OECD Business and Finance Outlook 2016

Chapter 8

The impact of investment treaties on companies, shareholders and creditors

Investment treaties are concluded between two or more governments and typically offer covered foreign investors protection for their investments from host government conduct in violation of the treaty such as expropriation without compensation, discrimination or treatment that is not "fair and equitable". This chapter identifies the unique combination of rules applied under many investment treaties which includes rules about the types of loss recoverable by shareholders covered by treaties and about the availability of damages for covered investors in claims against governments. The chapter considers the incentives created by these rules and how they may affect companies, shareholders, creditors and capital markets. It also considers how those incentives may affect corporate structuring of investment.

Main findings

- Investment treaties are concluded between two or more governments. They typically offer covered foreign investors protection for their investments from host government conduct in violation of the treaty such as expropriation without compensation, discrimination or treatment that is not in accordance with "fair and equitable treatment" obligations. They include both stand-alone investment treaties (often referred to as bilateral investment treaties or BITs) and investment chapters in broader trade and investment agreements such as the North American Free Trade Agreement (NAFTA), the Transpacific Partnership agreement (TPP) or the Energy Charter Treaty (ECT).
- Investment treaties were developed to protect investors of one country when investing in another country, to lower non-commercial risk for such investors, and overall to promote a sound investment climate. A mostly-older generation of investment treaties provides little detail on the applicable substantive and procedural rules, while a number of modern agreements provide significantly greater detail on these and other issues.
- Investment treaties create economic incentives and disincentives. As treaties become better known to investors and lawyers, and apply to more investments between advanced economies, their economic impact is likely to increase. At least 70 investment claims against governments were filed last year, many against developed countries, far outstripping the 14 requests for consultations at the World Trade Organization (WTO).
- As interpreted by arbitral tribunals in claims brought by covered investors against governments, many of the over 3 000 existing investment treaties establish a unique combination of rules. Some of those rules significantly modify widely-applied corporate law and corporate governance principles, and can result in fragmentation of companies. The unique combination includes i) the acceptance of claims by covered shareholders for losses incurred by companies in which they own shares (claims for reflective loss); and ii) the general availability of damages, including lost profits, as a remedy for government misconduct in breach of a treaty, subject to adequate proof.
- The general acceptance of covered shareholder claims against governments for damages for reflective losses under many investment treaties is unique because such claims are generally barred under national corporate law and other systems of law. The injured company, not its shareholders, owns the claim for redress and recovers any damages. The impact of the unique treaty rules in fragmenting recovery of corporate loss is amplified because frequently indirect shareholders higher up the corporate ownership chain have also been permitted to recover reflective loss.
- Because the unique rules can allow covered shareholders to bring claims that could be perceived as stripping assets from the company to the detriment of company creditors and other shareholders, they could affect the availability, pricing and other conditions of debt and equity financing for investment that is subject to regulatory risk. The unique rules provide greater rights to covered foreign shareholders than those of non-covered domestic shareholders which is likely to affect the ratio of foreign and domestic share ownership.

The unique rules can also fragment corporate governance because they shift power on key issues from the centralised corporate board of directors to covered shareholders.

- By allowing a wide range of claims by direct and indirect shareholders of a corporation injured by a government, the unique rules may also encourage the complex structuring of investment through multi-tiered corporate structures. Each covered shareholder can be a potential claimant under a different treaty. Governments and others should carefully analyse and evaluate the impact of treaty incentives on companies and stakeholders as part of their investment treaty policy.

Introduction

Companies carry out practically all large-scale investment today. Throughout all sectors of the economy, companies are used to gather financial and human resources for investment and to organise the production of goods and services. The company as an institution – as a set of legal rules and incentives – is thus of central importance to contemporary society. Some describe it as the most important organisation in the world, besting governments and rivalled only by the family. Others recognise that the company is the central institution of economics that has produced remarkable benefits and prosperity for society, but have decried its recent evolution and failings. Recent comparative corporate law scholarship has underlined that the worldwide success of the company has led to its introduction in remarkably similar form in many different national legal systems.

Investment treaties play a growing role in company life. Concluded between two or more governments, investment treaties protect covered foreign investors from certain host government conduct and abuse. Treaties typically provide protection from expropriation, discrimination or treatment that is not "fair and equitable". They can provide additional protection to covered foreign investors beyond that provided in national legal frameworks, including constitutions, laws and regulations.

Today, there are over 3 000 investment treaties, including many stand-alone investment treaties (often referred to as bilateral investment treaties or BITs) and a much smaller but growing number of investment chapters in broader trade and investment agreements, such as the North American Free Trade Agreement (NAFTA) or the Energy Charter Treaty (ECT). Investment treaties have become a high-profile issue in recent years in a growing number of countries. Claims under investment treaties involving the regulation of tobacco marketing, fracking, nuclear power and health care have attracted intense public interest. An ad hoc investment arbitration tribunal recently awarded USD 50 billion to shareholders in Yukos. A public consultation in the European Union on proposed investment provisions in the Transatlantic Trade and Investment Partnership (TTIP) with the United States generated a record 150 000 comments. G20 and OECD governments have been considering investment treaty policy issues on an on-going basis since 2010 at the OECD-hosted Freedom of Investment (FOI) Roundtable and many governments are actively engaged in reform of their treaty policies.

The vast majority of existing investment treaties are short bilateral treaties, providing little detail. They may simply require the government to provide covered foreign investors with "fair and equitable treatment", for example, without further specification as to the nature or breadth of the obligation or the consequences of its breach. Arbitrators in ad hoc arbitration tribunals have broad discretion to interpret such treaties in individual cases. This approach dominated in early treaty-making and is reflected in the majority of treaties in force today. While some treaties of this type are still being concluded, this class of treaties is referred to herein for convenience as "first-generation" investment treaties.

Recent OECD analysis has identified a unique combination of rules generally applied under many investment treaties that are of particular importance to the company. First, investor-state dispute settlement (ISDS) arbitral tribunals have found that covered shareholders are entitled to recover for reflective loss under many first-generation investment treaties. (Shareholders' reflective loss is incurred as a result of injury to "their" company, typically a loss in value of the shares.) In contrast, courts in advanced systems of national corporate law generally reject shareholder claims for reflective loss – largely for explicit policy reasons. Shareholders are permitted to bring cases for direct injury – for example to their voting rights as shareholders – but not where they suffer reflective loss due to an injury to the company. Only the directly-injured company can bring the claim.[1]

Second, these treaties make money damages generally available as redress against government breaches of investment treaties. Subject to appropriate proof, treaty claimants can generally recover past and future lost profits as well as interest. In contrast, only non-monetary remedies (such as annulment of improper government action) are generally available for investors against governments under domestic law in advanced economies, except for expropriation.

This combination of rules creates incentives that may have a number of consequences for corporations with significant relations with governments. They may include both "*ex post*" and "*ex ante*" consequences as investors and others learn about and react to the new rules. This chapter explores these potential incentives and consequences.

Some treaties, recent model treaties and proposed treaties have provisions or have introduced reforms that may exclude or affect the application of these rules in different ways. These approaches are found for example in NAFTA-style treaties and many of the treaties of the NAFTA parties with other countries, the US model BIT, the Transpacific Partnership agreement (TPP), recent European Union treaties and proposals and the recent Indian model BIT. These approaches are discussed briefly below, but many are recent and not yet in force. The main focus of analysis here is the impact on companies of the many existing first-generation treaties that are in force and are likely to be interpreted as establishing the unique combination of rules. Analysis of the full range of incentives created by these existing treaties can assist in understanding their possible effects and can also help inform possible reform efforts.

The remainder of this chapter is structured as follows. It first provides an overview of investment treaties and outlines the unique combination of rules applicable under many treaties. It then examines the impact of those rules on the corporation and on corporate stakeholders including shareholders and creditors. A subsequent section examines how the rules may create incentives for the creation of complex corporate structures for investment. The chapter ends with conclusions.

