Receiving Entities submitted claims to the Commission.

<sup>82</sup> The Panel notes that it has routinely, as have other panels, accepted evidence submitted by claimants in similar situations. See, for example, paragraph 366 of “Report and recommendations made by the Panel of Commissioners concerning the second instalment of ‘E1’ claims” (S/AC.26/1999/10).

<sup>83</sup> See paragraphs 139 and 140 of this report.

<sup>84</sup> See section VII.E.7 of this report.

<sup>85</sup> Descriptions of such adjustments are found at paragraph 49 of this report. Adjustments reflect a variety of matters, such as overstatement or the risk thereof, and incidental gains. A panel may accordingly be satisfied that a claimant in fact expended more in funding a direct loss than it may receive in compensation for that loss.

<sup>86</sup> KIA adds that “[a]warding such profits to KIA is also more consistent with the international and municipal law authorities that afford a victim such as Kuwait great latitude in establishing the amount of its damages. See Jack Gill v. United Mexican States, 5 R.I.A.A. 157 (1931) ... Bigelow v. RKO Radio Pictures, 327 U.S. 257, 265 (1946)”.

<sup>87</sup> Kuwait cites Harbutt’s ‘Plasticine’ Ltd. v. Wayne Tank & Pump Co., (1970) 1 Q.B. 447, 473.

<sup>88</sup> Kuwait argues that making adjustments is contrary to international humanitarian law, and that the wrongdoer has no right to set off against compensation due for either direct losses, or the expenses incidental to carrying through its unlawful act.

<sup>89</sup> See paragraph 133 of this report.

<sup>90</sup> Alexandra et Spasenije Pritza c. Dame Kathi Fahry (Yugoslavia v. Germany), II Recueil des décisions des tribunaux arbitraux mixtes (1923) 668, cited in Marjorie M. Whiteman, Damages in International Law, (Washington, D.C., United States Government Printing Office, 1937), vol. II, p. 937.

<sup>91</sup> In James Street Hardware & Furniture Co. v. Spizziri (1987), 43 CCLT 9, (“James Street”) (also reported at (1988) 62 OR (2d) 385), (Ontario Court of Appeal, obiter, in which the Court also stated that “[w]e add the reservation that, where the plaintiff alleges a loss with respect to being required to make an unexpected expenditure, the onus of proof with respect to it should lie on him or her”).

<sup>92</sup> S. D. Waddams, The Law of Damages, (Toronto, Canada Book Inc., December 2000), paragraph 1.2730.

<sup>93</sup> In Upper Lakes Shipping Ltd. v. St Lawrence Cement Inc. (1992), 89 DLR (4th) 722, (“Upper Lakes”), the Ontario Court of Appeal, applying the obiter comments from James Street (op. cit.).

<sup>94</sup> Upper Lakes, (op. cit.), at p. 725.

<sup>95</sup> That is, those adjustments made in the underlying claims.

<sup>96</sup> See paragraph 49 of this report.

<sup>97</sup> This programme is described in note 14 above.

<sup>98</sup> The Panel notes that adjustments for “incorrect valuation of KERP assets” are adjustments for a particular “inadequate accounting for residual value”.

<sup>99</sup> Adjustments for “amounts claimed in excess of those allowed under the UNROP agreement” and “inadequate accounting for UNROP returned property” are adjustments for a particular “overstatement”.

<sup>100</sup> Kuwait cites in support of these statements “C. McCormack, Handbook on the Law of Damages, 221 (1935)” and Dan B. Dobbs, Law of Remedies, 2nd edition (St. Paul, Minnesota, West Publishing Co., 1993), 5.15(2), in which it is said that “[w]hen the plaintiff’s chattel was converted and sometimes when it was destroyed beyond repair, courts historically allowed interest on the value of the chattel as the measure of damage for loss or use, and usually rejected alternate measure such as rental value.” Kuwait also cites Sedco, Inc. v. Iran, Iran-United States Claims Tribunal Reports Claims Tribunal Reports (Cambridge, Grotius) (“Iran-U.S. C.T.R.”), vol. 15 (1988), p. 23.

<sup>101</sup> KIA also states, “[w]hen an owner of property has at some earlier time lost the value of his asset but has not received the monetary equivalent that then became due to him, the amount of compensation should reflect, at least in part, the additional sum that his money would have earned, had it, and the income generated by it, been reinvested each year at generally prevailing rates of interest ... it is a mechanism to ensure that the compensation awarded the Claimant is appropriate in the circumstances”.

