Shareholder Claims for Reflective Loss in Investor-State Disputes and Reform Options

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〈 목 차 〉

Ⅰ. Introduction
Ⅱ. Shareholder claims and reflective loss
Ⅲ. Responses by ISDS tribunals and States
1. Treatment of reflective loss claims by ISDS tribunals
2. Treaty-based responses by States
Ⅳ. Proposed reform solutions and concluding remarks

Ⅰ. Introduction

Since 2017, the United Nations Commission on International Trade Law ("UNCITRAL" or the "Commission") has been considering a number of reform options to improve the investor-State dispute settlement ("ISDS") system.[1] One of the concerns identified by Working Group III, tasked with that work by the Commission, relates to multiple proceedings in ISDS.[2] This was on the basis that multiple proceedings could: (i) result in divergent interpretations by ISDS tribunals

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* The views expressed herein are those of the author and do not reflect the views of the United Nations or UNCITRAL.

1) Official Records of the General Assembly, Seventy-second Session, Supplement No. 17 (A/72/17), para. 264.

2) Working papers and reports of Working Group III as well as comments received from States are available on the Working Group website (https://uncitral.un.org/en/working_groups/3/investor-state).

leading to inconsistent or conflicting outcomes, undermining predictability;[3] (ii) increase the overall cost and duration of the dispute resolution,[4] impairing judicial economy; and (iii) distort the balance of rights and interests of relevant stakeholders.[5] It was mentioned that multiple proceedings could have damaging effects, particularly for developing States.[6] Accordingly, the Working Group concluded that reforms would be desirable.[7]

Multiple proceedings in ISDS may result from a number of factors - the involvement of multiple parties located in different jurisdictions, the existence of multiple legal bases or causes for claims as well as the availability of multiple fora for asserting such claims.[8] However, they result mainly from two types of situations. The first type is where different entities within the same corporate structure assert claims against the same measure in relation to the same investment. Those entities may raise their claims in various fora and under different sources of law, while seeking the benefit of substantially the same interest. The second type is where a State measure has an impact on a number of non-related investors. While issues of law and fact in these proceedings will generally be common to all the claimants, decisions rendered by separate tribunals may yield different outcomes.

This article examines the first type of situation leading to multiple proceedings, more specifically where foreign shareholders of a local company raise claims against a State for reflective loss.[9] It provides an overview of issues and concerns relating to

3) Report of Working Group III (ISDS Reform) on the work of its thirty-sixth session (Vienna, 29 October - 2 November 2018) (A/CN.9/964), para. 42, available at https://undocs.org/en/A/CN.9/964.

4) *Ibid.,* para. 45.

5) *Ibid.,* para. 42.

6) *Ibid.,* para. 46.

7) *Ibid.,* para. 53.

8) The topic of concurrent proceedings in international arbitration was considered by the Commission as a future topic at its forty-eighth (2015) and forty-ninth (2016) sessions based on notes prepared by the Secretariat (A/CN.9/848 and A/CN.9/881, available respectively at https://undocs.org/en/A/CN.9/848 and https://undocs.org/en/A/CN.9/881). The deliberations at those sessions eventually contributed to the decision by the Commission to embark work on ISDS reform in 2017. *See supra note* 1.

9) While the topic of shareholder claims and reflective loss had been identified by the Working Group as a topic separate from multiple proceedings, the Working Group began to consider the two topics jointly beginning at

shareholder claims for reflective loss in ISDS (referred to below as "reflective loss claims"). This article then analyzes relevant case law of ISDS tribunals and treaty-based measures taken by States to respond to reflective loss claims and concludes by examining reform options under consideration by Working Group III. As the Working Group is focusing on procedural reforms mainly in the context of treaty-based arbitration, this paper also focuses on procedural solutions.[10)]

Ⅱ. Shareholder claims and reflective loss

Shareholders of companies can be harmed in broadly two ways by measures taken by States or government entities. First, they can suffer 'direct' injury to their rights as a shareholder (for example, when their shares are seized, or when their right to dividends or to attend and vote at a shareholder meeting is restricted). Second, they can suffer 'indirect' injury or so-called 'reflective loss' through an injury to the company, which affects its overall value and leads to a loss in the value of the shares.

This distinction between shareholders' direct injuries and reflective loss is generally recognized in international law and has been reaffirmed by the International Court of Justice ("ICJ"). In the *Barcelona Traction case,* the court stated that "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".[11)] The 2006 Draft Articles on Diplomatic Protection adopted by the International Law Commission (ILC) also makes this distinction.[12)]

its fortieth session. *See* Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-ninth session (Vienna, 5-9 October 2020) (A/CN.9/1044), paras. 41-56, available at https://undocs.org/en/A/CN.9/1044.

10) For example, this paper does not examine more substantive issues, like whether shareholders can assert contractual rights of the company and how to calculate damages. It also does not address other relevant issues, such as whether minority shareholders can raise claims and whether indirect shareholders can raise claims.

11) *Case Concerning Barcelona Traction, Light and Power Company, Limited (Belgium v. Spain),* Second Phase, Judgment (1970), paras. 46-47, ICJ Reports of Judgments, Advisory Opinions and Orders (1970), 36, available at https://www.icj-cij.org/public/files/case-related/50/050-19700205-JUD-01-00-EN.pdf. *See also, Case Concerning Ahmadou Sadio Diallo (Republic of Guinea v. Democratic Republic of the Congo),* Judgment on Preliminary Objections (2007), para. 88, ICJ Reports of Judgments, Advisory Opinions and Orders (2007), 614-615 ("The

In the domestic context, reflective loss claims are generally barred due to a number of policy reasons including judicial economy and the prevention of double recovery.[13] Accordingly, reflective loss claims are dismissed by domestic courts and only the directly injured company can recover the loss.[14] This is found to be more efficient and fairer considering a number of corporate stakeholders involved, including creditors.

In contrast, many ISDS tribunals have

theory of protection by substitution seeks indeed to offer protection to the foreign shareholders of a company who could not rely on the benefit of an international treaty and to whom no other remedy is available, the allegedly unlawful acts having been committed against the company by the State of its nationality. Protection by 'substitution' would therefore appear to constitute the very last resort for the protection of foreign investments"), available at https://www.icj-cij.org/public/files/case-related/103/103-20070524-JUD-01-00-EN.pdf, and *Case concerning Elettronica Sicula S.p.A. (ELSI) (United States of America v. Italy),* Judgment (1989), para. 106, ICJ Reports of Judgments, Advisory Opinions and Orders (1989), 64 ("The 'property' to be protected under the Treaty of Friendship, Commerce and Navigation was not the plant and equipment of the Italian company, ELSI, but the entity of ELSI itself, which was argued by the United States as being the property of the two US corporations"), available at https://www.icj-cij.org/public/files/case-related/76/076-19890720-JUD-01-00-EN.pdf.

12) Article 11 states that a State of nationality of shareholders in a corporation shall not be entitled to exercise diplomatic protection except in two circumstances. In contrast, article 12 states that the State is entitled to exercise diplomatic protection to the extent that an internationally wrongful act of another State causes direct injury to the rights of shareholders as such, as distinct from those of the corporation itself. *See* Official Records of the General Assembly, Sixty-first Session, Supplement No. 10 (A/61/10), paras. 49-50. The Draft Articles are also available at https://legal.un.org/ilc/texts/instruments/english/draft_articles/9_8_2006.pdf.

13) *See* Gaukrodger, David, Investment Treaties as Corporate Law: Shareholder Claims and Issues of Consistency, OECD Working Papers on International Investment, 2013/03, OECD Publishing, 15-21, available at http://dx.doi.org/10.1787/5k3w9t44mt0v-en. *See also* Gaukrodger, David, Investment Treaties and Shareholder Claims for Reflective Loss: Insights from Advanced Systems of Corporate Law, OECD Working Papers on International Investment, 2014/02, OECD Publishing, available at http://dx.doi.org/10.1787/5jz0xvgngmr3-en; Gaukrodger, David, Investment Treaties and Shareholder Claims: Analysis of Treaty Practice, OECD Working Papers on International Investment, 2014/03, OECD Publishing, available at https://doi.org/10.1787/5jxvk6shpvs4-en; and Chaisse, Julien and Lisa Zhuoyue Li, "Shareholder Protection Reloaded: Redesigning the Matrix of Shareholder Claims for Reflective Loss", 52 Stan. J. Int'l L. 51 (2016), 54-57.