Overview of investment treaties

Investment treaties entered into between two or more countries can offer covered foreign investors substantive and procedural protection for their investments in host states; assist with the liberalisation of restrictions on investment flows; and provide for dispute resolution mechanisms. Substantive protections under treaties generally include protection against expropriation without compensation and against discrimination. They may, for example, guarantee that covered foreign investors will be treated no less favourably than investors from the host state (national treatment) or third states (most-favoured nation). Fair and equitable treatment (FET) clauses have been the provision most frequently invoked by foreign investors in recent years. Additional treaty clauses can facilitate the transfer of profits, or limit or exclude certain performance requirements, such as local content rules.

Foreign investors are sometimes subject to disadvantages such as discrimination based on nationality. Most investment treaties give covered investors the right to bring claims against the host state in investor-state dispute settlement (ISDS). Many treaties do not require claimants to exhaust domestic remedies; under such treaties, covered investors are given an alternative of proceeding directly to international arbitration without being required to have recourse to domestic courts.

Under most treaties, practically all types of national law and government action can be the subject of a claim by a covered investor. The range of measures under review or at issue can include relevant provisions of national constitutions, legislation adopted by parliaments, legislation adopted by federal states or provinces, regulations of many kinds, as well as the application of the law in individual cases. A growing range of treaty provisions in recent treaties provide greater protection for regulation in particular areas such as tax or financial services through exceptions or more precise drafting.

Treaties have been subject to increasing scrutiny, debate and reform

Investment treaties have come under increasing scrutiny and the balance of their benefits and costs is the subject of intense interest and debate. An original purpose of most investment treaties was to create economic incentives and to reduce risks in order to attract foreign investment and its associated economic development.

ISDS has been an important innovation to remedy what is often lacking in international treaties: a strong enforcement mechanism. Advocates for ISDS see it as a depoliticised system in which foreign investors and host states may resolve disputes without the need for the investor's home state to become involved as under systems of state-to-state dispute resolution (SSDS). However, the ISDS system itself is now a major political issue in a number of jurisdictions and some have rejected investor-state arbitration.

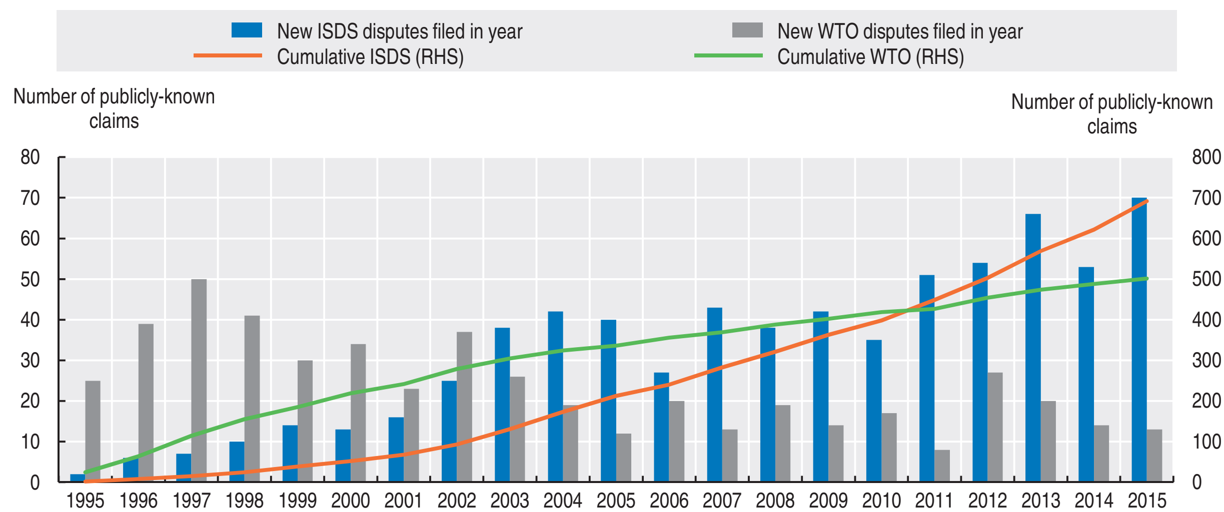
The issue of the balance between investor protection and the right to regulate is another key issue both in the current public debate about investment treaties and for governments' treaty policy. Much of the current criticism of treaties focuses on their alleged impact on the right to regulate. A number of jurisdictions have taken action to reduce the risk of successful ISDS claims. In contrast, defenders of treaties contend that treaties protect covered investors from government misrule. While it has been contended that investment treaties advance the rule of law in host states by holding governments accountable, critics argue that opaque legal proceedings and conflicts of interest in the arbitration system are contrary to rule of law standards (Van Harten, 2008). Many governments are recognising the importance of the issue of balance while adopting varying policy responses (OECD, 2016).

Policy analysis of investment treaties has often been focused on the impact of treaties as a whole. There is, for example, a substantial amount of analysis about whether treaties encourage foreign direct investment (FDI). Today, however, there is increasing interest in legal, institutional and economic analysis of individual rules. Large awards and claims based on specific rules obviously draw significant attention, particularly where the rules are developed through interpretation and are not expressly set out in the treaty text. Increasing comparison of rules applied under treaties to domestic law rules also leads to greater attention to individual rules, especially where it is contended that they provide greater benefits to covered investors than those available under domestic law.

Investor claims and dispute settlement

The number of ISDS claims against governments has increased significantly in recent years, but the number of claims and damages paid by most governments remain modest when viewed against the volumes of covered investment. Disputes in ISDS now significantly outnumber those in the WTO with 70 known ISDS claims filed in 2015, compared to 13 claims initiated under the SSDS system at the WTO (UNCTAD, 2016a; WTO, 2016). Precise numbers of ISDS cases are unknown because some proceedings are confidential, but the number of publicly-known claims is now approaching 700 (See Figure 8.1).

Figure 8.1. **Claims in ISDS and at the WTO**



Note: ISDS: investor-state dispute settlement; World Trade Organization: (WTO).
Source: UNCTAD; WTO. WTO disputes filed are based on requests for consultations.

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The average claim in all publicly-available ISDS cases resolved as of 2012 reportedly exceeded USD 620 million, almost doubling from five years earlier (Franck, 2015: 488). According to recent statistics, claimants have succeeded in establishing liability and obtaining damages in 26% of cases, respondent governments have prevailed in 36% of cases and the parties settled in 26% of cases. The remainder were discontinued or found liability but no damages (UNCTAD, 2016b). Claimants that succeed in establishing liability generally recover only a fraction of the claimed amount, but damages are still very significant, especially compared to government liability under other law, as discussed below.

The number of claims against advanced economy governments, in particular in Western Europe, has noticeably increased in recent years despite still limited treaty coverage for relations between advanced economies. Western European countries have been respondents in numerous recent energy-related claims under the ECT since 2009. There is generally little public information about these claims, in part because the ECT lacks provisions on transparency found in some other treaties.

Much of world investment, which occurs in and between the largest developed economies (such as the European Union, Japan or the United States), is not covered by treaties today. However, major trade and investment treaties under negotiation or in the process of ratification, such the TPP, TTIP or the Comprehensive Economic and Trade Agreement between the European Union and Canada (CETA), are expected to expand the application of investment treaties to much of the investment between developed countries. Treaties will interact more frequently with sophisticated capital markets and advanced corporate law and finance systems. The nature of applicable treaty rules on claims for reflective loss and damages will be of greater practical importance in many economies.

Many investment treaties, as interpreted by arbitral tribunals, create a unique combination of rules

As described below, many treaties uniquely combine allowing reflective loss claims and a broad scope for recovery of damages against governments. In many treaties, neither of these rules is expressly addressed in the text. The only reference to shares in many investment treaties is usually a clarification in general terms that shares are assets that can qualify as a covered investment.[2] Similarly, many treaties are also silent on the remedies available to investor claimants. Government obligations to provide national treatment or fair and equitable treatment to covered investors are set forth, but the consequences of breach are not addressed[3] (Pohl, Mashigo and Nolen, 2012: 31).