<sup>102</sup> The Panel notes that these submissions were made concerning pre-judgment interest, but the Panel finds that they pertain to awards of interest generally.

<sup>103</sup> The Panel notes that Kuwait acknowledged this point, but that the funding of the Ministry’s loss “created a new distinct loss to ... KIA”.

<sup>104</sup> Or transaction costs and interest, in the case of the Funds Borrowed.

<sup>105</sup> The Panel further notes that some of the funds have been claimed by the Ministry (the sum of 300 in the working example). See, also, paragraph 60 of this report.

<sup>106</sup> Notably, given short-term fluctuations in the values of equities and bonds.

<sup>107</sup> The Panel construes Governing Council decision 16 to mean that loss of use of principal amounts of awards will be compensated only through the mechanism of that decision, in amounts to be assessed solely by the Council.

<sup>108</sup> The Panel notes that there are certain authorities that provide that compensation for certain unliquidated damages may not be due until a later date (when they can be ascertained), but does not consider that such authorities apply to the underlying claims.

<sup>109</sup> Such loss of use is a loss of use of the principal amount of the award, and will therefore be compensated by an award of interest under Governing Council decision 16.

<sup>110</sup> The Panel considers the possible overlap of the loss of use of the funds and of the loss of use of the building in paragraph 336 of this report.

<sup>111</sup> The Panel notes that, in some cases, the payment of compensation for the underlying loss and interest on that loss (to compensate for loss of use in the principal amount of the relevant award) may take place after the normal (non-invasion) replacement date for that asset. The period in respect of which interest is paid may therefore exceed the relevant period of loss. There is, therefore, a risk that the claimant may be overcompensated if the amount of interest paid exceeds the amount of losses in fact sustained by reason of loss of use of the principal amount of the award and any other uncompensated but direct loss (such as those described in paragraphs 336 and 337 of this report). That risk cannot be quantified until the rate of interest is set by the Governing Council and the Panel does not therefore consider it further.

<sup>112</sup> It is also the Panel's expectation that the awards made to the Receiving Entities would be transferred to KIA.

<sup>113</sup> Subject to the limits on compensation set out in paragraphs 148 and 149 of this report.

<sup>114</sup> See section IV.B of this report.

<sup>115</sup> The Panel notes that the level of materiality was set by reference to the direct funding requirement for each head of claim in the underlying claims.

<sup>116</sup> The Panel notes that its review includes applying the application of the specific verification and valuation programme, described in this section of the report, to each head of claim in each underlying claim.

<sup>117</sup> The Panel notes that KIA has not sought compensation for losses that may arise after 30 June 2003.

<sup>118</sup> See paragraph 51 of this report.

<sup>119</sup> See paragraph 114 of this report regarding unadjudicated claims.

<sup>120</sup> The Panel notes that the Government may have sustained direct financing losses in respect of lost profits from Kuwait Oil Tanker Co (SAK) ("E1" claimant, UNCC claim No. 4003068), but this claim has not yet been reviewed by the "E1" Panel and falls within the group of claims described in

paragraph 114 of this report. The Panel notes that the Government may have sustained financing losses in respect of lost profits from KAC, but, as KAC has not filed a claim for such lost profits with the Commission, the Panel finds that there is insufficient evidence of relevant underlying losses, and therefore any financing losses sustained by the Government.

<sup>121</sup> The reason that there is no such excess is that there were no adjustments made for involuntary betterment in the relevant underlying claims, and so no funding gap arises in these claims.

<sup>122</sup> Defined in paragraph 108 of this report.

<sup>123</sup> See paragraph 42 of this report for a definition of these terms.

<sup>124</sup> In essence, therefore, part of the involuntary betterment adjustments in the underlying claims may be treated as an adjustment for insufficient evidence, and, if so, will be excluded from the amounts of involuntary betterment that form the basis of direct financing losses.

<sup>125</sup> The Panel has treated those accounts as sufficient evidence of the Government's total revenue and expenditure position.

<sup>126</sup> The Government's revenue loss is the amount of lost profits that were ordinarily distributed to the Government by the relevant entity. In some cases the entities retained a proportion of their profits as reserves, and so the Government's lost revenue does not always equal the underlying entities' lost profits in cash terms.

