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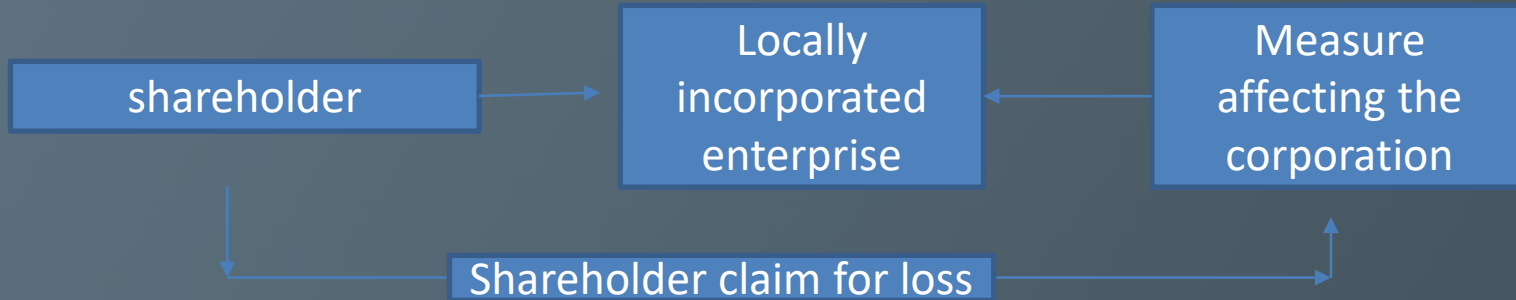
Canada

SHAREHOLDER REFLECTIVE LOSS

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What is Shareholder Reflective Loss?



SRL arises in situation where a foreign investor is a shareholder who invested directly or indirectly in a corporation in the host state

What is Shareholder Reflective Loss?

- Distinction between:

Direct damages for measures that interfere with shareholders' rights (e.g. share ownership, voting rights, dividends, etc.)

Indirect damages of shareholder as a result of harm to the corporation

- What claims can shareholders bring?
- Distinction between shareholders who own/control the enterprise and other shareholders



Treatment of SRL in Domestic Law

Canadian law generally prohibits claims by shareholders for reflective loss

[12] The rule in *Foss v. Harbottle* provides simply that **a shareholder of a corporation -- even a controlling shareholder or the sole shareholder -- does not have a personal cause of action for a wrong done to the corporation.** The rule respects a basic principle of corporate law: a corporation has a legal existence separate from that of its shareholders. A shareholder cannot be sued for the liabilities of the corporation and, equally, a shareholder cannot sue for the losses suffered by the corporation.

[13] The rule in *Foss v. Harbottle* also avoids multiple lawsuits. Indeed, without the rule, a shareholder would always be able to sue for harm to the corporation because any harm to the corporation indirectly harms the shareholders.

Meditrust Healthcare Inc. v. Shoppers Drug Mart, 2002 CanLII 41710 (ON CA)

The prohibition against SRL also exists in most civil and common law jurisdictions



Treatment of SRL in International Law

International law also generally prohibits SRL

Barcelona Traction, Light and Power Company, Limited, (Belgium v. Spain) second phase, Judgment, (1970)

44. Notwithstanding the separate corporate personality, a wrong done to the company frequently causes prejudice to its shareholders. But the mere fact that damage is sustained by both company and shareholder does not imply that both are entitled to claim compensation. Thus no legal conclusion can be drawn from the fact that the same event caused damage simultaneously affecting several natural or juristic persons. Creditors do not have any right to claim compensation from a person who, by wronging their debtor, causes them loss. In such cases, no doubt, the interests of the aggrieved are affected, but not their rights. Thus whenever a shareholder's interests are harmed by an act done to the company, it is to the latter that he must look to institute appropriate action; for although two separate entities may have suffered from the same wrong, it is only one entity whose rights have been infringed.



Treatment of SRL in International Law

International law also generally prohibits SRL

Barcelona Traction, Light and Power Company, Limited, (Belgium v. Spain) second phase, Judgment, (1970)

47. The situation is different if the act complained of is aimed at the direct rights of the shareholder as such. It is well known that there are rights which municipal law confers upon the latter distinct from those of the company, including the right to any declared dividend, the right to attend and vote at general meetings, the right to share in the residual assets of the company on liquidation. Whenever one of his direct rights is infringed, the shareholder has an independent right of action. On this there is no disagreement between the Parties. But a distinction must be drawn between a direct infringement of the shareholder's rights, and difficulties or financial losses to which he may be exposed as the result of the situation of the company.



