11

Admissibility: Shareholder claims

Rule 47: A claim founded upon an investment treaty obligation which seeks a remedy for the interference by the host state contracting party with the rights attaching to a shareholding in a company having the nationality of the host state is admissible.

Rule 48: A claim founded upon an investment treaty obligation which seeks a remedy for the breach by the host state contracting party of undertakings or representations made to the shareholder but not to the company, or such a claim for other types of loss that are separate and distinct from the company's loss, is admissible.

Rule 49: A claim founded upon an investment treaty obligation which seeks a remedy for the diminution of value of a shareholding in a limited liability company having the nationality of the host contracting state party is admissible if the claimant can establish a *prima facie* case that: (i) the assets of the company have been expropriated by the host contracting state party so that the shareholding has been rendered worthless; or (ii) the company is without or has been deprived of a remedy to redress the injury it has suffered; or (iii) the company is without or has been deprived of the capacity to sue either under the *lex societatis* or *de facto*; or (iv) the company has been subjected to a denial of justice in the pursuit of a remedy in the system for the administration of justice of the host contracting state party.

Rule 50: For a claim to be admissible pursuant to Rule 49, the tribunal should satisfy itself that the shareholder's claim will not: (i) unfairly expose the host state or the company to a multiplicity of actions; (ii) materially prejudice the interests of the creditors of the company; or, (iii) interfere with a fair distribution of the recovery among all interested parties.

A. INTRODUCTION TO THE PRINCIPLE OF ADMISSIBILITY FOR SHAREHOLDER CLAIMS

743. Perhaps the single greatest misconception that has plagued the investment treaty jurisprudence to date concerns the problem of claims by shareholders. The root of this misconception is the incorrect characterisation of the problem as one of jurisdiction rather than admissibility. There is no difficulty in confirming the tribunal's jurisdiction *ratione personae* over a shareholder with the requisite nationality. There is also no difficulty in confirming a tribunal's jurisdiction *ratione materiae* over claims by that shareholder in relation to its investment in shares in a company incorporated in the host state. A shareholding is a ubiquitous inclusion in the list of assets entitled to investment protection in the first article of investment treaties. But is that the end of the analysis?

744. If a claimant with the requisite nationality seeks compensation for the expropriation of land situated in the host state, the jurisdiction of the tribunal may be uncontroversial. There may, however, be a substantive issue that requires determination as a preliminary matter. Suppose the claimant's rights over the land in question were in the nature of a leasehold, and, following the expropriation, the host state simply substituted itself for the previous lessor and performed the obligations of the lessor in accordance with the terms of the lease so that the rights of the lessee (the claimant) over the land were completely unaffected. Should the tribunal proceed to hear the merits of the claimant's claim for an expropriation? The answer is no; not because the tribunal lacks jurisdiction, but because the claim belongs to the original owner of the land. In other words, the claim advanced by the claimant/lessee is inadmissible. It is inadmissible because, as a matter of law, the claimant does not have the requisite legal interest in the investment property in question (the land) to prosecute an investment treaty claim of this character.[1]

745. With these distinctions in mind we revert to the problem of shareholder claims.

746. Suppose it transpired that a major foreign oil company relinquished a controlling interest in an oil and gas project in the host state to a state-owned company at below market price under duress from the host state's government. The oil company's board of directors ratified this transaction, which was memorialised in a new shareholders' agreement with the state-owned company. Assume also that, as a result of this transaction, the share price of the oil company

[1] Thus, for instance, the Iran/US Claims Tribunal dismissed an expropriation claim brought by the bailee of property rather than by the owner: *Petrolane v Iran* (Case AWD 518-131-2, 14 August 1991) 27 Iran-US CTR 64, 92.

deteriorated. As is typical among the major oil companies, there are thousands of shareholders affected thereby in varying degrees. A majority of those shareholders are nationals of states with bilateral investment treaties with the host state. Would an investment treaty claim by each individual shareholder of the oil company be admissible?

747. From a functional perspective, if the answer were to be affirmative then the investment treaty regime would be doomed as a sustainable system of investment protection. The purpose of this extreme and improbable scenario is merely to illustrate the point that there must be a limiting principle of admissibility for shareholder claims. It cannot be right that any shareholder may bring any type of claim in respect of any prejudice caused to the company by the host state resulting in any diminution of the value of the shareholding. A remarkable and disturbing feature of a canon of investment treaty precedents is that, if their basis for decision were to be generalised, this would be the position. Indeed this possibility was accepted as an inevitable feature of the investment treaty regime in *Camuzzi v Argentina*:[2]

> The argument made by the Argentine Republic and which is also reflected in Methanex, to the effect that if the right of shareholders to claim when only their interests are affected is recognized it could lead to an unlimited chain of claims, is theoretically correct. However, in practice any claim for derivative damages will be limited by the arbitration clause.[3]

748. The 'arbitration clause' in the investment treaty might restrict the class of claimants that can resort to arbitration under that treaty, but it can hardly be claimed that this is the panacea for dealing with the problem of admissibility.[4]

749. Every legal system that recognises a limited liability company as an independent legal entity insists upon a distinction between the company and its shareholders.[5] A shareholder cannot, for instance, seize a physical asset of the company in return for relinquishing its share with an equivalent value. That would amount to conversion or theft, because the shareholder has no rights *in rem* over the assets of the company. The company, as a legal entity separate from its shareholders, holds the assets for its own account and in its own name. A company does not hold assets as an agent or trustee of its shareholders. Likewise, if a third party seizes an asset of the company unlawfully, then it is not the shareholder who is the victim of conversion or a theft; it is the company.

2 *Camuzzi v Argentina* (Preliminary Objections).
3 *Ibid*. para. 65.
4 See also: *Sempra v Argentina* (Preliminary Objections) para. 77.
5 In *Deutsche Amerikanische Petroleum Gesellschaft Oil Tankers* 2 RIAA 777 (1926), an attempt to discard this principle as a technicality of municipal law was rejected by an international tribunal: 'most doctrine and nearly all jurisprudence in all countries accord to the legal entity known as a company a personality and a patrimony entirely distinct from those of its shareholders'.

These observations are trite, and yet the fundamental distinction between a company and its shareholders appears to have been ignored or diluted to the point of extinction in many investment treaty awards.

750. Whether a shareholder is bringing a claim in tort, for a breach of the fair and equitable standard of treatment, or pursuant to Article 1 Protocol 1 of the European Convention of Human Rights, the object of the claim is the same – a shareholding in a limited liability company. In other words, the nature of the legal institution known as a shareholding is invariable, regardless of the legal source of the obligation that is sued upon to vindicate rights attaching to the shareholding.

751. An investment treaty does not create a new type of shareholding by listing it among the categories of assets that may constitute investments any more than it creates a new type of land by the same device. Neither general international law, nor investment treaties, purport to alter fundamentally a shareholding as a legal institution known to most if not all municipal legal systems. It follows that where a shareholding is the object of an investment treaty claim, the basic contours of the rights attaching to that form of investment must be derived from the municipal legal order. An investment treaty tribunal cannot, for instance, wholly discard the basic distinction between the shareholder's property and the company's property merely because the cause of action arises in international law. De Visscher stated the obvious almost half a century ago: 'L'actionnaire qui profite de la distinction des patrimoines et des personnalités doit en accepter les inconvénients comme les avantages.'[6] This axiomatic principle has been largely ignored in the jurisprudence on investment treaties. In *Total v Argentina*,[7] for instance, the tribunal justified its decision to uphold the admissibility of shareholder claims as follows:

> The protection that BITs afford to such investors is accordingly not limited to the free enjoyment of the shares but extends to the respect of the treaty standards as to the substance of their investments.[8]

752. This statement appears to imply that the 'substance' of the investments of shareholders is the property of the company they invested in.

753. At this juncture it is necessary to refer briefly to the *Barcelona Traction* case. One finds a ubiquitous statement in a great number of investment treaty awards to the effect that the judgments of the International Court of Justice in *Barcelona Traction*[9] are entirely irrelevant to the investment treaty

[6] P. De Visscher, 'La Protection Diplomatique des Personnes Morales' (1961-I) 102 *Hague Recueil* 395, 465.
[7] (Preliminary Objections).
[8] *Ibid*. para. 74.
[9] (*Belgium v Spain*) 1970 ICJ Rep 4.

regime.[10] In an important respect, this statement is correct. To the extent that the Court was preoccupied with defining the nationality of the claim in relation to the injury caused to the Barcelona Traction Company by Spain, then its judgments are not on point for investment treaty arbitration. Investment treaties have their own nationality requirements and there is no justification for importing the rules of diplomatic protection into the investment treaty regime. It is for this reason that *Loewen v USA*[11] was wrongly decided: not because the tribunal applied the continuous nationality rule of diplomatic protection incorrectly, but because the tribunal had no reason to apply it in the first place. To the extent, however, that the International Court was concerned with the manner in which the legal institution of a shareholding should be transposed onto the international plane, its judgments demand very careful consideration, because that is precisely the issue that confronts the investment treaty regime as well. The truth is that the learning revealed in the hundreds of pages of the report on the preliminary objections and second phase of the proceedings in *Barcelona Traction*, which includes opinions from some of the great international jurists of our time, cannot be categorically dismissed as besides the point.

754. The International Court posed the following question in *Barcelona Traction*:

> It can be asked whether international law recognizes for the shareholders in a company a separate and independent right or interest in respect of damage done to the company by a foreign government; and if so to what extent and in what circumstances.[12]

755. That question, which was addressed by the Court and by several of the Judges individually, is entirely distinct from the problem of attributing nationality to a claim for the purposes of diplomatic protection. That question must be confronted by every supranational regime concerned with the protection of property rights.

756. A survey of investment treaty precedents permits one of two conclusions on the answer of this supranational regime for the protection of property rights to the question posed by the International Court. The charitable conclusion would be that investment treaty tribunals have failed to grapple with the problem directly and instead have proceeded in an incremental fashion by upholding the admissibility of shareholder claims in each specific context without articulating

[10] *Siemens v Argentina* (Preliminary Objections) 12 ICSID Rep 174, 207/141; *LG&E v Argentina* (Preliminary Objections) 11 ICSID Rep 414, 424/52; *Camuzzi v Argentina* (Preliminary Objections) para. 139; *Continental Casualty v Argentina* (Preliminary Objections) para. 82; *Suez v Argentina* (Preliminary Objections) para. 50.

[11] (Merits) 7 ICSID Rep 442.

[12] *Barcelona Traction, Light and Power Company Ltd* (*Belgium v Spain*) 1964 ICJ Rep 6, 44 (Preliminary Objections).

a general principle. The less charitable and more realistic conclusion would be that investment treaty tribunals have indeed answered the International Court's question in the following terms:

> The investment treaty regime recognises for the shareholders in the company a separate and independent right or interest in respect of damage done to the company by a foreign government to any extent and in all circumstances.

757. If that is an accurate summary of the current position, which has indeed been endorsed by numerous tribunals,[13] then the sustainability of the investment treaty regime cannot be assured.

758. This chapter provides a full assessment of the *Barcelona Traction* case insofar as it is relevant to the investment treaty regime. The proposed principles of admissibility for shareholder claims in the investment treaty context in Rule 47 to Rule 50 are then introduced and analysed by reference to the relevant investment treaty precedents, other international cases and municipal court decisions. The focus of the chapter then shifts to other supranational regimes for the protection of property rights such as the Iran/US Claims Tribunal and the European Court of Human Rights before moving to an account of the specific provisions in investment treaties that deal with derivative claims by shareholders, such as Article 1117 of NAFTA and Article 25(2)(b) of the ICSID Convention.

759. In this chapter, shareholder actions for 'direct injury' and 'reflective loss' are distinguished. An action for a 'direct injury' is premised upon the third party having breached an obligation owed directly to the shareholder rather than just to the company, whereas in an action for 'reflective loss' the shareholder is suing for the diminution of the value of its shares caused by acts of the third party directed to the company itself. Reflective loss can be defined as:

> [T]he diminution of the value of the shares … the loss of dividends … and all other payments which the shareholder might have obtained from the company if it had not been deprived of its funds.[14]

760. The third party in investment treaty arbitration is of course the host state or one of its emanations.

[13] *AES v Argentina* (Preliminary Objections) 12 ICSID Rep 312, 328/85–9; *CMS v Argentina* (Preliminary Objections) 7 ICSID Rep 494, 508–9/68; *Siemens v Argentina* (Preliminary Objections) 12 ICSID Rep 174, 207–8/141–2; *National Grid v Argentina* (Preliminary Objections) para. 169; *LG&E v Argentina* (Preliminary Objections) 11 ICSID Rep 414, 426/63; *Gas Natural v Argentina* (Preliminary Objections) paras. 34–5; *Continental Casualty v Argentina* (Preliminary Objections) paras. 79, 87; *Pan American Energy v Argentina* (Preliminary Objections) para. 218; *Suez v Argentina* (Preliminary Objections) para. 51; *Total v Argentina* (Preliminary Objections) para. 74; *Noble v Ecuador* (Preliminary Objections) para. 77.

[14] *Johnson v Gore Wood & Co*. [2001] 1 All ER 481, 532.

B. THE *BARCELONA TRACTION* CASE

761. Great care must attend the deployment of judicial reasoning discovered outside the investment treaty context to resolve contentious issues within it. But even greater care must be taken before dismissing the valuable insights gained from the rich experience of other judicial fora by simplistic appeals to the *sui generis* nature of investment treaty arbitration. This applies with equal force to the relevant experience of international and municipal courts.

762. It is often proclaimed that the *Barcelona Traction* case can be safely ignored for investment treaty arbitration because it was concerned with defining the nationality of the claim in respect of an injury caused to the Barcelona Traction Company for the purposes of the general international law of diplomatic protection.[15] It is certainly true that the nationality of claim rules of diplomatic protection should not be superimposed upon the nationality requirements in investment treaties, and this is the essence of Rule 38. The International Court was careful, however, to distinguish between questions of capacity and substance.[16] The question of substance was to identify the rights of shareholders that are entitled to international protection as distinct from the rights of the company. The question of capacity was to identify the state that had standing to bring a diplomatic protection claim on behalf of the shareholders if the question of substance were to be resolved in favour of the recognition of their rights on the international plane. Thus, in its Decision on Preliminary Objections, the International Court stated:

> In short, the question of the *jus standi* of a government to protect the interests of the shareholders as such, is itself merely a reflection, or consequence, of the antecedent question of what is the juridical situation in respect of the shareholding interests, as recognized by international law.[17]

763. This distinction informed the separate opinions of Judges Morelli, Fitzmaurice and Gros in the Second Phase of the Proceedings. According to Judge Morelli:

> To say that there is no rule which authorises diplomatic protection of shareholders on account of measures taken in respect of the company is to exclude the existence of any obligation of Spain in this connection,

[15] In *CMS v Argentina* (Preliminary Objections) 7 ICSID Rep 492, 502–3/43, it was stated by the tribunal that *Barcelona Traction* was not ‘directly relevant to the present dispute’ because it was ‘concerned only with the exercise of diplomatic protection’. The same comment was made in *Enron v Argentina* (Preliminary Objections) 11 ICSID Rep 273, 280–1/38. See also: *GAMI v Mexico* (Merits) para. 30.

[16] An analysis of these two distinct issues is provided in: C. Staker, ‘Diplomatic Protection of Private Business Companies: Determining Corporate Personality for International Law Purposes’ (1990) 61 *BYBIL* 155, 155–8.

[17] (*Belgium v Spain*) 1964 ICJ Rep 5, 45.

> vis-a-vis any other States. Belgium's right is thereby denied, not because such a right might hypothetically belong to a State other than Belgium (in other words, not for lack of capacity on the part of Belgium), but rather because no such right can be invoked by any State, since no rule exists from which it could derive.[18]

764. The question of substance logically preceded the question of capacity, as the Court itself recognised. In essence, it was necessary to identify the rights of the shareholders that formed the object of the diplomatic protection claim and determine whether or not those rights attracted the protection of international law. The Court formulated the question as follows:

> It can be asked whether international law recognizes for the shareholders in a company a separate and independent right or interest in respect of damage done to the company by a foreign government; and if so to what extent and in what circumstances.[19]

765. This question was resolved by a *renvoi* to municipal law:

> If the Court were to decide the case in disregard of the relevant institutions of municipal law it would, without justification, invite serious legal difficulties. It would lose touch with reality, for there are no corresponding institutions of international law to which the Court could resort. Thus the Court has, as indicated, not only to take cognizance of municipal law but also to refer to it. It is to rules generally accepted by municipal legal systems which recognise the limited company whose capital is represented by shares, and not to the municipal law of a particular state, that international law refers. In referring to such rules, the Court cannot modify, still less deform them.[20]

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[18] (*Belgium v Spain*) 1970 ICJ Rep 4, 228 (Morelli J). Fitzmaurice J agreed with Morelli J's approach: *ibid*. 65 at note 2. Gros J stated that: '[T]he right of diplomatic protection, so far as it materializes in a legal action, is to be distinguished from the substantive right which the applicant State claims to have re-established.' *Ibid*. 287.

[19] *Barcelona Traction, Light and Power Company Ltd* (*Belgium v Spain*) 1964 ICJ Rep 6, 44 (Preliminary Objections).

[20] *Barcelona Traction, Light and Power Company Ltd* (*Belgium v Spain*) 1970 ICJ Rep 3, 37. See also: *ibid*. 33–4. See also: Separate Opinion of Fitzmaurice J, *ibid*. 66–8 ('Since the limited liability company with share capital is exclusively a creation of private law, international law is obviously bound in principle to deal with companies as they are – that is to say by recognizing and giving effect to their basic structure as it exists according to the applicable private law conceptions. Fundamental to the structure of the company is the ascription to it, qua corporate entity, of a separate personality over and above that of its component parts, viz. the shareholders, with resulting carefully drawn distinct distinctions between the sphere, functions and rights of the company as such, acting through its management or board, and those of the shareholder. These distinctions must obviously be maintained at the international level: indeed to do otherwise would be completely to travesty the notion of the company as a corporate entity. Thus it is that, just as in domestic courts no shareholder could take proceedings in respect of a tort or breach of contract committed in respect of the company, but only the latter could do so, through the action of its management with whom the decision would lie – a decision which, broadly speaking, the

766. Judge Fitzmaurice made the same point in his Separate Opinion with characteristic lucidity:

> [I]f it is not right that international law should distort the structure of the company (an essentially private law concept) by failing to give all due effect to the logic of its separate personality, distinct from that of the shareholders, it is no less wrong, and an equal distortion, if international law fails to give due effect to the limitations on this principle recognised by the very system which, *mutatis mutandis*, it is sought to apply on the international plane.[21]

767. On what basis can an investment treaty tribunal approach this substantive question differently or, indeed, ignore it altogether?

