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Shareholder Protection in International Investment Law

CHRISTOPH SCHREUER

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I. Introduction

In the vast majority of cases investors are companies. Although we often speak of the protection of the individual in international law, in international investment cases the relevant actors usually appear in the form of juridical persons. Corporations are owned by shareholders who may themselves be companies. A shareholder may own the company entirely, may own a majority of its shares or may just own a minority of shares. A shareholder may or may not control the company, which is not necessarily the same as majority ownership.

Under traditional international law the interests of foreign investors are represented by way of diplomatic protection. A State exercising diplomatic protection espouses the claim of its national and pursues it in its own name on the international plane. If the national is a company its nationality must be established. The usual method to determine a company's nationality is the place of its incorporation or *siège social*. More recently, a number of techniques have been developed to look behind these formal criteria in order to take account of economic realities.¹

¹ For a comprehensive analysis see Pia Acconci, "Determining the Internationally Relevant Link between a State and a Corporate Investor, Recent Trends concerning the Application of the 'Genuine Link' Test", 5 *The Journal of World Investment & Trade* (2004), pp. 139-175. See also Francisco Orrego Vicuña, "Changing Approaches to the Nationality of Claims in the Context of Diplomatic Protection and International Dispute Settlement", 15 *ICSID Review – Foreign Investment Law Journal* (2000), pp. 340-361.

In current international investment law, diplomatic protection has given way to new methods of dispute settlement. The most frequently applied method is direct arbitration between the host State and the foreign investor. The arbitration agreement underlying this form of arbitration need not be contained in a direct agreement between the host State and the foreign investor. In the majority of current cases it is based on a general offer contained in a treaty or, less frequently, in domestic legislation. The most important type of treaty for this purpose is bilateral investment treaties (BITs) of which over 2400 are currently in force. The majority of cases take place in the framework of the Convention on the Settlement of Investment Disputes between State and Nationals of other States (ICSID Convention).

The claimants in investment arbitration must meet certain requirements with respect to their nationality. Most importantly, they must not be nationals of the host State.² In order to be able to rely on a treaty for the protection of investments, they must have the nationality of a State party to the treaty with the host State. In a number of situations companies that are instrumental in investments may be unable to institute arbitration because they do not have the requisite nationality. A company established under the law of the host State will be disqualified, in principle, because it does not have the status of a foreign investor. A company established under the law of another State may be disqualified because that State does not have a BIT or another suitable treaty with the host State or because the company's home State is not a party to the ICSID Convention.

In situations such as these the owners or shareholders behind the company may want to institute proceedings if they meet the necessary requirements of nationality and consent to arbitration. The question arises whether shareholders may pursue their rights independently or are dependent on action by the company.

The question is particularly acute with respect to companies incorporated in the host State. But a similar problem arises also, though less frequently, where the company in question is incorporated in another State. The shareholding may be controlling, in which case it makes sense to see the controlling owner as the true investor and to pierce the corporate veil. But a shareholder who neither owns a majority of the company nor controls it may also have a legitimate interest in the protection of its investment. The shareholding may be held directly by the claimant or indirectly by way of another company. The damage done to the shareholder may affect its rights as shareholder directly, such as the expropriation of its shares, or the damage may be more indirect, such as the diminution of the profitability or value of the company.

² Article 25(2)(b) of the ICSID Convention excludes nationals of the host State from party status in principle.

II. Barcelona Traction

The *casus classicus* on the protection of shareholders is the *Barcelona Traction* case.³ In a nutshell, in that case the International Court of Justice held that Belgium, the State of nationality of the majority shareholders of a company incorporated in Canada, was unable to pursue claims against Spain for damage done to the company.⁴ Upon a superficial reading one might reach the conclusion that *Barcelona Traction* is authority for the general proposition that shareholders as such enjoy no protection under international law. Such a conclusion would be in error for a number of reasons.

First, *Barcelona Traction* was decided under customary international law. The ICJ was aware of the limited usefulness of customary international law on this point and specifically referred to the protection of shareholders' rights by way of treaties.⁵ The ICJ said:

Thus, in the present state of the law, the protection of shareholders requires that recourse be had to treaty stipulations or special agreements directly concluded between the private investor and the State in which the investment is placed. States ever more frequently provide for such protection, in both bilateral and multilateral relations, either by means of special instruments or within the framework of wider economic arrangements.⁶

Second, the ICJ recognized that the exclusion of shareholders' rights against a host State inflicting damage on a company would not necessarily apply if the company in question is incorporated in the host State. That situation is, of course, by far the most frequent one in practice. The Court said:

... a theory has been developed to the effect that the State of the shareholders has a right of diplomatic protection when the State whose responsibility is invoked is the national State of the company.⁷

Third, and most importantly, practice since 1970, the year of the decision in *Barcelona Traction*, demonstrates an increasing willingness to grant an

³ *Barcelona Traction, Light and Power Co., Ltd. (Belgium v. Spain)*, Judgment, 5 February 1970, ICJ Reports 1970, p. 4.

⁴ For recent commentary on this case see Ian A. Laird, "A Community of Destiny – The *Barcelona Traction* Case and the Development of Shareholder Rights to Bring Investment Claims", in Todd Weiler, ed., *International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law* (2005), pp. 77-96; Yoram Dinstein, "Diplomatic Protection of Companies under International Law", in Karel Wellens, ed., *International Law: Theory and Practice, Essays in Honour of Eric Suy*, 1998, pp. 505-517.

⁵ See especially paras. 89-90 of the Judgment at pp. 47-48.

⁶ At para. 90.