14) *See*, for example, *Meditrust Healthcare Inc. v. Shoppers Drug Mart* (2002), paras. 12 and 13. The Court of Appeal for Ontario stated: "[12] The rule in Foss v. Harbottle provides simply that a shareholder of a corporation – even a controlling shareholder or the sole shareholder – does not have a personal cause of action for a wrong done to the corporation. The rule respects a basic principle of corporate law: a corporation has a legal existence separate from that of its shareholders. A shareholder cannot be sued for the liabilities of the corporation and, equally, a shareholder cannot sue for the losses suffered by the corporation. … [13] The rule in Foss v. Harbottle also avoids multiple lawsuits. Indeed, without the rule, a shareholder would always be able to sue for harm to the corporation because any harm to the corporation indirectly harms the shareholders." Available at https://files.pca-cpa.org/pcadocs/bi-c/2.%20Canada/3.%20Exhibits/R-0584.PDF.

interpreted bilateral investment treaties ("BIT") and multilateral treaties containing provisions on protection of investment and investors (referred to below generally as "investment treaties") as permitting reflective loss claims. References to "shares" in many investment treaties are simply that they are treated as investment. For example, article 11.28 of the Korea-United States Free Trade Agreement ("KORUS") states that an investment may take the form of shares, stocks and other forms of equity participation in an enterprise.[15] As shares in a local company typically fall under the definition of protected assets and constitute direct investment,[16] shareholders and indirect investors are protected through an extensive notion thereof.

In fact, most of the ISDS claims against the Korean government have been raised by foreign shareholders, for example, LSF-KEB Holding SCA as a shareholder of Korea Exchange Bank,[17] Elliot Associates[18] and Mason Capital Management LLC[19] as shareholders of Samsung C&T, and Schindler Holding AG as a shareholder of Hyundai Elevator.[20]

Foreign investments are often structured through a number of different legal entities, including companies incorporated in the host State.[21] Instances where a foreign investor directly acquires physical assets are relatively

15) The text of KORUS is available at https://ustr.gov/sites/default/files/uploads/agreements/fta/korus/Chapter_Eleven_Investment.pdf.

16) Wehland, Hanno, The Coordination of Multiple Proceedings in Investment Treaty Arbitration, Oxford International Arbitration Series, 2013, 29-32. Article 1139 of the North American Free Trade Agreement (NAFTA) refers to equity or debt securities and defines them as including "voting and non-voting shares, bonds, convertible debentures, stock options and warrants."

17) For more information, *see* UNCTAD Investment Dispute Settlement Navigator, https://investmentpolicy.unctad.org/investment-dispute-settlement/cases/485/lsf-keb-v-korea.

18) For more information, *see* UNCTAD Investment Dispute Settlement Navigator, https://investmentpolicy.unctad.org/investment-dispute-settlement/cases/893/elliott-v-korea.

19) For more information, *see* UNCTAD Investment Dispute Settlement Navigator, https://investmentpolicy.unctad.org/investment-dispute-settlement/cases/941/mason-v-korea.

20) For more information, *see* UNCTAD Investment Dispute Settlement Navigator, https://investmentpolicy.unctad.org/investment-dispute-settlement/cases/939/schindler-v-korea.

21) ISDS tribunals have generally indicated that structuring of an investment through companies incorporated in a specific jurisdiction with a view to obtaining protection under an investment treaty is legitimate. Wehland, *supra note* 16, 28, *footnote* 75.

rare. Instead, investors hold the shares of local companies directly or indirectly through an entity in a different jurisdiction.[22] To complicate the scenario, the investor may itself be owned by a foreign entity, which may include a portfolio investor with minority shares. Considering that foreign shareholdings have greatly increased in recent years, there may be a wide range of entities that could be in a position to assert claims against the host State.

This may be due to foreign equity limitations in sectors like media, electricity, and telecommunications.[23] Taking a minority stake in a company controlled by a domestic shareholder may be the only way of investment for foreign investors.[24] In such cases, treaty-based claims might be the only way to seek compensation arising from an injury caused by the host State's breach of its obligations under the applicable investment treaty. If foreign shareholders are denied this remedy, measures in breach of investment treaties might prevail, which could increase the potential risks for foreign investors. Accordingly, reflective loss claims could be a deterrent against any misconduct by the host State and could protect the

22) *See European American Bank Investment Bank AG (Austria) v. Slovak Republic,* PCA Case No. 2010-17, Award on Jurisdiction (22 October 2012), para. 321, available at https://www.italaw.com/sites/default/files/case-documents/italaw4226.pdf. The tribunal noted: "This is broad language which is quite wide enough to encompass what is today the very common situation of a foreign company making an investment through a subsidiary incorporated in the host State. In the usage [⋯], an investor of State A which acquired control of a shareholding in a company incorporated in State B would be described as investing in the territory of State B irrespective of whether it had purchased the shares in its own name or arranged that they be purchased by a locally incorporated subsidiary whose decision-making it controlled."

23) *See* Mistura, Fernando and Caroline Rouet, The determinants of Foreign Direct Investment: Do Statutory restrictions matter?, OECD Working Papers on International Investment, 2019/01, OECD Publishing, 13, available at https://www.oecdilibrary.org/finance-and-investment/the-determinants-of-foreign-direct-investment_641507ce-en. "Equity restrictions are by far the most frequent type of restriction and can take different forms: they typically prevent full or foreign-majority ownership, but sometimes forbid foreign participation entirely; sometimes the scope is limited to acquisitions only instead of all foreign investments, i.e. acquisitions and greenfield projects; on rare occasions it applies only to listed companies or to investments in a specific company, typically former state monopoly holders; sometimes the cap on foreign ownership applies to the entire sector, stimulating competition only among foreign investors when the threshold is attained." The World Bank's analysis of foreign investment conditions in 103 countries indicates that nearly 80% of 103 countries surveyed maintain foreign equity limitations in some sectors. *See* De la Medina Soto, Christian and Tania Ghossein, Starting a Foreign Investment across Sectors, World Bank Policy Research Working Paper 6707, 2013, 6-7, available at http://documents1.worldbank.org/curated/en/668051468333271202/pdf/WPS6707.pdf.

24) *Supra note* 9 (A/CN.9/1044), para. 51.

interest of the shareholders and eventually that of the company.[25)]

Nonetheless, Working Group III has identified a number of concerns with regard to reflective loss claims, some of which overlap with those identified with respect to multiple proceedings. This is because reflective loss claims by unrelated shareholders of the same injured company and by different shareholders in the vertical corporate chain combined with direct claims by the injured company itself, all of which can be based on different legal bases and in different fora (including domestic courts) are likely to generate multiple claims. In short, reflective loss claims open the possibility of a single economic entity having multiple chances to raise claims, only needing to prevail in one of them to be compensated. This scenario exposes a respondent State to the risk that it has to defend itself multiple times against essentially the same alleged injury to the same economic entity, even if it prevails in one of them. Furthermore, divergent interpretations of the same facts and the same treaty provisions by different tribunals could lead to very different outcomes, raising concerns about inconsistency.

More specific to reflective loss claims, it is argued that their availability makes it difficult for the disputing parties to reach an amicable settlement due to the existence of potentially multiple as well as unknown claimants.[26)] Another concern about reflective loss claims is that they increase the risk of the so-called double recovery, compensations surmounting the injury suffered. In theory, a respondent State could be required to pay overlapping damages, should it fail to defend against more than one claim.[27)] Yet another externality relates

25) Submission by the Corporate Counsel International Arbitration Group (CCIAG) to UNCITRAL Working Group III (30 September 2020), available at https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/cciag_shareholder_claims_submission_093020.pdf.

26) Arato, Julian, Kathleen Claussen, Jaemin Lee, and Giovanni Zarra, “Reforming Shareholder Claims in ISDS,” Academic Forum on ISDS Concept Paper, 2019/9, para. 14. “The availability of reflective loss claims also makes it difficult for States to have confidence in any settlement with management, or individual shareholders, as other shareholders may still be able to bring independent reflective loss claims for the same alleged injury.”

27) Damages, methodologies for calculating damages and underlying legal principles are also topics, which States have suggested the reforms might be necessary. *See* Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of thirty-eighth session (Vienna, 14-18 October 2019) (A/CN.9/1004*), paras.

to their distorting effect on corporate governance. One consequence of permitting reflective loss claims by foreign shareholders is discrimination as domestic shareholders are deprived of the same remedy. Furthermore, the local company might itself not be able to seek remedies under domestic law or an investment treaty. This could undermine the company's separate legal personality by enabling shareholders to impact its overall management and gain access to funds belonging to the company. In the case of the insolvency of the company, reflective loss claims pose potential risks for the company, its creditors as well as other shareholders because foreign shareholders could recover damages that would normally be shielded from liquidation,[28] on which various creditors may have priority, and on which other shareholders expect parity.[29] Needless to say, these stakeholders may also have rights and means to raise claims and be compensated (also as an investor under an investment treaty).[30] The availability of reflective loss claims does not necessarily negate such rights but rather complicates the overall process for recovering damages suffered by the company.

One may argue that the concerns outlined above are hypothetical, speculative and do not manifest in reality.[31] Nevertheless, it can be said that the uncertainties surrounding reflective loss claims continue to have a negative impact on the predictability of the

24, 102 and 104.

