SHAREHOLDER CLAIMS FOR REFLECTIVE LOSS: HOW INTERNATIONAL INVESTMENT LAW CHANGES CORPORATE LAW AND GOVERNANCE

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ABSTRACT

Scholarly debate on the legitimacy crisis of investment dispute resolution has focused on the ability of multinational corporations to interfere with the state's right to regulate by challenging government measures in investor-state arbitration. Prior work has addressed the hybrid public-private nature of investment treaties that allow foreign investors to sue sovereign states and emphasized the role of multinational corporations in international lawmaking. The academic discourse misses entirely the fact that international investment law drastically impacts relationships *within* the corporation (between the shareholders, the management, and the board of directors) and alters the expectations about the corporation as a standard-form legal entity. Remarkably, international investment law allows shareholders to bring in arbitration claims for damages for "reflective loss"—that is, loss incurred by shareholders indirectly as a result of injury to their company. Shareholders can bring these claims without consulting with the company's management and irrespective of any claims by the corporation. Thus, inherent

* Assistant Professor of Law, University of Akron School of Law. I would like to thank Sean J. Griffith and Robin A. Lenhardt for comments and conversations on earlier drafts. I also would like to thank for comments Julian Arato, who served as a commentator for this Article at the Fourth Workshop on Comparative Business and Financial Law of the ASCL's Younger Comparativists Committee (YCC) hosted by Fordham Law School on February 2–3, 2018. I am also grateful for comments I received at the National Business Law Scholars Conference (NBLSC) held at the University of Utah S.J. Quinney College of Law on June 8–9, 2017; the Annual Research Forum of the American Society of International Law (ASIL) held at the Washington University in St. Louis School of Law on October 27–28, 2017; and a faculty presentation at the University of Akron School of Law on October 31, 2017.

in investment arbitration is the ability of individual shareholders to make decisions affecting the company and to benefit at the expense of the corporation, its creditors, and other stakeholders.

Drawing on case studies, this Article seeks to surface the extent of the impact of shareholder claims for reflective loss on corporate law and governance—the rules, structure, and processes of the management and control within the corporation. Having established the distortive impact of shareholder claims on the corporate legal entity, the Article further explores the ways to address the systemic problem of reflective loss claims. It makes a normative argument: in view of the policy goals of foreign investor protection, shareholder claims for reflective loss should be permitted in international investment law, but only in limited circumstances to curtail the disruption of corporate governance and to reduce the social costs of litigation. The Article concludes by offering a novel private ordering solution to the problem of reflective loss claims. It argues that the corporate distortion problem is best addressed at the level of individual corporations through targeted provisions in corporate charters and bylaws waiving the right of shareholders to bring reflective loss claims in investment arbitration.

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1. INTRODUCTION

As a standard-form legal entity, the business corporation provides two types of asset protection. It protects personal assets of its equity holders from the firm's creditors (owner shielding) and firm's assets from personal creditors of the equity holders (entity shielding).[1] Such asset partitioning within the corporation creates common expectations among the firm's shareholders and creditors as to the corporate form and the effect of contracts entered between the creditors and the corporation.[2] Relying on these expectations, creditors provide financing to the firm. In doing so, creditors know that they have a claim against the assets of the company and expect to be paid in bankruptcy ahead of shareholders according to the priority rules. On their side, shareholders invest in the company to benefit from capital appreciation or dividends payout. They expect to have only a residual claim on the corporation's assets upon its dissolution. Unbeknownst to most creditors and shareholders, international investment law distorts this legal framework of corporate and bankruptcy law by allowing shareholders to bring claims for reflective loss in investment arbitration.

Corporate attorneys are often critical of arbitration as a method of dispute resolution, dismissing arbitration as a proper forum for resolving corporate disputes. The criticism is largely directed at domestic arbitration, such as an arbitration that can be commenced by domestic shareholders in the state of incorporation to challenge a merger. Members of the Delaware judiciary have expressed concerns that arbitral tribunals may disrupt the development of common law by misapplying Delaware corporate law and keeping

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1 *See* Henry Hansmann & Richard Squire, *External and Internal Asset Partitioning: Corporations and Their Subsidiaries*, *in* THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE (Jeffrey N. Gordon & Wolf-Georg Ringe eds., 2018) ("The corporate form partitions assets in two ways. First, it provides owner shielding . . . second, the corporation provides entity shielding."); *see also* Henry Hansmann & Reinier Kraakman, *The Essential Role of Organizational Law*, 110 YALE L.J. 387, 390 (2000) ("The truly essential aspect of asset partitioning is . . . the shielding of the assets of the entity from claims of the creditors of the entity's owners or managers.")

2 *See* REINIER H. KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 8 (2d ed. 2009) ("Entity shielding doctrine is needed to create common expectations, among a firm and its various present and potential creditors, concerning the effect that a contract between a firm and one of its creditors will have on the security available to the firm's other creditors.").

their decisions private and confidential.[3] To "preserve Delaware's preeminence in offering cost-effective options for resolving disputes, particularly those involving commercial, corporate, and technology matters," Delaware even attempted a state-sponsored arbitration program.[4] Business disputes in these arbitrations were to be heard by the sitting judges of the Delaware Court of Chancery acting as arbitrators.[5] This arbitration experiment has ultimately failed following an opinion by the United States Court of Appeals for the Third Circuit, which upheld a lower court decision that a confidential program of this type violates the First Amendment right of public access.[6]

But a bigger threat to the development of corporate law may come from the investment treaty arbitration. This hybrid form of international arbitration, also called investor-state arbitration, allows private parties to sue foreign governments for breaches of investor protection obligations. Most important for corporate law and governance, international investment law allows foreign shareholders to bring claims for "reflective loss"—that is, loss incurred by shareholders as a result of injury to the company. A common example of reflective loss is the diminution of the market value of shares resulting from the company's loss.

Domestic corporate law and international investment law take opposing views on shareholder standing for reflective loss. Most advanced systems of corporate law prohibit shareholder claims for reflective loss based on the "no reflective loss" principle.[7] The no

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[3] *See* Steven Davidoff Solomon, *Appeals Court Throws Out Confidential Arbitration in Delaware*, N.Y. TIMES: DEALBOOK (Oct. 23, 2013, 3:59 PM), https://dealbook.nytimes.com/2013/10/23/appeals-court-throws-out-confidential-arbitration-in-delaware/?_r=0 [https://perma.cc/3SLV-UUZN] (emphasizing the concern that "corporate law would be made [in private and confidential arbitration] but no one would know about it, making the life of companies and lawyers who advise them much harder.").

[4] *See* Delaware Coal. for Open Gov't, Inc. v. Strine, 733 F.3d 510, 512 (3d Cir. 2013) (quoting H.B. 49, 145th Gen. Assemb., 1st Reg. Sess. (Del. 2009)).

[5] *See id.* at 522 (noting that sitting judges of the Delaware Court of Chancery would conduct private arbitrations under the state-sponsored arbitration).

[6] *See id.* at 521 ("[W]e find that there is a First Amendment right of access to Delaware's government-sponsored arbitrations. We will therefore affirm the order of the District Court.").

[7] *See, e.g.*, Agrotexim v. Greece, 330 Eur. Ct. H.R. (ser. A) 3, 25 (1995) ("It 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."); *see also* Julien Chaisse & Lisa Zhuoyue Li, *Shareholder Protection Reloaded: Redesigning the Matrix of Shareholder Claims for Reflective Loss*, 52 STAN. J. INT'L L. 51, 53 (2016) (explaining that in do-

reflective loss principle is largely grounded on policy considerations seeking to avoid double recovery,[8] multiple claims and inconsistent outcomes,[9] and the negative impact on creditors and other shareholders.[10]

By contrast, international investment law, which is driven by investor protection considerations, allows shareholders to bring claims for reflective loss, regardless of the claims by the corporation.[11] Depending on the treaty, not only a controlling or majority shareholder,[12] but even a minority shareholder[13] may be able to

mestic jurisdictions, shareholders may not recover damages for loss in the value of their shares). *See generally id.* at 54–58 (providing a review of corporate law provisions of countries that adhere to the "no reflective loss" principle, such as the United States, the United Kingdom, Hong Kong, France and Germany).

8 *See, e.g.*, Chaisse & Li, *supra* note 7, at 82 (discussing the various policy considerations underlining the no reflective loss principle and the rationale as to why double recovery should be avoided).

9 For instance, in decisions such as *CME v. Czech Republic* and *Lauder v. Czech Republic*, different tribunals rendered different decisions based on the same facts. *See* CME Czech Republic B.V. (The Netherlands) v. Czech Republic, UNCITRAL, Partial Award, ¶ 620 (Sept. 13, 2001) (stating that the Respondent used the same pleadings and witness statements that were originally drafted for the Respondent in Lauder v. Czech Republic); Lauder v. Czech Republic, UNCITRAL, Final Award, ¶¶ 176–80 (Sept. 3, 2001); *see also* Eskosol S.p.A. in liquidazione v. Italian Republic, ICSID Case No. ARB/15/50, Decision on Respondent's Application under Rule 41(5), ¶¶ 20–21 (Mar. 20, 2017) [hereinafter Eskosol] (raising legal consistency and certainty as an argument where Italy objected to an arbitration commenced by Italian company Eskosol S.p.A. following a separate arbitration which was brought against Italy and lost by Eskosol's majority shareholder).

10 *See, e.g.*, Victor Joffe & James Mather, *The Vanishing Exception Part One: How Rare Are Exceptions to the No Reflective Loss Principle*, NEW L.J., Nov. 28, 2008, https://www.newlawjournal.co.uk/content/vanishing-exception [https://perma.cc/BY58-AQY2] ("The existence of the rule is justified by the need both to prevent double recovery and to provide protection for the company's creditors, who might be prejudiced if the shareholder's claim were to succeed.").

11 *See* Christoph Schreuer, *Shareholder Protection in International Investment Law*, TRANSNAT'L DISP. MGMT., no. 3, 2005, at 4, https://www.transnational-dispute-management.com/article.asp?key=426 [https://perma.cc/FA5X-MRZR] (noting that "practice since 1970 . . . demonstrates an increasing willingness to grant an independent standing to shareholders. Most of this practice [arose] in cases in which shareholders pursued their own claims through international investment arbitration."). *See generally* Chaisse & Li, *supra* note 7 (discussing the divergence between domestic company and administrative law and international investment law with respect shareholder standing for reflective loss and arguing that "allowing recovery for reflective loss [under international investment law] is a sound legal principle from a practical, legal, and policy perspective.").

12 Investment arbitrations brought by majority or controlling shareholders are numerous. *See, e.g.*, EuroGas Inc. v. Slovak Republic, ICSID Case No. ARB/14/14, Award, ¶ 325 (Aug. 18, 2017), https://www.italaw.com/cases/documents/6233 [https://perma.cc/22RK-WLVL] ("On 17 August 2013, Mr. Alexander Danicek, an executive of Rozmin

bring a claim in investor-state arbitration.[14] In addition to direct shareholders, the right to sue for reflective loss may be available to indirect shareholders of the corporation.[15] As a result, investment

from 2008 to 2014, stated before Austrian criminal authorities that EuroGas owned a 90% share in Rozmin."); Emergofin B.V. v. Ukraine, ICSID Case No. ARB/16/35 (claimants held 68.01% of stock), http://investmentpolicyhub.unctad.org/ISDS/Details/751 [https://perma.cc/9GQU-XKYT]; Unión Fenosa Gas, S.A. v. Arab Republic of Egypt, ICSID Case No. ARB/14/4, Notice of Arbitration (Feb. 27, 2014) (80% of stock), http://investmentpolicyhub.unctad.org/ISDS/Details/567 [https://perma.cc/59JH-J7LN]; ASA International S.p.A. v. Arab Republic of Egypt, ICSID Case No. ARB/13/23, Notice of Arbitration (Sept. 13, 2013) (85% of stock), http://investmentpolicyhub.unctad.org/ISDS/Details/525 [https://perma.cc/ZG56-GRSE]; EVN AG v. Republic of Bulgaria, ICSID Case No. ARB/13/17, Notice of Arbitration (July 19, 2013) (67% of stock), http://investmentpolicyhub.unctad.org/ISDS/Details/518 [https://perma.cc/9W8C-QU6H].

13 *See* RosInvestCo UK Ltd. v. Russian Federation, SCC Case No. V079/2005, Final Award, ¶ 608 (Sept. 12, 2010) (noting that "the recent jurisprudence from investment arbitration tribunals considering other investment treaties has confirmed the ability for shareholders to claim for measures taken against the company in which they hold shares and has been developed to the point accepting that minority shareholders have made claims for indirect damage."). Arbitrations involving minority shareholders are numerous. *See, e.g.*, Koch Minerals Sàrl v. Bolivarian Republic of Venezuela, ICSID Case No. ARB/11/19, Award, ¶ 5.1 (Oct. 30, 2017) (describing arbitrations involving minority shareholders, and, in this particular case, the minority shareholders held 25% of stock); Lanco Int'l, Inc. v. Argentine Republic, ICSID Case No. ARB/97/6, Preliminary Decision on Jurisdiction, ¶ 10 (Dec. 8, 1998) ("[T]he fact that LANCO holds an equity share of 18.3% in the capital stock of the Grantee allows one to conclude that it is an investor . . . ."); Champion Trading Co. v. Arab Republic of Egypt, ICSID Case No. ARB/02/9, Decision on Jurisdiction, ¶ 1 (Oct. 21, 2003) (involving two corporate claimants holding 20% and 5% of issued stock in a company formed and incorporated under the laws of Egypt); GAMI Investments, Inc. v. Mexico, UNCITRAL, Final Award, ¶ 1 (Nov. 15, 2004) ("GAMI owns 14.18% of the shares of *Grupo Azucarero Mexico SA de CV* ('GAM')."); CMS Gas Transmission Company v. Argentine Republic, ICSID Case No. ARB/01/8, Decision on Objections to Jurisdiction, ¶ 19 (July 17, 2003) ("CMS purchased the shares still remaining in government hands that represented 25% of TGN, and later purchased an additional 4.42% that had been assigned to an employee share program, thus totaling 29.42% of TGN.").

14 At least one tribunal held that it was irrelevant whether a shareholder was a majority or a minority shareholder as long as the treaty provided protection to shareholders. *See* LG&E Energy Corp. v. Argentine Republic, ICSID Case No. ARB/02/1, Decision of the Arbitral Tribunal on Objections to Jurisdiction, ¶ 50 (Apr. 30, 2004) ("The Respondent has not disputed that those shares are 'owned or controlled directly or indirectly' by the Claimants. In that connection, it is irrelevant whether the shares are majority or minority shares.").

15 *See, e.g.*, Venezuela Holdings B.V. v. Bolivarian Republic of Venezuela, ICSID Case No. ARB/07/27, Decision on Jurisdiction, ¶ 165 (June 10, 2010) [hereinafter Venezuela Holdings] (allowing an indirect shareholder to assert claims under a BIT relying on the literal reading of the treaty, which granted protection to investments without distinguishing between direct and indirect investments).

tribunals have allowed double recovery and rendered conflicting awards to related claimants at different levels of the corporate ownership structure. To achieve greater consistency of arbitral awards and avoid double recovery, scholars have suggested claim consolidation, reliance on res judicata, and damage apportionment among related claimants, all procedural solutions. However, as I argue in this Article, the problem with reflective loss claims goes further than double recovery, conflicting awards, and increased costs of dispute resolution. Reflective loss claims distort corporate governance choices in a way that cannot be fixed by international law and civil procedure solutions.

By granting shareholders a direct right to bring claims in arbitration, investor protection treaties effectively create a separate class of stakeholders in the company—treaty-protected shareholders—whose rights are prioritized over the rights of the company as well as its management, creditors, and other stakeholders. Rational treaty-protected shareholders will always attempt to recover corporate losses regardless of the interests of the corporation and other stakeholders. In doing so, they may interfere with management decisions and may demand concessions at the expense of the company. Shareholder claims also make it more difficult for the company to settle because a settlement agreement concluded by the company would not extinguish shareholder claims, making a responding state reluctant to settle.[16] In addition, by collecting damages otherwise owed to the company, treaty-protected shareholders prioritize their claims over the claims of creditors and all other stakeholders of the corporation. This practice is especially dangerous for companies in financial distress. Consequently, shareholder claims for reflective loss distort corporate law and governance—the rules, structure, and processes of the management and control within the corporation. And as the number of investor-state arbitrations continues to grow,[17] so will the influence

[16] *See, e.g.*, David Gaukrodger, *Investment Treaties as Corporate Law: Shareholder Claims and Issues of Consistency* 33–34 (OECD, Working Papers on International Investment 2013/03), http://dx.doi.org/10.1787/5k3w9t44mt0v-en [https://perma.cc/83GC-A2AU] (explaining that "uncertainties associated with shareholder claims may complicate settlement negotiations.")

[17] *See* U.N. CONF. ON TRADE & DEV., WORLD INVESTMENT REPORT 2017: INVESTMENT AND THE DIGITAL ECONOMY, at xii, U.N. Sales No. E.17.II.D.3 (2017) [hereinafter UNCTAD 2017 REPORT] ("The rate of new treaty-based investor-State dispute settlement (ISDS) cases continued unabated."). Most recently, the UNCTAD reported on 62 new known ISDS cases initiated in 2016 pursuant to IIAs, which is "higher than the 10-year average of 49 cases per year (2006–2015)." *Id.* at 114. By the beginning of 2017, "the total number of publicly known ISDS

of international investment law on domestic corporate law and governance.

This Article has two goals. First, it seeks to examine how shareholder claims for reflective loss permitted under international investment law affect domestic corporate law, corporate governance, and the structure and corporate ownership chains of companies investing abroad. Prior work has examined the history and evolution of shareholder standing under international investment law by exploring the practice of investment tribunals.[18] Separately, recent policy papers have addressed theoretical concerns about the effects of shareholder claims for reflective loss on corporate law and governance.[19] To my knowledge, this is the first work that seeks to combine corporate law and international investment law tools to provide a comprehensive study of shareholder claims for reflective loss and their impact on corporate law and governance.

The second goal of this Article is to provide a solution to the problem of reflective loss claims and distortions these claims create on corporate law and governance choices. The legal framework of reflective loss claims and the practice of arbitral tribunals suggest that corporate law, international law, and civil procedure rules are not equipped to deal with the impact of these claims on corporate governance and structure. The Article makes a normative argument: in view of the policy goals of foreign investment protection, shareholder claims for reflective loss should be permitted in international investment law, but only in limited circumstances to curtail the disruption of corporate governance and to reduce the social costs of litigation. The Article offers a private ordering solution to

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claims had reached 767." *Id.*

18 *See, e.g.*, Schreuer, *supra* note 11, at 6–7 (detailing arbitral practice and the impact a shareholder's investment has on the shareholder's standing); Chaisse & Li, *supra* note 7, at 64 (remarking on how over the last three decades, "out of the more than 300 investment awards made, fourteen awards . . . explicitly address[ed] the issue of the meaning of investment in the context of international disputes."); Stanimir A. Alexandrov, *The "Baby Boom" of Treaty-Based Arbitrations and the Jurisdiction of ICSID Tribunals: Shareholders as "Investors" under Investment Treaties*, 6 J. WORLD INV. & TRADE 387, 387 (2005) (noting how in recent years, there has been a "rapid increase in the number of international arbitrations between foreign investors and host governments.").

