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Reforming Shareholder Claims in ISDS

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Reforming Shareholder Claims in ISDS

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ABSTRACT

ISDS stands alone in empowering shareholders to bring claims for reflective loss (SRL) – meaning claims over harms allegedly inflicted upon the company, but which somehow affect share value. National systems of corporate law and public international law regimes generally bar SRL claims for strong policy reasons bearing on the efficiency and fairness of the corporate form. Though not necessitated by treaty text, nor beneficial in policy terms, ISDS tribunals nevertheless allow shareholders broad and regular access to seek relief for reflective loss. The availability of SRL claims in ISDS ultimately harms States and investors alike, imposing surprise ex post costs on States and various corporate stakeholders (particularly creditors), and creating perverse incentives likely to raise the cost of doing business ex ante. The Article sets out the harms caused by allowing ISDS claims for reflective loss, as well as the possible justifications for allowing such claims in this specific context. Concluding that any potential benefits of SRL can be realized through less invasive means, we then canvas a number of plausible reform options, with an eye to their trade-offs.

INTRODUCTION

Arbitral tribunals have generally interpreted investment treaties as granting shareholders wide access to investor-state dispute settlement (***ISDS***).[1] By covering shareholders in a local company as "investors," most investment treaties afford them an international private right of action to sue host States for treaty breach. However, few treaties specify what kinds of claims shareholders can bring, and under what circumstances.[2] Though controversial, ISDS tribunals have for the most part found that a shareholder's right of action includes not only *direct* claims (e.g., for seizure of shares, interference with dividends, or total expropriation of the firm), but also claims for *shareholder reflective loss* (***SRL***): claims concerning injuries to the company that diminish share value.[3]

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[1] Julian Arato, *The Elastic Corporate Form in International Law*, 62 VA. J. INT'L L. 383 (2022); David Gaukrodger, "Investment Treaties and Shareholder Claims for Reflective Loss: Insights from Advanced Systems of Corporate Law" 15 (OECD Working Papers on International Investment, 2014/02); Vera Korzun, *Shareholder Claims for Reflective Loss: How International Investment Law Changes Corporate Law and Governance*, 40 U. PA. J. INT'L L. 189 (2018); LUKAS VAHONNAEKER, SHAREHOLDERS' CLAIMS FOR REFLECTIVE LOSS IN INTERNATIONAL INVESTMENT LAW (2020).

[2] Julian Arato, *The Private Law Critique of International Investment Law*, 113 AM. J. INT'L L. 1, 4, 32–34 (2019).

[3] *See* David Gaukrodger, "Investment Treaties and Shareholder Claims for Reflective Loss: Insights from Advanced Systems of Corporate Law" 15 (OECD Working Papers on International Investment, 2014/02); Vera

ISDS stands alone in empowering shareholders to bring claims for reflective loss. National systems of corporate law generally bar reflective loss claims for strong policy reasons bearing on the efficiency and fairness of the corporate form.[4] Similarly, international jurisdictions mostly refuse to entertain SRL claims.[5] Only ISDS tribunals allow shareholders broad and regular access to seek relief for reflective loss. Moreover, their openness to SRL is neither necessitated by treaty text, nor, on balance, beneficial in policy terms. The availability of SRL claims in ISDS ultimately harms States and investors alike. In the short term, it imposes

Korzun, *Shareholder Claims for Reflective Loss: How International Investment Law Changes Corporate Law and Governance*, 40 U. PA. J. INT'L L. 189 (2018).

[4] English Law has prohibited reflective loss claims since *Foss v. Harbottle*, (1843) 67 ER 189, for clear policy reasons. The Supreme Court affirmed the principle most recently in *Marex*:

> where a company suffers actionable loss, and that loss results in a fall in the value of its shares (or in its distributions), the fall in share value (or in distributions) is not a loss which the law recognises as being separate and distinct from the loss sustained by the company. It is for that reason that it does not give rise to an independent claim to damages on the part of the shareholders.

Marex Financial Ltd. v. Sevilleja [2020] UKSC 31, 15 July 2020, [28] (Lord Reed) & [102] (Lord Hodge). Carrying a majority between them, Lord Reed and Lord Hodge stressed that this principle follows from the "unique position in which a shareholder stands in relation to his company" ([51], Lord Reed), such that each shareholder's investment "follows the fortunes of the company." ([108], Lord Hodge). Lords Reed and Hodge were unambiguous in stressing the policy rationales at stake, including: avoiding double recovery and claim proliferation; avoiding first-mover incentives among shareholders where the wrongdoer may have insufficient assets to make the company completely whole; preserving management's ability to act in what it takes to be the best interests of the company; and protecting creditors' normal expectations of priority on firm assets. [37]–[38], [51] (Lord Reed) and [101]–[108] (Lord Hodge).

Courts apply similar restrictions on reflective loss for similar reasons across common law jurisdictions. *See, e.g. Gaubert v. United States*, 855 F.2d 1284 (5 Cir. 1989) (United States); *Hercules Management Ltd. v. Ernst & Young*, [1997] 2 S.C.R. 165 (Canada); *Gould v. Vaggelas*, [1984] H.C.A. 68 (Australia); *Waddington Ltd. v. Chan Chun Hoo* [2009] 4 HKC 381 § 49 (Hong Kong). In civil law countries, SRL is similarly prohibited by statute or case law. *See, e.g.*, Italian Civil Code, art. 2395 (Italy); Company Law, arts. 847, 423 (Japan); German Stock Corporation Act (Aktiengesetz), §§ 117(1) & 317(1) (Germany); Cour de cassation, chambre commerciale, No. 97-10886 (15 January 2002) (France); *Poot v. ABP*, Hoge Raad, 2 December 1994, NJ 1995, 288 (Netherlands) (with narrow exceptions where the wrongdoer and shareholder are in privity). *See further* Gaukrodger, *supra* note 3; Bas de Jong, *Shareholders' Claims for Reflective Loss: A Comparative Analysis*, 14 EUR. BUS. ORG. L. REV. 97 (2013); Korzun, *supra* note 3. However, in most of these jurisdictions, shareholders do have limited rights to bring derivative claims—on behalf of the company and with recovery due to the company—where, for example, directors or management have a conflict of interest in the dispute. *See* Gaukrodger, *supra* note 3, at 19.

[5] The International Court of Justice (***ICJ***) has held that customary international law prohibits diplomatic protection for SRL claims, and that a shareholder's national State can invoke diplomatic protection only if the shareholder suffered a direct injury. *See Barcelona Traction, Light and Power Company, Limited (Belgium v. Spain)*, Judgment, paras. 46 & 47 (1970); and *Ahmadou Sadio Diallo (Republic of Guinea v. Democratic Republic of the Congo)*, Judgment, para. 87 (2007) (denying diplomatic protection for SRL even where the shareholder is sole owner). The ICJ has acknowledged, however, that States can opt out of the customary no-SRL rule. *See, e.g. Case concerning Elettronica Sicula S.p.a. (United States of America v. Italy)*, Judgment, 1989, paras. 106, 132–33 (accepting in principle that treaties can authorize diplomatic protection for SRL as *lex specialis*, without deciding whether the bilateral treaty in question actually did so); *see also Barcelona Traction*, para. 90; *Diallo*, para. 87. The European Court of Human Rights (***ECtHR***) takes a softer approach. In general, it also denies shareholder standing to claim for SRL under the right to property, at Article 1 of Protocol 1 of the European Convention on Human Rights (***ECHR***). However, the ECtHR allows several exceptions. *See e.g., Agrotexim and others* v. *Greece* (1995) Series A no. 330, para. 66 (permitting "piercing of the 'corporate veil'… where it is impossible for the company [itself] to apply to the Convention institutions"); *GJ* v. *Luxemburg* App no. 21156/93, para. 24 (ECtHR 26 October 2000) (allowing an SRL claim by a 90% shareholder where the company was in liquidation and the claim involved the actions of the liquidators); and *Ankarcrona* v. *Sweden* (2000) ECHR 2000-VI (allowing a sole owner to bring an SRL claim, reasoning that there would not be competing interests within the company). *See further* De Jong, *supra* note 4, 104.

surprise *ex post* costs on States and various corporate stakeholders (particularly creditors).[6] In the long run, it creates perverse incentives likely to raise the cost of doing business *ex ante*.[7]

At its 37th session, the United Nations Commission on International Trade Law (***UNCITRAL***) Working Group III (***WGIII***) indicated that it would continue to study shareholder claims as a possible subject of reform.[8] The problems posed by SRL relate strongly to numerous concerns expressed by States, and already on WGIII's agenda, including inconsistency, multiple proceedings, finality, duration, and costs. The matter is also on the agenda of the Organization for Economic Co-operation and Development (***OECD***).[9] This Article expands upon our 2019 Academic Forum Working Paper, written in support of these inter-governmental processes.[10] In 2019, few scholars were engaging intensely with the issue,[11] but scholarly attention to SRL in ISDS has since grown.[12] All this confirms that the time is ripe to rethink shareholders rights of action in investment arbitration, with a real possibility for multilateral, treaty-based reform.

