Comments: Shareholder Claims for Reflective Loss
Submission by the Corporate Counsel International Arbitration Group (CCIAG) to UNCITRAL Working Group III
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1. The Corporate Counsel International Arbitration Group (CCIAG)[1] looks forward to the opportunity to exchange views regarding the reform topics that are on the agenda of the 39th session of UNCITRAL Working Group III. In advance of the discussions, we would like to highlight our views on one priority issue: shareholder claims for "reflective loss." These are claims that a shareholder can bring under investment treaties for damages that the shareholder incurs as a result of injuries inflicted on the company in which it has invested. Investment tribunals have widely held that such claims are permitted. In this submission, we explain the importance of allowing shareholder claims for reflective loss. We also offer our views on reforms that can address any perceived negative externalities associated with such claims.

I. The Case for Shareholder Claims for Reflective Loss

2. Consider the following scenario. A foreign investor takes a 40% stake in a hydroelectric project that is majority-owned by a domestic investor. The domestic investor and the host state benefit from the foreign investor's infusion of capital, experience, know-how, technology, and other resources. The foreign investor had been interested in pursuing a controlling stake but was barred by the foreign equity limitations in the host state's foreign investment rules. The hydroelectric project is successful, but its success becomes its undoing. The provincial government in the host state determines that the project is an attractive revenue source, or that the project has become a competitive threat to entrenched politically connected interests, and proceeds to engage in a series of acts that result in the indirect expropriation of the project. The host state's legal regime does not provide the foreign investor or the joint venture with a remedy to compensate for losses suffered as result of the government's actions.

3. This scenario has been repeated time and time again in the modern history of international investment disputes. Investment treaties have provided the answer. Most investment treaties protect corporate shares as covered investments, and further, most tribunals that have examined the question have determined that such treaties permit shareholder claims for reflective loss. As a result, the foreign investor obtains a fair hearing before a neutral tribunal. Win or lose, the availability of investor-state dispute settlement (ISDS) signals to present and future foreign shareholders that their investments will be protected in accordance with international law.

4. We would surmise that all states participating in UNCITRAL Working Group III have investors that invest abroad through shareholdings. Importantly, many investors face the scenario described above: to invest, they have no choice but to take a minority stake in a company controlled by a domestic investor. According to the OECD, sectoral foreign equity

[1] The CCIAG is an association of corporate counsel from a broad variety of international companies focused on international arbitration and dispute resolution. The CCIAG offers this submission as an observer in UNCITRAL Working Group III.

limitations are the most common restrictions faced by foreign investors in most countries.[2] The World Bank's detailed analysis of foreign investment conditions in 103 countries indicates that nearly 80% of 103 countries surveyed maintain foreign equity limitations in some sectors.[3] These restrictions are most common in the media, transport, electricity, and telecommunications sectors, but touch nearly all sectors. Investors facing these restrictions will effectively have no access to ISDS without shareholder claims for reflective loss.[4] Same for investors that choose to take a minority stake for other reasons aside from the existence of foreign equity limitations. This is a key reason why these claims are important.

5. These claims are also important in other scenarios, including when a shareholder holds a direct or indirect controlling interest in a company that is harmed by the host state's breach of its obligations in the applicable investment treaty. Asserting a claim for reflective loss may be the best available (or even only) option for the investor to obtain compensation. Moreover, the investment may not have been made in the first place if not for the availability of such a claim.

6. The fact that shareholder claims for reflective loss are unavailable under domestic corporate laws in many jurisdictions is inapposite.[5] Treaties regularly create rights that are not found at the domestic level. In the case of investment treaties, investors' substantive and procedural rights sometimes parallel those found in domestic legal systems, but perfect alignment is not necessary or desirable. The reason for the different approach to reflective loss claims is that the purpose of investment treaties is to promote and protect foreign investment. States that enter into investment treaties recognize that foreign investors face a heightened risk of discrimination and unfair treatment that justifies the need for additional legal protections, including the right to bring claims for reflective loss. By way of example, domestic investors do not face equity limitations; only foreign investors do. An investment treaty aimed at promoting and protecting foreign investment needs to account for that difference and ensure that foreign investors have access to meaningful remedies.