768. The misconception that meanders through the corpus of investment treaty precedents is that the recognition by investment treaties of a shareholding as a covered investment somehow disposes of the question relating to the rights of the shareholder that can form the object of an investment treaty claim. These are entirely distinct issues. A shareholder is entitled to resort to international arbitration against the host state because it has satisfied its side of the *quid pro quo* by making a covered investment in the territory of the host state. In other words, the recognition of a shareholding as a covered investment in the investment treaty settles the question of the *capacity* of the investor to prosecute a claim against the host state. But this does not mean that the question of *substance* has been resolved in favour of the admissibility of any and every claim advanced by the shareholder. The *ad hoc* committee in *CMS v Argentina*[22] clearly had this distinction in mind:

> CMS must be considered an investor within the meaning of the BIT. It asserted causes of action under the BIT in connection with that protected investment. Its claims for violation of its rights under the BIT were accordingly within the jurisdiction of the Tribunal. This is without prejudice to

shareholder must accept – so also if an illicit act injurious to the company or infringing its rights takes place on the international plane, it is not the government of the shareholder but, in principle, that of the company alone, which can make an international claim or bring international proceedings'). In contrast, Tanaka J preferred to bypass the municipal law conception of a company altogether: 'The concept of juridical personality mainly governs private law relationships. It cannot be made an obstacle to diplomatic protection of shareholders. Concerning diplomatic protection, international law looks into the substance of matters instead of the legal form or technique; it pays more consideration to ascertaining where real interest exists, disregarding legal concepts.' *Ibid*. 127.

21 Separate Opinion of Fitzmaurice J, *ibid*. 71. See also the ICJ's judgment: *ibid*. 39–40. See also: Separate Opinion of Morelli J: '[T]here is on the one hand a set of rights conferred by the municipal order of the company and, on the other hand, within the same legal order, another, quite distinct set of rights conferred on the members. Each set of rights is entitled to its own, distinct international protection.' *Ibid*. 235.

22 *CMS v Argentina* (Annulment).

> the determination of the *extent* of those rights, a question to which the Committee will return.[23]

769. The *ad hoc* committee annulled the tribunal's decision on the umbrella clause because it had assumed, without analysis, that CMS as the shareholder of TGN could enforce the obligations as between TGN and Argentina under the licence to transport gas.[24]

770. From the very outset, international law might have taken the view that the company as an artificial person should not be recognised at all on the international plane so that any injury to the corporation ultimately would be reducible to the prejudice caused to the natural persons standing behind the corporation. This approach has been emphatically rejected by international law and by investment treaties.

771. In the *Case Concerning Ahmadou Sadio Diallo*,[25] the International Court confirmed the basic principles governing the approach of international law to the limited liability company as were articulated in *Barcelona Traction*. According to the Court, the important threshold question is whether or not the artificial person in question has 'a legal personality independent of [its] members' – and in 'determining whether a company possesses independent and distinct legal personality, international law looks to the rules of the relevant domestic law'.[26] An axiomatic principle of municipal legal systems recognising the institution of a limited liability company is that 'conferring independent corporate personality on a company implies granting it rights over its own property, rights which it alone is capable of protecting'[27] so that 'as long as the company is in existence the shareholder has no right to the corporate assets'.[28]

772. An investment treaty does not purport to create a new international legal institution of a limited liability company any more than general international law does. An investment treaty tribunal is thus bound to follow the same approach to the problem of shareholder claims as the International Court by carefully examining 'the rules generally accepted by municipal legal systems which recognise the limited liability company whose capital is represented by shares'.[29] The consideration of such rules in the modern context might yield different conclusions to those of the International Court in *Barcelona Traction*, but this does not detract from the validity of the Court's analytical approach,

[23] *Ibid*. para. 75.
[24] *Ibid*. para. 97. The *ad hoc* committee set out several reasons why the shareholder's reliance upon obligations entered into by the company is inadmissible (*ibid*. para. 95).
[25] (*Guinea v Congo*) Preliminary Objections, 24 May 2007.
[26] *Ibid*. para. 61.
[27] *Ibid*.
[28] *Ibid*. para. 63.
[29] *Barcelona Traction, Light and Power Company Ltd* (*Belgium v Spain*) 1970 ICJ Rep 3, 37.

endorsed as it was by fifteen of its judges and reaffirmed in the *Case Concerning Ahmadou Sadio Diallo*.

Rule 47. A claim founded upon an investment treaty obligation which seeks a remedy for the interference by the host state contracting party with the rights attaching to a shareholding in a company having the nationality of the host state is admissible.

A. 'RIGHTS ATTACHING TO A SHAREHOLDING'

(i) General rights

773. A share is an aggregate of rights and responsibilities. The principal rights attaching to a share include:[30]

> The right to dividends and to share in the proceeds of liquidation. This right can be characterised as a right *in rem*.
>
> The right to participate in the functioning and administration of the company.
>
> The right to exercise control and in particular the right to participate in shareholder meetings.

774. In addition, there are several subsidiary rights that are necessary for the proper enjoyment of the aforementioned primary rights attaching to shares:[31]

> The right to the timely notice of shareholder meetings.
>
> The right to receive certain corporate documents, including the articles of incorporation and financial statements.
>
> The right to receive information about the company and inspect its business records.

775. The extent to which a shareholder can exercise the property and participatory rights attaching to its shares generally depends upon the size of its contribution to the share capital of the company.[32]

776. The International Court in *Barcelona Traction* had little difficultly in recognising the possibility of an international claim for interference in what it perceived to be a limited category of the direct rights of shareholders. According to the Court, such rights included the right to any dividend declared by the company, the right to attend and vote at general meetings and the right

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30 *International Encyclopedia of Comparative Law, Vol. XIII Business and Private Organizations*, Ch. 2 'Limited Liability Companies and Private Companies' (1998, by M. Lutter) 75.
31 *Ibid*.
32 *Ibid*.

to share in the residual assets of the company upon liquidation.[33] In the *Case Concerning Ahmadou Sadio Diallo*,[34] the International Court clarified the law applicable to determine the scope and extent of such direct rights:

> [W]hat amounts to the internationally wrongful act, in the case of *associés* or shareholders, is the violation by the respondent State of their direct rights in relation to a legal person, direct rights that are defined by the domestic law of that State.[35]

777. Perhaps the best illustration of the distinction between shareholder claims for a direct injury and claims for reflective loss is the judgment of the Chamber of the International Court of Justice in *ELSI*.

777C. Case Concerning Elettronica Sicula SpA (ELSI)[36]

The *ELSI* case arose out of a Treaty of Friendship, Commerce and Navigation[37] (the 'FCN Treaty') rather than a modern investment treaty, and hence the claim was prosecuted by the United States as an instance of diplomatic protection rather than directly by the American investors. The two American corporate investors, Raytheon and Machlett,[38] owned all the shares in the Italian manufacturing company ELSI.[39] ELSI was established in Palermo, Sicily, where it had a plant producing electronic components. Before the events alleged by the United States to have violated the FCN Treaty, ELSI was in a precarious financial state. By 1964, its accumulated losses had exceeded one-third of the company's share capital, thereby requiring a reduction in its equity in accordance with Italian law.[40] The same was required of the company in March 1967.[41] Between February 1967 and March 1968, representatives of ELSI and Raytheon negotiated with Italian Government officials to find an Italian partner for ELSI and to explore the possibilities of State support, but these negotiations proved to be unsuccessful.[42] In June 1967, ELSI resolved to dismiss some 300 employees, resulting eventually in a strike at the plant on 4 March 1968.[43]

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[33] *Barcelona Traction, Light and Power Company Ltd* (*Belgium v Spain*) 1970 ICJ Rep 3, 36. See also: Separate Opinion of Fitzmaurice J, *ibid*. 67–8 at note 6 (if the shareholder's right to dispose freely of its shares were to be interfered with or resolutions duly passed at the general meetings of shareholders were to be declared null and void).

[34] (*Guinea v Congo*) Preliminary Objections, 24 May 2007, General List No. 103.

[35] *Ibid*. para. 64.

[36] (*USA v Italy*) 1989 ICJ Rep 15.

[37] Signed by the USA and Italy on 2 February 1948. *Ibid*. 23.

[38] The full company names were, respectively, Raytheon Company and Machlett Laboratories Incorporated (*ibid*. 23).

[39] 'ELSI' refers to the company Electtronica Sicula S.p.A., which changed its name to Raytheon-Elsi S.p.A. in 1963 (*ibid*.).

[40] *Ibid*. 24.

[41] *Ibid*.

[42] *Ibid*. 24–5.

[43] *Ibid*. 25.

From late 1967, Raytheon and Machlett commenced preparations for the cessation of ELSI's operations and its liquidation.[44] The minutes of a meeting on 21 February 1968 with ELSI, Raytheon and the President of the Sicilian Region recorded that 'the date of March 8 was stressed repeatedly as the absolute limit for the shut-down due to a total financial crisis'.[45] On 7 March 1968, Raytheon formally notified ELSI that, notwithstanding ELSI's need for further capital, Raytheon would not subscribe to any further shares or guarantee any further loans.[46] Nonetheless, it was contended by the United States that Raytheon was prepared at the relevant time to give the financial support to ELSI necessary to ensure an orderly liquidation to proceed.[47] On 16 March 1968, the Board of Directors of ELSI resolved to discontinue production immediately and terminate commercial activities and employment contracts on 29 March 1968.[48]

The United States did not advance a claim with respect to any acts attributable to Italy covering the time period just described.[49] The first act to be impleaded as a breach of the FCN Treaty occurred on 1 April 1968 when the Mayor of Palermo issued an order requisitioning ELSI's plant for six months.[50] On 25 April 1968, the Board of Directors of ELSI resolved to file a voluntary petition in bankruptcy and such a petition was filed the next day. The petition referred to the impossibility of ELSI meeting its payment obligations due to the requisition order, which prevented ELSI from availing itself of its only immediate source of liquid funds.[51] A decree in bankruptcy was issued by the *Tribunale di Palermo* on 16 May 1968 and a trustee in bankruptcy was thereby appointed.[52]

ELSI had appealed against the Mayor's requisition order on 19 April 1968 and on 22 August 1969 the Prefect of Palermo quashed the requisition order on the ground that it had no 'juridical cause' under Italian law insofar as the intended purpose of the requisition (the continuation of ELSI's activities) had been impossible to achieve due to the plight of the company.[53]

The trustee in bankruptcy had also brought proceedings before the courts in Palermo to seek compensation for damages resulting from the requisition. Although unsuccessful at first instance, the Court of Appeal of Palermo ruled that the trustee was entitled to compensation for the loss of use and possession of ELSI's plant and assets during the six-month requisition

[44] *Ibid*.
[45] *Ibid*. 30.
[46] *Ibid*. 26.
[47] *Ibid*. 29.
[48] *Ibid*. 30.
[49] *Ibid*. 48.
[50] *Ibid*. 32.
[51] *Ibid*. 35–6.
[52] *Ibid*. 36.
[53] *Ibid*. 38–9, 74–5.

period.[54] The compensation was distributed to ELSI's creditors pursuant to the Italian bankruptcy procedure.[55]

In the bankruptcy proceedings, the secured creditors were paid in full, the unsecured creditors received less than one per cent of their claims and, accordingly, there remained no surplus for distribution to the shareholders Raytheon and Machlett.[56]

The first and most important claim advanced by the United States on behalf of Raytheon and Machlett was based on Article III(2) of the FCN Treaty which, in relevant part, read:

> The nationals, corporations and associations of either High Contracting Party shall be permitted, in conformity with the applicable laws and regulations within the territories of the other High Contracting Party, to organize, control and manage corporations of such other High Contracting Party…

The essence of the claim was that Raytheon and Machlett were deprived of their right to manage the liquidation of ELSI in an orderly fashion. It is critical to observe that this *is* a right vested *directly* in shareholders of a company but it is a right obviously contingent upon satisfaction of the conditions for a voluntary liquidation as derived from the general principles of municipal legal systems. In this respect Judge Oda's critique of the Chamber's judgment in his Separate Opinion is unfounded. Judge Oda complained that the Chamber of the International Court had overlooked the problem of the *jus standi* of the United States to bring claims on behalf of Raytheon and Machlett that were in essence claims regarding an injury to ELSI and thus contradicted the Court's judgment in the *Barcelona Traction* case.[57] But the United States' primary claim under consideration was concerned with the direct rights of the American shareholders in ELSI and thus was plainly admissible, even if the reasoning in *Barcelona Traction* were to be adopted wholesale.

Hence this claim is capable of being classified as an admissible shareholder action for a direct injury pursuant to Rule 47 and an investment treaty tribunal would be required to determine the claim on the merits. (It is not difficult to envisage how the claim might be formulated as a violation of an investment treaty obligation to accord fair and equitable treatment.)

Article III(2) of the FCN Treaty was invoked to protect the alleged right of Raytheon and Machlett to manage the liquidation of ELSI in an orderly fashion. But Article III(2) does not operate to create a right to 'control and manage' a corporation where no such right can be derived from the general

[54] *Ibid*. 39.
[55] *Ibid*. 40.
[56] *Ibid*.
[57] *Ibid*. 83–7.

principles of corporate insolvency. The FCN Treaty, like modern investment treaties, does not rewrite the general principles of insolvency law. In the particular circumstances of the *ELSI* case, Article III(2) could not operate to vest Raytheon and Machlett with a right to conduct an orderly liquidation of ELSI if ELSI was in fact *insolvent*. The general principle of insolvency law derived from municipal legal systems is that the right of the shareholders of a company to manage the liquidation procedure is conditional upon the company being solvent. This is a principle strictly enforced: in some municipal legal systems the directors of the company are liable for criminal sanctions in the event that they endorse a voluntary liquidation where the company is unable to pay its debts in full. The relevant provisions of the Italian Civil Code and bankruptcy law reflected this general principle.[58]

Judge Oda's observations pertaining to Article III(2) can thus be endorsed up to a point:

> Raytheon and Machlett certainly could, in Italy, 'organize, control and manage' corporations in which they held 100 per cent of the shares – as in the case of ELSI – but this cannot be taken to mean that those United States corporations, as shareholders of ELSI, can lay claim to any rights other than those rights of shareholders guaranteed to them under Italian law as well as under the general principles of law concerning companies. The rights of Raytheon and Machlett as shareholders of ELSI remained the same and were not augmented by the FCN Treaty.[59]

This statement is perfectly consistent with the approach taken by the Chamber of the Court. The divergence with the Chamber's approach commences with the next line of Judge Oda's Separate Opinion:

> Those rights which Raytheon and Machlett could have enjoyed under the FCN Treaty were not breached by the requisition order, because that order did not affect the 'direct rights' of those United States corporations, as shareholders of an Italian company, but was directed at the Italian company of which they remained shareholders.[60]

Although the Chamber did not directly consider this particular point, for the reasons previously articulated it cannot be accepted insofar as the 'direct rights' of Raytheon and Machlett were capable of being prejudiced by the requisition order. That would settle any objection to the admissibility of this claim. Whether or not those alleged direct rights were vested in Raytheon and Machlett at the critical time was a question for the merits.

[58] *Ibid*. 29, 53, 58.
[59] *Ibid*. 87–8.
[60] *Ibid*. 88.

Hence proceeding now to the merits, to determine whether or not Raytheon and Machlett had the right to conduct an orderly liquidation of ELSI it was necessary for the Chamber to make a finding of fact as to whether ELSI was solvent prior to the act complained of: viz. the Mayor of Palermo's requisition order on 1 April 1968.[61] The Chamber's ruling was to the effect that ELSI was insolvent on or before 1 April 1968 and thus Raytheon and Machlett did not have a right to pursue a voluntary liquidation of ELSI's assets capable of attracting the protection of Article III(2) of the FCN Treaty.[62]

We have concluded that the claim alleging an interference with the American investors' right to manage and control its investment in ELSI was admissible for the purposes of the FCN Treaty and that this conclusion would be no different in the investment treaty context. The admissibility of the other claims formulated by the United States, including those for reflective loss, is now analysed by reference to the principles in Rule 49 and Rule 50.[63]

The United States maintained that the obligation in Article V(1) of the FCN Treaty to accord 'most constant protection and security' to US nationals and corporations both 'for their persons and property' was violated by Italy when it 'allowed ELSI workers to occupy the plant'.[64] Italy objected to this claim because the property in question was ELSI's plant in Palermo. The property of Raytheon and Machlett consisted of their shares in ELSI and the occupation of ELSI's plant in no way interfered with any rights *in rem* over the shares. Italy's objection was justified. Before dismissing the claim on the merits, the Chamber merely noted that:

> [T]here may be doubts whether the word 'property' in Article V, paragraph 1, extends, in the case of shareholders, beyond the shares themselves, to the company or its assets.[65]

Rather than dismissing the claim on the merits, the Chamber should have properly investigated those 'doubts' and found that it was inadmissible and hence Judge Oda's general point about the lack of *jus standi* of the United States was well taken in relation to this claim. In the investment treaty context, the same approach would be required with respect to a claim of this type based on an obligation to accord full protection and security in accordance with Rule 49.

[61] According to the Chamber of the Court: 'The crucial question is whether Raytheon, on the event of the requisition, and after the closure of the plant and the dismissal, on 29 March 1968, of the majority of its employees, was in a position to carry out its orderly liquidation plan, even apart from its alleged frustration by the requisition' (*ibid*. 55).