This Article lays the groundwork for reforming shareholder claims in investment arbitration, by focusing on values, interests, and the trade-offs any such effort would entail. It *first* explains ISDS tribunals' permissive approach to SRL. *Second*, it sets out the harms caused by allowing ISDS claims for reflective loss. *Third*, it explores possible justifications for allowing SRL claims in this context. We suggest, however, that potential benefits of SRL can be realized through less invasive means. *Fourth,* this Article explores how States and tribunals have sought to mitigate problems associated with SRL. While important, these solutions have mostly proven irregular, inconsistent, and incomplete. *Fifth*, we conclude by considering a range of reform options and their trade-offs, taking into account the diversity of interests at stake. In our view, the most promising options are those that prioritize company claims in lieu of SRL. But it bears emphasizing up front that no option will be a perfect fix. Potential solutions here should be understood as imperfect alternatives, each with its own trade-offs.[13] Without advocating for

[6] David Gaukrodger, "Investment Treaties as Corporate Law: Shareholder Claims and Issues of Consistency," 34–47 (OECD Working Papers on International Investment, 2013/03); Arato, *supra* note 2, at 37, 39; Korzun, *supra* note 3.
[7] *See* Arato, *supra* note 2, at 38–39; Gaukrodger, *supra* note 3, at 29.
[8] UNCITRAL, 'Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-seventh session (New York, 1–5 April 2019)', UN Doc No A/CN.9/970 (9 April 2019), para. 84.
[9] *See, e.g.* OECD, 'Shareholder Claims for Reflective Loss in Investment State Dispute Settlement: A 'Component-by-Component' Approach to Reform Proposals,' Informal Discussion Paper (2021) [hereinafter OECD Discussion Paper] (proposing draft treaty language for restricting SRL claims).
[10] Julian Arato, Kathleen Claussen, Jaemin Lee, & Giovanni Zarra, *Reforming Shareholder Claims in ISDS*, Academic Forum on ISDS Concept Paper 2019/9 (17 Sep. 2019).
[11] *See, e.g.*, Arato, *supra* note 2; Gabriel Bottini, 'The Admissibility of Shareholder Claims: Standing, Causes of Action, and Damages,' Doctoral Dissertation, University of Cambridge (September 2017), *available at* https://www.repository.cam.ac.uk/bitstream/handle/1810/267916/Bottini-2017-PhD.pdf?sequence=1; ZACHARY DOUGLAS, THE INTERNATIONAL LAW OF INVESTMENT CLAIMS, 455 (2009); Gaukrodger, *supra* note 3; Korzun; *supra* note 3; GIOVANNI ZARRA, PARALLEL PROCEEDINGS IN INVESTMENT ARBITRATION 40 (2016).
[12] *See, e.g.*, VAHONNAEKER, *supra* note 1; GABRIEL BOTTINI & URÍA MENÉNDEZ, ADMISSIBILITY OF SHAREHOLDER CLAIMS UNDER INVESTMENT TREATIES (2020); Gustavo Minervini, Shareholders' claims for reflective losses in international investment law, Doctoral thesis, Federico II University of Naples, available at www.fedoa.unina.it, 2021; Benny Wuenschmann, 'Toward Higher Coherence in Shareholder Claims for Reflective Loss', *in* Chaisse, J., Choukroune, L., Jusoh, S. (eds) *Handbook of International Investment Law and Policy*. Springer, *see further* Julia Calvert, Charlotte Rommerskirchen & Arjen van der Heide, "Does ownership matter? Claimant characteristics and case outcomes in investor-state arbitration," 27 NEW POLIT. ECON. 788 (2022)
[13] *See* Sergio Puig & Gregory Shaffer, *Imperfect Alternatives: Institutional Choice and the Reform of Investment Law*, 112 AM. J. INT'L L. 361 (2018).

any particular reform, this Article seeks to help ground the reform process by clarifying the objectives, and comparing concrete alternatives.

I. SHAREHOLDER CLAIMS IN ISDS

The vast majority of investment treaties define their ambits broadly. They typically incorporate capacious definitions of "investment," vast enough to include both enterprises, and stocks or shares in an enterprise.[14] They generally define "investors" as natural or legal persons with the nationality of one party and with an investment in the other. And they entitle covered investors to invoke ISDS to enforce the host State's treaty obligations—to seek redress for treaty breaches that affect the value of their investment. However, they usually do not specifically authorize shareholder-investors to claim relief for reflective loss.

ISDS tribunals tend to accept that, taken together, these provisions empower shareholders-qua-investors to bring ISDS claims against host States for any treaty breach that harms them—whether directly (e.g., seizure of shares or total expropriation) or indirectly (SRL).[15] Still, it is not clear that investment treaties are best interpreted as departing from the near-universal "no-SRL" rule in domestic corporate law and customary international law.[16] While investment treaties clearly ascribe to shareholder-investors *some* right to invoke ISDS, they usually say nothing about *what kind of access* shareholders should have. This ambiguity can be interpreted narrowly to allow only shareholder claims for direct loss.[17] Yet ISDS tribunals frequently adopt a permissive approach—accepting that the typical investment treaty authorizes SRL on its face by simply including stocks and shares in the definition of investment.[18]

[14] *See, e.g.*, Germany—Russia BIT, Art. 1(a) ("The term 'investment' shall apply to all types of assets … in particular … shares and other forms of participation in commercial enterprises"); Canada—Peru BIT, Art. 1 ("investment means: (I) an enterprise; (II) an equity security of an enterprise …").

[15] A great many ISDS cases have been admitted as reflective loss claims, usually over the Respondent State's strenuous objections. Several of the earliest ISDS awards were based on SRL, for example *Asian Agricultural Products Ltd. (AAPL) v. Sri Lanka*, ICSID Case No. ARB/87/3, Final Award, ¶ 95 (27 June, 1990) and *American Manufacturing & Trading (AMT)* v. Zaire, ICSID Case No. ARB/93/1, Award ¶¶ 4.05, 5.10–5.15 (21 Feb., 1997); as were many of the formative early claims against Argentina, including *Enron Corp. & Ponderosa Assets L.P. v. Argentina*, ICSID Case No. ARB/01/3, Decision on Jurisdiction ¶¶ 35, 49 (14 Jan. 2004); *Sempra Energy International v. Argentina*, ICSID Case No. ARB/02/16, Decision on Objections to Jurisdiction, ¶¶ 67–79 (11 May, 2005); and *BG Group v. Argentina*, Final Award, ¶¶189–205 (24 Dec. 2007). *See also Chevron & Texaco v. Ecuador*, PCA Case No. 2009-23, Third Interim Award on Jurisdiction and Admissibility, ¶ 4.24 (27 Feb. 2012). For more recent examples, see *Daniel W. Kappes et al. v. Guatemala*, ICSID Case No. ARB/18/43, Award, ¶¶ 122, 130 (13 March 2020); and *Bridgestone Licensing Services Inc. et al v. Panama*, ICSID Case No. ARB/16/34, Award, ¶ 172 (14 August 2020).