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[2] *See* Fernando Mistura and Caroline Rouet, *The Determinants of Foreign Direct Investment: Do Statutory Restrictions Matter?*, at 13 (OECD Working Papers on International Investment 2019/01), https://www.oecd-ilibrary.org/finance-and-investment/the-determinants-of-foreign-direct-investment_641507ce-en ("Equity restrictions are by far the most frequent type of restriction and can take different forms: they typically prevent full or foreign-majority ownership, but sometimes forbid foreign participation entirely; sometimes the scope is limited to acquisitions only instead of all foreign investments, i.e. acquisitions and greenfield projects; on rare occasions it applies only to listed companies or to investments in a specific company, typically former state monopoly holders; sometimes the cap on foreign ownership applies to the entire sector, stimulating competition only among foreign investors when the threshold is attained."). It is important to note that reducing foreign equity limitations is the most effective reform to attract foreign investment. *See id*. at 38.

[3] Christian De la Medina Soto and Tania Ghossein, *Starting a Foreign Investment across Sectors*, at 7-8 (World Bank Policy Research Working Paper 6707), http://documents1.worldbank.org/curated/en/668051468333271202/pdf/WPS6707.pdf.

[4] Shareholders would only have ISDS claims for "direct loss," such as loss resulting from the host state's actual seizure of shares or interference with voting rights.

[5] *See* Julien Chaisse & Lisa Zhuoyue Li, *Shareholder Protection Reloaded: Redesigning the Matrix of Shareholder Claims for Reflective Loss*, 52 STAN. J. INT'L L. 51, 84 (2016) ("[P]olicy 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.").

7. Importantly, shareholder claims for reflective loss do not displace other rights that the company or other shareholders may have under the host state's domestic laws or other authorities. This is discussed in more detail in the next section.

II. Reforms Found in Many Investment Treaties Can Address Any Legitimate Concerns Relating to Shareholder Claims for Reflective Loss While Preserving Access to Such Claims

8. The UNCITRAL Secretariat's Working Paper 170 summarizes negative externalities that are sometimes associated with shareholder claims for reflective loss. The discussion is striking because it omits any evidence or examples to support the concerns raised. There have been over 1000 ISDS cases under dozens of treaties, and yet there are, for example, no known cases of a shareholder obtaining "double recovery," *i.e.*, compensation for reflective loss and then again for the same harm as a result of a successful claim by the company in which it has invested.[6] From our vantage point, it is important to bear in mind the abstract and largely theoretical nature of the concerns raised in considering potential reforms, particularly in light of the long list of other issues on the Working Group's agenda. The paucity of examples of harm caused by reflective loss claims stands in stark contrast to the concrete harm that foreign investors worldwide would face if shareholder claims for reflective loss were unavailable.

9. This section summarizes each potential negative externality and suggests reforms, as appropriate, to address them. Most of these reforms are found in modern investment treaties or in background principles of international law and have been successfully used in ISDS cases.

10. <u>*Increased number of cases and multiple proceedings*</u>. The Secretariat explains that shareholder claims for reflective loss increase the risk that a state will need to defend multiple cases arising from the same government measure. In our view, while that is true in theory, the actual number of cases in which tribunals have faced multiple cases as a result of the availability of reflective loss claims is vanishingly small. That said, solutions are available.

11. An increasing number of investment treaties permit a tribunal to order multiple proceedings that present common legal and factual issues to be heard together, in some cases without the consent of the disputing parties. These consolidation mechanisms have been used effectively in practice.[7] Some newer mechanisms even allow consolidation across treaties.[8] Interestingly, in the most famous example of multiple cases that included a reflective loss claim – *CME v. Czech Republic* and *Lauder v. Czech Republic* – the respondent declined to

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[6] *See*, *e.g.*, *Impregilo S.p.A. v. Argentina,* ICSID Case No. ARB/07/17, Award (June 11, 2011), at para. 139 ("The question of double compensation being granted would seem to the Arbitral Tribunal to be a theoretical rather than a real practical problem. It seems obvious that if compensation were granted to [the company] at domestic level, this would affect the claims that [the shareholder] could make under the BIT, and conversely, any compensation granted to [the shareholder] at international level would affect the claims that could be presented by [the company] before Argentine courts.").