⁷ At para. 92. This theory is reflected in Article 11 of the International Law Commission's Draft Articles on Diplomatic protection as of 2004. See: A/CN.4/L.647. The ILC's draft subjects this rule to the further requirement that incorporation under the law of the host State's law was required by it as a precondition for doing business there.

independent standing to shareholders. Most of this practice, which will be examined below, did not arise in the context of diplomatic protection but in cases in which shareholders pursued their own claims through international investment arbitration.⁸ This state of affairs has recently prompted a commentator to observe, with respect to *Barcelona Traction*, that

one can make a strong argument that the decision of the ICJ no longer reflects the current state of international law.⁹

The limited applicability of a doctrine denying rights to shareholders under international law is demonstrated by another Judgment of the ICJ in the subsequent *ELSI* case.¹⁰ That case concerned claims against Italy on behalf of United States shareholders in a company incorporated in Italy. In that case, the ICJ took it for granted, without discussion in the Judgment, that the United States was entitled to protect its shareholders in the Italian company.¹¹

III. Companies incorporated in the host State

1. Locally incorporated companies as foreign investors

Investments are frequently carried out through companies incorporated in the host State. In fact, many States require the establishment of a local company as a precondition for foreign investment. The local company may have been established by the foreign investor especially for the purpose of carrying out a particular investment. Alternatively, the foreign investor may have acquired shares in an existing company.

The local company would not as such qualify as a foreign investor and would hence be excluded from resorting to international arbitration. This would have deprived a large proportion of foreign investment of international protection. In order to avoid this undesirable result a number of treaties have resorted to various techniques.

Under the ICSID Convention the host State and the foreign investor may agree that the locally incorporated company should be treated as a foreign company because of its foreign control.¹² Under this technique there are two

⁸ For the significance of this distinction see Stanimir A. Alexandrov, "The 'Baby Boom' of Treaty-Based Arbitrations and the Jurisdiction of ICSID Tribunals: Shareholders as 'Investors' and Jurisdiction *Ratione Temporis*", 4 *The Law and Practice of International Courts and Tribunals* (2005), pp. 19-59 at p. 27.

⁹ Laird, *op. cit.* (note 4), p. 77. See also Acconci, *op. cit.* (note 1), p. 154.

¹⁰ *Case concerning the Elettronica Sicula S.p.A. (ELSI) (United States of America v. Italy)*, Judgment, 20 July 1989, ICJ Reports 1989, p. 15.

¹¹ See the Separate Opinion of Judge Oda at p. 83 indicating that this point must have played a role in the Court's deliberations. On this point see also Dinstein, *op. cit.* (note 4), pp. 511-513.

¹² Article 25(2)(b) of the ICSID Convention provides in relevant part: "National of another Contracting State" means: ... any juridical person which had the nationality of the Contracting State party to the dispute on that date and which, because of foreign control, the parties have agreed should be treated as a national of another Contracting State for the purposes of this Convention.

requirements: an agreement and the objective fact of foreign control.¹³ The local company itself has standing and the shareholders are protected indirectly through its actions. This method works only if the foreign investor controls the company, especially through sole ownership or majority shareholding. It will not work if the foreign investor only holds a minority of the shares and does not control the company.

A slightly different method is used by the NAFTA. An investor that owns or controls a company registered in another State party may submit a claim to arbitration on behalf of that company.¹⁴ This provision too requires ownership or control by the foreign investor.¹⁵

Tribunals have interpreted these provisions with some flexibility. In *Amco v. Indonesia*,¹⁶ the foreign parent company, Amco Asia, carried out the investment through its subsidiary PT Amco, which was registered in the host State. The ICSID consent agreement only named PT Amco. The Tribunal accepted PT Amco as a claimant in accordance with Article 25(2)(b) of the ICSID Convention since Indonesia had agreed to treat it as a foreign investor because of its foreign control.¹⁷ In addition, the Tribunal accepted the controlling parent company as a claimant.¹⁸ The Tribunal said:

The foreign investor was Amco Asia; PT Amco was but an instrumentality through which Amco Asia was to realize the investment.

Now, the goal of the arbitration clause was to protect the investor. How could such protection be ensured, if Amco Asia would be refused the benefit of the clause? Moreover, the Tribunal did find that PT Amco had this benefit, because of the foreign control under which it is placed: would it not be fully illogical to grant this protection to the controlled entity, but not to the controlling one?¹⁹

¹³ For detailed discussion see Christoph Schreuer, *The ICSID Convention: A Commentary*, Cambridge 2001, pp. 290-334.

¹⁴ Article 1117 NAFTA provides in relevant part: 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 ...

¹⁵ See also the Claims Settlement Declaration of 19 January 1981 establishing the jurisdiction of the Iran-US Claims Tribunal. Article VII(2) of the Declaration defines eligible claims as: ... including claims that are owned indirectly by such nationals through ownership of capital stock or other proprietary interests in juridical persons, provided that the ownership interests of such nationals, collectively, were sufficient at the time the claim arose to control the corporation or other entity, and provided, further, that the corporation or other entity is not itself entitled to bring a claim under the terms of this Agreement. For provisions in BITs treating control over companies as a relevant criterion see Rudolf Dolzer / Margrete Stevens, *Bilateral Investment Treaties*, The Hague/Boston/London 1995, pp. 38-41.

¹⁶ *Amco v. Indonesia*, Decision on Jurisdiction, 25 September 1983, 1 ICSID Reports 389.

¹⁷ At paras. 10-15.

¹⁸ At paras. 16-26

¹⁹ At para. 24.