19 *See, e.g.*, Gaukrodger, *supra* note 16, at 24 (explaining that the no reflective loss principle "is a long-standing rule primarily generated by case law."); OECD, *The Impact of Investment Treaties on Companies, Shareholders and Creditors*, *in* OECD BUSINESS AND FINANCE OUTLOOK 223, 234–46 (2016) [hereinafter OECD Policy Paper] (illustrating how the various incentives created by rules that govern the types of loss recoverable by shareholders affect companies, shareholders, and creditors).

the problem of reflective loss claims, arguing that the corporate distortion problem is best addressed at the level of individual corporations through targeted provisions in the corporation's governing documents—corporate charters and bylaws.

Following this introduction, Part 2 of the Article examines reflective loss claims under domestic corporate and international investment law, focusing on the corporate law of the United States, United Kingdom, and Germany. It also explores the concept of shareholder claims for reflective loss in the practice of international investment tribunals. Part 3 first discusses theoretical concerns about the impact of reflective loss claims on corporate law and governance, and examines empirical evidence and case studies of investment disputes that have impacted corporate governance and structure choices of the companies investing abroad. Based on these insights, it then draws lessons for the law and public policy on how to deal with the negative impact of reflective loss claims on corporate law and governance. Part 4 explores whether international law and civil procedure rules can restore distortions created by reflective loss claims and offers a private ordering solution to the problem of shareholder claims for reflective loss. A short conclusion follows.

2. REFLECTIVE LOSS UNDER DOMESTIC AND INTERNATIONAL INVESTMENT LAW

Shareholders can suffer two types of loss: direct loss and indirect, or reflective, loss.[20] Shareholders incur direct loss when they are deprived of or restricted in their rights as shareholders, such as the rights to vote or to share proceeds upon dissolution of the company.[21] Shareholders also suffer direct loss when their shares are cancelled[22] or expropriated.[23] Under most domestic law sys-

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20 *See* Bas J. de Jong, *Shareholders' Claims for Reflective Loss: A Comparative Legal Analysis*, 14 EUR. BUS. ORG. L. REV. 97, 99 (2013) (explaining that it is not always easy to distinguish between direct and reflective loss and to identify whether an exception to the "no reflective loss" principle can be applied; in the Netherlands and the United Kingdom, these issues have led to the extensive case law and literature on the subject).

21 *See generally* Gaukrodger, *supra* note 16.

22 *See* Olczak v. Poland, 2002-X Eur. Ct. H.R. 239, 252 (holding that shareholders can claim victim status if they can establish direct loss in the form of shares' cancellation).

23 *See* Schreuer, *supra* note 11, at 3 ("The damage done to the shareholder

tems—including those of the United States, United Kingdom, Germany, and the Netherlands— shareholders can recover direct loss by bringing a claim for losses resulting from a breach of a duty owed to shareholders by a third party.[24]

Shareholders suffer reflective loss when there is an injury to "their" company that affects the company's value or profitability, but the loss to the company also reflects on shareholders, for instance, by decreasing the value of their shares or diminishing dividend payout.[25] In contrast to direct loss, shareholders generally cannot recover reflective loss under domestic law. The laws of Australia, Canada, China, France, Germany, Hong Kong, the Netherlands, the United Kingdom, and the United States, all follow the so-called "no reflective loss" principle, which prohibits shareholders from recovering reflective loss.[26] Instead, corporate laws of these countries give the corporation the right to bring a claim for its (direct) loss.[27] The no reflective loss principle recognizes the company's autonomy and views the loss by shareholders merely as a reflection of the corporate loss. Inherent within the no reflective loss principle is the proposition that once the corporation successfully recovers its loss (and replenishes its assets), the economic in-

may affect its rights as shareholder directly, such as the expropriation of its shares, or the damage may be done indirectly, such as the diminution of the profitability or value of the company.").

[24] *See* de Jong, *supra* note 20, at 98–99 (explaining the definition of a loss, specifically the loss the shareholder may recover if a third party breaches duties owed to the company and the shareholder).

[25] *See id*. at 98 ("A reflective loss . . . is a decrease in the value of the share that corresponds to the diminution in the value of the company."); *see also* ANDREW CHARMAN & JOHAN DU TOIT, SHAREHOLDER ACTIONS 161 (2013) (explaining that "loss does not only affect the company's balance sheet, but should have, to some extent, the effect of a diminution of [company's] share price or share value.").

[26] *See, e.g.*, Gaukrodger, *supra* note 1621, at 15–17 (discussing the laws of the United States, Canada, U.K., Germany, and France, and noting that the laws of Australia, China, and Hong Kong similarly adhere to the no reflective loss principle); *see also* Hans de Wulf, *Direct Shareholder Suits for Damages Based on Reflective Losses*, *in* FESTSCHRIFT FUR KLAUS J. HOPT ZUM 70. GEBURTSTAG AM 24. AUGUST 2010: UNTERNEHMEN, MARKT UND VERANTWORTUNG 1537, 1547–48 (Stefan Grundmann et al. eds., 2010) (discussing the law of the Netherlands and recounting a Dutch Supreme Court ruling on shareholder's rights).

[27] *See* de Jong, *supra* note 20, at 98 (detailing what a reflective loss means and how it relates to direct losses); *see also* CHARMAN & DU TOIT, *supra* note 25, at 161 (describing U.K. law and noting that "a shareholder is usually not permitted to recover any such loss or damage [suffered at the hands of third parties] if it overlaps with, or is reflective of, any loss suffered by the company arising out of the wrongdoing.").

terests of shareholders will be served as well.[28] Prior work has suggested that shareholders can benefit from "an improved share price or value, the payment of dividends, [and/or] the declaration of enhanced dividends."[29]

Despite general reluctance to compensate shareholders for reflective loss, domestic law recognizes that shareholder claims for reflective loss may sometimes be warranted; for instance, where the corporation ceases to exist or is unable to submit a claim.[30] For these rare cases, domestic law provides for exceptions to the no reflective loss principle, allowing shareholders to bring direct claims for losses suffered by the company.[31] The courts are cognizant of the conflicting interests of, on the one hand, shareholders seeking recovery for reflective loss, and, on the other hand, interests of the company, its creditors, and other stakeholders.[32] In *Johnson v. Gore Wood & Co.*, Lord Bingham described the balancing exercise that the courts perform in assessing the claims for reflective loss:

> On the one hand the court must respect the principle of company autonomy, ensure that the company's creditors are not prejudiced by the action of individual shareholders and ensure that a party does not recover compensation for a loss which another party has suffered. On the other, the court must be astute to ensure that the party who has in fact suffered loss is not arbitrarily denied fair compensation.[33]

Thus, compensation of reflective loss requires weighing the in-

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[28] *See* CHARMAN & DU TOIT, *supra* note 25, at 161–62 (describing the assumption behind the no reflective loss rule that "the economic interests of shareholders will be served by the company's . . . recovery, by benefiting from one or more of an improved share price or value, the payment of dividends, or the declaration of enhanced dividends."); *see also* Gaubert v. United States, 885 F.2d 1284, 1291 (5th Cir. 1989), *rev'd*, 499 U.S. 315 (1991) ("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").

[29] CHARMAN & DU TOIT, *supra* note 25, at 161–62.

[30] *See, e.g.*, Giles v. Rhind [2002] EWCA (Civ) 1428 (Eng.) (holding that shareholders may submit a reflective loss claims because the company was unable to submit its own claims due to the defendant's actions).

[31] *See infra* Part 2.1. for a discussion of corporate law of the United Kingdom and the Netherlands.

[32] *See, e.g.*, Johnson v. Gore Wood & Co. [2002] 2 AC 1 (HL) 66–67 (appeal taken from Eng.) (noting how the treatment of the company and shareholder as one would impact the recovery of the reflective loss).

[33] *Id.* at 36.

terests of shareholders against the interests of the company and its creditors to identify instances where compensation of shareholders does not distort the principle of company autonomy or benefit shareholders at the expense of the company's creditors.

In sharp contrast to domestic corporate law, international investment law is largely blind to these concerns. Driven by investor protection considerations, investment treaties allow both direct and indirect shareholders to bring claims for reflective loss. As a result, controlling, majority, and sometimes minority shareholders have been able to recover reflective loss in investment arbitration, independently of any claims submitted by their company.

2.1. Corporate law in the United States, U.K., and Germany

In the United States, the concept of "reflective loss" does not exist under state corporate or federal securities law.[34] The taxonomy of shareholder claims in the United States includes *derivative actions* brought by shareholders on behalf of the company (for instance, corporate governance suits alleging breaches of fiduciary duties by management or board of directors) and *direct actions* brought by shareholders on their own behalf. In turn, direct actions include *class actions*—such as mergers and acquisitions (M&A) and securities class actions—which shareholders bring as representatives of other shareholders similarly injured, and *individual actions* by shareholders, including actions by shareholders who opted out of class actions.

In the context of derivative actions, the courts distinguish two types of harm: harm suffered by the company and harm suffered by shareholders. It is the harm to the company, not to shareholders, that shareholders can recover through derivative suits.[35] In *Tooley v. Donaldson*, the Delaware Supreme Court held that the issue of whether a stockholder's claim is derivative or direct turns "*solely* on the following questions: (1) who suffered the alleged harm (the corporation or the suing stockholders, individually); and (2) who would receive the benefit of any recovery or other remedy

[34] *See* Chaisse & Li, *supra* note 7, at 57 (highlighting the way in which the United States handles the concept of "reflective loss").

[35] *See, e.g.*, Kramer v. W. Pac. Indus., Inc., 546 A.2d 348, 351 (Del. 1988) (explaining the mechanism by which a shareholder may bring a derivative suit).

(the corporation or the stockholders, individually)?"[36] The law is thus clear that derivative suits provide a tool for shareholders to sue on the company's behalf for the harm suffered by the company when those in control of the corporation fail to assert a company's claim.[37]

The harm suffered by shareholders—both direct and reflective loss—is not recoverable by shareholders through derivative suits. To recover direct loss, a shareholder can bring an individual action if a duty was owed directly to the shareholder.[38] Under Delaware law, "[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."[39]

With respect to reflective loss, the law generally does not provide shareholders with the right to sue.[40] Instead, the law explicitly prohibits shareholder claims for reflective loss largely because of policy considerations, such as avoidance of double recovery, excessive litigation, and inconsistent and conflicting awards. Permitting shareholder claims for reflective loss would allow shareholders to

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36 Tooley v. Donaldson, Lufkin & Jenrette, Inc., 845 A.2d 1031, 1033 (Del. 2004).

37 *See, e.g.*, R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS & BUSINESS ORGANIZATIONS § 13.10, at 23–24 (Supp. 2014) (citing Kramer, 546 A.2d at 351) ("The derivative action was developed to enable stockholders to sue on behalf of the corporation where those in control of the corporation refused to assert a claim belonging to it.").

38 *See, e.g.*, F.D.I.C. v. Howse, 802 F. Supp. 1554, 1562 (S.D. Tex. 1992) (noting that where a shareholder cannot bring a derivative suit because a harm was caused to the shareholder, "a shareholder may still bring suit if a director violates a duty arising from a contract or representation owing directly to [the shareholder].").

39 Tooley, *supra* note 36, at 1039.

40 *See* Gaukrodger, *supra* note 16, at 15 (stating that "[a]s a general rule, only the company can sue to recover the loss"); *see also* Gaubert v. United States, 885 F.2d 1284, 1291 (5th Cir. 1989) ("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." (citations omitted)); *F.D.I.C.*, 802 F. Supp. at 1562 ("As a matter of law, a cause of action for injury to the property of a corporation or for destruction of its business is vested in the corporation . . . . A corporate shareholder has no individual cause of action for personal damages caused solely by wrong done to the corporation." (citations omitted)); Sutter v. Gen. Petroleum Corp., 170 P.2d 898, 900–01 (Cal. 1946) ("Generally, a stockholder may not maintain an action in his own behalf for a wrong done by a third person to the corporation on the theory that such wrong devalued his stock and the stock of the other shareholders . . . .").

recover twice, either at the expense of the defendant (if it pays twice), or the company and its creditors and other stakeholders (if a shareholder sues and recovers first and the amount of his recovery is then deducted from damages awarded to the corporation).[41] The courts have also proven to be unsympathetic to shareholder claimants who use the corporate entity to shield from unlimited liability, but then turn around and seek to disregard the corporate entity to claim for reflective loss.[42]

Although not allowed under domestic law, in theory shareholder claims for reflective loss are distinguishable from other categories of shareholder claims in the United States. First, they are direct suits by shareholders. By contrast to derivate suits brought on behalf of the company, shareholder claims for reflective loss are brought by shareholders on their own behalf. In addition, claims for reflective loss allow shareholders to personally recover their losses, instead of securing recovery to their company in derivative actions. Derivate suits are also usually limited to corporate "insiders"—people involved in some way in corporate governance, such as directors, officers, controlling shareholders.[43] Derivative suits against third parties are generally impossible or, where they are allowed, rare in practice.[44] To sum up, shareholder claims for reflective loss do what the derivative suits prohibit—they allow shareholder to bring claims against third parties, such as business counter-parties or host states in investment arbitration, for breaches of duties owned to the company. Shareholder claims for reflective loss also differ from class actions under federal securities and state corporate laws in that reflective loss claims allege a breach of a duty owned to the company that resulted in an injury to share-

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41 *See, e.g.*, Johnson v. Gore Wood & Co. [2002] 2 AC 1 (HL) 62 ("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 . . . ."). *But see* Chaisse & Li, *supra* note 7, at 86 (arguing that a low risk of double recovery does not justify a bar of reflective loss because double recovery occurs in rare instances where "the shareholder sues first and recovers and then the company sues and recovers.").

42 *See, e.g.*, Alford v. Frontier Enter., Inc., 599 F.2d 483, 484 (1st. Cir. 1979) (holding that a shareholder cannot claim reflective loss because that would suggest "[the shareholder] is attempting to use the corporate form both as shield and sword at his will . . . . Of course, this is impermissible.").

43 *See* Gaukrodger, *supra* note 16, at 20 ("This regime for shareholder claims for reflective loss is essentially circumscribed to claims against corporate 'insiders'.").

44 *See id.* at 19–21 (describing shareholder derivative actions generally).

holders. By contrast, securities and M&A class actions allege breach of duties owned directly to shareholders.

In the United Kingdom, corporate law is well familiar with the term "reflective loss."[45] The U.K. law generally follows the no reflective loss principle, but provides for several exceptions discussed below. The no reflective loss principle as we know it today dates back to the case of *Prudential Assurance Co. Ltd. v. Newman Industries Ltd. (No. 2)*.[46] The Court of Appeal in *Prudential* held that the shareholder cannot recover reflective losses, explaining that:

> [W]hat [a shareholder] cannot do is to recover damages merely because the company in which he is interested has suffered damage. He cannot recover a sum equal to the diminution in the market value of his shares, or equal to the likely diminution in dividend, because such a "loss" is merely a reflection of the loss suffered by the company. The shareholder does not suffer any personal loss. His only "loss" is through the company, in the diminution in the value of the net assets of the company . . . .[47]

More recently, the House of Lords discussed the principle in its decision in *Johnson v. Gore Wood & Co.*, where Lord Bingham summarized the U.K. case law on reflective loss.[48] The case suggests

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[45] *See, e.g.*, Johnson v. Gore Wood & Co. [2002] 2 AC 1 (HL) 66 (discussing "reflective loss" by shareholders); Gardner v. Parker [2004] EWCA (Civ) 781 [1] (Eng.) ("This appeal raises, not for the first time, the ambit and limits of the rule against reflective loss . . . ."); *see also* Joffe & Mather, *supra* note 10 (explaining that "[r]eflective loss is . . . the loss suffered by a shareholder where there is both breach of a duty owed to the company, and breach of a duty owed to the shareholder, but the shareholder's loss would be made good if the company enforced its rights against the wrongdoer . . . ."); CHARMAN & DU TOIT, *supra* note 25, at 161–83 (devoting a separate chapter to non-recoverability of reflective loss under English company law).

[46] *See generally* Joffe & Mather, *supra* note 10 (outlining the case law that has directed present thought on reflective loss).

[47] Prudential Assurance Co. Ltd. v. Newman Indus. Ltd. (No. 2) [1982] Ch 204 (CA) 222–23.

[48] Lord Bingham summarized the law on reflective loss as:

> (1) Where a company suffers loss caused by a breach of duty owed to it, only the company may sue in respect of that loss. No action lies at the suit of a shareholder suing in that capacity and no other to make good a diminution in the value of the shareholder's shareholding where that merely reflects the loss suffered by the company. . . . [E]ven if the company . . . has declined or failed to make good that loss. . . . (2) Where a company suffers loss but has no cause of action to sue to recover that loss, the shareholder in the company may sue in respect of it (if the shareholder has a cause of action to do so), even though the loss is a dim-

that under U.K. law the recovery of reflective loss will not be permitted even if the company is not pursuing an independent claim; for instance, because the period of limitations has expired for the company (but not the shareholders), or the company chooses not to bring a claim.[49] It is irrelevant that the shareholder has a separate cause of action, as the law prohibits recovery for reflective loss regardless of the existence of a separate cause of action for the shareholder.[50] It is further irrelevant that a court could avoid double recovery by carefully drafting its decision.[51]

The case law also provides for exceptions—or, as some commentators have argued, the limits[52]—to the no reflective loss prin-

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> inution in the value of the shareholding. . . . (3) Where a company suffers loss caused by a breach of duty to it, and a shareholder suffers a loss separate and distinct from that suffered by the company caused by breach of a duty independently owed to the shareholder, each may sue to recover the loss caused to it by breach of the duty owed to it but neither may recover loss caused to the other by breach of the duty owed to that other.

Johnson v. Gore Wood & Co. [2002] 2 AC 1 (HL) 35–36 (citations omitted).

[49] *See id. See also* Joffe & Mather, *supra* note 10 (summarizing the no reflective loss principle); CHARMAN & DU TOIT, *supra* note 25, at 162–63 (discussing the case law on the no reflective loss principle and noting two exceptions to the basic proposition: "if the company refuses to recover its loss, shareholders may intervene . . . by derivative action procedures; and . . . if the wrongdoer makes it impossible for the company to recover its loss, shareholders may be able to recover in respect to their own loss, even where it is reflective loss.").

[50] The English Court of Appeal held that:

> It does not matter that [the shareholder]'s and [the company]'s causes 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.

Gardner v. Parker [2003] EWHC (Ch) 1463 [41] (Eng.).

[51] Joffe & Mather, *supra* note 10 ("[T]he existence of the rule is justified by the need both to prevent double recovery and to provide protection for the company's creditors, who might be prejudiced if the shareholder's claim were to succeed.").