[16] Some observers have questioned whether these broad provisions, on their own, necessarily imply that SRL claims should be allowed in ISDS. *See* Arato, *supra* note 2, 35 and fns. 182 & 183 ("even as a matter of formal treaty interpretation, it is not clear why tribunals have given such short shrift to the position in general international law, or the uniformity across domestic jurisdictions" which arguably reflects a general principle). Under normal rules of treaty interpretation, an interpreter should take into account customary international law and general principles—and all the more so when treaty text is silent or unclear. Vienna Convention on the Law of Treaties, Art. 31(3)(c), May 23, 1969, 1155 UNTS 331 (1969) ("There shall be taken into account, together with context … any relevant rules of international law applicable in the relations between the parties."). *See also* Gaukrodger, *supra* note 6, at 25.

[17] *See* Arato, *supra* note 2, at 35; Gaukrodger, *supra* note 6, at 30.

[18] *See, e.g.*, *Impregilo v. Argentina*, ICSID Case No. ARB/07/17, Award, para. 138 (June 21, 2011); CAMPBELL MCLACHLAN, LAURENCE SHORE & MATTHEW WEINIGER, INTERNATIONAL INVESTMENT ARBITRATION: SUBSTANTIVE PRINCIPLES, §§ 6.77, 6.79 (1st ed. 2007) ("Given the wide definition of investment … there is no conceptual reason to prevent an investor recovering for damage caused to those shares which has resulted in a

Under ISDS tribunals' permissive approach to SRL (the "pro-SRL interpretation"), investment treaties expose the States parties to multiple (potentially endless) claims in relation to a single dispute. The firm and its individual shareholders may all bring suit over the same alleged treaty breach. And most treaties require neither that such claims be joined nor that they be brought simultaneously.[19]

The situation is compounded where investment treaties cover "indirect equity," which expands the universe of potential claimants.[20] Indirect equity refers to an ownership stake in a firm that is held through an extended chain of companies. The "indirect" owner holds no formal shares in the local corporation actually engaged in the investment. It has an indirect stake, through ownership of shares in an intermediary entity that holds shares in the local company. Including indirect equity within the definition of investment exponentially expands the possibility of shareholder claims in ISDS. Most tribunals read such provisions to allow any entity in the chain to bring claims against the host State as indirect shareholders alongside any claims by immediate shareholders and/or the local firm itself.

II. THE HARMS IN UNREGULATED SHAREHOLDER CLAIMS

Allowing SRL claims in ISDS creates numerous risks and perverse incentives. Most glaringly, the possibility of multiple claims exposes the State to a risk that it will have to defend itself repeatedly with respect to essentially the same claim, by essentially the same parties, even if it wins in any one dispute (*multiple bites at the apple*); and that it might be forced to pay overlapping damages claims where it loses successively (*double recovery*). At the same time, the pro-SRL interpretation harms foreign investors and States alike by distorting the corporate form, inefficiently undermining national corporate governance law, and creating significant conflicts of interest between various corporate stakeholders. All this can inflate the costs of doing business for all parties *ex ante*.

A. Multiple bites at the apple.

diminution in their value"). However, the link between a broad definition of investment and a permissive approach to SRL is more tenuous than advertised. There are strong interpretive reasons to doubt that that the pro-SRL interpretation follows logically from a wide definition of investment (*supra*, fn. 16), and strong policy reasons to prefer a no-SRL interpretation (*infra*, para. 0 *et seq*.). As Gaukrodger notes, ISDS tribunals "have apparently considered it unnecessary to consider policy consequences in any detail because they consider that the issue is resolved by the inclusion of shares in the investment definition … [and by force of] arbitral precedent"—although the precedents themselves "rarely if ever addressed the policy issues or consequences." Gaukrodger, *supra* note 6, at 30.

[19] A few treaties do incorporate sophisticated consolidation (or joinder) regimes. *See, e.g.*, EU—Canada Comprehensive and Economic Trade Agreement, Art. 8.43 (***CETA***) available at http://ec.europa.eu/trade/policy/in-focus/ceta/ceta-chapter-by-chapter; and North American Free Trade Agreement, Art. 1117(3) entered into force Jan. 1, 1994, Pub. L. No. 103-182, 107 Stat. 2057, Art. 1117(3) (1993) (***NAFTA***), discussed further below.

[20] *See, e.g.*, Japan—Israel BIT, Art. 1(a) ("the term 'investment' means every kind of asset . . . owned or controlled, *directly or indirectly*, by an investor); US—Turkey BIT, Art. 1(c) ("'investment' means every kind of investment owned or controlled *directly or indirectly*") (emphasis added). Tribunals tend to read "indirect" equity broadly. *See, e.g.*, *Ampal-American Israel Corp. v. Egypt*, ICSID Case No. ARB/12/11, Decision on Jurisdiction, para. 343 (Feb. 1, 2016) (refusing to "read into the Treaty restrictions … [on] 'passive, indirect and very small' holdings)."

SRL claims derive from an original harm caused by a State's measure to a business organization (the primary entity). Losses associated with that harm can be "reflected" in diminution of share value, causing secondary harm to the primary entity's owners—the shareholders. Such diminution in value may be further reflected in tertiary losses for the shareholders' shareholders ("indirect owners"), and so on *ad infinitum*. Tribunals tend to recognize claims by the entity, its shareholders, and indirect owners as independent. And investment treaties rarely provide for mandatory joinder of claims.[21] Moreover, tribunals tend to allow investor-shareholders to plead for compensation not only for demonstrable diminution in share value, but for the value of the harm inflicted on the company in proportion to their shareholding—a potentially significantly higher figure. As a result, the most glaring consequence of the pro-SRL interpretation is that it subjects States to concurrent and successive claims by all of these entities, for recompense for the same alleged injury to the same primary entity. Even if a State defeats the entity claim, it may face additional reflective claims by other stakeholders.[22] In a world of SRL, a defensive victory may not be final.[23]

This situation creates numerous perverse incentives for sophisticated investors. By investing through a chain of treaty-covered subsidiaries, an ultimate owner can ensure that, should a dispute arise, it will have the opportunity (or opportunities) to relitigate.[24] This possibility of endless claims also endows well-structured investors with extraordinary leverage to press for settlement.[25] To some extent, this situation can be moderated by tribunals through careful application of equitable doctrines like *res judicata*,[26] collateral estoppel/issue preclusion,[27] and abuse of right[28]—but given the *ad hoc* structure of ISDS, such solutions are at best irregular, inconsistent, and incomplete.[29]

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[21] Even where keenly aware of the consequences of multiple SRL claims, tribunals have proven hesitant to require joinder without clear treaty-based authorization to do so. *See, e.g.*, *Eskosol v. Italy*, para. 170 ("Obviously there are both efficiency and fairness reasons to prefer that all shareholders of an entity affected by a challenged State measure [and the entity itself] could be heard in a single forum at a single time … But the fact remains that neither the ICSID system, as presently constituted, nor the ECT itself, incorporate clear avenues (much less a requirement) for joinder.").

[22] This risk has materialized in numerous high profile cases. *See, e.g., CME v. Czech Republic*, UNCITRAL, Final Award, para. 436 (Mar. 14, 2003), and *Ronald Lauder v. Czech Republic*, UNCITRAL, Final Award, para. 172 (Sept. 3, 2001) (in which separate suits by the company (CME) and the controlling shareholder (Lauder) both proceeded to the merits, resulting in inconsistent awards on liability—Lauder lost on the merits while CME recovered over $270 million). For a more recent example, see the successive claims against Italy in *Blusun* (corporate claim) and *Eskosol* (SRL). *Eskosol v. Italy*, para. 166 ("The ECT authorizes a variety of entities to proceed as qualified 'investor[s]' under its terms. This includes *foreign* [shareholder] investors like Blusun. … But it also includes *local companies* like Eskosol … 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."). *See also Union Fenosa Gas, S.A. v. Arab Republic of Egypt*, ICSID Case No. ARB/14/4, Award of 31 August 2018, para. 6.81; DOUGLAS, *supra* note 11, at 455; ZARRA, *supra* note 11, at 40 ("when giving their consent to investment arbitration, the normal expectation of the parties—and in particular States (and the national public opinion)—is, *inter alia*, that an issue will be tried only once").

[23] Emmanuel Gaillard, *Abuse of Process in International Arbitration*, 32 ICSID Rev—FILJ 1, 9 (2017) ("To prevail in the overall dispute, the host State must win each of the arbitrations brought against it, while the investor need only succeed before any one of the tribunals"); ZARRA, *supra* note 11 (emphasizing finality and judicial economy).