<sup>127</sup> Direct financing losses arising in respect of any proportion of awarded lost profits that was ordinarily retained and not distributed to the Government will be compensated through the mechanism of Governing Council decision 16.

<sup>128</sup> The responses to Procedural Order No. 63 did not address heads of claim, or parts thereof, that had been found not to be losses that are compensable in principle.

<sup>129</sup> In other words, all amounts adjusted by the Panel except for involuntary betterment, as defined in paragraph 141 of this report.

<sup>130</sup> For example, if the remaining sum of 200 were spent after the expenditure period.

<sup>131</sup> The Panel notes that the expenditure is presented and considered not simply as a total amount spent in funding direct losses, but as an amount spent in funding direct losses during each year of the expenditure period.

<sup>132</sup> The measure of direct losses excludes amounts of voluntary betterment, as such amounts do not themselves constitute losses, as set out more fully in paragraph 148 of this report.

<sup>133</sup> A ceding agreement is an agreement by two entities for one to settle the other's liability with an unconnected third party by the payment of an amount directly to that third party. The effect of such an agreement releases a similar level of indebtedness between the two original entities.

<sup>134</sup> The Panel notes that such dates will be the date of payment of the award in respect of those direct financing losses for which the Panel recommends compensation, and the date of payment of interest for those direct financing losses that will be compensated through the mechanism of Governing Council decision 16.

<sup>135</sup> See paragraphs 153 to 158 of this report.

<sup>136</sup> The KERP claim is described in note 14 above.

<sup>137</sup> The Panel notes that, in such cases, the involuntary betterment arises commonly as the amount of residual value that the claimants should take into account at the end of the relevant period of use.

<sup>138</sup> See paragraph 398 of this report.

<sup>139</sup> Subject to the qualification described in paragraph 409 of this report.

<sup>140</sup> The Panel notes that the “relevant Amounts Liquidated” and the “relevant Funds Borrowed” comprise the sum of the Amounts Liquidated and Funds Borrowed that were disbursed in funding direct losses.

<sup>141</sup> Banco de Portugal v. Waterlow & Sons Ltd., (1932) A.C. 452, 506 [HL].

<sup>142</sup> The Panel also notes that the credit facilities were entered into after Operation Desert Storm was complete, and so is satisfied that the Funds Borrowed were not expended in connection with that operation.

<sup>143</sup> The Panel recalls that the Funds Borrowed were fully repaid by 31 December 1999, as more fully set out in paragraph 84 of this report.

<sup>144</sup> By analogy, the relevant proportion of the Borrowing Costs claim should be valued, as Kuwait submitted, as the “total amount of money disbursed to pay the costs of KIA’s international borrowings”.

<sup>145</sup> In some cases, outperforming the world market indices.

<sup>146</sup> The Panel notes that the total funding requirement could have been satisfied without the use of the funds temporarily raised through the derivatives transactions, and that it is not possible to ascertain the net costs of those transactions from the evidence available. Accordingly, the Panel has not adjusted the composite financing rate to take account of any amounts raised through derivative transactions. Further, the Panel has also considered whether there were any returns or income earned on the property repaired or replaced that should be set against the direct financing losses. The Panel finds that there were no returns or income in excess of those that would have accrued had Iraq not invaded and occupied Kuwait and, accordingly, that the composite financing rate does not need to be adjusted to take account of such returns or income.

<sup>147</sup> The Panel notes that the useful life of the items of property concerned extends from 1 to 40 years, but that the claim does not seek compensation for losses sustained beyond 30 June 2003. Accordingly, the periods in respect of which the Panel recommends compensation do not exceed 13 years in any case.

<sup>148</sup> The Panel notes that this measure of compensation does not fully reflect the Government’s financing losses, in that it includes claims for which no financing cost arose, and that it excludes elements of direct losses that give rise to direct financing losses.

<sup>149</sup> These amounts include the funding gap amounts to be expected for the claims that have not yet been adjudicated. See paragraph 114 of this report.

<sup>150</sup> KIA originally claimed USD 8,648,034 for “Income-producing property”. KIA informed the Panel that, since submission of its claim, one of its Managers had filed a category “E” claim that

duplicated KIA's claim for loss of revenue from properties managed by that Manager. Therefore KIA withdrew its claim in respect of that loss in the amount of USD 2,421,598. The Panel is satisfied that there is no duplication between this claim and the category "E" claims submitted by the other four Managers.