2. Shareholding as investment

Treaties for the protection of investments, especially BITs, contain definitions of investments that include shares or participation in companies as typical forms of investment.²⁰ A typical example is the BIT between Argentina and the United States which includes the following item in its definition of “investment”:

a company or shares of stock or other interests in a company or interests in the assets thereof;²¹

In this way, the participation in the locally incorporated company becomes the investment. Even if the local company is unable or unwilling to pursue the claim internationally, the foreign shareholder in the local company may pursue the claim in his own name. Put differently, the local company is not endowed with investor status but the participation therein is seen as the investment. The shareholder may then pursue claims for adverse action by the host State against the local company that affects its value and profitability. In the words of *Alexandrov*:

As a result, the question whether investors holding shares in local companies have made an investment in the host state and, therefore, have standing to submit claims to ICSID arising directly out of that investment, should not pose significant obstacles to ICSID jurisdiction.²²

Arbitral practice on this point is extensive and uniform.²³ In *AMT v. Zaire*,²⁴ jurisdiction was based on the BIT between the United States and Zaire. Under the terms of the Zaire-United States BIT the term “investment” includes “a company or shares of stock or other interests in a company or interests in the assets thereof.”²⁵ AMT’s claim was based on its 94% ownership of SINZA, a locally incorporated company. The claim arose from Zaire’s failure to protect SINZA’s property against looting and losses to that property caused by

²⁰ See Dolzer/Stevens, *op. cit.* (note 15), pp. 27/28. See also Article 1139 of the NAFTA; Article 1(6)(b) of the Energy Charter Treaty. For the practice of the United Nations Compensation Commission see Acconci, *op. cit.* (note 1), pp. 163-168.

²¹ Argentina-United States BIT, Article I(1)a)(ii).

²² *Alexandrov*, *op. cit.* (note 8), p. 28.

²³ In addition to the cases discussed below see *Antoine Goetz et consorts c. République du Burundi*, Decision of 2 September 1998, 6 ICSID Reports 3 at para. 89; *Emilio Augustín Maffezini v. The Kingdom of Spain*, Decision on Jurisdiction, 25 January 2000, 5 ICSID Reports 396 at paras. 68-70; *Compañía de Aguas del Aconquija, S.A. & Compagnie Générale des Eaux v. Argentine Republic* (the Vivendi case), Decision on Annulment, 3 July 2002, 6 ICSID Reports 340 at para. 50; *Azurix Corp. v. Argentine Republic*, Decision on Jurisdiction, 8 December 2003, 43 *ILM* (2004), p. 259 at paras. 63-65, 73; *LG&E Energy Corp. v. Argentine Republic*, Decision on Jurisdiction, 30 April 2004, <http://ita.law.uvic.ca/documents/LGE-DecisiononJurisdiction-English.pdf> at paras. 53-63; *Plama Consortium Ltd. v. Republic of Bulgaria*, Decision on Jurisdiction, 8 February 2005, 44 *ILM* (2005), p. 721 at paras. 125-129.

²⁴ *AMT v. Zaire*, Award, 21 February 1997, 36 *ILM* (1997), p. 1531, 5 ICSID Reports 11.

²⁵ Article I(c).

elements of Zaire's armed forces. The Respondent argued that its dispute was really with a Zairian company in which the Claimant was merely a majority stockholder. Therefore, AMT had not made a direct investment in its own name. The Tribunal rejected this argument and pointed out that under the terms of the Zaire-United States BIT, AMT's investment consisted of the participation in the Zairian company.²⁶ After quoting from the BIT's definition of "investment", cited above, the Tribunal said:

It is uncontested that SINZA belongs to AMT 94 per cent and that AMT, formed in the United States of America with 55 per cent of its shares owned by United States citizens, is controlled by the Americans, and hence is a U.S. company. Thus, SINZA should be considered in terms of the perfectly clear provisions of the Treaty [the BIT] as an investment of AMT.²⁷

In *Alex Genin v. Estonia*,²⁸ jurisdiction was based on the BIT between Estonia and the United States. That BIT, in its definition of "investment", includes "a company or shares of stock or other interests in a company or interests in the assets thereof". The Claimants, United States nationals, were the principal shareholders of EIB, a financial institution incorporated under the law of Estonia. The claims arose, principally, from the revocation of EIB's license by the Estonian authorities. The Tribunal rejected the Respondent's argument that the claim did not relate to an "investment" as understood in the BIT. It said:

The term "investment" as defined in Article I (a)(ii) of the BIT clearly embraces the investment of Claimants in EIB. The transaction at issue in the present case, namely the Claimants' ownership interest in EIB, is an investment in "shares of stock or other interests in a company" that was "owned or controlled, directly or indirectly" by Claimants.²⁹

In *CME v. Czech Republic*,³⁰ jurisdiction was based on the BIT between the Czech Republic and the Netherlands. That BIT contained a definition of the term "investment" which included "shares, bonds and other kinds of interests in companies and joint ventures, as well as rights derived therefrom;"³¹ CME, a Netherlands company, held a 99% equity interest in CNTS, a company registered in the Czech Republic. The claim arose from the alleged failure of the Czech authorities to protect CNTS against the loss of its use of a television license. The Respondent argued that CME had failed to establish that it had invested assets in the Czech Republic.³² The Tribunal rejected this argument:

²⁶ At paras. 3.13-3.15, 4.05, 5.07-5.16, 5.24-5.25.

²⁷ At para. 5.15

²⁸ *Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil v. The Republic of Estonia*, Award, 25 June 2001, 6 ICSID Reports 241.

²⁹ At para. 324.

³⁰ *CME Czech Republic B. V. (The Netherlands) v. The Czech Republic*, Partial Award, 13 September 2001, 9 ICSID Reports 121.

³¹ Article 1(a)(ii).

³² Partial Award paras. 291-293.

375. ... The dispute concerns an investment of the Claimant within the terms of Article 1 (a) of the Treaty. Article 1 (a) provides that the term investment shall comprise every kind of asset invested either directly or through an investor of a third State. The investment can be (*inter alia*) shares, other kinds of interests in companies and joint ventures, as well as rights deriving therefrom, title to money and other assets and to any performance having an economic value.