[24] Gaukrodger, *supra* note 6, at 37; ZARRA, *supra* note 11, at 41.

[25] Arato, *supra* note 2.

[26] *See, e.g. Apotex Holdings Inc. & Apotex Inc. v. United States*, ICSID Case No. ARB(AF)/12/1), Award, paras. 7.30 7.35–7.39, 7.57, 7.58 (Aug. 25, 2014).

[27] *See, e.g., Grynberg et al. v. Grenada*, ICSID Case No. ARB/05/14, Award, para. 7.1.6–7 (Mar. 13, 2009).

[28] *See, e.g., Orascom TMT Investments v. Algeria*, ICSID Case No. ARB/12/35, Award, para. 542 (May 31, 2017).

[29] Arato, *supra* note 2.

B. Double recovery.

A related concern about SRL is that multiple overlapping claims can allow shareholder-investors to secure double (or more) recovery, either at the expense of the State or at the expense of other corporate constituencies.[30] This would occur, for example, if one tribunal awarded recovery to the primary entity while another awarded recovery to a shareholder. This problem has not materialized in practice—in part for the contingent reason that, where shareholder and company have brought separate claims, they do not appear to have yet resulted in separate successful awards. Tribunals are also often attentive to this issue, and several have taken proactive steps to avoid it, such as by considering related pending and prior claims and pro-rating recovery.[31] However, these solutions cannot fully resolve the problem. Double recovery may be unavoidable when both shareholder and company claims succeed, because an already-compensated shareholder cannot be blocked from participating proportionately in any company recovery.[32] Further, even seemingly effective tribunal-imposed limitations on double recovery can be difficult to manage at the enforcement stage, where enforcing courts may not be well positioned to appreciate the interaction between multiple compensation awards.

C. Corporate governance distortions.

The availability of SRL in ISDS has the further effect of distorting the corporate form itself—inefficiently undercutting basic principles of corporate governance and generating significant conflicts of interests among all corporate stakeholders, including insiders (shareholders and management), and outside constituencies (creditors, governments, and publics). The corporate form is a uniquely efficient vehicle for mobilizing capital at scale.[33] The prime function of

[30] Lord Millet articulates the concern about double recovery neatly in *Johnson v. Gore Wood Co.*:

> If a shareholder is allowed to recover in respect of [SRL], 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. … Justice to the defendant requires the exclusion of one claim or another; protection of the interests of the company's creditors requires that it is the company which is allowed to recover at the exclusion of the shareholder.

[2000] UKHL 65; [2002] 2 A.C. 1, 62.

[31] ZARRA, *supra* note 11, at 39 (2016).

[32] Timing is crucial here. If the company wins full recovery first, then the tribunal hearing the later shareholder claim could award the shareholder zero damages, confident that the claimant had already recovered through its stake in the firm. The problem is more acute when the shareholder wins its SRL claim first, because this makes a shareholder windfall unavoidable. If, thereafter, the tribunal hearing the later company claim awards full compensation to the firm, the shareholder would share in that award in proportion to its shares, and thus recover double (at the expense of the State). But even if the latter tribunal pro-rates recovery in inverse proportion to the prior award, the shareholder would still recover an overlapping share of the now-reduced company claim (at the expense of other corporate stakeholders).

[33] JOHN ARMOUR, ET AL., THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 1, 1–2 (3d ed. 2017). Across all legal systems, the corporate (or company) form exhibits the same core characteristics: (1) separate legal personality (2) limited shareholder liability; (3) transferable shares; (4) centralized management; and (5) shared investor ownership. These features act together to allow the firm to operate as a nimble, independent, and potentially immortal market actor, while protecting owners from the debts of the firm (limited liability) and protecting the firm from the debts of its owners (entity shielding). *See also* KATHARINA PISTOR, THE CODE OF CAPITAL (2019). As a result, the business corporation is the most common vehicle for the large scale investment projects at issue in ISDS. Gaukrodger, *supra* note 3, at 8. For clarity, the

corporate law is to *empower* private parties to make use of this legal vehicle for doing business.[34] Yet, despite its advantages, the corporate form gives rise to conflicts of interests among its stakeholders.[35] As a legal entity, a corporation can only act through agents, and this fact creates numerous significant "agency problems," or misaligned interests between those who invest in a corporation, those who manage it, and those who engage with it. As a result, the second function of corporate law is *regulatory*.[36] In most domestic systems, much of corporate law is directed at mitigating three kinds of conflicts of interests: between shareholders and management; between controlling and minority shareholders; and between shareholders and outside constituencies (especially creditors).[37]

Permitting SRL claims in ISDS seriously undermines both of the main functions of corporate law. The pro-SRL interpretation inefficiently distorts the very features of the corporate form that make corporations appealing investment vehicles. In particular, it undermines the firm's *separate legal personality* by enabling treaty-covered shareholders to gain access to funds rightly belonging to the firm. By suing the host State directly, a shareholder can recover on corporate monies that would normally be shielded from liquidation by shareholders, on which various creditors may have priority, and on which other shareholders expect parity.[38] This rule also undermines *centralized management* by giving treaty-covered shareholders the ability to second-guess management on questions of when to litigate, when to settle, and how much to settle for.[39] From the State's perspective, this makes it difficult to know who speaks for the firm in settlement negotiations, and difficult to rely on settlement more generally. All this may afford *ex post* advantages to particular covered shareholders, to be sure, but it diminishes the broader *ex ante* business advantages of the corporate form—by calling into question the firm's independence from its owners, undermining its credibility as a separate owner of firm assets, and by weakening management's hand at critical moments.

At the same time, the possibility of SRL claims gives rise to significant conflicts of interests when a potential investor-state dispute arises, which can lead to unfair practices *ex post*, and raise the costs of doing business *ex ante*. Most importantly, SRL claims create conflicts between shareholders and creditors by upending typical creditor-priority rules. This creates significant risks for creditors which, if adequately understood and accounted for, would tend to drive up the costs of credit. SRL also creates conflicts among shareholders, including conflicts between treaty-covered shareholders and uncovered shareholders who may be left out of any eventual recovery, as well as first-mover conflicts among treaty-covered shareholders.[40] And, as noted above, it creates conflicts between shareholders and management with respect to litigation decisions, including about whether to litigate at all. All of these potential conflicts create perverse incentives *ex post*, once an ISDS dispute arises (or seems likely to arise). And these become especially distortive where the firm is involved in bankruptcy proceedings—or where for other reasons there may not be sufficient assets to make all corporate stakeholders whole even after recovery.[41] Moreover, as awareness of these problems grows, such conflicts

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analysis here is limited to formal corporations—but analogous problems arise for other organizational forms (such as LLCs and partnerships). Arato, *supra* note 2, at n. 148.

[34] Arato, *supra* note 2, at 30.

[35] ARMOUR, ET AL., *supra* note 33, at 2.

[36] Arato, *supra* note 2, at 30.

[37] ARMOUR, ET AL., *supra* note 33, at 2.

[38] Gaukrodger, *supra* note 3, at 20; Arato, *supra* note 2, at 39; Korzun, *supra* note 3; Douglas, *supra* note 11, at 455.

[39] Gaukrodger, *supra* note 3, at 25; Arato, *supra* note 2, at 39; Korzun, *supra* note 3, at 196.

[40] Arato, *supra* note 2, at 39.

[41] Korzun, *supra* note 3, at 192.

can have significant *ex ante* costs: by raising transaction costs for investing through the corporate form, inflating the costs of credit, and raising the costs of doing business for all concerned.[42]

III. PARTICULAR BENEFITS OF SRL IN THE CONTEXT OF ISDS

A case can be made that SRL has particular benefits in the context of ISDS that might not arise in other international or domestic law settings. The functional case for making SRL available in ISDS turns on the fact that foreign investments are frequently structured through companies incorporated in the host State—often at the latter's behest. SRL thus arguably helps avoid formal and material impediments to investor access to ISDS that might dilute its utility. However, these potential benefits can also be realized through other, less restrictive means.