[62] *Ibid*. 52–62. Schwebel J dissented with respect to this finding of fact but not from the Court's approach to this question (*ibid*. 100–8).

[63] See paras. 785 *et seq*. and paras. 853 *et seq*. below.

[64] *Ibid*. 63–4.

[65] *Ibid*. 64.

The position in relation to the expropriation claim advanced by the United States is more complicated. In accordance with Rule 49, a claim by a shareholder alleging the expropriation of the assets of the company is *prima facie* admissible subject to the discretionary principle set out in Rule 50. The three aspects of the discretionary principle would be resolved in favour of the American investors in this case because the municipal liquidation procedure had been concluded and hence there was no risk of prejudice to ELSI's creditors or parallel proceedings in different fora with the same object of restoring the property alleged to have been expropriated to the company. The claim would thus be admissible in accordance with Rule 49 to Rule 50. In the event, the Chamber of the International Court dismissed the expropriation claim, founded upon the requisition order and subsequent acts of the Italian authorities, on account of ELSI's precarious financial state at the relevant time. This determination is controversial: so long as there was something to be expropriated at the date of the requisition order, and the Chamber did not deny that there was, the financial state of ELSI provides no answer to the international legality of the alleged taking. It was incumbent upon the Chamber to adjudge the international legality of the requisition order and the subsequent acts complained of, and this it failed to do. The financial state of ELSI was of course relevant; but it was relevant to the issue of causation and this was not adequately addressed by the Chamber.

778. The Iran/US Claims Tribunal considered the admissibility of a claim for a direct injury in *Foremost-McKesson HBOC Inc v Iran*.[66] A US company held shares in a dairy company incorporated in Iran. It was alleged that the Iranian company had withheld dividends from the US shareholder over a period of several years while continuing to pay dividends to its Iranian shareholders. This type of claim falls squarely within Rule 47. The Tribunal ultimately found that the claim was not within its *ratione tempore* jurisdiction.

779. Outside the field of investment treaty arbitration, a recent example of an admissible shareholder claim in relation to prejudice to rights attaching to shares is the award in *Reineccius et al v Bank for International Settlements*.[67] The constituent documents of the Bank for International Settlements ('BIS'), established in 1930, allowed the central banks that had subscribed for shares in BIS to issue those shares to the public. The Central Banks of the USA, France and Belgium took advantage of this option and approximately 13 per cent of BIS's shares came to be held by private shareholders. In 2001, the Board of Directors called an Extraordinary General Meeting to amend the constituent documents so as to exclude private shareholders against payment of compensation fixed at

[66] (Case 220-37/231-1, 10 April 1986) 10 Iran-US CTR 228.

[67] *Dr Horst Reineccius, First Eagle SoGen Funds, Inc and Mr Pierre Mathieu and La Société de Concours hippique de La Châtre v Bank for International Settlements* (Partial Award on the Lawfulness of the Recall of the Privately Held Shares on 8 January 2001 and the Applicable Standards for Valuation of those Shares, 22 November 2002) PCA.

CHF 16,000 per share. Three shareholders brought claims against BIS to challenge the validity of its recall of privately held shares and the level of compensation and invoked the jurisdiction of the Arbitral Tribunal established pursuant to Article XV of the Agreement regarding the Complete and Final Settlement of the Question of Reparations of 20 January 1930. These claims were clearly directed at vindicating the shareholders' personal rights and hence claims of that nature would no doubt be admissible under Rule 47.

Rule 48. A claim founded upon an investment treaty obligation which seeks a remedy for the breach by the host state contracting party of undertakings or representations made to the shareholder but not to the company, or such a claim for other types of loss that are separate and distinct from the company's loss, is admissible.

A. UNDERTAKINGS OR REPRESENTATIONS MADE TO SHAREHOLDERS

780. In municipal systems of law it is generally accepted that if the defendant has breached a duty to the shareholder and owes no corresponding duty to the company, then a shareholder is entitled to pursue a claim for the resulting loss.[68] For instance, in the English case of *George Fischer (Great Britain) Ltd v Multi Construction Ltd*,[69] the defendant construction company entered into a contract with the claimant holding company for the design and construction of a warehouse for the use of one of the claimant's subsidiaries as a distribution depot for products manufactured by its other subsidiaries (the subsidiaries were not parties to the contract). The warehouse was defective in certain respects and the claimant holding company succeeded in its breach of contract claim in recovering reflective loss that it suffered as a result of its subsidiaries' lost sales and increased operating costs.

781. In the investment treaty context it should follow that where the host state has given the claimant/shareholder specific undertakings with respect to its investment in a company, it should be permitted to sue for a breach of such undertakings. The claim would normally be for breach of contract if the undertakings were formalised, subject to the scope of the tribunal's *ratione materiae* jurisdiction. In these circumstances, the company itself would have no cause of

[68] In England: *Lee v Sheard* [1956] 1 QB 192, 195–6; *George Fischer (Great Britain) Ltd v Multi Construction Ltd* [1995] 1 BCLC 260; *Gerber Garment Technology Inc v Lectra Systems Ltd* [1997] RPC 443; *Johnson v Gore Wood & Co*. [2001] 1 All ER 481, 503 (Lord Bingham), 528 (Lord Millett).

[69] [1997] RPC 443.

action and thus there is no risk of multiplicity of actions, double recovery or prejudice to creditors.

B. SHAREHOLDER CLAIMS FOR TYPES OF LOSS THAT ARE SEPARATE AND DISTINCT FROM THE COMPANY'S LOSS

782. A shareholder may suffer a direct loss upon an injury to the company if it has entered into loan agreements to fund the activities of the company. The elements of the damage might include bank or mortgage interest and charges and tax liabilities associated with the loan capital.[70]

783. In *Maffezini v Spain*,[71] Maffezini alleged that funds from his personal bank account were transferred to his local investment company in Spain 'EASMA'[72] without his consent by a representative of a Spanish state enterprise, 'SODIGA',[73] which had a shareholding in EASMA.[74] The tribunal concluded that SODIGA's representative had used public authority to procure the transfer and that this action constituted a breach of the Argentina/Spain BIT.[75] This claim was akin to a personal action by a shareholder rather than a derivative action for prejudice caused to the company itself. It was thus clearly admissible.[76]

784. Similarly, in *Lanco v Argentina*,[77] Lanco was not only a shareholder in the company to which the concession was granted by Argentina, but also a party to the concession agreement in its own right. Hence the tribunal was correct to surmise that Lanco had 'certain rights and obligations as a foreign investor'.[78]

Rule 49. A claim founded upon an investment treaty obligation which seeks a remedy for the diminution of value of a shareholding in a limited liability company having the nationality of the host contracting state party is admissible if the claimant can establish a *prima facie* case that: (i) the assets of the company have been expropriated by the host contracting state party

[70] *Johnson v Gore Wood & Co*. [2001] 1 All ER 481, 503–4 (Lord Bingham).
[71] (Merits) 5 ICSID Rep 419.
[72] Emilio A. Maffezini SA (*ibid*. 426/39).
[73] Sociedad para el Desarrollo Industrial de Galicia (*ibid*).
[74] *Ibid*. 433–4/72–3.
[75] *Ibid*. 435–6/83.
[76] Argentina had objected to Maffezini's standing to 'to seek to lift the corporate veil and sue in his personal capacity for damages sustained by the company'. This objection was rejected by the tribunal at the jurisdictional phase of the proceedings: *Maffezini v Spain* (Preliminary Objections) 5 ICSID Rep 396, 409/65, 410/69–70.
[77] *Lanco v Argentina* (Preliminary Objections) 5 ICSID Rep 367.
[78] *Ibid*. 373/11.

so that the shareholding has been rendered worthless; or (ii) the company is without or has been deprived of a remedy to redress the injury it has suffered; or (iii) the company is without or has been deprived of the capacity to sue either under the *lex societatis* or *de facto*; or (iv) the company has been subjected to a denial of justice in the pursuit of a remedy in the system for the administration of justice of the host contracting state party.

A. INTRODUCTION

(i) Shareholder claims for reflective loss in municipal law

785. There is no consensus among municipal legal systems as to the circumstances in which a shareholder should be entitled to bring a claim against third parties for damage inflicted upon the company.[79] It is not difficult to understand why the problem is intractable: once the door is open for such actions there is a distinct possibility of multiple proceedings in different fora with respect to the same loss (i.e. by other shareholders and the company itself) and thus double recovery against the third party. Moreover, the position of creditors of the company might be prejudiced if the shareholders recover in preference to the company.[80]

786. Corporate personality in municipal legal systems entails the company's capacity to own property in its own right so that it is not merely agent or trustee for its shareholders. Likewise, the debts of the company must be recovered from the company itself rather than the shareholders and the contracts entered into by the company do not bind the shareholders for they are not privy to the contractual relationship. The general position with respect to civil wrongs committed against the company is that the cause of action vests in the company rather than in the shareholders so that any redress must be sought by proceedings in the name of the company. Thus, according to the English Court of Appeal:

> The company acquires causes of action for breaches of contract and for torts which damage the company. No cause of action vests in the shareholder. When the shareholder acquires a share he accepts the fact that the

[79] It is generally accepted that the right of a shareholder to bring a derivative action in respect of wrongs done to the company is a matter of substance and not procedure and is governed by the law of the place of incorporation. See, in England: *Konamaneni v Rolls-Royce Industrial Power (India) Ltd* [2002] 1 WLR 1269; *Base Metal Trading Ltd v Shamurin* [2004] EWCA Civ 1316, [2005] 1 WLR 1157; *Dicey, Morris and Collins on the Conflict of Laws* (2006, 14th edn by L. Collins *et al*.) 1348–9.

[80] These problems are articulated in several US decisions including: *Green v Victor Talking Machines Co* 24 F 2d 378, 380 (1928); *Massachusetts v Davis* 320 US 310 (1942).

> value of his investment follows the fortunes of the company and that he can only exercise his influence over the fortunes of the company by the exercise of his voting rights in general meeting ... If it is right that the law has conferred or should in certain restricted circumstances confer further rights on the shareholder the scope and consequences of such further rights require careful consideration.[81]

787. Whilst it is generally the case that the cause of action to recover damages for an injury to the company vests in the company itself rather than in its shareholders, in some exceptional circumstances it is possible to characterise the injury as one to the shareholders as well based on a diminution in value of their property and thus giving rise to a personal cause of action with respect to those losses. If a shareholder has nothing more than a contractual right to participate in the company on the terms of the articles of association then a blanket rule barring claims by shareholders against third parties and the company itself would command the force of logic. So long as this right to participate, including the right to collect dividends, remain unaffected by the actions causing loss to the company, there is no scope for the shareholders to pursue a claim in their own name. But this is by no means an adequate description of the rights attaching to shares. A shareholder's relationship to the company has proprietary elements and shares as an item of property have a marketable value distinct from the assets of the company.[82] If damage is caused to that property by a third party, then the shareholder has in this sense suffered a *personal* loss.

788. In short, there is no absolute doctrinal imperative to characterise the cause of action as vesting in the company and the company alone,[83] but the 'scope and consequences' of any right vesting in the shareholders must be carefully assessed due to the problems previously enumerated; namely the potential for multiplicity of actions and double recovery and prejudice to the creditors of the company.

789. A comparative analysis of derivative claims by shareholders in municipal legal systems suggests that common law countries recognise a wider range of derivative claims than civilian countries.[84] In France, for instance, the principal circumstances in which a shareholder can act on behalf of the company are restricted to: (i) a request for the annulment of a collective decision that

[81] *Prudential Assurance Co v Newman Industries* [1982] Ch 204, 224.
[82] See: P. Davies, *Gower's Principles of Modern Company Law* (1997, 6th edn) 302.
[83] Even the ICJ in *Barcelona Traction* noted that 'the law has recognized that the independent existence of the legal entity cannot be treated as an absolute': 1970 ICJ Rep 4, 39.
[84] The USA appears to be the most liberal in this respect: Bernhard Grossfield, *International Encyclopedia of Comparative Law* (Vol. 13) 107. See generally: A. Pinto and G. Visentini, *The Legal Basis of Corporate Governance in Publicly Held Corporations: A Comparative Approach* (1998); Xiaoning Li, *A Comparative Study of Shareholders' Derivative Actions* (2007). In relation to Germany: The German Act Regarding Integrity of Companies and Modernization of Stock Corporation Law (UMAG), Arts. 147 and 148.

constitutes an '*abus de droit*';[85] (ii) the enforcement of the liability of a company officer;[86] (iii) a request for the dissolution of the company;[87] and (iv) a request for the nomination of an administrator.[88]

790. In this chapter, the principles of admissibility are inspired by a comparative analysis of municipal laws and the experience of international courts and tribunals. As these principles regulate the admissibility of international claims a simple *renvoi* to the company law of the host respondent state is inappropriate. First, it could make the admissibility of an international claim entirely dependant upon the acts of the host state. Second, it would not give sufficient weight to the particular vulnerabilities of foreign shareholders in companies incorporated in the host state.

(ii) Shareholder claims for reflective loss in investment treaty arbitration

791. We have considered the general position in municipal legal systems. It must also be the general position with respect to investment treaty regimes because precisely the same problems emerge where shareholders are permitted to claim for reflective loss against the host state. Investment treaty arbitration is not spared the complexities arising in municipal law merely because the shareholder's cause of action is founded upon an international obligation in a treaty rather than upon a tort or contract in municipal law. Indeed, the complexities are only augmented because the tribunal does not have the same procedural powers to ensure the fair distribution of damages among the interested parties by joining all such parties to the arbitration proceedings or appointing a receiver if the company itself is incapacitated.

792. The starting point in considering claims for reflective loss in investment treaty arbitration must be the general distinction between an injury to the company and a loss to the shareholder in municipal law. In this sense the International Court's differentiation of 'rights' and 'interests' of shareholders in *Barcelona Traction* is important. According to the Court's rationalisation, only the 'rights' of shareholders attract international legal protection:

> [W]henever a shareholder's interests are harmed by an act done to the company, it is to the latter that he must look to institute appropriate action; for although two separate entities may have suffered from the same wrong, it is only one entity whose rights have been infringed.[89]

[85] Civil Code, Art. 1833. An example is where the majority shareholders adopt a resolution that furthers their own interests to the detriment to the '*intérêt social*' of the company.

[86] Civil Code, Art. 1843–5.

[87] Decision of the Court of Cassation, Cass Com, 21 October 1997, No. 2182; Decision of the Court of Cassation, Cass Civ 1ère, 18 July 1995, No. 1609.

[88] Decision of the Court of Cassation, Cass Civ 3ème, 21 November 2000, No. 1542.

[89] 1970 ICJ Rep 4, 35. See also: Separate Opinion of Morelli J, *ibid*. 236–7.

> …[A]n act directed against and infringing only the company's rights does not involve responsibility towards the shareholders, even if their interests are affected … The situation is different if the act complained of is aimed at the direct rights of the shareholder as such. It is well known that there are rights which municipal law confers upon the latter distinct from those of the company, including the right to any declared dividend, the right to attend and vote at general meetings, the right to share in the residual assets of the company on liquidation. Whenever one of his direct rights is infringed, the shareholder has an independent right of action.[90]

793. Merely to recognise this distinction between the company's rights and the shareholder's interests is not to resolve the problem of demarcation. At the point of departure for undertaking this task is the imperative of faithfully transposing the concept of a shareholding in municipal law to the international plane. It follows that a shareholder should be able to claim for reflective loss in situations analogous to those permitted in municipal legal systems. This point of departure is, however, no more than that. It is for investment treaty tribunals to develop a coherent and balanced set of principles to deal with the admissibility of shareholder actions for reflective loss and, as the English Court of Appeal counselled, consider the 'scope and consequences' of any extension in favour of the shareholder in each and every case.

794. Before the advent of investment treaty arbitration, international tribunals were very much alive to the consequences of admitting claims for reflective loss by shareholders. In *Delagoa Bay Railway Company*,[91] the Portuguese government had granted a concession to build and operate a railroad to a Portuguese company, whose shares were owned by an English company. The principal shareholder of the English company was a US citizen. A tripartite arbitration agreement was entered into between Portugal, Britain and the USA in relation to the claims arising out of the Portuguese government's violation of the concession. The resulting award is often cited as authority for the admissibility of shareholder claims for reflective loss. In fact the award records that:

> [T]he only person who, in accordance with strict law, would have standing to appear as claimant vis-à-vis the Portuguese government would have been the (Portuguese) company which had received the concession to build and operate the railroad, since it is the only one which entered into a contractual relationship with the respondent State and the one dispossessed by the cancellation. However, the respondent government having

[90] *Ibid*. 36.

[91] B. Moore, *History and Digest of the International Arbitrations to which the United States has been a Party* (1893) 1865.

> itself declared that it will not oppose any objection to the fact that the person with a real legitimacy to act is not a party of the present litigation, the arbitral tribunal must record the fact that the parties have by common agreement decided to replace such person by the (English) Delagoa Bay Company.[92]

795. But even more importantly, the arbitral tribunal recognised that an award of damages to the English company would have to take into account the rights of creditors to the Portuguese company:

> [T]he amount allowed by the present award cannot be attributed to the English company except on the condition that this company effects such amount to the payment of its creditors, debenture holders and others which may exist, in accordance with their respective privileges … Since such creditors have not been directly represented in the proceedings and having lacked therefore the opportunity to formulate its cases and conclusions, the Tribunal cannot by itself effect such distribution.[93]

796. A similar sensitivity to the distinction between corporate rights and shareholder rights and to the problems of quantifying reflective losses is revealed in several awards of the various Mixed Claims Commissions hearing claims against Venezuela.[94]

797. The four categories of admissible claims for reflective loss in Rule 49 have been formulated to achieve a balance between the objectives of reducing the sovereign risk attaching to investments in shares and preserving the integrity of the host state's system for the administration of justice; to ensure that the protection of the claimant's rights over its shares in the company is not at the expense of the rights of the third party creditors of the company; and to safeguard against the destructive force of opening the floodgates to an infinite number of derivative claims by minority shareholders in a large company.