376. The Claimant is the 99 % shareholder of CNTS. These shares as well as all rights deriving therefrom qualify as an investment of the Claimant under Article 8.1 and Article 1 (a) (ii) of the Treaty.³³

3. Minority Shareholding

Accepting the controlling shareholder of a company that is incorporated in the host State as claimant may be seen as just another way of disregarding the corporate form and of looking for the true investor. Although tribunals have at times stressed the fact that the foreign investor owned a controlling majority of the local company,³⁴ practice shows that minority shareholders too have been accepted as claimants and have been granted protection under the respective treaties.³⁵ This practice has prompted Stanimir Alexandrov to state that

In sum, it is beyond doubt that shareholders have standing in ICSID to submit claims separate and independent from the claims of the corporation. Moreover, this principle applies to all shareholders, no matter whether or not they own the majority of the shares or control the corporation.³⁶

In *AAPL v. Sri Lanka*,³⁷ jurisdiction was based on the BIT between the United Kingdom and Sri Lanka. That BIT contains a definition of investment that includes “shares, stock and debentures of companies or interests in the property of such companies;”³⁸ AAPL was a minority shareholder in Serendib, a Sri Lankan company. The claim arose from the destruction of Serendib’s property by Sri Lankan security forces. The status of AAPL’s shareholding as an investment was never challenged. Nor was its right to put forward claims

³³ At paras. 375, 376.

³⁴ *Azurix Corp. v. Argentine Republic*, Decision on Jurisdiction, 8 December 2003, 43 *ILM* (2004), p. 259 at paras. 63 and 65.

³⁵ In addition to the cases discussed below see *Compañía de Aguas del Aconquija, S.A. & Compagnie Générale des Eaux v. Argentine Republic* (the *Vivendi* case), Decision on Annulment, 3 July 2002, 6 *ICSID Reports* 340 at para. 50; *Champion Trading Co. and Ameritrade International Inc. v. Arab Republic of Egypt*, Decision on Jurisdiction, 21 October 2003, <http://www.worldbank.org/icsid/cases/champion-decision.pdf> at para. 3.4.2.; *GAMI Investments, Inc. v. Mexico*, Award, 15 November 2004, <http://ita.law.uvic.ca/documents/Gami.pdf> at paras. 28, 29, 37; *LG&E Energy Corp. v. Argentine Republic*, Decision on Jurisdiction, 30 April 2004, <http://ita.law.uvic.ca/documents/LGE-DecisiononJurisdiction-English.pdf> at paras. 50, 53-63.

³⁶ Alexandrov, *op. cit.* (note 8), p. 30

³⁷ *AAPL v. Sri Lanka*, Award, 27 June 1990, 4 *ICSID Reports* 246.

³⁸ Article 1(a).

cast into doubt. In the Award's section dealing with the quantum of the compensation due to AAPL the Tribunal said:

The undisputed "investments" effected since 1985 by AAPL in Sri Lanka are in the form of acquiring shares in Serendib Company, which has been incorporated in Sri Lanka under the domestic Companies Law.

Accordingly, the Treaty protection provides no direct coverage with regard to Serendib's physical assets as such (...), or to the intangible assets of Serendib if any (...). The scope of the international law protection granted to the foreign investor in the present case is limited to a single item: The value of his share-holding in the joint-venture entity (Serendib Company).³⁹

In *LANCO v. Argentina*,⁴⁰ jurisdiction was based on the BIT between Argentina and the United States. LANCO's claim was based on a minority participation in a consortium which had been granted a concession under a Concession Agreement to operate port facilities. The investor claimed that Argentina had damaged its investment by giving more favourable treatment to a competitor. Argentina argued that LANCO did not have an investment protected by the BIT since it owned only about 18% of the capital stock of the local consortium. The Tribunal rejected this jurisdictional objection. It held that an investor was not required to have control over the company or to have a majority share for its investment to be protected by the BIT. After quoting the definition of "investment" from the Argentina-US BIT, the Tribunal said:

... as regards shareholder equity, the ARGENTINA-U.S. Treaty says nothing indicating that the investor in the capital stock has to have control over the administration of the company, or a majority share; thus the fact that LANCO holds an equity share of 18.3% in the capital stock of the Grantee allows one to conclude that it is an investor in the meaning of Article I of the ARGENTINA-U.S. Treaty.⁴¹

In *CMS v. Argentina*,⁴² jurisdiction was also based on the BIT between Argentina and the United States. The claimant owned 29.42% of TGN, a company incorporated in Argentina. The claim concerned the alleged suspension by Argentina of a tariff adjustment formula for gas transportation by TGN.⁴³ Argentina argued that CMS, as a minority shareholder in TGN, could not claim for any indirect damage resulting from its participation in the Argentinean company.⁴⁴ The Tribunal rejected this argument.⁴⁵ It said:

³⁹ At para. 95.

⁴⁰ *LANCO v. Argentina*, Decision on Jurisdiction, 8 December 1998, 5 ICSID Reports 367.

⁴¹ At para. 10. The Tribunal also noted that LANCO was a co-signor of the Concession Agreement and that this fact gave LANCO an independent status as an investor. See para. 15.

⁴² *CMS Gas Transmission Company v. Republic of Argentina*, Decision on Jurisdiction, 17 July 2003, 42 *ILM* (2003), p. 788.

⁴³ Paras. 1, 19.

⁴⁴ At paras. 36, 37.

⁴⁵ At paras. 47-65.

The Tribunal therefore finds no bar in current international law to the concept of allowing claims by shareholders independently from those of the corporation concerned, not even if those shareholders are minority or non-controlling shareholders.⁴⁶ ... There is indeed no requirement that an investment, in order to qualify, must necessarily be made by shareholders controlling a company or owning the majority of its shares.⁴⁷

4. Indirect shareholding

In some cases the claimant is not the immediate shareholder of the affected company. This raises the question whether an investor can claim for damage done to a company of which it owns shares only indirectly through the intermediary of another company. In other words, if investor A owns shares in company B and company B owns shares in company C, is it possible for investor A to pursue a claim for damage inflicted by a host State upon company C?