<sup>151</sup> The Panel notes that in respect of properties managed by three of the Managers, KIA claimed for loss of revenue for a lesser period. In respect of properties managed by two Managers, that period was from 1 August 1990 to 30 September 1991 and in respect of properties managed by another Manager, the period was from 1 August 1990 to 31 December 1992.

<sup>152</sup> See further paragraph 51 of the First "F3" Report.

<sup>153</sup> At note 65 to the Third "F3" Report Part One, the Panel referred to the decision of the "D1" Panel in the "Report and recommendations made by the 'D1' Panel of Commissioners concerning the seventh instalment of individual claims for damages above USD 100,000 (category 'D' claims)" (S/AC.26/2000/25), at paragraph 22 and noted that it is implicit in this and other decisions of the "D" Panels about claims for lost rental income that it was not demonstrated to the satisfaction of those Panels that the continuing reduction in Kuwait's post-liberation population after 1 August 1991 was the direct result of Iraq's invasion and occupation of Kuwait.

<sup>154</sup> Paragraph 52 of the First "F3" Report.

<sup>155</sup> See paragraph 433 of the First "F3" Report, in which the Panel considered the claim for loss of rental revenue submitted by the Ministry of Awqaf and Islamic Affairs.

<sup>156</sup> The Panel considered KIA's response to Procedural Order No. 45, issued 3 April 2001, to elicit further information about the causes of KIA's loss of revenue. KIA's response indicated that damage to the relevant properties as a result of Iraq's invasion and occupation of Kuwait was not severe and that all of the Managers resumed operations by 1 July 1991.

<sup>157</sup> The Panel has made corrections to arithmetical errors that it found in reviewing this claim.

<sup>158</sup> Paragraph 38 of the First "F3" Report.

<sup>159</sup> As a result of Iraq's response to Procedural Order No. 1 in relation to the claim of the Ministry of Interior (UNCC claim No. 5000137), the Panel made enquiries in relation to the extent to which the employees had received payment of their salaries in advance prior to the invasion. The Panel also notes that a few employees who received relief payments retrospectively also received payment for work done during the relevant period. The Panel has, in arriving at the percentage deduction to the claims for relief paid to employees set out in paragraph 516 of this report, taken into account the advance payments and the payments for work done.

<sup>160</sup> The Panel has considered the nature of economic activity in Kuwait and has concluded that this situation is explained by the fact that many Kuwaitis are owners or part-owners of businesses from which they derive income in addition to their salaried employment.

<sup>161</sup> The relief provided by the Government of Kuwait covered such items as living expenses while outside Kuwait, the provision of free utilities within Kuwait (by the forgiveness of payment therefor), the forgiveness of consumer debt, the forgiveness of certain rental payments, the distribution of free food, and the payment of a grant to each Kuwaiti individual who remained in Kuwait during the occupation period.

<sup>162</sup> The Panel notes that the response was compiled using Government of Kuwaiti national accounts and statistics and on the basis of certain assumptions regarding income and expenditure patterns, and has made suitable allowance for the use of such techniques in quantifying its findings.

<sup>163</sup> Amounts provided for living expenses outside Kuwait during the period (under a programme set up by MoF and the subject of UNCC claim No. 5000112) were paid in respect of additional living expenses and do not comprise “compensation received elsewhere”. Further, the Panel has not included in its consideration any relief provided for losses other than loss of income, such as relief in respect of loss of amenity, again to ensure that compensation is based upon the employees’ true financial losses.

<sup>164</sup> See paragraph 511 of this report.

<sup>165</sup> A large percentage of the 60 per cent deduction arises in respect of “saved expenses”.

<sup>166</sup> Kuwait cites in support of its argument, among other cases, Blount Brothers Corp. v. Iran, Iran-U.S. C.T.R., vol. 10 (1986) pp. 95, 98.

<sup>167</sup> See paragraph 60 of “Report and recommendations of the Panel of Commissioners concerning the first instalment of ‘E2’ claims” (S/AC.26/1998/7).

<sup>168</sup> Ibid., paragraphs 87 and 92 to 96.

<sup>169</sup> “Report and recommendations made by the Panel of Commissioners concerning the fifth instalment of ‘E2’ claims” (S/AC.26/2000/17).