28) *See* UNCITRAL Legislative Guide on Insolvency Law, 266-274 (also recommendations 187-189), available athttps://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/05-80722_ebook.pdf. "While many creditors will be similarly situated with respect to the kinds of claims they hold based on similar legal or contractual rights, others will have superior claims or hold superior rights. For these reasons, insolvency laws generally rank creditors for the purposes of distribution of the proceeds of the estate in liquidation by reference to their claims, an approach not inconsistent with the objective of equitable treatment. ⋯ most insolvency laws rank the claims in the following order, those of secured creditors, administrative costs and expenses, priority and privileged claims (such as employee and tax claims), unsecured creditors to be followed by owners and shareholders. The general rule in insolvency laws is that shareholders are not entitled to a distribution of the proceeds of assets until all other claims that are senior in priority have been fully repaid (including claims of interest). As such, shareholders rarely receive any distribution in respect of their interest in the debtor."

29) Gaukordger, *supra note* 13 (2014/02), 20.

30) Other shareholders or creditors may also qualify as an investor to raise an ISDS claim. *See* Gaukrodger, *supra note* 13 (2013/03), 45-47.

31) CCIAG, *supra note* 25.

ISDS system for States, investors and shareholders alike, possibly adding to the increased cost of ISDS. And these doubts contribute to undermining the overall ISDS system, resulting in calls for and efforts of ISDS reforms. However, in developing reform options, one must be mindful to not overlook the fact that investment treaties provide additional protection to foreign investors recognizing that they face a heightened risk and that access to ISDS may be the only means available to seek compensation. By doing so, investment treaties achieve their underlying objective of encouraging foreign investment.[32] Therefore, reforms aimed at bringing a level of certainty to issues arising from reflective loss claims through their regulation, either through substantive or procedural regulations, would need to take into account the impact that such regulations could have on the promotion of foreign investment.

Ⅲ. Reponses by ISDS tribunals and States

1. Treatment of reflective loss claims by ISDS tribunals

It is worth noting that the phrase “reflective loss claims” is nowhere to be found in investment treaties. However, the question of whether shareholders have a standing to raise such claims in investment disputes has been raised by governments in numerous cases and accordingly, addressed by ISDS tribunals. The *Lanco v. Argentina* case in 1998 is said to be the first tribunal to discuss this issue in detail, holding that the claimant with an equity share of 18.3% was an investor under article 1 of the Argentina-U.S. BIT.[33] Since then, tribunals have generally found that shareholders are entitled to raise reflective loss claims based on a broad understanding of the scope of protected investment under investment treaties.[34] Despite this general acceptance and permissive approach of arbitral tribunals

32) *Supra note* 9 (A/CN.9/1044).

33) *Lanco International Inc. v. Argentine Republic,* ICSID Case No. ARB/97/6, Decision on Jurisdiction, 8 December 1998, para. 10, available at https://www.italaw.com/sites/default/files/case-documents/ita0450_0.pdf.

34) A survey of available and important awards in this regard and their findings can be found in Chaisse, *supra note* 13, 69-74.

with respect to reflective loss claims, some tribunals have acknowledged potential problems that they raise. This section introduces some of those findings.

In *Grynberg v. Grenada,* three shareholders claimed reflective loss arising out of an injury to their wholly-owned company, RSM, against which Grenada had successfully defended a claim.[35] The tribunal, therefore, concluded that a prior award involving the company RSM had a binding effect on its shareholders and that if the shareholders wished to claim standing on their indirect interest in corporate assets, they are subject to the defences available against RSM, including collateral estoppel.[36]

ISDS tribunals have been attentive to double recovery by considering related pending and prior claims and prorating damages.[37] For example, the tribunal in I*mpregilo S.p.A. v. Argentina* noted: "The question of double compensation being granted would seem to the Arbitral Tribunal to be a theoretical rather than a real practical problem. It seems obvious that if compensation were granted to AGBA (the company) at domestic level, this would affect the claims that Impregilo (shareholder of AGBA) could make under the BIT, and conversely, any compensation granted to

35) *RSM Production Corporation v. Grenada,* ICSID Case No. ARB/05/14, Final award (13 March 2009)

36) *Grynberg et al. v. Grenada,* ICSID Case No. ARB/10/6, Award (14 October 2010), paras. 7.1.2-7. On the binding effect of the prior RSM award, the tribunal stated: "It is also not disputed that the doctrine of collateral estoppel is now well established as a general principle of law applicable in the international courts and tribunals such as this one⋯ This is because they are, and were at the time of the Prior Arbitration, RSM's three sole shareholders. They were thus privies of RSM at the time. As such, they, like RSM, are bound by those factual and other determinations regarding questions and rights arising out of or relating to the Agreement. Of course, RSM is a juridical entity with a legal personality separate from its three shareholders. But this does not alter the analysis. First, the Claimant shareholders' only investment is a contract to which RSM is a party and the shareholders are not: the shareholders seek compensation for damage they allege they have suffered indirectly, 'through RSM,' for violations of RSM's legal rights. Second, the three individual 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. It is true that shareholders, under many systems of law, may undertake litigation to pursue or defend rights belonging to the corporation. However, shareholders cannot use such opportunities as both sword and shield. If they wish to claim standing on the basis of their indirect interest in corporate assets, they must be subject to defences that would be available against the corporation - including collateral estoppel."

37) Zarra, Giovanni, Parallel Proceedings in Investment Arbitration, 2016, Eleven International Publishing and Giappichelli, 39.

Impregilo at international level would affect the claims that could be presented by AGBA before Argentine courts."[38)]

In *ST-AD Gmbh v. Bulgaria,* the tribunal stated that a claimant does not need to have a majority of the shares in order to be considered as a protected investor and that while a shareholder is not able to ask for compensation for interference with assets of the company, it may claim for any loss of value of its shares resulting from an interference with the assets or contracts of the company.[39)] It, however, concluded that the claimant acquired the shares to open the possibility for recourse to international arbitration and that the initiation and pursuit of this arbitration was an abuse of the system of international investment arbitration.[40)] The tribunal emphasized this by stating: "The Tribunal has to ensure that the BIT mechanism does not protect investments that it was not designed to protect, that is, domestic investments disguised as international investments or domestic disputes repackaged as international disputes for the sole purpose of gaining access to international arbitration."[41)]

In *Apotex Holdings Inc. and Apotex Inc. v. United States,* the tribunal held that *res judicata* barred the claims by Apotex-Holdings, which was resolved in a prior arbitration between the United States and Apotex-US, a company wholly owned and controlled by the claimants. The tribunal reasoned that the claimant was a "privy" with the Apotex-US as a result of their corporate relationship.[42)] In so doing, the tribunal noted that the doctrine of *res judicata* was a general principle of international law, applicable also to

38) *Impregilo S.p.A. v. Argentina,* ICSID Case No. ARB/07/17, Award (11 June 2011), paras. 139-140. The tribunal stated: "In any case, there is, …, a substantial caselaw showing that claims such as those presented by Impregilo enjoy protection under the applicable BITs. The Arbitral Tribunal finds no reason to depart from that caselaw." In the final award, the tribunal declared that the Argentine Republic violated the Argentina-Italy BIT by failing to treat Impregilo's investment in a fair and equitable manner and ordered compensation to Impregilo for damages it has suffered in the amount of USD 21,294,000 and interest on that amount. Available at https://www.italaw.com/sites/default/files/case-documents/ita0418.pdf

39) *ST-AD GmbH v. Republic of Bulgaria,* PCA Case No. 2011-06, Award on Jurisdiction (18 July 2013), paras. 271, 275, and 282. The tribunal concluded that the dispute brought by the claimant was not within the competence of the tribunal. Available at https://www.italaw.com/sites/default/files/case-documents/italaw3113.pdf.

40) *Ibid.*, paras. 415 and 423.

41) *Ibid.,* para. 423.

interpreting investment treaties.[43)]

In *Renée Rose Levy v. Peru,* the tribunal held that Ms. Levy's claim fulfilled the jurisdictional requirements under the ICSID Convention and the France-Peru BIT because she had both the requisite nationality under the BIT and owned and controlled Gremcitel, a Peruvian company, indirectly before the dispute had crystallized.[44)] Less than one month before a resolution was passed by the Peruvian government, which had the potential to frustrate the investment by the Levy family, the family had transferred the majority stake in the companies to Renée Rose Levy, the only French national in the family. The tribunal thus declined jurisdiction based on the "striking proximity of events" between the transfer of shares in Gremcitel to Ms. Levy and the issuing of the resolution of the Peruvian government, further stating that "the only reason for the sudden transfer of the majority of the shares in Gremcitel to Ms. Levy was her nationality." Accordingly, the tribunal concluded that "the corporate restructuring by which Ms. Levy became the main shareholder of Gremcitel ... constitutes an abuse of process" and declined jurisdiction.[45)]

In *Ampal-American Israel Corp. v. Egypt,* the tribunal, in considering whether the claimant improperly sought multiple chances of recovery, held that a claim by a shareholder and a claim by a 100 per cent subsidiary of that shareholder in a parallel arbitration was "tantamount to double pursuit of the same claim in respect of the same interest."[46)] The tribunal further observed that since jurisdiction of both proceedings were confirmed, it would crystallize into an "abuse of process" because, in substance, the same

42) *Apotex Holdings Inc. and Apotex Inc. v. United States*, ICSID Case No. ARB(AF)/12/1, Award (25 August 2014), para. 7.40. Available at https://www.italaw.com/sites/default/files/case-documents/italaw3324.pdf. The tribunal upheld the respondent's jurisdiction objections against the claims on the grounds of *res judicata (Ibid.,* para. 12.1).