Permitting covered shareholders to claim for recovery of reflective loss as a general rule

The first rule applicable under many treaties expands the range of potential treaty claimants when a company is injured. Instead of the company owning the claim as under domestic law, covered shareholders of the company can recover directly for reflective losses they incur as a result of injury to the company.[4] Numerous ISDS tribunals have found that direct or indirect shareholders can claim for reflective loss.[5] Tribunals have in effect found that covered shareholder claimants can disregard the corporate entity in which they have invested for purposes of their treaty claims.[6]

Covered shareholders under these treaties are thus in the enviable position of having the best of both worlds: limited liability for debts incurred in the corporate name and direct compensation for corporate losses due to government misconduct in violation of the treaty. This "cushy position" for covered shareholders is unique to treaties and is not available under other law.[7]

OECD analysis and inter-governmental discussions have demonstrated that domestic corporate law and other bodies of law generally apply exactly the opposite principle – what has been called a general "no reflective loss" principle. Following analysis of both common law (United States; Canada; United Kingdom; Australia; Hong Kong, China) and civil law (Germany; France) systems, the findings were confirmed in inter-governmental discussions at the OECD-hosted FOI Roundtable:

> "The Roundtable recognised that all of the advanced national law systems surveyed to date, including both leading common law and civil law systems, generally bar shareholder claims for reflective loss due notably to concerns about consistency raised by such claims. Some participants from countries with legal systems not surveyed in the background paper confirmed that their national law also generally bars shareholder claims for reflective loss. Additional government input in this area was encouraged,

> but there was a consensus about the widely-applied prohibition under domestic law. The general no reflective loss principle is also applied in customary international law and under the European Convention on Human Rights."[8]

Except under investment treaties, shareholders are generally permitted to recover only direct losses, but not reflective losses (Ferran, 2001). This widely recognised distinction arises because shareholders in companies can be harmed in two broadly different ways. First, they can suffer direct loss as a result of injury to their rights as a shareholder, such as the right to attend and vote at general meetings. Such injury is relatively rare and shareholder recovery for it is uncontroversial. Second, shareholders (and others) can suffer reflective loss through an injury to the company: the market value of the company's shares and/or bonds may fall.[9] Shareholders' reflective loss is incurred as a result of injury to "their" company. Reflective loss is generally suffered by all shareholders in proportion to their shareholding. Shareholder recovery of reflective loss is generally barred because the claim belongs to the company.

The differences between many treaties and national corporate law are accentuated by i) the acceptance of reflective loss claims by indirect shareholders higher up the corporate chain; and ii) the wide variety of covered direct and indirect shareholders allowed to recover reflective loss under many treaties, including 100% parent companies, majority shareholders and minority shareholders.[10]

The no reflective loss principle in domestic law is based on the assumption that the company has the power to recover the loss (although it may not do so for a variety of reasons) and is better placed to do so. In some investment cases, recourse by the company may not be feasible including due to host government interference. International protection through ISDS or SSDS may in some case be the only realistic chance for protection of the company, its creditors and its shareholders. However, the scope of shareholder reflective loss claims available under many treaties is general and extends beyond cases where the company's recourse is blocked. Shareholders are considered to have autonomous rights and can claim without showing that the company lacks an effective remedy.[11]

Awarding recovery of money damages including lost profits rather than primary (non-pecuniary) remedies for breach of investment treaties

Other than under investment treaties, damages remedies for investors are rare. National legal systems rarely award damages to investors in claims against the government other than in cases of expropriation. Instead, they use so-called "primary", "judicial review" remedies which do not involve an award of money.[12] The FOI Roundtable note took note of this fundamental difference in its 2012 report on ISDS:

> "Except for cases of expropriation, advanced national systems strongly emphasise so-called 'primary', 'judicial review' remedies which are non-pecuniary (annulling illegal action, prohibiting or requiring specified government action, etc.); these remedies (but only these remedies) are often available in specialised proceedings. In contrast, damages remedies for investors are rare. The Roundtable noted that the legal doctrines, rules and approaches that have the effect of favouring primary remedies and making damages difficult to obtain for investors vary between the countries surveyed, but the outcome in terms of remedies is uniform in all countries surveyed."[13]

The WTO system similarly excludes money remedies against governments. WTO adjudicators can recommend that a government modify or withdraw a measure they find to contravene the WTO treaty, but cannot award damages.

In contrast, money damages are routinely awarded for breach of investment treaties. Remedies under treaties generally take the form of money damages and can include lost profits where adequate proof exists (Ripinsky and Williams, 2008: § 7.3.1). Investment treaties can thus transform many types of investor claims against government action and regulation into claims for damages.

The consequences of the new potential government damages liability to some but not all investors are largely still to be seen.[14] Among other things, its impact will depend on the scope of government obligations and liability exposure under treaties, which can vary significantly depending on factors such as the nature and precision of treaty drafting or the adjudicators interpreting the treaty. It will also depend on the scope of the treaty network; this is also subject to fundamental change with both expansion, notably into relationships between advanced economies, and contraction, as governments terminate some treaties.

The prospect of being awarded monetary compensation as a result of government misconduct accentuates the financial aspects of relations between companies, stakeholders in companies, and governments. Non-pecuniary remedies against a government are generally indivisible. For example, if a government wrongly denies the renewal of a permit to a company, a court decision resulting in the renewal of the permit (perhaps after a new decision-making process) benefits the company as a whole. The benefit from the permit accrues to the company even if a shareholder were permitted to bring the claim.

In contrast, money damages are divisible. Thus, if the remedy for the permit denial is damages including lost profits, shareholder claims against governments become more attractive. Shareholders can potentially claim for reflective losses. They can argue for different evaluations of damages and lost profits. The availability of damages rather than non-pecuniary remedies under treaties increases covered shareholder interest in claims against governments.

The rules substantially increase the number of potential investor claims under investment treaties

Under normal corporate law rules, an injured company owns the claim for recovery of its loss – shareholders have no relevant legal rights. Accordingly, one proceeding can resolve the claim (Figure 8.2).

In contrast, the rules under many treaties fragment claims for government injury to a company. Instead of a single claim by or on behalf of the company, claims can be brought by different covered shareholders for reflective loss, possibly along with a claim by the company for its direct injury.

A first type of multiple shareholder claim in ISDS can be brought by unrelated foreign shareholders of the same company (Figure 8.3). The shareholders are separate entities without any common ownership. For example, CMS and Total were two unrelated minority shareholders of TGN, an Argentine gas distribution company. Each brought a separate claim in ISDS for reflective loss.[15] Subsequently the company, TGN, announced that it also intended to sue the government for alleged damages apparently arising out of the same measures; the degree of overlap with the damages awarded or at issue in the CMS and Total cases is unclear.[16]

Claims can also be brought by related entities (with common ownership). The fragmentation is amplified because indirect covered shareholders higher up the corporate chain have also frequently been permitted to recover reflective loss (Figure 8.4).

Figure 8.2. **Domestic Law: "No Reflective Loss" principle bars shareholder claims**