798. Although not purporting to offer a solution to the problem of derivative claims in the investment treaty context, the award in *GAMI v Mexico*[95] is of singular importance as a guide through the potential traps and pitfalls that must be negotiated by a tribunal in dealing with a derivative claim.

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[92] *Ibid*.
[93] *Ibid*.
[94] See: *Kunhardt Co. (USA v Venezuela)* 9 RIAA 171 (1903) ('the shareholders of a corporation are not co-owners of the property of the corporation during its existence; they only have in their possession a certificate which entitles them to participate in the profits and to become owners of proportional parts of the property of the corporation when the latter is by final adjudication dissolved or liquidated'); *Brewer, Moller and Co.*10 RIAA 433–5; *Baasch & Romer (Netherlands v Venezuela)* 10 RIAA 723; *Aslop (Chile v USA)* 11 RIAA 349.
[95] (Final Award, 15 November 2004) UNCITRAL.

798C. GAMI Investments, Inc v Government of the United Mexican States[96]

GAMI, a US company, owned 14.18 per cent of the shares in a Mexican holding company named GAM,[97] which in turn owned five sugar mills in Mexico.[98] GAMI advanced claims alleging breaches of Mexico's obligations under NAFTA on the basis of Mexico's failure to fulfil its regulatory functions under the legislative regime established for the sugar industry. GAMI alleged that this blend of misfeasance and nonfeasance resulted in a crisis in the industry beginning in 1999.[99] Mexico's response to the crisis was to expropriate 22 of the 56 private sugar mills in operation in Mexico, including all five of the mills owned by GAM, on 3 September 2001.[100]

GAM challenged the legality of the expropriation of its sugar mills before the Mexican courts.[101] On 20 February 2004, some months before the hearing on the merits of GAMI's NAFTA claims, a Mexican court upheld that challenge and annulled the expropriation of GAM's mills.[102] This decision (referred to as the '*Sentencia*' in the Award) was not subject to further appeal and the procedure for determining the indemnity for the expropriation was confirmed by Mexico to be in progress.[103]

GAMI's claims were brought under Article 1116 of NAFTA, and, insofar as it did not own or control GAM, no waiver on behalf of GAM was required by Article 1121. GAM was thus entitled to prosecute its *amparo* proceedings in the Mexican courts to their successful conclusion.

In the opening paragraph dealing with GAMI's claims, the tribunal identified their 'derivative' nature:

> A fundamental feature of GAMI's claims is that they are derivative. GAMI does not claim that Mexican governmental measures were directed against its shareholding in GAM. Its grievance is that the value of its shareholding was adversely affected by measures which caused GAM's business to suffer. Another fundamental aspect of the case is that GAMI cannot invoke contractual commitments by Mexico. Neither GAM nor GAMI had contracts with the Government. GAMI therefore cannot say that its investment decision was predicated on contractual promises to establish or maintain a certain regime for its investment.[104]

96 (Merits).
97 Grupo Azucarero México SA de CV.
98 *Ibid*. paras. 1, 12.
99 *Ibid*. para. 16.
100 *Ibid*. para. 17.
101 *Ibid*. para. 18.
102 *Ibid*. para. 8.
103 *Ibid*. GAM had not pursued its challenge to the expropriation of two of its five mills before the Mexican courts, apparently because they were loss making enterprises (*ibid*. para. 18).
104 *Ibid*. para. 23.

From the foregoing description of GAMI's claims, one must conclude that Rule 47, dealing with admissible claims based upon the infringement of a shareholder's direct rights, and the second to the fourth limbs of Rule 49 are not applicable in these circumstances. That leaves the first limb of Rule 49, which would permit GAMI to plead a claim alleging the expropriation of its shares in GAM resulting from the total destruction of their value by acts attributable to Mexico.

The tribunal upheld the admissibility of GAMI's expropriation claim under Article 1110 of NAFTA and this is consistent with Rule 49. But the intervening judgment of the Mexican court, which 'neutralised'[105] the effect of Mexico's expropriation of GAM's mills, rendered GAMI's expropriation claim for reflective loss based upon the total destruction of the value of its shareholding untenable. GAMI sought to overcome this obstacle by agreeing to relinquish the value of its shares in GAM in the event its expropriation claim was upheld.[106] The tribunal rejected this device, for '[it] cannot be indifferent to the true effect on the value of the investment of the allegedly wrongful act'.[107] The expropriation claim was therefore dismissed.

Contrary to Rule 49, the tribunal also upheld the admissibility of GAMI's fair and equitable treatment claim for reflective loss to its shareholding in GAM under Article 1105 of NAFTA.[108] It is useful to trace the tribunal's reasoning on the merits of this claim in order to expose the consequences of its admissibility. The tribunal formulated the question concerning the admissibility of GAMI's claims under Article 1116 as follows:

> The issue is whether a breach of NAFTA leads with sufficient directness to loss or damage in respect of a given investment.[109]

As a general statement of principle this is unimpeachable and it underlines the delineation of admissible and inadmissible claims in Rule 49. The question is whether a breach of the fair and equitable standard of treatment by measures of the host state affecting a company is capable of leading to 'sufficient directness to loss or damage in respect of a given investment' in shares of the company. For the purposes of admissibility, the tribunal assumed that it was. Such a finding, however, produces insurmountable difficulties with respect to the quantification of any loss to the investor/shareholder. The tribunal in *GAMI* faced up to these difficulties squarely in the opening paragraph of its consideration of the Article 1105 claim:

[105] *Ibid*. para. 35.
[106] *Ibid*. para. 133.
[107] *Ibid*.
[108] The tribunal also upheld the admissibility of GAMI's claim for a breach of the national treatment standard in Article 1102 of NAFTA. The tribunal devotes far more attention to GAMI's Article 1105 claim in its Award and thus it is this latter claim that is the focus of the ensuing analysis.
[109] *Ibid*. para. 33.

> One cannot fail to observe that GAMI's complaint of alleged unfair and inequitable treatment is not connected with a demonstration of specific and quantifiable prejudice. Mexico's alleged wrongdoing would doubtless have resulted in some short-term decline in the value of its shares in GAM. (There would have been no loss of dividends: GAM's business strategy has never been to distribute earnings to shareholders.) The ultimate duration of this unspecified decline in value is uncertain. It was bound to be reserved to some degree by the return of the… wrongfully expropriated mills ... [The tribunal then listed all the factors pointing towards GAM's positive commercial prospects for the future.]
>
> GAM's approach seems to be all or nothing. But no credible cause-and-effect analysis can lay the totality of GAMI's disappointments as an investor at the feet of the Mexican Government ... GAMI can assert only the maladministration of the Sugar Program caused it *some* prejudice ... Absent a complete destruction of its investment GAMI has not identified a particular point in time when a metaphorical snapshot of its prejudice should be taken. It may be that such demonstration is impossible in this case. At any rate the tribunal would have been in no position to award damages even if it had found a violation of Article 1105.[110]

The tribunal in *GAMI* also gave a lucid account of the difficulties that attend the tribunal's mission if due consideration is given to the rights of the creditors of the company and the possibility of disparate proceedings in multiple judicial fora in relation to the same events leading to the same injury.[111]

> A consequence of GAMI's independent right of action under NAFTA may be illustrated by a hypothetical example. The notional compensation of GAM by Mexico in an amount representing M$100 per share would not in principle disentitle GAMI from asking the NAFTA Tribunal for an additional amount representing an additional M$50 per share. But the theory gives rise to a number of practical difficulties. One might imagine a perfect world in which a national court of last recourse sits down with a NAFTA tribunal incapable of reviewable error to discharge their respective responsibilities. This could be done quite logically. The Mexican court could order payment to GAM based on an evaluation of the five expropriated mills. As a matter of mathematics that evaluation might represent M$100 per share of all shares of GAM. At the same time the NAFTA tribunal might find that a higher level of compensation was mandated and thus order a top-up to GAMI of M$50 per share proportionate to its 14.18% shareholding. This would be a graphic

110 *Ibid*. paras. 83–5.
111 *Ibid*. paras. 36–42, 116–22.

> illustration of the value to GAMI of its entitlement to a direct international remedy beyond its indirect benefit from the national remedy obtained by GAM. A state cannot avoid international responsibility by arguing that the foreigner must content himself with whatever compensation has been decreed by national authorities.
>
> This scenario is of course a fantasy. It is factually implausible. It lacks legal foundation. The Tribunal is aware of no *procedural* basis on which such coordination could take place. And the *Sentencia* itself plausibly rejects the right of shareholders to challenge the expropriation on the *substantive* ground that the protected interest is that of the corporate owner of the expropriated assets.
>
> The scenario also lacks commercial credibility. On what basis could one rationally conclude that the payment to GAMI should be reduced to account for the payment to GAM? It is an acknowledged fact that GAM has never paid a dividend to its shareholders. Why should GAMI's recovery be debited on account of a payment to GAM which is perhaps utterly unlikely to find its way to the pockets of its shareholders?
>
> The overwhelming *implausibility* of a simultaneous resolution of the problem by national and international jurisdictions impels consideration of the practically *certain* scenario of unsynchronised resolution.
>
> It is sufficient to consider the hypothesis that a NAFTA tribunal were to order payment to GAMI before the Mexican courts render their final decision. One might adapt the hypothetical example given… above. GAMI would thus have received M$150 per share. (There would have been no prior offsetting Mexican recovery.) What effect should the Mexican courts now give to the NAFTA award? How could GAM's recovery be reduced because of the payment to GAMI? GAM is the owner of the expropriated assets. It has never paid dividends. It would have been most unlikely to distribute revenues in the amount recovered by GAMI. At any rate such a decision would have required due deliberation of GAM's corporate organs. Creditors would come first. And other shareholders would have an equal right to the distribution. GAM would obviously say that it is the expropriated owner and that its compensatable loss under Mexican law could not be diminished by the amount paid to one of its shareholders.
>
> These difficulties are attributable to the derivative nature of GAMI's claim.[112]

799. The tribunal in *GAMI* was ultimately spared the task of fashioning a decision that might overcome the problems relating to quantification of loss,

[112] *Ibid*. paras. 116–21.

multiplicity of actions by disparate interested parties, the rights of creditors, and so on, because GAMI's claims were dismissed on the merits. The question must be asked as to whether GAMI's Article 1105 claim in particular was *destined* to fail from the moment it wriggled through the net cast by Article 1116. That is certainly the impression that is left by the tribunal's careful analysis of the spectrum of issues arising from this type of claim for reflective loss. If that impression is accurate then it suggests that such a claim is inherently misconceived as a matter of law and must properly be deemed to be inadmissible under Article 1116 of NAFTA. This means that the claim should have been brought under Article 1117 if the controlling shareholder of GAMI qualified for NAFTA protection. Unfortunately subsequent tribunals have relied upon *GAMI* to uphold the admissibility of derivative shareholder claims without considering the tribunal's extensive discussion of the problems inherent in such claims in the section of the award dealing with the merits.[113]

B. FIRST LIMB OF RULE 49: EXPROPRIATION OF THE ASSETS OF THE COMPANY

800. International and municipal legal precedents recognise the possibility of an admissible claim by a shareholder in circumstances where there has been a total destruction of the value of the company's assets.[114] The *El Triunfo* claim[115] is perhaps the best example of the first limb of Rule 49. A concession for the monopoly over steam navigation at the port of El Triunfo was granted by the Government of El Salvador and subsequently acquired by the El Salvadoranean company 'El Triunfo Company Ltd', of which the principal shareholder was the American company 'Salvador Commercial Company'. The local management of El Triunfo Company convened an illegal meeting of the board of directors in order to ratify a petition for bankruptcy, which was filed at the court of first instance at Santiago de Maria. The court made a declaration of bankruptcy and appointed a receiver. Salvador Commercial Company called for a meeting of the shareholders of El Triunfo Company in order to annul the court's decision and to recover control of the El Triunfo Company. The next day, the President of El Salvador issued a decree by which he cancelled the concession and awarded it to a group of citizens of El Salvador.

[113] E.g. *BG v Argentina* (Merits) paras. 196–200.

[114] For instance, in England the Court of Appeal ruled that a claimant could pursue a claim where his shares had become valueless because of the harm occasioned to the company: *Giles v Rhind* [2003] Ch 618.

[115] *Rosa Gelbtrunk and the 'Salvador Commercial Company'* (*El Salvador & USA*) 15 RIAA 459 (1902).

801. The two arbitrators distinguished between the actions of the local conspirators and the presidential decree. Redress for any prejudice caused by the former had to be sought in the name of El Triunfo Company itself in the courts of Salvador. As soon as the President intervened on the side of the local conspirators, however, 'the only thing of value worth retrieving through the courts'[116] had been destroyed. It was this executive act that vested the American shareholder with an admissible claim in relation to its interest in El Triunfo Company.[117]

802. Shareholder claims for the expropriation of the company's assets are admissible because such prejudice affects the shareholder's rights rather than merely its interests. The shareholder's right to the enjoyment of its property in its shares is devoid of content if those shares are in an empty corporate shell. The taking or destruction of the company's assets entails that it is impotent to generate value for the shares in the future and hence the consequences for the shareholder are not ephemeral but permanent. For this reason, the direct expropriation of the company's assets is capable of constituting the indirect expropriation of the shareholding as well. All other types of prejudice caused to the company do not vest admissible investment claims in its shareholders because such prejudice only affects the interests of the shareholders and not its rights. It is the company that must seek a remedy and the prejudice to the shareholders' interests might be rectified over time by success in the company's pursuit of that remedy, or by shareholder value generated in the usual pursuit of the company's activities.

803. The USA's position as a NAFTA Party is consistent with the first limb of Rule 49. It has differentiated between the admissibility of an expropriation claim by a shareholder under Article 1116 of NAFTA and other claims that would be inadmissible as vesting exclusively in the company. Such other claims, according to the USA, would have to be brought in the name of the company under Article 1117 of NAFTA.[118]

804. One particular category of cases that might be deemed to be admissible by investment treaty tribunals is where the company has settled its claims against

[116] *Ibid*. 476.

[117] The arbitrators usefully reflected upon the hypothetical situation whereby the Republic of Salvador had asserted a just cause to terminate the concession by reference to the conduct of the El Triunfo Company: 'if the Republic of Salvador, a party to the contract which involved the franchise to El Triunfo Company, had just grounds for complaint that under its organic law the grantees had, by misuser or nonuser of the franchise granted, brought upon themselves the penalty of forfeiture of their rights under it, then the course of that Government should have been to have itself appealed to the courts against the company and there, by the due process of judicial proceedings, involving notice, full opportunity to be heard, consideration, and solemn judgment, have invoked and secured the remedy sought' (*ibid*. 478).

[118] USA, Article 1128 Submission on Jurisdiction in *GAMI v Mexico*, 30 June 2003, available at: http://naftaclaims.com/Disputes/Mexico/GAMI/GAMIus1128Jurisdiction.pdf.

the host state for undervalue. There is no consensus in common law countries as to whether a shareholder should be able to claim reflective loss in this situation. In New Zealand it is permissible,[119] whereas in England it is not.[120] No doubt a treaty tribunal would have to tread very carefully where the settlement has been reached by the receiver of a company in liquidation so as to avoid a conflict between the interests of the shareholders and the creditors. There is authority for this exception in the investment treaty context in *GAMI v Mexico*:[121] 'Clearly GAMI [an American minority shareholder in the Mexican company GAM] would not lose its rights if the outcome had been that the local courts upheld the expropriation and fixed a derisory amount of compensation.'[122]

C. SECOND LIMB OF RULE 49: DEPRIVATION OF A REMEDY FOR THE COMPANY

805. If no remedy is available to the company to redress the injury caused by the host state pursuant to its law (or another *lex causae* determined by the conflicts of law rules of the host state) then the shareholder's claim in investment treaty arbitration must be admissible.[123]

806. In *BG v Argentina*,[124] the tribunal found that the executive branch of the host state had interfered with the normal operation of the courts so that, if the admissibility of the claimant shareholder's claims were to be denied, the respondent would be permitted to:

(a) restrict the effectiveness of domestic judicial remedies as a means to achieve the full implementation of the Emergency Law and its regulations;
(b) insist that claimant go to domestic courts to challenge the very same measures; and
(c) exclude from the renegotiation process any licensee that does bring its grievance to local courts.[125]

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[119] *Christensen v Scott* [1996] 1 NZLR 273 (NZ CA).
[120] The majority of the House of Lords in *Johnson v Gore Wood & Co*. [2001] 1 All ER 481 refused to follow the New Zealand Court of Appeal's decision in *Christensen v Scott*, *ibid*.: 503 (Lord Bingham), 522 (Lord Hutton), 531–2 (Lord Millett). Only Lord Cooke was prepared to defend the result in *Christensen v Scott*: *ibid*. 510–15. The English Court of Appeal's decision in *Barings plc (in administration) v Coopers & Lybrand (a firm)* [1997] 1 BCLC 427 favoured the approach in *Christensen v Scott*, but this authority must now be in doubt after the House of Lords decision in *Johnson v Gore Wood & Co*. [2001] 1 All ER 481, 520 (Lord Hutton).
[121] (Merits).
[122] *Ibid*. para. 38(A).
[123] This appears to have been the basis for upholding the admissibility of claims before several Mixed Claims Commissions: *Baasch & Romer* (*Netherlands v Venezuela*) 10 RIAA 723.
[124] (Merits).
[125] *Ibid*. 156.

807. This approach to admissibility appears to be consistent with the second limb of Rule 49.

808. Some municipal systems of law do recognise a right of the shareholder to sue for reflective loss in circumstances where the company suffers a loss but has no cause of action.[126]

D. THIRD LIMB OF RULE 49: DEPRIVATION OF THE COMPANY'S CAPACITY TO SUE

809. The company may be deprived of its legal capacity to sue *ab initio* by virtue of the particular rules relating to standing pursuant to the *lex societatis* of the company (the law of the host state) or *ex post facto* if those rules have been modified or manipulated by the host state in connection with the particular dispute. Rule 49 also refers to *de facto* incapacity, which might arise where the theoretical existence of standing to sue as a matter of law is emptied of practical utility.

