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Abstract

Investment treaties as corporate law: Shareholder claims and issues of consistency
A preliminary framework for policy analysis

by

David Gaukrodger

Claims by company shareholders seeking damages from governments for so-called "reflective loss" now make up a substantial part of the investor-state dispute settlement (ISDS) caseload. (Shareholders’ reflective loss is incurred as a result of injury to “their” company, typically a loss in value of the shares; it is generally contrasted with direct injury to shareholder rights, such as interference with shareholder voting rights.) This paper considers the consistency issues raised by shareholder claims for reflective loss in ISDS.

The paper first compares the approach to shareholder claims in ISDS with advanced systems of national corporate law (and other international law). ISDS arbitrators have consistently found that shareholders can claim individually for reflective loss in ISDS under typical BITs. This can be seen as a success story from the point of view of consistency of legal interpretation and improves investor protection for potential claimant shareholders in many cases. In contrast, however, advanced national systems and international law generally apply what has been called a "no reflective loss" principle to shareholder claims.

Second, the paper analyses the policy issues relating to consistency that are raised by shareholder claims for reflective loss in ISDS. National and international law barring shareholder claims for reflective loss is often explicitly driven by policy considerations relating to consistency, predictability, avoidance of double recovery and judicial economy. Limiting recovery to the company is seen as both more efficient and fairer to all interested parties. In contrast, ISDS tribunals and commentators have generally given limited consideration to the policy consequences of allowing shareholder claims for reflective loss. The third part of the paper addresses the issue of company recovery (including two different existing systems which expand the ability of foreign-controlled companies to recover in ISDS) and its relevance to shareholder claims for reflective loss. The paper also contains a series of questions for discussion and has been discussed by governments participating in an OECD-hosted investment roundtable.


Keywords: shareholders; stockholders; shareholder claims; shareholder rights; shareholder remedies; stockholder remedies; reflective loss; reflective injury; derivative action; derivative loss; derivative injury; consistency; consistency of arbitral decisions; double recovery; double jeopardy; multiple claims; judicial economy; settlement; corporate law; company law; creditors; creditors’ rights; investor-state dispute settlement; international arbitration; arbitrators; international economic law; comparative law; domestic impact of investment law; international arbitration; investment arbitration; foreign investment; international investment; international investment law; access to justice; level playing field; competitive neutrality; treaty shopping; international investment agreements; investment treaties; bilateral investment treaties.

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EXECUTIVE SUMMARY

Claims by company shareholders seeking damages from governments for so-called "reflective loss" now make up a substantial part of the ISDS caseload. (Shareholders’ reflective loss is incurred as a result of injury to “their” company, typically a loss in value of the shares.) A rough count suggests that there are easily more than 40 decisions involving shareholder claims and numerous pending cases, many of which involve claims for reflective loss.

While governments have challenged these reflective loss claims in a number of cases, many ISDS arbitral tribunals have found that shareholders are entitled to recover for reflective loss in ISDS. This can be seen as a success story from the point of view of consistency of legal interpretation. A number of commentators reviewing the case law have treated the issue as one of settled law under a typical BIT. This case law also allows for and improves investor protection for potential claimant shareholders in many cases.

Courts in advanced systems of national corporate law, however, generally reject shareholder claims for reflective loss – largely for explicit policy reasons relating to consistency, predictability, avoidance of double recovery, and judicial economy. Shareholders are permitted to bring cases for direct injury – for example to their voting rights as shareholders – but not where they suffer reflective loss due to an injury to the company. Only the directly-injured company can bring the claim, a solution that is seen as both more efficient and fairer to corporate stakeholders including creditors and all shareholders.

This background paper seeks to assist governments in analysing the consistency issues raised by shareholder claims for reflective loss in ISDS. The issues are challenging because they involve the relationships between different stakeholders in the company – principally shareholders and creditors2 – as well as their relationships with the company. They also involve the relationship between ISDS and domestic recourse. It is accordingly proposed to proceed by stages.

This paper seeks to set out a preliminary framework for analysis of the consistency issues raised by claims by shareholders for reflective loss in ISDS. To provide an initial basis for policy analysis, the paper reviews comparative law sources, and compares ISDS outcomes and approaches. It then engages in preliminary analysis of consistency policy issues raised by such claims. The paper then considers the question of company recourse.

Comparative Law

Shareholders in companies can be harmed in two broadly different ways. First, they can suffer direct injury to their rights as a shareholder, such as the right to attend and vote at general meetings. Shares may also be expropriated. Second, shareholders (and others) can suffer so-called "reflective loss" through an injury to the company: the market value of the company’s shares and/or bonds may fall.

For a shareholder, both direct injury and reflective loss cause loss. However, for policy reasons, advanced national legal systems, both common law (United States, Canada, United Kingdom, Australia, Hong Kong), and civil law (Germany, France), generally apply a "no reflective loss" principle: shareholders generally cannot recover damages for reflective loss. As a general rule, only

2 Creditors are broadly defined to include contractual claimants on the company, including bondholders and other lenders, employees, suppliers and others.
the company can sue to recover the loss. The same approach applies in general international law and under the European Convention on Human Rights.

The no reflective loss principle is based on the view that limiting recovery to the company is both more efficient and fairer to all interested parties. It avoids multiple high-cost claims for the same injury; potentially inconsistent results; complex and expensive efforts to allocate the reflective losses; and risks of double recovery. With recovery by the company in a single case, all interested parties who suffer reflective loss will automatically benefit in accordance with their relative interests in any flow of assets to the company. The no reflective loss principle is based on the assumption that the company has the power to recover the loss (although it may not do so for a variety of reasons) and is better placed to do so.

The treatment of shareholder claims in ISDS, largely derived from case law, contrasts with this approach. It appears that most investment treaties do not expressly address the issue of the scope of shareholder claims. Typically, the only reference to shares in a BIT is a clause that clarifies that shares are assets that qualify as an investment under the treaty definition of investment. Creditor interests in companies, such as bonds, are also frequently included in such lists, sometimes with qualifications. NAFTA and some other treaties establish explicit regimes for shareholder claims, including a form of derivative action. (The main discussion principally focuses on the typical shorter BIT; NAFTA is addressed separately.)

While treaty provisions in the typical BIT are reduced to a minimum, they have been interpreted in the case law as having an important impact on corporate law principles. The consequence is three outcomes with regard to shareholder claims that contrast with domestic law. First, shareholders have generally been able to claim for reflective loss in ISDS whereas such shareholder claims are generally barred in national law. Second, ISDS tribunals have awarded recovery of reflective loss to shareholders rather than to the company as under domestic law shareholder derivative action procedures (which exceptionally allow shareholders to bring claims for reflective loss, but with recovery for the company). Third, ISDS tribunals have found shareholder claims for reflective loss to be autonomous from those of the company in ISDS so that both claims can co-exist; this cannot occur under general domestic law principles.

These differences in outcomes are in turn related to two broad differences in approach between national courts and ISDS tribunals. First, as noted in domestic law and general international law, “[t]he disallowance of the shareholder’s claim in respect of reflective loss is driven by policy considerations”; cases routinely consider the consequences of allowing shareholder claims as part of their analysis. In contrast, ISDS tribunals have given limited consideration to policy aspects and the consequences of allowing shareholder claims for reflective loss.

Second, for policy reasons, national courts frequently focus primarily on the nature of the shareholder’s loss. If the loss is reflective and the company has or had the power to claim, the shareholder claim can in general be dismissed regardless of whether the shareholder can identify a separate cause of action (legal basis) for a claim. In contrast, ISDS tribunals have concluded that a separate cause of action created by the treaty is determinative. Whether the company can also recover the loss becomes immaterial to the admissibility of the shareholder claim.

3 The focus here is on general trends for policy analysis rather than the details of the case law. The paper takes no position on whether these ISDS interpretations are correct with regard to BITs in general or any particular treaty.

Preliminary Policy Analysis

For purposes of preliminary policy analysis, an expansive regime allowing shareholder claims for reflective loss is assumed. The policy analysis first addresses the general impact of the admissibility of shareholder claims on predictability and legal uncertainty. Shareholder claims are likely to be less predictable for governments than claims by the injured company because company nationality is both known and hard to change; in contrast, the identity of shareholders is both more likely to change and frequently hard to monitor. For similar reasons, treaty shopping by investors is facilitated if shareholder claims are admissible. It may also be harder to settle cases. Under the no reflective loss rule in domestic law, a government–company settlement can resolve the dispute. In contrast, where shareholders can claim autonomously for reflective loss, a settlement with the company may be of little value to the government (and thus to the company and its creditors). Shareholder consent to the settlement may be hard, expensive or impossible to obtain.

Second, as the UK House of Lords and other appellate courts have underlined, shareholder claims for reflective loss raise serious concerns about double recovery. Some ISDS investment tribunals have dismissed the problem as a non-issue without explanation; others have addressed it in more concrete terms by using creative remedies, such as fixing a price for a government acquisition of the claimant's shares. This goes beyond compensation and can involve high costs for governments.

Third, national courts have frequently underlined that the no reflective loss principle serves the societal interest in “judicial economy” by reducing the number of cases needed to address the harm. Where each shareholder (or other sufferer of reflective loss) can claim separately, multiple claims are more likely, raising costs. Multiple claims also create a risk of inconsistent results.

Fourth, consistency concerns could be exacerbated if creditors also seek to bring reflective loss claims in ISDS. A core policy reason for the bar on shareholder claims for reflective loss is that they can injure creditors of the company: such claims can allow shareholders "to bypass the corporate structure and effectively preference themselves at the expense of other persons with a superior financial interest in the corporation". Creditor claims arising out of the same underlying injury, on top of shareholder claims, could exacerbate consistency-related concerns.

Fifth, the paper preliminarily analyses the variable shareholder interests and incentives with regard to shareholder and company claims. Some shareholders are “likely claimants” in ISDS who can decide between supporting company action or their own claim or both - these may be the principal beneficiaries of an expansive regime for shareholder claims. Others may be “potential but unlikely claimants”, due to the size of their investment or diversified investment strategy - their fortunes may lie primarily but not exclusively with company remedies. For a third group of shareholders, the "excluded claimants", their fortunes lie solely with company remedies. Creditors can be divided into similar albeit somewhat different categories.

Company Recourse

As noted above, the no reflective loss principle in domestic law is based on the assumption that the company has the power to recover the loss (although it may not do so for a variety of reasons) and is better placed to do so. It is clear that in a substantial number of ISDS cases, the operating company may not have access to effective recourse due to, for example, a denial of justice (eg. government

5 Gaubert v. United States, 855 F.2d 1284, 1291 (5th Cir. 1989).
6 No view is expressed about the likelihood of success of such claims at any stage.
interference with the judiciary leading to denial of the claim). The status of the company and its recourse is of central importance in considering shareholder claims and consistency issues.

This section first examines two different existing systems which expand the ability of foreign-controlled companies to recover in ISDS: (i) the derivative action in NAFTA art. 1117; and (ii) ICSID art. 25(2)(b)). It has been suggested that the expanded availability of recovery for the company in ISDS may reduce or eliminate the rationale for shareholder claims for reflective loss.

The paper then begins to analyse the wide variety of situations of companies and the potential relevance for shareholder claims. The company may have effective recourse, such as where the company has access to ISDS or to effective primary remedies under domestic law. There are other situations where the company has no real recourse, such as where a government expropriates all of the company’s assets. There are also scenarios where the company has effective recourse but chooses not to litigate a claim such as where, after full consideration of the costs and benefits, the company settles the claim for less than full value due to concerns about government relations, the expectation of future benefits from a good relationship and the costs and uncertainties of litigation. Given the variety of situations, a general rule with regard to shareholder claims may not be appropriate.
A. INTRODUCTION

Claims by company shareholders seeking damages from governments for so-called "reflective loss" now make up a substantial part of the ISDS caseload. (Shareholders suffer reflective loss as a result of injury to “their” company, typically a loss in value of the shares.) A rough count suggests that there are easily more than 40 decisions involving shareholder claims and numerous pending cases, many of which involve claims for reflective loss.

While governments have challenged these reflective loss claims in a number of cases, many ISDS arbitral tribunals have found that shareholders are entitled to recover for reflective loss in ISDS. This case law improves investor protection for potential claimant shareholders in many situations. It can be seen as a success story from the point of view of consistency of legal interpretation. A number of commentators have treated the issue as one of settled law under a typical BIT.

Courts in advanced systems of national corporate law, however, generally reject shareholder claims for reflective loss – largely for explicit policy reasons relating to consistency, predictability, avoidance of double recovery and judicial economy. Shareholders are permitted to bring cases for direct injury – for example to their voting rights as shareholders – but not where they suffer reflective loss due to an injury to “their” company. Only the directly-injured company can bring the claim, a solution that is seen as both more efficient and fairer to defendants and corporate stakeholders including creditors and all shareholders. There are few shareholder claims against governments for reflective loss in domestic courts; those few cases are generally dismissed (without considering the merits) on the grounds that only the company can sue.

ISDS case law and commentary has generally paid limited attention to the policy consequences of allowing shareholder claims for reflective loss – the issue has been seen as being resolved by the inclusion of shares in the BIT definition of investment and by arbitral precedent. This contrasts with the often explicit policy basis of domestic law generally barring shareholder claims for reflective loss. Governments concerned about consistency in ISDS may want to ensure that they have analysed, inter alia, the expected costs and benefits in terms of consistency of a particular shareholder claims regime in deciding upon their investment law policy.

This background paper seeks to assist governments in analysing these consistency issues. The issues are challenging because they involve the relationships between different stakeholders in the company – principally shareholders and creditors – as well as their relationships with the company. They also involve the relationship between ISDS and domestic recourse. It is accordingly proposed to proceed by stages.

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7 This paper has been discussed by governments participating in the OECD-hosted Freedom of Investment Roundtable. It does not necessarily reflect the views of the OECD or of the governments that participate in the Roundtable, and it cannot be construed as prejudging ongoing or future negotiations or disputes pertaining to international investment agreements.

8 Roundtable participants have previously noted that shareholder claims in ISDS raise a number of questions relating to consistency. See, e.g., David Gaukrodger & Kathryn Gordon, Investor-State Dispute Settlement: A Scoping Paper for the Investment Policy Community (Dec. 2012) (“ISDS Scoping Paper”), pp. 56, 60, 77.

9 Creditors are broadly defined to include contractual claimants on the company, including bondholders and other lenders, employees, suppliers and others.
This paper seeks to set out a preliminary framework for policy analysis of the consistency issues raised by shareholder claims. It is structured as follows. It first outlines the nature of the two main types of possible shareholder loss: (i) direct injury; and (ii) reflective (or derivative) loss due to an injury to the company. It then reviews the general bar on shareholder claims for reflective loss in several major common law and civil law jurisdictions, as well as the similar general prohibition under general international law and the European Convention on Human Rights system.

The analysis then turns to ISDS. The lack of explicit attention to the question of shareholder claims for reflective loss in most investment treaties is noted (as are some exceptions). The analysis then identifies in broad terms key outcomes and approaches in ISDS case law on shareholder claims.

The fourth section provides preliminary analysis of the consistency policy issues raised by the treatment of shareholder claims in ISDS. Some simplifying assumptions about applicable law are made for purposes of initial policy analysis, with detailed case law analysis being deferred. The policy analysis first addresses the general impact of the admissibility of shareholder claims on predictability and legal uncertainty. It then considers the issues of potential double recovery, multiplication of claims for the same injury and risk of inconsistent results. It then considers the impact of shareholder claims on creditors of the company and the impact of potential creditor claims for reflective loss in ISDS. The section concludes by briefly considering the variable shareholder interests and incentives with regard to shareholder and company claims.

The paper then turns to the question of company recourse - the ability of the company to obtain a remedy for its direct loss (the direct loss which is also the source of the shareholder’s reflective or derivative loss). The general bar on shareholder claims for reflective loss in domestic law and general international law is based on the assumption that the company is better placed to recover the loss. The analysis first briefly focuses on two existing systems which strengthen the potential for companies with foreign shareholders to recover through ISDS: the NAFTA derivative action mechanism and the ICSID art. 25(2)(b) mechanism that deems certain companies to be foreign for purposes of access to ISDS. In ISDS, the “company” can be in a broader variety of situations than under domestic law. These range from situations where the company has access to both domestic and ISDS remedies, to situations where the company is paralysed and unable to act at all due to host state misconduct.