[7] *See*, *e.g.*, Order of the Consolidation Tribunal: *Canfor Corporation, Tembec et al., and Terminal Forest Products Ltd. v. United States* (Sept. 7, 2005) (consolidating three NAFTA ISDS cases sharing common questions of law and fact).

[8] *See, e.g.*, Korea-United States Free Trade Agreement, Art. 11.18(4)(b).

consolidate.[9] In a more recent tandem of cases, there appears to have been multiple unsuccessful requests to consolidate, which might have had a stronger foundation had the treaty at issue (the Energy Charter Treaty) included a consolidation mechanism.[10]

12. A concern may be raised that it is impossible to consolidate successive cases. However, most modern treaties include statutes of limitation that ensure that claims arising out of the same injury must be heard within a set time period after the injury, greatly reducing the likelihood of successive claims that cannot be consolidated by virtue of the passage of time.

13. *Impact on the cost and duration of cases of ISDS proceedings*. Consolidation is an effective tool to address the cost and duration concerns associated with the theoretical possibility of shareholder claims for reflective loss resulting in multiple claims relating to the same measure. In addition, as we have previously articulated, we are interested in exploring both mandatory rules and guidance to enable tribunals to resolve cases in a more expeditious fashion. For example, the Secretariat notes that shareholder claims for reflective loss may require complex assessments of damages that flow to the shareholder, which could impact the cost and duration of disputes. While we do not necessarily share this concern, we would support exploring the development of rules or guidance to help tribunals make these assessments accurately and efficiently.

14. *Lack of consistent outcomes and interpretations*. In addition to consolidation – which again, the respondent declined to accept in the most famous (and perhaps only) case of inconsistent judgments resulting from reflective loss claims – international law includes ample tools to address the risk of inconsistent judgments and interpretations. The doctrine of *res judicata* is an example. *Res judicata* bars the re-litigation of claims between the same parties concerning the same type of relief and same legal arguments. Because *res judicata* is widely deemed to be a general principle of international law, tribunals can (and do) apply *res judicata* to interpret and apply the rules and procedures in investment treaties.[11]

15. The decision in *Apotex Holdings Inc. and Apotex Inc. v. United States* demonstrates the effectiveness of *res judicata* in ensuring consistency of judgments where the claimants in two different cases are related but not strictly identical, such as when a shareholder brings a claim for reflective loss followed by a claim by its parent or subsidiary. In this case, the tribunal held that *res judicata* barred the re-litigation of claims resolved in a prior arbitration between the same respondent and a company wholly owned and controlled by the claimant. The tribunal reasoned that the claimant was a "privy" with the claimant in the prior arbitration as a result of their

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[9] *Lauder v. Czech Republic*, Final Award (Sept. 3, 2001), at para. 173.

[10] These two cases are: *Eskosol S.p.A. in liquidazione v. Italian Republic* (*Eskosol*) and *Blusun S.A., Jean-Pierre Lecorcier and Michael Stein v. Italian Republic*. In the former case, the tribunal specifically noted that its consolidation powers were limited by the applicable investment treaty. *See Eskosol*, ICSID Case No. ARB/15/50, Decision on Respondent's Application under Rule 41(5) (Mar. 20, 2017), at para. 170 (noting that "neither the ICSID system as presently designed, nor the ECT itself, incorporate clear avenues (much less a requirement) for joinder in a single proceeding of all stakeholders potentially affected by the outcome").

[11] See *Apotex Holdings Inc. and Apotex Inc. v. United States*, ICSID Case No. ARB(AF)/12/1, Award (Aug. 25, 2014), at para. 7.11 ("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.").

corporate relationship.[12] Before considering reforms that would impair the availability of reflective loss claims, it behooves the Working Group to study the pros and cons of providing guidance to tribunals to interpret and apply *res judicata* in a similar manner.