43) *Ibid.*, para. 7.11. "In the Tribunal's view, the doctrine of res judicata is a general principle of law and is thus an applicable rule of international law within the meaning of NAFTA Article 1131."

44) *Renée Rose Levy and Gremcitel SA v Republic of Peru,* ICSID Case No ARB/11/17, Award (9 January 2015), para. 63. Available at https://www.italaw.com/sites/default/files/case-documents/italaw4105.pdf.

45) *Ibid.,* para. 195.

46) *Ampal-American Israel Corp. v. Egypt,* ICSID Case No. ARB/12/11, Decision on Jurisdiction (1 February 2016), paras. 331 and 333. The tribunal further noted: "It follows from this therefore that there is no risk of a denial of justice occasioned by the absence of a tribunal competent to determine the MAGL portion of

claim was to be pursued on the merits before two tribunals. However, the tribunal qualified its statement by noting that "this resulting abuse of process is in no way tainted by bad faith on the part of the Claimants ... It is merely the result of the factual situation that would arise were two claims to be pursued before different investment tribunals in respect of the same tranche of the same investment."[47)]

With regard to a respondent State having to face multiple claims, the tribunal in *Eskosol S.p.A. in Liquidazione v. Italian Republic* stated: "Obviously, there could be both efficiency and fairness reasons to prefer that all shareholders of an entity affected by a challenged State measure could be heard in a single forum at a single time, together with the entity that they collectively own. The Tribunal is not unsympathetic to Italy's circumstances, having to face claims now that are closely related to those it already successfully vanquished in a prior proceeding. But the fact remains that neither the ICSID system as presently designed, nor the Energy Charter Treaty ("ECT") itself, incorporate clear avenues (much less a requirement) for joinder in a single proceeding of all stakeholders potentially affected by the outcome. Absent such a system – which States have the power to create if they so wish – it would not be appropriate for tribunals to preclude arbitration by qualified investors …". In a sense, the tribunal was noting the shortcomings of the existing consolidation mechanisms and urging States to create one. In a footnote, the tribunal further stated: "Had Italy instead not prevailed in the prior proceeding but been ordered to pay compensation to the *Blusun* claimants, the Tribunal of course would have to be vigilant to prevent double recovery from Italy for the same loss. Because of the outcome of the *Blusun* case, however, that situation does not arise here."[48)]

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the claim. Both Tribunals are seized of the merits and neither Tribunal has yet reached a decision on the merits."

47) *Ibid.*

48) *Eskosol S.p.A. in Liquidazione v. Italian Republic,* ICSID Case No. ARB/15/50, Decision on Respondent's Application Under Rule 41(5) (20 March 2017), para. 170. In *Blusun S.A., Jean-Pierre Lecorcier and Michael Stein v. Italian Republic,* Eskosol had filed an application for leave to file a written submission as a non-party. In that submission, Eskosol explained that it had initiated this case against Italy on its own behalf, that this case "arise[s] from the same factual matrix and adverse measures that are at issue in the

In 2017, the tribunal in *Orascom v. Algeria* observed that an investor who controls several entities in a vertical chain of companies, which was not illegitimate, may commit an 'abuse' if it seeks to impugn the same host State measures and claims for the same harm at various levels of the chain relying on several investment treaties concluded by the host State.[49] The tribunal justified its conclusion stating that: "If the protection provided under an investment treaty is sought at one level of the vertical chain, and in particular at the first level of foreign shareholding, that purpose is fulfilled. The purpose is not served by allowing other entities in the vertical chain controlled by the same shareholder to seek protection for the same harm inflicted on the investment. … such additional protection would give rise to a risk of multiple recoveries and conflicting decisions, not to speak of the waste of resources that multiple proceedings involve." The tribunal further went on to stress that such risks would conflict with the promotion of economic development because the initiation of multiple proceedings to recover for essentially the same economic harm would entail the exercise of rights for

Blusun arbitration," and that the claims advanced by the Blusun claimants were of an "abusive nature." Eskosol asserted that "the Blusun Claimants appear to be attempting to abuse these proceedings by seeking damages to which only Eskosol is entitled," which would cause prejudice to Eskosol, its creditors and its minority shareholders. It affirmed that the Blusun claimants "have no authority to represent Eskosol's interests" in the Blusun case, but nonetheless were attempting to obtain compensation "for all of Eskosol's losses … without the intent to channel these moneys into Eskosol so Eskosol can reimburse any such payments to the Eskosol Creditors." *See Blusun S.A., Jean-Pierre Lecorcier and Michael Stein v. Italian Republic,* ICSID Case No. ARB/14/3, Application Under ICSID Arbitration Rule 37(2) (21 June 2016), Exhibit R-003, 1, 5, 17, 36. The tribunal apparently denied Esoksol's application for non-disputing party submission. *See* Procedural Order No. 5 available at https://icsid.worldbank.org/en/Pages/cases/casedetail.aspx?CaseNo=ARB/14/3.

49) *Orascom TMT Investments v. Algeria,* ICSID Case No. ARB/12/35, Award (31 May 2017), paras. 542–543. Available at https://www.italaw.com/sites/default/files/case-documents/italaw8973.pdf. The tribunal further stated: "It goes without saying that structuring an investment through several layers of corporate entities in different states is not illegitimate. Indeed, the structure may well pursue legitimate corporate, tax, or pre-dispute BIT nationality planning purposes. In the field of investment treaties, the existence of a vertical corporate chain and of treaty protection covering 'indirect' investments implies that several entities in the chain may claim treaty protection, especially where a host state has entered into several investment treaties. In other words, several corporate entities in the chain may be in a position to bring an arbitration against the host state in relation to the same investment. This possibility, however, does not mean that the host state has accepted to be sued multiple times by various entities under the same control that are part of the vertical chain in relation to the same investment, the same measures and the same harm."

purposes that are alien to those for which these rights were established.

In *Lotus v. Turkmenistan*, the tribunal observed that: "… For example, the expropriation of the shares in the subsidiaries themselves, held by a claimant, would clearly violate the claimant's rights, entitling it to bring a claim. But that is not the case here. The Request for Arbitration does not articulate any claims that do not derive exclusively from – and are not wholly overlapping with – contract claims belonging to Lotus Enerji."[50] The tribunal went on to decide that the claims by Lotus Holdings were manifestly without legal merit under ICSID Rule 41(5) and dismissed the claim.[51]

Summary

The case law above shows that tribunals have been attentive to reflective loss claims and multiple proceedings that result therefrom. In certain instances, the tribunals have decided that the claims were not within their jurisdiction. However, in most instances, they had to rely on doctrines of international law or precedents to reach such a conclusion. This is most likely due to the lack of concrete language in investment treaties and guidance provided to tribunals to address reflective loss claims and problems arising therefrom.

2. Treaty-based response by States

As illustrated above, governments, in a number of investment disputes, have argued that reflective loss claims should not be allowed. Whereas investment treaties do not provide express provisions on reflective loss claims, some States have responded by addressing the concerns.[52] A number of recently concluded investment treaties provide provisions to mitigate the problems arising from reflective loss claims and multiple proceedings. This section examines such responses by States.

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50) *Lotus Holding Anonim Şirketi v. Turkmenistan*, ICSID Case No. ARB/17/30, Award (6 April 2020), para. 187. Available at https://www.italaw.com/sites/default/files/case-documents/italaw11411.pdf.

51) *Ibid.*, para. 196.

52) *See* Chapter IV in UNCTAD, World Investment Report – Reforming International Investment Governance, 2015, United Nations Publication, available at https://unctad.org/en/PublicationsLibrary/wir2015_en.pdf.

A. Investor and investment

For example, treaty provisions have been drafted to prevent claims by certain investors.[53] As the terms "investor" and "investment" determine which investors are protected and are able to bring claims against the host State, attempts have been made to clarify their meaning.

While not strictly relevant in the context of reflective loss claims, some investment treaties introduce minimum equity requirements. For example, article 1 of the Turkey-Azerbaijan BIT states that investments which are in the nature of acquisition of shares or voting power amounting to or representing of less than 10% of a company are not covered by the BIT.[54]

Some investment treaties have tackled the issue by clarifying the scope of covered shareholders and claims permitted. They set a threshold, a level of direct ownership or a significant degree of influence in the management, to acquire standing under the investment treaty. This approach adopted in the North American Free Trade Agreement ("NAFTA") has been followed in recent investment treaties.[55] Article 1116 of NAFTA permits claims by shareholders on

53) *Ibid. See for example*, China-Mexico BIT (2008), article 13(8), which reads: "The Contracting Parties recognize that under this Article, minority non-controlling investors have standing to submit only a claim for direct loss or damage to their own legal interest as investors." Available at https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/759/download.