[52] Joffe & Mather have argued that exceptions to the no reflective loss principle are in fact the limits on the no reflective loss principle. The authors have explained:

> Where the defendant owes a duty to the shareholder but not to the company, or where the shareholder's loss is separate and distinct, the no reflective loss principle has no application at all. They are not situations in which duties are owed to both company and the shareholder, and the shareholder's loss is reflective, but it is nonetheless permitted to sue to recover that loss.

ciple under U.K. law. First, a shareholder can bring a claim for reflective loss under U.K. law if the company has no cause of action to recover its loss.[53] Second, a shareholder can bring a claim for reflective loss if the "breach of duty was owed to [the shareholder] personally; and . . . [their loss was] separate and distinct from the loss suffered by the company."[54] Third, the Court of Appeal in *Giles v. Rhind*—where Lord Justice Walker allowed a shareholder to claim for reflective loss where the defendant (the wrongdoer) disabled the company from pursuing that cause of action—identified an additional exception under U.K law.[55] The *Giles v. Rhind* exception allowed for the consideration of the impact of a defendant's conduct in determining a shareholder's standing to assert a claim for reflective loss.

Prior work has shown that civil law jurisdictions, such as Germany, France, and the Netherlands, similarly prohibit shareholder claims for reflective loss.[56] Among these countries, Germany adheres to the strongest version of the no reflective loss principle,[57] usually banning shareholder recovery for reflective loss. De Wulf has discussed an important decision by the German *Bundesgerichtshof* (BGH) of November 10, 1986, where the court rejected a shareholder claim for reflective loss because "this would run counter to the principle of capital maintenance . . . and would be incompatible with the fact that company property or assets are earmarked for a specific goal, namely the company's purpose . . . ."[58] According to the BGH, the shareholder could claim for "sepa-

Id.

[53] *See* Johnson v. Gore Wood & Co. [2002] 2 AC 1 (HL) 66 ("The test is not whether the company could have made a claim in respect of the loss in question; the question is whether, treating the company and the shareholder as one for this purpose, the shareholder's loss is franked by that of the company.").

[54] CHARMAN & DU TOIT, *supra* note 25, at 174.

[55] *See* Giles v. Rhind [2002] EWCA (Civ) 1428 (Eng.); *see also* Victor Joffe & James Mather, *The Vanishing Exception Part Two: Victor Joffe & James Mather Continue Their Reflections on Controversial Cases on Ability to Pay*, NEW L.J., Dec. 5, 2008, https://www.newlawjournal.co.uk/content/vanishing-exception-0 [https://perma.cc/49J8-7BLL] (describing the facts and outcome of *Giles v. Rhind* in detail).

[56] *See, e.g.*, Gaukrodger, *supra* note 16, at 17–18 (discussing Germany and France); s*ee also* de Jong, *supra* note 20, at 99 ("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.").

[57] *See* de Jong, *supra* note 20, at 107 ("German law strictly adheres to the 'no reflective loss' principle.").

[58] de Wulf, *supra* note 26, at 1545.

rate, direct damage," but not for reflective loss resulting from the injury to the company.[59] Similarly, in France, a shareholder can only claim for "personal injury" that is independent from the injury suffered by the company.[60] The French courts have dismissed shareholder claims where the injury to shareholder was only corollary to the injury of the company.[61]

Consequently, most advanced systems of corporate law unanimously prohibit shareholder claims for reflective loss, allowing only limited exceptions to the no reflective loss principle. For most domestic systems of law—including the legal systems of the United Kingdom, the United States, and Germany—it is irrelevant whether the shareholder has a separate cause of action, as these legal systems prohibit shareholder claims for reflective loss in either case.[62] In general, it appears that the nature of the loss—reflective loss to shareholders resulting from a direct loss to the company—largely determines the prohibition of the recovery, regardless of a separate cause of action by shareholders.

The no reflective loss principle does, however, have weaknesses. First, the principle is based on the assumption that the company will be able to bring its own claim. Further, it assumes that once the company recovers its losses, the shareholders will recover indirectly. For instance, the indirect recovery may occur through dividend payout; but, it is unclear whether this payout would restore the economic interests of the shareholders and, consequently, put shareholders in a position they would have found themselves in if the loss had never occurred. Furthermore, even if the share price or value is restored, this would not provide recovery to shareholders that sold their shares at a lower price prior to recovery by the company.

Despite these concerns, the no reflective loss principle is commonly accepted as a practical and fair solution. It is also supported by sound policy considerations, such as the avoidance of double recovery, increase of judicial economy, and consistency and predictability of court decisions.[63] And so, in unusual unison, both ef-

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59 *Id.*

60 *See id.* at 1557–61 (discussing French law).

61 *See id.* at 1559 (explaining that shareholder suffering because of dropped stocks is actually a corollary to damage suffered by the company).

62 *See, e.g.*, Gaukrodger, *supra* note 16, at 17 (explaining that Germany and France typically do not allow shareholders to make claims for reflective loss).

63 *See id.* at 7 ("Courts in advanced systems of national corporate law, however, generally reject shareholder claims for reflective loss—largely for explicit

ficiency and fairness concerns dictate the no reflective loss principle, barring shareholders from claiming reflective loss under domestic corporate law.[64]

2.2. *International investment law: Treaties and the practice of arbitral tribunals*

In international investment law, the concept of shareholder standing has developed through the practice of arbitral tribunals called upon to interpret investment treaty provisions as part of investor-state dispute settlement ("ISDS"). Historically, shareholders that invested abroad could only seek protection through the customary international law of diplomatic protection. Similar to domestic law, customary international law distinguishes between direct and reflective loss and generally granted protection to shareholders only for direct loss.[65] The role of customary international law has diminished over time with the growth of investor protection treaties, which largely replaced customary international law in the area of investment protection.[66]

Today, there are over 3,300 international investment agreements (IIAs) that provide foreign investors with various investor protections— such as non-discrimination, fair and equitable treatment (FET), and full protection and security (FPS)—and may also contain the state's consent to arbitration.[67] Treaties protect various

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policy reasons relating to consistency, predictability, avoidance of double recovery, and judicial economy.").

[64] *See id.* at 3 ("Limiting recovery to the company [under domestic law] is seen as both more efficient and fairer to all interested parties.").

[65] *See, e.g.*, Barcelona Traction, Light & Power Ltd. (Belg. v. Spain), Judgment, 1970 I.C.J. Rep. 3, ¶ 88 (Feb. 5) ("[W]here it is a question of an unlawful act committed against a company representing foreign capital, the general rule of international law authorizes the national State of the company alone to make a claim."); *see also* Gaukrodger, *supra* note 16, at 20 (providing examples from German, French, U.K. and Japanese law).

[66] *See, e.g.*, CMS Gas Transmission Company v. Argentine Republic, ICSID Case No. ARB/01/8, Decision on Objections to Jurisdiction, ¶ 45 (July 17, 2003) ("To some extent, diplomatic protection is intervening as a residual mechanism to be resorted to in the absence of other arrangements recognizing the direct right of action by individuals. It is precisely this kind of arrangement that has come to prevail under international law . . . .").

[67] *See* UNCTAD 2017 REPORT, *supra* note 17, at xii ("In 2016, 37 new IIAs were concluded, bringing the total number of treaties to 3,324 by year-end . . . ."). *But see id.* ("Over the same time, terminations of at least 19 IIAs became effective, with more to come.").

forms of investments and may cover shares, stock, and other forms of equity participation in the company. Reflecting the treaty practice, arbitral tribunals have consistently allowed shareholders in investment arbitrations to bring claims for reflective loss since 1970.[68] In doing so, the tribunals have sought guidelines from the terms of investment treaties and, in the words of the *Teinver v. Argentina* tribunal, have "refus[ed] to take the cues from domestic corporate law,"[69] which generally prohibits reflective loss claims. Where treaties protect foreign investments in equity securities, it is settled law today that shareholders have independent standing under IIAs to bring individual claims for losses suffered by the company.[70]

Arbitral tribunals examine shareholding issues at the beginning of an arbitration to establish whether a tribunal has the right to hear a claim[71]—the jurisdictional approach—or whether a claim by

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68 *See* Schreuer, *supra* note 11, at 4 ("[P]ractice since 1970, the year of the decision in Barcelona Traction, demonstrates an increasing willingness to grant an independent standing to shareholders."); *see also* CMS Gas Transmission Company v. Argentine Republic, ICSID Case No. ARB/01/8, Decision on Objections to Jurisdiction, ¶ 48 (July 17, 2003) ("The Tribunal therefore finds no bar in current international law to the concept of allowing claims by shareholders independently from those of the corporation concerned, not even if those shareholders are minority or non-controlling shareholders."). *See generally* Alexandrov, *supra* note 18 (reviewing early arbitral tribunal practice that affirmed the status of shareholders as investors under investment treaties).

69 Teinver S.A. v. Argentine Republic, ICSID Case No. ARB/09/1, Decision on Jurisdiction, ¶ 212 (Dec. 21, 2012).

70 *See, e.g.*, Enron v. Argentine Republic, ICSID Case No. ARB/01/3, Decision on Jurisdiction, ¶ 39 (Jan. 14, 2004) (noting that "there is nothing contrary to international law or the ICSID Convention in upholding the concept that shareholders may claim independently from the corporation concerned, even if those shareholders are not in the majority or in control of the company.").

71 Arbitral tribunals and scholars disagree as to whether the shareholder standing constitutes an issue of jurisdiction or, instead, of admissibility of a claim. The distinction between the issues of admissibility and jurisdiction is not always easy to draw. Crawford distinguishes the two concepts as follows:

> Objections to jurisdiction relate to conditions affecting the parties' consent to have the tribunal decide the case at all . . . . An objection to the admissibility of a claim invites the tribunal to dismiss (or perhaps postpone) the claim on a ground which, while it does not exclude its authority in principle, affects the possibility or propriety of its deciding the particular case at the particular time.

JAMES CRAWFORD, BROWNLIE'S PRINCIPLES OF PUBLIC INTERNATIONAL LAW 693 (8th ed. 2012).

As a result, there is "a degree of confusion and indifference in international investment law" as to the difference between these two concepts. Tania Voon et al., *Legal Responses to Corporate Manoeuvring in International Investment Arbitration*, 5 J.

a shareholder can be brought in arbitration—the admissibility approach. Once arbitral tribunals identify the first entity or a physical person that has standing in investment arbitration, they usually end their jurisdictional analysis and proceed to the merits of a claim.[72] The tribunals also look at shareholding at the end of the arbitration to calculate damages.[73] By contrast to the jurisdictional phase, investment tribunals tend to be more open to the double recovery concerns[74] and have been known to award damages to shareholders in proportion to the shareholders' shares of equity.[75]

For shareholders seeking to bring a claim in investor-state arbitration, two questions become determinative. First, what constitutes an *investment* under a treaty and, in particular, do protected investments under a treaty include stock or other interest in the company? Second, who can bring a claim under an investor protection treaty? Answering these questions requires treaty interpretation by an arbitral tribunal and would ultimately determine whether a tribunal has jurisdiction to hear a dispute involving a particular investment activity or an investor.

Arbitral tribunals interpret treaties by giving the treaties' terms

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INT'L DISP. SETTLEMENT 41, 45 (2014).

72 *See* CHRISTOPHER F. DUGAN ET AL., INVESTOR-STATE ARBITRATION 325 (2008) (noting that there is "the tendency of tribunals to end the jurisdictional analysis once they identify an entity with standing."); s*ee also* CMS Gas Transmission v. Argentine Republic, ICSID Case No. ARB/01/8, Decision on Objections to Jurisdiction, ¶¶ 84, 86 (July 17, 2003) (finding Argentina's argument that it is not necessarily true that CMS may claim compensation for Argentina's actions proportionate to its share in TGN because it is not guaranteed that this compensation would reach TGN's shareholders was irrelevant for the jurisdiction).

73 *See* ZACHARY DOUGLAS, THE INTERNATIONAL LAW OF INVESTMENT CLAIMS 456 (2009) (citing arbitral awards where the tribunals analyzed shareholding to calculate damages).

74 *See, e.g.*, Gemplus, S.A. v. United Mexican States, ICSID Case No. ARB(AF)/04/3, Award, ¶¶ 12–60 (June 16, 2010) (explaining that shareholder claimants insisted that their claim was "jurisdictionally distinct and wholly separate" from the company's claim for damages in the host state's domestic courts, but the tribunal "[n]evertheless . . . appreciate[d] the concern that, in practical terms, they may be seen as recovering compensation for the same acts through separate sets of proceedings.").

75 *See, e.g.*, CME Czech Republic B.V. (The Netherlands) v. Czech Republic, UNCITRAL, Final Award, ¶ 620 (Mar. 14, 2003) (finding that an arbitral tribunal awarded damages to the claimant in proportion to the claimant's direct shareholding of 93.2% in the investment, but in awarding damages disregarded an additional share of 5.8% held indirectly by the claimant); *see also* Eskosol, *supra* note 9, ¶ 170 n.294 ("Had Italy instead not prevailed in the prior proceeding . . . the Tribunal of course would have to be vigilant to prevent double recovery from Italy for the same loss. Because of the outcome of the *Blusun* case, however, that situation does not arise here.").

their ordinary meaning in view of the treaties' respective object and purpose.[76] Yet, most investment treaties are inherently vague and provide little or no clarification as to what constitutes an investment under the treaty. As a result, interpretations by arbitral tribunals vary substantially across treaties and disputes. In the absence of the doctrine of *stare decisis* or binding precedents in international investment law, tribunals may also interpret identical treaty provisions differently in subsequent arbitrations.

2.2.1. Shareholding as investment

First-generation bilateral investment treaties ("BITs")—the most common form of IIAs—were relatively short. Such treaties sought to increase inward investments and granted protection largely to *foreign direct investments (FDIs)*, which—by contrast to two other categories of investments, *portfolio* and *indirect* investments—entail a lasting relationship with a certain degree of control or influence over investments.[77] BITs provided very little guidance as to what constitutes an investment, leaving it to the arbitral tribunals to identify whether protection is warranted under a particular treaty. The Convention on the Settlement of Investment Disputes between States and Nationals of Other States[78] (the ICSID

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[76] *See* Vienna Convention on the Law of Treaties art. 31(1), May 23, 1969, 1155 U.N.T.S. 331 ("A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose"). For instance, arbitral tribunals have allowed claims by both direct and indirect shareholders because BITs generally do not distinguish between direct and indirect investments. *See, e.g.*, Siemens A.G. v. Argentine Republic, ICSID Case No. ARB/02/8, Decision on Jurisdiction, ¶ 137 (Aug. 3, 2004) ("The Tribunal observes that there is no explicit reference to direct or indirect investment as such in the [Treaty between the Federal Republic of Germany and the Argentine Republic concerning the Reciprocal Encouragement and Protection of Investments]. The definition of 'investment' is very broad.").

[77] *See* INTERNATIONAL MONETARY FUND, BALANCE OF PAYMENTS AND INTERNATIONAL INVESTMENT POSITION MANUAL 99 (6th ed. 2009) [hereinafter IMF POSITION MANUAL] ("Direct investment is related to control or a significant degree of influence, and tends to be associated with a lasting relationship. As well as funds, direct investors may supply additional contributions such as know-how, technology, management, and marketing.").

[78] *See generally* Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the Washington Convention), Mar. 18, 1965, 17 U.S.T. 1290, 575 U.N.T.S. 159 [hereinafter ICSID Convention] (establishing the International Centre for Settlement of Investment Disputes (ICSID) and providing facilities for conciliation and arbitration of investment disputes between contracting states and nationals of other contracting states).

Convention), adopted in 1965, offers largely a procedural mechanism of investor-state dispute resolution. The ICSID Convention does not address the scope of protected investments and/or investors. Its only reference to investments is found in Article 25(1), which limits the jurisdiction of the International Centre for Settlement of Investment Disputes (ICSID) to "any legal dispute arising directly out of an investment."[79] Therefore, the ICSID Convention leaves it to sovereign states to specify in their treaties or investment agreements what constitutes an investment with respect to which a state agrees to arbitration under the ICSID Convention. Similarly, there are no references to investments or investors in other arbitration rules commonly used in ISDS, such as the UNCITRAL arbitration rules.[80]

In this legal vacuum, scholars and arbitral tribunals sought to establish certain criteria for distinguishing FDIs from other categories of investments. Notably, following the decision in *Salini*,[81] tribunals incorporated the typical "features" identified by Schreuer for investments under the ICSID Convention into the Convention's jurisdictional requirements.[82] And so, in ICSID arbitrations, the tribunals granted protection to investments that satisfied *all* of the so-called *Salini-Schreuer factors*, which are: (a) a certain duration, (b) a certain regularity of profit and return, (c) the assumption of risk by both sides, (d) substantial commitment of capital, and (e) significance of the operation for the host state's development.[83] Applied cumulatively, these stringent criteria provided little deference to the state parties' own determination of what constituted an

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[79] *Id.* art. 25(1).

[80] *See generally* UNCITRAL, UNCITRAL ARBITRATION RULES (2011), https://www.uncitral.org/pdf/english/texts/arbitration/arb-rules-revised/arb-rules-revised-2010-e.pdf [https://perma.cc/4TYK-F387].

[81] Salini Costruttori S.p.A. v. Kingdom of Morocco, ICSID Case No. ARB/00/4, Decision on Jurisdiction, ¶ 52 (July 23, 2001) ("The doctrine generally considers that investment infers: contributions, a certain duration of performance of the contract and a participation in the risks of the transaction . . . . In reading the Convention's preamble, one may add the contribution to the economic development of the host State of the investment as an additional condition.").

[82] *See* Julian Davis Mortenson, *The Meaning of "Investment": ICSID's* Travaux *and the Domain of International Investment Law*, 51 HARVARD INT'L L.J. 257, 273 (2010) (explaining that arbitral tribunals have gone even further than *Salini* by "requiring *each* of [Schreuer's 'typical features' of investments] to be satisfied in some objective measure, rather than allowing for some totality-of-the-circumstances balancing among the factors.").

[83] *See* CHRISTOPH H. SCHREUER, THE ICSID CONVENTION: A COMMENTARY 140, ¶ 122 (2001) (defining "investment" based on ICSID's history").

investment under the treaty. These criteria also limited protection for *portfolio investments*,[84] such as investments in equity and debt securities, largely because portfolio investments do not provide an investor with control over the company, unless the case involves a controlling or a majority shareholder. Furthermore, beyond the amounts invested in actual shares, portfolio investments generally do not entail sharing of risk between an investor (a shareholder) and a host state. Finally, such investments can be of a short duration, which does not warrant protection under the *Salini-Schreuer* factors.[85]

The need to satisfy the *Salini-Schreuer* criteria has subsided over time as the new generation of BITs have come into force. These treaties have explicitly extended protection to *portfolio investments* (such as stock and bonds) and *indirect investments* (such as agreements on technical assistance, intellectual property transfers, and joint marketing arrangements).[86] Today, most modern IIAs would consider holding shares in companies that have made investments abroad or being a foreign shareholder in the local companies established in the host state to be protected investment activities. A typical example is Article 1 of the U.S. Model BIT, which defines "investment" as:

> [E]very asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, in-

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[84] *See* IMF POSITION MANUAL, *supra* note 77, at 99 (outlining the functional categories of investment and distinguishing portfolio investors from direct investors). There are different dynamics at work in cases of portfolio investments as compared to FDIs. As the IMF explains:

> "[P]ortfolio investors typically have less of a role in the decision making of the enterprise with potentially important implications for future flows and for the volatility of the price and volume of positions. Portfolio investment differs from other investment in that it provides a direct way to access financial markets, and thus it can provide liquidity and flexibility. It is associated with financial markets and with their specialized service providers, such as exchanges, dealers, and regulators."

