CLAIMS FOR REFLECTIVE LOSS UNDER INVESTMENT TREATIES

David Gaukrodger

Senior Legal Adviser
Investment Division
OECD

OECD-hosted Side Meeting
UNCITRAL Working Group III on ISDS Reform
Resumed 38th session, 20-24 January 2020, Vienna

22 January 2020
1. Contrast between domestic law and unique ISDS interpretation generally allowing reflective loss claims
2. Allowing reflective loss claims expands scope of ISDS and generates multiple potential claims for the same injury
3. Treaty shopping and forum shopping in ISDS using attribution of reflective loss claims
4. Minority shareholder claims for reflective loss
5. Effects of availability of reflective loss claims for some shareholders on corporate law and finance
6. Company recovery regimes: NAFTA-style derivative action and deemed foreign company models
7. Links and contact
Domestic Law: “No Reflective Loss” principle bars shareholder claims for reflective loss

Indirect Shareholder → Direct Shareholder Entity → Operating company

- No Reflective loss claims by shareholders
- alleged harm
- sole permissible claimant

Government → Operating company

Creditors
ISDS: Reflective Loss Claim

Government

ISDS claim

Alleged harm

GRETEL
Indirect covered shareholder (100%)

CHELSEA
Foreign covered shareholder (60%)

DONNA
Domestic and foreign non-covered shareholders (20%)

ABLE
Domestic operating company

HANSEL?

JERRY?

FRANK
Foreign covered shareholder (20%)

BAKER
Creditors of ABLE

Alleged harm

DONNA
Domestic and foreign non-covered shareholders (20%)
ISDS: Multiple Reflective Loss Claims – Unrelated Entities

- **Gretele**: Indirect covered shareholder
- **Chelsea**: Foreign covered shareholder
- **Donna**: Domestic and foreign non-covered shareholders
- **Frank**: Foreign covered shareholder
- **Hansel?**
- **Jerry?**

Graph:

- **Government**: alleged harm to
  - **Able**: Domestic operating company
  - **Baker**: Creditors of Able

- ISDS claim
ISDS: Multiple Reflective Loss Claims – Related Entities

- **GRETEL**: Indirect covered shareholder
- **CHELSEA**: Foreign covered shareholder
- **DONNA**: Domestic and foreign non-covered shareholders
- **FRANK**: Foreign covered shareholder
- **HANSEL?**
- **JERRY?**
- **ABLE**: Domestic operating company
- **BAKER**: Creditors of ABLE
- **Government**: alleged harm

**ISDS claim**
ISDS: Potential Claims 1

- **Government**
  - **ISDS claim**
  - alleged harm

- **GRETEL**
  - Indirect covered shareholder (100%)

- **CHELSEA**
  - Foreign covered shareholder (60%)

- **DONNA**
  - Domestic and foreign non-covered shareholders (20%)

- **FRANK**
  - Foreign covered shareholder (20%)

- **ABLE**
  - Domestic operating company

- **BAKER**
  - Creditors of ABLE

- **HANSEL?**

- **JERRY?**

**Shareholders:**
- **DOMESTIC and FOREIGN non-covered shareholders (20%)**
- **DOMESTIC operating company**
- **Foreign covered shareholders (60%)**
- **INDIRECT covered shareholder (100%)**
ISDS: Potential Claims 2

- **DONNA**: Domestic and foreign non-covered shareholders (20%)
- **Domestic operating company**: CHELSEA (Foreign covered shareholder (60%))
- **GRETEL**: Indirect covered shareholder (100%)
- **HANSEL?**: Foreign covered shareholder (20%)
- **JERRY?**: Creditors of ABLE
- **FRANK**: Foreign covered shareholder (20%)

**Claim under contract or domestic law**

**ISDS claim**

**alleged harm**
ISDS: Potential Claims 3

- **DONNA**: Domestic and foreign non-covered shareholders (20%)
- **Government**: Alleged harm
- **CHELSEA**: Foreign covered shareholder (60%)
- **ABLE**: Domestic operating company
- **HANSEL?**: Creditors of ABLE
- **GRETEL**: Indirect covered shareholder (100%)
- **DONNA**: Domestic and foreign non-covered shareholders (20%)
- **FRANK**: Foreign covered shareholder (20%)
- **BAKER**: Creditors of ABLE
- **ISDS claim**: Alleged harm
ISDS: Treaty Shopping Using Attribution of Reflective Loss Claim(s)