First, opening ISDS to SRL claims avoids an unfortunate consequence of most treaties' formal nationality rules, which cover only *foreign* investors hailing from a treaty party other than the host State. If an investor in State A makes an investment in State B through a locally incorporated entity, that entity would not normally have a right to invoke ISDS against the host State (being its formal state of nationality). Without some fix, this lacuna would leave the investor from State A without a path for relief under ISDS—even if the State had required the investor to operate through a local entity. Allowing SRL claims clears this hurdle by enabling the foreign shareholder to claim for losses associated with injuries to the local firm.

Second, even where formal nationality rules are not a hurdle, local companies are still beholden to the State in myriad ways. This can give rise to "hold-up" problems, which reflective loss claims can help abate. For example, if all claims must be routed through the local company, a government could potentially interfere with that entity to disrupt an investor's access to ISDS (without fully expropriating it). Similarly, if all recovery is due to the local company, a government could interfere with its ability to transfer post-award recovery back to creditors and owners. Permitting SRL claims avoids these hold-up problems by shifting the right of action to shareholders, who are comparatively less likely to be beholden to the State.

However, permitting SRL claims is not necessary to achieve these objectives. They can be met through less restrictive means. Indeed, some investment treaties already incorporate other mechanisms that ensure local company access to ISDS, by providing for: (1) *deemed foreign nationality* for local companies owned or controlled by treaty-covered shareholders; or (2) *shareholder derivative suits*. The first allows a local company to itself invoke ISDS if it is owned (completely or partly) by investors from the other treaty party.[43] The second allows foreign shareholders to bring suit in the company's name and on its behalf.[44] These options differ from SRL in limiting the universe of possible claims and claimants, and by directing any recovery to the company itself. These "company recovery regimes" present an alternative for preserving investor access to ISDS.[45] As typically drafted, they respond to the formal

[42] Gaukrodger, *supra* note 3, at 20; Arato, *supra* note 2, at 51. For these reasons, the pro-SRL interpretation may not be beneficial to investors as a class, either *ex ante* or *ex post*, even though particular investors will obviously stand to gain in pursuing their claims. Arato, *supra* note 1, at 387, 422 (arguing that the only consistent beneficiaries are claimants, i.e. that narrower set of investors who are able to and actually do bring suit *ex post*).
[43] *See, e.g.*, US—Argentina BIT, Art. VII(8); US—Turkey BIT, Art. VI(6); Energy Charter Treaty, Art. 26(7).
[44] *See, e.g.*, NAFTA Art. 1117.
[45] *See* David Gaukrodger, "Investment Treaties and Shareholder Claims: Analysis of Treaty Practice," (OECD Working Papers on International Investment, 2014/03), *available at* http://www.oecd.org/daf/inv/investment-

nationality concerns noted above. And they could be supplemented with relative ease to mitigate the risk of hold-ups. Moreover, under either approach, shareholders would still have residual access to ISDS for claims of *direct* loss.[46]

IV. CURRENT LIMITS ON SHAREHOLDER CLAIMS IN ISDS

A few treaties have sought to introduce limits on SRL claims, and a few tribunals have likewise imposed partial limitations. Some of these approaches are promising. But the problems with SRL are difficult to solve through either tribunal action or one-off bilateral treaty reform.

The greatest hurdles to limiting shareholder claims in ISDS are uncertainty and arbitrage. The fragmented nature of ISDS means that even tribunal decisions that challenge the conventional pro-SRL approach cannot be relied upon for future planning. To be reliable, meaningful reform must be accomplished through treaty-drafting. However, the fragmented nature of the investment treaty regime allows sophisticated firms to structure investments through the most favorable treaties they can find ("treaty shopping"). Further, some tribunals have interpreted broadly drafted most-favored-nation ("MFN") clauses to allow investors to invoke more favorable dispute resolution provisions from the host State's treaties with third States—albeit inconsistently and controversially.[47] As a result, meaningful reform requires systematic efforts, whether through comprehensive treaty-by-treaty reform or multilateral treaty-making.[48]

Nevertheless, much can be learned from existing treaty- and tribunal-based responses in relation to any future systematic reform—about what works, and what does not. The below canvasses some of the main approaches as potential models for future systematic treaty reform.

A. Treaty-based responses

Some States have attempted to scale back the scope of SRL claims, or to dull their harmful side-effects, in their treaties. Most of these set only marginal restrictions, and only a few attempt to limit SRL claims comprehensively. A handful of approaches stand out.

policy/WP-2014-3.pdf. Though many treaties provide for company recovery regimes, they are often interpreted as *also* providing for SRL. *See, e.g.*, *Eskosol S.p.A. in Liquidazione v. Italian Republic*, ICSID Case No. ARB/15/50, Decision on Respondent's Application Under Rule 41(5), para. 166 (Mar. 20, 2017). As a result, at the time of a dispute, a shareholding investor has little incentive to opt for the former over the latter. SRL action both affords better control over the litigation, and allows the shareholder to recover directly. To provide an effective alternative, company recovery mechanisms must affirmatively *exclude* access to SRL. Gaukrodger, above; Arato, *supra* note 2, at 36.

[46] These alternatives have their own difficulties and tradeoffs, which will be assessed in a follow-up paper. At present, suffice it to note that SRL claims are not *necessary* for investor relief via ISDS.

[47] *See, e.g. Maffezini v. Spain*, ICSID Case No. 97/7, Decision on Jurisdiction (January 25, 2000) (allowing importation of more favorable procedural mechanisms); *see contra Plama Consortium Ltd v. Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction (February 8, 2005) (barring importation of procedural terms).

[48] One possible model would be that of the Mauritius Convention on Transparency. United Nations Convention on Transparency in Treaty-Based Investor-State Arbitration, adopted 10 Dec. 2014, entered into force 18 Oct. 2017, *available at* http://www.uncitral.org/uncitral/uncitral_texts/arbitration/2014Transparency_Convention.html.

(i) Exclusive shareholder derivative suit regimes.

Very few treaties address SRL head on, openly and explicitly. However, some treaties appear to mirror the classical domestic law distinction: permitting only direct shareholder claims and shareholder derivative suits, and implicitly excluding SRL claims. The original North American Free Trade Agreement (***NAFTA***) models this approach. The NAFTA permits a shareholder to bring a claim "on its own behalf" (Article 1116) as well as a claim "on behalf of an enterprise" that it owns or controls (Article 1117).[49] All three NAFTA parties have argued that this division excludes SRL claims. According to Canada, Mexico, and the United States, the NAFTA only enables a shareholder-investor to bring a claim for direct loss under Article 1116, or a derivative claim for injury to the company under Article 1117, but not its own claim for mere reflective loss.[50] Early NAFTA tribunals split on how to interpret these provisions: some accepted that they implicitly bar SRL,[51] but others found that Article 1116 is itself broad enough to allow shareholders to bring claims for both direct and reflective loss.[52] Yet the NAFTA parties continuously affirmed that the division between Articles 1116 and 1117 was designed to exclude SRL claims, and recent tribunals have concluded from the parties' consistent interpretive statements that the treaty bars SRL claims.[53] A good case can be made that ISDS provisions in other treaties that follow the NAFTA model should be read similarly to exclude SRL—such as the Dominican Republic–Central America–United States Free Trade Agreement (***DR-CAFTA***),[54] the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (***CPTPP***),[55] and the United States–Korea Free Trade Agreement (***KORUS***),[56] as well as the United States–Mexico–Canada Agreement (***USMCA***) which replaced the NAFTA.[57] Nevertheless, going forward, it would appear that this sort of implicit limit on SRL

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[49] *See* NAFTA, Arts. 1116 & 1117.

[50] *See, e.g.*, *Bilcon v. Canada*, PCA Case No. 2009-04, Canadian Counter-Memorial on Damages, para. 26 (June 9, 2017) (allowing shareholder reflective loss "undermines one of the most fundamental rules of corporate law in all three NAFTA Parties. . . . [This] will weaken the corporation's separate legal personality, create unpredictability for investors, creditors, banks, and others who participate in the foreign direct investment market, create unfair conditions of competition among these different sorts of investors, and hence, inevitably decrease the opportunities for investment in the NAFTA Parties."); *see also GAMI v. Mexico*, Submission of the United States, para. 17 (June 20, 2003); *GAMI v. Mexico*, Escrito de Contestación of Mexico, para. 167 (Nov. 24, 2003).

[51] *See, e.g.*, *Mondev Int'l v. United States*, ICSID Case No. ARB(AF)/99/2, Award, paras. 84–86 (Oct. 11, 2002).