Id.

[85] Investment treaties generally do not contain a minimum duration requirement for a foreign investment to receive protection under a treaty, although the Salini tribunal suggested a 2-year threshold. *See* Salini Costruttori S.p.A. v. Kingdom of Morocco, ICSID Case No. ARB/00/4, Decision on Jurisdiction, ¶ 54 (July 23, 2001) (The transaction, therefore, complies with the minimal length of time . . . which is from 2 to 5 years).

[86] *See* DUGAN ET AL., *supra* note 72, at 1–2 (defining three broad categories of cross-border investments as commonly described in international investment law).

> cluding such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk.[87]

The article further provides a non-exclusive list of forms that an investment may take, including: (a) an enterprise; (b) shares, stock, and other forms of equity participation in an enterprise; (c) bonds, debentures, other debt instruments, and loans.[88]

Similar provisions that extend the benefits of investment treaties to shareholders can be found in the majority of known IIAs. According to the Mapping Project of the United Nations Conference on Trade and Development (UNCTAD), out of 2,577 IIAs included in the project, only 25 treaties exclude portfolio investments from their coverage.[89] Although the project does not yet cover all known IIAs, one can clearly observe that the majority of modern investment treaties specifically provide for—or at least do not exclude—protection of investments in the stock of the company.

2.2.2. *Shareholder claims for reflective loss*

Although many IIAs list shares as a type of investment, investment treaties generally do not talk about shares or shareholder rights beyond that.[90] In particular, investment treaties do not tend to identify what kind of claims shareholders can bring in invest-

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[87] U.S. Dep't of State, 2012 U.S. Model Bilateral Investment Treaty, art. 1 (2012), https://www.state.gov/documents/organization/188371.pdf [https://perma.cc/PL8T-4ZQW].

[88] *See id.* (providing definitions). The model treaty recognizes the diverse nature of debt and attempts to distinguish debt that warrants investment protection from other types of debt. Footnote 1 to Article 1 explains that "[s]ome forms of debt . . . are more likely to have the characteristics of an investment, while other forms of debt, such as claims to payment that are immediately due and result from the sale of goods or services, are less likely to have such characteristics." *Id.* n.1.

[89] *See generally* UNCTAD, *IIA Mapping Project*, INV. POL'Y HUB, http://investmentpolicyhub.unctad.org/IIA/mappedContent [https://perma.cc/PXJ5-ELYB] (last visited Sept. 26, 2018). UNCTAD describes its IIA Mapping Project as "a collaborative initiative between UNCTAD and universities worldwide to map the content of IIAs. The resulting database serves as a tool to understand trends in IIA drafting, assess the prevalence of different policy approaches and identify treaty examples." *Id.*

[90] *See* Gaukrodger, *supra* note 16, at 8 ("Typically, the only reference to shares in BITs is a clause that clarifies that shares are assets that qualify as an investment under the treaty definition of investment.").

ment arbitration.[91] Despite concise treaty provisions, tribunals have consistently interpreted IIAs to allow shareholder claims for reflective loss, and the number of such arbitrations continue to grow.[92] Gaukrodger has observed that "[c]laims by company shareholders seeking damages from government for so-called 'reflective loss' now make up a substantial part of the [investor-state dispute settlement] caseload."[93]

Unlike domestic courts that focus on the type of loss suffered by shareholders and prohibit shareholder claims if the loss is reflective of the company's loss, arbitral tribunals focus their inquiry on the availability of a cause of action for shareholders. Once they are satisfied that a shareholder has been granted protection under a treaty, they allow the case to proceed without regard to the type of loss suffered by the shareholder. Having established liability, tribunals award damages to shareholders directly, usually on a pro rata basis to the company's loss.[94]

Moreover, it is largely irrelevant for shareholder standing whether a company can submit its claim in ISDS.[95] The tribunals view the claims by shareholders as autonomous from the claims by the company and generally allow both types of claims to proceed.[96] In this respect, tribunals have indicated that the interests of share-

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91 *See id.* (noting that most treaties do not "expressly address the issue of the scope of shareholder claims.").

92 *See id.* at 7 ("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.").

93 *Id.*

94 As Gaukrodger explains:

> 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.

Id. at 8.

95 *Cf. id.* at 29 (citing arbitrations where companies had recourse to claims in ISDS, yet their shareholders were also allowed to proceed in arbitration).

96 *See, e.g.*, Eskosol, *supra* note 9, ¶ 166 ("A shareholder's claim for its reflective loss through an entity in which it holds shares cannot be equated automatically to that entity's claim for its direct losses.").

holders and the company are rarely identical to the extent that it is abusive to allow both arbitrations to proceed.[97] For instance, interests of the shareholder and the company may be found to be identical where a foreign shareholder owns 100% of equity in a local company.[98]

Provisions of BITs and other IIAs establish who may bring a claim in arbitration with a focus on the nationality requirements. As a general rule, the claimant must be a national of the State party to the treaty and may not be a national of the host state.[99] For instance, under Chapter 11 of NAFTA, a foreign investor can submit a claim to arbitration on its own behalf (Article 1116), or on behalf of an enterprise—a juridical person established in the host State that the investor owns or controls directly or indirectly (Article 1117).[100] Article 1117(3) further provides that if claims are made both on behalf of an investor and an enterprise and they arise from the same events, such claims have to be generally heard together by the arbitral tribunal.[101] Thus, NAFTA Chapter 11 attempts to achieve greater consistency and judicial economy by providing for consolidation of arbitrations.

In addition, some treaties allow an *investment* to initiate an arbitration directly.[102] Under most of these treaties, an "investment" is a company that is incorporated in the host state to carry out in-

[97] *See id.* ¶ 167 (noting that the interests of the shareholders and the company can be identical such that it would be abusive to "permit arbitration of a given dispute by one after the other already has concluded an arbitration over the same dispute.").

[98] *See id.* ("In the Tribunal's view, the same conclusion would be equally logical in the reverse situation, if a first case were brought by the 100% shareholders of a local company and thereafter a second case was attempted by the local company that they wholly owned.").

[99] *See* Schreuer, *supra* note 11, at 2 ("The claimants in investment arbitration must meet certain requirement with respect to their nationality. Most importantly, they must not be nationals of the host State.").

[100] *See* North American Free Trade Agreement, Can.-Mex.-U.S., art. 1116–17, Dec. 17, 1992, 32 I.L.M. 289 (1992) [hereinafter NAFTA] (noting methods through which investors can submit claims to arbitration).

[101] *See id.* art. 1117(3) ("Where an investor makes a claim under this Article and the investor or a non-controlling investor in the enterprise makes a claim under Article 1116 . . . the claims should be heard together by a Tribunal established under Article 1126, unless the Tribunal finds that the interests of a disputing party would be prejudiced thereby.").

[102] U.N. Conference on Trade and Development, *Investor-State Disputes Arising from Investment Treaties: A Review*, 15, U.N. Doc. UNCTAD/ITE/IIT/2005/4 (2005) (defining "investor" and "investment"). *But see* NAFTA, *supra* note 100, art. 1117(4) ("An investment may not make a claim under this Section [B. Settlement of Disputes between a Party and an Investor of Another Party].").

vestment activity, as required by law or business considerations.[103] Although these are *local* companies that are generally not expected to benefit from investment treaties, they may be granted protections if such companies are under foreign control.[104] Arbitral tribunals have interpreted these provisions with "some flexibility,"[105] consistently allowing local companies under foreign control to act as claimants, irrespective of any claims by the controlling shareholders.[106]

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[103] *See* Schreuer, *supra* note 11, at 620 (noting that where "the company has the nationality of the host State and does not qualify as a foreign investor. . . . the company in question is not treated as the investor but as the investment."); *id.* at 4 (observing that "many States require the establishment of a local company as a precondition for foreign investment."); *see also* Compañía de Aguas del Aconquija, S.A. v. Argentine Republic (the Vivendi case), ICSID Case No. ARB/97/3, Decision on Annulment, ¶ 50 (July 3, 2002), 19 ICSID Rev. 89 (2004) ("While the foreign shareholding is by definition an 'investment' and its holder an 'investor,' the local company only falls within the scope of Article 1 [of the France-Argentina BIT] if it is 'effectively controlled, directly or indirectly, by nationals of one Contracting Party' or by corporations established under its laws."). Sometimes, establishment of the local company is motivated purely by business considerations. *See, e.g.*, Eskosol, *supra* note 9, ¶ 49 (noting that where there was no requirement under Italian law to establish a local company, but a foreign investor chose to do it for business reasons).

[104] Article 25(1)(b) of the ICSID Convention permits the host state and the foreign investor to agree that a locally incorporated company should be treated as a foreign company because of its foreign control. *See* ICSID Convention, *supra* note 78, art. 25(2)(b) (providing in relevant part that "'National of another Contracting State' means: . . . any juridical person which had the nationality of the Contracting State party to the dispute . . . 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."); *see also* The Energy Charter Treaty art. 26(7), Dec. 17, 1994, 2080 U.N.T.S. 51 [hereinafter ECT] (providing in relevant part that an investment "controlled by Investors of another Contracting Party . . . [shall] be treated as a 'national of another State.'"). Thus, provided there is agreement between the parties, the foreign control requirement allows departure from the principles of incorporation or seat of the company, which are commonly applied under international investment law to determine the nationality of the corporation. *Cf.* Schreuer, *supra* note 11, at 17 ("Under the ICSID Convention, departure from the principle of incorporation or *siège social* in favour of foreign control to determine corporate nationality is permissible only under the narrowly circumscribed conditions of Article 25(2)(b)."). Some tribunals may also apply the equitable doctrine of "veil piercing" to identify the true nationality of the party. *See, e.g.*, Alexandrov, *supra* note 18, at 402 (opining that a tribunal could pierce the veil only where the company's conduct "constitute[s] an abuse of legal personality" and there is evidence that the company "used its formal legal nationality for [an] improper purpose." (citation omitted)).

[105] Schreuer, *supra* note 11, at 5.

[106] *See, e.g.*, Amco Asia Corp. v. Republic of Indon., ICSID Case No. ARB/81/1, Decision on Jurisdiction, ¶¶ 15, 17 (Sept. 25, 1983) (asserting jurisdiction over claims against Indonesia by both PT Amco, a local Indonesian company,

Furthermore, arbitral tribunals have allowed both direct and indirect shareholders to bring claims for reflective loss. In doing so, tribunals rely on investment treaty provisions, which are usually broad and do not distinguish between direct and indirect investments. Without an express exclusion of indirect shareholders, arbitral tribunals have demonstrated certain reluctance to deny jurisdiction to indirect investments.[107] As a result, it is increasingly hard to predict if a tribunal will be willing to cut some of the potential claimants depending on a degree of remoteness from an investment.

The openness of ISDS to claims by indirect shareholders increases the multiplicity of claims in ISDS, especially because the pool of potential claimants expands beyond a local company (an "investment") and its direct shareholders.[108] The potential scenarios of how investments and claims can be structured are unlimited. They can involve shareholders of one or more intermediaries in the investor's home state, the host state or third countries, at several levels of corporate ownership structure.[109] Arbitral tribunals have

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and Amco Asia, its controlling shareholder).

107 *See, e.g.*, Siemens A.G. v. Argentine Republic, ICSID Case No. ARB/02/8, Decision on Jurisdiction, ¶ 137 (Aug. 3, 2004) (denying Argentina's objection to jurisdiction arising from the claimant's indirect shareholding in the Argentine investment because "there is no explicit reference to direct or indirect investment as such in the [Germany-Argentina bilateral investment] Treaty. The definition of 'investment' is very broad . . . . Therefore, a literal reading of the Treaty does not support the allegation [by Argentina] that the definition of investment excludes indirect investment.").

108 Schreuer, *supra* note 11, at 11 (observing that "[i]f there are two or more layers of minority shareholding the economic consequence of the adverse action by the host State may still be traceable. But the pursuit of legal remedies becomes increasingly complex especially if competing sets of shareholders at different levels pursue parallel or conflicting remedies.").

109 Schreuer points to a complex structure of investment in *Enron v. Argentina*, where the claimants indirectly owned 35.263% of the investments in Argentina. *See* Schreuer, *supra* note 11, at 12 (describing investment structure). The shareholding was described as follows:

> Claimants' participation concerns the privatization of Transportadora de Gas del Sur ("TGS"), one of the major networks for the transportation and distribution of gas produced in the provinces of the South of Argentina. The Claimants own 50% of the shares of CIESA, an Argentine incorporated company that controls TGS by owning 55.30% of its shares; the Claimants' participation in CIESA is held by two wholly-owned companies, EPCA and EACH. The Claimants, through EPCA, EACH and ECIL, another corporation controlled by the Claimants, also own 75.93% of EDIDESCA, another Argentine corporation that owns 10% of the shares of TGS; and they also have acquired an additional 0.02% of TGS through EPCA. The investment as a whole, it is explained, amounts

acknowledged the problem, but continue to grant jurisdiction as long as a treaty allows shareholder protection without reservations.[110]

Consequently, reflective loss claims under international investment law largely raise the same concerns that motivated domestic courts to adopt the no reflective loss principle: double recovery, increased cost of litigation, and conflicting awards.[111] Arbitral tribunals have acknowledged these concerns and expressed sympathy to the host states' circumstances,[112] yet they continue faithfully to enforce IIAs by permitting claims by shareholders independently of claims by local companies.[113]

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to 35.263% of TGS.

Enron v. Argentine Republic, ICSID Case No. ARB/01/3, Decision on Jurisdiction, ¶ 21 (Jan. 14, 2004).

110 *See, e.g.*, *id.* ¶ 50 (raising concern that "if minority shareholders can claim independently from the affected corporation, this could trigger an endless chain of claims, as any shareholder . . . could invoke a direct right of action for measures affecting a corporation at the end of the chain."); *id.* ¶ 52 ("The Tribunal notes that . . . there is indeed a need to establish a cut-off point beyond which claims would not be permissible as they would have only a remote connection to the affected company."). *But see* Schreuer, *supra* note 11, at 14 (criticizing the tribunal's suggestion to find a cut-off, stating that "[t]he Tribunal's demand for a cut-off point for indirect shareholding lacks a legal foundation. Any difficulties arising from a multiplicity of claimants can be taken care of by a number of devices but do not require that the investor be deprived of its standing.").

111 *See, e.g.*, Gaukrodger, *supra* note 16, at 9 (observing that "[s]hareholder 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.").

112 *See, e.g.*, Eskosol, *supra* note 9, ¶ 170 ("The tribunal is not unsympathetic to Italy's circumstances . . . . [I]t would not be appropriate for tribunals to preclude arbitration by qualified investors, simply because *other* qualified investors may have proceeded before them without their participation.").

113 *See, e.g.*, DUGAN ET AL., *supra* note 72, at 249 (citing American Mfg. & Trading v. Republic of Zaire, ICSID Case No. ARB/93/1, Award (Feb 21, 1997); Genin v. Estonia, ICSID Case No. ARB/99/2, Award, ¶ 324 (June 25, 2001)) (discussing cases where the protected foreign investments were shares in domestic companies); *see also* CME Czech Republic B.V. (The Netherlands) v. The Czech Republic, UNCITRAL, Partial Award (Sept. 13, 2001); Antoineé Goetz v. Republic of Burundi, ICSID Case No. ARB/95/3, Decision (Sept. 2, 1998), 15 ICSID Rev. 457 (2000); Emilio Augustín Maffezzini v. The Kingdom of Spain, ICSID Case No. ARB/97/7, Decision on Jurisdiction (Jan. 25, 2000), 16 ICSID Rev. 212 (2001); Compañía de Aguas del Aconquija, S.A. v. Argentine Republic (the Vivendi case), ICSID Case No. ARB/97/3, Decision on Annulment (July 3, 2002); Azurix Corp. v. Argentine Republic, ICSID Case No. ARB/01/12, Decision on Jurisdiction (Dec. 8, 2003); LG&E Energy Corp. v. Argentine Republic, ICSID Case No. ARB/02/1, Decision of the Arbitral Tribunal on Objections to Jurisdiction (Apr. 30, 2004); Plama Consortium Ltd. v. Republic of Bulg., ICSID Case No. ARB/03/24, Decision on Juris-

By contrast to their treatment of the host states, arbitral tribunals have shown little sympathy to multinational corporations whose shareholders submit reflective loss claims in ISDS. Most tribunals focus on the enforcement of investment treaties and do not discuss distortions that reflective loss claims create on corporate law and governance within the corporation.[114] Arbitral tribunals have not been sensitive to these concerns and instead have accepted shareholder claims and established jurisdiction even where it would harm the corporation—for instance, because it would destroy the management efforts to settle with a host state.[115] Only a few tribunals have acknowledged the problem, suggesting that disputes between the shareholders and the company resulting from their competing interests in investment arbitrations can be addressed under domestic law.[116] Other tribunals have dismissed any concerns over competing interests between the company and its treaty-protected shareholders, presumably leaving it for the company and the shareholders to resolve their disputes between themselves.

By contrast to domestic courts that focus on the nature of shareholder loss and reject claims for reflective loss, investment tribunals have focused on the cause of action. Once they establish that a shareholder has the right to claim for reflective loss under a treaty, tribunals establish jurisdiction regardless of the reflective nature of the shareholder loss.[117] Arbitral tribunals explain their

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diction (Feb. 8, 2005), 20 ICSID Rev. 262 (2005).

114 *See, e.g.*, Total S.A. v. Argentine Republic, ICSID Case No. ARB/04/01, Decision on Objections to Jurisdiction, ¶ 80 (Aug. 25, 2006) ("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.").

115 *See* ZACHARY DOUGLAS, THE INTERNATIONAL LAW OF INVESTMENT CLAIMS 456 (2009) (describing instances where 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.").

116 *See, e.g.*, Eskosol, *supra* note 9, ¶ 170 (holding that it was not a "sufficient basis for precluding qualified investors from exercising their fundamental right to access the ICSID system," even where domestic law affords "potential remedies—for example, claims by minority shareholders or bankruptcy receivers against majority shareholders who take unauthorized actions in contravention of domestic law.").

117 *See, e.g.*, RosInvestCo UK Ltd. v. Russian Federation, SCC Case No. V079/2005, Final Award, ¶ 608 (Sep. 12, 2010) (noting that "investment treaty arbitration does not require that a shareholder can only claim protection in respect of measures that directly affect shares in their own right, but that the investor can also claim protection for the effect on its shares by measures of the host state taken

position by express provisions of investor protection treaties, which permit shareholder claims for reflective loss irrespective of the legal nature and status of foreign investors under domestic law. Scholars have expressed their support to such arbitral tribunals' practice.[118] Considering the text of existing IIAs and decisions by investment tribunals interpreting such treaties, one can clearly observe that—in international investment law—concerns about foreign investor protection prevail over concerns over double recovery, conflicting awards, and judicial economy, the justifications for the "no reflective loss" principle under domestic law.[119]

3. REFLECTIVE LOSS AND CORPORATE LAW AND GOVERNANCE

3.1. *Theoretical predictions*

Courts and commentators have suggested that the no reflective loss principle under domestic corporate law is based on policy considerations.[120] In other words, domestic law does not provide shareholders with the right to bring a claim for reflective loss not because the law does not recognize shareholder's injury, but because the law finds it more efficient and more fair to give a right to claim for injury to the company.[121] Most frequently, such policy

against the company.").