While the analysis primarily focuses on consistency, it continues to briefly identify relationships with other issues of interest to the Roundtable in its work on ISDS, such as costs, access to justice, a level playing field or arbitrators.
B. SHAREHOLDER CLAIMS: DIRECT INJURY AND REFLECTIVE LOSS

Shareholders in companies can be harmed in two broadly different ways. First, they can suffer direct injury to their rights as a shareholder. Those rights include, for example, the right to attend and vote at general meetings, and the right to share in the residual assets of the company on liquidation. Shares held only by a particular category of owners may be expropriated.

The second type of injury that can be suffered by shareholders of a company is reflective loss through an injury to the company. An act that injures the company affects its overall value. Shareholders normally suffer the most reflective losses because they are the residual claimants on corporate assets, i.e. all other claims have priority in the event of liquidation. When the company is near insolvency or insolvent, creditors become the residual claimants and suffer the most from reflective losses. Where an injury is substantial, reflective losses may be distributed amongst both shareholders and creditors (the latter broadly defined to include all those with a contractual claim on the company, including employees, suppliers and customers).

The distinction between direct injury and reflective (or derivative) loss is well established in advanced systems of national law from both the common law and civil law traditions. As set forth in the Principles of Corporate Governance of the American Law Institute (ALI), “a wrongful act that depletes corporate assets and thereby injures shareholders only indirectly, by reason of the prior injury to the corporation, should be seen as derivative in character; conversely, a wrongful act that is separate and distinct from any corporate injury, such as one that denies or interferes with the rightful incidents of share ownership, gives rise to a direct action.”

Civil law systems recognise the same basic distinction. French and German law both distinguish between a shareholder's personal injury and reflective shareholder losses that are the corollary of those suffered by the company. The distinction between shareholders' direct rights and reflective loss is also well recognised in general international law and has been recently reaffirmed in strong terms by the ICJ.

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12 See, e.g., Case Concerning Ahmadou Sadio Diallo (Republic of Guinea v. Democratic Republic of the Congo), Judgment on Preliminary Objections, (2007) (“Diallo 2007”), § 67 (distinguishing between admissible claims based on direct rights as shareholder and inadmissible claims based on reflective loss); Case Concerning Ahmadou Sadio Diallo (Republic of Guinea v Democratic Republic of the Congo), Judgement, (“Diallo 2010”) (reaffirming the distinction); Barcelona Traction, Light and Power Company, Limited (Belgium v. Spain), Second Phase, Judgment, I.C.J. Reports 1970 (“Barcelona Traction 1970”), § 47 (“a distinction must be drawn between a direct infringement of the shareholder's rights, and difficulties or financial losses to which he may be exposed as the result of the situation of the company”); Oppenheim’s International Law, 9th ed. (1990), p. 520 (“Shareholders may, furthermore, have their rights directly infringed (as where shares held only by a particular category of owners are expropriated), as opposed to
Issues for discussion

- Would FOI participants wish to explain whether their country’s law distinguishes between direct and reflective loss?

suffering loss indirectly through damage inflicted upon the company”). For the European Court of Human Rights, see, e.g., Olczak v. Poland, § 58 (7 Nov. 2002) (distinguishing direct and reflective loss).
C. COMPARATIVE LAW

1. Advanced systems of domestic law

a. Shareholder claims for reflective loss are generally barred under advanced systems of national law

A review of the law in several OECD jurisdictions suggests that shareholders generally cannot recover damages for reflective loss in advanced national legal systems. As a general rule, only the company can sue to recover the loss. The initial analysis presented here could be completed with information about additional legal systems and refined and improved by government input.

i. Common law jurisdictions

In the United States, individual shareholders generally have no separate right to sue for reflective loss incurred due to injury to “their” company. Gaubert v. United States illustrates the issues in the context of a shareholder claim against the government for damages. The claimant was the largest shareholder of a financial institution. Federal regulators had extensively engaged in management of the company including allegedly both negligently selecting its directors and officers, and negligently conducting its day to day operations. After the company became insolvent, Gaubert sued the US government, claiming the loss in value of his shares in the amount of USD 75 million.

Without considering the merits, a federal appellate court dismissed the claim because “generally, individual shareholders have no separate right to sue for damages suffered by the corporation which result solely in the diminution of the value of the corporation's shares.” The Gaubert approach is routinely applied in the United States to bar shareholder claims for reflective loss.

Canadian law similarly generally prohibits claims by shareholders for reflective loss:

[A] shareholder of a corporation – even a controlling shareholder or the sole shareholder – does not have a personal cause of action for a wrong done to the corporation. The rule respects a basic principle of corporate

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13 Gaubert v. United States, 855 F.2d 1284 (5th Cir. 1989).
14 The claimant's factual allegations were assumed to be true for purposes of the government's motion to dismiss the claim at the outset of the case. Because the claim was dismissed, it was not determined whether there was in fact negligence.
15 See, e.g., Quarles v. City of East Cleveland, Quarles v. City of East Cleveland, 1999 US App. LEXIS 34061 (6th Cir. 1999) (dismissing shareholder claims against a city government for reflective loss without addressing the merits; only the company could claim for the alleged violations of due process, expropriation (a regulatory taking) and violations of equal protection); 12B Fletcher, Cyclopedia of Corporations, § 5911 (2012) (if damages to a stockholder result indirectly, as the result of an injury to the corporation, and not directly, he cannot sue as an individual).
law: a corporation has a legal existence separate from that of its shareholders. A shareholder cannot be sued for the liabilities of the corporation and, equally, a shareholder cannot sue for the losses suffered by the corporation.

The rule ... avoids multiple lawsuits. Indeed, without the rule, a shareholder would always be able to sue for harm to the corporation because any harm to the corporation indirectly harms the shareholders.16

1. English law also recognises a general “no reflective loss principle”.17 The House of Lords reaffirmed the general prohibition on shareholder claims for reflective loss in the leading case of Johnson v. Gore Wood & Co.18 Lord Millett considered that allowing shareholder claims for reflective loss would result in one of two unacceptable outcomes. Either the defendant has to pay the same damages twice – this would allow the claimant shareholder to recover without harming the company’s creditors and other shareholders – or the claimant shareholder recovers at the expense of the creditors and other shareholders of the company:

If the shareholder is allowed to recover in respect of [reflective] loss, then either there will be double recovery at the expense of the defendant or the shareholder will recover at the expense of the company and its creditors and other shareholders. Neither course can be permitted. This is a matter of principle; there is no discretion involved. Justice to the defendant requires the exclusion of one claim or the other; protection of the interests of the company’s creditors requires that it is the company which is allowed to recover to the exclusion of the shareholder.19

The law in Australia and in Hong Kong, China similarly generally bars shareholder claims for reflective loss.20 The Hong Kong Court of Final Appeal recently unanimously upheld a decision striking out a shareholder claim for reflective loss as a matter of law. Expressly adopting the House of Lords reasoning in Johnson, the court held that the general rule is that "where a company suffers loss as a result of an actionable wrong done to it, the cause of action is vested in the company and the company alone can sue. ... No action lies at the suit of a shareholder suing as such".21

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19 Id., 2 A.C. at p. 62 (Lord Millett).


21 Waddington Ltd. v. Chan Chun Hoo, [2009] 4 HKC 381 (Hong Kong Ct. of Final Appeal 2008), § 49.
ii. **Civil law jurisdictions**

Germany and France similarly generally bar shareholder claims for reflective loss.\(^{22}\) The German Supreme Civil Court (BGH) has held that where a third party negligently damages a company, the shareholder cannot claim damages from the third party because this would run counter to the principle of capital maintenance (*Kapitalerhaltung*) and would conflict with the principle that the company’s assets are bound for the purpose of the business (*Zweckwidmung des Gesellschaftsvermögens*).\(^{23}\) The BGH noted that the shareholder could claim for any separate, direct damage, but not for reflective loss. In a scholarly article, a BGH judge further explained that any monetary compensation the shareholder receives would have remained within the company but for the injury caused by the third party; the shareholder would not have had a claim against the company for distribution of this sum.\(^{24}\) The principle that a shareholder cannot claim for reflective loss directly applies both to the AG and the GmbH types of companies.\(^{25}\)

In France, a shareholder can generally only bring an individual action where the shareholder has suffered a “personal” injury, independent from that suffered by the company.\(^{26}\) The Cour de cassation has dismissed several shareholder claims for reflective loss because the injury claimed by the shareholder is only a “corollary” of that suffered by the company.\(^{27}\)

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\(^{22}\) See Xiaoning Li, A comparative study of shareholder derivative claims (2007), pp. 199-200, 202 (“According to German law, only the injured [AG] company can bring an action to enforce its claims. Although the shareholders also suffer from the loss in value of shares, the loss is no more than indirect damage and the shareholders cannot bring actions directly”; same rule for GmbH type companies); Bas J. de Jong, Shareholders’ claims for reflective loss: a comparative legal analysis, European Finance eJournal 10/2011, p. 3 (“The basic rule in most jurisdictions, including the United Kingdom, Germany and the Netherlands, is that a shareholder cannot recover a loss which is simply reflective of the company’s loss.”); de Wulf, op.cit., p. 8 (“In France, The Netherlands and Germany, too, recovery of reflective losses by an individual shareholder, who wants damages to be paid out to him personally, is usually banned”).

\(^{23}\) See de Wulf, p. 12 (citing “Dubai-Fall”, BGH 10 November 1986, WM 1987 13).


\(^{25}\) Xiaoning Li, A comparative study of shareholder derivative claims (2007), pp. 199-200, 202. Ms. Li’s study also reviews the law in China. She argues that based on the intention behind the 2006 Chinese Company Law and comparative analysis, “an individual shareholder should not be allowed to apply article 153 [of the law] in order to bring a direct action for his reflective losses”. Id., p. 280.


\(^{27}\) See, e.g., Cour de cassation, chambre commerciale, No. 97-10886 (15 January 2002) (“le préjudice invoqué par M. X, ... n’étant que le corollaire de celui causé à la société, n’avait aucun caractère personnel”); Cour de cassation, chambre criminelle, Nos. 97-80664, 99-80387, 99-84855 (13 December 2000) (three decisions) (rejecting shareholder claims because “la dépréciation des titres d'une société découlant des agissements délétères de ses dirigeants constitue, non pas un dommage propre à chaque associé, mais un préjudice subi par la société elle-même”); Versailles Ct. App. No. 04-1262 (13 Sept. 2005) (same). See also Guy-Auguste Likilimba, Le préjudice individuel et/ou collectif en droit des groupements, 2009 Revue trimestrielle de droit commercial 1, § 6 (“Selon le juge commercial, lorsque la société est en bonis, le constat est qu’il écarte presque systématiquement toute demande de réparation du préjudice individuel dès lors qu’il est considéré comme ‘inclus dans le préjudice social’. La prise en compte du préjudice individuel n’est envisagée qu’à titre exceptionnel, c'est-à-dire à la condition d'en démontrer le caractère personnel et distinct par rapport au préjudice collectif.”)
b. The analysis frequently focuses on the nature of the loss rather than whether there is a separate legal basis for the claim

Courts adjudicating shareholder claims often focus on the nature of the loss. Under this approach, it is not sufficient for a shareholder merely to identify a separate cause of action (separate legal basis) in order to successfully bring a claim. This is illustrated, for example, by the English Court of Appeal decision in *Gardner v. Parker*:

It does not matter that [the shareholder]’s and [the company]’s cause of action are different. The essential point is that [the shareholder]’s claim against [the defendant] is in substance a claim for compensation in respect of the same loss to which [the company] has a claim against him. ... [The shareholder's] loss will be made good if the wronged company, which has the primary claim, enforces in full its claims against the wrongdoer.”

In the “Dubai-Fall” case cited above, the German Supreme Civil Court found that if the shareholder’s loss was reflective, the existence of a separate legal duty to the shareholder made no difference; the claim was denied. In *Landune International Ltd v. Cheung Chung Leung*, the Hong Kong Court of Appeal emphatically stated that the focus of the rule against reflective loss must be on the type of loss claimed as opposed to the causes of action being asserted. Thus the rule applies even if the shareholder can establish an independent cause of action against the wrongdoer. In *Thomas v. D’Arcy*, Justice Williams’ opinion similarly underlined that the court was denying the shareholder’s claim notwithstanding that “the respondents owed [the shareholder] a duty separate and distinct from

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28 See *Gardner v. Parker*, [2004] 1 BCLC 417, 430 (Eng. Ct. App. 2004) (dismissing shareholder claim for reflective loss). See also Victor Joffe et al., Minority Shareholders, op. cit, §§ 1.151-152 [“The no reflective loss principle is not concerned with barring causes of action as such, but with barring recovery for certain types of loss. ... It is irrelevant that the duties owed by the defendant to the company and to the claimant may be different in content.”] (citations omitted).

In the US, see, e.g., *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031 (Sup. Ct. Del. 2004) (“[t]he stockholder's claimed direct injury must be independent of any alleged injury to the corporation. The stockholder must demonstrate that the duty breached was owed to the stockholder and that he or she can prevail without showing an injury to the corporation.”) (emphasis added).

While many cases such as *Gardner* rely on an analysis of the injury, some other cases frame the issues in terms of the respective rights of the company and shareholder. In domestic law, this has not usually affected the results, as noted in the Principles of Corporate Governance of the American Law Institute:

All decisions are in fundamental agreement with the basic distinction ...: a wrongful act that depletes corporate assets and thereby injures shareholders only indirectly, by reason of the prior injury to the corporation, should be seen as derivative in character; conversely, a wrongful act that is separate and distinct from any corporate injury, such as one that denies or interferes with the rightful incidents of share ownership, gives rise to a direct action. Sometimes this result has been justified in terms of an “injury” test that looks to whose interests were more directly damaged; at other times, the test has been phrased in terms of the respective rights of the corporation and its shareholders; but regardless of the verbal formula employed, the results have been substantially similar.

American Law Institute, Principles of Corporate Governance, § 7.01, cmt. c (1994 & 2012 Supp.).

29 See “Dubai-Fall”, BGH 10 November 1986, WM 1987 13) (denying shareholder claim for reflective loss even though the defendant breached duties towards the shareholder).

the duty owed to the [two] corporations. The critical question is not so much with respect to the duty, but with respect to the damages recoverable consequent upon its breach.\textsuperscript{31}

The distinction between direct and reflective claims is frequently clear. However, in some cases, it can be difficult to draw the lines between the two types of claims. In such cases, the courts can decline to strike the claims at an initial stage, and make a determination about its nature in dealing with the merits when all of the necessary facts are established.\textsuperscript{32}

c. \textit{The no reflective loss principle is based on the assumption that the company has or had the power to recover the loss.}

The prohibition on shareholder claims is based on the premise that the company has the power to recover the loss.\textsuperscript{33} Recovery by the company is seen as more efficient: it avoids multiple claims (and complex and expensive efforts to allocate the reflective losses). It is also seen as fairer: all interested parties who suffer reflective loss will automatically benefit in accordance with their relative interests in any flow of assets to the company.

For a variety of reasons, the company may choose not to bring the claim. Alternatively, the company may have settled the claim for less than full value. The company may also be insolvent. As a general matter, none of these situations affects the rule.\textsuperscript{34}

The status of the company is an important issue in the ISDS context and is addressed further below.

d. \textit{Shareholder derivative actions}

Many advanced systems have adopted a form of “derivative action” that lets shareholders bring claims – on behalf of the company and with recovery for the company – where the machinery of corporate governance has broken down. For example, where the conduct of directors is at issue, the company’s board of directors may be subject to a conflict of interest in deciding about litigation against a director.


\textsuperscript{32} See, e.g., Fletcher, Cyclopedia of Corporations, § 5911 (“While there usually is little difficulty in determining whether a cause of action in behalf of a shareholder is individual or derivative, there are border-line cases that may be hard to classify.”); \textit{Johnson}, 2 A.C. at p. 36 (Lord Bingham).

\textsuperscript{33} See \textit{Mid-State Fertilizer Co. v. Exchange National Bank of Chicago}, 877 F.2d 1333, 1335-36 (7th Cir. 1989); \textit{Johnson}, 2 A.C. at p. 36 (Lord Bingham); \textit{Barcelona Traction} 1970, separate opinion of Judge Sir Gerald Fitzmaurice, § 10.