[52] *See, e.g.*, *GAMI v. Mexico*, Award, paras. 120–21 (Nov. 15, 2004) (acknowledging the policy tradeoffs); *Pope & Talbot v. Canada*, Award in Respect of Damages, paras. 75–76 (May 31, 2002).

[53] *See Bilcon v. Canada*, Award on Damages, paras. 379 & 389.

[54] *See* Dominican Republic—Central America Free Trade Agreement, Art. 10.16(1) (***DR-CAFTA***), *ava*ilable at https://ustr.gov/sites/default/files/uploads/agreements/cafta/asset_upload_file328_4718.pdf.

[55] Comprehensive and Progressive Agreement for Trans-Pacific Partnership, Art. 9.19(1) (***CPTPP***), *available at* https://dfat.gov.au/trade/agreements/in-force/cptpp/official-documents/Pages/official-documents.aspx.

[56] Korea—United States Free Trade Agreement, Art. 11.16(1) (amended in 2018) (***KORUS 2.0***), *available at* https://ustr.gov/sites/default/files/uploads/agreements/fta/korus/Chapter_Eleven_Investment.pdf. Article 11.18(4) further bars an investor from pursuing a KORUS claim while its parent or subsidiary (owned or controlled, directly or indirectly) is litigating a separate claim over the same measure and "arising from the same events or circumstances."

[57] United States—Mexico—Canada Agreement (**USMCA**), *available at* https://ustr.gov/sites/default/files/files/agreements/FTA/USMCA/Text/14-Investment.pdf. Where it allows ISDS, the USMCA follows the NAFTA's basic two-track approach with respect to corporations and shareholders. However, it mostly limits ISDS to claims between the US and Mexico, and further mostly limits ISDS substantively to claims of discrimination (national treatment and MFN) and direct expropriation. *Id.*, at Art. 14.D.3. For certain covered industries (including energy and telecommunications), the USMCA also allows ISDS claims involving investment contracts—again on the same two-track model, but with different privity rules for shareholder and company claims. *Id.*, at Art. 14.E.2. For "legacy" investments, i.e. those made after the NAFTA entered into force but before its replacement, the original NAFTA rules continue to apply to all three parties. There is no indication therein that any of the parties have changed their views as to the unavailability of SRL claims. In any case the severe truncation of ISDS more generally significantly reduces the question's sting.

remains risky and unpredictable given the varied interpretations of the NAFTA, and the fragmented institutional structure of ISDS.

(ii) Minimum equity requirements.

A handful of treaties limit small shareholdings' SRL claims by imposing minimum equity requirements on access to ISDS.[58] Such provisions may limit the universe of potential claimants at the margins. But they do little to limit multiple claims by parent-subsidiary chains, or to mitigate the corporate governance problems described above.

(iii) Consolidation and sequencing regimes.

Several treaties envision joinder of overlapping claims. They do so by empowering parties to an ISDS dispute to request consolidation, and/or by empowering tribunals to order consolidation under certain circumstances.[59] However, they rarely mandate joinder—nor could they do so comprehensively under current institutional arrangements, as overlapping claims may arise under separate treaties. Some treaties supplement claims consolidation rules by empowering tribunals to issue a stay pending resolution of overlapping or related ISDS claims.[60] But, here too, most treaties stop short of requiring such sequencing. Consolidation and sequencing provisions can strongly limit the universe of possible claims. They do not, however, limit SRL claims directly, and thus neither close off the possibility of overlapping claims and double recovery, nor resolve the basic corporate governance problems that SRL claims engender.

B. Tribunal-based responses

Most ISDS tribunals simply assume that investment treaties authorize SRL claims. Some have recognized potential problems with SRL—in relation to double recovery and multiple claims, and, occasionally, corporate governance. Lacking guidance in the underlying treaties, some tribunals have considered these concerns regrettable but unresolvable.[61] Yet a few have sought to craft techniques to minimize these problems *ex post*—essentially engaging in equitable balancing on a case-by-case basis. A few approaches can be distilled from the cases.

(i) Identity of parties limitations.

[58] *See, e.g.*, Turkey—Azerbaijan BIT, Art. 1 (2011) (excluding access to ISDS for shareholdings under 10%). The Southern African Development Community (***SADC***) Model BIT similarly excludes portfolio investments, defined as shareholdings under 10%. *See* SADC 2012 Model BIT Template with Commentary, 9-11 (2012), *available at* https://www.iisd.org/itn/wp-content/uploads/2012/10/SADC-Model-BIT-Template-Final.pdf.
[59] *See, e.g.* NAFTA Art. 1117(3) (mandating joinder of shareholder and company claims concerning the same facts, unless this would prejudice the interests of a party); and CETA, Art. 8.43 (providing for more comprehensive joinder rules within the structure of the standing CETA Tribunal).
[60] *See, e.g.* NAFTA Art. 1120(9); CETA Art. 8.24.
[61] *Eskosol v. Italy*, para. 170; *GAMI v. Mexico*, paras. 120–121*;* DOUGLAS, *supra* note 11, at 455.

A few tribunals have resisted entertaining multiple claims by an entity and its 100-percent owner(s), and instead looked through the corporate form.[62] In *Grynberg v. Grenada*, for example, three shareholders claimed reflective loss arising out of an injury to their wholly owned firm (RSM), after Grenada successfully fended off an earlier arbitration against the company itself. Highlighting the total identity of interest between these Claimants and RSM, the tribunal was comfortable invoking collateral estoppel to block the successive claims.[63] As an equitable *ex post* control, estoppel-style remedies are by nature indeterminate and likely to be inconsistently applied in practice. It is particularly difficult to draw bright lines for identifying a firm with its shareholders. Equitable limits based on identity-of-parties thus do little to remove the cloud of SRL claims *ex ante*, with its attendant negative effects for corporate governance, pricing credit, and host states' internal risk assessments.

(ii) Identity of shares limitations.

A similar equitable approach bars multiple SRL claims over the same tranche of shares. According to the tribunal in *Ampal v. Egypt*, this occurs where direct and indirect shareholders sue separately for reflective loss arising out of "the same tranche of interest in the same investment."[64] Such would be "tantamount to double pursuit of the same claim," and would amount to an "abuse of process" irrespective of the claimant's good or bad faith.[65] Although this approach may do more to limit multiple claims than the identity-of-parties test, it is similarly only a partial solution, unlikely to alleviate SRL's *ex ante* impact.

(iii) First shot rules.

Another recent approach focuses on limiting a controlling investor's ability to exploit parent-subsidiary chains to secure multiple bites at the apple. In *Orascom v. Algeria*, the ultimate owner both brought its own SRL claim against the State, and caused several subsidiary entities to bring separate claims under discrete treaties (including the local entity, the direct shareholder, and several intermediaries). In the tribunal's view "an investor who controls several entities in a vertical chain of companies may commit an abuse [of rights] if it seeks to impugn the same host state measures and claims for the same harm at various levels of the chain."[66] On this theory, such an investor can choose which entity brings the claim, but the first claim "crystallizes" the dispute and bars further shots.[67] This approach focuses on policing coordinated abusive practices within parent-subsidiary chains. It does not limit claims by non-controlling shareholders, and it is unclear if it would limit good faith uncoordinated action by discrete entities in the chain.[68] This *ex post* approach can somewhat reduce well-structured investors' leverage, and can partially limit the State's exposure to multiple claims. But it too is

[62] *See, e.g.*, *Eskosol v. Italy*, para. 167.

[63] *Grynberg et al. v. Grenada*, ICSID Case No. ARB/05/14, Award, para. 7.1.6–7 (Mar. 13, 2009) (the "Claimants collectively own 100% of RSM's stock and therefore entirely control the corporation. In these circumstances … there is nothing unfair in holding them to the results of RSM's Prior Arbitration." In claiming "standing on the basis of their indirect interest in corporate assets, they must be subject to defences that would be available against the corporation.").

[64] *Ampal-American v. Egypt*, para. 331

[65] *Id.*

[66] *Orascom TMT Investments v. Algeria*, ICSID Case No. ARB/12/35, Award, para. 542 (May 31, 2017).

[67] *Id.*, paras. 496, 523-524, 543.