54) *See* Turkey-Azerbaijan BIT (2011), article 1, available at https://investmentpolicy.unctad.org/international-investment-agreements/treaties/tips/328/azerbaijan---turkey-bit-2011-. *See also* article 2 of the Southern African Development Community (SADC) Model BIT Template (2012), which excludes portfolio investment (defined as investment that constitutes less than 10% of the shares of the company or otherwise does not give effective management or influence on the management of the investment) in all three options for defining investment. Available at https://www.iisd.org/itn/wp-content/uploads/2012/10/SADC-Model-BIT-Template-Final.pdf. The 1998 Framework Agreement on the ASEAN Investment Area (AIA) explicitly excluded portfolio investment, but the more recent ASEAN Comprehensive Investment Agreement (ACIA), which entered into force in April 2012 superseding the AIA (article 47(1)), is not similarly restricted. It expressly extends protection to "shares, stocks, bonds and debentures and any other forms of participation in a juridical person and rights or interests derived therefrom". According to article 4(a) and (c) of ACIA, assets must have the characteristics of an investment and, where applicable, may be subject to prior written approval.

55) *See, for instance*, article 10.16(1) of the Dominican Republic - Central America Free Trade Agreement (CAFTA-DR), article 8.23 of the European Union-Canada Comprehensive Economic and Trade Agreement (CETA), article 9.19(1) of the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) and article 11.16 (1) of KORUS.

their own behalf and article 1117 permits claims by shareholders on behalf of the enterprise that they own or control directly or indirectly. A level of "control" is required for an investor to bring a claim and compensation is provided to the enterprises for claims brought on behalf of the enterprise.[56)]

While some tribunals had interpreted that these articles can be construed to permit reflective loss claims,[57)] recent tribunals have generally concluded that reflective loss claims are prohibited under NAFTA.[58)] This is largely due to the consistent arguments by the NAFTA governments that shareholders cannot assert reflective loss claims on their own behalf, because it can only bring a direct loss claim under article 1116 and a derivative claim for injury to the company under article 1117.[59)] Article 11.16(1) of KORUS, which follows a similar approach, is further qualified by article 11.18(4), which states that the investors may not initiate or continue a claim if its parent company or subsidiary has raised a claim involving the

56) *See* article 1135(2) of NAFTA, "⋯, where a claim is made under Article 1117(1): (a) an award of restitution of property shall provide that restitution be made to the enterprise; (b) an award of monetary damages and any applicable interest shall provide that the sum be paid to the enterprise; and (c) the award shall provide that it is made without prejudice to any right that any person may have in the relief under applicable domestic law."

57) *Gami Investments Inc. v. Mexico*, Award (15 November 2004), paras. 120-21, available at https://www.italaw.com/sites/default/files/case-documents/ita0353_0.pdf and *Pope & Talbot v. Canada,* Award in Respect of Damages (31 May 2002), paras. 75-76, available at https://www.italaw.com/sites/default/files/case-documents/ita0686.pdf.

58) *Bilcon of Delaware et al v. Government of Canada,* PCA Case No. 2009-04, Award on Damages (10 January 2019), paras. 379, 389 and 396. The tribunal stated: "(⋯) Articles 1116 and 1117 are to be interpreted to prevent claims for reflective loss from being brought under Article 1116. (...) Moreover, the Tribunal takes account of the common positions of the NAFTA Parties in their submission to Chapter Eleven tribunals." It further stated: "The opportunity to invest .., which was denied by the Respondent's unlawful conduct, was an opportunity of the Investors and not an opportunity of Bilcon of Nova Scotia. Accordingly, compensation is owed directly to the Investors pursuant to Article 1116. It is not precluded by the prohibition against awarding 'reflective loss'."

59) *See, Bilcon of Delaware et al v. Government of Canada,* PCA Case No. 2009-04, Canadian Counter-Memorial on Damages, para. 26 (9 June 2017); *Gami Investments Inc. v. Mexico,* Submission of the United States (available at https://www.italaw.com/sites/default/files/case-documents/italaw7789.pdf), paras. 14 and 17 (30 June 2003); Statement of Defence of Mexico (in Spanish, available at https://www.italaw.com/sites/default/files/case-documents/italaw8041.pdf), para. 167 (24 November 2003).Treaty interpretation by State parties and their effect is also one of the topics being considered by Working Group III. *See supra note* 9 (A/CN.9/1044), paras. 90-101 and a note by the Secretariat on the topic (A/CN.9/WG.III/WP.191).

same measure and arising from the same events or circumstances. This illustrates the need for further clarifying the language as found in NAFTA.

B. Denial of benefit

Some States have introduced a denial of benefit clause preventing third State nationals who own or control the investor from gaining access to treaty protection when they would otherwise not benefit from such protection due to their nationality.[60] For example, article 17(2) of the 2012 U.S. Model BIT allows a State party to deny benefits to an investor incorporated in the other State party, if the investor has no substantial business activity at the place of incorporation and is owned or controlled by persons of a non-party or the denying State party.[61] KORUS follows this approach adding a requirement for the denying Party to notify and to consult the other party under such circumstances. In practice, this means that investors controlled not only by a national of a non-State party but also by nationals of the host State could be denied

60) Denial of benefit clauses are said to have originated in Friendship, Commerce and Navigation treaties signed by the United States after 1945, in which companies of one State party were guaranteed certain rights in the territory of the other State party, namely the right to be recognized as an entity having legal personality and the right to access courts. Denial of benefit clauses were then included in the 1983 and following US Model BITs. *See* Gaillard, Emmanuel and Yas Banifatemi (eds.), Jurisdiction in Investment Treaty Arbitration, IAI Series No. 8, 2018. *See also* Gastrell, Lindsay and Paul-Jean Le Cannu, “Procedural Requirements of ‘Denial-of-Benefits’ Clauses in Investment Treaties: A Review of Arbitral Decisions”, ICSID Review - Foreign Investment Law Journal, Vol.30(1), 2015, 78-97, available at https://doi.org/10.1093/icsidreview/siu030.

61) The text of the 2012 U.S. Model Law on Bilateral Investment Treaty is available at https://ustr.gov/sites/default/files/BIT%20text%20for%20ACIEP%20Meeting.pdf.
“Article 17: Denial of Benefit
1. A Party may deny the benefits of this Treaty to an investor of the other Party that is an enterprise of such other Party and to investments of that investor if persons of a non-Party own or control the enterprise and the denying Party:
(a) does not maintain diplomatic relations with the non-Party; or
(b) adopts or maintains measures with respect to the non-Party or a person of the non-Party that prohibit transactions with the enterprise or that would be violated or circumvented if the benefits of this Treaty were accorded to the enterprise or to its investments.
2. A Party may deny the benefits of this Treaty to an investor of the other Party that is an enterprise of such other Party and to investments of that investor if the enterprise has no substantial business activities in the territory of the other Party and persons of a non-Party, or of the denying Party, own or control the enterprise.”

benefits by not being able to raise claims under the investment treaty. The aim is to avoid circumventing the protection provided under investment treaties and exclude from a treaty's protection (i) third State interests behind a mailbox company (as that State has not undertaken any commitment) and (ii) host State interests behind a mailbox company in order to deny protection to ultimate domestic shareholders. In relation to reflective loss claims, a denial of benefit clause would limit shareholders from using a mailbox company to raise their claims. However, the wording of denial of benefit clauses found in investment treaties vary to some extent and are not clear on instances where reflective loss claims would be denied.[62] The language in recently concluded treaties which are almost identical, for example, article 14.14 of the United States-Mexico-Canada Agreement ("USMCA")[63] and article 9.15 of CPTPP may shed some light.[64] Article 10.14 of the Regional Comprehensive Economic Partnership ("RCEP") Agreement follows a similar approach with some additional clauses and the footnote clarifies that Parties may deny the benefits at any times.[65]

Supplementing the provisions above, article 1117(2) of NAFTA[66] as well as other provisions in investment treaties impose temporal limitations on when claims can be

62) *See, for example*, article 19(1) of ACIA, article 10.12.2 of CAFTA-DR, and article 17 of the Energy Charter Treaty.

63) Available at https://ustr.gov/sites/default/files/files/agreements/FTA/USMCA/Text/14-Investment.pdf.

64) *See also* article 11.18(4)(a) of KORUS, infra note 74. Article 9.15 of CPTPP provides: "1. A Party may deny the benefits of this Chapter to an investor of another Party that is an enterprise of that other Party and to investments of that investor if the enterprise: (a) is owned or controlled by a person of a non-Party or of the denying Party; and (b) has no substantial business activities in the territory of any Party other than the denying Party. 2. A Party may deny the benefits of this Chapter to an investor of another Party that is an enterprise of that other Party and to investments of that investor if persons of a non-Party own or control the enterprise and the denying Party adopts or maintains measures with respect to the non-Party or a person of the non-Party that prohibit transactions with the enterprise or that would be violated or circumvented if the benefits of this Chapter were accorded to the enterprise or to its investments."