\textsuperscript{34} See Victor Joffe et al, Minority Shareholders, § 1.142 (2009) (“It is ... irrelevant that the company has not yet brought proceedings against the wrongdoer, that it is not in a position to bring such proceedings by reason of lack of means or that it chooses not to claim against a defendant or to settle with him on comparatively generous terms. Similarly the principle applies if the company is in liquidation or receivership, if it has been dissolved or if its claim is time-barred.”) (footnotes omitted).

Shareholders are in effect allowed to bring claims for reflective loss only under specified conditions, which frequently include, *inter alia*: (i) recovery going to the company rather than the claimant shareholder; (ii) an ability for the company to either block or take over the litigation unless its board or management is disqualified due to a conflict of interest; and (iii) court oversight of the proceedings including any settlement. (See box 1 - Shareholder derivative actions)

**Box 1. Shareholder derivative actions**

Shareholder derivative actions are governed by specific rules to address the policy concerns relating to consistency raised by reflective loss. For example, Germany introduced a shareholder derivative action into its Company Law in 2005. For the first time, the law allows shareholders to personally enforce a claim for reflective loss. The company recovers the damages, not the shareholder.

The policy concerns raised by shareholder claims for reflective loss are addressed in detail by the law. The law ensures that there is practically no risk of multiple claims: (i) shareholders must obtain leave from the court to bring the action; (ii) all shareholder claims must be consolidated in a single action; and (iii) the judgment or settlement in a shareholder derivative suit binds all shareholders and the company. Creditor and non-claiming shareholder interests are also protected because, as noted, recovery goes to the company rather than the claiming shareholder. The company's pre-eminent role in deciding on the litigation is preserved: shareholders must first demand that the company bring the suit before seeking court authorisation to file their suit and the company is a party to the request for authorisation; even if the court authorises the claim and the shareholders file suit, the company can take over the suit at any time, the shareholder is joined to the company claim, and the shareholder suit is discontinued.

This regime for shareholder claims for reflective loss is essentially circumscribed to claims against corporate "insiders". It is not available for claims against outside third parties such as a government. As in Germany, derivative suits in most other systems of national law primarily if not exclusively allow shareholders to challenge actions by persons involved in some way in corporate governance or surveillance. Derivative suits against unrelated outsider third parties who injure the company but are uninvolved in its governance – such as governments, outside tortfeasors or co-contractants – are generally impossible; even where they are in theory possible, they are infrequent in practice.

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1 See AktG art. 148(4) ("The action shall be brought ... with the aim of obtaining compensation for the company").

2 See AktG § 147(1) (listing only members of the supervisory and management boards and promoters of the company as potential defendants); Martin Gelter, Why do shareholder derivative suits remain rare in Continental Europe?, 37 Brooklyn J. Int’l Law 843.

3 See, eg., Code de commerce art. L.225-252 (France) (shareholder can only bring derivative claim against directors or the managing director). In Japan, shareholders may only bring derivative claims against "corporate members", defined as the directors, officers and certain auditors and accountants. See Company Law 2006 (Japan), arts. 847, 423. In the UK, derivative claims against outsider third parties are possible, but only where a company director was also at fault. See UK Companies Act s. 260(3) (derivative actions can [generally] only be brought in cases involving alleged misconduct by a director of the company); Explanatory Notes to Companies Act ("Derivative claims against third parties would be permitted only in very narrow circumstances, where the damage suffered by the company arose from an act involving a breach of duty etc on the part of the director.").

4 See Gelter, p. 877 (derivative suits against outsider third parties are not permitted in Continental Europe: "possible defendants in Continental European [shareholder] derivative suits are limited to directors (including supervisory board members) and in some cases corporate officers, auditors, or the founders of the corporation") (citations omitted).

In the US, defendants in derivative suits are also usually directors, officers or other corporate insiders although there is no legal limit on the targets of derivative suits. Gelter, p. 875-76; Robert C. Clark, Corporate Law (1986), pp. 643-44.

**e. Exceptions to the general bar are policy based and carefully defined**

The bar on shareholder claims for reflective injury is recognised as a general principle in all of the systems reviewed. There are, however, exceptions recognised in some systems of national law although they often remain controversial.
The principal exception arises where the company has no claim at all. Where the company has no claim, the rule does not apply. For example, a defendant may contract with the shareholder to do work for the company. If the company is not a party to the contract, it has no claim. The defendant's failure to perform the contract may harm the company and thus shareholder. Since the company has no ability to claim and the shareholder has a contract claim, there is no bar to the shareholder claim.35

Some US states recognise a "special injury" exception where a shareholder suffers injury beyond that suffered by shareholders generally.36 The exception remains controversial and was rejected in Delaware, a leading corporate law jurisdiction, in a 2004 decision.37 Roughly half of US publicly-listed companies are incorporated in Delaware.38

The derivative action discussed above is arguably a “partial” exception. It is exceptional in that a shareholder is able to bring a claim for reflective loss. However, it is not an exception to the bar on shareholder recovery because it does not allow direct shareholder recovery. Recovery goes to the company, not the shareholder, because the derivative action must be brought by the shareholder on behalf of the company.

2. General international law

Customary international law is much less developed than national law with regard to shareholder claims, but the general principles with regard to shareholder claims for reflective loss have been squarely addressed by the ICJ in two cases. The distinction between direct loss and reflective loss is well established, as is their different treatment.

a. Direct injury to a shareholder’s rights can form the basis of a claim.

As in domestic law, claims based on direct injury to shareholders are admissible. As the ICJ noted in Barcelona Traction, “[w]henever one of his direct rights is infringed, the shareholder has an independent right of action.”39

35 See George Fischer (Great Britain) Ltd v Multi Construction Ltd., [1995] 1 BCLC 260 (UK) (Ct. App. 1994). See also Fletcher Cyclopedia of Corporations, (US) § 5911 (“If the injury is one to the plaintiff as a shareholder as an individual, and not to the corporation, for example, where the action is based on a contract to which the shareholder is a party, or on a right belonging severally to the shareholder, or on a fraud affecting the shareholder directly, or where there is a duty owed to the individual independent of the person's status as a shareholder, it is an individual action. If the wrong is primarily against the corporation, the redress for it must be sought by the corporation, except where a derivative action by a shareholder is allowable, and a shareholder cannot sue as an individual.”) (footnotes omitted).

36 Laws relating to the creation, organisation and dissolution of companies are primarily state laws rather than federal law in the United States.

37 See Tooley v. Donaldson, Lufkin & Jenrette, Inc., 845 A.2d 1031 (Sup. Ct. Del. 2004) (“[t]he stockholder's claimed direct injury must be independent of any alleged injury to the corporation. The stockholder must demonstrate that the duty breached was owed to the stockholder and that he or she can prevail without showing an injury to the corporation.”) (emphasis added).


39 Barcelona Traction 1970, § 47.
b. **Claims based on reflective injury to shareholders are generally barred.**

The general principle that shareholder reflective loss cannot form the basis of a claim under general international law is also well-established. In its decisions in the *Diallo* case in 2007 and 2010, the ICJ reaffirmed the general bar against claims based on reflective injury to shareholders:

The Court, in the Barcelona Traction case, recognized that “a wrong done to the company frequently causes prejudice to its shareholders”. But, it added, damage affecting both company and shareholder will not mean that both are entitled to claim compensation:

“whenever 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”.

This principle was reaffirmed when the Court, responding to a Belgian contention, established a

“distinction between injury in respect of a right and injury to a simple interest . . . Not a mere interest affected, but solely a right infringed involves responsibility, so that an act directed against and infringing only the company’s rights does not involve responsibility towards the shareholders, even if their interests are affected.”

In its 1970 *Barcelona Traction* decision referred to in *Diallo*, the ICJ dismissed a claim by Belgium because it was based on alleged reflective injury to shareholders. Only the company's alleged injury could form the basis for a claim and the company was incorporated in Canada. Accordingly, the claim was inadmissible.

In making this determination, the ICJ relied on comparative national law principles of corporate law given the recognised absence of any general international corporate law. The Court also noted that there were policy reasons for the rule.

No exceptions have been found to exist by the ICJ to date although there has been considerable debate among judges of the ICJ and others about the possible existence of exceptions. Claimant states have argued for the recognition of exceptions to the general rule analogous to some exceptions recognised in some systems of national law. As noted by Ian Brownlie, two exceptions to the general prohibition were proposed and rejected by the Court in Barcelona Traction. Several judges argued

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40 *Diallo* 2010, § 156 (citations omitted).

41 *Barcelona Traction* 1970, § 38 (“In this field international law is called upon to recognize institutions of municipal law that have an important and extensive role in the international field . . . All it means is that international law has had to recognize the corporate entity as an institution created by States in a domain essentially within their domestic jurisdiction. This in turn requires that, whenever legal issues arise concerning the rights of States with regard to the treatment of companies and shareholders, as to which rights international law has not established its own rules, it has to refer to the relevant rules of municipal law.”), quoted in *Diallo* 2010, § 104.

42 See *Barcelona Traction* 1970, § 96 (claims based on reflective injury to shareholders, by opening the door to competing diplomatic claims, "could create an atmosphere of confusion and insecurity in international economic relations. The danger would be all the greater inasmuch as the shares of companies whose activity is international are widely scattered and frequently change hands").

for a more flexible approach to exceptions in separate opinions, while others rejected the proposed exceptions.

c. The ICJ has recognised that specific treaties may apply different rules.

The ICJ has recognised that States may agree in a treaty to vary the principles applicable under general international law for purposes of the treaty. States may thus agree to modify the general principles to permit certain claims based on reflective loss or to give shareholders expanded direct rights.

The Court has also recognised that the bulk of investment claims are now brought by investors under investment treaties rather than through diplomatic protection under general international law. The Court did not otherwise address those treaties in Diallo, except to reject the argument that the proliferation of investment treaties, or investment treaty case law interpreting such treaties, had changed customary international law relating to claims based on injury to shareholders.

3. European Convention on Human Rights

As in national law systems, shareholders may bring claims under the European Convention on Human Rights (ECHR) when they suffer direct loss.44 Like national courts, the European Court of Human Rights (ECtHR) also bars shareholder claims for reflective loss as a general rule.45 The Grand Chamber of the Court reiterated the applicable principles in a recent case:

[A] person cannot complain of a violation of his or her rights in proceedings to which he or she was not a party, even if he or she was a shareholder ... of a company which was party to the proceedings ... [W]hile in certain circumstances the sole owner of a company can claim to be a “victim” within the meaning of Article 34 of the Convention where the impugned measures were taken in respect of his or her company, when that is not the case the disregarding of a company’s legal personality can be justified only in exceptional circumstances ....

The ECtHR has noted that if claims were not restricted to the company, it would be hard to determine which shareholder or creditor constituencies should be allowed to bring ECHR claims against governments.46

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44 See, e.g., Olczak v. Poland, Case 30417/96 (2002) § 58 (ECtHR has held shareholder claims for reflective loss generally inadmissible, but shareholder could bring admissible claim where measures at issue involved direct injury such as the cancellation of certain shares). The court noted that "[i]t may be assumed that in the majority of national legal systems shareholders do not normally have the right to bring an action for damages in respect of an act or an omission that is prejudicial to 'their' company"). Id., § 57.

45 Agrotexim and Others v. Greece, Series A no. 330, pp. 25-26, §§ 68-71; Géniteau v. France (no. 2), Case 4069/02 (8 Nov. 2005) (finding shareholder claim inadmissible; "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. ... 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 ... ").

46 Agrotexim, § 65.
4. Conclusions with respect to comparative law

The no reflective loss principle is applied as a general rule to bar shareholder claims for reflective loss in all of the advanced legal systems surveyed. It is a long-standing rule primarily generated by case law. It is primarily based on policy considerations (which are further discussed below). The shareholder’s loss is recognised, but it is seen as more efficient and fairer to restrict the power to bring suit to the company. The rule is based on the assumption that the company has the power to recover the loss. The principle is also derived from the legal personality of the corporation and is often seen as a corollary of shareholders' limited liability for the company’s obligations.

The bar on claims for reflective loss under national law does not mean that shareholders, including minority shareholders, cannot bring claims. However, such claims are generally limited to claims for direct injury.

In addition, the bar is not absolute. Exceptions exist. Their existence and scope is frequently the subject of debate. Policy concerns are central to the debate about exceptions.

Issues for discussion

- How does your country's domestic law generally resolve shareholder claims for reflective loss?
- If your country applies a different general rule, what is it?
- What is the rationale for the applicable rules?
- The Roundtable has previously noted that, other than for expropriation, investor claims for damages under domestic law are very rare. Shareholder claims appear to be especially rare. Have shareholders claimed for damages against your government under domestic law for reflective loss? Would such claims be permitted under your domestic law?

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47 In civil law systems, the analysis is generally derived from statutory or Code provisions. However, these appear not to resolve the reflective loss issue directly so that significant judicial interpretation is involved.
D. SHAREHOLDER CLAIMS IN ISDS

1. Investment treaties

It appears that most investment treaties do not expressly address the issue of the scope of shareholder claims. Typically, the only reference to shares in a typical BIT is a clause that clarifies that shares are assets that qualify as an investment under the treaty definition of investment. Creditor interests in companies, such as bonds, are also frequently included in such lists, sometimes with qualifications.

For example, the UK-Russia BIT provides in its Article 1(a) that:

the term "investment" means every kind of asset and in particular, though not exclusively, includes: [...] (ii) shares in and stock, bonds and debentures of, and any form of participation in, a company or business enterprise. 48

NAFTA, CAFTA-DR and a few other treaties establish more articulated regimes for shareholder claims, including regimes for a form of derivative action (see below).

The sparse treaty provisions mean that the law has primarily been developed through case law. However, while treaty provisions are reduced to a minimum in the typical BIT, they have been interpreted as having a considerable impact on corporate law principles. The consequence is outcomes with regard to shareholder claims that differ sharply from domestic law.

2. ISDS case law

The treatment of shareholder claims in ISDS contrasts significantly from that adopted in advanced systems of national law, ECHR and customary international law. Four substantive differences in outcomes between ISDS and domestic law are noteworthy: (i) shareholders have generally been able to claim for reflective loss in ISDS whereas such shareholder claims are generally barred in national law; (ii) tribunals have awarded recovery of reflective loss to shareholders rather than to the company as under domestic law derivative action procedures; (iii) ISDS tribunals have found the separate cause of action (in the treaty) rather than the nature of the loss to be determinative; and (iv) the focus on the treaty cause of action leads to the conclusion that shareholder claims for reflective loss are autonomous from the company’s claims, thereby allowing for overlapping and separate shareholder/company claims in ISDS. 49 A fifth difference is one of approach: unlike national and international courts, ISDS tribunals have given limited consideration to the policy aspects and consequences of allowing shareholder claims for reflective loss.

a. Admissibility of shareholder claims for reflective loss in ISDS

ISDS tribunals have accepted claims for adjudication from a wide variety of shareholder interests:


49 The focus in this paper is on identifying general trends for policy analysis. The paper takes no position on whether any particular interpretation is correct with regard to BITs in general or any particular treaty.
• 100% parent companies
• majority shareholders
• minority shareholders
• indirect shareholders with ultimate control
• other indirect shareholders, such as intermediate holding companies.  

In a significant number of ISDS cases, tribunals have expressly held that shareholders can recover reflective loss. A number of commentators have described the issue of the admissibility of shareholder claims for reflective loss in ISDS as settled.  

b. Recovery of reflective loss by the shareholder rather than the company

As noted above, under derivative action statutes in domestic law, shareholders can bring actions to recover reflective loss under certain conditions. However, recovery of damages goes to the company. Shareholders generally cannot recover reflective loss directly.

Except for the special case of NAFTA-type treaties and ICSID art. 25(2)(b) (see below section F.1), BITs generally do not provide for recovery by the company in ISDS as a solution for shareholder reflective loss. ISDS tribunals have awarded damages for shareholders’ reflective loss to the claimant shareholder rather than to the company.

c. ISDS tribunals have found the separate cause of action (in the treaty) rather than the nature of the loss to be determinative.