[68] *Id.*, para. 543, n. 835 (viewing minority shareholder claims as essentially independent).

ultimately unpredictable and does little to resolve the *ex ante* problems that SRL creates. It may also amplify inefficient first mover incentives within the corporate chain.

A review of the relevant decisions suggests that case-by-case equitable balancing is an insufficient solution. Most of these approaches address only the problems of double recovery and multiple bites at the apple, and these only partially and indeterminately—although the *Orascom* abuse of rights standard goes furthest, and represents an ambitious and interesting development. Moreover, the fragmented nature of the system makes tribunal-driven reform unreliable in practice. To have full effect, any reform on this model would need to be codified.

V. REFORM OPTIONS

The availability of SRL claims in the context of ISDS causes significant harm—by exposing States to multiple overlapping claims, and by distorting basic principles of corporate governance on which all stakeholders rely. While allowing SRL claims in this context can have benefits, these are strongly outweighed by the harms. The benefits can also be realized through other, less restrictive means. On balance, the availability of SRL claims in ISDS is unfair, inefficient, and likely to drive up the costs of doing business for all concerned in the long term.

States and tribunals have sought to grapple with these problems to only a limited extent. While some existing treaty- and tribunal-based solutions are promising, these efforts remain irregular, inconsistent, and incomplete. Comprehensive, treaty-based reform is sorely needed in this area. In what follows we canvas a variety of reform options, paying due attention to their trade-offs. No reform will satisfy any actor completely, particularly given a status quo that is highly favorable to claimants.[69] We limit ourselves to pointing out a range of plausible reform options, which serve different mixes of values and interests. We proceed from the most radical option: (i) simply closing the door to SRL; to (ii) reforms that prioritize company claims over shareholder claims; to (iii) various forms of narrower procedural tinkering that seek to preserve SRL while moderating its harms.

A. Eliminating Shareholder Claims for Reflective Loss

A natural response to the critique of shareholder claims in ISDS might be to eliminate reflective loss claims altogether. This would be by far the easiest reform to operationalize, and would be immediately effective at responding to the critiques discussed above. It would also bring ISDS neatly in line with the normal expectations of domestic corporate law, on which corporate insiders and outsiders rely.

Such a step would also be the most radical departure from *status quo*. Recall that under most treaties locally incorporated companies would not themselves have the requisite nationality to compel the State into investment arbitration. Banning shareholder claims without more would empower States to almost entirely avoid exposure to ISDS, by simply requiring foreign investors to incorporate locally (though shareholder direct claims would still be available on current models). A simple ban would also allow States to exercise far more control over which foreign investors will have access to ISDS, either through allowing foreign incorporation or by

[69] Arato, *supra* note 1.

offering ISDS as a contract term.[70] In any case, a ban puts States firmly in the driver's seat. To some, upending ISDS will be a desirable option.[71] Banning SRL outright would go far toward accomplishing that goal, though there are probably cleaner ways to go about it.

For those who would reform *but maintain* ISDS, there are other options. It is possible to preserve ISDS as a credible protection for investors while completely mitigating the specific harms of SRL—non-zero-sum options focused on replacing shareholder claims with company claims, to which we now turn.

B. Perfecting Company Claim Regimes

It is possible to thread the needle between preserving ISDS protections for companies while eliminating the specific harms of the current SRL regime including the risks of double recovery, multiple claims, and corporate governance concerns. This entails funneling all ISDS claims through the local company, using various mechanisms for avoiding the nationality problem canvassed above either through deeming the local company foreign on the basis of its shareholders' nationality, or by empowering shareholders to engage in derivative action on the company's behalf. Both of these approaches can be found in current treaties, but in both cases current models can and should be improved to ensure that they are effective and adequately protective.

(a) "Deemed Foreign" Provisions

One way to prioritize company claims is to deem a locally incorporated entity as having the nationality of its otherwise treaty-covered shareholder for the purposes of ISDS, while explicitly closing the door to SRL. Several treaties provide for "nationality deeming" in this way.[72] Funneling all claims through the company would still maintain ISDS as a robust protection, while allaying the concerns canvassed above. However current models need to be reworked to avoid two particular pitfalls.

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[70] *See* J. Benton Heath, 'The Anti-Reformist Stance in Investment Law' (forthcoming 2023, working paper on file with authors).

[71] *See, e.g.* Public Statement on the International Investment Regime ("Osgoode Hall Statement"), 31 August 2010, para. 8, *available at* https://www.bilaterals.org/IMG/pdf/Public_Statement.pdf; M. Sornarajah, 'An International Investment Court: panacea or purgatory?,' Columbia FDI Perspectives, No. 180, August 15, 2016; Martti Koskenniemi, 'It's not the Cases, It's the System,' 18 JWIT 343, (2017) (reviewing M. Sornarajah, *Resistance and Change in the International Law of Foreign Investment* (2015)); Harrison Mbori, 'Exit is the Only Way Out: A Polemic Response to John Nyanje's "Hegemony in Investor-State Dispute Settlement: How African States Need to Approach Reforms,' Afronomicslaw, 10 Sep., 2020, *available at* https://www.afronomicslaw.org/2020/09/10/exit-is-the-only-way-out-a-polemic-response-to-john-nyanjes-hegemony-in-investor-state-dispute-settlement-how-african-states-need-to-approach-reforms/; Daria Davitti, Jean Ho, Paolo Vargiu, & Anil Yilmaz Vastardis, 'COVID-19 and the Precarity of International Investment Law,' IEL Collective (26 May, 2020), *available at* https://medium.com/iel-collective/covid-19-and-the-precarity-of-international-investment-law-c9fc254b3878.

[72] *See, e.g.*, US—Argentina BIT, Art. VII(8) and US—Turkey BIT, Art. VI(6) (allowing deeming whenever the local company is, at the time the dispute arises, "an investment" or shareholders with the requisite nationality); and Energy Charter Treaty, Art. 26(7) (limiting the deeming to cases of where controlling shareholders have the requisite nationality).

One downside with current models is that treaties that provide for nationality deeming have been interpreted as *also* allowing for SRL claims, undercutting the benefits entirely. Thus, key to operationalizing deeming provisions as a viable reform would be to *explicitly bar SRL* claims. Here, unlike with a simple ban on ISDS, the company claim preserves ISDS as a robust protection for corporate investors. However, without more, this fix creates a narrow, but serious risk of under-inclusion.

If made *exclusive,* the other downside of current deeming models is that the way they enable company claims might fail to provide adequate protection in two specific circumstances: where the State expropriates the local company outright, or where it interferes with the local company's management (e.g., by putting it in forced receivership, replacing officers or board members, and so on). The deeming approach requires relying on the local entity to bring any claim. But if the company is destroyed, taken over, or otherwise interfered with in such a way as to block its capacity to autonomously sue on its own behalf – i.e., if it is *made* unable or unwilling to press a claim – then investors could find themselves unprotected by ISDS when they need it most. Here, too, there are solutions.

Enabling company claims through deeming, such that the treaty explicitly bans shareholder claims for reflective loss, but expressly permits, defines, and broaden the scope of shareholder claims for direct loss, is a better way. Typically direct harms to shares would include interference with corporate governance rights like voting or selling stocks. The category could be easily expanded to include a right to claim for harm to the shares where the company has been destroyed by the State, or expropriated outright.[73] A provision defining the nature and scope of permissible shareholder direct claims could also cover indirect expropriation, as a protection against more subtle interference with the local company's internal corporate governance. But extending shareholder claim-making to *de facto* takings will involve resolving familiar line-drawing problems about the scope of indirect expropriation – tailored, in this case, to open the door to shareholder claims only where State action has made the company unable or unwilling to act on its own behalf.[74] These fixes are functional equivalents, though the former has the advantage of greater conceptual clarity.

Lastly, this model requires establishing a threshold for when a company can be deemed foreign. The Energy Charter Treaty, for instance, sets the threshold at control. There, the company's controlling shareholder must have the requisite foreign nationality.[75] Other treaties are more vague, requiring only that "immediately before the … events giving rise to the dispute, [the company] was an investment of nationals or companies of the other Party."[76] The threshold could use some refinement. It is not clear that the mechanism needs to be limited to control. That may not, for instance, strike the right balance vis-à-vis public companies without a controlling shareholder. The deeming threshold could be eased to expand protection for smaller shareholders without reopening risks of double recovery, multiple claims, or corporate governance distortions because the decision to sue would still lie with management, not with

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[73] *See* OECD Discussion Paper, *supra* note 9 (proposing a model clause generally barring SRL claims except in cases of direct expropriation).