<sup>170</sup> An example of such a statement is found in the terms of Decree No. 377 of the Revolutionary Command Council of Iraq, enacting Act No. 57 (16 September 1990), under Articles 5 and 7 of which Iraqi State organizations, corporations and citizens were effectively prohibited from making payments to foreign suppliers and which confirmed previous declarations made by Iraqi officials announcing that Iraq had suspended payment of its foreign debt.

<sup>171</sup> Governing Council decision 16 provides in part that “[i]nterest 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”.

<sup>172</sup> This date was selected on the basis that it was the last date on which Iraq could have taken or damaged assets, and that the Government was entitled to interest from that date, regardless of when expenditure was incurred on repairing or replacing the asset. A further reason was that since many of the losses occurred near the end of the occupation, the date of liberation was closer to the date of the actual losses than any other.

<sup>173</sup> The Panel has therefore ascribed the date of loss for interest purposes, for all previous “F3” claims, as 26 February 1991, with the exception of the claim of the National Committee for Missing and Prisoner of War’s Affairs, in which the Panel determined that the date of loss for calculation of interest is 31 October 1997 (see paragraph 344 of the First “F3” Report).

<sup>174</sup> See paragraph 137 of the “Report and recommendations made by the Panel of Commissioners concerning the sixth instalment of ‘E2’ claims” (S/AC.26/2001/1).

<sup>175</sup> S/AC.26/1998/4. This report concerns the claims of the Ministry of Foreign Affairs (UNCC claim No. 5000015) and a claim of Kuwait University (UNCC claim No. 5000017).

<sup>176</sup> The Panel notes that the KIA claim includes a claim for interest covering the period 2 August 1990 to 1 January 1998. In addition, the SI claim includes a claim for interest on any KIA award of compensation on the basis of an interest period from 2 August 1990 to 30 September 1995 (and with a daily amount claimed thereafter). The Panel notes this apparent duplication for consideration by the Governing Council at the appropriate time when it deals with awards of interest in accordance with its decision 16.

<sup>177</sup> With the exceptions of the claimed filed by KIA, (UNCC claim No. 5000158), in which interest on the components of the claim was claimed from a variety of dates, and the claim of the National Committee for Missing and Prisoner of War's Affairs (UNCC claim No. 5000169), and the claim of the Public Authority for the Assessment of Compensation for Damages Resulting from Iraqi Aggression (UNCC claim No. 5000193), in which the dates from which interest was claimed were the mid-point of the fiscal year in which payments or expenses were incurred.

<sup>178</sup> This remaining claim is UNCC claim No. 5000459.

<sup>179</sup> The Panel has not made a recommendation in respect of regarding UNCC claim numbers 5000169 and 5000459 (National Committee for Missing and Prisoner of War's Affairs). See further paragraphs 567 to 570 of this report.

Annex

## PRESENTATION OF THE WORKING EXAMPLE

## I. TABULAR SUMMARY OF THE WORKING EXAMPLE

<u>Parameters</u>	<u>Valuation comments</u>
Age of the destroyed building at the time of its destruction	16 years
Original cost of construction	500
Useful life anticipated by claimant	40 years
Book value at the time of its destruction	300
The amount spent on replacing the destroyed building with an identical building (no inflation assumed)	500
Underlying claim as asserted	300 + 5 per cent interest per annum <sup>a</sup>
Depreciated cost of replacement building (500-200)	300
Panel's depreciation adjustment for an anticipated useful life of 30 and not 40 years	(67)
Award of compensation, as recommended by the Panel	233