As outlined above, domestic law generally requires shareholders to establish both a separate cause of action and non-reflective damages. In many cases, such as Gardner v. Parker, the shareholder

50 For recent survey of shareholder cases of these various types, see, e.g., Martin J. Valasek & Patrick Dumerry, Developments in the Legal Standing of Shareholders and Holding Corporations in Investor-State Disputes, ICSID Review, Spring 2011, p. 73 et seq. [hereinafter “Valasek”].

51 See, e.g., Christoph Schreuer, Shareholder Protection in International Investment Law, (2005) 2 Transnational Dispute Management, issue No.3 (“Shareholder protection extends not only to ownership in the shares but also to the assets of the company. Adverse action by the host State in violation of treaty guarantees that affect the company’s economic position gives rise to rights by [sic] the shareholders.”); Stanimir Alexandrov, The “Baby Boom” of Treaty-Based Arbitrations and the Jurisdiction of ICSID Tribunals: Shareholders as “Investors” and Jurisdiction Ratione Temporis, The Law and Practice of International Courts and Tribunals, Vol. 4 (2005) 19, 40-45 (noting that tribunals considering shareholder claims “all considered it to be beyond doubt that a shareholder’s interest in a company includes an interest in the assets of that company, including its licenses, contractual rights, rights under law, claims to money or economic performance, etc., and that in finding jurisdiction they based that reasoning on the broad definition of investment in the applicable BITs”).

52 In a NAFTA case, Marvin Roy Feldman Karpa v. Mexico, involving the specific NAFTA derivative action provisions applicable to shareholder claims, Mexico requested that the tribunal correct the award to conform to the mandatory NAFTA requirement that shareholder derivative claims under NAFTA provide for recovery to the company. The tribunal did so. Marvin Roy Feldman Karpa v. Mexico, ICSID (AF), Correction and Interpretation of the Award (2003).
can establish a separate cause of action, but the reflective nature of the loss is determinative and precludes a claim.\(^{53}\)

In contrast, in ISDS the existence of a separate legal basis for a claim in the treaty has been seen as sufficient to allow for claims for reflective loss. The analysis focuses on the shareholder's separate cause of action based on the inclusion of shares in the definition of investment in the BIT. For example, in *Impregilo v. Argentina*, the tribunal found that Impregilo's shares in the company (AGBA) were protected under the BIT because of the definition of investment. It concluded that Impregilo could recover for reflective loss.\(^{54}\) The relationship of the shareholder loss to the loss by the company is not considered to be relevant to determining whether the shareholder can bring the claim.\(^{55}\) In some cases, tribunals do not determine whether the claim is for direct or reflective loss.

**d. The focus on the treaty cause of action leads to the conclusion that shareholder claims for reflective loss are autonomous from the company’s claims.**

As noted above, the general domestic corporate law rule barring shareholder claims is based on the company being better placed to bring the claim for the same losses. Where the company sues, no shareholder suit is possible. Even where the company decides not to sue, shareholder suits are generally barred.

In contrast, in ISDS, tribunals have generally interpreted the shareholder’s right as autonomous from the company’s claim due to the separate cause of action. The BIT is interpreted as giving the shareholder an independent right to claim alongside the company regardless of whether the company has a claim. The company’s possible or even actual recourse with regard to the direct loss appears to be seen as largely irrelevant in a number of ISDS shareholder cases.

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\(^{53}\) See Eilís Ferran, Litigation by Shareholders and Reflective Loss, The Cambridge Law Journal, 60 [2001], pp. 245-247 ("it is clear that where a company and a shareholder have overlapping claims the shareholder cannot pursue its personal claim if its loss is merely reflective of the company's loss").

\(^{54}\) *Impregilo S.p.A. v. Argentina*, Award (2011), § 138 (“It follows from Article 1(1)(b) of the Argentina-Italy BIT that Impregilo's shares in AGBA were protected under the BIT. If AGBA was subjected to expropriation or unfair treatment with respect to its concession - an issue to be determined on the merits of the case - such action must also be considered to have affected Impregilo's rights as an investor, rights that were protected under the BIT.”).

\(^{55}\) See, e.g., *Total S.A. v. Argentina*, Decision on Objections to Jurisdiction (2006) § 80 ("Having found, however, that the assets and rights that Total claims have been injured in breach of the BIT fall under the definition of investments under the BIT, it is immaterial that they belong to Argentine companies in accordance with the law of Argentina. Total asserts its own treaty rights for their protection, regardless of any right, contractual or non-contractual that the various companies [in which it owns shares] might assert in respect of such assets and rights under local law before the courts of other authorities of Argentina, in order to seek redress or indemnification for damages suffered as a consequence of actions taken by those authorities."); *Suez, Sociedad General de Aguas de Barcelona S.A. and Interagua Servicios Integrales de Agua S.A. v. Argentine Republic*, ICSID, Decision on Jurisdiction (2006) § 49; see also Campbell McLachlan et al., International Investment Arbitration: Substantive Principles (2007) §§ 6.77, 6.79 ("Given the wide definition of investment contained in most bilateral investment treaties, if an 'investment' can include shares in a company there is no conceptual reason to prevent an investor recovering for damage caused to those shares which has resulted in a diminution in their value. ... The simplest approach to justify claims [for reflective loss] is ... based upon the wording of the treaty."); Stanimir Alexandrov, The "Baby Boom" of Treaty-Based Arbitrations and the Jurisdiction of ICSID Tribunals: Shareholders as "Investors" and Jurisdiction Ratione Temporis, The Law and Practice of International Courts and Tribunals, Vol. 4 (2005) 19, 40-45; Christoph Schreuer, Shareholder Protection in International Investment Law, (2005) 2 Transnational Dispute Management, issue No.3.
As noted by Zachary Douglas, several ISDS tribunals have found shareholder claims to be admissible without regard to the quality of the recourse available to the company to obtain a remedy:

[S]everal 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. 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.56

The view that shareholder recourse is autonomous may be related to a tendency of some ISDS tribunals and commentators to consider that domestic remedies (in this case, for the company) are of little practical use or relevance. Many ISDS shareholder cases involve claims by shareholders of domestic law companies with access to the domestic courts but without access to ISDS. In Roundtable 16, the Roundtable discussed this apparent tendency to dismiss domestic recourse. It noted that a number of ISDS tribunals have characterised treaty requirements for time-limited recourse to domestic courts (as a pre-condition to ISDS arbitration) as "nonsensical".57 Some ISDS commentators take a similar view.58 If the working assumption is that domestic recourse by the company is futile, an approach which discounts the need to consider the company situation may be more likely to be seen as appropriate.

Views may differ on the degree, if any, that an implicit belief that domestic recourse is generally futile lies behind the theory that shareholder claims in ISDS should be autonomous from company


57 See Plama Consortium Limited v. the Republic of Bulgaria, ICSID, Decision on Jurisdiction (8 February 2005) (allowing investor to circumvent "curious" 18-month requirement using an MFN clause; finding it appropriate "to neutralize ... a provision that is nonsensical from a practical point of view"); Suez, Sociedad General de Aguas de Barcelona S.A., and Vivendi Universal S.A. v. The Argentine Republic, ICSID Case No. ARB/03/19; AWG Group Ltd. v. The Argentine Republic, UNCITRAL (joined cases), Decision on Jurisdiction § 67 (citing Plama's "nonsense" theory in allowing application of MFN to avoid 18-month requirement); ISDS Scoping Paper, p. 27 & n.59.

58 See, e.g., Christoph Schreuer et al, The ICSID Convention: A Commentary (2d ed. 2009), p. 413 ("It is questionable whether insistence by a host State on the exhaustion of local remedies prior to ICSID arbitration serves any useful purpose. .... The host State's investment climate may be affected by the public proceedings in its courts ....") The Roundtable has noted that the view that domestic recourse does not serve any purpose contrasts with a number of advanced systems of administrative law, such as the Austrian, German and Swiss systems, which strictly require exhaustion of recourse seeking primary remedies as a pre-condition for claims for damages (notably through the substantive law principle of contributory negligence). See ISDS Scoping Paper, p. 27 n.59. In Roundtable 16, Prof. van Aaken questioned whether current ISDS practice underestimates the usefulness of domestic administrative law recourse. See Summary of FOI Roundtable 16 (March 2012), p. 13 (Prof. van Aaken "considered that national courts can be unbiased and independent in many cases; it is not appropriate to base policy on the assumption that national courts are necessarily biased. They can grant primary remedies that satisfy an investor better than an ex post damages remedy."); see also id., p. 17 (Roundtable discussion about the appropriate ISDS policy assumptions with regard to expected national court performance).
What appears clear, however, is that the primary basis for the finding of autonomous shareholder rights to claim – arbitral interpretation of the definition of investment – has a broader application than where company recourse is futile.

Tribunals have not limited autonomous shareholder claims to cases where the company may have limited recourse. They have found that shareholders can bring autonomous claims even when the company has effective recourse. One example of this autonomy is that, even where a company has the entitlement to claim under ISDS, tribunals have held that shareholders of that company can still pursue their own autonomous claims in ISDS.60 (See below section on multiple claims).

The theory that the shareholder ISDS claim is autonomous from the company claim has been strongly affirmed at the jurisdictional, admissibility and liability phases. However, the distinction tends to break down at the damages phase if the policy concern about double recovery is addressed.61

The recognition of shareholders’ ability to bring autonomous claims without regard to company recourse may have significant consequences as ISDS cases increasingly address government action in advanced legal systems with effective systems of primary remedies for domestic companies. Under this approach, foreign shareholders would have the power to bring autonomous ISDS claims regardless of company action in the domestic courts.

e. ISDS tribunals have given limited consideration to the policy aspects and consequences of shareholder claims.

In domestic law and general international law, the general bar on shareholder claims for reflective loss is driven by policy. As recently underlined by the Hong Kong Court of Final Appeal, the principle barring shareholder claims for reflective loss “is a matter of legal policy. It is not because the law does not recognise the loss as a real loss”.62 Judgments on shareholder claims for reflective loss in national law regularly review the policy interests that weigh against such claims, including the risks of multiple actions and inconsistent outcomes, double recovery, and the impact on creditors and other shareholders. Judicial decisions to recognise an exception to the general rule barring claims is generally based on explicit analysis showing that the relevant policy interests will not be affected.

In contrast, arbitral decisions in ISDS have rarely given consideration to the policy implications of allowing shareholder claims, as noted by one critical commentator:


60 See, e.g., Lauder v. Czech Republic (Final Award) (2001); CME Czech Republic BV (The Netherlands) v. Czech Republic, Partial Award (2001) & Final Award (2003); Sempra Energy International v. Argentina, Preliminary Objections (2005), § 42.

61 See, e.g., Gemplus, S.A. v. Mexico, Award, Part XII (16 June 2010), § 60 (shareholder claimants insisted that their claim is “jurisdictionally distinct and wholly separate” from the company claim for damages in the host state’s domestic courts, but “[n]evertheless ... appreciate the concern that, in practical terms, they may be seen as recovering compensation for the same acts through separate sets of proceedings”).

The remarkable and disquieting feature of the investment jurisprudence is that tribunals have so readily abdicated their responsibility to give proper consideration [to whether allowing shareholder claims for reflective loss will] ... (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. The common refrain is no more sophisticated than 'it is not our problem'.

Tribunals have apparently considered it unnecessary to consider policy consequences in any detail because they consider that the issue is resolved by the inclusion of shares in the investment definition. Tribunals also rely heavily on arbitral precedent (although it has rarely if ever addressed the policy issues or consequences).

The lack of arbitral interest in the policy consequences is also reflected in some commentators’ treatment of the issue of shareholder claims. Much of the commentary on shareholder claims focuses on arbitral decisions and address policy issues only briefly if at all. The limited attention to creditor and other policy interests is puzzling because the United States and more recently Argentina have raised these issues in a substantial number of cases. A few commentators have more extensively analysed the policy interests raised by shareholder claims.

Different governments (and others) likely have different views about whether ISDS tribunals should explicitly address policy issues relating to consistency that are raised by potential interpretations they are considering. As a matter of practice, however, the reluctance of tribunals to do so in the area of shareholder claims appears clear. Early cases under typical BITs did not consider the policy issues, and today it appears that a significant number of tribunals consider the issue to be one of

63 Zachary Douglas, The International Law of Investment Claims (2009), p. 455; see also Meg Kinnear et al, Investment Disputes under NAFTA, An Annotated Guide to NAFTA Chapter 11 (2006 & 2008 Supp.), p. 1116-7 (the policy issues relating to the risk of double recovery, the effect on other shareholders and on creditors “have not been adequately considered” by NAFTA tribunals); Schreuer, 2005 ("tribunals have disposed of the argument in a rather summary fashion") (quoting Alexandrov, 2005).

64 As discussed below, some arbitral tribunals have sought to address the risk of double recovery at the stage of granting a remedy.

65 See Stanimir Alexandrov, The "Baby Boom" of Treaty-Based Arbitrations and the Jurisdiction of ICSID Tribunals: Shareholders as "Investors" and Jurisdiction Ratione Temporis, The Law and Practice of International Courts and Tribunals, Vol. 4 (2005) 19, 40-45 (analysis of case law outcomes but no reference to policy consequences for judicial economy, creditor, non-claimant shareholder or respondent government interests); Christoph Schreuer, Shareholder Protection in International Investment Law, (2005) 2 Transnational Dispute Management, issue No.3 (same).

Other commentary briefly addresses some policy issues although creditor interests are rarely addressed. See, e.g., Valasek (discussing multiple claims, costs and risk of inconsistent outcomes); Campbell McLachlan et al., International Investment Arbitration: Substantive Principles (2007) §§ 6.84-6.85 (briefly noting that some policy concerns "are well-founded and could result in substantial prejudice for respondent States", but suggesting that tribunals' reliance on the treaty definition of investment precludes consideration of the policy consequences; no discussion of creditor interests). Critical commentary about ISDS from NGOs is also rarely concerned with creditor or non-claimant shareholder interests.

settled law under a typical BIT and thus unworthy of significant analysis. If the policy issues raised by shareholder claims are to be considered, governments likely need to play a role.

**Issues for discussion**

- *Has your country experienced shareholder claims in ISDS? What is your perspective on the consistency issues raised by such claims?*

- *As noted, domestic and general international law cases extensively discuss the policy consequences of proposed interpretations relating to shareholder claims whereas ISDS tribunals have not done so. What explains the different approaches in your view?*

- *Under advanced systems of national law, significant changes to corporate law, such as the 2005 and 2006 reforms in Germany and the UK that adjusted the regimes for shareholder claims, are typically preceded by years of study and debate. As noted above, many ISDS tribunals have considered that the inclusion of shares in the definition of investment in BITs has modified general principles of corporate law governing shareholder claims for purposes of damages claims against governments under BITs; moreover, they have in effect concluded that the treaty language largely eliminates any need for tribunal consideration of the consequences of the new approach. Has your government analysed the consequences of these changes to corporate law and in particular the impact on issues of consistency?*

- *Has your government analysed how ISDS principles will interact with principles for shareholder claims under your national law?*
E. PRELIMINARY POLICY ANALYSIS

This section provides some preliminary policy analysis of consistency interests raised by shareholder claims for reflective loss in ISDS. For purposes of this analysis, the following simplifying assumptions are made: (i) both direct and indirect shareholders can bring ISDS claims; (ii) both controlling and minority shareholders can bring ISDS claims; (iii) shareholders can bring ISDS claims for both direct and reflective loss; (iv) shareholders have an autonomous right to claim in ISDS regardless of company recourse; and (v) company nationality (including the nationality of shareholders who are companies) is determined by the state of incorporation without any requirement of a “genuine link”. 67

It is also assumed that nonexpropriatory government misconduct in violation of an investment treaty has injured an operating company causing a loss in value of shares; the loss is suffered equally by all shareholders in proportion to their economic interest. Other stakeholders such as creditors may suffer part or all of the loss. It is also assumed that the company may have access to an effective remedy in domestic law or ISDS. Some of these assumptions will subsequently be relaxed.

References to the “company” refer to the company in which the shareholder owns shares (directly or indirectly). References to the “operating company” generally refer to the company that is active and that incurs the direct loss due to government misconduct. References to shareholders refer generally to shareholders covered by an investment treaty; where clarification is needed, covered and non-covered shareholders are distinguished.

1. Impact of the admissibility of shareholder claims on predictability and legal uncertainty

a. Shareholder claims are likely to be less predictable for governments than claims by the injured company.