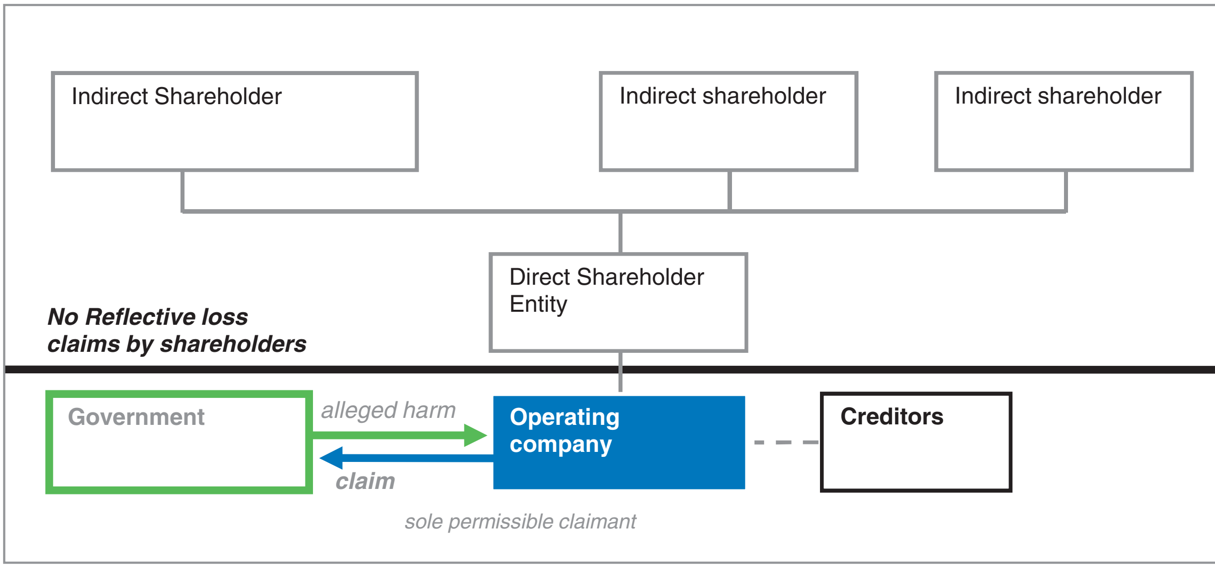
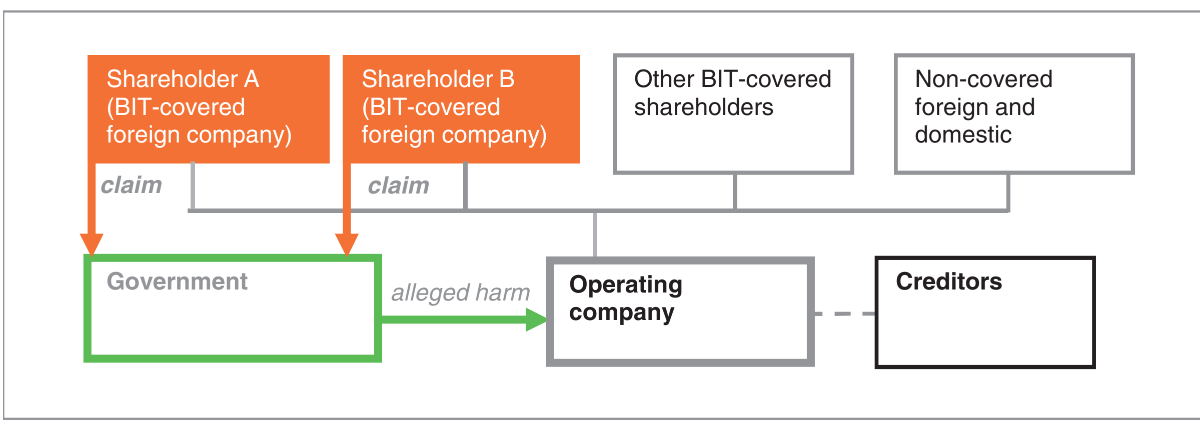


Figure 8.3. **Multiple claims for reflective loss by unrelated shareholders (domestic law claims omitted)**

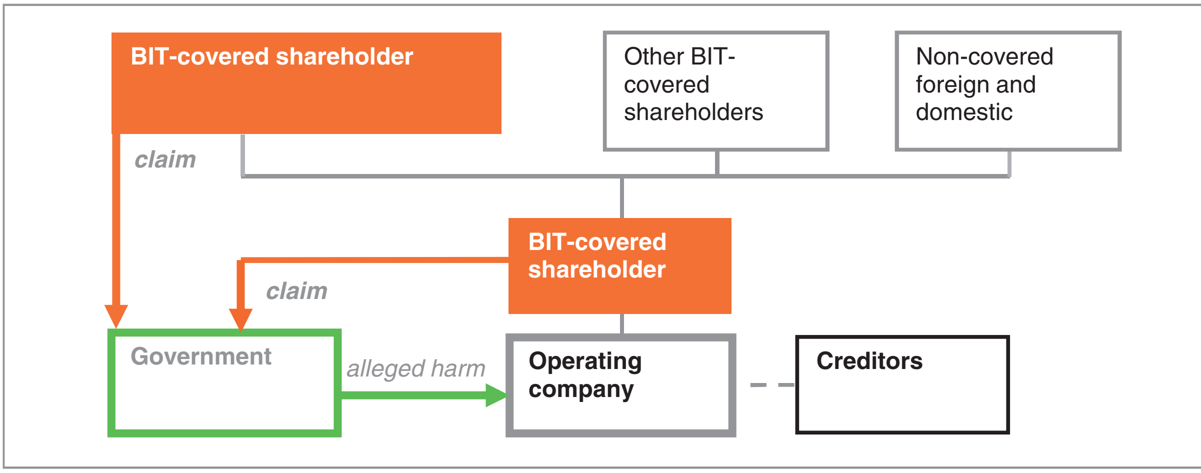


These variations can be combined. For example, claims by unrelated foreign shareholders can be accompanied by a further claim by the company (in ISDS or in the domestic courts).

Arbitral decisions on shareholder claims for reflective loss in ISDS have not demonstrated significant concern with the societal interest in "judicial economy" – reducing the number of cases needed to address the harm. In contrast, national courts have frequently underlined that the prohibition on shareholder claims for reflective loss achieves judicial economy, as illustrated by a US federal appellate court decision:

> "One rationale behind this prohibition [on shareholder claims for reflective loss] rests on principles of judicial economy. A corporation can protect its shareholder's interest by suing in the corporate name, and if the suit is successful the proceeds will inure to the benefit of the corporation; this increases the value of the individual shares in proportion to the amount of the recovery. Compare this to a situation where all

Figure 8.4. **Multiple claims for reflective loss by related entities: Two different-tier foreign shareholders both with access to ISDS (domestic law claims omitted)**



shareholders sue in their individual capacities, which achieves the same resultant recovery, but requires our legal system to process hundreds or thousands of suits, rather than one suit in the name of the corporation."[17]

As participants have noted in FOI Roundtable discussions of ISDS, high costs for the parties in ISDS constitute revenues for the arbitration bar and create economic incentives. The impact of those incentives on case outcomes, if any, is the subject of differing views (OECD, 2012: 16). High costs may also dissuade some covered investors from bringing claims, as discussed below.

Expansion of the scope of investment treaties to cover reflective loss also makes them applicable to alleged government injuries to many more companies, including major domestic companies. While domestic companies are generally excluded from treaty protection, government injury to a domestic company can give rise to treaty claims for reflective loss by foreign covered shareholders of the company which has given rise to expressions of concern. In the absence of legal barriers to covered shareholder claims for reflective loss under many treaties, high case costs for ISDS claims (averaging over USD 8 million per case as of 2011)[18] may be the principal barrier to such claims.

Some treaties adopt a different approach or address the issues in different ways

Damages as the main remedy for breach applies broadly across practically all investment treaties. A small but growing number of treaties expressly provide for damages or in effect limit final remedies to damages. The use of damages as a remedy appears to be widely accepted in current practice.

The situation with reflective loss is more complex and contested. Two additional groups of treaties are of note although they are not addressed in this chapter. First, NAFTA and NAFTA-style treaties establish more explicit regimes for covered shareholder claims. The NAFTA model in this area has been followed with minor variations in a number of other treaties including in the recently-concluded TPP and in the 2012 US model BIT. In addition to claims by covered shareholders on their own behalf, these treaties provide in particular for a form of derivative action in which a controlling covered shareholder can bring a claim on behalf of the company and with recovery that accrues to the company.

Governments party to these treaties, and in particular the United States, have stated that covered shareholders cannot bring reflective loss claims on their own behalf under these treaties; claims arising from injury to the company losses can only be brought on behalf of the company (with recovery for the company) under the derivative action-type mechanism.[19] Tribunal decisions have reached varying results. Applicable rules under NAFTA-style treaties remains somewhat uncertain (Gaukrodger, 2013: 52-56).