Treatment of SRL in IIAs

A different rule for IIAs?

- ICJ seems to suggest so...
 - In *ELSI*, the ICJ recognized the right for the US to bring a claim on behalf of US shareholders against Italy for measures imposed in relation to the corporation
 - In *Diallo*, the ICJ recognized the distinction between rights of shareholders and those of a corporation in the context of diplomatic protection but noted that IIAs address shareholder protection
- Arbitral tribunals have distinguished general international law rules and found that IIAs allow SRL



Treatment of SRL in IIAs

Are IIAs *lex specialis*?

- Definition of investment usually includes shares
- Shareholders benefit from treaty protections
- IIAs provide a remedy to shareholders to bring claims directly for damages to their investments caused by a Party's breach of its treaty obligations



Tribunals Have Recognized some of the Concerns with Allowing SRL under IIAs

Risk of double recovery *Impregilo S.p.A. v. Argentine Republic – Final Award (21 June 2011)*

Multiple proceedings taking advantage of corporate form (chain of company) may be an abuse of process *Orascom TMT Investments S.à r.l. v. People's Democratic Republic of Algeria – Final Award (31 May 2017)*



...But Few Tribunals Have Rejected Claims for SRL

Lotus Holding Anonim Şirketi v. Turkmenistan – Award (6 April 2020)

187. It is undoubtedly correct that shareholders and parent companies may in certain circumstances bring claims in respect of their own losses that result from the treatment of a subsidiary. For example, the expropriation of the shares in the subsidiaries themselves, held by a claimant, would clearly violate the claimant's rights, entitling it to bring a claim. But that is not the case here. The Request for Arbitration does not articulate any claims that do not derive exclusively from – and are not wholly overlapping with – contract claims belonging to Lotus Enerji.



Policy Considerations

- corporate form/veil piercing, effect on creditors;
- Double recovery/ multiplication of proceedings;
- Effective remedies for shareholders;
- Should all shareholders be protected by IIAs? Minority vs majority shareholders, portfolio investment;
- What is the extent of the protection that should be granted to shareholders? For what measures? What harm?
- Should shareholders be entitled to bring claims on behalf of the corporation for a breach of corporation's rights? In what situations?



NAFTA model /CETA Approach

- Shareholders can bring claim on their own behalf for their direct losses
- Shareholders that own or control an enterprise can bring a claim on behalf of the corporation
- Waiver by the shareholder and waiver by the enterprise if the claim is for damage to the enterprise
- Award is paid to the enterprise for claims brought on behalf of the enterprise



NAFTA

Article 1116: Claim by an Investor of a Party on Its Own Behalf

1. An investor of a Party may submit to arbitration under this Section a claim that another Party has breached an obligation under:

- (a) Section A or Article 1503(2) (State Enterprises), or
- (b) Article 1502(3)(a) (Monopolies and State Enterprises) where the monopoly has acted in a manner inconsistent with the Party's obligations under Section A,

And that the investor has incurred loss or damage by reason of, or arising out of, that breach.

Article 1117: Claim by an Investor of a Party on Behalf of an Enterprise

1. An investor of a Party, on behalf of an enterprise of another Party that is a juridical person that the investor owns or controls directly or indirectly, may submit to arbitration under this Section a claim that the other Party has breached an obligation under:

- (a) Section A or Article 1503(2) (State Enterprises), or
- (b) Article 1502(3)(a) (Monopolies and State Enterprises) where the monopoly has acted in a manner inconsistent with the Party's obligations under Section A, and that the enterprise has incurred loss or damage by reason of, or arising out of, that breach.

[...] 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 arising out of the same events that gave rise to the claim under this Article, and two or more of the claims are submitted to arbitration under Article 1120, 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.

NAFTA Approach

Article 1121: Conditions Precedent to Submission of a Claim to Arbitration

1. A disputing investor may submit a claim under Article 1116 to arbitration only if: [...]

(b) the investor and, where the claim is for loss or damage to an interest in an enterprise of another Party that is a juridical person that the investor owns or controls directly or indirectly, the enterprise, waive their right to initiate or continue before any administrative tribunal or court under the law of any Party, or other dispute settlement procedures, any proceedings with respect to the measure of the disputing Party that is alleged to be a breach referred to in Article 1116, except for proceedings for injunctive, declaratory or other extraordinary relief, not involving the payment of damages, before an administrative tribunal or court under the law of the disputing Party.