810. This third limb of Rule 49 relating to the incapacity of the company is wider than the equivalent exception in the context of diplomatic protection. The International Court in *Barcelona Traction* held that a right vests in a shareholder (here in the shareholder's government) to pursue an international claim for reflective loss caused by an injury to the company only where the company ceases to exist *de jure*. Notwithstanding the Court's observation that 'from the economic viewpoint the company has been entirely paralyzed',[127] so long as the Barcelona Traction Corporation remained in receivership, it continued to exist in law and hence no international claim could be advanced on behalf of the shareholders.[128]

811. The individual opinions rendered by several of the judges in *Barcelona Traction* reveal a greater concern with substance than form and, even if the Court's narrow formulation might have accurately reflected the general position in municipal legal systems at that time, that position should no longer hold today.

812. Judge Fitzmaurice stated the exception as applying where: (i) the company has the same nationality as the host state; (ii) the host state is responsible for the very acts or damage complained of; and, (iii) as a result the company is incapable *de facto* of protecting its interests and hence those

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[126] In England: *Johnson v Gore Wood & Co*. [2001] 1 All ER 481, 503 (Lord Bingham) citing *Lee v Sheard* [1955] 3 All ER 777, 778; *Fischer (George) GB Ltd v Multi-Construction Ltd* [1995] 1 BCLC 260; *Gerber Garment Technology Inc v Lectra Systems Ltd* [1997] RPC 443.

[127] *(Belgium v Spain)* 1970 ICJ 3, 40.

[128] According to the ICJ: 'Only in the event of the legal demise of the company are the shareholders deprived of the possibility of a remedy available through the company' (*ibid*. 41).

of the shareholders.[129] In this situation, 'the very authority to which the company should be able to look for support or protection is itself the author of the damage'.[130] Judges Jessup and Gros endorsed the same exception in similar terms and all three judges rejected the requirement that the company must have ceased to exist *de jure*.[131] In contrast, Judge Padilla Nervo insisted upon the 'legal death' of the corporation before the shareholders would acquire a right of action,[132] as did Judge Ammoun.[133]

813. In *Deutsche Amerikanische Petroleum Gesellschaft Oil Tankers*,[134] the US Reparation Commission referred to the awards in *Delagoa Bay* and *El Triunfo* and commented that:

> [I]t was clearly specified that the shareholders and debenture-holders were admitted, in view of the circumstances, to be exercising, not their own rights, but the rights which the company, wrongfully dissolved or despoiled, was unable thenceforth to enforce; and they were therefore seeking to enforce not direct and personal rights, but indirect and substituted rights.

814. There are some authorities in common law jurisdictions for the proposition that where the company is unable to pursue its own action because it is procedurally incapacitated due to the actions of the defendant, then the shareholder is entitled to recover for reflective loss. For instance, the English Court of Appeal in *Giles v Rhind*[135] allowed the shareholder to pursue a claim for reflective loss where the defendant's actions had brought the company into insolvency.[136]

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[129] *Ibid*. 72. If the Barcelona Traction Company had been a Spanish company, then Judge Fitzmaurice would have found that a cause of action on behalf of the Belgium shareholders was admissible (*ibid*. at 75).

[130] *Ibid*. 72. According to Fitzmaurice J, in such a situation, '[the corporate entity's] personality is no longer anything but a fiction void of all meaning, in which there can now be seen nothing but a bundle of individual rights' (*ibid*. 73).

[131] *Ibid*. 191–3 (Jessup J). Like Fitzmaurice J, Jessup J does not insist upon the demise of the company *de jure*: 'The doctrine in question generally does not insist that the life of the corporation must have been extinguished so that it could be said the shareholders had acquired a direct right to the assets' (*ibid*. 193). '[S]urely no economic, social or political advantage would be gained if in a situation like that in the instant case, the life of the Barcelona Traction Company had to be officially ended in Canada so that the principal shareholders, who are the real parties in interest, could be protected diplomatically.' *Ibid*. 220. Likewise, Gros J said that: 'In the present case the company has been entirely deprived of the means for pursuing its corporate objects and, from the point of view of the shareholders, this produces the same effects as a disappearance of the company. The shade of difference is therefore a matter of form or rather of formality. As from 1952 the corporate objects of the Barcelona Traction group have been void of meaning.' *Ibid*. 276.

[132] *Ibid*. 256.

[133] *Ibid*. 318–20.

[134] 2 RIAA 777 (1926).

[135] [2003] Ch 618.

[136] In Singapore: *Hengwell Development Pte Ltd v Thing Chiang Ching* [2002] 4 SLR 902 (Singapore High Court).

E. FOURTH LIMB OF RULE 49: DENIAL OF JUSTICE IN THE PURSUIT OF A REMEDY BY THE COMPANY

815. If the company suffers a denial of justice in the pursuit of a remedy within the host state's system for the administration of justice,[137] then a shareholder's claim for reflective loss should in principle be admissible, subject to Rule 50.

816. A serious flaw in the International Court's judgment in *Barcelona Traction* is that it failed to take into account the substantive complaint of the Belgium shareholders; namely, that Barcelona Traction Corporation had suffered a denial of justice in the Spanish courts. This omission perhaps entered into the Court's reasoning because too much attention was devoted to the status of the company, both *de jure* and *de facto*, rather than the status of the remedies available to the company to repair the confiscation of its assets. The reality was that any further appeal to the Spanish judicial organs for relief would have been completely futile and hence an exception to the general rule prohibiting a shareholder action should have come into play. But even if a remedy was available to the Barcelona Traction Corporation in the Spanish courts, it could still have been found to have been frustrated because of the acts attributable to the Spanish authorities. By stripping the company of its assets and means to seek redress, the legal remedies, even if theoretical available, had been put beyond the company's reach. In this situation, the shareholders should have been able to avail themselves of an exception based upon the expropriation of the company's assets or a denial of justice suffered by the company.

F. INADMISSIBLE SHAREHOLDER CLAIMS FOR REFLECTIVE LOSS

(i) *The enforcement of a contractual obligation or other undertaking owed to the company but not to the shareholder by means of an investment treaty claim*

817. A shareholder cannot enforce rights under a contract between its company and the host state by prosecuting an investment treaty claim. The shareholder has no cognisable legal interest in the contract and hence it cannot be the object of an investment treaty claim: it is inadmissible.

[137] This assumes that the company has exhausted local remedies as a substantive requirement for the delict of denial of justice. See generally: J. Paulsson, *Denial of Justice in International Law* (2005) Ch 5.

818. In *BG v Argentina*,[138] BG was attempting to enforce rights under a licence for the distribution of natural gas, which was granted by the Argentine President to MetroGAS, an Argentine company in which BG (an English company) had a minority shareholding interest. Consistent with Rule 49, the tribunal found that: 'BG does not have standing to seize this Tribunal with "claims to money" and "claims to performance", or to assert other rights, which it is not entitled to exercise directly.'[139]

819. The most striking illustration of a failure to recognise this principle, and the consequential difficulties encountered on the merits, is the award in *CMS v Argentina*.

819C. CMS Gas Transmission Company v Argentine Republic[140]

The award in *CMS*, which followed soon after the award in *GAMI*, was among the first to uphold a claim for fair and equitable treatment by a minority shareholder.

In 1995, CMS, an American company, acquired 29.42 per cent of the shares in an Argentine company TGN,[141] a company created for gas transportation following the privatisation of public utilities in the late 1980s.[142] At the time of CMS's investment, the legal regime for the gas transportation activities was regulated by the licence granted to TGN by the Government in conjunction with several legislative acts and decrees. That regime provided for (i) the calculation of gas tariffs in US dollars to be converted into pesos at the time of billing and (ii) the adjustment of tariffs every six months in accordance with the US Producer Price Index (US PPI).[143]

A serious economic crisis began to unfold in Argentina towards the end of the 1990s and the Argentine Government requested the gas companies, including TGN, to agree to the temporary suspension of the US PPI adjustment of the gas tariffs from 1 January 2000.[144] The suspension was agreed but subject to the gas companies' right to recoup the costs of the deferral at a later time.[145] Further deferrals were then negotiated with the gas companies as the economic crisis deepened, but no adjustments were made by the Government as originally promised to enable the gas companies to recover their resulting lost income.[146] CMS, as a shareholder of TGN, instituted ICSID proceedings on 12 July 2001.

[138] (Merits).
[139] *Ibid*. para. 214.
[140] (Preliminary Objections) 7 ICSID Rep 492; (Merits).
[141] Transportadora de Gas del Norte.
[142] (Merits) paras. 53–8.
[143] *Ibid*. paras. 54–7.
[144] *Ibid*. paras. 59–60.
[145] *Ibid*. para. 60.
[146] *Ibid*. paras. 61–3.

In late 2001, the peso collapsed and there was a massive run on deposits held in Argentine banks. On 7 December 2001, the Argentine Government announced that it could no longer service its foreign debt repayments, leading to the largest default on foreign debt in history. Following the resignation of a succession of Presidents and several Ministers in the midst of rioting and nationwide strikes, the interim President and Argentine Congress passed an Emergency Law on 6 January 2002, by which a public emergency was declared until 10 December 2003.[147] The Emergency Law abolished the right of licensees of public utilities to calculate the tariffs in US dollars and adjust tariffs according to the US PPI.[148] Moreover, the tariffs were redenominated in pesos at the rate of one peso to the dollar, as were all private contracts denominated in dollars or other foreign currencies.[149] CMS supplemented its claim in the ICSID proceedings to include a claim for damages based on the effects of the Emergency Law upon the value of its shareholding in TGN.[150]

Argentina objected to the admissibility of CMS's claims on the ground that the substantive rights that formed the basis of such claims belonged to TGN and not to CMS as a shareholder.[151]

In ruling upon this objection, the tribunal conflated the questions of jurisdiction and admissibility and, perhaps for this reason, fell into serious error.[152] There could be no question of the tribunal's jurisdiction *ratione personae* over CMS. CMS, a legal entity incorporated in the United States, had made an investment in shares that satisfied the definition of an investment both in Article 25(1) of the ICSID Convention and Article I(1) of the Argentina/USA BIT. There could also be no question of the tribunal's jurisdiction *ratione materiae* over the dispute between CMS and Argentina insofar as it was a 'legal dispute arising directly out of an investment' pursuant to Article 25(1) of the ICSID Convention and an 'investment dispute' pursuant to Article VII of the BIT. The contentious issue related to the *admissibilit*y of the *claims* advanced by CMS.

The essence of Argentina's objection to the substantive admissibility of CMS's specific claims was that the rights invoked to substantiate those claims did not belong to CMS but to TGN. Considering the nature of the objection, it is at once surprising and disturbing that there is no analysis (or even articulation) of the specific claims advanced by CMS in the tribunal's decision. This omission suggests that the tribunal mistakenly assumed that, by upholding its jurisdiction, the admissibility of the claims must

147 *Ibid*. para. 64.
148 *Ibid*. para. 65.
149 *Ibid*.
150 (Preliminary Objections) 7 ICSID Rep 492, 518–9/116–120.
151 *Ibid*. 501/36.
152 See also: *Azurix v Argentina* (Preliminary Objections) para. 67.

automatically follow.[153] Indeed the tribunal, in its consideration of the position under the ICSID Convention and the BIT, answered Argentina's objection to admissibility by expressly affirming its jurisdiction on each occasion;[154] in other words, the tribunal merely affirmed the capacity of CMS to bring its investment dispute to an ICSID tribunal in accordance with the BIT and the ICSID Convention. But with respect to the admissibility of the specific claims advanced by CMS, the only finding of the tribunal is the following statement that is too general to throw any light on the problem:

> The tribunal therefore finds no bar in current international law to the concept of allowing claims by shareholders independently from those of the corporation concerned, not even if those shareholders are minority or non-controlling shareholders.[155]

It is certainly true that there is no comprehensive bar to shareholder actions, as is reflected in Rule 49; but the converse must also be true – there cannot be a comprehensive eligibility either, for otherwise a host state might be exposed to an almost infinite number of claims by minority shareholders in a single large multinational corporation in respect of a single injury. Unfortunately, there is no further elaboration upon the tribunal's statement in the appropriately titled 'Decision on Objections to Jurisdiction'. So we must go to the tribunal's final award to extract more information about the rights invoked by CMS to substantiate its claims in order to determine whether they are admissible. In the section entitled 'CMS's Legal Justification of its Claims' it is noted:

> The claimant is of the view that the measures adopted by the Argentine Government are in violation of the commitments that the Government made to foreign investors in the offering memoranda, relevant laws and regulations and the License itself.[156]

The essence of CMS's treaty claims were thus the violation of commitments alleged to have been made to CMS by the Argentine Government. Put differently, CMS was seeking the international protection of these commitments by reference to the minimum standards of treatment set out in the BIT. For those claims to have been admissible, the rights arising from such commitments must have belonged to CMS and not to TGN. If that were the case, then it would be a permissible shareholder action in accordance with Rule 48.[157] It is, therefore, necessary to examine each alleged source of right that is alleged to vest in CMS as a shareholder rather than in TGN as a company.

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[153] This impression is confirmed by the tribunal's statement that: 'The distinction between admissibility and jurisdiction does not appear quite appropriate in the context of ICSID as the Convention deals only with jurisdiction and competence.' (Preliminary Objections) 7 ICSID Rep 492, 502/41.

[154] *Ibid*. 506/56, 508/65. Argentina's objection to admissibility was clearly noted by the tribunal in this part of its reasoning (*ibid*. 506–7/59).

[155] *Ibid*. 504/48.

[156] (Merits) paras. 84–5.

[157] There was, moreover, no allegation of a denial of justice in respect of the proceedings involving TGN before the Argentine courts.

The most obvious source of such a right was the offering memorandum which enticed CMS to make its investment in TGN. If the Argentine Government made commitments of the type relied upon by CMS in this memorandum, then any subsequent breach of such commitments would be actionable by reference to the fair and equitable treatment standard. Such a claim is clearly admissible pursuant to Rule 48.

Next we must consider the Licence. The parties to the Licence were TGN and Argentine Government. CMS was therefore not privy to this relationship as a shareholder of TGN and could not, therefore, derive rights from the Licence that were capable of attracting international protection. In the same way, Argentina could not insist that CMS was bound by TGN's obligations under the Licence, including, for instance, the obligation to submit any disputes to the federal courts of Buenos Aires.[158]

The only precedent cited by the tribunal in support of its general statement on admissibility was the *ELSI* case, where it was found by the Chamber of the International Court that Raytheon and Machlett, the US shareholders in ELSI, had no right to an orderly liquidation deserving the protection of international law because ELSI was insolvent at the relevant time. The general principles of municipal legal systems do not confer an exclusive right upon the shareholders to control and manage the liquidation of the company where it is insolvent. Nor do municipal legal systems vest shareholders with the rights under contracts and licences entered into or granted to the company. CMS cannot have a legitimate expectation or acquired right based on a theory of shareholders' rights that does not exist in any jurisdiction of the world. A claim by CMS asserting rights based on the Licence is therefore inadmissible.

In the event, the tribunal upheld the admissibility of all CMS's claims and determined on the merits that Argentina had violated the fair and equitable standard of treatment and the umbrella clause in the BIT and assessed the damages owing to CMS by using the discounted cash flow method. The consequences of the tribunal's approach to admissibility can now be usefully examined.

The standard of fair and equitable treatment was said to have been violated because Argentina had failed to respect its 'solemn legal and contractual commitments' concerning the 'stability and predictability of the business environment'[159] that had induced CMS to make its investment in TGN. The possible sources for these 'solemn' commitments have been touched upon earlier. They were the offering memoranda and the Licence. The tribunal found that the offering memoranda were not legally binding and were prepared by private consultants rather than the Argentine Government. That left the tribunal with the Licence and the stabilisation

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[158] As was found by the tribunal: (Preliminary Objections) 7 ICSID Rep 492, 510/76.
[159] (Merits) para. 284.

clauses contained therein which obliged the Argentine Government (i) not to freeze the tariff regime or subject it to price controls or (ii) not to alter the basic rules governing the Licence without TGN's written consent.[160] The tribunal found that these commitments had been breached, thereby attracting Argentina's international responsibility under the fair and equitable treatment standard and the umbrella clause.[161]

Investment treaty obligations do not protect expectations that are wholly unsubstantiated by reference to the municipal law of the host state or general principles of municipal legal systems. Just as a minority shareholder cannot rely upon an investment treaty obligation to cast a majority vote at the annual meeting of shareholders, neither can a shareholder invoke an investment treaty obligation to assert the rights of the company, thereby bypassing the principles relating to privity of contract and corporate personality.

Suppose that TGN had given its written consent to an alteration of the basic rules governing the Licence to ensure that it could continue to realise a commercial return on its gas transportation activities during the period of economic recovery in Argentina. Could CMS assert that it is not bound by this corporate act and claim damages in an investment treaty arbitration on the basis of TGN's commercial return prior to the alteration of the Licence? Or suppose that TGN had recovered damages in the Argentine courts for the Government's failure to comply with the terms of the Licence and the proceeds were reinvested by TGN. Could CMS recover further damages, perhaps on a different basis, in an investment treaty arbitration? Suppose finally that TGN returns to profitability and the Board of Directors resolves to reduce its indebtedness to creditors rather than pay dividends to shareholders. Could CMS nevertheless recover an amount commensurate with the value of its shares prior to the financial crisis in Argentina in an investment treaty arbitration?

If the tribunal's reasoning is followed to its logical conclusion, each of these questions would be answered in the affirmative.