A second group of recent model treaties and treaties is more heterogeneous, but reflects a trend among a number of major jurisdictions to limit the potential for shareholder claims for reflective loss (or claims based on such injury in state-to-state proceedings). Several approaches have reduced protection for shareholders by excluding certain shareholdings from the definition of investment. This prevents reflective loss claims but also claims for direct loss by those types of shareholders. For example, India's new model treaty adopts an "enterprise approach" to defining covered investments that "equates investment with an enterprise incorporated in the host state".[20] South Africa's recent investment legislation also defines the investment to be protected as "enterprise-based" and does not cover short-term portfolio investments.[21] The definition of investment in Brazil's new model treaty, which is now reflected in several concluded treaties, excludes portfolio investments, i.e., those that do not allow the investor to exert a significant degree of influence in the management of the company.[22]

The CETA agreement and the European Union negotiating proposal for the investment chapter in TTIP contain a form of derivative action similar to the NAFTA model in some respects. They also contain a number of innovative provisions that would exclude or limit key aspects of reflective loss claims such as the availability of concurrent claims or overlapping claims by related entities.

A number of these approaches are recent and merit careful analysis. However, many of these new provisions are yet to take effect in treaties in force. As noted, this chapter primarily addresses the impact on companies of the many existing treaties in force which are interpreted as outlined above and which still dominate the treaty and treaty claim landscape.

The impact of the unique combination of rules under many treaties on key attributes of the corporation and on stakeholders

Corporations are created under national law. National law statutes on business organisations typically also make available other organisational options like partnerships that lack some of the attributes of corporations.[23] But market participants regularly choose companies for large-scale investment.

The corporate form that is used globally for major investments has "the same fundamental legal features around the world: legal personality, limited shareholder liability, transferable shares, centralised (and delegated) management, and investor ownership" (Davies et al., 2009: 305). The strong market preference around the world for use of the corporation for major investments over other available organisational forms suggests that it is seen as efficient.

The discussion below analyses the impact of the unique combination of rules applicable under many treaties on the corporation, on corporate stakeholders including shareholders and creditors, and on corporate governance. The analysis assumes that profit-maximising investors and others will respond to economic incentives created by treaties. A working assumption is that all treaty incentives are likely to be taken into account by informed investors and their lawyers, and that they are likely to have an impact on investor behaviour and on the legal structures proposed by lawyers to their investor clients. Treaties may not have the expected effects outlined here if there is, for example, a lack of awareness of the rules or if there are countervailing considerations. Future work can test the expected impacts identified here against available empirical evidence.

The impact on the company as a separate entity with legal personality and its own property

The establishment of a separate pool of assets that belongs to the corporation as a separate legal entity distinct from its shareholders or managers has been described as perhaps the single most important rule in corporate law (Armour, Hansmann and Kraakman, 2009a: 6-7; Blair, 2015). It is crucial to the ability of the corporation to obtain credit because corporate creditors know that they can attach (seize) corporate assets. It is also at the core of the corporation's ability to commit credibly including to contracts (Mayer, 2013). It notably facilitates contracting among the various participants in the enterprise by allowing them each to contract with the corporation itself, rather than having to create separate contracts with each of the other participants.

In addition to the pool of assets that belongs to the company, corporate law also separates out a pool of shareholders' assets. The pool of shareholders' personal assets is not available to satisfy corporate debts. Shareholders benefit from limited liability: their exposure to corporate losses is normally limited to the amount of their investment in their shares.[24]

Legal rules that provide for "entity shielding" establish and protect the company's ownership of a separate pool of assets, which is generally considered to be value-enhancing

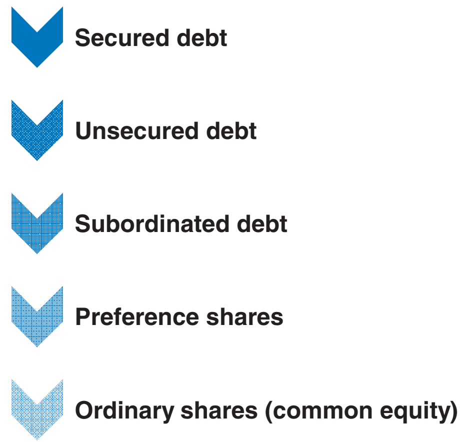
Two key rules that establish and protect the company's ownership of a separate pool of assets have been usefully described as "entity shielding".[25] This is because the rules in effect protect or shield the corporate entity from its shareholders (and their personal creditors). Limited liability for shareholders protects them from creditors of the corporation; entity shielding protects the corporation from its shareholders and their personal creditors.

The first component of entity shielding is a priority rule that establishes the hierarchy of claims on company assets. Legal rules give company creditors a priority claim over corporate assets. The pool of assets used in the business will be available to meet the needs of the business first (including paying creditors of the company) before those assets can be distributed to shareholders. Ordinary shareholders are the lowest priority claimants (Figure 8.5).

The second component of entity shielding protects the corporation's value as a going concern by protecting it from liquidation. Legal rules make shareholders' investments in a company generally permanent and help provide the entity with stable capital. Shareholder capital is in effect "locked in" subject to limited exceptions.[26] Liquidation protection helps preserve the going concern value of the company which is important because companies are often worth more both to their creditors and their shareholders as a going concern rather than as piece-meal assets upon liquidation.

Rules that protect creditors from inappropriate shareholder diversion of corporate assets work to lower the cost of debt finance for the company, resulting in gains to both creditors and shareholders.[27] Stronger legal protection of creditors' rights is generally associated with more

Figure 8.5. **Corporate finance: repayment rank order**



Source: Ferran, Eilís, "Reflective Loss", Presentation to Freedom of Investment Roundtable 19, October 2013.

lending to corporate borrowers (Armour, Hertig and Kanda 2009: 115). A lower cost of capital for companies generally allows for increased investment (Ferran, 2009: 64).

Law and economics scholars have also suggested that the permanency of shareholder investment allows the firm to draw in other valuable resources including from other investors, and to rely on the maintenance of shareholder capital for long-term projects. It has been seen as important for the historical development of large-scale enterprises and economic growth in various jurisdictions.[28]

The rules under many treaties can undermine both components of entity shielding

The rules under many treaties can undercut both elements of entity shielding where a government injures a company in breach of an investment treaty. In the case of government injury to the company, the company has generally already incurred a loss. The reflective loss claim intervenes at a moment when the company is already weakened and the damages paid to covered shareholders reduce its capacity to reconstitute its assets. The covered shareholders are in effect permitted partially to liquidate the company to the extent of their reflective loss. Second, as discussed below, the treaty rules may upset the priority rule by giving covered shareholders, in practice or in law, a priority right to corporate assets over creditors.

If modified, corporate law rules providing for entity shielding may not be replicable by contract

As noted, corporate law typically provides investors with a choice of corporate forms. The forms typically contain a mix of default rules (that can be modified by contract) and mandatory rules (that cannot be modified). The combination of mandatory rules and the power to choose among forms helps investors to signal commitment to certain rules:

> "Mandatory rules can facilitate freedom of contract by helping corporate actors to signal the terms they offer and to bond themselves to those terms. The law accomplishes this by creating corporate forms that are to some degree inflexible (i.e. are subject to mandatory rules), but then permitting choice among different corporate forms. … Formation as a business corporation, for example, signals simply and clearly – to all who deal with the firm, whether by purchasing shares or simply by contract – that the firm is

characterised by a variety of familiar governance provisions, and that it will continue to have those characteristics unless and until it changes statutory form."[29]

Hansmann, Kraakman and Squire maintain that the mandatory law providing for entity shielding of the company is of fundamental importance in part because its enhancement of company value cannot be replicated by contract.[30] The need for law creating mandatory rules distinguishes separate legal personality from the other core characteristics of the business corporation (such as limited liability) which can be replicated by contract.[31]

The inability of market participants to recreate by contract the corporate law rules creating entity shielding would make it particularly important to analyse carefully changes to those rules by investment treaties. The uncertainties caused with regard to company assets may undermine advantages of corporate personality outlined above, including the ability of the firm to serve as a single contracting party and make credible commitments, and its ability to use its assets to obtain credit. In addition, the applicability of investment treaties only to some shareholders and not others raises additional issues.

Shareholders are impacted differentially

Policy discussion about reflective loss under national law, by courts and commentators, considers shareholders in general. Existing rules and rules under discussion, including the general rule barring reflective loss claims and any exceptions, are generally proposed and understood as a rule to apply equally (as a matter of law) to any shareholder.