Several variables may be relevant in a situation of this kind. One is the issue of majority ownership and control. As demonstrated above, minority and non-controlling shareholders are capable, in principle, of pursuing claims arising from damage inflicted upon the company. If there are two or more layers of minority shareholding the economic consequence of the adverse action by the host State may still be traceable. But the pursuit of legal remedies becomes increasingly complex especially if competing sets of shareholders at different levels pursue parallel or conflicting remedies.

Another variable is the country of the seat or place of incorporation of the intermediate shareholder. This may be the claimant's home State, the host State or a third State. The cases discussed below are organized according to this latter criterion. But the examples offered by practice so far, by no means exhaust the full range of possibilities that may arise in the future.

a) Shareholding through an intermediary in the investor's home State

A relatively simple issue presented itself in *Siemens v. Argentina*.⁴⁸ In that case Argentina objected to the Tribunal's jurisdiction on the ground that the shares in SITS, the company incorporated in Argentina for the purpose of carrying out the investment, were not held by Siemens but by SNI (Siemens Nixdorf Informationssysteme AG), another German company. This, in Argentina's view, meant that there was no direct relationship between

⁴⁶ At para. 48.

⁴⁷ At para. 51. To the same effect see *Enron Corp. and Ponderosa Assets, L.P. v. Argentine Republic*, Decision on Jurisdiction, 14 January 2004, <http://ita.law.uvic.ca/documents/Enron-Jurisdiction.pdf> at paras. 39, 44, 49 and Decision on Jurisdiction (Ancillary Claim), 2 August 2004, <http://ita.law.uvic.ca/documents/Enron-DecisiononJurisdiction-FINAL-English.pdf> at paras. 21, 22, 29, 39.

⁴⁸ *Siemens A.G. v. Argentine Republic*, Decision on Jurisdiction, 3 August 2004, 44 *ILM* (2005), p. 138.

Siemens and the investment. Siemens pointed out that it not only wholly owned SNI but that the latter was entirely integrated into Siemens.⁴⁹ The Tribunal rejected Argentina's argument. It found that the Argentina-Germany BIT contained no explicit reference to direct or indirect investment. It noted that the BIT's definition of investment included "shares, rights of participation in companies and other types of participation in companies" and concluded:

The plain meaning of this provision is that shares held by a German shareholder are protected under the Treaty. The Treaty does not require that there be no interposed companies between the investment and the ultimate owner of the company. Therefore, a literal reading of the Treaty does not support the allegation that the definition of investment excludes indirect investments.⁵⁰

b) Shareholding through an Intermediary in the Host State

The situation is considerably more complex in *Enron v. Argentina*.⁵¹ That case arose under the Argentina-United States BIT and concerned allegedly excessive tax assessments imposed by Argentinean provinces in respect to a gas transportation company. The Tribunal explained the indirect shareholding of Enron in the affected Argentinean registered company TGS in the following terms:

Claimants' participation concerns the privatization of *Transportadora de Gas del Sur* ("TGS"), one of the major networks for the transportation and distribution of gas produced in the provinces of the South of Argentina. The Claimants own 50% of the shares of CIESA, an Argentine incorporated company that controls TGS by owning 55.30% of its shares; the Claimants' participation in CIESA is held by two wholly-owned companies, EPCA and EACH. The Claimants, through EPCA, EACH and ECIL, another corporation controlled by the Claimants, also own 75.93% of EDIDESCA, another Argentine corporation that owns 10% of the shares of TGS; and they also have acquired an additional 0.02% of TGS through EPCA. The investment as a whole, it is explained, amounts to 35.263% of TGS.⁵²

As is apparent from this description, the claimant's shareholding in the affected local company TGS was not only indirect but involved a number of other locally registered companies and several layers of ownership. The Tribunal looked at the definition of investment in the BIT and found that it does not exclude claims by minority or non-controlling shareholders.⁵³ The Tribunal said:

... there is nothing contrary to international law or the ICSID Convention in upholding the concept that shareholders may claim independently from the

⁴⁹ At paras. 123-134.

⁵⁰ At para. 137. See also para. 142.

⁵¹ *Enron Corp. and Ponderosa Assets, L.P. v. Argentine Republic*, Decision on Jurisdiction, 14 January 2004, <http://ita.law.uvic.ca/documents/Enron-Jurisdiction.pdf>

⁵² At para. 21.

⁵³ At para. 44.

corporation concerned, even if those shareholders are not in the majority or in control of the company.⁵⁴

Therefore

... claims made by investors that are not in the majority or in the control of the affected corporation when claiming for violations of their rights under such treaty are admissible.⁵⁵

But the Tribunal was concerned about the consequences of an application of this principle to indirect shareholding, especially if several intermediate companies are involved. It said:

... the Claimants made their investment in various companies participating in CIESA and only marginally in TGS. That is, they invested in a string of locally incorporated companies that in turn made the investment in TGS. The Argentine Republic has rightly raised a concern about the fact that if minority shareholders can claim independently from the affected corporation, this could trigger an endless chain of claims, as any shareholder making an investment in a company that makes an investment in another company, and so on, could invoke a direct right of action for measures affecting a corporation at the end of the chain. ... there is indeed a need to establish a cut-off point beyond which claims would not be permissible as they would have only a remote connection to the affected company.⁵⁶

The Tribunal found the solution in the extent of the host State's consent to arbitration. It held that the claimants had been specifically invited by the Argentinean government to make their investment. In addition, the investors had certain decision making powers in the management of TGS. It followed that the claimants had *jus standi* in their capacity as protected investors.⁵⁷

This reasoning, while leading to a satisfactory solution in the particular case, does not lend itself for general application. Reliance on participation in management is a partial departure from the principle that non-controlling shareholders enjoy protection. The emphasis on consent to arbitration through an invitation to the investor is at variance with the principle of "arbitration without privity".⁵⁸ Under this principle an offer of consent to arbitration by a host State through a treaty or national legislation does not depend on personal contact with a particular investor. Any investor who qualifies under the terms of the BIT would be entitled to institute arbitration. The Tribunal's demand for a cut-off point for indirect shareholding lacks a legal foundation. Any difficulties arising from a multiplicity of claimants can be taken care of by a number of devices but do not require that the investor be deprived of its standing.