KAPPA has several choices for shopping

Claim 1
Claim 2
Claim 3
Claim 4

KAPPA
100% - covered
Nationality: K
K-G Treaty

EPSILON
80% - covered
Nationality: E
E-G Treaty

DELTA
100% - covered
Nationality: D
D-G Treaty

ALPHA
Operating company

Non-covered Shareholders
20%

Creditors

Creditors

alleged harm
ISDS: Forum Shopping Using Attribution of Reflective Loss Claim(s)

KAPPA has several choices for shopping

Claim 1

Claim 2

Claim 3

Claim 4

Government

alleged harm

KAPPA
100% - covered
K-G Treaty
ICSID

EPIILON
80% - covered
E-G Treaty
PCA

DELTA
100% - covered
D-G Treaty
AI-SCC

Non-covered Shareholders
20%

Creditors

Creditors

ALPHA
Operating company
ISDS: Minority Shareholder in Large Domestic Company

- Domestic non-covered shareholders (91%)
- Covered financial investor, e.g. hedge fund (9%)
- Government
- Alleged harm
- Large domestic company; Eg. market capitalisation USD 100 billion
- Creditors
- ISDS claim
Domestic Law: “No Reflective Loss” principle bars shareholder claims for reflective loss

Diagram:

- Indirect Shareholder
- Indirect shareholder
- Indirect shareholder
- Direct Shareholder Entity
- Government
- Operating company
- Creditors

No Reflective loss claims by shareholders

alleged harm
claim
sole permissible claimant
Corporate finance: repayment rank order

- Secured debt
- Unsecured debt
- Subordinated debt
- Preference shares
- Ordinary shares (common equity)

Domestic Law: **Who is Protected? – All Investors**

- **Indirect Shareholder**
- **Indirect shareholder**
- **Indirect shareholder**

**No Reflective loss claims by shareholders**

- **Direct Shareholder Entity**
- **Operating company**
  - **Government**
  - **Creditors**

- **alleged harm**
- **sole permissible claimant**

- **claim**
ISDS Reflective Loss Claim: **Who is Protected?**

* Note: This slide and the next slide have been corrected from the versions discussed at the side meeting. Frank’s treaty coverage, which was inadvertently omitted, has been restored. Frank is not protected by the claim by Chelsea. It may bring its own ISDS claim if its individual loss is significant; this would generate multiple claims for the government and high costs while still leaving investors unprotected. Only a company claim protects all investors. On the categories of excluded and potential claimants for reflective loss in ISDS and claim incentives, see Gaukrodger (2013b), pp. 47-48, [http://dx.doi.org/10.1787/5k3w9t44mt0v-en](http://dx.doi.org/10.1787/5k3w9t44mt0v-en).
ISDS Reflective Loss Claim: Who is not Protected?

- **DONNA**: Domestic and foreign non-covered shareholder
- **CHELSEA**: Foreign covered shareholder
- **GRETEL**: Indirect covered shareholder
- **ABLE**: Domestic operating company
- **BAKER**: Creditors of ABLE
- **DONNA**: Domestic and foreign non-covered shareholders
- **FRANK**: Foreign covered shareholder
- **HANSEL?**
- **JERRY?**

*ISDS claim*

*alleged harm*
ISDS: NAFTA-style Derivative Claim

1. alleged harm

2. derivative ISDS claim on behalf of ABLE; requires waiver of other recourse by CHELSEA and ABLE

3. if claim successful, damages payable only to ABLE (company)

Government

$\$

ABLE Domestic operating company

BAKER Creditors of ABLE

GRETEL Indirect covered shareholder (100%)

CHESLEA Foreign covered shareholder (60%)

DONNA Domestic and foreign non-covered shareholders (20%)

FRANK Foreign covered shareholder (20%)
ISDS: Deemed Foreign Company Claim

1. alleged harm
2. ISDS claim
3. if claim successful, damages payable only to ABLE (company)


Contact

For questions or comments regarding this presentation, please contact david.gaukrodger@oecd.org.