In contrast, treaties create rights only for a subset of shareholders – those foreign shareholders who are covered by treaties.[32] Assuming no change in the well-established general corporate law rule barring reflective loss claims, the policy question for investment treaties is thus whether reflective loss claims should be allowed for covered shareholders but not others. This adds an additional element to the analysis and invites consideration of the impact on different shareholders.

As a practical matter, in particular in light of the high costs associated with ISDS, it appears that the unique combination of rules applicable under many treaties is likely to divide shareholders into three groups with different profiles, incentives and outcomes (Gaukrodger, 2013: 47-51).

- Category I shareholders: "Likely claimants". These covered shareholders are likely to be ready, willing and able to claim for reflective loss as shareholders under treaties. Category I shareholders first need to have a sufficient stake to make bringing a claim worthwhile. They also need to be ready to incur the cost to bring an individual claim if the company is mistreated. Such covered shareholders can decide between supporting company action or their own claim (at one or more levels as a shareholder) or both. They may be the principal beneficiaries of an expansive regime for shareholder claims.
- Category II shareholders: "Potential but unlikely claimants". This group is composed of covered shareholders but who are unlikely to claim as shareholders. This may be due to the limited size of their investment or their diversified investment strategy.[33] The fortunes of these shareholders lie primarily but not exclusively with company remedies.
- Category III shareholders: "Excluded claimants." This group includes domestic shareholders and foreign shareholders not covered by a treaty. These shareholders cannot bring an ISDS claim as a shareholder. They also cannot bring a claim under domestic law because only the company can bring the claim. The fortunes of these shareholders lie solely with company remedies.

Categories I and II are not rigid categories and the dividing line may vary depending on the facts. For most if not all shareholders, including Category I shareholders, litigation is generally undesirable. Some normally passive Category II investors might be driven to bring a personal claim as a shareholder if their losses are unusually high or if government liability appears certain. Nonetheless, the broad categories are likely to exist.[34]

Category I covered shareholders are likely the principal beneficiaries of the rules on reflective loss in ISDS. The additional rights given to such covered shareholders under many treaties should encourage investment by them. However, to some degree this may reflect transaction structuring and increased transactions costs to obtain foreign status rather than real flows.

The preferential access to corporate assets for covered shareholders as compared to non-covered shareholders, once apparent to the investing public, is likely to lead over time to decreased non-covered share ownership. Given applicable rules, a foreseeable scenario will see domestic shareholders barred from a reflective loss claim under domestic law but required, as taxpayers, to contribute to substantial damages to a fellow (covered) shareholder for the same loss.[35] Both the impact on the investment market and the political impact of such a scenario in a high-profile case may be significant. It may also affect public acceptance of investment treaties.

A variety of other reactions are possible. Some shareholders may restructure to obtain coverage, raising transaction costs for investment. New vehicles providing coverage through a foreign entity may be offered to existing domestic shareholders. Small shareholders excluded from treaty protection will have an incentive to invest through vehicles that consolidate interests and benefit from coverage through a foreign vehicle. Individual share ownership may decline if small shareholders are perceived to have lesser rights in high-profile situations.

The availability of reflective loss claims for covered shareholders but not others may give the former increased leverage within the company and affect negotiations on various issues. Most directly, it may be likely to affect negotiations and decisions about how to respond to alleged government misconduct affecting the company. More generally, Category II and III shareholders may fear that major covered shareholders will have less interest in remedies for the company than in their own individual remedies under investment treaties.

Transferability and liquidity of shares may be adversely affected

The transferability of shares is another core characteristic of the business corporation. Transferability allows the firm to continue to conduct business notwithstanding changes in the identity of shareholders. In particular, the transfer of shares by an existing shareholder to a third party generally does not significantly affect the creditworthiness of the company.[36] This enhances the liquidity of shareholders' interests:

> "Transferability permits the firm to conduct business uninterruptedly as the identity of its owners changes, thus avoiding the complications of member withdrawal that are common among, for example, partnerships, cooperatives, and mutuals. This in turn enhances the liquidity of shareholders' interests and makes it easier for shareholders to construct and maintain diversified investment portfolios." (Armour, Hansmann and Kraakman, 2009a: 11).

The existence of this transferability – share transfers that do not cause a substantial impact on the firm's creditworthiness or business – requires entity shielding. If shareholders have access to corporate assets, transfers of shares between shareholders with different financial profiles will affect the company. For example, acquisition of shares by a shareholder close to personal insolvency could generate a claim on corporate assets. The creditworthiness of the firm as a whole could change, perhaps fundamentally, as the identity of its shareholders changed. Consequently, the value of shares would be difficult for potential purchasers to judge (Armour, Hansmann and Kraakman, 2009a: 12).

The differentiation between covered and non-covered shareholders under many treaties means that a transfer of shares between covered and non-covered shareholders (as well as between different covered shareholders) may have consequences for the creditworthiness of the firm.[37] Because covered indirect shareholders can also recover reflective loss under many treaties, transfers between indirect shareholders are also at issue.

The consequences of the new rules and the incentives created are hard to determine because the treaties create a new situation and there appear to be few domestic law precedents. However, they would appear likely to interfere with transferability in part because the impact of the new rules is frequently unclear.[38] In addition, creditors and others may find it difficult to monitor share transactions that increase or decrease the likelihood of reflective loss claims including for domestic companies. The impact of the rules on creditors more broadly also deserves careful consideration.

Shareholder claims for reflective loss can injure creditors

As noted above, the entity shielding rules that help establish the corporation's legal personality protect creditors by partitioning off a separate pool of assets that belong to the company. This is achieved by i) ensuring that creditors have a priority claim on corporate assets that comes before shareholder claims; and ii) preventing partial or complete liquidation of the firm, thus protecting its going-concern value.

As noted, both rules that provide for entity shielding are undermined by the unique combination of rules under many treaties, and this has significant impact on creditors. Recovery of damages for reflective loss by a shareholder can be perceived as stripping an asset from the corporation. If recovery for a company injury does not go to the company, company creditors will suffer a detriment. For potential lenders to the company, the asset stripping permitted by the treaty rules may mean that regulatory risk for the company may be compounded by additional risks. There is liquidation risk because lenders perceive that the company is less likely to reconstitute its assets following a government injury.

The priority rule is also undermined because it is at best unclear whether ISDS arbitrators will prioritise creditor claims. As noted by a well-known practitioner and commentator, ISDS cases proceed in a "generally simplistic manner" on this issue and consider that the covered shareholder can recover its pro rata share of the company injury based on its percentage ownership of the share capital without regard for creditors.[39] Many cases do not even refer to creditors. In the recent *Micula et al. v. Romania* case, covered shareholder investors argued that these outcomes in fact reflect a legal rule that gives covered shareholders a legal right to a pro rata share of the company damages in preference to company creditors. This issue was expressly left open after significant argument on the point; in an unusual footnote, the arbitrators revealed that they would have disagreed on the issue[40] (Box 8.1).

As a practical matter, creditors will likely have reservations about the effectiveness of their protection in this context for several reasons. First, as noted, ISDS cases to date often

Box 8.1. **The issue of creditor subordination – *Micula et al. v. Romania***

In *Micula*, two individual claimant shareholders (Individual Shareholder Claimants) owned over 99% of the shares in three companies which were also claimants in the same case (Corporate Claimants). The Corporate Claimants were allegedly unable to pay their debts (accordingly to all the claimants themselves); the companies apparently had substantial tax and debt obligations although no attempt was made to quantify them.

Most of the case apparently proceeded on the basis that all five claimants would recover together without the Respondent's counsel raising the issue of reflective loss. Late in the case, however, the two Individual Shareholder Claimants sought to exclude the Corporate Claimants from the recovery and to recover all of the damages themselves on a 50/50 basis.