⁵⁴ At para. 39.

⁵⁵ At para. 49.

⁵⁶ At paras 50, 52.

⁵⁷ At paras. 52-57.

⁵⁸ This expression has been coined by Jan Paulsson, "Arbitration Without Privity", 10 *ICSID Review – Foreign Investment Law Journal* (1995), p. 232.

c) *Shareholding through an intermediary in a third State*

The intermediate owner of the shares in the company that is registered in the host State may have its seat or place of registration in a third country, that is, neither in the claimant's home State nor in the host State. In *Lauder v. The Czech Republic*,⁵⁹ the Claimant, a U.S. citizen, controlled CME, a Dutch company which in turn owned 99% of CNTS, a company registered in the Czech Republic. The claim arose from action by a Czech regulatory authority that allegedly contributed to destroying the value of the Czech company. The right of the claimant as the indirect shareholder in CNTS to bring a claim seems to have been disputed initially but the respondent eventually admitted that for jurisdictional purposes the claimant controlled the investment.⁶⁰ The Tribunal decided that it had jurisdiction to decide upon the claim on the basis of the BIT between the Czech Republic and the United States. It found that some breaches had occurred but declined the claims for damages.

The case achieved notoriety because CME pursued parallel proceedings under the BIT between the Czech Republic and the Netherlands. The Tribunal in these proceedings came to a different decision on the merits and awarded substantial damages.⁶¹ The conflicting awards in these two cases dealing with the same set of facts, on the basis of practically identical treaty provisions, has caused justified concern.⁶² The situation was caused, in part, by the decision to allow parallel proceedings by the direct and by the indirect owners of the shares in the host State company. But these two cases are not necessarily a convincing argument against allowing claims by indirect owners where the intermediate owner is incorporated in a third State. The problem could have been dealt with satisfactorily through a consolidation of the two cases or a flexible application of the principles of *lis pendens* and *res judicata*.

*Waste Management v. Mexico*⁶³ demonstrates that claims based on shareholding by way of a third country intermediary are possible also in the framework of the NAFTA. The case arose from a concession agreement between the city of Acapulco and Acaverde, a Mexican company. The claimant owned Acaverde by way of a holding company (AcaVerde Holdings Ltd.), a Cayman Islands company.⁶⁴ The Tribunal examined Chapter Eleven of the NAFTA and found:

⁵⁹ *Ronal S. Lauder v. The Czech Republic*, Award, 3 September 2001, 9 ICSID Reports 66.

⁶⁰ At paras. 77, 120, 153, 154.

⁶¹ *CME Czech Republic B. V. (The Netherlands) v. The Czech Republic*, Partial Award, 13 September 2001, 9 ICSID Reports 121.

⁶² See e.g. Wolfgang Kühn *et al.*, "How to Avoid Conflicting Awards – The *Lauder* and *CME* Cases", 5 *The Journal of World Investment & Trade* (2004), p. 7.

⁶³ *Waste Management INC. v. United Mexican States*, Award, 30 April 2004, 43 *ILM* (2004), p. 967.

⁶⁴ The history of the holding arrangement is described by the Tribunal in para. 77.

There is no hint of any concern that investments are held through companies or enterprises of non-NAFTA States, if the beneficial ownership at relevant times is with a NAFTA investor.⁶⁵

The Tribunal noted that Article 1139 of the NAFTA contained a definition of the term “investment” which included: “(e) an interest in an enterprise that entitles the owner to share in income or profits of the enterprise”. It concluded that the nationality of the investment (as opposed to the investor) is irrelevant.⁶⁶ The Tribunal said:

If the NAFTA Parties had wished to limit their obligations of conduct to enterprises or investments having the nationality of one of the other Parties they could have done so. Similarly they could have restricted claims of loss or damage by reference to the nationality of the corporation which itself suffered direct injury. No such restrictions appear in the text. It is not disputed that at the time the actions said to amount to a breach of NAFTA occurred, Acaverde was an enterprise owned or controlled indirectly by the Claimant, an investor of the United States. The nationality of any intermediate holding companies is irrelevant to the present claim.⁶⁷

The above practice would indicate that indirect shareholding by way of an intermediate company does not deprive the beneficial owner of its right to pursue claims for damage done to the company by the host State. In this context it matters little whether the intermediate owner of the affected company’s shares is incorporated in the claimant’s home State, the host State or in a third State.

IV. Companies incorporated in a State other than the host State

In all the cases discussed so far the company adversely affected by the host State’s action was incorporated in that State. It is possible to analyze the facts in the last two cases, discussed above (*Lauder* and *Waste Management*), from a different angle. In both these cases the intermediate owners of the shares were incorporated in States other than the host State and it is arguable that these companies too were affected by the host States’ adverse action. Therefore, the claimants who were shareholders in the third country companies suffered damage through the devaluation of their shares in these companies. That, of course, would be the classical situation as it arose in *Barcelona Traction*. But that is not how the claims were presented in these cases nor did the tribunals examine the facts from that perspective.