[118] *See, e.g.*, CAMPBELL MCLACHLAN, LAURENCE SHORE , & MATTHEW WEINIGER, INTERNATIONAL INVESTMENT ARBITRATION: SUBSTANTIVE PRINCIPLES ¶¶ 6.77, 6.79 (2007) ("[T]here 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.").

[119] Chaisse and Li have argued in this respect that "policy considerations underlining the non-reflective loss principle that are developed by the domestic courts should not be blindly adopted by international arbitration tribunals adjudicating investment treaty disputes." Chaisse & Li, *supra* note 7, at 84. Instead, "the tribunals should first analyze the policy considerations in the context of international investment and economic development." *Id.*

[120] *See, e.g.*, Gaukrodger, *supra* note 16, at 29 (quoting Waddington Ltd. v. Chan Chun Hoo, [2008] 4 H.K.C. 381, § 49 (C.F.A.)) (noting that "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.'"); Johnson v. Gore Wood & Co. [2002] 2 AC 1 (HL) 66 ("The disallowance of the shareholder's claim in respect of reflective loss is driven by policy considerations."); Thomas v. D'Arcy, 2005 QCA 68 (Queensland Ct. App. 2005) ("[T]he no reflective loss principle is 'driven by policy considerations'.").

[121] *See* Gaukrodger, *supra* note 16, at 8 ("The no reflective loss principle is based on the view that limiting recovery to the company is both more efficient

considerations include consistency, predictability, judicial economy, and avoidance of double recovery.[122]

The no reflective loss principle contributes to consistency and predictability by prohibiting claims by shareholders, which makes it easier for a wrongdoer to predict who will bring a claim for a breach. This reduces the likelihood of multiple claims and, as a result, inconsistent and conflicting decisions arising out of the same events. In doing so, the no reflective loss principle eliminates the likelihood of double recovery by shareholders (both direct recovery and indirect recovery through a company) and reduces the costs of litigation, thereby contributing to judicial economy. Separately, the no reflective loss principle is supported by fairness considerations because it is largely considered to be unfair to make a party in litigation defend itself again in a separate litigation and potentially pay twice for the same breach.

Regardless of the exact nature of policy considerations, domestic corporate laws across the globe are consistent today in prohibiting shareholder claims for reflective loss. Corporations bring direct claims for losses they sustain, without having to compete against their own shareholders for potential damages. In this world of the no reflective loss principle, a corporation and a wrongdoer that litigate their dispute are merely the users of the domestic court system. The rules of civil procedure the corporation relies on to bring its claim and achieve a dispute resolution, as a general rule, do not impact the inner structure of the corporation or its corporate governance choices.

The story is, however, very different in international investment law. There, shareholder claims for reflective loss are permitted and they penetrate the corporate shield, contributing to an inherent conflict of interests between the shareholders and the company. A rational shareholder with the right to bring its own claim for losses suffered by the corporation due to a breach of investor protection obligations will always bring such a claim in arbitration.[123] These shareholder actions will interfere with the control

and fairer to all interested parties.")

122 *Id.* at 11; *see also* Gaubert v. United States, 885 F.2d 1284, 1291 ("One rationale behind this prohibition [of shareholder claims for reflective loss] rests on principles of judicial economy.").

123 *See* DOUGLAS, *supra* note 115, at 452 (2009) (questioning "why a shareholder would elect to bring a claim for the account of its company if it had the option of bypassing the company altogether. The company might be liable to pay creditors, local taxes and discharge other obligations before distributing the residual amount of any damages recovered to the shareholders.").

and management decisions within the corporation, may harm the company's settlement and litigation efforts, and—even more troublesome for the corporate form—may directly benefit treaty-protected shareholders at the expense of the company, its creditors, and all other stakeholders. For instance, without regard to the management decision to settle a dispute with the host state in order to continue operations in the country, a treaty-protected shareholder can commence an arbitration seeking recovery of reflective loss and consequently destroy any attempts by the company to settle. Moreover, once the treaty-protected shareholders win in arbitration against a host state, they can deplete corporate assets by collecting damages otherwise owed to the company.

In theory, one can anticipate several areas of distortion created by reflective loss claims on corporate law and governance, as well as the structure of the corporate ownership chain of companies investing abroad. In its policy paper, the OECD has examined how the rules on reflective loss claims can affect corporate governance as well as the corporation and its stakeholders, including shareholders and creditors.[124] The paper suggests that reflective loss rules under investment treaties may undermine "entity shielding"[125] by allowing a shareholder (a) "partially to liquidate the company to the extent of their reflective loss" and (b) to "upset the priority rule by giving covered shareholders . . . a priority right to corporate assets over creditors."[126] From a firm's perspective, such changes to the corporate law and the incentives they create are particularly troublesome, in large part, because they deprive present and potential creditors of the firm of common expectations as to the corporate form and the effect of contracts entered between the creditors and the corporation.[127] This may impact the ability of and the cost for the corporation to obtain future credit.[128] On a broader

[124] *See* OECD Policy Paper, *supra* note 19, at 234–46 (2016) (noting that rules related to investment treaties may affect companies, shareholders, creditors, capital markets, and the corporate structuring of investment).

[125] *See* Henry Hansmann, Reinier Kraakman, & Richard Squire, *Law and the Rise of the Firm*, 119 HARV. L. REV. 1333, 1335 (2006) (introducing and defining the term "entity shielding" as a form of asset partitioning which "protects firm assets from the owners' personal creditors (and from creditors of other business ventures), thus reserving those assets for the firm's creditors.").

[126] OECD Policy Paper, *supra* note 19, at 236.

[127] *See* KRAAKMAN ET AL., *supra* note 2, at 7 ("Entity shielding doctrine . . . is needed to create common expectations, among a firm and its various present and potential creditors, concerning the effect that a contract between a firm and one of its creditors will have one the security available to the firm's other creditors.").

[128] *See, e.g.*, Gaukrodger, *supra* note 16, at 45 n.104 (noting that "[a] policy

scale, as the OECD has suggested, this may affect the "corporate personality" of the company, including its ability to "serve as a single contracting party and make credible commitments, and its ability to use its assets to obtain credit."[129] Undermining entity shielding in the corporation has a significant impact on its creditors and may injure creditors when shareholders recover damages, thereby effectively stripping away corporate assets.[130]

While domestic courts have addressed the same questions of partial liquidation of corporate assets and changes to the priority rules, they have consistently protected the corporate form by applying the no reflective loss principle. For instance, in *Holmes v. Securities Investor Protection Corp.*, the U.S. Supreme Court held that "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."[131] Similarly, the court in *Gaubert v. United States* has explained that, "[w]ere 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."[132] International arbitral tribunals have been blind to the corporate law concerns, allowing shareholder claims for reflective loss that may lead to the distortions to the corporate law and governance and, in effect, redistribute wealth from the corporation and its creditors to the treaty-protected shareholders.

The OECD has further observed that the rules on reflective loss will affect shareholders differentially since only a subset of shareholders will be covered by a treaty and, within this subset, only some shareholders will be likely to bring a claim (due to the high

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that puts creditors of companies engaged in foreign investment at risk may affect the availability and price of debt finance for foreign investment.").

129 OECD Policy Paper, *supra* note 19, at 237.

130 *See id.* at 239–40 (explaining that shareholder claims for reflective loss can hurt creditors); Gaukrodger, *supra* note 16, at 44 ("[A]llowing that shareholders claims for reflective loss can injure creditors of the company (unless the defendant is forced to pay the same damages twice)."); *see also* KRAAKMAN ET AL., *supra* note 2, at 2 (explaining that 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).

131 Holmes v. Sec. Inv'r Prot. Corp., 503 U.S. 258, 274 (1992).

132 Gaubert v. United States, 885 F.2d 1284, 1291 (5th Cir. 1989), *rev'd*, 499 U.S. 315 (1991) (footnote omitted).

cost of investment arbitration).[133] This differential treatment may provide incentives to some shareholders to restructure to benefit from a stronger investor protection regime.[134] In addition, the right to submit a claim for reflective loss in investment arbitration provides leverage to treaty-protected shareholders in their negotiations with the management on various important corporate issues, including arbitration and settlement strategy.[135] Furthermore, shareholder claims for reflective loss may impact the centralized management of the corporation by the board of directors, who are generally vested with making business decisions. Instead, the rules on reflective loss allow shareholders to individually make important decisions on "key issues of corporate interest," such as whether to commence an investment arbitration.[136] In addition, the OECD has suggested that the rules on reflective loss claims may interfere and have adverse effect on the transferability and liquidity of shares, although the impact of these rules on such issues is currently unclear.[137]

One can add to the OECD's impact list a further impact area, which Lord Millett identified in *Johnson v. Gore Wood & Co.* with respect to domestic claims for reflective loss.[138] Lord Millett argued that allowing shareholder claims for reflective loss would create a conflict of interest for directors who are also shareholders of the company and, in this latter capacity, likely interested in bringing a personal suit, thereby undermining the company's efforts to settle.[139] The same concern is valid in the context of international investment law, where there are high damages at stake resulting from failed investment projects abroad. Allowing reflective loss claims creates a conflict of interest for shareholders who are also directors. As in domestic corporate law, these shareholders would

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133 *See* OECD Policy Paper, *supra* note 19, at 237–38 (noting that in view of the high costs of ISDS provisions of investment treaties are likely to divide shareholders into separate groups, or subsets, including shareholders that are not covered by a treaty and shareholders that are unlikely to bring claims).

134 *See id.*

135 *See id.*

136 *See id.* at 244.

137 *See id.* at 238–39 (explaining how share transferability and liquidity can be adversely affected).

138 *See generally* Johnson v. Gore Wood & Co. [2002] 2 AC 1 (HL) at 66 (discussing reflective loss).

139 *See id.* ("[I]f the company's action were brought by its directors [who are also shareholders], they would be placed in a position where their interest conflicted with their duty . . . .").

likely be interested in bringing personal claims instead of making decisions in their director's capacity for the benefit of the corporation.

In addition to creating a conflict of interest for some shareholders, reflective loss claims create a problem of shareholder inequality. They provide additional rights to treaty-protected shareholders that other shareholders of the same corporation do not have, even though they might have paid the same price for the shares. These rights—including the rights to bring a claim in arbitration, to decide on a strategy in arbitration and/or whether to settle, and to collect damages awarded in arbitration—give treaty-protected shareholders the upper hand in their negotiations with corporate management once an investment dispute arises.

Apart from the impact on corporate governance, shareholder claims for reflective loss may contribute to forum- and treaty-shopping. International investment law provides incentives to the corporation to restructure to benefit from a more beneficial investor protection regime. The reflective loss claims increase the likelihood and complexity of restructuring within the corporate ownership chain because, in addition to incentives to the company, it provides incentives to the shareholders to acquire more beneficial protection for present or potential reflective loss claims.

With these predictions in mind, let us examine the practice of arbitral tribunals with a view of studying the impact of shareholder claims on corporate law and governance, as well as on structuring of the multinational corporations that have chosen to invest abroad. I will discuss two categories of cases: disputes that illustrate the impact of reflective loss claims on (1) corporate governance, and (2) the structure of the corporations.

3.2. Empirical evidence and case studies

3.2.1. Reflective loss and corporate governance

One of the most recent cases that reflects the essence of the problem of reflective loss claims is the *Eskosol* arbitration.[140] The facts of this case deserve closer attention. The dispute in *Eskosol* emerged from a regulatory change in the Italian renewable energy sector that led to the abandonment of photovoltaic (PV) project by

[140] *See* Eskosol, *supra* note 9, ¶ 122 (adjudicating on and discussing the core problem of reflective loss claims).

a foreign investor and a bankruptcy of a locally-incorporated Italian company, Eskosol. The case demonstrates how claims by treaty-protected shareholders can conflict with the interests of the company and its creditors, especially if the company is in financial distress and would benefit from submitting its own claim and collecting damages awarded to the shareholder. The *Eskosol* arbitration is the second arbitration resulting from the same facts in a dispute with Italy.[141] It follows an ICSID arbitration under the Energy Charter Treaty (ECT) brought by Eskosol's majority shareholder—Blusun S.A.—and two individuals who owned Blusun.[142] Italy prevailed in the *Blusun* arbitration but is currently facing an ICSID annulment proceeding.[143]

Eskosol was constituted in Italy in 2009 as a limited liability company (S.r.l.), but was later transformed into an Italian joint stock company (S.p.A.).[144] Eskosol was established by its shareholders—a Belgian company Blusun (which originally held a 50% equity stake in Eskosol, but over time increased its equity to 80%) and four Italian nationals (by the time of the dispute only two of them remained shareholders, each holding a 10% equity).[145] In its turn, Blusun was owned by two individuals—a French citizen and a German citizen.[146]

As a project company, Eskosol was to develop, build, and connect to the national power grid a number of solar PV power plants in Italy. Eskosol allegedly invested €38.5 million to the planning, construction, and operation of its solar energy generation project comprising of 120 solar PV power plants.[147] Between May and July 2010, Eskosol acquired 100% shareholding in 12 special purpose vehicle companies (SPVs), thus receiving access to all permits,

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141 *Id.* (noting that "Italy argue[d] that 'the dispute' . . . already has been submitted to arbitration in the *Blusun* case.").

142 *See generally* Blusun S.A., Jean-Pierre Lecorcier and Michael Stein v. Italian Republic, ICSID Case No. ARB/14/3, Final Award (Dec. 27, 2016) [hereinafter Blusun].

143 *See generally* Blusun S.A., Jean-Pierre Lecorcier and Michael Stein v. Italian Republic, ICSID Case No. ARB/14/3, Application for Annulment (May 2, 2017).

144 *See* Eskosol, *supra* note 9, ¶20 (indicating that Eskosol was established on December 21, 2009, as a limited liability partnership).

145 *Id.* ¶¶ 20–21 (describing how Eskosol was established).

146 *Id.* ¶ 20 ("Blusun in turn was owned by two individuals, Messrs. Jean-Pierre Lecorcier, a French citizen, and Michael Stein, a German citizen.").

147 *Id.* ¶ 23 ("The Claimant alleges that it made a number of investments in relation to the development of a solar energy generation project in Italy comprising 120 solar PV power plants. Eskosol allegedly devoted approximately €38.5 million to the planning, construction and operation of the plants.").

rights, entitlements, and infrastructure necessary to bring its plants into operation within eighteen months. Eskosol also began work on the installation of a 150- to 180-kilometer private network of cables to connect each plant to dedicated substations. In December 2010, it entered into an agreement with Siemens S.p.A. for the construction and commissioning of the plants.[148]

At the time when Eskosol was created, Italy had in place a feed-in tariffs (FITs) program that guaranteed fixed payments to qualifying photovoltaic (PV) power plants that generated energy from renewable sources. The Italian government subsequently adopted two regulatory measures—the "Romani decree" and the "Conto Energia IV"—which reduced the FITs, making Eskosol's projects economically unviable.[149] Eskosol alleges in the ICSID arbitration that these changes in the FIT program have forced it to abandon its PV projects and led to Eskosol's inability to pay its debts. As a result, it argues, Eskosol was declared insolvent and placed under receivership in November 2013.[150]

Soon thereafter, on February 21, 2014, the majority shareholder of Eskosol—Belgian company Blusun and its owners—began an ICSID arbitration challenging regulatory measures by the Italian government. The Blusun claimants sought recovery of the "loss of investment made and to the capital gains that the Claimants were unable to realize on their investments," in an amount estimated to be €187.8 million.[151] Eskosol's claims arise directly out of the losses that it suffered as the operating company.[152] According to Eskosol, Blusun initiated and litigated the ICSID arbitration without consulting Eskosol, attempting to "usurp Eskosol's claims and seek compensation for its direct losses."[153] Furthermore, Eskosol alleges that claimants in the *Blusun* arbitration have not cooperated with

148 *Id.* ¶ 24 ("On December 29, 2010, Eskosol entered into an engineering, construction and procurement agreement . . . with Siemens S.p.A . . . for the construction and commissioning of the plants.").

149 *Id.* ¶¶ 25–26.

150 *See id.* ¶ 27 ("The Claimant asserts that the Eskosol Project became economically unviable as a result of these measures, and Eskosol had no alternative but to abandon its project.").

151 Blusun, *supra* note 142, ¶ 48.

152 *See* Eskosol, *supra* note 9, ¶ 161 ("In its view, the excerpts suggests [sic] that Blusun sought recovery for lost 'capital gains' benefits it could have secured by selling its shareholding in Eskosol, while Eskosol's claims arise directly out of the losses that it suffered as the operating company.").

153 *Id.* ¶ 151.

Eskosol's insolvency proceedings.[154] With the *Blusun* arbitration then pending, on December 9, 2015, Eskosol filed its own request for ICSID arbitration under the ECT against Italy.[155]

Aware of the *Blusun* arbitration that derived largely from the same facts as its own arbitration, Eskosol states that it attempted to consolidate the two arbitrations, but its request to consolidate was denied by the *Blusun* tribunal.[156] Eskosol further sought permission to intervene in the *Blusun* arbitration proceedings by submitting its observations as a non-disputing party under ICSID Arbitration Rule 37(2).[157] In its application, Eskosol argued that claims by Blusun and its owners were of an "abusive nature" and, in particular, that the Blusun claimants were "attempting to abuse these [arbitral] proceedings by seeking damages to which only Eskosol is entitled."[158] It also disputed that awarding damages to Blusun and its owners would prejudice Eskosol, its creditors, and its minority shareholders.[159] In addition, Eskosol raised concerns that "the *Blusun* claimants 'have no authority to represent Eskosol's interests' in the *Blusun* case, but nonetheless were attempting to obtain compensation 'for all of Eskosol's losses . . . without the intent to channel these moneys into Eskosol so Eskosol can reimburse any such payments to the Eskosol Creditors.'"[160] The arbitral tribunal denied Eskosol's application to submit observations as a non-party.[161] The tribunal indicated that the non-party submission could disrupt the arbitral proceeding as it was submitted "extraor-

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154 *See id.* ¶ 29 ("Eskosol further asserts that the Blusun claimants have not cooperated with Eskosol's insolvency proceedings.").

155 *Id.* ¶ 30 ("When Eskosol filed its Request in this case on December 9, 2015, it acknowledged the pendency of the Blusun case, but stated that '[t]he present claim is distinct and separate from that being pursued' by the Blusun claimants." (citation omitted)).