The Individual Shareholder Claimants argued that ISDS precedent supported finding that shareholder rights to reflective loss under the treaty trump company creditor rights. It was suggested that company creditors now understood that they have a subordinated status to shareholder treaty claims. As the tribunal's award reflects, these points were made notably in oral closing argument in response to questions from the tribunal regarding the protection of the Corporate Claimants' creditors (including Romania) in the case of an award to the Individual Shareholder Claimants:

> "[T]hose points are kind of answered in allowing shareholders to bring these kind of claims. And the reason for that in investment law is they are the real parties in interest in these matters, and creditors, including state creditors, cannot think that they have a claim to these kinds of losses because they know that shareholders have their own rights in international law. So a creditor or the taxman has no expectation that they can recover these taxes or whatever on the basis of amounts to be awarded in an ICSID arbitration. …
>
> With respect to the position of the [C]orporate [C]laimants and their creditors and employees if the Tribunal were to make an award to the shareholders, […] in our view strictly as a legal matter, the answer is that the BIT protects foreign investors and breaches of the foreign investors' rights entitled them to compensation, and the foreign investors are the real parties in interest, as has been decided in a number of cases. The fate of the investment vehicle doesn't come into the balance, strictly legally speaking, in our submission.
>
> As a more pragmatic matter it seems to us that if you were to make the award that we urge, then my client – Johnny Micula would have an award, and an award is not money. There would be a negotiation with the state and with the banks. Probably the banks would have to take a bit of a haircut because these are basically more or less sound businesses but crippled by debt. If the debt were relieved, things might be better. The state might have to do something as well.
>
> We see it more as an issue that arises after an award rather than in arriving at the award, as a strict matter. I suppose if the parties can't agree, it is of course plausible that the companies will go into bankruptcy. That doesn't actually mean that people will lose jobs because the businesses will presumably be sold, new investors will be found, they won't have to carry those debts; they will remain with the bankrupt entities. The banks will presumably lose money if the assets aren't sufficient to cover all the debts. We think that's the proper view."[1]

Romania argued that creditors' rights should be given priority in accordance with normal corporate law principles. The arbitrators did not resolve this question. They rejected the attempt to exclude recovery by the Corporate Claimants, but only on procedural grounds. They found that it was not possible to discontinue the three Corporate Claimants' claims so late in the case. The tribunal decided it could not allocate the damages between the five claimants and awarded the damages to them collectively.

Box 8.1. **The issue of creditor subordination – *Micula et al. v. Romania*** *(cont.)*

The tribunal thus decided not to "enter into the discussion of whether shareholder damages are equivalent to the damages suffered by the underlying company".[2] In a footnote, however, it indicated that the tribunal would have been split on that point.[3] The issue of whether treaties grant covered shareholders a priority right over company creditors as a legal matter may be somewhat uncertain and subject to future arbitral decisions.

1. *Micula*, § 1204.
2. *Micula*, § 1245.
3. *Micula*, § 1245 n.269 ("If the Tribunal had to address this point, it would not do so unanimously.")

apply a pro rata approach and provide little reason for optimism about the recognition of creditor rights in this context. Second, investment arbitration tribunals have limited powers which appear to be insufficient to engage in corporate valuation exercises. Valuation exercises that evaluate competing claims on corporate assets are time-consuming and expensive.[41] Scholars have underlined that many of the special powers of a bankruptcy court are needed to effectively recognise priorities in this context. Because the adjudicating body must be able to assess the ratio between firm assets and debts, "[t]ypically, this will require the court to exercise the broad powers associated with a bankruptcy system: the powers to stay division of firm assets and determine their aggregate value, simultaneously evaluate the validity and worth of the claims of multiple creditors, and oversee ongoing firm operations during the pendency of proceedings".[42]

ISDS arbitrators do not have these powers. Indeed, because the company is frequently not a party in a shareholder claim for reflective loss, the tribunal may not even have jurisdiction over the company. Even obtaining basic information about company finances and credit exposure may thus be difficult. Only publicly available information about the largest creditors, such as bondholders, may be available. The lack of capacity to engage in serious valuation may explain the observed tendency to use a simplistic pro rata approach that ignores creditor interests.

Third, creditors are also rarely represented in ISDS cases brought by shareholders. Creditor interests will likely only be represented at most by the government which may argue that the claimant shareholder's recovery should be reduced because creditors have suffered some of the reflective loss. The government will likely have limited information about the company. Creditors may also feel that the government is a less than ideal advocate for their interests.[43]

In advanced systems of corporate law, contracts with a corporation are drafted against the background of well-established law providing for its separate legal personality. For example, the contracting parties to a loan generally do not need to address the risks of shareholder claims in the loan contract. Because creditors do not need to worry about these issues in domestic law, their potential responses to the expected availability of such claims by covered shareholders under treaties is somewhat speculative. As discussed above, it would appear difficult to recreate the company's separate legal personality by contract.

In the absence of legal rules creating entity shielding, creditors may seek to take other actions to protect their investments.[44] Some possible reactions are outlined here. Decisions in this area are affected by creditor awareness of the issues. Most of the potential

Box 8.2. **Greater opportunities for shareholder opportunism: Risks to creditors from the allocation of ISDS claims in shareholder ownership chains**

The unique combination of rules under many treaties facilitate treaty shopping by shareholders because a shareholder can claim for company loss at its preferred covered level of the chain of ownership (Gaukrodger, 2013: 33). Shareholder ability to allocate claims within an ownership structure can also be used to provide benefits to covered shareholders in a fashion detrimental to creditors (Gaukrodger, 2014a: 20). National corporate law generally does not permit claims for reflective loss, but similar issues can arise from actions taken by controlling shareholders in the context of a corporate group:

> "A group structure allows controllers to set the terms of intra-group transactions, and thus to assign (and reassign) value within the group. Sometimes an intra-group transaction is designed solely in order to extract value from the creditors of a financially distressed group member or to favour the creditors of one subsidiary to the detriment of the creditors of other group members. Yet creditors may also suffer harm as a by-product of intra-group asset transfers undertaken for other reasons – for example, to secure a tax advantage."[1]

Many treaties that apply the unique combination of rules may give rise to broader scope for this type of opportunism than under national corporate law. First, any shareholder, rather than only controlling shareholders, can choose the (covered) level at which to bring its reflective loss claim. Second, the intra-group transactions described above generally involve at least some payment for the valuable asset, albeit one below its real value. In the case of a shareholder decision to locate its treaty claim, the non-claiming entities do not receive any compensation. The potential problems for creditors may be compounded by the lack of transparency in ISDS.

1. Armour, Hertig and Kanda (2009: 127); compare id. p. 116 (noting risk of shareholder opportunism vis-a-vis creditors by falsely claiming that the firm holds title to assets that actually belong to other entities or to the shareholders personally).

responses may not be meaningfully available to smaller or local creditors even if they are aware of the additional risks. Higher risks for creditors may fall in particular on them.

- *Increase the price and/or decrease the availability of credit for foreign investment.* Creditors can react to increased risk or uncertainty about the applicable rules by changing the terms on which they make credit available to the company. They can raise the price of credit or choose to lend elsewhere. The company's cost of credit and thus its overall cost of capital may be affected which may limit its perceived investment opportunities.
- *Seek contract provisions and loan covenants.* Major loan contracts with companies are frequently intensively negotiated. Lenders seek company agreement to clauses limiting creditor risk. A frequently-included covenant of relevance to the new treaty rules is a disposal of assets covenant which is "intended to prevent asset-stripping" (Ferran, 2009: 333). These covenants, however, may only address and bind the company. A contract between the lender and the company normally does not bind shareholders. A successful covered shareholder claim, however, can diminish corporate assets without any action by the borrower (the company) because it only requires a unilateral act by a covered shareholder.
- *Seek to expand use of secured credit.* For creditors with sufficient bargaining power, it may be possible to take proprietary security interests over company assets. A lender to a company could also seek security interests from shareholders over their shares. However, creditors would need to address the possibility of claims by indirect shareholders. Increased use by

dominant creditors of secured credit to respond to risks posed by covered shareholder recovery of reflective loss would likely shift additional risk to the unsecured creditors of the company. It may thus affect the terms and cost to the company for such inputs.[45] Unsecured creditors may also incur greater costs to monitor the company's financial health which may also affect the terms and cost of credit.[46]