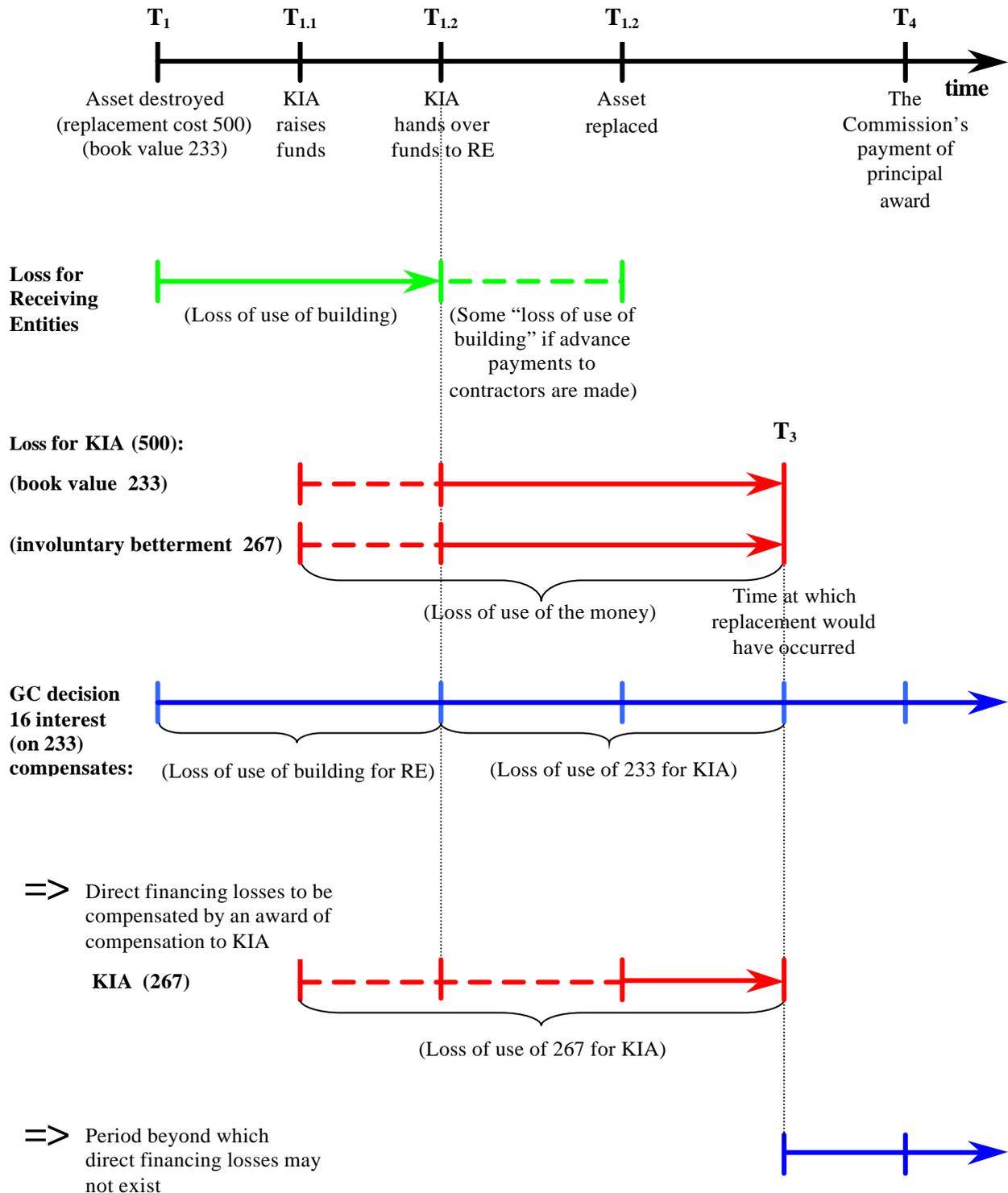
---

<sup>a</sup> The interest element will be addressed under Governing Council decision 16 (the text of which is set out in paragraph 168).

## II. TABULAR SUMMARY OF LOSSES ARISING IN THE WORKING EXAMPLE

	<u>Loss 1</u>	<u>Loss 2</u>	<u>Loss 3</u>
Ministry	Loss of the building from the date of destruction	Loss of use of the building (from the date of destruction until the earlier of the date upon which the building is replaced and the date at which the funding entity provides the monetary equivalent of the building)	
Funding entity	Loss of the funds (on the day they were raised for and handed to the Ministry)		Loss of use of the funds from the day they were raised and transaction costs
Ministry and funding entity = Government	Loss of the building, subsequently replaced by loss of the funds when the building is replaced	Loss of use of the building from the date of destruction until the date at which the funding entity provides the monetary equivalent of the building	Loss of use of the funds from the day they were raised and transaction costs
Directness	The loss of the building (or its monetary equivalent, i.e. the funds) is a direct loss	The loss of use of the building is a direct loss	The loss of use of the funds raised is a direct loss

III. GRAPHICAL PRESENTATION OF THE PERIOD DURING WHICH THE LOSSES WERE SUSTAINED <sup>a</sup>



<sup>a</sup> The horizontal dashed lines represent time periods during which losses may have been sustained, but in respect of which compensation will not be awarded, for the reasons set out in paragraphs 337 and 365 to 368 of the text.