156 *See id*. (noting that the *Blusun* tribunal denied Eskosol's request to consolidate). It is unclear who proposed to consolidate the two arbitrations. In the Blusun case, Italy claimed that it proposed to Blusun and Eskosol to consolidate their two cases, but they refused. *See* Blusun, *supra* note 142, ¶ 43 (recalling Italy's consolidation proposal to Blusun and Eskosol as a ground to deny Eskosol's request to intervene as a non-disputing party in the Blusun case).

157 *See* Blusun, *supra* note 142, ¶¶ 42–43 (rejecting Eskosol's application to intervene).

158 *See* Eskosol, *supra* note 9, ¶ 31 (quoting Blusun, *supra* note 142, ¶ 5).

159 *See id.* (reciting Eskosol's application to intervene in the *Blusun* case).

160 *Id.*

161 *See* Blusun, *supra* note 142, ¶ 43 (explaining how the tribunal rejected the party's application).

dinarily late" and there was no excuse for such lateness.[162]

In the *Eskosol* arbitration, on November 18, 2016, Italy attempted to secure a summary dismissal of Eskosol's case by filing an Objection under Rule 41(5) of the ICSID Arbitration Rules arguing that the claims were manifestly without legal merit.[163] Soon thereafter, on December 27, 2016, Blusun lost its arbitration on the merits.[164] This allowed Italy to add res judicata (and collateral estoppel) arguments to its Objection, arguing that the Blusun award has preclusive effect on the dispute between Eskosol and Italy.[165] As a result, Italy presented four separate grounds for its application under Rule 41(5).[166] In particular, Italy argued that Eskosol was no longer a foreign investor because it was not under "foreign control" by Blusun, as required by the ECT to establish jurisdiction. Italy further argued that Eskosol was under the control of a bankruptcy receiver and an Italian bankruptcy court.[167] In light of the *Blusun* arbitration, Italy also argued that under Article 26(3)(b)(i) and Annex ID of the ECT Treaty, Italy did not give its unconditional consent to arbitration because an investor has previously submitted the dispute to resolution in the *Blusun* arbitration.[168] Separately, Italy argued that public international law principles "preclude the opening of a new proceeding on a dispute that previously was submitted to another international arbitration tribunal (*lis pendens*), or actually was decided by such a tribunal (*res judicata* or collateral estoppel)."[169] According to Italy, the *Blusun* arbitra-

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162 *Id.* By the time Eskosol submitted its request to intervene as a non-disputing party, the hearings on jurisdiction and the merits in the arbitral proceedings in the Blusun case were held. *See id.* ¶¶ 33, 42 (noting that the hearings were held in April 2016, while ICSID received Eskosol's application to intervene in June 2016). Hence, the tribunal noted that Eskosol's submission was made very late, even though Eskosol knew about the *Blusun* arbitration and could have made its submission earlier in the arbitral proceedings. *See id.* ¶ 43 ("The Tribunal also notes that Eskosol's Application was submitted extraordinarily late and that there is no excuse for the lateness.").

163 *See* Eskosol, *supra* note 9, ¶ 13 (stating that Italy filed an objection).

164 *See* Blusun, *supra* note 142, ¶ 423 (dismissing the entirety of Blusun's claims on the merits).

165 *See* Eskosol, *supra* note 9, ¶¶ 136–37, 148 (reciting Italy's res judicata defense).

166 *See id.* ¶ 43 ("Italy presents four separate grounds for its application that the Tribunal dismiss Eskosol's claims for manifest lack of legal merit . . . .").

167 *See id.* ¶ 59 (explaining Eskosol's bankruptcy proceedings).

168 *See id.* ¶ 121–24 (reciting Italy's argument that its "consent [to ISDS] provided in the ECT did not extend to the initiation of a new arbitration proceeding involving . . . 'perfect identity of object and cause' with the prior Blusun case.").

169 *Id.* ¶ 136. (footnotes omitted).

tion was a "parallel proceeding[] with perfect identity of object and cause."[170]

On its side, Eskosol argued that there was no legal basis to deprive Eskosol of its legal right, since Eskosol and Blusun were not substantially the same claimants. It further argued that Blusun was not authorized to present Eskosol in the first arbitration; to the contrary, Blusun and its owners (1) failed to consult with Eskosol in making a decision to bring an ICSID arbitration and (2) failed to communicate with Eskosol during the course of their arbitration, (3) refused to consider a consolidation of two arbitrations, (4) did not represent the interests of Eskosol, including its minority shareholders and creditors, and (5) had "no intention of sharing any proceeds with Eskosol to make it whole."[171]

The tribunal was unconvinced with Italy's arguments raised in the Rule 41(5) objection. It denied Italy's application for dismissal of Eskosol's claims on the grounds that they are "manifestly without legal merit," pursuant to Rule 41(5) of the ICSID Arbitration Rules.[172] The Eskosol case is currently pending, and it remains to be seen what consequences the *Blusun* award will have on the tribunal's decision in the *Eskosol* arbitration.

The Italian objection under Rule 41(5) and its outcome underline the problem of reflective loss claims. Having failed to secure a summary dismissal, Italy is forced to defend itself in the second proceeding against claims derived from the same facts and, in doing so, to spend substantial financial resources on its defense.[173] Moreover, having won against Eskosol's majority shareholder Blusun and Blusun's owners, it is now forced to defend against Eskosol. Ironically, the ability of Eskosol as an Italian company to bring a claim in arbitration is based on the fact that the company is

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170 *Id.* ¶ 43.

171 *Id.* ¶ 156 (footnote omitted).

172 *Id.* ¶ 173.

173 A host state's average legal defenses costs are $4.5 million in legal fees in addition to about $373,200 in tribunal costs (if tribunal costs are split equally between parties). *See* Matthew Hodgson, *Counting the Cost of Investment Treaty Arbitration*, GLOBAL ARB. REV. (Mar. 24, 2014) (describing an Allen & Overy study of 176 investment treaty arbitration cases). Another study of 138 ICSID arbitrations concluded in the period of July 1, 2010 to June 30, 2015, revealed higher costs of, on average, $5,619,261.74 for claimants and $4,954,461.27 for respondents, in addition to $882,668.19 in tribunal costs. *See generally* Jeffery P. Commission, *How Much Does an ICSID Arbitration Cost? A Snapshot of the Last Five Years*, KLUWER ARB. BLOG (Feb. 29, 2016), http://kluwerarbitrationblog.com/2016/02/29/how-much-does-an-icsid-arbitration-cost-a-snapshot-of-the-last-five-years/ [https://perma.cc/D3NB-6P4Q].

majority owned and controlled by Blusun, whose claims were denied in the *Blusun* arbitration.[174] The *Eskosol* arbitration thus gives Blusun a second chance to argue its case, although indirectly through Eskosol.[175] Given the circumstances of the *Eskosol* case, Blusun is unlikely to benefit from any damages awarded to Eskosol, as Eskosol is currently in a bankruptcy proceeding. But considering that the damages might help Eskosol to pay its creditors and emerge from bankruptcy as a viable company, Blusun might benefit without collecting monetary damages directly. Generally speaking, one can anticipate that where a company is financially stable and brings its claims in arbitration following an arbitration lost by its shareholder, a second arbitration would effectively provide the shareholder with the so-called second bite at the apple and may benefit such shareholders indirectly.

From Eskosol's perspective, the *Blusun* arbitration—although it was lost by Blusun—creates concerns of the res judicata effect of the *Blusun* award. Under the circumstances of the case, Blusun commenced its arbitration without coordinating with Eskosol or taking into account the company's interest. Furthermore, the *Blusun* tribunal did not take into account Eskosol's interests through either consolidation, or submissions by a non-party. As a result, Eskosol's interests were not presented in the *Blusun* arbitration, yet the outcome of the *Blusun* arbitration might have a preclusive effect on the *Eskosol* decision due to res judicata.

Deciding on Italy's Objection under Rule 41(5), the tribunal did not grant the *Blusun* award res judicata effect, mainly because Italy was bound by a confidentiality agreement with Blusun and could not provide the tribunal with a copy of the *Blusun* award to make

[174] In the Eskosol arbitration, Eskosol brought claims against Italy under the ECT. Eskosol, *supra* note 9, ¶ 1 ("This case concerns a dispute submitted to the International Centre for Settlement of Investment Disputes . . . on the basis of the Energy Charter Treaty."). Under Article 26(7) of the ECT, a company that has a nationality of the host state, but is controlled by investors of another state, is treated as a national of the other state. *See* ECT, *supra* note 104, art. 26(7) ("An Investor which . . . is controlled by Investors of another Contracting Party, shall for the purpose of article 25(2)(b) of the ICSID Convention be treated as a 'national of another Contracting State'."). Consequently, although an Italian company, Eskosol is treated as a Belgian company for purposes of the ICSID Convention.

[175] The circumstances of this case show that Eskosol is in bankruptcy and that its ICSID arbitration was commenced on Eskosol's behalf by the bankruptcy receiver. *See* Eskosol, *supra* note 9, ¶ 27 ("Eskosol's bankruptcy receiver is Mr. Teodoro Contardi, who has the power to institute proceedings on behalf of Eskosol, as a matter of Italian law."). But circumstances may vary and in other instances shareholders can benefit from the follow-up arbitrations by the company, effectively rearguing the case after shareholders' loss in a prior arbitration.

an assessment of whether the two cases were largely identical.[176] However, in the future proceeding the tribunal can still grant the *Blusun* award res judicata effect.[177] An indicator of this is the fact that the tribunal ordered Italy to submit a copy of the *Blusun* award in the *Eskosol* arbitration.[178] ICSID has since published the *Blusun* award and it remains to be seen if and how the *Eskosol* arbitration will be affected by the *Blusun* award.

From the corporate governance perspective, the *Blusun* case demonstrates how shareholder claims for reflective loss can actualize conflicts of interests between shareholders and "their" companies. Instead of just being a theoretical concern and a possible cause of tension at the shareholder meetings, reflective loss claims allow shareholders to directly oppose the company and its management. They give shareholders a right to bypass corporate governance choices and benefit directly by collecting damages for losses suffered by the corporation due to a breach of investor protection obligations. Moreover, even if a treaty-protected shareholder loses in its arbitration, it can destroy the company's ability to seek damages for breaches of investor protection obligations through res judicata.

Two additional observations can be made with regards to the *Eskosol* case. First, there is an inherent conflict of interest between the shareholders and the management of the corporation. Granting the right to bring a claim in arbitration to shareholders provides shareholders with a means to bypass the corporate management and control structure of the company and submit a claim to arbitration disregarding the company's interests. In the *Eskosol* case, the company actively sought but failed to reach an agreement with Blusun, which chose to submit its own claims to arbitration in the hope it could benefit directly. Second, various procedural mechanisms—such as claim consolidation and submission of nonparty observations—that would theoretically allow coordination between the company's and the shareholders' interests may not

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176 *See id.* ¶ 32 n.35 ("Italy contends that it is restricted by confidentiality obligations agreed in the *Blusun* case from submitting the full Award to this Tribunal.").

177 *See id.* ¶ 172 (inviting Italy to invoke the *Blusun* award later in the case, by stating that "Italy is free later in this case to argue, if it so wishes, that the conclusions of the *Blusun* tribunal were persuasive and should be followed by this Tribunal, exercising its independent judgment.").

178 *See id.* ¶ 173 "[T]he Tribunal . . . . [o]rders Italy, to the extent and at such time as it wishes to rely on the Blusun award for any purpose in this case, to produce such award in full.").

always work for various reasons. For instance, the applicable arbitration rules might not provide for consolidation,[179] or either the parties or the arbitral tribunal might not agree on consolidation. Similarly, non-party submissions could not be allowed by the tribunal or the parties, for instance, where such submissions interfere with the arbitral proceedings.[180]

3.2.2. Reflective loss and corporate structure

Critics of the ISDS system often suspect corporate claimants of treaty- and forum-shopping, alleging that multinational corporations restructure solely to benefit from a stronger investor protection regime.[181] There are no definite studies uncovering why companies investing abroad restructure and, for shareholders in particular, what role reflective loss claims play in corporate restructuring.[182] However, there are cases that suggest that reflective loss claims contribute to treaty- and forum-shopping through corporate restructuring.

In *Mobil Corporation v. Venezuela*, in the midst of changes to the regulatory regime of the Venezuelan petroleum industry, the claimants created a new private company under the laws of the Netherlands that was wholly owned by Mobil, a Delaware corporation.[183] Within a year, the Dutch company acquired all shares in

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[179] For instance, the ICSID Convention and Arbitration rules do not provide for consolidation specifically. *See generally*, ICSID, *Rules of Procedure for Arbitration Proceedings (Arbitration Rules)*, *in* ICSID CONVENTION, REGULATIONS AND RULES (2006), https://icsid.worldbank.org/en/Documents/resources/2006%20CRR_English-final.pdf [https://perma.cc/GH6K-45QY].

[180] For instance, the Blusun tribunal has refused the non-party submission by Eskosol because the tribunal thought the submission was too late and could interfere with the arbitral proceedings. *See* Blusun, *supra* note 142, ¶ 43 (explaining how the tribunal rejected the party's application).

[181] Similarly, host states have argued that institution by the "same substantial investor" of two parallel proceedings before two different tribunals amounts to forum-shopping and should be prohibited as such. *See, e.g.*, Eskosol, *supra* note 9, ¶ 127 (reciting Italy's argument equating multiple related proceedings to prohibitive forum shopping).

[182] *See* OECD Policy Paper, *supra* note 19, at 244 (noting the lack of any studies showing companies disbursing shareholders across jurisdictions to obtain the benefits of a larger number of investment treaties).

[183] *See* Venezuela Holdings, *supra* note 15, ¶ 20 ("[T]he claimants in October 2005 created a new entity under the laws of the Netherlands, Venezuela Holdings, and inserted it into the corporate chains for the Cerro Negro and La Ceiba Projects

two Delaware companies indirectly involved in the Venezuelan oil projects through two Bahamian companies.[184] Having thus inserted a Dutch holding company into the corporate chain of ownership, the claimants filed for arbitration on September 6, 2007—less than a year after the second acquisition—under the Dutch-Venezuelan BIT.[185] It should be noted that as of today—nearly a decade later—neither the United States nor the Bahamas has a BIT with Venezuela. Without its newly created Dutch company, Mobil would not have been able to claim protection under an investment treaty. The tribunal in this case focused on the timing of the restructuring. It distinguished between pre-existing and future disputes and established jurisdiction only with respect to disputes that arose after the respective dates of acquisition of two Delaware companies by the Dutch entity.[186] In doing so, the tribunal concluded that both Delaware subsidiaries of the Dutch company were to be considered as nationals of the Netherlands because of their control by the Dutch entity. No actual control had to be established as it was presumed that the Dutch company could exercise control because it owned 100% shares of both Delaware subsidiaries, which in turn wholly owned the Bahamian companies and the investment.[187] Perhaps not surprisingly, while the arbitration was ongoing, Venezuela submitted a notice of unilateral termination of its BIT with the Netherlands in April 2008.[188]

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in February 2006 and November 2006 respectively.").

184 *See id.* ¶¶ 21–22 ("Mobil (Delaware) owns 100% of Venezuela Holdings (Netherlands), which owns 100% of Mobil CN Holding (Delaware)" and "100 % of Mobil Venezolana (Bahamas), which finally owns a 50 % interest in the La Ceiba Association.").

185 *See id.* ¶ 1 (describing request for arbitration).

186 *See id.* ¶ 206 (limiting the tribunal's jurisdiction to only those disputes that arose after the Dutch company acquired the Delaware and Bahamian companies).

187 *See id.* ¶ 160 (ruling that holding 100% of the subsidiary share capital was enough to establish control under the Netherlands-Venezuela BIT).

188 *See* Luke Eric Peterson, *Venezuela Surprises the Netherlands with Termination Notice for BIT; Treaty Has Been Used by Many Investors to "Route" Investments into Venezuela*, INV. ARB. REP. (May 16, 2008), https://www.iareporter.com/articles/venezuela-surprises-the-netherlands-with-termination-notice-for-bit-treaty-has-been-used-by-many-investors-to-route-investments-into-venezuela/ [https://perma.cc/MZX5-LRMZ] (discussing Venezuela's termination notice to the Netherlands in April 2008); *see also The Importance of Bilateral Investment Treaties (BITs) When Investing in Emerging Markets*, A.B.A. (June 29, 2017), https://www.americanbar.org/groups/business_law/publications/blt/2014/03/01_sprenger/[https://perma.cc/6KLV-QZUP] (stating that the official termination occurred on November 1, 2008).

Some cases of corporate restructuring are blatantly fraudulent, and tribunals have no difficulty recognizing this. In *Phoenix v. Czech Republic*, a former Czech national incorporated an Israeli company, forced it to acquire an interest in the Czech companies owned by members of his family and already involved in the litigation with the Czech authorities, and then filed for an arbitration under the Czech-Israeli BIT.[189] Having examined the timing of the investment and the nature and substance of the transaction, the arbitral tribunal established that the "Claimant's initiation and pursuit of [the] arbitration [was] an abuse of the system of international ICSID investment arbitration" and accordingly found that it lacked jurisdiction.[190]

In *Tidewater v. Venezuela*, the claimants conducted their operations in Venezuela through Tidewater Marine Service, C.A. ("SEMARCA"), a company incorporated in Venezuela and owned by another Venezuelan company—Tidewater Caribe.[191] Tidewater Caribe was owned by a company in the Cayman Islands, which was in turn owned by Tidewater, Inc. (a U.S. corporation).[192] Through SEMARCA, the claimants provided marine support services to the oil industry in Venezuela under commercial contracts with certain Venezuelan national and semi-national oil companies.[193] In 2008–2009, once oil prices fell, the Venezuelan national oil companies struggled to pay for services under the contracts with SEMARCA.[194] As the arrears grew, SEMARCA continued providing services but ultimately halted its performance and refused to extend its contracts until the arrears were reduced.[195] While the contractual dispute was developing, Tidewater, Inc. created a new corporation in Barbados—Tidewater Barbados—and

189 *See generally* Phoenix Action Ltd. v. Czech Republic, ICSID Case No. ARB/06/5, Award (Apr. 15, 2009).

190 *Id.* ¶ 144.

191 *See* Tidewater Investment SRL and Tidewater Caribe, C.A. v. Bolivarian Republic of Venezuela, ICSID Case No. ARB/10/5, Decision on Jurisdiction, ¶¶ 2–3 (Feb. 8, 2013) (describing the dispute).

192 *See id.* ¶ 3 (describing the corporate ownership structure of the local Venezuelan investment).

193 *See id.* ¶¶ 2, 5 (noting that Venezuelan national oil company PDVSA engaged SEMARCA for oil industry support services).

194 *See* ¶¶ 154–64 (describing contractual dispute between SEMARCA and PDVSA).

195 *See id.* ¶ 169 ("On 6 April 2009, Mr Jacob wrote to PDVSA to say that SEMARCA would not continue to provide services to PDVSA after the expiration of the two contracts due to expire on 31 May 2009 unless the arrears were reduced.").

transferred to it all the shares of Tidewater Caribe.[196] Tidewater Barbados was thus inserted into the claimants' chain of corporate ownership, becoming the sole owner of Tidewater Caribe.

