The International Law of Investment Claims

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H. THE SPECIAL CASE OF NAFTA

832. Articles 1116 and 1117 of NAFTA create a sophisticated mechanism for dealing, *inter alia*, with shareholder actions. Article 1116 governs a 'claim by an investor on its own behalf' in relation to damage caused by the breach of a NAFTA obligation. Article 1117, on the other hand, deals with a 'claim by an investor on behalf of an enterprise'. An enterprise is defined as 'a juridical person that the investor owns or controls directly or indirectly'.

833. It is clear that a non-controlling shareholder cannot make a claim under Article 1117, for paragraph 3 of Article 1117, which deals with the potential multiplicity of proceedings, refers to the possibility that a 'non-controlling investor' in the same enterprise is making a claim under Article 1116.[205] Moreover, if a non-controlling shareholder in an enterprise has submitted a claim under Article 1116, and that claim is for reflective loss, then it is obliged to submit written evidence to the arbitral tribunal that the enterprise itself has waived any claim for damages in any other judicial forum (including, it would seem, an international forum)[206] as a condition precedent to the submission of its claim under Chapter 11 of NAFTA in accordance with Article 1121. Hence, if the majority of shareholders of the enterprise in question vote against the waiver, the non-controlling shareholder cannot bring a claim for reflective loss under Article 1116 of NAFTA. A waiver is also required from the enterprise in the case of a claim brought under Article 1117.

834. These provisions are carefully designed to eliminate as far as possible the problem of multiple proceedings relating to the same loss caused by the same measures attributable to the host state by prohibiting claims by minority (or majority) shareholders where the company itself is pursuing a remedy in a

[205] The text of Art. 1117(3) reads: 'Where an investor makes a claim under this Article and the investor or a non-controlling investor in the enterprise makes a claim under Article 1116 arising out of the same events that gave rise to the claim under this Article, and two or more of the claims are submitted to arbitration under Article 1120, the claims should be heard together by a Tribunal established under Article 1126, unless the Tribunal finds that the interests of a disputing party would be prejudiced thereby.' See Appendix 3.

[206] Art. 1121(1)(b) refers to 'any administrative tribunal or court under the law of any Party, or *other dispute settlement procedures*'. Insofar as Art. 1117 refers to 'an investor of a Party, on behalf of an enterprise of *another* Party' then the possibility of the enterprise having a separate right under Art. 1116 of NAFTA or another investment treaty is excluded (as the enterprise would be a national of the host state), unless 'another Party' could be the third NAFTA State (i.e. not the national State of the investor and not the host state of the investment). This possibility, however, appears to be excluded by the subsequent use of the post-determiner 'other': '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.' Nevertheless, the reference to 'other dispute settlement procedures' in Art. 1121 might well encompass international arbitration based upon an arbitration agreement in a contract between the enterprise and the host state.

different judicial forum.[207] Moreover, Article 1135 serves to protect the rights of the creditors of the enterprise by ensuring that any damages recovered by an action brought on behalf of the enterprise pursuant to Article 1117 are paid to the enterprise and not to the investor/shareholder, thus allowing the creditors to enforce any security interests or other rights they may have over the assets of the enterprise, which would include the award.[208]

835. The question left open by the careful scheme enacted by Articles 1116 and 1117 is whether a shareholder can bring an action for reflective loss under Article 1116, in addition to an action to recover damages for an injury to its direct rights. The arguments for and against each possible interpretation are evenly balanced. One must first resolve a threshold question as to the relationship between Articles 1116 and 1117. Can an investor who does own or control an enterprise elect to bring a claim under Article 1116 for reflective loss, or *must* it bring an action under Article 1117 in this situation? The latter interpretation is to be preferred. Otherwise the safeguard built into Article 1135(2) to protect creditors of the company would be nullified because the investor would recover the damages suffered by the enterprise directly under Article 1116, rather than the enterprise itself in an action under Article 1117. Thus, according to the tribunal in *Mondev v USA*:

> Having regard to the distinctions drawn between claims brought under Articles 1116 and 1117, a NAFTA tribunal should be careful not to allow any recovery, in a claim that should have been brought under Article 1117, to be paid directly to the investor.[209]

836. The inference here is that if a claim can be brought under Article 1117 then it must be brought under Article 1117 rather than Article 1116. The same inference must be drawn from the documents accompanying the implementation of NAFTA in the United States:

> Articles 1116 and 1117 set forth the kinds of claims that may be submitted to arbitration: respectively, allegations of *direct* injury to an investor, and allegations of *indirect* injury to an investor caused by injury to a firm in the host country that is owned or controlled by an investor.[210]

837. Then we must turn to the waiver requirements for an Article 1116 claim as set out in Article 1121(1):

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

[207] Save for 'injunctive, declaratory or other extraordinary relief, not involving the payment of damages, before an administrative tribunal or court under the law of the disputing Party'.