The nationality of a company is generally public information and it is generally expensive and difficult for a company to change it. This allows governments to ascertain the law, including the investment treaty, applicable to claims by the company.

In contrast, it can be difficult to identify the shareholders and particularly the indirect shareholders of a company. This may be particularly true for special purpose vehicles with direct or indirect shareholders located in non-transparent jurisdictions. The identity of shareholders also frequently evolves; this can involve both intra-group transactions and share transactions with third parties.

In addition, shareholders acquire their shares at different times. Since it is often recognised that at least most pre-investment state policy is not subject to challenge under ISDS, the different dates of purchase mean that the facts regarding the state of national law and policy are different for each shareholder claim. The separate ISDS cases brought by CMS and Total, two minority shareholders of

67 As noted above, this paper takes no position on whether these interpretations are correct with regard to BITs in general or any particular treaty.
the same company (TGN), focused on the different dates of the purchase of the TGN shares by different shareholders as key considerations in the analysis.⁶⁸

In contrast, under corporate law applying the no reflective loss principle, shareholders who acquire shares in a company after the events in a dispute involving the company, but before the dispute is resolved, normally acquire an indirect interest in the outcome of the dispute. Share purchasers acquire a potential reflective gain with regard to claims by the company against third parties, and a risk of reflective loss with regard to any pending claims against the company.

b. Treaty shopping is facilitated if shareholder claims are admissible.

Roundtable delegates have noted that a regime that facilitates treaty shopping can create uncertainty for governments: "where investors can engage in treaty shopping, States parties to investment treaties cannot be sure of the exact scope of their commitments under these treaties; this increases the legal uncertainties countries face in relation to these treaties."⁶⁹

Treaty shopping is facilitated if shareholder claims for reflective loss are generally admissible. Shareholder ownership structures are often easy to modify. For example, intermediate holding company subsidiaries can be created in various jurisdictions between the beneficial owner and the operating company, with each being a potential ISDS claimant under a different treaty if the operating company suffers loss. Ownership of an operating company can also be transferred from one part of a corporate group to another. Simple incorporation of a company in a state has been interpreted as sufficient to qualify as a national of that State under many BITs.

As noted in the scoping paper, companies frequently seek to structure their affairs to benefit from advantageous legal rules. It is not suggested here that there is anything inherently improper in that process. The policy issue addressed here is the scope for such behaviour that is provided by the ISDS system.

c. The ability of shareholders to claim for reflective loss may make it harder to settle cases.

The Roundtable has noted that consistency can promote settlement and that, conversely, settlement negotiations are made more difficult by greater legal uncertainty. The uncertainties associated with shareholder claims may complicate settlement negotiations.

Under the no reflective loss rule, a settlement with the company normally provides the defendant with the assurance that the matter is resolved. The law bars any subsequent shareholder claims. The company normally does not need to seek shareholder consent to settle a claim.

In contrast, where shareholders can claim autonomously for reflective loss, a settlement with the company may be much less attractive for the government. The settlement may be followed by additional claims by one or more shareholders arising out of the same events. The settlement value to the State, and thus to the company, will be less if the company is unable to deliver “real peace” in exchange for the settlement consideration.⁷⁰

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⁶⁸ See CMS Gas Transmission Company v. Argentina, Award (2005); Total, S.A. v. Argentina, Award (2010). See also below the discussion of the risk of inconsistent results.


⁷⁰ See, e.g., Eilís Ferran, Litigation by Shareholders and Reflective Loss, The Cambridge Law Journal, 60 [2001], pp 245-247 (“Secondary policy considerations also come into play to explain the absolute nature of the rule that [a shareholder] cannot sue for reflective loss where the company also has a cause of action. If a
In particular, the spectre of subsequent shareholder damages claims could hinder attempts to work out a settlement involving continuing investor presence in the host state. As the Roundtable has noted, governments may seek to replicate, through settlement with the company, the non-pecuniary remedies available under domestic law. If such settlements are followed by shareholder claims for damages in ISDS, the incentive to reach them may be lower. Weaker settlement incentives may encourage exit by investors and/or litigation.

The parties to settlement discussions could seek to re-establish, by contract, the optimal conditions for a settlement. This would involve waiver by shareholders of their rights as part of the settlement. However, this is likely only feasible in companies with few shareholders and only with unanimous shareholder consent. The company normally has no power to compel a waiver by shareholders of their claims.\(^1\)

2. The risk of double recovery

As illustrated by the House of Lords decision in *Johnson*, it is widely recognised that claims for reflective loss raise serious concerns about double recovery. The basic financial problem has been described in the following example by Eilís Ferran:

A simple example can set the scene: take a company with a net present value of £1 million and four shareholders, A, B, C and D; £2 million has been extracted from the company by wrongdoers in breach of duties owed to the company and to its shareholders personally. All four shareholders would be fully and equally compensated if the company sued successfully to recover the lost £2 million: the shareholders' loss is *reflective* of the company's loss. What if, say, A, could sue personally to recover its share of the loss as reflected in the value of its shares—£500,000? That £500,000 would be for A's benefit alone. If the company were then to pursue its claim, the wrongdoers could not be held liable for more than £1.5 million since that would offend against basic principles. Should the company succeed, the value of each individual shareholding would increase to £625,000, not the £750,000 that would have been recovered if the company had been able to sue for the full £2 million. But in the absence of court orders taking into account what has already occurred, A would end up considerably better off than the others since it

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\(^1\) A US appellate court has painted a colourful picture of the potential paralysis of the company that it foresaw if shareholder claims for reflective loss were permitted:

> The rule is a salutary one: if a shareholder, dissatisfied with the dealings entered into between his corporation and a third party, automatically possessed a personal right of action against the third party, then corporations would be paralyzed. They could rarely act except upon unanimous consent [of all shareholders]. Business affairs would slow to a crawl, and the courts, confronted with a bewildering myriad of shareholder claims, would be as busy as a colony of centipedes with athlete's foot.

*Potthoff v. Morin*, 245 F.3d 710, 717 (8th Cir. 2001) (dismissing shareholder suit arising out of termination of license to company by local government port authority; only the company could claim) (quoting *In re Dein Host*, Inc., 835 F.2d 402, 406 (1st Cir.1987)).
holds shares now worth £625,000 plus the £500,000 recovered in its personal action.\textsuperscript{72}

Professor Ferran considers that recovery of more than a total of £2 million would offend against basic principles. Nonetheless, such recovery would be necessary to make the other shareholders whole and restore the value of their shares to their original value of £750,000. To fully compensate the other shareholders, the defendant would have to found liable in the second proceeding for £2 million; its total liability of £2.5 million would exceed the £2 million in damages that it caused. As Prof. Ferran notes, it is this dilemma of being required either to undercompensate some injured parties or to impose double recovery on the defendant that led the House of Lords to reject recovery of reflective loss in \textit{Johnson}.

While their rejection of reflective loss claims exempts them from the problem of double recovery, national courts have far more effective powers than an arbitral tribunal to address it. National courts could normally bring most if not all of the relevant constituencies together in a single proceeding or in related proceedings. Parties can intervene or be joined to court proceedings by the court because jurisdiction is not based on consent. National court decisions can also bind non-parties. A national court could thus try to allocate reflective damages among most of the affected parties in a single proceeding.

Arbitral tribunals have no such powers because their jurisdiction is based on party consent. If the company and one or more shareholders bring claims, several international tribunals as well as national courts would normally be involved. There is no mechanism for coordination of their decisions.

Some ISDS investment tribunals have expressed strong confidence that double recovery is a non-issue.\textsuperscript{73} However, these tribunals have generally not explained how the problem would in fact be resolved. In effect, the problem is left to be resolved (or not) by a subsequent court or tribunal. This view contrasts with \textit{Johnson}, \textit{Waddington} and other domestic cases which have considered the problem sufficiently serious to bar recovery.\textsuperscript{74}

ISDS tribunals that have faced the double recovery problem in more concrete terms have used creative remedies. One innovative remedial approach to allowing recovery by a shareholder for reflective loss is in effect to give the government an option to avoid the risk of double recovery by acquiring the claimant’s shares. Where the government is to acquire the shares as part of a remedial package, it must pay both the damages it caused and the residual value of the shares.

Perhaps because this remedy is innovative and extends beyond compensation, and thus may be questioned in terms of the tribunal’s jurisdiction, tribunals frequently seek to rely on a degree of consent from one or both parties. The claimant may volunteer to cede its shares (and thus exit the market) if it obtains its desired damages remedy, as in the \textit{CMS} case. The tribunal then conducts the analysis, and its order provides for damages and gives the government an option to purchase the shares.


\textsuperscript{73} See, e.g., \textit{Impregilo S.p.A. v. Argentina}, Award (2011) § 139 (“The question of double compensation being granted would seem to the Arbitral Tribunal to be a theoretical rather than a real practical problem. It seems obvious that if compensation were granted to [the company] at domestic level, this would affect the claims that [the shareholder] could make under the BIT, and conversely, any compensation granted to [the shareholder] at international level would affect the claims that could be presented by [the company] before Argentine courts.”).

\textsuperscript{74} See also below in the section on NAFTA (section F.1), the decision of a NAFTA tribunal recognising the issue as a significant problem for the subsequent court or tribunal.
at a price fixed by the tribunal. Given the broad discretion of tribunals in fixing damages (and valuing companies), the tribunal may have some ability in practice to evaluate the amount of damages and the residual value in a manner that makes the purchase option more or less attractive for the government. In CMS, the damages caused to the shareholder were evaluated at US$133.2 million whereas the residual value of the claimant's shares was valued at approximately $2.1 million.\footnote{In the event, Argentina did not acquire the shares. The purchase option was available for one year and was conditioned on prior payment of the damages component of the award, which has not been paid. CMS sold the shares to a third party in 2008.}

The share purchase remedy can provide a solution to the problem of double recovery. If the company subsequently recovers its full direct loss (which includes the shareholder’s reflective loss), the government (now as shareholder) will benefit from the company recovery in proportion to its shareholding.

The share purchase remedy appears to be most relevant for treaty violations that destroy practically all of the value of the company. In such cases, the residual (post-breach) value of the shares is close to zero. Where the residual value remains substantial, at least two issues are raised.

First, the cost of the share purchase option for the government could be significantly higher than the damages caused. For example, a treaty violation could damage a major company (initially valued at $10 billion) by $1 billion (10% of its value). This could give rise to an award of $200 million to a 20% shareholder of the company. For the government, avoiding the risk of double recovery through a share purchase remedy would be very expensive. The acquisition of the 20% shareholding to avoid double recovery would involve an additional government payment of $1.8 billion to cover the residual value of the shares.

Second, if the government were interested in acquiring the shares to protect itself from double recovery, the valuation of the company by the tribunal could have more practical importance than the case for breach. In the example above, consider a reduction of 10% in the tribunal's pre-injury valuation of the company (from $10 billion to $9 billion). The $1 billion in damages would leave a post-injury value of $8 billion for the company. The residual value of the 20% shareholder interest would be $1.6 billion (20% of $8 billion). The $1.8 billion cost to the government of the total package here (200 million plus $1.6 billion) would be the same as the residual value alone in the first example. The 10% change in company valuation by the tribunal would have the same effect as the entire damages award on the “package price”.\footnote{In addition, the share purchase remedy gives rise to substantial government ownership of the company with consequences for the remaining shareholders and others.}

Further research or monitoring could determine if any subsequent courts/tribunals have in fact been able to adjust their remedies to overcome the effects of previous shareholder remedies. It could also determine whether pre-emptive attempts to resolve the problem by the first tribunal through share repurchase orders or claimant undertakings are effective in practice.

It does not appear that national courts have given significant consideration to attempting to resolve the problem of double recovery using the creative techniques developed by ISDS tribunals, such as share purchases or shareholder undertakings. This may be in part because the techniques developed by arbitral tribunals to date to address double recovery do not appear to address other policy concerns that underlie the prohibition on the recovery of reflective loss, such as judicial economy (the avoidance of multiple proceedings for the same injury and risk of inconsistent rulings) or the protection of creditors of the company.
3. **Multiple claims and inconsistent outcomes**

Multiple shareholder claims cause high legal costs and a risk of inconsistent results with regard to the same underlying situation. They may also provide a single shareholder with an opportunity to bring essentially the same case twice as a beneficial owner. These issues are addressed in turn.

a. **The interest in judicial economy and the issue of costs**

National courts have frequently underlined that the prohibition on shareholder claims for reflective loss serves the societal interest in “judicial economy” by reducing the number of cases needed to address the harm. The *Gaubert* court underlined this interest:

> One rationale behind this prohibition [on shareholder claims for reflective loss] rests on principles of judicial economy. A corporation can protect its shareholder's interest by suing in the corporate name, and if the suit is successful the proceeds will inure to the benefit of the corporation; this increases the value of the individual shares in proportion to the amount of the recovery. Compare this to a situation where all shareholders sue in their individual capacities, which achieves the same resultant recovery, but requires our legal system to process hundreds or thousands of suits, rather than one suit in the name of the corporation.

Multiple shareholder claims in ISDS substantially increase costs for governments as well as for claimants:

> [Because shareholder claims are widely available in ISDS,] capital-importing countries having entered into a significant number of BITs will increasingly run the risk of being respondents in multiple (and often simultaneous) arbitration claims filed by different entities included in the increasingly sophisticated and complex corporate structure of foreign investors. Such multiple claims will clearly result in very high legal costs for respondent States.

For example, CMS and Total were two unrelated minority shareholders of TGN, an Argentine gas distribution company. Each brought a separate claim. Only partial costs information has been released in either case, but there is no doubt that costs in both multi-year cases have been very substantial for all parties. In its 2010 award on liability, the *Total* tribunal noted that the claimant was seeking an interim costs award in the amount of EUR 10,264,735.62 plus USD 4,368,881.87 for its legal and related costs incurred to that date, as well as USD 431,500 for arbitral costs to that date. Argentina claimed that its interim costs amounted to USD 1,215,222.99. The company, TGN, has recently announced that it also intends to sue the government for alleged damages arising out of

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77 *Gaubert*, 885 F. 2d at 1291.

78 Valasek, p. 73.

79 The CMS case was filed in 2001. It gave rise to a 2003 decision on jurisdiction, a 2005 decision on the merits and a 2007 decision on an application for annulment. The *Total* case was filed in 2003 and has given rise to a 2006 decision on jurisdiction and a 2010 decision on the merits; a further decision is expected on damages, which may be followed by additional proceedings seeking an annulment.

80 See *Total* 2010, § 19.
"pesification"; the degree of overlap with the damages awarded or at issue in the CMS and Total claims is unclear.81

In another example, Egypt reportedly faces multiple ISDS claims from shareholders with regard to alleged treatment of East Mediterranean Gas Company (EMG).82 An alleged 12.5% shareholder of EMG known as Ampal has brought an ICSID case against Egypt. Other shareholders with overlapping interests in EMG, include Ampal’s CEO and controlling shareholder, are reportedly pursuing a separate ad-hoc UNCITRAL ISDS arbitration under the Poland-Egypt bilateral investment treaty over the same events.83

Costs for claims for reflective loss may be increased because of the need for high-cost expert evidence to address the problem of how much reflective loss is suffered by the different corporate stakeholders.84

In addition to increased costs for governments, the availability of multiple shareholder claims may allow tactical behaviour by shareholders. The Yukos situation has generated multiple claims against Russia by different shareholders of Yukos in different proceedings. A small Spanish Yukos shareholder claim for $2.6 million in Quasar v. Russia was entirely financed by $14.5 million provided by the majority Yukos shareholder (which is bringing three separate Yukos-related cases against Russia).85 This interested third party financing arrangement was discovered only late in the Quasar proceedings.86 The small Quasar case gave rise to tribunal findings that are expected to be used by the majority shareholder-funder as well as by other Yukos shareholder claimants.87

There are additional contract claims and commercial arbitration proceedings involving the company, EMG, and Egyptian SOEs apparently also arising out of the same events. Id.

81 See TGN demandará a gobierno de Argentina, El Economista (Mexico) (10 October 2012) (TGN announces expected claim against government due to 2002 pesification law and subsequent freezing of tariffs; claim to seek damages incurred since 2006). CMS’s damages as a shareholder were apparently calculated based on the life of the TGN concession to 2027. CMS Gas Transmission Company v. Argentina, Award (2005), § 199.