About two months after the creation of the Barbados company, Venezuela seized the claimants' operations and assets in Venezuela, including fifteen vessels, driven in particular by concerns that "the service companies might remove their vessels from Venezuela" and as a "response to contractors refusing to lower their rates by at least 40%."[197] On 16 February 2010, the claimants filed a request for arbitration under the ICSID Convention invoking the Barbados-Venezuela BIT. The request for arbitration was amended on March 1, 2013 following the tribunal's decision on jurisdiction of February 8, 2013.

In the arbitration, Venezuela objected to the tribunal's jurisdiction, arguing that the claimant's restructuring constituted an abuse of right under international law.[198] The claimants through its expert witness effectively acknowledged that the "restructuring was motivated by both tax considerations and also by 'risk mitigation perspectives.'"[199] The tribunal found that there was no abuse of the treaty by the claimants. It accepted the claimant's argument that it thought to protect itself from a risk of expropriation, but only with respect to the general risk of future disputes.[200] Having then distinguished between the pre-existing contractual dispute and the expropriation dispute, and found that the acts of expropriation were not reasonably foreseeable at the time of the restructuring, the tribunal established jurisdiction only with respect to the expropriation claims.[201]

Finally, in the infamous *Philip Morris v. Australia* case, the tri-

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[196] *See id.* ¶ 166 ("The formal steps for the incorporation of Tidewater Barbados and its acquisition of the shares of Tidewater Caribe were taken in Barbados and Venezuela from 25 February to 9 March 2009 . . . .").

[197] *Id.* ¶¶ 174, 177.

[198] *See id.* ¶ 48 (describing Venezuela's claim of lack of jurisdiction).

[199] *Id.* ¶ 183 (footnote omitted).

[200] *See id.* ¶ 184 ("[I]t is a perfectly legitimate goal, and no abuse an investment protection treaty regime, for an investor to seek to protect itself from the general risk of future disputes with a host state in this way. But the same is not the case in relation to pre-existing disputes between the specific investor and the state.").

[201] *See id.* ¶ 194 (holding Venezuela's threat to withhold service agreement payments were contractual and not an act of expropriation); *id.* ¶¶ 197–99 (holding Venezuelan acts of expropriation were not foreseeable during the corporate restructuring).

bunal notably declined jurisdiction because Philip Morris was not "able to prove that tax or other business reasons were determinative for the restructuring [which lead the tribunal to] conclude that the main and determinative, if not sole, reason for the restructuring was the intention to bring a claim under the [Hong Kong-Australia BIT]."[202]

The above cases illustrate that the companies and their shareholders sometimes restructure solely to acquire the benefits of a stronger investor protection regime with respect to imminent or potential investment disputes. The reflective loss claims available to shareholders have arguably contributed to the dynamics of these restructuring efforts by providing incentives to restructure not only to the local company and its direct shareholders, but also to indirect shareholders at the higher levels of the corporate ownership chain. The challenge for the tribunals in these cases is to distinguish instances of restructuring that are motivated by genuine business or tax considerations from opportunistic actions by the management that seek to exploit the ISDS system and may hurt the company. In a separate and forthcoming article, I will examine the role of investment treaties and disputes, including the rules on reflective loss claims, in the restructuring of the multinational corporations and their corporate ownership chains.

3.3. Lessons for the law and public policy

Consistent with the theoretical predictions, investment arbitration cases provide evidence that shareholder claims for reflective loss impact corporate law, its governance, and the corporate ownership structure of companies investing abroad. The case studies offer several lessons for the law and public policy. First, the impact of investment treaties on attracting foreign investments might be less significant than expected,[203] because companies may establish

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[202] Philip Morris Asia Ltd. v. Commonwealth of Australia, UNCITRAL, PCA Case No. 2012-12, Award on Jurisdiction and Admissibility, ¶ 584 (Dec. 17, 2015).

[203] Prior studies on the impact of investor protection treaties on attracting foreign investment are inconclusive. One of the recent studies has demonstrated that there might be benefits of BITs for lower- and middle-income countries, but not to high-income countries, although there are observable differences among world regions. *See, e.g.*, Arjan Lejour & Maria Salfi, *The Regional Impact of Bilateral Investment Treaties on Foreign Direct Investment* (CPB Netherlands Bureau for Economic Policy Analysis, CPB Discussion Paper 298, Jan. 16, 2015), https://www.cpb.nl/sites/default/files/publicaties/download/cpb-discussion-

a presence in a foreign jurisdiction only to benefit from a stronger investment protection regime. Although they may be considered foreign investors under local law, some of these companies may not actually provide investments and contribute to the economy of the host state.

Second, with regard to companies' decision-making process, prior studies have suggested that companies make decisions to invest abroad largely based on business and tax considerations. They rarely, if at all, consider the advantages of a particular investor protection regime.[204] Yet, as cases discussed in this Article suggest, if and when a dispute is looming, a foreign investor becomes more aware and responsive to an investor protection regime and may seek to opportunistically benefit through restructuring or asset transfers. International investment law can respond to these concerns by reducing the pool of potential claimants under investor protection treaties. For instance, this can be achieved by limiting protection to the local companies under foreign control and their direct shareholders. Countries could also consider a greater reliance on the denial of benefits provisions, which would allow them to revoke a consent to arbitrate where the claimant did not make any real investments in the host state.

Third, by allowing shareholder claims for reflective loss, international investment law may trump domestic corporate law rules and impact the corporate structure and governance choices of the companies investing abroad. One can identify three broad categories of such impact—*legal*, *corporate governance*, and *structural effects*. Legal effects include changes of the legal framework within which the corporation operates. This framework changes for the corporation once the company invests abroad and acquires the benefits of investor protection. Most importantly, for corporate investors, investment treaties not only provide investor protection guarantees,

paper-298-regional-impact-bilateral-investment-treaties-foreign-direct-investment.pdf [https://perma.cc/C42C-P4F3] (concluding that "[u]pper middle income countries seem to benefit the most from BITs. . . . [but] BITs do not support significantly foreign investment in high income countries.").

[204] *See, e.g.*, COLUM. CTR. SUSTAINABLE INV., COSTS AND BENEFITS OF INVESTMENT TREATIES: PRACTICAL CONSIDERATIONS FOR STATES (March 2018), http://ccsi.columbia.edu/files/2018/04/07-Columbia-IIA-investor-policy-briefing-ENG-mr.pdf [https://perma.cc/5FDF-XV42] ("Studies on determinants of foreign direct investment (FDI) confirm that other factors—such as market size and growth, the availability of natural resources, and the quality of hard and soft infrastructure—tend to be far more important to investors than investment treaties when making the decision to invest.").

but in effect alter the dynamics of intra-corporate relationships—the matters which are generally governed by domestic law of the company's state of incorporation. The right of shareholders to bring individual claims in investment arbitration for reflective loss allows shareholders to independently make decisions that affect, and may harm, the corporation. First and foremost, treaty-protected shareholders can decide on their own whether to begin an arbitration against a host state to recover reflective losses suffered by the corporation. None of the advanced systems of corporate law allow shareholders to bring claims for reflective loss and benefit from damages otherwise owed to the company. In this sense, international investment law directly contradicts and will trump domestic law provisions by allowing shareholders to advance claims for reflective loss.

Governance effects include international investment law's observable impact on the internal structure of the management and control relationships within the corporation, as well as relationships between the shareholders and the company and its creditors. The rules on reflective loss allow shareholders to bring a claim in ISDS without consulting the management of the company and taking into account the company's interests. The rules also give shareholders leverage in any negotiations with the management of the company. Additionally, they allow shareholders to benefit directly at the expense of the company and its creditors once the damages are awarded to the shareholders.

As the number of investor-state arbitrations continues to grow, more data will become available on disputes where shareholders have exercised their rights and benefited directly at the expense of the corporation and its creditors. The *Eskosol* decision demonstrates that the problem is no longer theoretical, and that international law is not concerned about its impact on corporate law and governance. And the potential disruptive effects of reflective loss claims are increasing since the share of foreign shareholders in most leading corporate law jurisdictions continues to grow. For instance, current data on foreign ownership in corporations shows that "half of the listed companies in the U.K and Belgium, 40 % of the companies in France and Germany and around 30 % of the companies in Spain and Italy have a large foreign shareholder."[205] This suggests that "countries with advanced capital markets and

[205] OECD Policy Paper, *supra* note 19, at 248 n.32 (citing Gaukrodger, *supra* note 16, at 49).

traditional BITs may be beginning to see their first shareholder claims."[206] This may also "raise the profile of the question of the comparative treatment of shareholders."[207]

International investment law and, in particular, rules on reflective loss claims also lead to structural effects by providing incentives to corporations and shareholders to restructure, in particular, to benefit from a more advantageous investor protection regime. Restructuring can be motivated by legitimate business and tax considerations,[208] but may also be the product of opportunistic actions—such as treaty- or forum-shopping—by the management or controlling shareholder.[209] The investor's initial decision to establish a local company is often motivated by business considerations or legal requirements, such as a requirement to establish a local company in the host state as a condition of operating in the country.[210] Once the investments are established, the corporate ownership chain can change over time as part of the normal course of business. Foreign investors may also restructure in response to the regulatory change in the host state to gain access to a BIT and ICSID or to benefit from a more advantageous investor protection regime.[211] Apart from restructuring, foreign investors may seek the benefits of IIAs by transferring assets to new or existing entities or by changing corporate nationality.[212] This practice is not in itself

[206] Gaukrodger, *supra* note 16, at 49.

[207] *Id.*

[208] *See* OECD Policy Paper, *supra* note 19, at 242 (noting that intra-group asset transfers may be undertaken to secure a tax advantage).

[209] In fact, the allegations of abuse of the BITs through restructuring or other corporate changes, as well as treaty-shopping are often made by respondents in investor-state arbitrations. For instance, Venezuela argued in *Mobil Corporation v. Venezuela* that Mobil has abused the right by establishing a holding company in the Netherlands and thereby restructuring its investments after they were made to allegedly gain access to ICSID. *See* Venezuela Holdings, *supra* note 15, ¶ 32 (June 10, 2010) (noting Venezuela's allegations that restructuring was completed "to 'position' the Claimants for disputes that 'had arisen'.").

[210] Domestic rules and regulations differ in this respect, but the requirement is common across jurisdictions. *See* Schreuer, *supra* note 11, at 4 (noting that "many States require the establishment of a local company as a precondition for foreign investment.").

[211] *See* Venezuela Holdings, *supra* note 15, ¶ 204 ("[T]he aim of the restructuring . . . was to protect those investments against breaches of their rights by the Venezuelan authorities by gaining access to ICSID arbitration through the BIT. The Tribunal considers that this was a perfectly legitimate goal as far as it concerned *future* disputes." (emphasis added)).

[212] *See* Voon et al., *supra* note 71, at 41 ("Host states not infrequently find themselves responding to claims by investors under international investment agreements (IIAs) following a series of corporate steps to enable the claim to take

illegal under international investment law,[213] although it understandably produced a furious reaction from host states, which in various cases have argued that corporate restructuring and asset transfers constitute an abuse of corporate form,[214] abuse of right,[215] abuse of process,[216] abuse of the treaty regime,[217] or fraud.[218] However, as I have emphasized in this Article, the effects of corporate

place: restructuring of existing chains of corporate ownership; transfers of assets to new or existing entities; or changes in corporate nationality."); *see also* Autopista Concesionada de Venezuela, C.A. v. Bolivarian Republic of Venezuela, ICSID Case No. ARB/00/5, Decision on Jurisdiction (Sept. 27, 2001), 16 ICSID Rev. 469 (2001) (regarding a Mexican investor who restructured its investment in Venezuela by transferring 75% of its shares to a U.S. corporation; under a concession agreement between the parties, such transfer allowed submission of a claim to the ICSID arbitration because a majority of shareholders in the Venezuelan investment were nationals of a country party to the ICSID Convention—the United States); Aguas del Tunari S.A. v. Bolivia, ICSID Case No. ARB/02/3, Decision on Respondent's Objections to Jurisdiction (Oct. 21, 2005), 20 ICSID Rev. 450 (2005) (regarding a U.S. corporation that owned 55% shares in the corporation organized under the laws of Bolivia, but transferred them to a Dutch company before filing for an arbitration under the Dutch-Bolivian BIT).

213 *See* Aguas del Tunari S.A. v. Bolivia, ICSID Case No. ARB/02/3, Decision on Respondent's Objections to Jurisdiction, ¶ 330 (holding that "it is not uncommon in practice and—absent a particular limitation—not illegal to locate one's operation in a jurisdiction perceived to provide a beneficial regulatory and legal environment in terms, for example, of taxation or the substantive law of the jurisdiction, including the availability of a BIT.").

214 *See, e.g.*, Phoenix Action Ltd v. Czech Republic, ICSID Case No. ARB/06/5, Award, ¶ 40 ("When there is – as the Respondent contends is the case here – an abuse of a corporate structure, the Tribunal should look beyond the apparent facts and lift the corporate veil.").

215 *See, e.g.*, Venezuela Holdings, *supra* note 15, ¶¶ 161–85 (noting that Venezuela argued, in particular, that the arbitral tribunal had no jurisdiction because the corporate restructuring by claimants constituted an abuse of right. In reply, claimants argued that the corporate restructuring was motivated by business reasons—the royalty rate increase by Venezuela in late 2004 and thereafter new investments projected and made by claimants. Claimants also argued that the restructuring was completed before Venezuela announced nationalization of claimants' oil projects in Venezuela); *id.* ¶ 205 (considering that to restructure investments only in order to gain jurisdiction under a BIT for pre-existing disputes would constitute "an abusive manipulation" of the system of international investment protection under the ICSID Convention and the BITs).

216 *See, e.g.*, Lauder v. Czech Republic, UNCITRAL, Final Award, ¶¶ 176–80 (Sept. 3, 2001) (describing the alleged abuse of process).

217 *See, e.g.*, CME Czech Republic B.V. (The Netherlands) v. Czech Republic, UNCITRAL, Partial Award, ¶412 (Sept. 13, 2001) (finding no abuse of the treaty regime where two related claimants in the chain of corporate ownership bring virtually identical claims under two separate treaties).

218 *See, e.g.*, Aguas del Tunari S.A. v. Bolivia, ICSID Case No. ARB/02/3, Decision on Respondent's Objections to Jurisdiction, ¶ 331 (Oct. 21, 2005), 20 ICSID Rev. 450 (2005) (finding an insufficient basis to support an allegation of fraud).

restructuring expand beyond the international law arena. They affect the inner structure of the corporation and contribute to the ability of shareholders to bring reflective loss claims.

Most importantly, as further discussed below, domestic corporate law and international investment law are not equipped to deal with the reflective loss claims and their effects on corporate law, governance, and structure. This suggests that the only solution to the problem of reflective loss claims might be in private ordering.

4. SOLVING THE PROBLEM OF REFLECTIVE LOSS CLAIMS

Legal scholars and arbitration practitioners have suggested several international law and civil procedure solutions to address concerns about the multiplicity of claims, such as the risk of double recovery and inconsistent awards. In theory, they can be used in addressing distortions created to corporate law and governance by reflective loss claims. However, as further explained below, most international law and civil procedure rules are unable to resolve the problem of reflective loss claims for practical or legal reasons. In addition, domestic law—most notably, corporate law that regulates intra-company relationships—is generally powerless against shareholder claims for reflective loss. This is because provisions under domestic law that seek to limit the shareholder's ability to bring claims in ISDS—in direct contradiction to a state's obligations under investor protection treaties—will likely be trumped by the state's international law obligations.

In the absence of a feasible solution under domestic or international law, private ordering offers the best approach to tackle reflective loss claims. It allows shareholders and the company to agree on the ways to coordinate their competing claims, litigation strategy and/or settlement terms with the host state. Moreover, to avoid the problem all together, self-regulation allows shareholders to waive their right to submit a reflective loss claim in ISDS, giving up their right for the benefit of the company and its stakeholders. This allows restoring the processes of the management and control within the corporation and reducing corporate structural changes motivated by ISDS. As a result, the corporation is brought back to the legal framework provided by domestic corporate law.

4.1. Invoking the help of international law

One way to resolve the problem of reflective loss is to employ the help of international law. Since the shareholder claims for reflective loss are directly authorized by IIAs, they could be restricted or eliminated altogether through treaty revision and more careful treaty drafting. Instead of allowing shareholders to bring claims in ISDS and benefit from monetary damages, the treaty could mimic the domestic law approach and reserve such right to the company. To account for cases where the company is no longer able to bring a claim (for instance, where the corporation has been dissolved), the treaty may grant shareholders the exceptional right to bring such a claim, but provide that damages are to be awarded only to the corporation (or its successors), but not to the shareholders bringing the claim. This approach would follow the NAFTA solution, and would largely eliminate independent claims by shareholders.

Although invoking the help of international law is a logical solution, it will be very difficult to apply in practice. It would require a revision of the majority of nearly 3,300 IIAs, which is unlikely to happen. It also requires a political will on the side of contracting states, which may be more concerned about attracting foreign investors—through both foreign direct investments and portfolio investments—than about distortions to corporate law and governance created by shareholder claims under investor protection treaties. Consequently, this solution is possible in theory but highly unlikely to occur in practice.

4.2. Civil procedure solutions

Procedural law offers another solution to the reflective loss claims. At first sight, it appears that the doctrines of res judicata (claim preclusion) or collateral estoppel (issue preclusion) could prevent parallel or consecutive claims brought independently by the company and its shareholders. The doctrine of res judicata serves as "[a]n affirmative defense barring the same parties from litigating a second lawsuit on the same claim, or any other claim arising from the same transaction or series of transactions and that could have been—but was not—raised in the first suit."[219] The doctrine thus bars a second lawsuit between the same parties (or parties in privity with the original parties) arising from the same transaction following a final judgment on the merits.[220] The doctrine of collateral estoppel "[bars] a party from relitigating an issue determined against that party in an earlier action, even if the second action differs significantly from the first one."[221] As such, the doctrine of collateral estoppel does not reduce multiple proceedings, but helps to achieve greater consistency among arbitration awards rendered to the company and—possibly independently—to its shareholders. Successive investment arbitrations by a company and a shareholder (or vice versa) can sometimes be dismissed under the doctrines of abuse of process or abuse of right, especially in cases of vexatious arbitration.[222]

To address concerns over successive arbitrations, arbitral tribunals have sought to invoke the doctrines of res judicata and collateral estoppel.[223] Investment tribunals are largely in consensus today that res judicata constitutes a general principle of law and a rule of international law.[224] They therefore have invoked the doctrine of res judicata in cases where the rules of international law were to be applied in addition to an investment treaty.[225] Similarly,

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219 BLACK'S LAW DICTIONARY 1504 (10th ed. 2014).

220 *See id.* (providing several definitions for the term "res judicata").

221 *Id.* at 318.

222 *See, e.g.*, RSM Prod. Corp. et al. v. Grenada, ICSID Case No. ARB/10/6, Award, ¶ 4.6.17 (Dec. 10, 2010) (describing the respondent's reliance on notable commentators from common-law jurisdictions supporting the view that successive proceedings should be dismissed "even where the requirements of *res judicata* may not have been met . . . particularly . . . if the successive proceedings are vexatious.")