2. A disputing investor may submit a claim under Article 1117 to arbitration only if both the investor and the enterprise: [...]

(b) waive their right to initiate or continue before any administrative tribunal or court under the law of any Party, or other dispute settlement procedures, any proceedings with respect to the measure of the disputing Party that is alleged to be a breach referred to in Article 1117, except for proceedings for injunctive, declaratory or other extraordinary relief, not involving the payment of damages, before an administrative tribunal or court under the law of the disputing Party.



NAFTA Approach

Article 1135: Final Award

[...]

2. Subject to paragraph 1, where a claim is made under Article 1117(1):

(a) an award of restitution of property shall provide that restitution be made to the enterprise;

(b) an award of monetary damages and any applicable interest shall provide that the sum be paid to the enterprise; and

(c) the award shall provide that it is made without prejudice to any right that any person may have in the relief under applicable domestic law.



NAFTA Parties agree that SRL is not permitted in NAFTA...

GAMI Investments, Inc. v. United Mexican States (UNCITRAL) – Submission of the United States of America (30 June 2003)

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



NAFTA Parties agree that SRL is not permitted in NAFTA...

Bilcon of Delaware et al v. Government of Canada –
Submission of the United States of America (29 December 2017)

6. This distinction between Articles 1116 and 1117 was drafted purposefully in light of two existing principles of customary international law addressing the status of corporations. The first of these principles is that no claim by or on behalf of a shareholder may be asserted for loss or damage suffered directly by a corporation in which that shareholder holds shares. This is so because, as recently reaffirmed by the International Court of Justice in *Diallo*, “international law has repeatedly acknowledged the principle of domestic law that a company has a legal personality distinct from that of its shareholders.” As the *Diallo* Court further reaffirmed, quoting *Barcelona Traction*: “a wrong done to the company frequently causes prejudice to its shareholders.” Nonetheless, “whenever a shareholder’s interests are harmed by an act done to the company, it is to the latter that he must look to institute appropriate action; for although two separate entities may have suffered from the same wrong, it is only one entity whose rights have been infringed.” Thus, only direct loss or damage suffered by shareholders is cognizable under international law.



...But Tribunals have been inconsistent in respecting the distinction between direct injuries and SRL

In *Gami*, the Tribunal rejected the application of *Barcelona Traction* and found that minority shareholders could bring claims for measures affecting the local corporation's sugar mills

In *Bilcon*, the Tribunal recognized that shareholders could only bring claims for direct damages but failed to apply it properly...



Distinction between direct injuries and SRL

*Bilcon of Delaware et al v. Government of Canada –
Award on Damages (10 January 2019)*

389. [...] Articles 1116 and 1117 are to be interpreted to prevent claims for reflective loss from being brought under Article 1116. This follows from the wording of Article 1116 in its context, which includes Articles 1121 and 1135. Moreover, the Tribunal takes account of the common position of the NAFTA Parties in their submissions to Chapter Eleven tribunals

396. [...] The opportunity to invest in a quarry and a marine terminal, which was denied by the Respondent's unlawful conduct, was an opportunity of the Investors and not an opportunity of Bilcon of Nova Scotia. Accordingly, compensation is owed directly to the Investors pursuant to Article 1116. It is not precluded by the prohibition against awarding "reflective loss".



Considerations to Guide Reform Options

- If the Parties intend to depart from the international law rule and allow SRL in IIAs what treaty language should be used? If Parties do not want to allow SRL, are provisions such as NAFTA sufficient?
- ICSID Convention and most IIAs do not address SRL
- Are there situations where shareholders can bring claims for damages to the corporation? E.g. expropriation, host state interference with management of the corporation
- Should shareholders be allowed to bring derivative claims on behalf of the corporation? In what circumstances? payment of damages to the corporation?



Reform Options

What reform options are possible?

- Clarification/interpretation
 - Few attempts to address SRL explicitly. See e.g. China-Mexico BIT (2008), art. 13.8: The Contracting Parties recognize that under this Article, minority non-controlling investors have standing to submit only a claim for direct loss or damage to their own legal interest as investors.
 - Difficult given the different treaty provisions at issue and scope of consent to arbitrate
 - Address distinction between direct and indirect shareholder loss
- Amendment through a multilateral convention
- Tools to mitigate the effects of SRL