65) The Investment Chapter of RCEP does not contain an ISDS mechanism. Article 10.18 indicates that the Parties shall enter into discussion on ISDS no later than two years after the date of entry into force of the Agreement. Worth noting is article 10.4(3) on the most-favoured-nation treatment, excluding the applicability of the clause to international dispute settlement procedures or mechanisms under other existing or future international agreements. The text of RCEP is available at https://rcepsec.org/wp-content/uploads/2020/11/All-Chapters.pdf.

raised.[67] This requires claims to be raised within a reasonable period of time and thus reduces the possibility of multiple proceedings after that period.

C. Consolidation

Provisions on consolidation and joinder are increasingly found in investment treaties. Consolidation and joinder are effective tools to address the cost and duration concerns associated with reflective loss claims that result in multiple proceedings. An increasing number of investment treaties permit a tribunal to order multiple proceedings that present common legal and factual issues to be heard together, in some cases, without the consent of the disputing parties. For example, article 1117(3) of NAFTA mandates consolidating claims under article 1116 and those under article 1117 arising out of the same events, unless the tribunal finds that the interests of a disputing party would be prejudiced thereby. A more detailed provision on consolidation is found in article 14.D.12 of the USMCA. Article 8.43 of CETA also provides detailed rules for consolidation through the establishment of a separate division of a tribunal, referred to as the "consolidating division."[68]

While effective in some instances,[69] consolidation has its limitations. As had been the case in *CME v. Czech Republic* and *Lauder v. Czech Republic,*[70] one limitation arises from the fact that consent of the disputing parties is required for consolidation and that disputing parties are often reluctant to consolidate.[71] In *Eskosol and Blusun,* attempts by Eskosol to join and for the

66) The text reads: "An investor may not make a claim on behalf of an enterprise described in paragraph 1 if more than three years have elapsed from the date on which the enterprise first acquired, or should have first acquired, knowledge of the alleged breach and knowledge that the enterprise has incurred loss or damage."

67) *See, for example*, article 11.18 of KORUS.

68) Text of CETA is available at https://trade.ec.europa.eu/doclib/docs/2014/september/tradoc_152806.pdf.

69) *See, for example*, *Canfor Corporation, Tembec et al., and Terminal Forest Products Ltd. v. United States, UNCITRAL,* Order of the Consolidation Tribunal (7 September 2005), consolidating three NAFTA ISDS cases sharing common questions of law and fact. The text of the order is available at https://www.italaw.com/sites/default/files/case-documents/ita0115.pdf.

70) *Ronald S. Lauder v. Czech Republic,* Final Award (3 September 2001), para. 173.

71) *Ampal-American Israel Corp. v. Egypt,* Decision on Jurisdiction (1 February 2016), para. 329. "It may not be a desirable situation but it cannot be characterized as abusive especially when the Respondent has declined the Claimants' offers to consolidate the proceedings."

tribunal to consolidate the proceedings were unsuccessful due to the lack of a mechanism.[72] The difficulties intensify because claims may arise from different treaties and different institutional arrangements. Consolidating claims based on different underlying treaties can prove difficult because they may contain differing substantive obligations, diverging time limits, and different dispute settlement fora and procedural rules. Attempts to address such difficulties by providing a single arbitration rule to govern the consolidated proceedings are found in article 3.24(5) of the European Union-Singapore Investment Protection Agreement[73] and article 14.D.12(8) of the USMCA. They provide that the consolidated tribunal "shall conduct its proceedings in accordance with the UNCITRAL Arbitration Rules, except as modified." Article 11.18 (4)(b) of KORUS takes a similar approach allowing for cross-treaty consolidation yet without indicating the rules to be applied to the consolidated procedure.[74] It remains to be seen whether such provisions on consolidation would prove effective to address multiple proceedings and reflective loss claims that arise from a wide range of circumstances involving various actors, investments and fora.

72) Eskosol asserts that it had asked ICSID to consolidate its case with the *Blusun S.A., Jean-Pierre Lecorcier and Michael Stein v. Italian Republic* case, but that the request was denied. *See Eskosol S.p.A. in Liquidazione v. Italian Republic, supra note* 48, paras. 30 and 170.

73) The text reads: "The consolidating division of the Tribunal shall conduct its proceedings in the following manner: (a) unless all disputing parties otherwise agree, where all the claims for which a consolidation order is sought have been submitted under the same dispute settlement rules, the consolidating division shall proceed under the same dispute settlement rules; (b) where the claims for which a consolidation order is sought have not been submitted under the same dispute settlement rules: (i) the disputing parties may agree on the applicable dispute settlement rules available under Article 3.6 (Submission of Claim to Tribunal) which shall apply to the consolidation proceedings; or (ii) if the disputing parties cannot agree on the same dispute settlement rules within thirty days from the request made pursuant to paragraph 3, the UNCITRAL arbitration rules shall apply to the consolidation proceedings."

74) Article 11.18(4) reads: "(a) An investor of a Party may not initiate or continue a claim under this Section if a claim involving the same measure or measures alleged to constitute a breach under Article 11.16 and arising from the same events or circumstances is initiated or continued pursuant to an agreement between the respondent and a non-Party by: (i) a person of a non-Party that owns or controls, directly or indirectly, the investor of a Party; or (ii) a person of a non-Party that is owned or controlled, directly or indirectly, by the investor of a Party. (b) Notwithstanding subparagraph (a), the claim may proceed if the respondent agrees that the claim may proceed, or if the investor of a Party and the person of a non-Party agree to consolidate the claims under the respective agreements before a tribunal constituted under this Section."

D. Stay and coordination

In addition, States have included language in investment treaties empowering the tribunal to stay its proceedings and to take into account the decisions and awards of other related proceedings.[75] For example, article 8.24 of CETA provides that if there is potential for overlapping compensation; or the other international claim could have a significant impact, the tribunal shall stay its proceedings or otherwise ensure that proceedings brought pursuant to another international agreement are taken into account in its decision, order or award.

E. Fork-in-the-road clauses

Some investment treaties have included the so-called "fork-in-the-road" clause, which provide that the investor must choose between the litigation of its claims in the host State's domestic courts or through international arbitration and that the choice, once made, is final and irrevocable.[76] Article VII (3) of the Argentina-U.S. BIT[77] and article 8.2 of the France-Argentina BIT[78] are just two examples.[79] The tribunal in *M.C.I. Power Group v. Ecuador* noted in relation to article VI(2) of the U.S.-Ecuador BIT, that the fork-in-the-road rule refers to

75) Article 1120(9) of NAFTA empowers tribunals to issue a stay pending resolution of overlapping or related claims.

76) Dolzer, Rudolf and Christoph Schreuer, Principles of International Investment Law, Second edition, 2012, Oxford University Press, 267.

77) The paragraphs read: "2. In the event of an investment dispute, the parties to the dispute should initially seek a resolution through consultation and negotiation. If the dispute cannot be settled amicably, the national or company concerned may choose to submit the dispute for resolution:(a) to the courts or administrative tribunals of the Party that is a party to the dispute; or (b) in accordance with any applicable, previously agreed dispute-settlement procedures; or (c) in accordance with the terms of paragraph 3.

3. (a) Provided that the national or company concerned has not submitted the dispute for resolution under paragraph 2 (a) or (b) and that six months have elapsed from the date on which the dispute arose, the national or company concerned may choose to consent in writing to the submission of the dispute for settlement by binding arbitration […]"

78) The article reads: "If such dispute could not be solved within six months from the time it was stated by any of the parties concerned, it shall be submitted at the request of the investor: either to the national jurisdictions of the Contracting Party involved in the dispute; or to investment arbitration….Once an investor has submitted the dispute either to the jurisdictions of the Contracting Party involved or to international arbitration, the choice of one of the other of these procedures shall be final."

79) An asymmetrical fork-in-the-road clause found in USMCA Annex 14-D (Mexico-United States Investment Disputes) Appendix 3 (Submission of a claim to arbitration), which states: "An investor of the United States may not submit to arbitration a claim that Mexico has breached an obligation under this Chapter …, if the

an option, expressed as a right to choose irrevocably between different jurisdictional systems. Once the choice has been made, there is no possibility of resorting to any other option, and the right to choose once is the essence of the fork-in-the-road rule.[80] However, such clauses may not be so relevant in the context of reflective loss claims, whereby the shareholders, foreign and domestic, are generally not able to raise such claims in domestic courts.

F. Waiver requirement

Some investment treaties require claims to be accompanied by the claimant's written waiver of any right to initiate or continue other dispute settlement procedures as conditions on consent. For example, article 11.18(2) of KORUS provides that claims on behalf of a company which the claimant directly owns or controls may not be submitted if the notice of arbitration is not accompanied by the claimant's and the enterprise's written waivers of any right to initiate or continue before any administrative tribunal or court under the law of either Party, or other dispute settlement procedures, any proceeding with respect to any measure alleged to constitute a breach.[81] This is almost identical to the approach found in article 14.D.5(e) of USMCA,[82] which requires as a pre-condition to submission of a claim to arbitration that investors and, in certain circumstances enterprises owned or controlled by them waive their rights to initiate any other proceedings on the same measure.[83]

investor or the enterprise, respectively, has alleged that breach of an obligation under this Chapter, as distinguished from breach of other obligations under Mexican law, in proceedings before a court or administrative tribunal of Mexico." An analysis of this provision is provided in Bedrosyan, Alexander, "The Asymmetrical Fork-in-the-Road Clause in the USMCA: Helpful and Unique", Kluwer Arbitration Blog (29 October 2019), available at http://arbitrationblog.kluwerarbitration.com/2018/10/29/usmca/.