(ii) Breach by the host state of the obligation of fair and equitable treatment or full protection or security or national treatment or most-favoured-nation treatment or other minimum standard of treatment with respect to measures attributable to the host state taken against the company except where the company is deprived of capacity or a remedy in accordance with Rule 49

820. The first limb of Rule 49 provides that claims by shareholders for reflective loss where the company's assets have been expropriated are admissible. In such a situation, the shareholder's rights are devoid of content; they are rights to an

[160] *Ibid*. para. 302.
[161] *Ibid*. paras. 275, 302–3.

empty corporate shell. It follows that the shareholder's rights have been indirectly expropriated as well as the company's assets and hence the shareholder's claim for expropriation must be admissible. In contradistinction, if the company has been prejudiced by measures attributable to the host state which fall short of the expropriation of its assets, the shareholder's rights are not thereby extinguished and the damage to the shareholder has merely taken the form of a diminuition in the value of its shares. In this situation, the shareholder must look to the company to pursue a remedy against the host state for the shareholder's rights have not been prejudiced, only its interests.

821. Where investment treaty tribunals have admitted shareholder claims for reflective loss founded upon a breach of the obligation of fair and equitable treatment or full protection or security or national treatment or most-favoured-nation treatment or other minimum standard of treatment, an intractable problem has arisen as to where to draw the line. The problem was confonted in *Enron v Argentina*. The problems with the solution proposed by the tribunal reinforces the justification for Rule 49.

821C. Enron Corporation and Ponderosa Assets, L.P. v The Argentine Republic[162]

The facts in the *Enron* case bear many similarities with the *CMS* case, and the claims were based upon the same Argentina/USA BIT. Enron's investment in the privatised gas industry of Argentina was in the 'TGS' company,[163] the owner of a network for the transportation and distribution of gas produced in the southern provinces of Argentina.[164] Enron was the ultimate beneficiary of 35.263 per cent of the shares in TGS, having structured its investment through several corporate layers.[165]

Enron advanced two claims against Argentina. The first concerned stamp taxes levied by several Argentine provinces on the operations of TGS.[166] The second was an 'ancillary claim' arising from the refusal of the Argentine Government to allow the adjustment of tariffs pursuant to the United States Producer Price Index and the calculation of tariffs in US dollars.[167]

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[162] *Enron v Argentina* (Preliminary Objections) 11 ICSID Rep 273; (Merits).

[163] Transportadora de Gas del Sur.

[164] (Preliminary Objections) 11 ICSID Rep 273, 277/21.

[165] *Ibid*. Enron's beneficiary interest in the shares of TGS was held by two corporate structures. First, Enron owned two companies, 'EPCA' and 'EACH'. These two companies owned 50% of the shares in 'CIESA' (an Argentine company). CIESA owned 55.30% of the shares in TGS. Second, EPCA, EACH and 'ECIL' (another Enron-owned company), owned 75.93% of 'EDIDESCA' (an Argentine company). EDIDESCA owned 10% of the shares in TGS. Through these two structures, Enron claimed beneficial ownership of 35.263% of the shares in TGS.

[166] (Preliminary Objections) 11 ICSID Rep 273, 278/25.

[167] *Enron v Argentina* (Preliminary Objections: Ancillary Claim) 11 ICSID Rep 295, 296/8.

Argentina raised an objection to the admissibility of Enron's claims because Enron could not, as a shareholder of TGS, identify any rights attaching to that shareholding, which had been affected by measures attributable to Argentina. The tribunal stated the question to be decided in the following terms:

> The Argentine Republic has rightly raised the concern about the fact that if minority shareholders can claim independently from the affected corporation, this could trigger an endless chain of claims, as any shareholder making an investment in a company that makes an investment in another company, and so on, could invoke a direct right of action for measures affecting a corporation at the end of the chain.[168]

The tribunal dealt with this 'concern' as follows. First, it correctly characterised the question as one of admissibility.[169] Secondly, the tribunal postulated that it could be resolved by 'establishing the extent of the consent to arbitration of the host State'.[170] Thirdly, the tribunal ruled that '[i]f consent has been given in respect of an investor and an investment, it can be reasonably concluded that the claims brought by such investor are admissible under the treaty'.[171] Fourthly, by applying this test to the facts, the tribunal concluded:

> At the hearing on jurisdiction held in the present case, the Tribunal put a question to the parties as to whether the Claimants had been invited by the Government of Argentina to participate in the investment connected to the privatization of TGS. It turned out that this had been precisely the case.[172]

It followed that all the claims advanced by Enron were admissible.[173]

The test for admissibility devised by the tribunal was thus founded upon the criterion of an 'invitation'. The specific indices of the invitation extended by Argentina to a class of foreign investors that included Enron were recounted as follows:

> [T]he Information Memorandum issued in 1992 and other instruments related to the privatisation of the gas industry had specifically invited foreign investors to participate in this process. A 'road show'

[168] (Preliminary Objections) 11 ICSID Rep 273, 283/50.
[169] *Ibid*. 283–4/52.
[170] *Ibid*.
[171] *Ibid*.
[172] *Ibid*. 284/54.
[173] *Ibid*. 284/56. This test was approved in: *African Holding Co. v Congo* (Preliminary Objections) paras. 100–1. Again, in *Société Générale v Dominica* (Preliminary Objections) paras. 49–51, the tribunal applied the test in *Enron* and concluded that it could extend to claims by entities separated from the investment 'by several corporate layers'.

> followed in key cities around the world and specific meetings with the Claimants were held in this context.[174]

The criterion of an 'invitation' for the purposes of determining the admissibility of shareholder claims is very problematic. Reliance upon such conduct of a third party would not create an independent duty to a shareholder in municipal legal systems.[175] In the *Enron* case, the Information Memorandum (a document with no legal significance that was prepared by private consultants), a 'road show' and 'specific meetings' were found to discharge the test. Would the investor's attendance at a presidential banquet also qualify? Or would lunch with the relevant minister suffice? In short, the test proposed by the tribunal suffers from its obvious subjectivity and cannot be generalised without confronting the intractable difficulty of where to draw the line. At one level it could be said that all foreign investors who qualify for investment treaty protection are 'invited' by the host state, insofar as the very policy underlying the treaty is the promotion and encouragement of such investments.

The proper test for admissibility of shareholder claims in this context does not rest upon evidence of an 'invitation' by the host state but rather upon the existence of a legal relationship between the investor and the host state. If, for example, the Information Memorandum had established a contractual relationship between Enron and Argentina, then Enron's investment treaty claims based upon the disappointment of its contractual expectations might have been admissible within Rule 47. But if the claimant did not secure a direct legal relationship with the host state, then the investment treaty cannot fill this void. Indeed, it would be very surprising if a sophisticated investor like Enron contemplated that its participation in a 'road show' and the like would attain singular importance for the admissibility of its treaty claims several years later.

As previously stated, the tribunal affirmed the admissibility of the claims, thus permitting Enron to challenge the imposition of a tax upon TGS, despite these two entities being separated by three corporate layers. It was noted in relation to the *CMS* case that the legal quagmire into which interested third parties are thrown by such an approach to admissibility was identified and then passed over by the Tribunal; the same can be said about the *Enron* award. Here TGS had been successful before the Argentine Supreme Court in securing a provisional stay for the collection of the taxes.[176] The tribunal nevertheless decided to proceed to the merits of Enron's claim, which alleged the *expropriation* of its investment by the

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174 *Enron v Argentina* (Preliminary Objections) 11 ICSID Rep 273, 284/55.

175 For instance, in England, the Court of Appeal ruled that a private bank did not owe an independent duty to a shareholder in addition to the company even where the bank courted the shareholder to be its client and gave investment advice to the shareholder personally: *Diamantides v JP Morgan Chase Bank* [2005] EWCA Civ 1612.

176 (Preliminary Objections) 11 ICSID Rep 273, 278/26.

imposition of the taxes.[177] Suppose, in the meantime, the general meeting of shareholders of TGS decided to ratify a settlement with the provincial tax authorities for a third of the amount presently claimed and a reduction on TGS's future tax liability. Enron causes the TGS shareholders in which it has an indirect interest, CIESA and EDIDESCA, to vote against the settlement, but the majority shareholders prevail. Can Enron maintain its investment treaty claim against Argentina? Or consider a scenario whereby the provisional stay is lifted and the taxes are imposed. Enron then successfully prosecutes its investment treaty claim and recovers damages. But following the tribunal's award, TGN manages to have the imposition of taxes quashed in the Argentine courts as *ultra vires*.[178] Surely these variations on the theme are not so far-fetched as to justify a primitive solution that is oblivious to them. The tribunal in *GAMI* certainly did not think so.

822. The concern expressed by the *Enron* tribunal about the prospect of an endless chain of claims of different shareholders in different companies with indirect control over the same investment was taken up in *Noble v Ecuador*.[179] The tribunal's answer to this problem does not inspire confidence:

> The Tribunal does not disagree with the statement made by the *Enron* tribunal. There may well be a cut-off point somewhere, and future tribunals may be called upon to define it. In the present case, the need for such a definition does not arise. Indeed, the cut-off point, whatever it may be, is not reached with two intermediate layers. The relationship between the investment and the direct shareholder, on the one hand, and the indirect shareholder, on the other, is not too remote.[180]

823. It is impossible to make a legal judgment on the remoteness of a claim unless one has a legal test for remoteness in mind. The 'need for such a definition' certainly did arise.

(iii) The intractable problems of quantifying the loss for inadmissible shareholder claims

824. A tribunal's failure to give proper analysis to the admissibility of a derivative claim by a shareholder generates intractable problems in respect of the quantification of damages if the claim is upheld on the merits. In other words, the assertion of jurisdiction over an inadmissible claim by a shareholder

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[177] *Ibid*. 288/74. It was essential for Enron to make out a case of expropriation in order to fall within the exception to the exemption of taxation matters from the scope of the tribunal's jurisdiction *ratione materiae* in Article XII of the BIT, which is reproduced at *ibid*. 285–6/61.

[178] According to the tribunal: 'The Federal Government has supported before the courts TGS's arguments in respect of the illegality or inapplicability of the taxes assessed, including the view that some taxes violate the law of Federal Co-participation that governs the relationship between the Federal Government and the Provinces' (*ibid*. 278/26).

[179] (Preliminary Objections).

[180] *Ibid*. para. 82.

leads to consequential errors in the assessment of damages. Two such consequential errors can be found in the jurisprudence to date.

825. The first is for the tribunal to assess the damages to an investment in shares flowing from a breach of an investment treaty obligation by employing the standard of compensation for an expropriation even where the tribunal has ruled that there has been no expropriation. If there has not been an expropriation of the assets of the company and the shares retain a positive value, then a tribunal cannot assess the damages payable to the shareholder as if those shares had no value at all. To avoid the obvious injustice to the host state by following this approach, tribunals have ordered the claimant to transfer its shares to the host state. This was the solution adopted in *CMS v Argentina* and, for the reasons considered below, it is flawed as beyond the powers of the tribunal.

826. The second consequential error is to assess damages on the basis of a crude estimate of the loss to the shareholder caused by an injury to the company. The leading example of such an error is the award in *Nykomb v Latvia*.

826C. CMS Gas Transmission Company v The Republic of Argentina[181]

It is important in this context to recall that the tribunal dismissed the expropriation claim because 'the investor is in control of the investment; the Government does not manage the day-to-day operations of the company; and the investor has full ownership and control of the investment'.[182] As stated in Rule 49, a claim for reflective loss based upon the total destruction of the value of the shareholding due to the expropriation of the assets of the company is *prima facie* admissible and such a claim, if substantiated, would not cause difficulties for the assessment of damages: the investor would be entitled to recover the market value of the shares before the acts constituting the expropriation. But what of a finding that certain general measures of the host state have impaired the value of shares, which are still within the ownership and control of the investor? This was the essence of the tribunal's determination that the fair and equitable standard and the umbrella clause had been violated by Argentina. One might assess the damages as the amount corresponding to the deterioration in the value of the shares during the relevant period when the acts attributable to the host state caused the impairment. Such an approach does, however, present a tribunal with an acute problem. So long as the investor remains the owner of the shares, and the company a going concern, there is a distinct possibility that the share value has or will improve along with the fortunes of the company over the course of time.[183]

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[181] (Merits).

[182] *Ibid*. para. 263.

[183] The tribunal indeed forecasted significant improvements in relation to the demand for gas and the revenues of TGN in its assumptions for the discounted cash flow analysis (*ibid*. para. 446).

How, then, did the *CMS* tribunal deal with this conundrum? In effect, the tribunal assessed the damages owing to CMS as if there had been a total destruction of the share value and thus an expropriation. It employed the discounted cash flow method to determine the value of TGN before the adjudged violations of the BIT and awarded damages based on a proportion of this value corresponding to the shareholding of CMS.[184] The discounted cash flow method is employed to determine the value of an enterprise in the context of a sale to a purchaser in the market. If the enterprise has been expropriated, then this method is clearly appropriate. But TGN had not been expropriated; it continues to conduct its activities in the gas sector in Argentina and, in the fullness of time, one would expect that its share value will increase as the Argentine economy recovers. CMS anticipated this obvious objection to its double recovery and so offered to transfer its shares in TGN to Argentina.[185] The tribunal endorsed this offer by making an order to that effect and calculated the price Argentina was obligated to pay.[186] This compulsory purchase order was essential to the logic of the tribunal's assessment of damages, which had proceeded on the fiction that CMS had been deprived of its shares or the entire value thereof. But it was manifestly beyond the jurisdiction of the tribunal to make such an order. On what basis can one party to arbitration proceedings be compelled to purchase an asset from the other party? A tribunal has jurisdiction to determine the compensation flowing from a breach of a legal obligation. It is impossible to rationalise the sum payable by Argentina pursuant to the compulsory purchase order as part of that compensation.

827. By embarking upon the adjudication of what should have been found to be an inadmissible claim, the tribunal in *CMS* ultimately had to resort to a fiction in order to assess damages (the expropriation of CMS's shares) and an impermissible device to mitigate the injustice of that fiction (a compulsory purchase order). There is no better illustration of the importance of a disciplined and principled approach to the admissibility of claims. In *GAMI v Mexico*,[187] GAMI sought to bypass the task of assessing the damage caused by the acts of maladministration attributable to Mexico – a task the tribunal described as perhaps being 'impossible' – by suggesting the following 'remedy': it quantified its loss as if the value of its shares had been totally destroyed and simultaneously offered to transfer its shares in GAM to the Mexican Government. This was the same ploy adopted by the tribunal in *CMS*. But the tribunal in *GAMI* flatly rejected this approach:

GAMI has staked its case on the proposition that the wrong done to it did in fact destroy the whole value of its investment. GAMI seeks to lend credibility to its posture by agreeing to relinquish its shares in GAM as a condition of the award it seeks. It suggests that any residual value is

[184] *Ibid*. para. 411.
[185] *Ibid*. para. 465.
[186] *Ibid*. para. 469.
[187] (Merits).

therefore of no moment. This posture is untenable. The Tribunal cannot be indifferent to the true effect on the value of the investment of the allegedly wrongful act.[188]

827C. Nykomb Synergetics Technology Holding AB v Republic of Latvia[189]

This award has already been examined in the context of Rule 44. It will be recalled that the tribunal decided to exercise its jurisdiction over a claim brought by the parent company, Nykomb (a Swedish company), in respect of a dispute concerning an entitlement to a double tariff rate in a contract between its local subsidiary, Windau, and the Latvian state company, Latvenergo.

The following determination by the tribunal should have resulted in a finding of inadmissibility in respect of Nykomb's derivative claim:

> In the present case, there is no possession taking of Windau or its assets, no interference with the shareholder's rights or with the management's control over and running of the enterprise – apart from ordinary regulatory provisions laid down in the production licence, the off-take agreement, etc.
>
> The Tribunal therefore concludes that the withholding of payment at the double tariff does not qualify as an expropriation or the equivalent of an expropriation under the Treaty.[190]

Nykomb was alive to the legal difficulties of maintaining a derivative action as a shareholder of Windau. In its submissions, Nykomb suggested that the tribunal's award might be considered as binding upon Windau as well by virtue of the doctrine of *res judicata* in international law as this entity was 'wholly-owned and under direct control' of Nykomb.[191] If the award of the tribunal were to be *res judicata* against Windau as a 'privy' of Nykomb, then it would be difficult to maintain that Nykomb was not bound by Windau's choice of jurisdiction in its Contract with Latvenergo by virtue of the same close relationship. In the event, the tribunal did not consider Nykomb's *res judicata* point in its award.

Nykomb further anticipated problems in the quantification of its losses and alleged that the tribunal had the discretion to award damages 'directly to the investment enterprise Windau rather than to Nykomb as claimant investor'.[192] The tribunal implicitly rejected this contention because its

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188 *Ibid*. para. 133.
189 (Merits) 11 ICSID Rep 158.
190 *Ibid*. 194/section 4.3.1.
191 *Ibid*. 161/section 1.2.1.
192 *Ibid*.

exercise of jurisdiction was premised upon the notion that '[Nykomb] must be understood to claim for the losses or damages it has incurred itself' as opposed to those incurred by Windau as the party to the Contract. The tribunal went on to adjudge that Latvenergo's insistence that the 0.75 tariff multiplier should be applied instead of the double rate was a breach of the ECT.[193] What losses or damages had Nykomb suffered as a result?

The tribunal must be commended as being among the first to acknowledge the axiomatic rule of valuation that a loss to a company is not reflected exactly as a loss to a shareholder:

> [T]he reduced flow of income into Windau obviously does not cause an identical loss for Nykomb as an investor. If one compares this with a situation where Latvenergo would have paid the double tariff to Windau, it is clear that the higher payments for electric power would not have flowed fully and directly through to Nykomb. The money would have been subject to Latvian taxes etc., would have been used to cover Windau's costs and down payments on Windau's loans etc., and disbursements to the shareholder would be subject to restrictions in Latvian company law on payment of dividends. An assessment of [Nykomb's] loss on or damage to its investment based directly on the reduced income flow into Windau is unfounded and must be rejected.[194]

The problem of quantifying 'reflective loss' has been analysed extensively in many jurisdictions. It is an issue that does not evaporate in the international stratosphere of an investment treatment claim. The tribunal was forthcoming in recognising the complexity of the problem[195] but, in so doing, left itself exposed to criticism for the arbitrariness of its solution. The tribunal resolved to make a 'discretionary award' by taking the loss estimated to have been suffered by Windau and dividing it by three.[196] There is no explanation of how the factor of three was calculated. The claimant/shareholder was thus absolved from having to prove causation and the quantum of its damages in the normal way.[197]

[193] *Ibid*. 194/section 4.3.2. The tribunal found specifically that Nykomb had been subjected to a 'discriminatory measure' in the context of Art. 10(1) of the ECT.