223 *See, e.g.*, *id.* ¶ 7.1.7 ("[S]hareholders . . . may undertake litigation to pursue or defend rights belonging to the corporation. However, . . . [i]f they wish to claim standing on the basis of their indirect interest in corporate assets, they must be subject to defences . . . including collateral estoppel.").

224 *See* Apotex Holdings Inc. v. United States, ICSID Case No. ARB(AF)/12/1, Award, ¶ 7.11 (Aug. 25, 2014) ("In the Tribunal's view, the doctrine of *res judicata* is a general principle of law and is thus an applicable rule of international law within the meaning of NAFTA Article 1131.").

225 *See, e.g.*, Mobil Invs. Can. Inc. v. Canada, ICSID Case No. ARB/15/6, Decision on Jurisdiction and Admissibility, ¶ 187 (July 13, 2018) ("The principle of *res judicata* has long formed part of many—if not most—systems of national law. . . . [I]t is now an established principle of international law."); *id.* ¶ 191 ("The question, therefore, is not whether a principle of res judicata is embodied in international law but rather what is its extent."); Waste Management, Inc. v. United Mexican States (II), ICSID Case No. ARB(AF)/00/3, Mexico's Preliminary Objection Concerning the Previous Proceedings, Decision of the Tribunal, ¶ 39 (June 26, 2002)

arbitral tribunals have relied on the doctrine of collateral estoppel to prevent re-litigation of an issue in a subsequent investment arbitration. For instance, the tribunal in the second RSM arbitration, which was brought under the U.S.-Grenada BIT, showed deference to a prior ICSID arbitration brought under an underlying contract between the parties invoking the doctrine of collateral estoppel.[226] The tribunal held that the claimants were barred on the ground of collateral estoppel from re-litigating conclusions of fact and law concerning the parties' rights and obligations that were already resolved in a prior arbitration.[227]

However, in practice it can be difficult to achieve the application of res judicata in investment arbitration. For the doctrine of res judicata to operate, one has to satisfy the triple identity test, which requires that the parties, the object (a type of relief sought), and the ground (the claims, or the legal arguments relied upon by the parties) to be identical in both arbitrations.[228] Such stringent interpretation of the doctrine of res judicata reduces the operation of the doctrine and allows the second arbitration to proceed. This frequently happens because of the lack of identity between the par-

("There is no doubt that res judicata is a principle of international law and even a general principle of law within the meaning of Article 38(1)(c) of the statute of the International Court of Justice."); *see also* Apotex Holdings Inc. v. United States, ICSID Case No. ARB(AF)/12/1, Award, ¶ 7.37 (Aug. 25, 2014) ("Applying NAFTA Article 1131(1), the rules of international law and the UNCITRAL Arbitration Rules, the Tribunal concludes that the Apotex I & II Award, with its relevant reasons, operates in this arbitration as *res judicata* as regards both named parties to that arbitration, namely Apotex Inc. and the Respondent. It remains to be considered in what manner it operates in regard to the specific claims made by Apotex Inc. in this arbitration.").

226 *See* RSM Prod. Co. v. Grenada, ICSID Case No. ARB/10/6, Award ¶ 7.1.5 (Dec. 10, 2010) ("[The claimants] were . . . privies of RSM at the time [of the prior arbitration]. As such, they, like RSM, are bound by those factual and other determinations regarding questions and rights arising out of or relating to the Agreement.").

227 *See id.* ¶¶ 7.1.5–7.1.6 (explaining that the parties in the two arbitrations were not identical because, for the second ICSID arbitration, the company—RSM Production Corporation—was joined by its three shareholders. However, the tribunal held that the shareholders were bound by the results of the first ICSID arbitration because they were the only shareholders of RSM, jointly owning 100% of the company).

228 *See* Gabrielle Kaufmann-Kohler, *Multiple Proceedings—New Challenges for the Settlement of Investment Disputes*, *in* CONTEMPORARY ISSUES IN INTERNATIONAL ARBITRATION AND MEDIATION—THE FORDHAM PAPERS 2013 3, 8 (Arthur W. Rovine ed., 2015) ("[T]he main difficulty with [res judicata and *lis pendens*] is that in general they come into play only if the so-called triple identity test is met. The triple identity test requires identity of facts, parties and causes of action." (footnote omitted)).

ties in cases where the tribunal adheres to the formalistic interpretation of the treaty, refusing to look behind the separate legal identity of related claimants. For instance, the respondent in the *CME v. Czech Republic* arbitration argued that the arbitral tribunal should reconsider its partial award (and apply res judicata at the quantum stage) in view of the award in the parallel arbitration in *Lauder v. Czech Republic*.[229] However, the arbitral tribunal in *CME* concluded that the respondent explicitly "waived [its res judicata and *lis pendens*] defenses by refusing to accept any of the Claimant's proposals to coordinate the two proceedings."[230] Furthermore, the tribunal established that res judicata did not apply in substance because the parties in both arbitrations were not identical, they invoked different BITs (and, consequently, different claims based on these BITs), and the tribunal could not ascertain whether the facts and circumstances presented to the tribunals in both arbitrations were the same.[231] In the *Blusun* and *Eskosol* arbitrations, Italy unsuccessfully argued that Blusun (a shareholder) and Eskosol (the company) must be considered the same investor, despite the fact they are two different legal entities.[232]

Some tribunals have looked into whether the application of res judicata in investment arbitration could be established through the application of a concept of a "single economic entity," which discounts the separate legal existence of the shareholder and the company.[233] For instance, the arbitral tribunal in *CME v. Czech Republic* considered the issue, but concluded that prior arbitral tribunals

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229 *See* CME Czech Republic B.V. (The Netherlands) v. Czech Republic, UNCITRAL, Final Award, ¶ 199 (Mar. 14, 2003) ("The Respondent's view is that the rule of *res judicata* must be applied by the Tribunal at the Quantum Phase. . . . The London Final Award not only was *res judicata* at the time the Partial Award was issued; it remains *res judicata* for the Quantum Phase and, therefore, cannot be ignored by the Tribunal.").

230 *Id.* ¶ 430; *see also id.* ¶¶ 426–427 (noting that in the first stage of this arbitration, the Czech Republic "refused any coordination of [*Lauder v. Czech Republic*] and this arbitration", and "[a]t the hearing . . . declined anew to accept any of the Claimant's alternative proposals" to coordinate the arbitration).

231 *See id.* ¶ 432 ('The Tribunal further is of the view that the principle of res judicata does not apply in favour of the London Arbitration for more than one reason. . . . the Tribunal cannot judge whether the facts submitted to the two tribunals for decision are identical . . . .").

232 *See* Eskosol, *supra* note 9, ¶ 125 ("Italy further argues that Blusun and Eskosol must be considered the same investor for the purposes of Article 26(3)(b)(i) of the ECT, even though they are two different legal entities.").

233 *See, e.g.*, CME Czech Republic B.V. (The Netherlands) v. Czech Republic, UNCITRAL, Final Award, ¶ 436 (Mar. 14, 2003) (considering the concept of the "single economic entity" and the "company group" theory).

and the courts had accepted the concept only in exceptional cases—in particular, competition law.[234] The same tribunal acknowledged that "prominent authorities" had promoted a "company group" theory in international arbitration, but refused to follow it, having established that the concept was not generally accepted in international arbitration.[235]

The application of res judicata in investment arbitrations can also be restricted by the state parties' interpretation of their investor protection treaties. For instance, in the *CME* arbitration, the tribunal's view with respect to res judicata was supported by the "common position" of the Netherlands and the Czech Republic, the state parties to the Netherlands-Czech Republic BIT invoked in the arbitration. In their common position, the Netherlands and the Czech Republic stated that the *Lauder* arbitration in London did not govern the *CME* arbitration in Stockholm.[236] In particular, they stressed that the claims in two arbitrations were made by different legal entities and that "[c]laims of different legal entities, even though they may be controlled by the same economic entity, are not necessarily the same claims . . . ."[237]

Once the award was rendered, the Czech Republic itself invoked the doctrines of res judicata and *lis pendens* as part of its challenge of the award at the Svea Court of Appeal.[238] There, the Czech Republic argued that non-application of these doctrines violated the public order of Sweden (the seat of arbitration) and therefore warranted setting aside of the award. Rejecting this argument, the court noted that there was no identity between the claimant parties in the *Lauder* and *CME* arbitrations, as required by the Swedish law.[239] The court refused to pierce the corporate veil not-

[234] *See id.* ("Only in exceptional cases, in particular in competition law, have tribunals or law courts accepted a concept of a 'single economic entity,' which allows discounting of the separate legal existences of the shareholder and the company, mostly, to allow the joining of a parent of a subsidiary to an arbitration.").

[235] *See id.* ("Also a 'company group' theory is not generally accepted in international arbitration (although promoted by prominent authorities) and there are no precedents of which the Tribunal is aware for its general acceptance. In this arbitration the situation is even less compelling.").

[236] *See id.* ¶ 437 ("The agreed minutes of the Common Position of the Netherlands and the Czech Republic . . . support the Tribunal's view that the London Award does not govern this arbitration.").

[237] *Id.* (citation omitted).

[238] *See* Svea Hovrätt [HovR] [Court of Appeals] 2003-05-15 T 8735-01 (Swed.), https://www.arbitration.sccinstitute.com/views/pages/getfile.ashx?portalId=89&docId=1242805&propId=1578 [https://perma.cc/8MAA-P749].

[239] *See id.* at 98 ("[O]ne of the fundamental conditions for *lis pendens* and *res*

ing that "no international cases have been presented in the case in which, in an actual situation of *lis pendens* and res judicata, a controlling minority shareholder has been equated with the company."[240]

As a result of failing the triple identity test in investor-state arbitrations, in particular, with respect of the identity of the parties, the res judicata doctrine has failed to provide relief against multiple proceedings in ISDS.[241] To mitigate against the strict triple identity test, advocates of ISDS have suggested to apply in investment arbitration "a relaxed notion" of res judicata.[242] Some arbitral tribunals have formulated and applied a less stringent test of res judicata.[243] However, other authors have pointed out that "it is unclear how this relaxed standard could be justified and what its precise content would be."[244]

Other procedural solutions include consolidation of arbitrations, joinder of parties, and—although less desirable for shareholders and their companies—submissions by non-parties. However, the application of these mechanisms—if they are available under applicable arbitration rules—helps largely the defending state, but not the company. In theory, consolidation and joinder would allow the defending state to avoid double recovery and to reduce the likelihood of conflicting awards. However, these procedural techniques do not diminish the conflict of interests be-

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judicata is that the same parties are involved in both cases . . . . Identity between a minority shareholder, albeit a controlling one, . . . and the actual company cannot . . . exist in a case such the instant one.").

240 *Id.* at 98; *see also id.* at 69 (observing that in the present case, Lauder held no more than 30% of the share capital in CME's parent company and was a controlling shareholder in that company).

241 *See* Kaufmann-Kohler, *supra* note 228, at 8 (noting that in investment arbitration multiple proceedings often occur because the triple identity test is not met since proceedings are initiated by different actors).

242 *Id.*

243 *See, e.g.*, Apotex Holdings Inc. v. United States of America, ICSID Case No. ARB(AF)/12/1, Award, ¶¶ 7.15–7.16 (Aug. 25, 2014) (discussing several international tribunals and scholars who questioned a division between the object and the ground of arbitration as two separate conditions of the triple identity test and have used a simpler analysis for establishing res judicata). Some tribunals take a more relaxed approach to res judicata. *See, e.g.*, Libananco Holdings Co. Limited v. Republic of Turkey, ICSID Case No. ARB/06/8, Award, ¶ 548 (Sept. 2, 2011) (finding "the application of a domestic rule of *res judicata* is there to prevent the re-litigation of an issue that has already been authoritatively determined; a treaty rule may serve the different purpose of preventing forum-shopping." (footnote omitted)).

244 Kaufmann-Kohler, *supra* note 228, at 8.

tween shareholders and the company, since they do not prevent shareholders from submitting their own claims to arbitration. As to the submissions by non-parties, they allow the shareholder or the company to indirectly defend their rights by presenting their arguments in each other's arbitrations, but these submissions do not preclude the shareholder (or the company) from commencing their own arbitration to defend their rights directly.

However, arbitration rules commonly applied in investment arbitrations—the ICSID Convention and Arbitration Rules and the UNCITRAL arbitration rules—do not provide for consolidation or joinder, although these procedural mechanisms are increasingly available under the rules of arbitral institutions, such as the International Court of Arbitration of the International Chamber of Commerce (ICC), the American Arbitration Association (AAA), and the Arbitration Institute of the Stockholm Chamber of Commerce(SCC). In the absence of specific rules, consolidation and joinder are only available if the parties to a dispute agree to consolidate their arbitrations or join additional parties. In particular, this requires willingness to consolidate or join the party from the shareholder and its company. Where the parties cannot agree, as was the case in the *Blusun* and *Eskosol* arbitrations, the hands of the tribunal are tied and consolidation or joinder are not available.

Other techniques, such as using the same tribunal members for different arbitrations, can be used to increase the consistency of arbitral awards rendered by tribunals in separate arbitrations commenced by the company and its shareholders. However, this also requires the agreement by the parties, which is often hard to achieve in these cases because the interests of the shareholders and the company conflict. Moreover, it may be difficult to appoint the same tribunal in cases where the first arbitration has concluded by the time the second arbitration is commenced.

Additionally, investment tribunals have sought to avoid double recovery by apportioning damages between the shareholders and their company. The apportionment of damages may allow reducing double recovery, but is hard to do in practice as the loss of the shareholders is reflective of the company's loss. In a given dispute, it is often unclear to which extent a particular shareholder has contributed to the foreign investments and was affected by the breach. In any case, the apportionment of damages provides for direct compensation of shareholders for reflective loss. As such, it does not restore the distortions created by reflective loss claims on corporate law and governance.

4.3. Private ordering solution

Private ordering may offer a superior solution to restoring the corporate governance dynamics distorted by shareholder claims for reflective loss. Viewed from the contractual theory point of view, a corporation is a "nexus of contracts" among participants in the organization, such as shareholders, directors, creditors, suppliers, and employees.[245] Under this view, the role of corporate law is limited to enforcing private contracts, and fiduciary duties "serve as a legal constraint on managerial opportunism."[246] As a corollary to that, the freedom of contract suggests that participants in the corporation shall be free to contract as they wish. The Delaware courts have also described internal corporate relationship as a "flexible contract" formed by corporate law together with the corporate charter and bylaws.[247]

Private ordering, or self-regulation, allows private parties to adopt systems of rules to regulate their relations within the constraints of existing laws and regulation. Regardless of the view of the corporation as a contractual or a legal product, private ordering offers a practical solution to the reflective loss problem. As a general rule, the right to bring claims in investment arbitration shall be reserved to the corporation. To address the issue of shareholder claims for reflective loss, corporations can adopt targeted provisions in the corporation's governing documents—corporate charters or bylaws. Such provisions can provide for a waiver by shareholders of their right to bring claims under international

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[245] *See* Henry N. Butler, *The Contractual Theory of the Corporation*, 11 GEO. MASON L. REV. 99, 100 (1989) ("The contractual theory views the corporation as founded in private contract, where the role of the state is limited to enforcing contracts. In this regard, a state charter merely recognizes the existence of a 'nexus of contracts' called a corporation.").

[246] *Id.* at 119.

[247] *See, e.g.*, Airgas, Inc. v. Air Prods. & Chems., Inc., 8 A.3d 1182, 1188 (Del. 2010) (holding that "[c]orporate charters and bylaws are contracts among a corporation's shareholders; therefore, our rules of contract interpretation apply."); Lawson v. Household Finance Corp., 152 A 723, 727 (Del. 1930) ("Ever since the decision in the *Dartmouth College Case* . . . it has been generally recognized in this country that the charter of a corporation is a contract both between the corporation and the state and the corporation and its stockholders."); Centaur Partners, IV v. National Intergroup, Inc., 582 A.2d 923, 928 (Del. 1990) ("Corporate charters and by-laws are contracts among the shareholders of a corporation and the general rules of contract interpretation are held to apply.").

investment treaties. In addition, provisions in the corporation's governing documents can stipulate that any damages resulting from a breach by a foreign state of investor protection obligations are to be awarded to the corporation.

Such private ordering solution aims to bar investment arbitrations of shareholder claims for reflective loss at the outset. Once the waiver provisions are adopted in the corporate charters or by-laws, they attach to shares and bind the shareholders who accept the terms of these provisions by acquiring shares in the corporation. However, such a waiver system would only work if the arbitral tribunals are willing to prioritize contract waivers over investment treaty provisions granting shareholders a direct right of action. As of now, however, as Arato has observed, tribunals seem to be doing the opposite—rigidly and formalistically "prioritizing treaty provisions over negotiated contractual bargains."[248] This practice is flawed from a contractual point of view and should be abandoned if we really treat consent to arbitration in investment treaties as an open offer to arbitrate, which is then accepted (albeit with amendments through a waiver of shareholder claims) by a foreign investor when it files for arbitration. The proposed private ordering solution would privilege party choice, which, as Arato has argued in the context of transnational investment contracts, is "the best way to protect *both* the private law values of fairness and efficiency and the state's capacity to govern in the public interest."[249]

The enforcement of the waiver provisions will rest with the board, which can choose not to enforce the waiver and allow a shareholder to proceed in arbitration, for instance, where the corporation is unable to bring its own claim. In effect, this solution allows restoring the domestic corporate law prohibition on shareholder claims for reflective loss, and largely follows the NAFTA approach to shareholder claims in investment arbitration.

It is also a sound solution from a theory point of view. If the corporation is the product of private contracts, it is only logical to amend a contract between the shareholders and the management for the benefit of the corporation at large. The state can always intervene to correct distortions created by reflective loss claims on corporate law and governance, for instance, by revisiting the terms

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[248] Julian Arato, *The Logic of Contract in the World of Investment Treaties*, 58 WM. & MARY L. REV. 351, 357 (2016).

[249] *Id.* at 356.

of a state's investor protection treaties. Until then, private systems of rules offer a superior solution to the problem of reflective loss claims by allowing the shareholders and the corporation to agree that (1) the right to bring a claim in investment arbitration generally rests with the corporation, and (2) only the corporation can be awarded damages for losses resulting from a breach of investor protection obligations.

5. CONCLUSION

Reflective loss claims allow treaty-protected shareholders to bring individual claims in investment arbitrations for losses suffered by the corporation due to a breach of investor protection obligations. The right to bring these claims provides shareholders with leverage in their negotiations with corporate management and allows them to individually make decisions on important issues that affect the corporation. Reflective loss claims also allow shareholders to divert corporate assets by collecting damages awarded to them in investment arbitrations. Especially for companies in financial distress, this may harm the corporation, its creditors, non-protected shareholders, and all other stakeholders of the corporation. In the absence of a feasible solution under domestic and international law and civil procedure rules, private ordering offers the best approach to tackle the problem of reflective loss claims. It allows shareholders and the corporation to agree on the waiver of the shareholder right to claim for reflective loss in investment arbitration, thereby bringing the corporation back to the legal framework of domestic corporate law.