82 See Luke Eric Peterson, Battle is joined on second treaty-arbitration front in Israel-Egypt gas fight, as ad-hoc arbitral tribunal is chosen, International Arbitration Reporter (6 Feb. 2013).

83 See id. ("In the Ampal claim at ICSID, as well as in the ad-hoc claim, ... damages are sought not merely for the interruptions in supply suffered as a result of the “terror” attacks, but also for the ultimate termination of the gas venture by the Egyptian counter-parties (whose conduct is attributed by the claimants to the Egyptian state)). There are additional contract claims and commercial arbitration proceedings involving the company, EMG, and Egyptian SOEs apparently also arising out of the same events. Id.

84 See GAMI v. Mexico, Submission of the United States (non-disputing party) (30 June 2003) (noting that “international tribunals have rejected shareholder claims in part because of the difficulty in determining what relief can fairly be granted in light of potential claims by creditors and other interested parties”).

85 Quasar de Valores SICAV, S.A. v. Russian Federation, (SCC), Award (2012); Hulley Enterprises Ltd ((Cyprus) v. Russia; Yukos Universal Limited v. Russia; Veteran Petroleum Limited v. Russia. The three latter cases are being heard together by a single tribunal.

86 See Quasar de Valores SICAV, S.A. v. Russian Federation, (SCC), Award (2012); Luke Eric Peterson, Russia held liable for expropriation of Yukos ownership in case brought by minority Spanish shareholders (but funded by majority owner), International Arbitration Reporter (26 July 2012) (“with the publication of the final award in the Spanish shareholders' claim, it has been confirmed that the $14.5 million (US) used to pursue the Spanish BIT claim was provided entirely by an interested third-party: the majority Yukos shareholder, Group Menatep Limited”).

87 See id. (“Compensation is modest [in Quasar], but majority shareholders (and funders of this case) may be heartened” [by the tenor of the Quasar decision]).

In addition to the three joined cases brought by majority shareholder of Yukos and the Quasar case, ISDS shareholder claims arising out of the alleged injury to Yukos include a claim by RosInvestCo Ltd, a UK
that a government may take a risk if it seeks to save money on its defence costs in defending a small shareholder claim.\textsuperscript{88}

In contrast to domestic law, the admissibility of shareholder claims for reflective loss in ISDS makes possible a broad range of multiple claims for the same underlying injury to an operating company. Some of these possibilities are illustrated in figures below.

A first type of multiple shareholder claims are brought by unrelated foreign shareholders of the same company. The shareholders are separate entities without any common ownership.

**Figure 1. Multiple Claims by Unrelated Shareholders**

Other types of multiple claims can be brought by related entities (with common ownership). Three scenarios can be distinguished. In the first, a domestic company (without access to ISDS) claims in the domestic courts and a foreign shareholder brings an ISDS claim.

\textsuperscript{88}To the extent the Yukos cases involve direct loss rather than reflective loss for shareholders, the cases would not be subject to any principles on reflective loss. See, e.g., *Hulley v. Russia*, Interim Award on Jurisdiction and Admissibility, §§ 61, 372 (2009) (finding that the claimant’s shares were frozen by the government and the company was prevented from disposing of any assets; finding that claim is an action for direct loss). They are addressed here to illustrate issues raised by multiple shareholder claims.
In the second type of multiple claim by related parties, a foreign company and a domestic company with access to ISDS bring separate claims.  

In a third type of multiple claims by related parties, two different foreign shareholders, at different levels of the corporate chain, both bring ISDS claims.

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89 Domestic companies can, for example, have access to ISDS pursuant to certain provisions of the ICSID Convention. See below section on ICSID art. 25(2)(b).
These variations can be combined. For example, multiple claims by unrelated foreign shareholders can be accompanied by a further claim by the company (in ISDS or in the domestic courts).

In the absence of legal barriers to shareholder claims, high case costs for ISDS claims may be the principal barrier to multiple shareholder claims against governments. In terms of the costs effects for governments, this may cut both ways: while these costs will diminish the number of multiple claims, the costs in each case that is brought will be very high. High costs also raise issues about access to justice and equal treatment between foreign investors.

Arbitral case law on shareholder claims does not appear to have reflected significant concern with judicial economy issues raised by allowing multiple shareholder claims for reflective loss in ISDS. As with other policy issues, arbitrators have generally interpreted the treaty definition of investment and arbitral precedent as resolving the issue without the need to consider the consequences (in this case, for respondent States and non-claimant victims of reflective loss such as other shareholders and creditors).

b. The risk of inconsistent outcomes rises with multiple claims

National courts appear to have focused more on the costs consequences of multiple claims than on the risk of inconsistent outcomes. Because the applicable rules in national law generally block shareholder claims, cases of inconsistent outcomes are very rare in national law.

The risks of incoherent outcomes may be greater in ISDS that it would be if claims for reflective loss were permitted in national law. The ISDS system is decentralised and uncoordinated compared to national courts. In ISDS, each shareholder (or other reflective claimant) is entitled to its own tribunal

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90 As participants have noted in earlier Roundtable discussions of ISDS, high costs for the parties in ISDS constitute revenues for the arbitration bar and create economic incentives, particularly with regard to decisions on jurisdiction. See ISDS Scoping Paper, pp. 47-48. The impact of those incentives, if any, is the subject of differing views. See FOI Roundtable Progress Report on ISDS, p. 16 (section on arbitrator incentives). Because of the corporate law context, the alignment of certain economic incentives for arbitrators and foreign investor interests may differ somewhat from other jurisdictional decisions.
(in the absence of clauses requiring consolidation, which are rare). It can often file its claim under a different treaty so that different law may apply. Some or all of the proceedings may be confidential. As Valasek notes, the admissibility of shareholder claims “will ... increase the likelihood of inconsistent arbitral decisions.”

The Lauder/CME cases are a well-known example. Ronald Lauder, a U.S. national, was the ultimate beneficiary of an investment in a Czech operating company (CNTS). The investment was held through an intermediate corporation (CME). Lauder commenced a first ISDS arbitration claim in August 1999. Six months later, CME started a second ISDS proceeding before a different arbitral tribunal under a different BIT. (See Figure 5). The Czech Republic refused to consolidate the proceedings as proposed by the claimants.

Figure 5. Multiple Claims by Related Entities: Lauder/CME
Two different-tier foreign shareholders both with access to ISDS
(Reflective loss hypothesis; domestic law claims omitted)

This chart is derived from the corporate structure of the claimants in the Lauder and CME claims as available from public sources. It presents a simplified version of the corporate structure. Some aspects, such as the number of intermediate holding companies, have been hypothesised.

91 Valasek, p. 73 et seq.
Both ISDS claims arose from the same facts and involved essentially the same claims.\textsuperscript{92} As noted by Susan Franck, however, “one of the few common conclusions the two tribunals made was that Lauder and his Dutch investment vehicle had been the victims of discrimination. Beyond that point, the two tribunals came to diametrically opposed conclusions on issues related to expropriation, fair and equitable treatment, full protection and security, and compliance with minimum obligations under international law”.\textsuperscript{93}

The tribunals also took different views of the facts. The CME damages award was US $269,814,000, roughly equivalent to the annual health budget of the Czech Republic. The Lauder tribunal did not award any damages. In a third case, the primary wrong-doer, Lauder's Czech partner, was held in an ICC arbitration liable to pay CME a “mere” US$20 million.\textsuperscript{94} The inconsistencies over the same issues in Lauder/CME were further highlighted by the “impression of a race to the judgment seat between the two tribunals” with the two decisions being issued within 10 days of one another.\textsuperscript{95}

Even where a second tribunal carefully considers an earlier decision, however, inconsistencies are possible. The two tribunals that heard the two separate claims by TGN shareholders against Argentina reached divergent results, notwithstanding careful consideration of the first decision (CMS) by the second (Total). Contrary to the CMS tribunal, the Total tribunal rejected the claimed breach of the fair and equitable treatment standard during the height of the financial crisis. This appeared to be based on (i) an expressly different interpretive approach to the fair and equitable treatment obligation, and to the nature and relevance of legitimate expectations; (ii) somewhat different wording in the BITs at issue; and (iii) different facts (a later date of purchase of the shares by Total).\textsuperscript{96} Views may differ as to the relative importance of these factors in explaining the different outcomes for the two shareholders of TGN.

c. A single beneficial owner of shares may be able to bring essentially the same case twice.

In addition to their inconsistent outcomes, the Lauder/CME cases have been sharply criticised because critics consider that the same shareholder was in effect given “two bites at the apple”. The risk of inconsistent outcomes is borne principally by the respondent state, because a single victory is enough for the shareholder to obtain the benefit of an enforceable award for the full amount; a loss in the other case has no impact:

An appeal to basic notions of justice would surely suffice to refute any suggestion that such a state of affairs is acceptable as a matter of principle. A host state cannot be expected to defend a barrage of concurrent or consecutive claims relating to precisely the same prejudice to a single investment. Nor can it be right for a host state to defend consecutive claims in relation to the same investment by different members of the group of claimant companies until an award favourable

\textsuperscript{92} For a detailed analysis of the background and decisions, including the similar provisions in the two investment treaties, see Susan D. Franck, The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law through Inconsistent Decisions, 73 Fordham L. Rev. 1521 (2007).

\textsuperscript{93} Id., p. 1563.


\textsuperscript{95} Id.

\textsuperscript{96} See Total v. Argentina, Award on Liability (2010). Both tribunals found Argentina liable for the period after the peak of the financial crisis.
to that group is procured. The enduring and disturbing feature of the award in CME v. Czech Republic is that this state of affairs was condoned as an inevitable feature of the investment treaty regime.97

These types of claims are not possible in domestic law under the no reflective loss principle. They would appear to require not only the admissibility of reflective loss claims, but also that each claim is seen as autonomous.

A number of commentators have argued that a more flexible use of the principles of res judicata could address the “two bites at the apple” problem in the context of claims by related entities.98 In the Lauder/CME cases, arguments based on res judicata were rejected by the tribunal and by a Swedish appellate court.99

4. Consistency concerns could be exacerbated if creditors, at risk of injury from shareholder claims for reflective loss in ISDS, also seek to bring reflective loss claims in ISDS

a. Shareholder claims for reflective loss put creditors at risk

It is widely recognised that allowing shareholder claims for reflective loss can injure creditors of the company (unless the defendant is forced to pay the same damages twice).100 As noted above, Lord Millett underlined in Johnson that "protection of the interests of the company's creditors requires that it is the company which is allowed to recover to the exclusion of the shareholder" (assuming double recovery is excluded).101 The Gaubert court similarly underlined how the bar on shareholder suits serves to protect the company’s creditors:

Were common shareholders allowed to sue directly and individually for damages to the value of their shares, we would be allowing them to bypass the corporate structure and effectively preference themselves at the expense of the other persons with a superior financial interest in the corporation.102

97 Douglas, p. 309. See Valasek, p. 71 (“each holding company in a long chain of ownership could file its own separate claim against the host State for the same treaty breach.”) (emphasis in original).

98 In broad terms, res judicata refers to the principle that once a lawsuit is decided, the parties are barred from raising the case again.

99 CME Czech Republic BV (the Netherlands) v. Czech Republic, Partial Award on the Merits (2001); CME Czech Republic BV (the Netherlands) v. Czech Republic, Svea Ct. App. (2003) (rejecting the claim of res judicata because the cases involved different parties, different treaties and possibly different presentations of the facts).

100 Conflicts of interest between shareholders and creditors of a company are one of the key concerns of corporate law and finance. See, e.g., Reinier Kraakman et al, The Anatomy of Corporate Law (2d ed. 2009), p. 2 (conflicts between shareholders and the corporation's other constituencies, including creditors, are one of the three principal agency conflicts that are addressed by corporate law); Peter O. Mulbert, A synthetic view of different concepts of creditor protection, or: a high-level framework for corporate creditor protection, E.B.O.R. 2006, 7(1), 357-408 (reporting on a pan-European discussion on creditor protection and company law).

101 2 A.C. at p. 62 (Lord Millett).

102 Gaubert, 885 F. 2d at 1291; see also Holmes v. Securities Investor Protection Corp., 503 U.S. 258, 274 (1992) (US Supreme Court) ("a suit by an indirectly injured victim could be an attempt to circumvent the relative priority its claim would have in the directly injured victim's liquidation proceedings").
The Supreme Courts of Germany and the Netherlands have also noted the no reflective loss principle protects the interests of the company’s creditors. Corporate law and finance textbooks similarly recognise the protection of creditors as a core reason for appropriate restrictions on shareholders diverting corporate assets and more specifically for the prohibition on shareholder claims.

In ISDS, the United States and Mexico have similarly argued that the NAFTA provision requiring that recovery for derivative action claims be paid to the company rather than a shareholder protects creditors. (See below section on NAFTA) Argentina has also made policy arguments based on the risk of injury to creditors from shareholder claims for reflective loss in more recent cases. As noted above, however, tribunals have rarely addressed creditor interests.

b. **Creditors may seek to bring ISDS claims for their reflective loss**

International investment, like domestic investment, usually involves a mix of debt and equity financing. As noted above, creditors, like shareholders, can suffer reflective loss when the debtor company suffers a substantial injury. A company may default on its debt or the market value of a company's bonds may fall due to a higher risk of default. Harm to creditors from shareholder claims is most clearly at issue if the injured company appears to be in financial difficulty, as may often be the case in ISDS if there is serious governmental misconduct.

Under the no reflective loss principle, only the company can make the claim and its recovery indirectly benefits creditors as well as shareholders. As noted by appellate judge and corporate law

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103 See Girmes, (BGH, German Supreme Civil Court 20 March 1995), BGHZ 129, 136, 166; Poot/ABP, (Hoge Raad, Dutch Supreme Civil Court, 2 December 1994), NJ 1995, 288, cited by de Jong, p. 3.

104 A policy that puts creditors of companies engaged in foreign investment at risk may affect the availability and price of debt finance for foreign investment. As noted by leading corporate law scholars, stronger legal protection of creditors' rights is generally associated with more lending to corporate borrowers. Protection of creditors from inappropriate shareholder diversion of corporate assets can lower the cost of debt finance for the company, resulting in gains to both creditors and shareholders. See John Armour, Gerard Hertig and Hideki Kanda, Transactions with Creditors, ch. 5 in Reinier Kraakman et al, The Anatomy of Corporate Law (2d ed. 2009), p. 115 n.1 (citing sources); see id. p. 118 (“both creditors and shareholders can benefit from appropriate restrictions on the ability [of shareholders] to divert ... assets, because such restrictions are likely to reduce a firm’s costs of debt finance”) (emphasis in original). See also Louise Gullifer & Jennifer Payne, Corporate Finance Law: Principles and Policy (2011), p. 96 (approving House of Lords decision in Johnson).

105 See, e.g., GAMI v. Mexico, Submission of the United States (non-disputing party) (30 June 2003) § 17 (non-disputing party submission); id, Escrito de Contestación de Mexico, §§ 166-67, pp. 61-64 (24 Nov. 2003).

106 Creditors can also suffer a direct loss. For example, if a State were to prohibit a company from making foreign currency payments to foreign lenders, the debtor company would not suffer any loss; only the creditors would.