[194] *Ibid*. 200/section 5.2. Elsewhere, the tribunal noted that: 'An award obliging the Republic to make payments to Windau in accordance with the Contract would also in effect be equivalent to ordering payment under Contract No. 16/07 in the present Treaty arbitration.' *Ibid*. 199/section 5.1.

[195] The tribunal noted that: '[T]he loss or damage suffered by Nykomb as an investor is difficult to quantify'. This difficulty was augmented by the fact that 'the Tribunal had little material upon which to base an assessment, apart from various submitted financial analyses and Windau's accounts for the last few years' (*ibid*. 200/section 5.2).

[196] *Ibid*.

[197] The tribunal noted that: '[T]he Claimant has submitted rather limited documentation concerning the financial and economic situation of Windau and the circumstances concerning its own investment' (*ibid*.).

G. THE SPECIAL CASE OF THE EUROPEAN CONVENTION ON HUMAN RIGHTS

828. It is instructive to consider the jurisprudence of the European Court of Human Rights on shareholder claims for reflective loss based upon Article 1 of Protocol No. 1 ('A1P1') of the European Convention on Human Rights which, like the majority of investment treaties, does not expressly regulate the problem. The solution has, therefore, been developed judicially by interpreting the text of A1P1 in conformity with general principles of law relating to the rights attaching to shareholdings in limited liability companies. A1P1 reads:

> Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.
>
> The proceeding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.

829. The Court has never had any difficulty in recognising that shares constitute a 'possession' for the purposes of A1P1.[198] Hence the starting point is no different from an investment treaty that includes shares in its definition of an investment. But whereas that consideration tends to signal the end of the analysis in the investment treaty context, the European Court of Human Rights has addressed the separate question of admissibility by seeking to preserve the essential characteristics of a shareholding as revealed in comparative law. The leading case is *Agrotexim v Greece*:[199]

> [I]n its report the Commission seems to accept that where a violation of a company's rights protected by Article 1 of Protocol No. 1 (P1-1) results in a fall in the value of its shares, there is automatically an infringement of the shareholders' rights under that Article (P1-1). The Court considers that such an affirmation seeks to establish a criterion – and in the Court's view an unacceptable one – for according shareholders *locus standi* to complain of a violation of their company's rights under Article 1 of Protocol No. 1 (P1-1).
>
> It is a perfectly normal occurrence in the life of a limited company for there to be differences of opinion among its shareholders or between its shareholders and its board of directors as to the reality of an infringement of the right to the peaceful enjoyment of the company's possessions or

198 E.g. *Bramelid and Malmström v Sweden* (1982) 29 DR 64.
199 21 EHRR 250.

> concerning the most appropriate way of reacting to such an infringement … To adopt the Commission's position would be to run the risk of creating – in view of these competing interests – difficulties in determining who is entitled to apply to the Strasbourg institutions … Concerned to reduce such risks and difficulties the Court considers that the piercing of the 'corporate veil' or the disregarding of a company's legal personality will be justified only in exceptional circumstances, in particular where it is clearly established that it is impossible for the company to apply to the Convention institutions through the organs set up under its articles of incorporation or – in the event of liquidation – through its liquidators.[200]

830. *Agrotexim* has been subsequently applied in numerous cases before the Court.[201] Moreover, in *Olczak v Poland*,[202] the Court adopted the International Court of Justice's distinction between a shareholder's rights and interests in *Barcelona Traction*:

> A wrong done to the company can indirectly cause prejudice to its shareholders, but this does not imply that both are entitled to claim compensation. Whenever a shareholder's interests are harmed by a measure directed at the company, it is up to the latter to take appropriate action. An act infringing only the company's rights does not involve responsibility towards the shareholders, even if their interests are affected.[203]

831. The Court has recognised an exception to this general rule of inadmissibility for derivative claims in cases where the company has been put into liquidation and the shareholders have been deprived of an opportunity to contest the validity of the appointment of receivers for the company.[204]

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[200] *Ibid*. paras. 64–6.

[201] *Samardžić and Ad Plastika v Serbia* (Case 28443/05, 17 July 2007) paras. 30–2; *Teliga v Ukraine* (Case 72551/01, 21 December 2006) para. 87; *Bulinwar Ood and Hrusanov v Bulgaria* (Case 66455/01, 12 April 2007) para. 27; *Terem Ltd, Chechetkin and Olius v Ukraine* (Case 70297/01, 18 October 2005) paras. 28–30; *'Iza' Ltd and Makrakhidze v Georgia* (Case 28537/02, 27 September 2005) paras. 28–30; *Amat-G Ltd and Mebaghishvili v Georgia* (Case 2507/03, 27 September 2005) paras. 32–4; *Géniteau v France (No. 2)* (Case 4069/02, 8 November 2005) para. 22 ('La Cour relève que … le requérant ne se plaint pas en l'espèce d'une violation de ses droits en tant qu'actionnaire de la société Valeo, mais que son grief se fonde exclusivement sur l'allégation selon laquelle une violation du droit au respect de ses biens résulterait de la baisse de valeur de ses actions du fait d'une atteinte au patrimoine de la société. Se pose dès lors la question de savoir si le requérant peut se prétendre "victime" au sens de l'article 34 de la Convention. La Cour rappelle sa jurisprudence, selon laquelle il n'est justifié de lever le "voile social" ou de faire abstraction de la personnalité juridique d'une société que dans des circonstances exceptionnelles, notamment lorsqu'il est clairement établi que celle-ci se trouve dans l'impossibilité de saisir par l'intermédiaire de ses organes statutaires les organes de la Convention.').

[202] (Case 30417/96, 7 November 2002).

[203] *Ibid*. para. 59.

[204] *Credit and Industrial Bank v Czech Republic* (Case 29010/95, 21 October 2003) para. 6; *G.J. v Luxembourg* (Case 21156/93, 26 October 2000) para. 24. A further exception has been recognised in relation to a 'one-man' company: *Khamidov v Russia* (Case 72118/01, 15 November 2007) para. 12.

H. THE SPECIAL CASE OF NAFTA

832. Articles 1116 and 1117 of NAFTA create a sophisticated mechanism for dealing, *inter alia*, with shareholder actions. Article 1116 governs a 'claim by an investor on its own behalf' in relation to damage caused by the breach of a NAFTA obligation. Article 1117, on the other hand, deals with a 'claim by an investor on behalf of an enterprise'. An enterprise is defined as 'a juridical person that the investor owns or controls directly or indirectly'.

833. It is clear that a non-controlling shareholder cannot make a claim under Article 1117, for paragraph 3 of Article 1117, which deals with the potential multiplicity of proceedings, refers to the possibility that a 'non-controlling investor' in the same enterprise is making a claim under Article 1116.[205] Moreover, if a non-controlling shareholder in an enterprise has submitted a claim under Article 1116, and that claim is for reflective loss, then it is obliged to submit written evidence to the arbitral tribunal that the enterprise itself has waived any claim for damages in any other judicial forum (including, it would seem, an international forum)[206] as a condition precedent to the submission of its claim under Chapter 11 of NAFTA in accordance with Article 1121. Hence, if the majority of shareholders of the enterprise in question vote against the waiver, the non-controlling shareholder cannot bring a claim for reflective loss under Article 1116 of NAFTA. A waiver is also required from the enterprise in the case of a claim brought under Article 1117.

834. These provisions are carefully designed to eliminate as far as possible the problem of multiple proceedings relating to the same loss caused by the same measures attributable to the host state by prohibiting claims by minority (or majority) shareholders where the company itself is pursuing a remedy in a

[205] The text of Art. 1117(3) reads: 'Where an investor makes a claim under this Article and the investor or a non-controlling investor in the enterprise makes a claim under Article 1116 arising out of the same events that gave rise to the claim under this Article, and two or more of the claims are submitted to arbitration under Article 1120, the claims should be heard together by a Tribunal established under Article 1126, unless the Tribunal finds that the interests of a disputing party would be prejudiced thereby.' See Appendix 3.

[206] Art. 1121(1)(b) refers to 'any administrative tribunal or court under the law of any Party, or *other dispute settlement procedures*'. Insofar as Art. 1117 refers to 'an investor of a Party, on behalf of an enterprise of *another* Party' then the possibility of the enterprise having a separate right under Art. 1116 of NAFTA or another investment treaty is excluded (as the enterprise would be a national of the host state), unless 'another Party' could be the third NAFTA State (i.e. not the national State of the investor and not the host state of the investment). This possibility, however, appears to be excluded by the subsequent use of the post-determiner 'other': 'An investor of a Party, on behalf of an enterprise of another Party that is a juridical person that the investor owns or controls directly or indirectly, may submit to arbitration under this Section a claim that the *other* Party has breached an obligation.' Nevertheless, the reference to 'other dispute settlement procedures' in Art. 1121 might well encompass international arbitration based upon an arbitration agreement in a contract between the enterprise and the host state.

different judicial forum.[207] Moreover, Article 1135 serves to protect the rights of the creditors of the enterprise by ensuring that any damages recovered by an action brought on behalf of the enterprise pursuant to Article 1117 are paid to the enterprise and not to the investor/shareholder, thus allowing the creditors to enforce any security interests or other rights they may have over the assets of the enterprise, which would include the award.[208]

835. The question left open by the careful scheme enacted by Articles 1116 and 1117 is whether a shareholder can bring an action for reflective loss under Article 1116, in addition to an action to recover damages for an injury to its direct rights. The arguments for and against each possible interpretation are evenly balanced. One must first resolve a threshold question as to the relationship between Articles 1116 and 1117. Can an investor who does own or control an enterprise elect to bring a claim under Article 1116 for reflective loss, or *must* it bring an action under Article 1117 in this situation? The latter interpretation is to be preferred. Otherwise the safeguard built into Article 1135(2) to protect creditors of the company would be nullified because the investor would recover the damages suffered by the enterprise directly under Article 1116, rather than the enterprise itself in an action under Article 1117. Thus, according to the tribunal in *Mondev v USA*:

> Having regard to the distinctions drawn between claims brought under Articles 1116 and 1117, a NAFTA tribunal should be careful not to allow any recovery, in a claim that should have been brought under Article 1117, to be paid directly to the investor.[209]

836. The inference here is that if a claim can be brought under Article 1117 then it must be brought under Article 1117 rather than Article 1116. The same inference must be drawn from the documents accompanying the implementation of NAFTA in the United States:

> Articles 1116 and 1117 set forth the kinds of claims that may be submitted to arbitration: respectively, allegations of *direct* injury to an investor, and allegations of *indirect* injury to an investor caused by injury to a firm in the host country that is owned or controlled by an investor.[210]

837. Then we must turn to the waiver requirements for an Article 1116 claim as set out in Article 1121(1):

> 1. A disputing investor may submit a claim under Article 1116 to arbitration only if:

[207] Save for ‘injunctive, declaratory or other extraordinary relief, not involving the payment of damages, before an administrative tribunal or court under the law of the disputing Party’.

[208] *Mondev v USA* (Merits) 6 ICSID Rep 181, 212/84.

[209] *Ibid*. 213/86.

[210] North American Free Trade Agreement, Implementation Act, Statement of Administrative Action, H.R. Doc. 103–59 (Vol. 1, 1993) 145.

[…]

(b) the investor and, where the claim is for loss or damage to an interest in an enterprise of another Party that is a juridical person that the investor owns or controls directly or indirectly, the enterprise, waive their right to initiate or continue [other legal proceedings] …

838. If Article 1121(1)(b) were to be interpreted in isolation from the previous conclusion with respect to the relationship between Articles 1116 and 1117, the following possibilities arise:

(a) the investor is permitted to bring a claim for reflective loss, but only where the investor owns or controls the enterprise and a waiver is submitted by that enterprise, or
(b) the investor is permitted to bring a claim for reflective loss, both in circumstances where either (i) the investor owns or controls the enterprise and a waiver by the enterprise is given, or (ii) where the investor does not own or control the enterprise and the waiver requirement for the enterprise is thereby implicitly dispensed with, or
(c) the reference in Article 1121(1)(b) to a claim 'for loss or damage to an interest in an enterprise' implies that any claim under Article 1116 must be for the direct infringement with the investor's rights over its shares (i.e. claims covered by Rule 47) but only where the investor owns or controls the enterprise in question, or
(d) same as for (c) but such direct claims can be made both in circumstances where either (i) the investor owns or controls the enterprise and a waiver by the enterprise is given, or (ii) where the investor does not own or control the enterprise and the waiver requirement for the enterprise is thereby implicitly dispensed with.[211]

839. If the premise that a claim that can be brought under Article 1117 must be brought under Article 1117 is correct, then possibilities (a) and (b) can be excluded. Possibility (c) should also be excluded because otherwise a minority shareholder would not be able to pursue a claim alleging the expropriation of its shareholding caused by the host state's confiscation of the assets of the company. That leaves possibility (d) as the best interpretation of the problematic Article 1121(1)(b).

840. A further aspect of Article 1121 should be noted. Paragraph 4 absolves the investor from procuring a waiver from the enterprise in the context of claims under Article 1116 or 1117 if the host state has deprived the investor of control

[211] One clarification must be made in relation to this analysis of the possible interpretations of Art. 1121(1)(b): it is not possible to interpret that provision as excluding a claim by an investor under Art. 1116 who does own or control the enterprise because otherwise the provision would of course be rendered meaningless.

over the enterprise. Without this important exception to the waiver requirement, a denial of justice would be condoned by Chapter 11 of the NAFTA if the investor were to be deprived of a remedy both in a municipal and international forum due to measures attributable to the host state.

840C. Mondev International v United States of America[212]

The Boston City's planning agency, BRA,[213] selected Mondev and its joint venture partner Sefrius Corporation to construct a department store, retail mall and hotel in a dilapidated area of Boston.[214] Mondev and Sefrius formed a company 'LPA'[215] to implement the project and LPA then signed a 'Tripartite Agreement' with the City and BRA to govern the rights and responsibilities of the parties.[216]

Mondev brought several NAFTA claims based upon the disappointment of its contractual expectations in the Tripartite Agreement under Article 1116. The United States objected to Mondev's standing to bring a claim under Article 1116 on the basis that it was LPA that had suffered the alleged loss and not Mondev.[217] On this point, the Tribunal noted:

> [I]t is certainly open to Mondev to show that it has suffered loss or damage by reason of the decisions it complains of, even if loss or damage was also suffered by the enterprise itself, LPA.[218]

This statement is no doubt correct. If Mondev's claims alleged that it had suffered a distinct loss by reason of acts attributable to the United States, then such claims were clearly admissible under Article 1116. But could Mondev recover damages for an injury to LPA rather than to its rights as a shareholder in LPA? The United States maintained that such a claim for reflective loss must be brought on behalf of LPA as an enterprise under Article 1117 so as to give proper effect to Article 1135(2) and its concern with the protection of the company's creditors.[219] The tribunal's decision on this point has been mistakenly interpreted in subsequent cases and thus justifies full quotation and analysis here. By way of background, Mondev had filed a waiver with respect to other legal proceedings pursuant to Article 1121 not only on its own behalf but on behalf of LPA as well.[220] Mondev had not, however, referred to Article 1117 in its Notice of Arbitration.[221] The tribunal's decision reads:

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212 (Merits) 6 ICSID Rep 181.
213 Boston Redevelopment Authority.
214 6 ICSID Rep 181, 200/37.
215 Lafayette Place Associates.
216 6 ICSID Rep 181, 200/37.
217 *Ibid*. 212/82.
218 *Ibid*.
219 *Ibid*. 212/82, 212/84.
220 *Ibid*. 195/12.
221 *Ibid*. 204/49.

> Having regard to the distinctions drawn between claims brought under Articles 1116 and 1117, a NAFTA tribunal should be careful not to allow any recovery, in a claim that should have been brought under Article 1117, to be paid directly to the investor. There are various ways of achieving this, most simply by treating such a claim as in truth brought under Article 1117, provided there has been clear disclosure in the Article 1119 notice of the substance of the claim, compliance with Article 1121 and no prejudice to the Respondent State or third parties. International law does not place emphasis on merely formal considerations, nor does it require new proceedings to be commenced where a merely procedural defect is involved. In the present case there was no evidence of material nondisclosure or prejudice, and Article 1121 was complied with. Thus the Tribunal would have been prepared, if necessary, to treat Mondev's claim as brought in the alternative under Article 1117.* In the event, the matter does not have to be decided, since the case can be resolved on the basis of Claimant's standing under Article 1116. But it is clearly desirable in future NAFTA cases that claimants consider carefully whether to bring proceedings under Articles 1116 and 1117, either concurrently or in the alternative, and that they fully comply with the procedural requirements under Articles 1117 and 1121 if they are suing on behalf of an enterprise.[222]

In a footnote to the sentence marked with a '*' in this passage, the Tribunal stated that: 'Another possibility, if the case should have been brought under Article 1117, would be for the tribunal to order that the damages be paid to the enterprise.'[223]

From this passage one must conclude, first, that claims for reflective loss must be brought under Article 1117. The tribunal employs the word 'should' in the obligatory sense on two occasions in this context. Second, the tribunal was clearly of the view that Mondev's claims should have been brought under Article 1117 and was prepared to treat them in this way if Mondev's defective reliance on Article 1116 were to have been fatal to its case. Alternatively, the tribunal was prepared to exercise jurisdiction pursuant to Article 1116 but insist upon the payment of any damages to LPA rather than to Mondev. In the event, however, the tribunal rejected Mondev's claims on the merits, and hence a definitive ruling on the admissibility of its reliance upon Article 1116 was unnecessary.[224]

[222] *Ibid*. 213/86.
[223] *Ibid*. 213/note 24.
[224] The tribunal had previously joined questions of jurisdiction and admissibility to the merits. 6 ICSID Rep 183, 187.