[208] *Mondev v USA* (Merits) 6 ICSID Rep 181, 212/84.

[209] *Ibid.* 213/86.

[210] North American Free Trade Agreement, Implementation Act, Statement of Administrative Action, H.R. Doc. 103–59 (Vol. 1, 1993) 145.

[...]

> (b) the investor and, where the claim is for loss or damage to an interest in an enterprise of another Party that is a juridical person that the investor owns or controls directly or indirectly, the enterprise, waive their right to initiate or continue [other legal proceedings] ...

838. If Article 1121(1)(b) were to be interpreted in isolation from the previous conclusion with respect to the relationship between Articles 1116 and 1117, the following possibilities arise:

(a) the investor is permitted to bring a claim for reflective loss, but only where the investor owns or controls the enterprise and a waiver is submitted by that enterprise, or
(b) the investor is permitted to bring a claim for reflective loss, both in circumstances where either (i) the investor owns or controls the enterprise and a waiver by the enterprise is given, or (ii) where the investor does not own or control the enterprise and the waiver requirement for the enterprise is thereby implicitly dispensed with, or
(c) the reference in Article 1121(1)(b) to a claim 'for loss or damage to an interest in an enterprise' implies that any claim under Article 1116 must be for the direct infringement with the investor's rights over its shares (i.e. claims covered by Rule 47) but only where the investor owns or controls the enterprise in question, or
(d) same as for (c) but such direct claims can be made both in circumstances where either (i) the investor owns or controls the enterprise and a waiver by the enterprise is given, or (ii) where the investor does not own or control the enterprise and the waiver requirement for the enterprise is thereby implicitly dispensed with.[211]

839. If the premise that a claim that can be brought under Article 1117 must be brought under Article 1117 is correct, then possibilities (a) and (b) can be excluded. Possibility (c) should also be excluded because otherwise a minority shareholder would not be able to pursue a claim alleging the expropriation of its shareholding caused by the host state's confiscation of the assets of the company. That leaves possibility (d) as the best interpretation of the problematic Article 1121(1)(b).

840. A further aspect of Article 1121 should be noted. Paragraph 4 absolves the investor from procuring a waiver from the enterprise in the context of claims under Article 1116 or 1117 if the host state has deprived the investor of control

[211] One clarification must be made in relation to this analysis of the possible interpretations of Art. 1121(1)(b): it is not possible to interpret that provision as excluding a claim by an investor under Art. 1116 who does own or control the enterprise because otherwise the provision would of course be rendered meaningless.

over the enterprise. Without this important exception to the waiver requirement, a denial of justice would be condoned by Chapter 11 of the NAFTA if the investor were to be deprived of a remedy both in a municipal and international forum due to measures attributable to the host state.

840C. Mondev International v United States of America[212]

The Boston City's planning agency, BRA,[213] selected Mondev and its joint venture partner Sefrius Corporation to construct a department store, retail mall and hotel in a dilapidated area of Boston.[214] Mondev and Sefrius formed a company 'LPA'[215] to implement the project and LPA then signed a 'Tripartite Agreement' with the City and BRA to govern the rights and responsibilities of the parties.[216]

Mondev brought several NAFTA claims based upon the disappointment of its contractual expectations in the Tripartite Agreement under Article 1116. The United States objected to Mondev's standing to bring a claim under Article 1116 on the basis that it was LPA that had suffered the alleged loss and not Mondev.[217] On this point, the Tribunal noted:

> [I]t is certainly open to Mondev to show that it has suffered loss or damage by reason of the decisions it complains of, even if loss or damage was also suffered by the enterprise itself, LPA.[218]

This statement is no doubt correct. If Mondev's claims alleged that it had suffered a distinct loss by reason of acts attributable to the United States, then such claims were clearly admissible under Article 1116. But could Mondev recover damages for an injury to LPA rather than to its rights as a shareholder in LPA? The United States maintained that such a claim for reflective loss must be brought on behalf of LPA as an enterprise under Article 1117 so as to give proper effect to Article 1135(2) and its concern with the protection of the company's creditors.[219] The tribunal's decision on this point has been mistakenly interpreted in subsequent cases and thus justifies full quotation and analysis here. By way of background, Mondev had filed a waiver with respect to other legal proceedings pursuant to Article 1121 not only on its own behalf but on behalf of LPA as well.[220] Mondev had not, however, referred to Article 1117 in its Notice of Arbitration.[221] The tribunal's decision reads:

[212] (Merits) 6 ICSID Rep 181.
[213] Boston Redevelopment Authority.
[214] 6 ICSID Rep 181, 200/37.
[215] Lafayette Place Associates.
[216] 6 ICSID Rep 181, 200/37.
[217] *Ibid.* 212/82.
[218] *Ibid.*
[219] *Ibid.* 212/82, 212/84.
[220] *Ibid.* 195/12.
[221] *Ibid.* 204/49.