107 See Armour et al., in Kraakman 2009, p. 117.

108 See Mid-State Fertilizer Co. v. Exchange National Bank of Chicago, 877 F.2d 1333, 1336 (7th Cir. 1989) (“recovery by the firm, followed by division according to entitlements, is especially important when the firm has landed in bankruptcy. Suits by shareholders, guarantors, and the like may well be efforts to divert the debtor's assets – to pay off one set of creditors ... while keeping the proceeds out of the hands of the firm's other creditors.”); Peter O. Mulbert, A synthetic view of different concepts of creditor protection, or: a high-level framework for corporate creditor protection, E.B.O.R. 2006, 7(1), 357-408 (generally in corporate law, “since shareholders’ incentive to act to the detriment of creditors increases with the company becoming financially distressed, it is important to provide for mechanisms that will work to effectively control any opportunistic behaviour on the shareholder's part”).
Good reasons account for the enduring distinction between direct and derivative injury. When the injury is derivative, recovery by the indirectly-injured person is a form of double counting. "Corporation" is but a collective noun for real people – investors, employees, suppliers with contract rights, and others. A blow that costs "the firm" $100 injures one or more of those persons. If, however, we allow the corporation to litigate in its own name and collect the whole sum (as we do), we must exclude attempts by the participants in the venture to recover for their individual injuries. To avoid double counting courts must either restrict recoveries to the directly-injured party or attempt to apportion the recovery according to who bears the effects: say, $60 to equity investors, $20 to debt investors, $10 to employees with specialized skills, $10 to persons who leased property to the firm. Divvying up the recovery would be a nightmare.... Why undertake such a heroic task when recovery by the firm handles everything automatically? – for investors, workers, lessors, and others share any recovery according to the same rules that govern all receipts.109

Under national law, creditors of a company are also generally subject to a bar on the recovery of reflective loss. Creditors generally cannot sue third parties who injure the company for creditors’ reflective loss. Only the company can make the claim.110

If reflective loss claims are possible in ISDS, company creditors may seek to bring claims for reflective loss. In a context where shareholders can bring such claims, creditor claims may arise in part to protect creditor interests from shareholder claims. They may also be an effort to pre-empt other claimants on corporate assets.


110 See, e.g., Pagan v. Calderon, 448 F.3d 16, 29 (1st Cir. 2006) ("As is the case with shareholders, creditors do not have standing to sue in their personal capacities unless the alleged misconduct causes harm to them separate and distinct from the injury inflicted upon the debtor corporation."); Landune International Ltd v Cheung Chung Leung [2006] 1 HKLRD 39 (CA (Hong Kong)); Rita Cheung, The no reflective loss principle: a view from Hong Kong, I.C.C.L.R. 2009, 20(7), 223-229.

Creditor claims for reflective loss have arisen in the context of the financial crisis in domestic law. They raise similar issues with regard to consistency as shareholder claims and courts have dismissed them for similar reasons. In American National Insurance Co. v. JP Morgan Chase & Co., 2012 US Dist. Lexis 139831 (D.C. Dt. Ct. 2012), bondholders sued the acquirer of a bank. A government-organised seizure and sale of the bank to the acquirer – which rendered the bonds worthless – was allegedly caused in part by the acquirer's spreading of misinformation to regulators disparaging the bank's viability. The court dismissed the bondholder claims for reflective loss as "clearly barred", underlining that reflective claims are problematic because they involve "double counting". Only the bank's receiver could bring the claim. See also Mid-State and cites therein.

111 As described above, the primary textual basis for the recognition of shareholder claims for reflective loss in ISDS has been the reference to shares in the BIT definition of investment. As noted above, bonds and other credit instruments are frequently mentioned in the definition of investment as well. See, e.g., UK-Russia BIT, art. 1(a) (definition of investment includes “shares in and stock, bonds and debentures of, and any form of participation in, a company or business enterprise”). Other factors are relevant and no opinion is expressed with regard to the likelihood of such claims succeeding at any stage.
If creditor claims in ISDS for reflective loss were accepted, they could exacerbate the same consistency-related concerns raised by shareholder claims: (i) governments could face further separate claims from both shareholders and creditors arising out of the same events leading to increased litigation expenses (including for expert evidence to try to allocate the reflective losses) and risk of inconsistent outcomes; (ii) governments would face increased risks of double recovery, and efforts to address double recovery risks through share purchase remedies and undertakings to refund future dividends could be more complicated; and (iii) direct recovery by one creditor in ISDS would be at the expense of other claimants on the company (e.g., other creditors, shareholders), unless there is double recovery.

If, on the other hand, creditor claims for reflective loss were generally found inadmissible while shareholder claims were permitted in ISDS, the differential treatment could have an effect on investor incentives.

5. Multiple shareholder claims: shareholder interests and incentives

As the ECtHR noted in Agrotexim, there may often be disagreements among different constituencies in the company about whether the company's rights have been violated or whether a claim should be brought.112 Under corporate law applying the no reflective loss principle, the decision is normally taken by the company pursuant to the relevant rules on corporate governance. The availability of shareholder claims for reflective loss in ISDS may affect both shareholder and corporate incentives about how to address the injury.

a. Different types of shareholders will likely have different interests

Under an ISDS regime in which shareholder claims are admissible, it may be useful to distinguish three broad groups of shareholders in terms of their likely reactions to government misconduct affecting the company:

- Category I shareholders: “Likely claimants”. These shareholders are likely to be ready, willing and able to claim as shareholders in ISDS. Category I shareholders first need to have a sufficient stake to make bringing a claim worthwhile. They also need to be ready to incur the cost to bring an individual claim if the company is mistreated. Such shareholders can decide between supporting company action or their own claim (at one or more levels as a shareholder) or both. They may be the principal beneficiaries of an expansive regime for shareholder claims.

- Category II shareholders: “Potential but unlikely claimants”. This group is composed of shareholders covered by an investment treaty but who are unlikely to claim as shareholders. This may be due to the limited size of their investment or their diversified investment strategy.113 The fortunes of these shareholders lie primarily but not exclusively with company remedies.

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112 See Agrotexim, § 65 (“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 concerning the most appropriate way of reacting to such an infringement.”)

113 Category II may include some institutional investors who prefer to diversify their risk across many companies and sell at a loss in any particular company rather than bring high cost claims as a shareholder:

Since only those minority shareholders active, informed, and wealthy enough to pursue claims can recover even when other shareholders are equally injured, many minority shareholders are
• Category III shareholders: “Excluded claimants.” This group includes foreign shareholders not covered by a treaty and domestic shareholders. These shareholders cannot bring an ISDS claim as a shareholder. They also cannot bring a claim under domestic law because only the company can bring the claim. The fortunes of these shareholders lie solely with company remedies.

Categories I and II are not rigid categories and the dividing line may vary depending on the facts. For most if not all shareholders, including Category I shareholders, litigation is generally undesirable. Some normally passive Category II investors might be driven to bring a personal claim as a shareholder if their losses are unusually high and the government misconduct is egregious. Nonetheless, the broad categories are likely to exist.\(^\text{114}\)

b. Shareholder and company behaviour may be difficult to predict in a regime where shareholder claims are admissible.

The analysis differs with regard to separate claims by different unrelated shareholders of the same company and vertical claims by related entities (through common ownership). (See above figures 1-5).

i. Claims by unrelated shareholders

The number of horizontal claims will depend on the number of Category I “likely claimant” shareholders and the facts. (See Figure 1 above) Given ISDS case costs of over $8 million on average, only shareholders with substantial holdings are likely to bring claims.

In some cases, it may be possible to consolidate these claims, lessening the cost burden on the parties and encouraging consistent results. However, provisions providing for consolidation are rare: each shareholder can generally bring its own case. Governments seeking consolidation may lack bargaining power; for example, if consolidation is offered only after two or more tribunals are selected, the government may have to agree to the tribunal preferred by the investors as a condition for an agreed consolidation.

The number of horizontal claims may also depend on claim outcomes and limitations periods. Some shareholders may prefer to wait to see if a first shareholder claim is successful.\(^\text{115}\)

left out of [investment] arbitration remedies. This is especially important as institutional funds made up of portfolio investors ... have become increasingly important sources of capital. Such funds tend to be highly diversified, reducing or removing the incentive for portfolio managers to pursue claims when any one of their investments has been harmed by a host government.

D’Agostino, 98 Va. L. Rev. at 203 (footnotes omitted).

\(^{114}\) If it is assumed that creditors can also claim for reflective loss in ISDS, they could be categorised into similar categories. Likely reflective loss claimants among creditors may be fewer because, as noted above, creditors generally suffer less reflective loss than shareholders (providing the company is solvent); creditor interests and losses may also be dispersed if, for example, the company’s bonds are widely held. If it is assumed that creditors cannot claim for reflective loss in ISDS, they would all be “excluded claimants” whose fortunes would lie solely with company recourse.

\(^{115}\) For example, CMS and Total were both minority shareholders in TGN. CMS filed its shareholder claim in 2001. Total did not file its shareholder claim against Argentina until October 2003, shortly after the July 2003 tribunal ruling finding CMS’ minority shareholder claims to be admissible in ISDS. As noted in earlier Roundtable work, many BITs do not contains time limits on claims.
ii. **Claims by related entities at different levels of the corporate chain**

Further research and analysis is required to evaluate the litigation incentives in this area. However, a few preliminary points may be noted. In the House of Lords decision in *Johnson*, Lord Millett noted that a further policy reason weighing against allowing shareholder claims for reflective loss is that they would create conflicts of interest for company directors who are shareholders with an interest in a personal suit.116

For example, in the context of settlement negotiations, the director's duty would generally be to make the highest-value settlement for the company. However, this duty would conflict with his/her interest as a shareholder because a minimal recovery for the company followed by a personal shareholder action for the balance would allow the shareholder to recover the maximum amount for itself at the expense of the creditors and other shareholders.117 A similar conflict of interest could apply to decisions about whether the company should file a claim at all, and thus to whether the government would face two vertical claims.

### Box 2. Impact of shareholder claims for reflective loss in ISDS on a level playing field between foreign and domestic shareholders

The Roundtable has noted that ISDS creates differences in treatment between foreign and domestic companies. Domestic companies are largely limited to the non-pecuniary primary remedies in domestic administrative law whereas foreign companies have access to both primary remedies under domestic law and damages in investment arbitration.1

The Roundtable has discussed the issue of these differences on a level playing field for investors, with a variety of views being expressed.

In the case of shareholders, the differences in treatment between foreign and domestic shareholders in ISDS may be more stark than for companies. Under domestic law, shareholder claims may be dismissed without consideration of the merits on the grounds that only the company can sue. In contrast, foreign shareholders frequently have access to their own recourse for reflective loss in ISDS. For shareholders, ISDS may introduce a distinction between those who have personal recourse and those who have none.

As noted in the text, shares are much easier to buy and sell than companies. Rapid changes can occur in the proportion of foreign ownership of a company's shares (and more generally, in a country's listed companies).2 Overall, as a result of increasing foreign ownership, half of the listed companies in the UK and Belgium, 40 per cent of the companies in France and Germany and around 30 per cent of the companies in Spain and Italy have a large foreign shareholder.3 Countries with advanced capital markets and traditional BITs may be beginning to see their first shareholder claims, which, depending on the outcomes, may raise the profile of the comparative treatment of shareholders.

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1. See ISDS Scoping Paper, pp. 25-27 & Annex 4. As noted in the FOI Roundtable Progress Report on ISDS (p.10), "[f]oreign investors, which may generally choose between domestic fora or ISDS, have a wider range of options and available remedies against governments than do domestic investors faced with similar government action. In addition to having access to monetary damages, foreign investors can frequently go directly to international arbitration without having to resort to national courts or administrative remedies if the investor considers arbitration to be more advantageous."

2. See, e.g., Christoph van der Elst, Shareholder Rights and the Importance of Foreign Shareholders, (Tilburg Law and Economics Center (TILEC) Law and Economics Discussion Paper No. 2010-008) (Feb. 2010), pp. 5-6 (over an 8 year period, "the internationalisation of the shareholder structure was remarkable in Germany and France"; in Germany, 30% of all large stakes are held by foreign shareholders, including hedge funds, an increase of almost 300%).

3. Id., p.7.

116 *Johnson*, [2002] 2 A.C. at p. 66 ("The disallowance of the shareholder's claim in respect of reflective loss is driven by policy considerations. In my opinion, these preclude the shareholder from going behind the settlement of the company's claim. If he were allowed to do so then, if the company's action were brought by its directors, they would be placed in a position where their interest conflicted with their duty ...")

117 This conflict of interest may have different effects depending on whether the interested shareholder is a controlling or non-controlling shareholder.
ISDS cases, even where they are public, do not provide much information about the resolution of these conflicts. Securities law disclosure by listed companies can, however, provide some insight. In the *Lauder/CME* case, the first ISDS case was brought by Ronald Lauder, the top tier controlling shareholder. CME, a lower tier corporation controlled by Lauder, brought its claim only six months later.

Sandwiched in between Lauder and CME in the corporate chain was a listed company known as CEMEL. Lauder was the controlling shareholder and the chairman of the board of CEMEL. CEMEL owned 100% of CME, the claimant in the second case. (See Figure 5)

CEMEL had issued USD and deutschmark bonds to raise approximately USD 160 million. The two cases likely had different profiles from the perspective of CEMEL’s bondholders. Recovery by CME would benefit them (because CEMEL owned 100% of CME). CEMEL’s 2001 Form 10-K US securities law filing made clear that the fortunes of its bondholders were tied to CME’s ISDS claim:

> Should the Company receive and collect a substantial award [from the CME claim], the Company may be in a position to refinance or otherwise satisfy its Senior Notes, which currently have $163,563,000 of principal outstanding (the "Senior Notes"), on or before August 15, 2004. There can be no assurance that the Company will be awarded substantial damages in the second round of hearings, and if awarded such damages, that the Company will be able to collect the award. If substantial damages are not awarded and collected, the Company is likely to experience difficulties in refinancing the Senior Notes without additional external investment. If the Company is unsuccessful in refinancing the Senior Notes, the Company is likely to be unable to continue operations.\(^\text{118}\)

In contrast, Lauder’s personal recovery as a top tier shareholder would likely not have benefitted CEMEL’s bondholders or its other shareholders (unless special arrangements existed).\(^\text{119}\) The corporate decision-making processes about the two suits are not known. It is possible that CEMEL’s creditors and other shareholders expressed concern about the Lauder suit, and that the second CME suit resulted from that concern.

The incentive effects of the availability of shareholder claims on the likelihood of a company claim, however, are hard to predict. On the one hand, each shareholder claim could reduce the likelihood of a company claim: the claimant shareholder might not want to pay the legal costs again for the same claim at the company level, especially if double recovery is addressed. This may affect the chances of recovery by the other shareholders and creditors through a company action.

On the other hand, if “two bites at the apple” are permitted in ISDS along the lines of the *Lauder/CME* precedents discussed above, a shareholder might support action at two levels because a victory in either case can suffice. Because of the practical absence of investor exposure to counterclaims in ISDS, the only financial downside to multiple claims would be legal costs.

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\(^{119}\) CEMEL’s other shareholders similarly would normally benefit only from CME recovery and not from Lauder recovery.
Reputational concerns, however, could constrain opportunistic behaviour even in the absence of legal constraints.\textsuperscript{120}

\textbf{Issues for discussion}

- \textit{Are the following policy interests relating to consistency in ISDS of importance to your country?}
  - limiting the number of claims arising from the same injury and the attendant litigation costs
  - limiting the risk of conflicting decisions
  - potential double recovery of damages
  - the difficulty and costs of trying to evaluate and allocate reflective loss
  - avoiding giving the same beneficial claimant “two bites at the apple”
  - equal treatment of shareholders

- \textit{Have you considered methods to centralise claims and recovery with the company, such as ICSID art. 25(2)(b) consent or a derivative action mechanism?}

\textsuperscript{120} Corporate law constraints also likely exist in many systems of corporate law; views may differ on how effective they would be in controlling conflicts of interest in practice in this context.
F. THE ISSUE OF COMPANY RE COURSE

It has been suggested that the availability of recovery by the company can lessen or eliminate the need for shareholder recovery of reflective loss, and provide certain advantages. This section first reviews two existing systems in ISDS, one under NAFTA and one in ICSID, which expand the ability of companies with foreign shareholders to recover in ISDS. It then briefly outlines the wide variety of possible situations in ISDS with regard to company status and recourse.

1. Two existing systems which expand the ability of companies with foreign shareholders to recover in ISDS.

a. NAFTA

i. Introduction

NAFTA contains a significantly more developed system for shareholder claims than most investment treaties. Two separate provisions govern the standing of shareholders to bring claims.

Art. 1116 governs a "Claim by an Investor of a Party on Its Own Behalf" for damage caused by the breach of a NAFTA provision. Article 1117 of NAFTA allows certain shareholders to bring a claim on behalf of a company. Because the art. 1117 claim is brought by the foreign shareholder on behalf of the company rather than by the company itself, the company can be a host-state company.

Art. 1117 in effect establishes a special form of shareholder derivative action. The shareholder brings the art. 1117 claim, but the company is the beneficiary of the award. Art. 1135(2) ensures that recovery for all art. 1117 claims goes to the company rather than the shareholder. Recovery for the company protects company creditors and all shareholders, as derivative action mechanisms generally do under domestic law.