841. In *Enron v Argentina*,[225] the tribunal describes the arguments of Mondev and the United States and then reproduces the following truncated extract of the tribunal's reasoning:

> In the Tribunal's view, it is certainly open to Mondev to show that it has suffered loss or damage by reason of the decisions it complains of, even if loss or damage was also suffered by the enterprise itself … For these reasons, the Tribunal concludes that Mondev has standing to bring its claim.[226]

842. As the foregoing analysis reveals, there is a great deal of learning concealed behind the ellipsis in this quotation. The tribunal in *Enron* elaborated no further upon it; evidently concluding that this passage spoke for itself in the context of dismissing Argentina's reliance upon the *Mondev* case.

843. In *UPS v Canada*,[227] the tribunal characterised the 'distinction between claiming under Article 1116 or Article 1117' as 'an almost entirely formal one'. But the tribunal was careful to confine this statement to the circumstances of the case, which involved a claim by UPS as the sole owner of the investment company, UPS Canada. According to the tribunal:

> If there were multiple owners and divided ownership shares for UPS Canada, the question how much of UPS Canada's losses flow through to UPS – the question posed by Canada here – may have very different purchase.[228]

844. The tribunal's characterisation of the distinction between Articles 1116 and 1117 as merely 'formal' is unfortunate, but it is clear that the tribunal was alive to the problem posed by a derivative claim prosecuted under Article 1117.

I. RELEVANT PROVISIONS OF INVESTMENT TREATIES AND THE ICSID CONVENTION

845. Some investment treaties contain express provisions that regulate the instances where a controlling shareholder is permitted to claim on behalf of and in the name of its company incorporated in the host state for the purposes of Article 25(2)(b) of the ICSID Convention.[229] Article VII(8) of the USA/ Argentina BIT has received the most attention to date:

[225] (Preliminary Objections: Ancillary Claim) 11 ICSID Rep 295.
[226] *Ibid*. 301/35. See also: *Enron v Argentina* (Preliminary Objections) 11 ICSID Rep 273, 283/48.
[227] (Merits).
[228] *Ibid*. para. 35.
[229] Asian–African Legal Consultative Committee Model BIT, Art. 1(c), UNCTAD Compendium (Vol. III, 1996) 117; Switzerland Model BIT, Art. 8(3) ('A company which has been incorporated or constituted according to the laws in force on the territory of the Contracting Party and which, prior to the origin of the dispute, was under the control of nationals or companies of the other Contracting Party, is considered, in the sense of the Convention of Washington and

> For purposes of an arbitration held under paragraph 3 of this Article, any company legally constituted under the applicable laws and regulations of a Party or a political subdivision thereof but that, immediately before the occurrence of the event or events giving rise to the dispute, was an investment of nationals or companies of the other Party, shall be treated as a national or company of such other Party in accordance with Article 25(2)(b) of the ICSID Convention.[230]

846. Article 25(2)(b) of the ICSID Convention provides in relevant part:

> [A]ny juridical person which had the nationality of the Contracting State party to the dispute on that date and which, because of foreign control, the parties have agreed should be treated as a national of another Contracting State for the purposes of this Convention.

847. Article VII(8) of the USA/Argentina BIT is thus an 'agreement' as to the circumstances in which companies incorporated in, say, Argentina, should nevertheless be considered as nationals of the USA, thereby permitting such companies to prosecute investment treaty claims in their own name. For a company to be 'an investment of nationals or companies of the other Party' pursuant to Article VII(8), that company must be 'owned or controlled directly or indirectly' in accordance with the definition of an investment in Article I(1)(a) of the USA/Argentina BIT.

848. According to the tribunal in *Sempra v Argentina*,[231] these specific provisions dealing with claims on behalf of companies with the nationality of the host state gave a shareholder an *option* as to whether to bring a claim in the name of the company (assuming that it has the requisite control) or to pursue a derivative claim on its own behalf.[232] It is difficult to imagine why a shareholder would elect to bring a claim for the account of its company if it had the option of bypassing the company altogether. The company might be liable to pay creditors, local taxes and discharge other obligations before distributing the residual amount of any damages recovered to the shareholders. It is also difficult to

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according to its Article 25(2)(b), as a company of the latter'), *ibid*.181; UK Model BIT (1991), Art. 8(2), *ibid*. 189; USA Model BIT (1994), Art. 9(8), *ibid*. 202; Malaysia Model BIT, Art. 7(2), *ibid*. (Vol. V, 2000) 329; Netherlands Model BIT, Art. 9 ('a legal person which is a national of one Contracting Party and which before such a dispute arises is controlled by nationals of other Contracting Party shall, in accordance with Article 25(2)(b) of the Convention, for the purpose of the Convention, be treated as a national of the other Contracting Party') *ibid*. 336; Denmark Model BIT, Art. 9(3), *ibid*. (Vol. VII) 284; Mongolia Model BIT, Art. 8(5), *ibid*. (Vol. IX), 306; Sweden Model BIT, Art. 8(3), *ibid*. 313; Kenya Model BIT, Art. 10(c)(iv), *ibid*. (Vol. XII) 309; Energy Charter Treaty, Art. 26(7), Appendix 4.

[230] Available at: www.unctad.org/sections/dite/iia/docs/bits/argentina_us.pdf.

[231] (Preliminary Objections).

[232] *Ibid*. para. 42. The opposite conclusion was reached in *BG v Argentina* (Merits) para. 214, in relation to shareholder claims based upon rights of the company under a licence granted by the host state.

fathom why the contracting state parties would have included provisions like Article 25(2)(b) of the ICSID Convention and Article VII(8) of the USA/Argentina BIT in these international treaties if they could be bypassed at the unilateral election of prospective claimants. Finally, it is hardly consistent with the principles of treaty interpretation in Article 31 and 32 of the Vienna Convention on the Law of Treaties and the principle *verba aliquid operari debent* for an express provision of a treaty to be deprived of any utility.[233] The tribunal in *Sempra* sought to meet this inevitable criticism of its approach in the following way:

> At first sight, the Respondent notes, if an option such as the one discussed were to be permitted this would lead to a contradiction since a shareholder could always claim as such under the first sentence of the article, thus rendering the second sentence redundant. But in fact there is no such contradiction. It is conceivable that where various investor companies resort to arbitration, some can do so as shareholders and others as companies of the nationality of the State that is a party to the dispute, on the basis of the various corporate arrangements and control structures.[234]

849. Is it really plausible that the Contracting States to the ICSID Convention had this 'conceivable' scenario in mind when they drafted Article 25(2)(b) of the ICSID Convention? Schreuer's analysis of the *travaux préparatoires* suggests otherwise:

> A suggested solution to give access to dispute settlement not to the locally incorporated company but directly to its foreign owners was discarded. It was soon realized that this would not be feasible where shares are widely scattered and their owners are insufficiently organized.[235]

J. THE SPECIAL CASE OF THE IRAN/US CLAIMS TRIBUNAL

850. The American negotiators of the Algiers Declarations insisted upon a specific provision dealing with claims for reflective loss.[236] Article VII(2) of the Claims Settlement Declaration reads:

> 'Claims of nationals' of Iran or the United States, as the case may be, means claims owned continuously, from the date on which the claim arose to the date on which this agreement enters into force, by nationals of that

[233] A similar approach was taken in: *LG&E v Argentina* (Preliminary Objections) 11 ICSID Rep 414, 423/50; *Camuzzi v Argentina* (Preliminary Objections) para. 32.
[234] (Preliminary Objections) para. 44.
[235] C. Schreuer, *The ICSID Convention: A Commentary* (2001) 291 (references to *Documents Concerning the Origin and the Formulation of the Convention* (1968) are omitted).
[236] G. Aldrich, *The Jurisprudence of the Iran–United States Claims Tribunal* (1996) 88.

state, including claims that are owned indirectly by such nationals through ownership of capital stock or other proprietary interest in judicial persons, provided that the ownership interests of such nationals, collectively, were sufficient at the time the claim arose to control the corporation or other entity, and provided, further, that the corporation or other entity is not itself entitled to bring a claim under the terms of this agreement.[237]

851. The salient features of this provision are, first, that the shareholder must have control over the corporation in question for its claim for reflective loss to be admissible. 'Control' in this context was found by the Iran/US Claims Tribunal to be exercised where US nationals owned more than 50 per cent of the shares in the corporation. In no case was control found to exist where US nationals owned less than 50 per cent.[238] The second salient feature is the avoidance of multiple proceedings with respect to the same injury to the corporation. If the corporation is itself entitled to bring a claim under the Claim Settlement Declaration, then the shareholders are barred from doing so. One of the particular objectives of the Algiers Declarations was to terminate all litigation between the governments of each state party and the nationals of the other[239] and hence the possibility of overlapping claims in the municipal courts was excluded by the mutual agreement of Iran and the United States.

852. The Algiers Declarations were designed to diffuse an acute diplomatic crisis and facilitate the settlement of claims relating to a specific event and Article VII(2) on shareholder claims must be seen in this context.[240] The effect of the Declarations was to extricate the complex litigation pending before municipal courts and channel it into a neutral forum over which both states had a measure of control. In contradistinction, the dispute resolution procedure

[237] Reprinted at: (1981) 75 *AJIL* 418.

[238] G. Aldrich, *The Jurisprudence of the Iran–United States Claims Tribunal* (1996) 90.

[239] General Principle B of the General Declaration, *ibid.*; *Phillips Petroleum Co. v Iran* (Case ITL 11-39-2, 30 December 1982) 1 Iran-US CTR 487; *Amoco International Finance Corporation v Iran* (Case 310-56-3, 14 July 1987) 15 Iran-US CTR 189, 196–7.

[240] The same observation applies in relation to several Peace Treaties that contain provisions allowing certain types of shareholder actions. For example, Art. 297(e) of the Treaty of Versailles (1919): 'The nationals of Allied and Associated Powers shall be entitled to compensation in respect of damage or injury inflicted upon their property, rights or interests including any company or association in which they are interested, in German territory as it existed on 1st August, 1914'. The Treaties of Peace of 1947 with Italy, Romania, Bulgaria, Hungary and Finland contains a more detailed provision concerning shareholder claims. Art. 78(4)(b) of the Italian Treaty is representative: 'United Nations nationals who hold, directly or indirectly, ownership interests in corporations or associations which are not United Nations nationals within the meaning of paragraph 9(a) of this Article, but which have suffered a loss by reason of injury or damage to property in Italy, shall receive compensation in accordance with subparagraph (a) above. This compensation shall be calculated on the basis of the total loss or damage suffered by the corporation or association, and shall bear the same proportion to such loss or damage as the beneficial interests of such nationals in the corporation or association bear to the total capital thereof.' See: M. Jones, 'Claims on Behalf of Nationals Who Are Shareholders in Foreign Companies' (1949) 26 *BYBIL* 225, 251–4.

in investment treaties is not premised upon the total exclusion of the municipal court system of each contracting state party. Rather the relationship is one of coordination and the sophisticated scheme created by Articles 1116, 1117, 1121 and 1135 of NAFTA reflect this reality. In light of the careful balance struck in these specific provisions of the Claim Settlement Declaration for the Iran/US Claims Tribunal and NAFTA, it surely would be disingenuous to conclude that the *absence* of a specific provision in most bilateral investment treaties to regulate the admissibility of claims by shareholders for reflective loss means that any such claim should be determined by the tribunal regardless of the possibility of multiple proceedings or the potential prejudice to third parties.[241]

Rule 50. For a claim to be admissible pursuant to Rule 49, the tribunal should satisfy itself that the shareholder's claim will not: (i) unfairly expose the host state or the company to a multiplicity of actions; (ii) materially prejudice the interests of the creditors of the company; or, (iii) interfere with a fair distribution of the recovery among all interested parties.

853. This principle has been adapted from the American Law Institute's Report on Corporate Governance,[242] which has codified the discretion exercised by the courts in the majority of states in the USA in relation to direct recovery by shareholders in closely-held companies. The principle does not reflect the position in English law; indeed the Court of Appeal recently distanced itself from the American Law Institute's formulation in *Day v Cook*.[243]

854. The remarkable and disquieting feature of the investment treaty jurisprudence is that tribunals have so readily abdicated their responsibility to give proper consideration to the factors listed in Rule 50. The common refrain is no more sophisticated than 'it is not our problem'. For instance, the totality of the tribunal's consideration of these factors in *Pan American Energy v Argentina*[244] is revealed in the following statement:

> Another point raised by the Respondent in its Memorial on Jurisdiction … in connexion with foreign shareholders' claims is that the latter, in recovering their investment, do so to the prejudice of other domestic or foreign shareholders, creditors and employees. This may be true; but it does not

[241] *Harza v Iran* (Case 232-97-2, 2 May 1986) 11 Iran-US CTR 76, 87 (the rights of shareholders under the Algiers Accords were 'an exception to the normal rule of international law that shareholders may not bring the claims of the corporation (as opposed to claims relating to their ownership rights), it should be construed narrowly').

[242] American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations* (1994) para. 7.01.

[243] [2001] PNLR 32, at para. 42 (Arden LJ).

[244] (Preliminary Objections).

> empower this Tribunal to stray from the path traced by the Contracting Parties in their BIT, which unquestionably protects shareholdings.[245]

855. Is it really plausible that the 'path traced by the Contracting Parties in their BIT' leads straight into a legal quagmire? Investment treaties unquestionably do protect shareholders; but it is doubtful whether they do so at the expense of all other interested parties and in a manner that undermines the fundamental characteristics of the limited liability company. This dictum in *Pan American Energy* rests upon an assumption of no limiting principle of admissibility; in other words, once the *ratione personae* jurisdiction over the shareholder is established, there is no further analysis required as to whether its claims are admissible. That must be wrong for the reasons that have been explored in this chapter.

856. In the same spirit of abdicating responsibility for the development of a coherent relationship between the investment treaty regime and municipal legal orders, several tribunals hearing claims by shareholders have proclaimed as irrelevant the fact that the company is actively negotiating with the host state to achieve a settlement in respect of any prejudice caused to the company by the acts of the host state. This apparently extends to circumstances where the company's position in such negotiations contradicts the litigational approach of the shareholder.[246] Similarly, the company's pursuit of a claim in the local courts of the host state has been discarded as a factor that might be relevant in considering the admissibility of an investment treaty claim by the shareholder for the same prejudice.[247] The company's ratification of an exclusive jurisdiction clause in favour of the host state's courts has also been ignored as a relevant circumstance, even where the object of the shareholder's claims are rights based upon a contractual relationship between the company and the host state.[248] One factor that has at least generated sympathetic overtones from some tribunals is the distinct possibility that there will be double recovery from the host state in respect of the same prejudice by the shareholder and the company. In *Camuzzi v Argentina*[249] it was said:

> This is a real problem that needs to be discussed in due course, but again it is an issue belonging to the merits of the dispute. In any event, international

[245] *Ibid*. para. 220.

[246] *AES v Argentina* (Preliminary Objections) 12 ICSID Rep 312, 323/62, 325/71; *Camuzzi v Argentina* (Preliminary Objections) para. 97; *CMS v Argentina* (Preliminary Objections) 7 ICSID Rep 494, 512/86 ('it is not for the Tribunal to rule on the perspectives of the negotiation process or on what TGN might do in respect of its shareholders, as these are matters between Argentina and TGN or between TGN and its shareholders').

[247] *Pan American Energy v Argentina* (Preliminary Objections) paras. 154–60

[248] *AES v Argentina* (Preliminary Objections) 12 ICSID Rep 312, 329/93; *CMS v Argentina* (Preliminary Objections) 7 ICSID Rep 494, 510/76; *Azurix v Argentina* (Preliminary Objections)10 ICSID Rep 413, 436/79; *National Grid v Argentina* (Preliminary Objections) para. 169; *Siemens v Argentina* (Preliminary Objections) 12 ICSID Rep 174, 216/180.

[249] (Preliminary Objections).

> law and decisions offer numerous mechanisms for preventing the possibility of double recovery.[250]

857. The 'numerous mechanisms' available in international law were not articulated by the tribunal. In contrast, the tribunal in *Impregilo v Pakistan*[251] was far less certain about this purported capacity of international law to ensure fairness and justice among all stakeholders if there is no limitation upon the admissibility of claims by shareholders: 'a tribunal has no means of compelling a successful Claimant to pass on the appropriate share of damages to other shareholders or participants'.[252]

858. One of the factors leading to the International Court of Justice's decision on admissibility in *Barcelona Traction* was its concern that a settlement between the company and the host state might be jeopardised by potential claims brought on behalf of the shareholders, as well as the more general problem of the multiplicity of claims in relation to the same prejudice.[253] Investment treaty tribunals are obliged to shape principles of admissibility for shareholders' claims that give due consideration to the same problems. The guidance provided by the American Law Institute's Report on Corporate Governance[254] is apposite for this purpose. In accordance with Rule 50, there are three factors that a tribunal should take into account before ruling upon the admissibility of a claim by a shareholder for reflective loss: first, whether the claim will unfairly expose the host state or the company to a multiplicity of actions; secondly, the extent to which the claim will materially prejudice the interests of the creditors of the company; and thirdly, whether the claim will interfere with a fair distribution of the recovery among all interested parties.

[250] *Ibid*. para. 91. (*Semble*): *Suez v Argentina* (Preliminary Objections) para. 51.
[251] (Preliminary Objections) 12 ICSID Rep 245.
[252] *Ibid*. 276/152. The tribunal cited: *Blount Brothers Corporation v Iran* (Case 215-52-1, 28 February 1986) 10 Iran-US CTR 64.
[253] (*Belgium v Spain*) 1970 ICJ Rep 3, 49–50; (*contra*) Tanaka J, 130.
[254] American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations* (1994) para. 7.01.