> Having regard to the distinctions drawn between claims brought under Articles 1116 and 1117, a NAFTA tribunal should be careful not to allow any recovery, in a claim that should have been brought under Article 1117, to be paid directly to the investor. There are various ways of achieving this, most simply by treating such a claim as in truth brought under Article 1117, provided there has been clear disclosure in the Article 1119 notice of the substance of the claim, compliance with Article 1121 and no prejudice to the Respondent State or third parties. International law does not place emphasis on merely formal considerations, nor does it require new proceedings to be commenced where a merely procedural defect is involved. In the present case there was no evidence of material nondisclosure or prejudice, and Article 1121 was complied with. Thus the Tribunal would have been prepared, if necessary, to treat Mondev's claim as brought in the alternative under Article 1117.* In the event, the matter does not have to be decided, since the case can be resolved on the basis of Claimant's standing under Article 1116. But it is clearly desirable in future NAFTA cases that claimants consider carefully whether to bring proceedings under Articles 1116 and 1117, either concurrently or in the alternative, and that they fully comply with the procedural requirements under Articles 1117 and 1121 if they are suing on behalf of an enterprise.[222]

In a footnote to the sentence marked with a '*' in this passage, the Tribunal stated that: 'Another possibility, if the case should have been brought under Article 1117, would be for the tribunal to order that the damages be paid to the enterprise.'[223]

From this passage one must conclude, first, that claims for reflective loss must be brought under Article 1117. The tribunal employs the word 'should' in the obligatory sense on two occasions in this context. Second, the tribunal was clearly of the view that Mondev's claims should have been brought under Article 1117 and was prepared to treat them in this way if Mondev's defective reliance on Article 1116 were to have been fatal to its case. Alternatively, the tribunal was prepared to exercise jurisdiction pursuant to Article 1116 but insist upon the payment of any damages to LPA rather than to Mondev. In the event, however, the tribunal rejected Mondev's claims on the merits, and hence a definitive ruling on the admissibility of its reliance upon Article 1116 was unnecessary.[224]

[222] *Ibid.* 213/86.
[223] *Ibid.* 213/note 24.
[224] The tribunal had previously joined questions of jurisdiction and admissibility to the merits. 6 ICSID Rep 183, 187.

841. In *Enron v Argentina*,[225] the tribunal describes the arguments of Mondev and the United States and then reproduces the following truncated extract of the tribunal's reasoning:

> In the Tribunal's view, it is certainly open to Mondev to show that it has suffered loss or damage by reason of the decisions it complains of, even if loss or damage was also suffered by the enterprise itself ... For these reasons, the Tribunal concludes that Mondev has standing to bring its claim.[226]

842. As the foregoing analysis reveals, there is a great deal of learning concealed behind the ellipsis in this quotation. The tribunal in *Enron* elaborated no further upon it; evidently concluding that this passage spoke for itself in the context of dismissing Argentina's reliance upon the *Mondev* case.

843. In *UPS v Canada*,[227] the tribunal characterised the 'distinction between claiming under Article 1116 or Article 1117' as 'an almost entirely formal one'. But the tribunal was careful to confine this statement to the circumstances of the case, which involved a claim by UPS as the sole owner of the investment company, UPS Canada. According to the tribunal:

> If there were multiple owners and divided ownership shares for UPS Canada, the question how much of UPS Canada's losses flow through to UPS – the question posed by Canada here – may have very different purchase.[228]

844. The tribunal's characterisation of the distinction between Articles 1116 and 1117 as merely 'formal' is unfortunate, but it is clear that the tribunal was alive to the problem posed by a derivative claim prosecuted under Article 1117.

I. RELEVANT PROVISIONS OF INVESTMENT TREATIES AND THE ICSID CONVENTION

845. Some investment treaties contain express provisions that regulate the instances where a controlling shareholder is permitted to claim on behalf of and in the name of its company incorporated in the host state for the purposes of Article 25(2)(b) of the ICSID Convention.[229] Article VII(8) of the USA/Argentina BIT has received the most attention to date:

[225] (Preliminary Objections: Ancillary Claim) 11 ICSID Rep 295.
[226] *Ibid.* 301/35. See also: *Enron v Argentina* (Preliminary Objections) 11 ICSID Rep 273, 283/48.
[227] (Merits).
[228] *Ibid.* para. 35.
[229] Asian–African Legal Consultative Committee Model BIT, Art. 1(c), UNCTAD Compendium (Vol. III, 1996) 117; Switzerland Model BIT, Art. 8(3) ('A company which has been incorporated or constituted according to the laws in force on the territory of the Contracting Party and which, prior to the origin of the dispute, was under the control of nationals or companies of the other Contracting Party, is considered, in the sense of the Convention of Washington and