The claimant shareholder must own or control the company directly or indirectly to bring a claim under art. 1117. Non-controlling shareholders cannot bring claims under art. 1117. Where a shareholder brings an art. 1117 claim, the company is expressly prohibited from bringing a claim on its own behalf. As noted by Meg Kinnear, this likely helps avoid the possibility that a foreign company could make one ISDS claim while its controlling owner makes another.

Several provisions specifically address and reduce the risk of multiple proceedings. Waiver of claims is required as a pre-condition to bringing a claim, which largely precludes the possibility of multiple claims. If a claim is brought under art. 1117, both the investor and the company must waive

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121 For convenience and consistency, we refer herein to a company. NAFTA refers to a claim brought on behalf of an "enterprise", which is defined in art. 201(1) as "any entity constituted or organized under applicable law, whether or not for profit, and whether privately-owned or governmentally-owned, including any corporation, trust, partnership, sole proprietorship, joint venture or other association".

122 As noted above, a domestic company cannot claim against its home state under customary international law; a treaty provision is required.

123 NAFTA art. 1117(4).

the right to initiate or continue local proceedings (art. 1121(2)). Consolidation of related shareholder claims under arts. 1116 and 1117 is mandated unless the tribunal finds that a disputing party would be prejudiced.

ii. **Reflective loss claims and the relationship between articles 1116 and 1117**

As noted by Kinnear, the NAFTA Parties have argued in similar terms that claims for reflective loss (derivative damages) can only be brought under the derivative action procedure of art. 1117 with recovery for the company:

> The NAFTA Parties have argued that tribunals should treat seriously the differences between claims under Articles 1116 and 1117. In particular, they have argued that Article 1116 permits a claim only for damage suffered by the investor. If the investment is an enterprise, any claim for damages to the enterprise itself could only be made under Article 1117. Under this theory, so-called “derivative damages” – damages based on the diminution in value of the interest in the enterprise owned by the investor – would not be compensable under Article 1116.

For example, the United States has consistently argued that the two provisions are distinct and that reflective loss (indirect injury) can only be claimed through the art. 1117 derivative action procedure. In a case brought by a US investor against Mexico, the US filed a non-disputing party submission to this effect:

> the United States does not believe that Article 1116 can fairly be construed to reflect an intent to derogate from the rule that shareholders may assert claims only for injuries to their interests and not for injuries to the corporation. It is well recognized that “an important principle of international law should not be held to have been tacitly dispensed with by an international agreement, in the absence of words making clear intention to do so.” Nothing in the text of Article 1116 suggests an intent to derogate from customary international law restrictions on the assertion of claims on behalf of shareholders. By contrast, the view of at least one of the Parties as to the intent of the three NAFTA countries was expressed in the contemporaneous United States Statement of Administrative Action in terms that are quite clear: consistent with the prevailing rule under customary international law, Article 1116 provides standing for direct injuries; Article 1117 provides standing for indirect injuries. Were minority noncontrolling shareholders to be permitted to bring a claim under Article 1116 for indirect injuries, Article 1117 would be superfluous.

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125 Certain non-pecuniary remedies in domestic courts proceedings may still be sought.

126 NAFTA art. 1117(3).

127 Kinnear, pp. 1116-6 - 1116-7.

128 *GAMI v. Mexico*, Submission of the United States (non-disputing party) (30 June 2003) (footnotes omitted). As is customary in NAFTA art. 1128 submissions by non-disputing parties, the US did not take any position on the merits.

The US Statement of Administrative Action referred to in the excerpt describes the two provisions as follows:
As noted above, the US and Mexico have also highlighted the interests of company creditors in this context:

The distinction between Articles 1116 and 1117 is also critical to ensuring that creditors’ rights with respect to the investment are respected [because recovery in an art. 1117 claim goes to the enterprise]. This prevents the investor from effectively stripping away a corporate asset – the claim – to the detriment of others with a legitimate interest in that asset, such as the enterprise’s creditors.129

This view of articles 1116 and 1117 corresponds to a significant degree with the domestic law principles governing reflective loss discussed above. Reflective loss would generally only be recoverable through a claim brought on behalf of the company; recovery for the company would benefit all stakeholders.

The relevant NAFTA case law is somewhat uncertain. For example, in Mondev v. United States, the tribunal noted the creditor, respondent and tax interests protected by art. 1117 and that tribunals should ensure that in cases where those interests are at issue, damages should be recovered by the company:

[The] United States argued that Mondev should have brought the action on behalf of the enterprise, LPA, under Article 1117. It pointed to the importance of the distinction between claims brought by an investor of a Party on its own behalf under Article 1116 and claims brought by an investor of a Party on behalf of an enterprise under Article 1117. The principal difference relates to the treatment of any damages recovered. If the claim is brought under Article 1117, these must be paid to the enterprise, not to the investor (see Article 1135(2)). This would enable third parties with, for example, security interests or other rights against the enterprise to seek to satisfy these out of the damages paid. It could also make a difference in terms of the tax treatment of those damages.

In addition, if a claim is brought under Article 1117, both the investor and the enterprise must waive the right to initiate or continue local proceedings (Article 1121(2)). ...

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.130

Other NAFTA tribunals, however, have rejected the argument that reflective loss claims are limited to Art. 1117. Pope & Talbot v. Canada involved a claim by a foreign 100% shareholder for reflective loss incurred due to the treatment of its subsidiary. Over Canada’s objection (which was supported by the United States), the tribunal found that reflective loss was recoverable under Art.

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130 Mondev Int’l Ltd. v. United States, Award (2002), §§ 84-86.
In *GAMI*, the tribunal found that a claim for reflective loss by a minority shareholder under Art. 1116 was admissible.

However, consistent NAFTA government arguments in *Mondev, Pope & Talbot, GAMI* and other NAFTA cases about the policy issues and the difficulties of evaluating reflective loss (notably in light of the competing claims of creditors and others) may have encouraged NAFTA tribunals to recognise those difficulties either by ensuring that any recovery go to the company in appropriate cases or in considering damages.

In considering the issue of possible damages, the *GAMI* tribunal first recognised that resolution of multiple and overlapping shareholder and company claims for the same loss in the ISDS context is practically certain to be uncoordinated. The tribunal also (i) took note of the interests of creditors and the other shareholders; and (ii) recognised the risk of double recovery, underlining that it would be difficult to justify reducing the company's damages due to pre-existing shareholder recovery of reflective (derivative) loss in ISDS:

> How could [the company's] recovery be reduced because of the [hypothetical earlier ISDS] payment to [the shareholder]? [The company] 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 [the shareholder]. At any rate such a decision would have required due deliberation of [the company's] corporate organs. Creditors would come first. And other shareholders would have an equal right to the distribution. [The company] 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.

GAMI's claims were dismissed on the merits so that tribunal did not have to resolve the problems it identified.

As noted, the law under NAFTA remains somewhat uncertain. However, it would appear that minority shareholders may face substantial hurdles in successfully recovering reflective loss directly under NAFTA. There appear to have been few such claims under NAFTA since the 2004 decision in *GAMI* although further research is necessary.

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131 *Pope & Talbot v. Canada*, Award in Respect of Damages, ¶¶ 75–76 (31 May 2002). The tribunal relied on the waiver provision in Article 1121(1)(b), which refers to an Article 1116 claim which involves “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 tribunal concluded that NAFTA contemplates an Article 1116 claim arising from loss or damage to an investor's interest in the relevant enterprise. It noted, however, that the investor would still have to prove “that the loss or damage was caused to its interest, and that it was causally connected to the breach complained of.”

132 *GAMI v. Mexico*, Award (2004) § 119 ("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.") (emphasis in original).

133 Id., §§ 120-121.
ICSID also provides a mechanism under which foreign (and other) shareholders can be protected through which claims can be brought with recovery for the company. It operates differently from the NAFTA art. 1117 arrangement.134

b. **ICSID art. 25(2)(b)**

i. **Overview**

Article 25(2)(b) allows certain domestically-incorporated companies to be deemed to be foreign companies for purposes of access to ISDS.135 For purposes of treaty claims, the requirements are (i) foreign control of the host state company by nationals of the home state; and (ii) State consent – the home and host states must agree to treat the foreign-controlled host state company as foreign.136

For treaty claims, State consent is generally found in the investment treaty. The Secretariat statistical survey of ISDS provisions in BITs found that approximately 20% of the 1660 BITs reviewed contain consent provisions relating to art. 25(2)(b).137 In addition to bilateral treaties, consent under art. 25(2)(b) is included in the Energy Charter Treaty (art. 26(7)).

During the negotiation of ICSID, it appears that at least some governments saw company claims and shareholder claims as substitutes. During the negotiations over article 25, a proposal was advanced on several occasions to allow shareholder claims instead of company claims. It was rejected as unworkable:

While there was some resistance to the idea of giving locally incorporated companies the possibility to sue the host State, a majority of delegates found that it would be unwise to exclude locally incorporated but foreign controlled companies. 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 realised that this would not be feasible where shares are widely scattered and their owners are insufficiently organized.138

The art. 25(2)(b) regime ultimately provided for claims by foreign-controlled domestic companies as noted above, based on State consent.

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134 Of the NAFTA parties, only the United States is a party to ICSID.

135 As noted above, under customary international law, only a non-national has standing to bring a claim against a State. Article 25(2)(b) of the ICSID Convention derogates from that rule by making certain domestic companies eligible for ISDS at ICSID. A treaty provision is needed to modify customary international law. See generally, Christoph Schreuer et al, The ICSID Convention: A Commentary (2d ed. 2009), p. 296 et seq.

136 Article 25(2)(b) provides in relevant part as follows:

"National of Another Contracting State" means: [...] any 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.


138 See Schreuer, p. 297 (page references to drafting history omitted).
ii. **Relationship between art. 25(2)(b) claims by the company and shareholder claims**

As discussed above, the no reflective loss rule in domestic corporate law is based on the view that recovery by the company is both more efficient and more fair. Company recovery avoids multiple claims (and complex and expensive efforts to allocate the reflective losses). It is also seen as fairer to all interested parties who suffer reflective loss because they will automatically benefit in accordance with their relative interests in any flow of assets to the corporation. Recovery is thus available for creditors and all shareholders like any other corporate asset, and any distributions to shareholders are taxed in the normal way.

Consent to an art. 25(2)(b) regime provides certain domestic companies with access to ISDS; vis-a-vis a shareholder who also has access to ISDS, this makes the situation of the company more analogous to the situation of the company in domestic corporate law. Some States and commentators have argued that where governments have agreed to an art. 25(2)(b) regime, the availability of company recourse to ISDS further strengthens the argument for prohibiting shareholder claims for reflective loss.

However, arbitrators have generally not agreed that shareholder access to ISDS for reflective loss claims should be limited by the availability of company recourse to ISDS under art. 25(2)(b). The basic doctrinal rationale is that the inclusion of shares in the definition of investment amounts to acceptance by the government of autonomous shareholder claims for reflective loss. (See above section D.2.d). This right to claim is found to be unaffected by State consent to an art. 25(2)(b) regime allowing the company to also claim in ISDS.

The availability of a company claim under art. 25(2)(b) has thus been interpreted as having no impact on whether a shareholder can bring a claim arising out of the same injury to the company. As in other areas, the analysis does not address the consequences with regard to consistency concerns:

In the present case, the [shareholder] in fact had an option. It could claim as a national of the United States, the other contracting State, insofar as it meets the requirements laid down in the Convention and the Treaty. ... [The Argentine company] also had the option to complain [under the Treaty] as a company incorporated in Argentina, if it is established that this company is under foreign control .... This option was the subject of an agreement between the parties contained in Article VII(8) of the Treaty. The existence of this possibility does not prevent the investor claiming as such under the terms of the first sentence, if that option is also available.139

The continued availability of shareholder claims exemplified by *Sempra* and *CMS* likely leaves little if any practical role for company claims under art. 25(2)(b). As noted by Douglas, economic incentives are likely to favour separate shareholder claims rather than company claims if the former are available under applicable law:

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

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139 *Sempra Energy International v. Argentina*, Decision on Objections to Jurisdiction (2005), § 42; see also *CMS Gas Transmission Company v. Argentina*, Decision of the Tribunal on Objections to Jurisdiction (2003), § 51.
taxes and discharge other obligations before distributing the residual amount of any damages recovered to the shareholders.\textsuperscript{140}

Schreuer does not specifically address the economic incentives, but similarly recognises that shareholder claims are "usually preferred over proceedings brought by a locally incorporated company under Art. 25(2)(b) ... [The availability of shareholder claims] may lead to the relative disuse of the mechanism under Art. 25(2)((b))".\textsuperscript{141} Although more research is necessary, it appears that there have been few recent treaty-based claims by an art. 25(2)(b) company rather than a shareholder.

The availability of an art. 25(2)(b) claim by the company would appear to be unlikely to address the consistency issues identified above as long as shareholders have the ability to bypass it and bring their own claim.

2. The variety of company situations in ISDS

The status of the company and its recourse are of central importance in considering consistency issues relating to shareholder claims. It is also an area in which it is clear that there may be a broad range of situations.\textsuperscript{142} In some cases, the company will have effective recourse. In other cases, companies may have access to effective primary remedies, but not to damages. This may be increasingly the case as more ISDS claims are brought against governments with advanced systems of administrative law. In other cases, the company may have uncertain or no meaningful recourse.

It may be useful to outline some concrete examples. There may be various situations in which the company has effective recourse:

- the company has access to ISDS under the same treaty as the shareholder
- the company has access to ISDS under a different but comparable treaty
- a company (without access to ISDS) has access to effective primary remedies in an advanced administrative law system, but not to damages under domestic law principles\textsuperscript{143}

There are other situations where the company has no real recourse:

- the company (with no access to ISDS) brings a claim in the domestic courts, but suffers a denial of justice (eg. government interference with the judiciary leading to denial of the claim)
- the company suffers a "legal death", ie. ceases to exist due to a winding-up
- the company remains in existence, but is paralysed due to host state action (eg. all its assets are frozen or taken)

\textsuperscript{140} Douglas, p. 452.
\textsuperscript{142} In preliminary discussions, Roundtable participants have expressed a variety of views about the relative quality of domestic remedies. See FOI Progress report on ISDS, p. 11 ("Participants expressed differing views about the prevalence of bias against foreign investors in national legal systems and the appropriate working assumptions in this regard.").
\textsuperscript{143} As set forth in the ISDS Scoping Paper, advanced systems of administrative law generally provide non-pecuniary primary remedies for investors, but do not make damages remedies available. See ISDS Scoping Paper, Annex 4. A variety of views have been expressed about how close a substitute effective primary remedies are for money damages for investors, and the costs/benefits of each for governments.
There are also scenarios where the company has effective recourse but chooses not to fully litigate a claim:

- after full consideration of the costs and benefits, the company settles the claim for less than full value due to concerns about government relations and the expectation of future benefits from a good relationship.

- the company directors improperly settle the company claim for low value in order to obtain collateral benefits for themselves, e.g. favourable personal tax treatment.

In addition, there are many situations where the quality of recourse available to the company is not certain. For example, it may have access to a domestic system that works reasonably well, but is sometimes subject to political influence. Given the wide variety of situations, a general rule with regard to all shareholder claims may not be appropriate.
G. CONCLUSION

This paper has set out a preliminary framework for analysis of the consistency issues raised by shareholder claims for reflective loss in ISDS. These types of claims now make up a substantial proportion of ISDS claims, but they are the subject of very little attention in most BITs. They have been found admissible by many ISDS arbitral tribunals. This can be seen as a success story from the point of view of consistency of legal interpretation, and improves investor protection for potential claimant shareholders in many cases.

Courts in advanced systems of national corporate law, however, generally reject shareholder claims for reflective loss – largely for explicit policy reasons relating to consistency, predictability, avoidance of double recovery, and judicial economy. Only the directly-injured company can bring the claim, a solution that is seen as both more efficient and fairer to corporate stakeholders including creditors and all shareholders. The paper has preliminarily analysed the relevance of these policy considerations in ISDS cases. The scrutiny so far is preliminary and it is proposed to further consider, as part of the 2013 work program on investment law, the characteristics of international investment that might justify the differences in approach to shareholder claims for reflective loss in domestic corporate law and ISDS.