16. Transparency is a related issue. In the *Eskosol* case, the tribunal assessing a motion to dismiss under Rule 41(5) of the ICSID Arbitration Rules could not have granted preclusive effect to an award in a prior arbitration involving a related party because the prior award was unavailable due to the terms of a confidentiality agreement.[13] States would give tribunals more tools to prevent inconsistencies between awards if they would take measures to ensure greater transparency of awards and other case documents.[14]

17. _Double recovery, possibly leading to excess damages_. The Secretariat explains that allowing shareholder claims for reflective loss may lead tribunals in different cases to require a state to pay duplicative damages for the same injury. We are not persuaded that any additional reforms are necessary to address this possibility, which appears to have never occurred in practice, in part because of effective tribunal management. To the extent additional tools may be useful or necessary to prevent double recovery, the tools discussed above – including consolidation, statutes of limitation, and transparency – would be effective.

18. _Distortion of corporate law and finance_. The Secretariat describes the perception that shareholders winning compensation for reflective loss claims could undermine the corporate form by channeling funds away from the company or creditors with priority. Other critics of reflective loss claims argue that this will cause numerous negative externalities, such as increasing the cost of credit. The fundamental weakness of this argument – beyond the multiple levels of abstraction and lack of empirical support – is that it neglects to consider the full range of options that each player in the shareholder claims context may use to protect its interests under applicable domestic laws and investment treaties.

19. Take the creditor example. If the host state is ordered to pay damages to the shareholder for reflective loss, a creditor may have claims under domestic law against the company, the shareholder, or even the host state. The existence of an investment treaty allowing shareholder claims for reflective loss does not negate the creditor's rights under domestic law. Further, the creditor may have its own claims for reflective loss under an investment treaty,[15] which a tribunal could manage using consolidation and other tools discussed above to reduce or even eliminate the risk of inconsistency and other problematic outcomes. Rather than increasing the cost of credit, the availability of reflective loss claims may incentivize creditors to ensure that their own investments benefit from treaty protection.

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[12] *Id*. at para. 7.40.

[13] *See Eskosol*, ICSID Case No. ARB/15/50, Decision on Respondent's Application under Rule 41(5) (Mar. 20, 2017), at para. 32 note 35.

[14] It is unfortunate in this regard that only six states have ratified the UNCITRAL Transparency Convention.

[15] *See* David Gaukrodger, *Investment Treaties as Corporate Law: Shareholder Claims and Issues of Consistency* (OECD Working Papers on International Investment, 2013/03), at 45-47.

20. An additional consideration is that there is no risk to undermining the corporate form when the company has no possible path to obtaining compensation from the host state under domestic law or an investment treaty. Denying shareholder claims for reflective loss in such circumstances would only ensure that everyone loses, *i.e.*, no one obtains compensation as a result of the actions the host state took that breached the investment treaty. A reflective loss claim could not hurt the company. On the contrary, the possibility of a reflective loss claim in such circumstances could help protect the company by serving as the lone deterrent against misconduct by the host state. It could also facilitate a settlement that could benefit the company.

III. Conclusion

21. This submission outlines the CCIAG's views regarding the importance of shareholder claims for reflective loss and options that states may have to address perceived negative externalities associated with such claims. Above all, shareholder claims for reflective loss are often the only avenue for investors to obtain compensation for investment treaty breaches. We urge states to look to tools in recent investment treaties and international law – including consolidation, statutes of limitation, transparency, and *res judicata* – to address concerns arising from the possibility of multiple claims arising from the same injury. Restricting the right to bring shareholder claims is the wrong approach. We would be especially concerned by any proposal to apply restrictions on shareholder claims retroactively to existing treaties through a multilateral instrument, given that shareholders have made investments under existing treaties in reliance on treaty language that tribunals have consistently interpreted to allow such claims.

22. It is a privilege to observe the ongoing discussions on ISDS reform in Working Group III. Thank you for considering our views on this important topic.