The Protection of Shareholders in International Investment Law & Arbitration

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Why shareholder claims in international law?

- Imagine that, in the wake of a political turmoil, State A proceeds to revoke all the licenses of the largest national oil company, leaving the entity as an empty shell with no value or profitable business.
- Imagine also that State B has annexed half of State C. To consolidate its power, companies owned by political opponents are charged with tax evasion, fraud and corruption in order to force them into bankruptcy.
- In both cases, shareholders – holding a fraction of the company's capital – are left empty-handed: they retain formal ownership, but the value of their investment is completely annihilated. Which are the remedies under international law? Who is entitled to bring a claim?

Shareholder claims under municipal law

- The need to look at municipal law: an understanding of how company law addresses the relationship between the corporation and its shareholders is fundamental to scrutinize the international law rules.
- Methodology: comparative company law to ascertain the rules on the protection of shareholders and identify their foundations. Analysis of more than 25 jurisdictions, including Argentina, Australia, Colombia, France, Hong Kong, Italy, Japan, Korea, South Africa, USA.
- The main questions: have shareholders standing in respect of measures affecting the corporation in which they own shares? Why do domestic legal orders allow or prohibit to recover such a loss?

The results of the comparative analysis

- All domestic legal orders recognize the institution of the corporation, namely a legal entity possessing its own personality (thus the capacity to hold rights and duties autonomously) and patrimonial autonomy.
- A distinction is firmly drawn between the rights of the corporation and those of the shareholders. This being known as the corporate veil: a barrier between the wealth of the shareholders and the entity assets.
- When the rights of the shareholders (e.g., property or right to vote at general meetings) are infringed upon, judicial remedies are provided. However, a general prohibition to recover a loss that is reflective of the damage suffered by the corporation (so-called reflective loss) is upheld.

The general prohibition of reflective loss claims

- Why reflective loss claims are generally prohibited in domestic corporate law? The jurisprudence of domestic courts as well as doctrine have advanced different theories.
- Traditionally, the prohibition is considered a logical consequence of the corporate legal personality: different persons, different damages, different remedies. Others say it is a matter of causal link.
- In my view, the prohibition is grounded on legal policy grounds: capital maintenance and creditor protection, avoiding risks of double recovery and jeopardy, safeguarding corporate governance, preventing parallel proceedings concerning the same measures to be brought.

Shareholder claims under general international law

- In the late 19th century, whether – under international law – shareholders were entitled to claim for damages suffered by the corporation was much debated: fragmented and incoherent practice.
- No chance to identify a rule supporting the admissibility of reflective loss claims. Quite the opposite, the *Delagoa Bay Railway* (1900) and *El Triunfo* (1902) arbitrations actually prove the opposite.
- The leading case is the *Barcelona Traction Ltd.*, decided by the International Court of Justice in 1970. Application filed by Belgium on behalf of its national shareholders, following a series of wronglful measures taken by Spain against the corporation.

The *Barcelona Traction* case: establishing the rule

- The starting point: «international law is called upon to recognize institutions of municipal law that have an important and extensive role in the international field».
- Moving from this consideration, the Court adopted the domestic clear-cut distinction between the rights of the corporation and the rights of its shareholders → general principle *in foro domestico* (Article 38(1)c).
- Accordingly, under general international law, shareholders are protected only when a wrongful act impacts upon their direct rights. Contrariwise, if the measures affect the rights of the company, shareholders – as a general rule – will have no claim.

A good rule... but a weak rationale?

- The Court was accused of having limited its inquiry to municipal law, rather than fashioning a new rule for shareholder claims based on international law and its different needs to be fulfilled.
- This approach is incorrect! It is not for the ICJ to make the rules. Moreover, the reasons supporting the prohibition in domestic legal orders are equally valid in the international sphere: plethora of parallel proceedings, with risks of conflicting decisions and double jeopardy.
- The Court considered that the foundation of such a rule was the legal personality of corporations, thus carving out very few exceptions: this was later reaffirmed in the *Diallo* case (2007).

Shareholder claims in international investment law

- Currently, in international investment arbitration, the vast majority of the proceedings is brought by the shareholder for damages suffered by the corporation in which they hold shares.
- What is prohibited under domestic and general international law is permissible in international investment law: shareholders can bring reflective loss claims. The rule has been superseded by the exception.
- This means that the corporate veil, the barrier between the shareholders and the corporation, is pierced. How is it possible? Since investment treaties are generally silent on shareholder claims, attention shall be paid to the reasoning of investment tribunals.

Investment tribunals on shareholder claims

- The starting point is that, generally, shareholders qualify as investors and their shares as investments. However, this does not answer the question as to what a shareholder might be entitled to claim before an arbitral tribunal. This only means they can bring proceedings!
- What about the *Barcelona Traction* rule? In *CMS v. Argentina* (2003), the tribunal excluded its relevance: the ICJ dealt with diplomatic protection, while the US-Argentina BIT was *lex specialis*.
- In *Cemex v. Venezuela* (2010), the arbitral tribunal concluded that, inasmuch as indirect investments are protected under the BIT, shareholder claims for reflective loss shall be admitted.

The patent ungovernability of shareholder claims

- If it is true that the blanket admissibility of reflective loss made the fortune of the system, such an approach by investment tribunals threatens the legitimacy of investor-State arbitration.

- In *Lauder v. Czech Republic* (2001) and *CME v. Czech Republic* (2003) the arbitral tribunals reached an opposite conclusion on the merits for the same facts: no violation by the first, expropriation by the second. Think about the corporate chain of a multinational enterprise!

- In *Kappes and Kappes v. Guatemala* (2020), the arbitral tribunal ignored the treaty language which was arguably intended to limit reflective loss claims, concluding that the choice is up to the investor.

The interpretative tools to address the conundrum

- Leaving aside the question as to whether the broad and often vague treaty language adopted in investment treaties can really be said to support reflective loss claims, solutions are much needed.

  1. Abuse of process, consisting in the use of procedural instruments for purposes that are alien to those for which they were established → *Orascom v. Algeria* (2017) «[i]f the protection is sought at one level of the vertical chain […] that purpose is fulfilled».

  2. *Res judicata*, meaning that the final adjudication by a court or arbitral tribunal is conclusive and, thus, the dispute cannot be relitigated before any other judicial institution → «triple identity test».

Rethinking the protection of shareholders

- There are no easy solutions when the problem is deeply rooted within the system. Despite no unanimous views, it is apparent that the system requires a rapid response to ensure its legitimacy and viability.
- The establishment of a general prohibition to claim reflective loss (OECD and UNCITRAL proposals), recognizing the soundness of the legal policy grounds advanced in domestic legal orders.
- However, exceptions are necessary when they pursue a different interest which is worthy of protection. There is still a long way forward: why States do not act? How to implement the solution in over 3000 investment treaties? Shall we rethink the whole system of protection?

Thank you for your attention!

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