In *Sedelmayer v. Russia*,⁶⁸ the claimant, a German national, was the sole owner and CEO of SGC International incorporated in Missouri, USA. SGC International made an investment in Russia in the area of law enforcement

⁶⁵ At para. 80.

⁶⁶ At paras. 82, 83.

⁶⁷ At para. 85.

⁶⁸ *Franz Sedelmayer v. The Russian Federation*, Award, 7 July 1998, [http:// www.iisd.org/pdf/2004/investment_sedelmayer_v_ru.pdf](http://www.iisd.org/pdf/2004/investment_sedelmayer_v_ru.pdf)

equipment. When a dispute arose from this activity, Sedelmayer instituted arbitration proceedings under the BIT between Germany and the Russian Federation. The reason was obvious: there was no BIT in force between the United States and Russia, but there was a BIT between Germany and Russia. Russia objected to the Tribunal's jurisdiction on the ground that the US-company rather than its German owner was the investor.⁶⁹

The Tribunal found that it had jurisdiction over the claim under Russia's BIT with Germany. It based this finding on Sedelmayer's full control of SGC, on a growing support for the "control theory" as evidenced by the ICJ's judgment in the *ELSI* case, and on the BIT's object and purpose.⁷⁰

The significance of the *Sedelmayer* case is limited. It was adopted by a majority of the Tribunal and subject to a forceful dissenting opinion. The reasoning in the majority decision is not particularly strong. The decision is written not in terms of shareholder protection but of piercing the corporate veil in order to find the "true investor". Therefore, it cannot be taken as incontrovertible authority for the acceptance of the protection of shareholders in companies registered outside the host State.

Another pertinent case is *Tokios Tokelès v. Ukraine*.⁷¹ In that case a Lithuanian company claimed under the BIT between Lithuania and the Ukraine. The dispute arose from alleged adverse action against the claimant's subsidiary in the Ukraine by Ukrainian authorities. The respondent objected to the Tribunal's jurisdiction on the ground that the claimant was not a genuinely Lithuanian company since it was owned and controlled predominantly by Ukrainian nationals.⁷² The Tribunal rejected the objection. It found that the BIT looked exclusively at the place of incorporation to establish a corporate investor's nationality.⁷³ The BIT did not contain a "denial of benefits" clause that would have allowed a party to deny the benefits of the treaty to an entity that is controlled by foreign nationals and does not engage in substantial business activities in the State of its incorporation.⁷⁴ Under the ICSID Convention, departure from the principle of incorporation or *siège social* in favour of foreign control to determine corporate nationality is permissible only under the narrowly circumscribed conditions of Article 25(2)(b). These conditions were not met in the present case.⁷⁵ Equitable "veil piercing" would have been appropriate only in case of an abuse of legal personality which was not the case.⁷⁶

⁶⁹ At sections 4.1., 2.1.1. and 2.1.4.

⁷⁰ At section 2.1.5.

⁷¹ *Tokios Tokelès v. Ukraine*, Decision on Jurisdiction, 29 April 2004, http://ita.law.uvic.ca/documents/Tokios-Jurisdiction_000.pdf.

⁷² At paras. 21, 22.

⁷³ At paras. 27-30.

⁷⁴ At paras. 33-36.

⁷⁵ At paras 42-52.

⁷⁶ At paras. 53-56.

Tokios Tokelès might be interpreted as a case in which a tribunal gave protection to shareholders in respect of a company incorporated in a country other than the respondent host State. But it is unlikely that such an interpretation would do justice to the decision. The Tribunal's majority⁷⁷ was not concerned with shareholder protection but with the investor's nationality. The fact that the shareholders were predominantly nationals of the host State makes such an interpretation implausible.

What *Sedelmayer* and *Tokios Tokelès* have in common is that in both cases the shareholders channelled their investments through a company with a convenient nationality in order to obtain certain advantages. Strategies of this kind are not necessarily illegitimate. As the *Tokios* Tribunal pointed out, the States parties to investment treaties are perfectly capable of dealing with this issue through appropriate treaty provisions such as a denial of benefits clauses if they wish to do so.

V. Direct or indirect damage to shareholders

A recurrent theme in the cases concerning rights of shareholders is the question whether shareholders may only claim for State action that affects their shareholding directly or whether they are protected also against measures that reduce the economic value of the company.⁷⁸ The ICJ in *Barcelona Traction* said:

... 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.⁷⁹

The ICJ described the direct rights of the shareholder as the right to any dividend, voting rights and the right to a share in the company's residual assets upon liquidation. The Court added that whenever one of these direct rights was infringed, the shareholder had an independent right of action.⁸⁰

Respondent States have repeatedly relied on this distinction in order to fend off shareholders' claims arising from alleged damage to the company.⁸¹ In particular, Argentina has attempted to argue that only direct damage to

⁷⁷ The Tribunal's President appended a dissenting opinion and subsequently resigned from the case.

⁷⁸ For detailed treatment see Alexandrov, *op. cit.* (note 8), pp. 32-33, 40-45.

⁷⁹ *Barcelona Traction, Light and Power Co., Ltd. (Belgium v. Spain)*, Judgment, 5 February 1970, ICJ Reports 1970, p. 4, at para. 47.

⁸⁰ *Loc. cit.* See also *Case concerning the Elettronica Sicula S.p.A. (ELSI) (United States of America v. Italy)*, Judgment, 20 July 1989, ICJ Reports 1989, p. 15, at para. 106. The concept of direct injury to the rights of shareholders is also reflected in Article 12 of the International Law Commission's Draft Articles on Diplomatic protection as of 2004. See: A/CN.4/L.647.