[74] English law has at times recognized the existence of an exception to the prohibition of reflective loss claims where the company has been made unable to claim on its own behalf by the wrongdoer's action. *Giles v. Rhind,* [2003] Ch 618. However, in *Marex* a plurality of the Court cast doubt that exception (The bar on reflective loss claims "does not depend on whether the company is financially able to bring proceedings or not. If the shareholder has not suffered a recoverable loss, he has no claim for damages, regardless of whether, or why, the company may have failed to pursue its own cause of action."). *Marex,* at [70].

[75] *See* Energy Charter Treaty, Art. 26(7).

[76] *See, e.g.*, US—Argentina BIT, Art. VII(8); US—Turkey BIT, Art. VI(6).

the shareholders themselves. On the other hand, further caution might be warranted to avoid nationality deeming on the basis of a shareholder that is itself a purely paper company, to guard against the risk of treaty shopping by, for instance, a State's own nationals.[77]

In sum, deeming provisions can be a useful tool for funneling ISDS claims through the local company, thereby avoiding the major harms of multiple claims, double recovery, and upending corporate governance inside and outside the firm. However, current models would need to be improved by (i) expressly banning SRL; and (ii) providing for shareholder direct claims in case of expropriation. Further refinement is also possible by (iii) retooling the deeming threshold.

(b) Derivative Suits

The other mechanism for funneling ISDS claims into company claims is the derivative approach, famously present in the original NAFTA and its progeny. Here, the company is not deemed foreign, but a controlling shareholder with the requisite nationality is empowered to step into the local company's shoes and bring an ISDS suit in its name. This approach shares most of the benefits and disadvantages of the deeming approach. By prioritizing company claims, it eliminates the risks of double recovery and multiple claims, again (mostly) avoids distorting the ordinary expectations of corporate governance. It similarly must be perfected by explicitly banning shareholder claims for reflective loss, and should similarly be supplemented for some protection for shareholders in the event of outright expropriation.

With the derivative model, the risks arising out of expropriation are smaller because the shareholder can sue even if the State interferes with the company's internal governance. Still, some protection akin to the above would still be useful to ensure protection in the event of the legal destruction of the firm or where, due to illegitimate State interference, management refuses to make a claim on behalf of the company. These protections could be secured in much the same way as above: by expressly providing for shareholder recovery in cases of expropriation, as defined shareholder direct rights or by limiting SRL to the treaty's expropriation provision.

One difference between derivative suits and deeming models is that the former approach can distort relations between shareholders and management. For instance, in the event of perceived harmful State action against the company, one shareholder may wish to sue while management and/or other shareholders deem it in the best interest of the firm to preserve the relationship with the State and work things out. Overly broad access to the derivative suit may thus create distortive conflicts between management and shareholders, or among shareholders, and stand in the way of dispute prevention efforts. For this reason, current models tend to limit the derivative action to controlling shareholders. [78] Unlike in the case of deeming, some kind of control threshold here seems valuable. One downside is that companies without a single controlling shareholder may not be able to avail themselves of such derivative action unless the investment was already creatively structured (such that the local company was wholly owned by an intermediary with the requisite nationality, which could act as the agent of a derivative suit).

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[77] As was allowed, for example, by the Tribunal in *Tokios Tokelés v. Ukraine*, ICSID Case No. ARB/02/18, Decision on Jurisdiction, para. 37 (29 Apr., 2004).
[78] NAFTA, Art. 1117.

In sum, the NAFTA-style derivative approach is another promising route toward removing the harmful effects of SRL in ISDS while preserving meaningful protection for corporate investors. Like the deeming approach, it needs to be perfected by (i) expressly banning SRL; and (ii) providing for shareholder direct claims in cases of expropriation. Here, however, (iii) control thresholds are important from a corporate governance perspective, and any retooling must be mindful of distorting relations among controlling shareholders, minority shareholders, and management.

C) Procedural Tinkering

Finally, even if shareholder claims for reflective loss are retained in ISDS, reformers can mitigate some of their harms through a patchwork of procedural fixes. These options are not likely to resolve the problems systematically. But they may be useful in reducing the universe of possible claims, or in limiting opportunities for double recovery.

As noted above, *claim consolidation,* or *joinder* rules, can limit the problem of multiple claims.[79] Such provisions are valuable insofar as they empower parties to join claims by consent, and thus work well when the disputing parties wish to consolidate. But, as noted above, they are rarely framed as mandatory rules and likely cannot be made mandatory under current institutional arrangements given the significant jurisdictional hurdles tribunals would face in a regime where the bases of arbitration are so diverse. Claims consolidation is thus valuable in its own right in that it empowers disputing parties to join their claims and save time and effort in the process, but it does not really solve the problems with SRL where parties are not cooperating.

Ownership thresholds for SRL may also do some good from the perspective of respondent States, insofar as they reduce the overall universe of claims. However they will only mitigate, not solve, the problems of multiple claims and/or double recovery – and in fairly arbitrary ways unless the threshold is set at control. Doing so in the context of SRL (rather than a derivative suit or deeming provision) would grossly empower controlling shareholders over minority shareholders and creditors, since the latter alone could decide when to sue and would directly recover moneys that may not belong to it, or that may be necessary to keep the firm afloat.

A final option for procedural tinkering would involve codifying some of the *ex post* remedies that tribunals have innovated, such as the abuse of right standard developed in *Orascom*. These approaches have merit, insofar as they allow tribunals to police abuses on the back end. And codifying this would have the advantage of making all parties aware that there are limits on tolerable corporate behavior. But, as explained above, these techniques are incomplete and undependable, capable at most as serving as a back stop. It should also be understood that they would have to be operationalized by arbitrators who may not have the best incentives to limit shareholder claims for reflective loss.[80]

At the end of the day, the general openness of ISDS to shareholder claims for reflective loss creates many problems, with significant costs for States and investors alike. States can, and should, address these problems. If reform options focused on prioritizing company claims

[79] *See, e.g.* NAFTA Art. 1117(3) (mandating joinder of shareholder and company claims concerning the same facts, unless this would prejudice the interests of a party); and CETA, Art. 8.43 (providing for more comprehensive joinder rules within the structure of the standing CETA Tribunal).
[80] Arato, *supra* note 1.

prove unworkable under current political conditions, there may still be a place for procedural tinkering. But it should be understood that reform options like claim consolidation, equity thresholds, and *ex post* equitable remedies can only serve to soften the problem's edges.

CONCLUSION

Any project for reforming shareholder claims in ISDS should consider the varied interests at stake, including those of host States (as potential defendants) as well as corporate investors—with a special focus on the diverse interests of key corporate constituencies (controlling and minority shareholders, management, and creditors). These interests should not be thought of in zero-sum terms. However, they can be in tension. It may not be possible to perfectly balance all relevant interests, and any plausible reform options will likely be in the nature of imperfect alternatives. Still, it is certainly possible to improve upon the *status quo ante* for all concerned. The most promising options are those that funnel ISDS into company claims, like the deeming model and derivative model discussed above, as adequately buttressed with protections for investors in the event of expropriation. But narrower procedural fixes may also have their place.

At this stage, UNCITRAL is the place to pursue these reforms. These problems cannot be effectively addressed by arbitral interpretation. Treaty change is required, and preferably multilaterally given the possibility of treaty-shopping. Shareholder reflective loss fits squarely within WGIII's agenda, and is already the subject of a Secretariat working paper.[81] This Article has shown that the topic merits at least that level of attention.

[81] Note by the UNCITRAL Secretariat, 'Possible reform of investor-state dispute settlement (ISDS): Shareholder claims and reflective loss' UN Doc No A/CN.9/WG.III/WP.170 (9 August 2019), *relying* on an earlier version of the present Article, "Reforming Shareholder Claims in ISDS," Academic Forum on ISDS Working Paper 2019/9, available at http://bit.ly/ISDS_AF_SRL_2019.