80) *M.C.I. Power Group v. Ecuador,* ICSID Case No. ARB/03/6, Award (31 July 2007), para. 181, available at https://iaa-network.com/wp-content/uploads/2019/02/M.C.I.-Power-Group-v.-Ecuador.pdf

81) Paragraph 3 of that article, however, allows the claimant or the enterprise to initiate or continue an action that seeks interim injunctive relief and does not involve the payment of monetary damages, provided that sole purpose of preserving the claimant's or the enterprise's rights and interests during the pendency of the arbitration.

82) Similar language is included in article 1121 of NAFTA, article 26 (2), (3) of the 2012 Model U.S. BIT, article 10.18 of CAFTA-DR, article 10.17 of the U.S.-Chile FTA, and article 10.17 of the U.S.-Morocco FTA.

Summary

As illustrated in this section, a wide range of mechanisms and tools have been developed in investment treaties to prevent the occurrence of multiple proceedings arising from reflect loss claims and to effectively manage them, thus limiting their impact.

Ⅳ. Proposed reform solutions and concluding remarks

Intergovernmental discussions at OECD had considered the issues of shareholder claims in ISDS during FOI Roundtables in March and October of 2013.[84] Background papers were prepared by the OECD Secretariat on corporate law aspects and investment treaty practice.[85] Discussions were focused on the policy considerations for reflective loss claims, particularly in light of their treatment under domestic corporate law. Discussions at the Roundtables illustrated a divergence of views of governments on whether it would be advisable to allow reflective loss claims in ISDS.[86] While it was noted that further discussion and analysis would be required to assist governments refine their views about their

83) In *Waste Management Inc. v. United Mexican States,* the tribunal noted "when both legal actions have a legal basis derived from the same measures, they can no longer continue simultaneously in light of the imminent risk that the claimant may obtain the double benefit in its claim for damages. This is what NAFTA article 1121 seeks to avoid". *See Waste Management, Inc. v. United Mexican States,* ICSID Case No. ARB(AF)/98/2, Award (2 June 2000), para. 27, available at https://www.italaw.com/sites/default/files/case-documents/ita0892.pdf. The claim was submitted for a second time. Noting that Chapter 11 of NAFTA does not contain a "fork-in-the-road" clause, the tribunal stated: "Chapter 11 of NAFTA adopts a middle course. A disputing investor is evidently entitled to initiate or continue proceedings with respect to the measure in question before any administrative tribunal or court of the respondent State in accordance with its law, without prejudice to eventual recourse to international arbitration. It is only when submitting a claim under Article 1120 that the requirement of waiver arises". *See Waste Management, Inc. v. United Mexican States (Number 2),* ICSID Case No. ARB(AF)/00/3, Decision of the Tribunal on Mexico's Preliminary Objection concerning the Previous Proceedings (26 June 2002), paras. 29-30, available at https://www.italaw.com/sites/default/files/case-documents/ita0898.pdf.

84) OECD, Summary of the Roundtable discussion on Freedom of Investment 18 (20 March 2013), 4-8 and Summary of the Roundtable discussion on Freedom of Investment 19 (15-16 October 2013), 12-19, available respectively at http://www.oecd.org/daf/inv/investment-policy/18thFOIRoundtableSummary.pdf and http://www.oecd.org/daf/inv/investment-policy/19thFOIroundtableSummary.pdf.

85) Gaukordger, *supra note* 13 (2013/03, 2014/02 and 2014/03).

86) Gaukordger, *supra note* 13 (2014/03), 9.

individual and collective goals, there has not been much follow-up discussion at the OECD and no discussion on concrete reforms options.

The discussions at UNCITRAL on this topic built on the preliminary work undertaken by OECD and have led to a dialogue about a number of proposed solutions to address the concerns arising from reflective loss claims.[87] During the discussion, it was mentioned that the work should focus on instances which were perceived to be particularly problematic and had negative consequences.[88] While a suggestion was made that the regulation of reflective loss claims should include a *per se* prohibition,[89] it is unlikely that the Working Group would consider an entire ban on reflective loss, taking into account the doubts expressed about such a significant change in policy and the impact that a ban could have on foreign direct investment.[90] Rather, the work will likely build on the wide range of existing mechanisms and tools to mitigate concerns arising from shareholder claims as surveyed in chapter III, thus taking a restrictive approach. Guidance would also be sought from decisions rendered by ISDS tribunals on these issues. And obviously, reforms options to address multiple proceedings would obviously assist in addressing some of the issues arising from reflective loss claims.

It is anticipated that model clauses on consolidation would be developed addressing some basic questions such as who can initiate consolidation, who will make the determination and the basis for the determination. The aim would be to incentivize disputing parties and tribunals to proceed with consolidation thus reducing the number of multiple proceedings. More broadly, mechanisms to ensure coordination and cooperation among tribunals will be developed, which can only be based on enhanced information-sharing.[91] This

87) The discussions were based on the note prepared by the Secretariat on shareholder claims and reflective loss (A/CN.9/WG.III/WP.170), available at https://undocs.org/en/A/CN.9/WG.III/WP.170.

88) *Supra note* 9 (A/CN.9/1044), paras. 42 and 50.

89) *Ibid.,* para. 50.

90) *Ibid.,* para. 51.

91) *Ibid.,* para. 46.

highlights the need for enhanced transparency as lack thereof would be a huge barrier to any coordination.[92] One way of coordination is for a tribunal faced with a subsequent claim to stay or suspend its proceedings until an award is rendered. Clarifying the discretion of the tribunals to do so and setting forth the circumstances in which such a decision would be justified would need to be outlined.[93]

Development of tools for consolidation and coordination would, however, need to take into account their inherent limitations as mentioned in chapter III, particularly in cases where the proceedings might have been initiated based on different investment treaties, under different procedural rules, and administered by different institutions. Another aspect to take into account is that such mechanisms are more useful in concurrent proceedings and in this regard, introducing a clear statute of limitations would be useful.

As some tribunals have based their decisions on the doctrine of *res judicata* as a recognized principle in public international law, suggestions have been made that its application in investment arbitration could be clarified as part of the reform efforts. Therefore, reform efforts could focus on clarifying the requirements for applying the doctrine of *res judicata.* Nonetheless, doubts had been expressed that the doctrine could be interpreted differently depending on the jurisdiction and the applicable law and that providing guidance might inadvertently touch upon the substance or the merits of the dispute.[94]

Suggestions have also been made that further guidance could be provided on the doctrine of *lis pendens,* generally understood as providing that when an identical dispute is already pending before a tribunal, neither of the parties can initiate new proceedings relating to the same dispute for the duration of this pendency – the result being that only the first-in-time proceedings are allowed to

92) For example, in *Eskosol S.p.A. in Liquidazione v. Italian Republic,* the tribunal assessing a motion to dismiss the claim by Eskosol under Rule 41(5) of the ICSID Arbitration Rules was not able to review and give effect to the full award of the *Blusun* case due to confidentiality obligations. *See supra note* 48, Decision on Respondent's Application under Rule 41(5) (20 March 2017), para. 33, footnote 35.

93) *Supra note* 9 (A/CN.9/1044), para. 45.

94) *Ibid.,* para. 47.

proceed.[95] However, considering that the first-in-time principle is not recognized in public international law, it is doubtful that the doctrine of *lis pendens* could apply in the investment arbitration. In fact, it has proven ineffective to redress the problem of parallel investment arbitrations initiated by claimants at different levels of the same chain of companies arising out of the same dispute.[96]

It is also foreseen that model clauses denying the benefits of the investment treaties and those to address abuse of process will be developed. A challenge would be to clarify the circumstances in which the tribunal can rely on those clauses to deny benefits and to set forth clear criteria for regarding a reflective loss claim abusive and dismissing them. However, the aim of such clauses should not be to deter reflective loss claims, rather to encourage shareholders and other stakeholders to agree on a single forum for an amicable resolution of the dispute.

Tools to address reflective loss claims prior to the proceedings, for example, through waiver requirement may provide more certainty. For example, model waiver clauses for use by investors including companies in the case of claims by their shareholders, could be developed as one of the reform options.[97] While some support was expressed for further elaborating on the fork- in-the-road clauses, their implication with regard to the issue of reflective loss claims seems limited, considering the triple-identity test requirement[98] and the

95) *See* Reinisch, August, “The Use and Limits of Res Judicata and Lis Pendens as Procedural Tools to Avoid Conflicting Dispute Settlement Outcomes”, 3 L Practice Intl Courts Tribunals, 2004, 37.