⁸¹ *Mondev International Ltd. v. United States of America*, Award, 11 October 2002, 42 *ILM* (2003), p. 85 at paras. 82, 83.

shareholders' rights was actionable. These arguments have been rejected consistently by the tribunals.⁸²

In *GAMI v. Mexico*,⁸³ the claimant, a U.S. registered corporation, held a 14.18% equity interest in GAM, a Mexican registered corporation. Mexico had expropriated a number of mills belonging to GAM. The Tribunal found that GAMI's minority shareholding in GAM was covered by the definition of "investment" under Article 1139 of the NAFTA.⁸⁴ The Tribunal identified the question in the following terms:

The heart of this debate is whether governmental acts or omissions that adversely affect GAM may be pleaded as breaches of NAFTA because they had the result of reducing the value of GAMI's stake in GAM.⁸⁵

The Tribunal said:

GAMI's shareholding was never expropriated as such. GAMI contends that Mexico's conduct impaired the value of its shareholding to such an extent that it must be deemed tantamount to expropriation.⁸⁶

The United States, in a written observation to the Tribunal, invoked *Barcelona Traction* as authority for a "rule that shareholders may assert claims only for injuries to their interests and not for injuries to the corporation."⁸⁷ The Tribunal denied that *Barcelona Traction* established a rule that must be extended beyond diplomatic protection.⁸⁸

The Tribunal's decision was as follows:

The fact that a host State does not explicitly interfere with share ownership is not decisive. The issue is rather whether a breach of NAFTA leads with sufficient directness to loss or damage in respect of a given investment.⁸⁹

It follows that the distinction between direct rights of shareholders to ownership in the shares and their indirect rights in the assets of the company has not been sustained by practice. Alexandrov, after a detailed examination of the relevant practice, has summarized the situation as follows:

⁸² See *CMS Gas Transmission Company v. Republic of Argentina*, Decision on Jurisdiction, 17 July 2003, 42 *ILM* (2003), p. 788, paras. 59, 66-69; *Azurix Corp. v. Argentine Republic*, Decision on Jurisdiction, 8 December 2003, 43 *ILM* (2004), p. 259 at paras. 69, 73; *Enron Corp. and Ponderosa Assets, L.P. v. Argentine Republic*, Decision on Jurisdiction, 14 January 2004, <http://ita.law.uvic.ca/documents/Enron-Jurisdiction.pdf> at paras. 35, 43-49, 58-60 and Decision on Jurisdiction (Ancillary Claim), 2 August 2004, <http://ita.law.uvic.ca/documents/Enron-DecisiononJurisdiction-FINAL-English.pdf> at paras. 17, 34-35; *Siemens A.G. v. Argentine Republic*, Decision on Jurisdiction, 3 August 2004, 44 *ILM* (2005), p. 138 at paras. 125, 136-150.

⁸³ *GAMI Investments, Inc. v. Mexico*, Award, 15 November 2004, <http://ita.law.uvic.ca/documents/Gami.pdf>

⁸⁴ At para. 26.

⁸⁵ At para. 27.

⁸⁶ At para. 35.

⁸⁷ At para. 29.

⁸⁸ At para. 30. Curiously the Tribunal proceeded to rely on *ELSI* even though that case also involved diplomatic protection.

⁸⁹ At para. 33.

It is noteworthy that all the tribunals' decisions discussed above gave little if any credence to the argument that when a shareholder invokes a dispute relating to assets of the local company (e.g., rights under a license, or contractual rights), such a dispute does not arise directly out of an investment in the stock of the company. Tribunals disposed of this argument in a rather summary fashion. It is clear that they all considered it to be beyond doubt that a shareholder's interest in a company includes an interest in the assets of that company, including its licenses, contractual rights, rights under law, claims to money or economic performance, etc., and that in finding jurisdiction they based that reasoning on the broad definition of investment in the applicable BITs.⁹⁰

VI. Conclusions

Shareholder protection has come a long way since *Barcelona Traction*. It is now generally accepted, on the basis of treaty provisions, that shareholding in a company is a form of investment that enjoys protection. Even if the affected company does not fulfil the nationality requirements under the relevant treaty there will be a remedy if the shareholder does. This is particularly relevant where, as is frequently the case, the company has the nationality of the host State and does not qualify as a foreign investor. In this situation, the company in question is not treated as the investor but as the investment. Foreign shareholders in the local company may then avail themselves of any rights they may have as foreign investors under treaties. This right does not depend on any majority shareholding but extends to minority shareholders.

The rights of shareholders have been protected also in situations where the shares were held indirectly by way of intermediate companies. In this context it is irrelevant whether the intermediate companies holding the shares of the directly affected companies are incorporated in the claimant's home State, the respondent host State or in a third State.

There is authority for the proposition that shareholding in companies that are incorporated or have their seat in a State other than the host State is also protected. Therefore, a shareholder that fulfils the requisite nationality requirements under a treaty would be able to claim even if the investing company in which he holds shares does not.

Shareholder protection extends not only to ownership in the shares but also to the assets of the company. Adverse action by the host State in violation of treaty guarantees that affects the company's economic position gives rise to right by the shareholders.

The practice, as outlined above, grants broad protection to shareholders. This includes majority and minority shareholding as well as direct and indirect shareholding, irrespective of the nationality of the companies in which the shares are held. Practical problems may arise where claims are pursued in parallel, especially by different shareholders. In addition, the affected

⁹⁰ Alexandrov, *op. cit.* (note 8), p. 45.

company itself may pursue certain remedies while a group of its shareholders may pursue different ones. The situation becomes even more complex where indirect shareholding through intermediaries is combined with minority shareholding. In such a case shareholders and companies at different levels may pursue conflicting or competing litigation strategies that may be difficult to reconcile and coordinate. These procedural difficulties alone are not a sufficient reason to deny legal protection to certain groups of shareholders. But they will require careful and innovative efforts to coordinate the different proceedings. These will include consolidation, *pro rata* awards, a flexible application of *lis pendens* and *res judicata* as well as other methods.