96) Gaillard, Emmanuel, “Abuse of Process in International Arbitration”, ICSID Review – Foreign Investment Law Journal, Vol.32(1), 2017, 12. Footnote 53 states: “Some commentators have argued that the doctrine of *lis pendens* could apply in the context of parallel investment treaty arbitrations, and that parallel treaty arbitration claims by a company and a shareholder relating to the same underlying facts could meet the requirements of identity of cause of action and parties.”

97) *Supra note* 9 (A/CN.9/1044), para. 49.

98) The application of the fork-in-the-road clause generally requires that the claims brought before the domestic court and before arbitral tribunals have the same object, the same cause of action and the same parties. However, it should be noted that the tribunal in H&H *Enterprises Investments v. Egypt* considered the triple identity test not relevant, especially when the investment treaty does not expressly require it. The tribunal noted: “the triple identity test is not the relevant test as it would defeat the purpose of Article VII of the U.S.-Egypt BIT, which is to ensure that the same dispute is not litigated before different fora. ⋯, investment arbitration proceedings and local court proceedings are often not only based on different causes of action but

foreign shareholders' restricted standings in domestic courts.

While the above-mentioned reform options provide tools to address issues arising from reflective loss claims and multiple proceedings, it should be noted that the Working Group had decided to identify instances which were perceived to be particularly problematic and had negative consequences. Therefore, reforms may also attempt to address the core issue, by preparing model clauses which would clarify the meaning of terms like "investment", "investor" or "control" in investment treaties.[99] Another option would be to better define claims that shareholders could raise and the conditions to be met for them to raise such claims. The ultimate aim of the reforms should not be to prohibit reflective loss claims but rather to regulate them so that: (a) the protection provided under investment treaties is not circumvented through the use of such claims; (b) they can be pursued when not asserted elsewhere and when the company is not in a situation to do so or waives its right to pursue the claim; (c) reflective loss claims are heard in the same forum when the company itself is pursuing the claim; and (d) the outcome of the proceedings do not require multiple compensation by the respondent State for the same injury. With regard to the last point, rules on whom the damages should be paid would guarantee some consideration.

also involve different parties. More importantly, the language of Article VII does not require specifically that the parties be the same, but rather that the dispute at hand not be submitted to other dispute resolution procedures; what matters therefore is the subject matter of the dispute rather than whether the parties are exactly the same." *See H&H Enterprises Investments v. Egypt,* ICSID Case No. ARB/09/15, Excerpts of the Award (6 May 2014), paras. 364 and 367, available at https://www.italaw.com/sites/default/files/case-documents/italaw7979.pdf.

99) In *Phoenix Action v. Czech Republic,* the tribunal dismissed an entire claim based on a finding that the claimant had committed an abuse of right. In reviewing the criteria for an investment under the ICSID Convention as set out in *Salini v. Morocco,* it stated: "The Tribunal has to prevent an abuse of the system of international investment protection under the ICSID Convention, in ensuring that only investments that are made in compliance with the international principle of good faith and do not attempt to misuse the system are protected". It further stated that: "If it were accepted that the Tribunal has jurisdiction to decide Phoenix's claim, then any pre-existing national dispute could be brought to an ICSID tribunal by a transfer of the national economic interests to a foreign company in an attempt to seek protections under a BIT. Such transfer from the domestic arena to the international scene would ipso facto constitute a 'protected investment' – and the jurisdiction of BIT and ICSID tribunals would be virtually unlimited." *See Phoenix Action, Ltd v The Czech Republic,* ICSID Case No ARB/06/5, Award (15 April 2009), paras. 113 and 144.

While mechanisms have been developed to address concerns arising from reflective loss claims and more generally multiple proceedings, there seems to be agreement in the Working Group to develop multilateral options, particularly as the old-generation investment treaties do not provide for such means and as collective efforts and harmonized solutions to address those concerns would be more beneficial.[100] In other words, the path seems to be towards a more comprehensive reform.

In summary, it is anticipated that the Working Group will develop a toolbox including the wide array of mechanisms outlined above.[101] While the final form is yet to be determined, work would likely involve the preparation of model clauses to be incorporated in investment treaties and guidance text for tribunals faced with such claims. It would then be left to States to implement such tools and one of the options being considered is a multilateral convention on ISDS procedural reform. Possibly modelled on the United Nations Convention on Transparency in Treaty-based Investor-State Arbitration,[102] which provides for an opt-in mechanism for States to retroactively apply the UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration to disputes arising out of more than 3,000 existing investment treaties, such a multilateral convention could make it possible to apply such tools to the existing ISDS framework. Structural reforms being considered by the Working Group (establishment of a permanent investment court or an appellate mechanism) could also include the same or similar tools.

As examined in this paper, the availability of reflective loss claims has its benefits and detriments requiring a balanced approach. Development of reform options by the Working Group and the eventual implementation by States both need to strike a balance between the need to address the potential harms and the need to protect foreign investors and their investment through effective remedies. Therefore, reform solutions would need to ensure that foreign investment continues to

100) *Supra note* 9 (A/CN.9/1044), para. 53.

101) *Ibid.,* para. 55.

102) Additional information about the Transparency Convention is available at https://uncitral.un.org/en/texts/arbitration/conventions/transparency.

be promoted while possible harms of reflective loss claims are avoided. Furthermore, it would need to take into account the interest of a number of other stakeholders involved, for example, the impact that treatment of shareholder claims could have on the rights of non-claimant controlling or minority shareholders, creditors as well as the corporate/investment structure including the management's decision-making. The tension will remain. And prioritization of interests may be necessary. It might not be possible to achieve a perfect balance with the reform options providing only imperfect alternatives.[103] It is in this context that a toolbox approach might be viewed as the most appropriate in the sense that it would provide States with the flexibility in their implementation compared to a more stringent regulatory approach.

103) Arato, *supra note* 26, p.12.

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[국문초록]

투자자 국가 분쟁에 있어 간접손실에 따른 주주투자자의 청구권 및 관련 제도 개선에 대한 논의

2017년부터 유엔국제상거래법위원회는 투자자-국가 분쟁해결제도를 개선하기 위한 여러가지 방안들을 검토중에 있다. 그 동안의 논의를 통해 여러가지 사유에서 발생할 수 있는 복수의 투자중재절차 (특히, 국가의 특정 조치에 대하여 기업의 여러 이해관계자가 중재청구를 하는 경우) 그리고 그 원인 중 하나로 지목된 주주투자자들의 간접손실에 따른 청구권의 활용, 두 분야에 대해서는 제도 개선이 필요하다고 판단되었다. 이 글은 외국 주주투자자가 투자협정에 위배되는 투자유치국의 조치로 투자에 손실을 입은 경우, 해당 간접손실에 기인해 투자협정상의 중재청구를 할 수 있다는 입장을 견지한 중재판정부들의 결정 사례를 검토하고, 투자협정 개정 등을 통하여 간접손실에 기인한 주주투자자의 청구권을 제한하고자 하는 국가들의 노력을 살펴본다. 나아가 유엔국제상거래법위원회 제3실무작업반에서 거론되고 있는 여러가지 제도개선 방안들을 살펴본 후, 앞으로 나아갈 방향을 모색한다. 모델 조항을 비롯한 여러가지 절차적인 장치를 마련 또는 정비하고, 유사한 청구가 있을시 중재판정부가 어떻게 사건을 처리하는 것이 바람직한지에 대한 가이드라인을 준비하는 등 다양한 개선 방안을 제시한다. 마지막으로 간접손실에 따른 주주청구권이 해당 외국 투자자들의 권리를 보호할 수 있는 효과적인 장치가 될 수 있으면서도 동시에 부작용이 있을 수 있다는 점을 감안, 다양한 이해관계를 균형있게 조율할 수 있는 개선 방안이 마련되어야 함을 강조한다.

주제어

투자중재제도 개선, 유엔국제상거래법위원회, 간접손실, 주주청구권, 복수의 중재절차, 투자/투자자, 절차의 병합 및 조율, 혜택부인 조항, 권리포기규정

[ABSTRACT]

Shareholder claims for reflective loss in investor-State disputes and reform options

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Since 2017, UNCITRAL has been considering a number of reform options to improve the investor-State dispute settlement (ISDS) system. During the deliberations, multiple proceedings as well as shareholder claims for reflective loss were identified as concerns and areas where reform would be desirable. This article examines the situation where foreign shareholders of a local company raises claims against a State for reflective loss. It provides an overview of the issues relating to reflective loss claims by analysing relevant case law of ISDS tribunals and treaty-based measures taken by States to respond to reflect loss claims. The paper concludes by examining the wide array of reform solutions under consideration by Working Group III of UNCITRAL and suggests the possible way forward, including the development of model clauses and procedural tools as well as the preparation of guidance to tribunals faced with reflective loss claims. The paper emphasizes a balanced approach taking into account the fact that reflective loss claims provide an effective remedy for foreign shareholders and at the same time, pose a number of concerns to States as well as relevant stakeholders.

Keywords

investor-state dispute settlement (ISDS) reform, UNCITRAL, reflective loss, shareholder claims, multiple proceedings, investment, consolidation and coordination, denial of benefit clauses, waiver requirements