- *Try to lend at a different level in the corporate chain.* The creditors of a bottom- or mid-tier company may be exposed if a higher tier covered shareholder makes an ISDS claim for reflective loss. Recovery for the top-tier covered shareholder would normally not benefit creditors of a lower-tier entity.[47] As outlined in Box 8.2, a shareholder may be able to choose its preferred covered level to bring its claim. One potential creditor response to this risk could be to seek to lend to a higher tier covered shareholder or even the ultimate controlling shareholder. However, this approach may not be feasible or desirable. For example, the top-tier shareholder with the power to allocate its claims in the corporate chain may not want to expose its personal assets in the event the new venture fails. It may prefer to have the lending occur at a lower level.
- *Try to recover money awarded to covered shareholders under company or insolvency law.* It has been suggested in general terms that individual shareholder recovery of reflective loss could possibly be recycled to the company or to creditors, for example in the context of company law or insolvency proceedings. The legal basis for this remains unclear. Shareholders with an award or money in hand may be unlikely to recognise creditor priority, as suggested by the *Micula v. Romania* case, discussed above. Awards of reflective loss damages to shareholders of companies in financial difficulty, however, may lead to arguments of this type.
- *Rely on shareholder reputational interests and commercial considerations.* Some larger institutional creditors may rely on shareholder reputational interests and commercial considerations. Because reflective loss claims are generally barred in advanced systems of national law, use of such a claim in ISDS to obtain a preference over creditors could be perceived as opportunistic behaviour that could affect the ability of the relevant beneficial owner to return to the credit markets in the future. Some covered shareholders with the legal ability to engage in opportunistic behaviour in ISDS may choose not to do so in light of these commercial considerations.
- *Bring treaty claims for reflective loss.* Creditors may respond to the availability of recovery of reflective loss in ISDS by seeking to bring their own claims for reflective loss.[48] This would further disaggregate the company loss and lead to a larger number of arbitration claims arising out of the same injury. The ratio of legal costs to recovery would likely rise.

The impact on centralised management by the board of directors

Centralised management is a core characteristic of the business corporation. Shareholder investors who form a company or invest in one know that absent special agreement to the contrary, almost all business decisions will be taken by the board of directors (or by management subject to monitoring by the board) rather than shareholders directly. Corporate law identifies a small number of fundamental changes or issues for which shareholder approval is required, but otherwise leaves most decisions to the board.[49]

Investors choose the corporation with centralised management because it can promote both efficiency and fairness. It streamlines corporate decision-making because most decisions can be taken without the need to inform or obtain the consent of shareholders. It can also help protect vulnerable corporate constituencies – and thus encourage their investment and participation in corporate enterprises (Armour, Hansmann and Kraakman, 2009a: 14).

Different corporate constituencies frequently have very different views about appropriate corporate policy. Among shareholders, views frequently differ between those with a relatively short time horizon and longer-term investors. Corporate decisions about government relations and litigation can be some of the most sensitive decisions taken by the board of directors.

The treaty rules release covered shareholders to act individually on key issues of corporate interest. Covered shareholders with divergent interests no longer need to convince the board or management to act. Moreover, unlike the board, covered shareholders may be able to act solely in their own interest.[50] Individual covered shareholders such as hedge funds may have interests that diverge significantly from those of the company or other stakeholders with regard to maintaining the value of a brand or the importance of maintaining a constructive long-term investment relationship in the host jurisdiction.

The new rules can also hinder the ability of the corporation to take decisions about settlement of a claim and reduce the value of settlement. Under the usual corporate law rules, the injured company's board or senior management can decide about settlement with a party that has injured the company. In contrast, under the unique combination of rules under many treaties, a settlement with the injured company is both less attractive and more complicated. It is less attractive because the company is unable to deliver "real peace"; one or more covered shareholders can still bring claims arising out of the same events.[51] The settlement value to the government, and thus to the company, will be lower. They are more complicated because obtaining a full settlement requires the agreement of more parties including indirect shareholders.[52]

Settlement discussions are rarely public. However, recent press reports pointed to a major role of likely covered shareholders and unusually complicated settlement negotiations in a recent ISDS case.[53] Shareholder approval was reportedly a condition of the settlement agreement alongside company approval through its board.[54] As lawyers and covered shareholders learn about their new rights, the rules may encourage greater covered shareholder involvement in discussions between companies and governments about government policies affecting companies.

The potential impact on corporate structuring of the unique combination of rules under many treaties

As discussed above in the section addressing the transferability of shares, the shareholder ownership structure of a company normally has no impact on claims following an injury to the company. Consequently, there is no incentive to engage in corporate structuring to maximise shareholder returns from an injury to the company. In contrast, under many investment treaties complex corporate structures can maximise shareholder returns in the event of injury to a company.

The two unique treaty rules on recovery of reflective loss and recovery of damages in themselves create an incentive for complex corporate structuring. Maximising treaty coverage for reflective loss claims would appear to require spreading ownership at different shareholder tiers across different jurisdictions so that a larger number of investment treaties can potentially be used. However, there is no definitive study of which we are aware that addresses the role these considerations play in corporate structuring.

Additional rules applicable under many treaties as interpreted may further encourage advance structuring of investments using multiple shareholder tiers. First, many treaties allow a corporation to claim as a national based only on its place of incorporation. Under this approach, no real economic link to the home jurisdiction is required and holding (or "shell") company claimants are accepted.[55] This rule makes the nationality of the corporation easy to identify, but it also makes it easy to set up complex structures with many levels of treaty protection.[56] Holding companies are easy to set up and many jurisdictions compete to attract the creation of such companies under their law.

Second, claims by shareholder entities inserted relatively late into the chain of ownership of an operating company (after a dispute or potential dispute has emerged to some degree) have been rejected in some cases on the basis that the restructuring was "abusive".[57] Risks associated with a "late" transfer of ownership to a covered shareholder make it attractive to do corporate structuring in advance as a routine matter for significant investments.[58] Multiple potential shareholder claimants will then exist under different treaties without the need for a possibly "late" transfer.

While many treaties allow claims by holding companies, an increasing number of treaties include provisions that can exclude or limit the use of holding or shell company claimants without an economic connection to their state of incorporation. For example, treaties can require that claimants have a substantial business connection to their home state or can allow respondent governments to deny benefits to companies without such a connection.

A policy question is whether investment treaties should encourage the routine use of complex structures. Such complex structures create costs both for investors and for law enforcement. Complex structures increase transaction costs and can raise the costs of mergers and insolvency proceedings. They can also obscure the beneficial owner of the investment. At the same time, corporate vehicles have legitimate uses. For example, they can be used to facilitate certain mergers or joint ventures. A multinational joint-venture company may be incorporated in a neutral jurisdiction in an effort to ensure equal treatment of participants in the venture.

Conclusions

Evaluation of the impact of investment treaties on companies is increasingly important. Formerly largely limited to the protection of the investments of developed-county investors in developing countries, investment treaties are rapidly expanding their scope of application. They are being extended to include the vast amounts of investment in and between the largest economies in the world. They are expected to apply in the near future to many more companies and to much more of their activity. The rapid growth of foreign share ownership means that major domestic companies will frequently have covered foreign shareholders.

Treaty rights applicable in more situations involving more governments will cause treaty incentives to have greater impact on the company and its stakeholders. Of course, treaty impact on the company will remain limited by their application to the government-investor relationship and to difficult situations in that context. Companies that are little affected by government regulation are likely to be little affected by treaties. But treaties will have little impact in encouraging investment in those areas. Where treaties are relevant, they will affect investment in part through their impact on the company. The areas where massive investment is most needed – whether to address climate change or to improve infrastructure – are often closely related to governments. Public-private partnerships and many other models of development involve intensive and long-term interaction between governments and companies on major projects. Achieving investment in these areas may need to harness the full power of the company idea.

There would not appear to have been any demonstration to date of a strong policy need for the current general availability of reflective loss claims under many treaties as interpreted. At the October 2013 FOI Roundtable, governments noted that no strong policy basis had been put forward for the general acceptance of reflective loss claims under investment treaties. The importance of finding a countervailing strong policy basis was identified due to the many policy issues raised by allowing such claims as a general matter.[59] The current interpretation of many treaties as creating a general rule allowing reflective loss may impede more specific thinking, at least in the context of cases and case commentary, about particular circumstances in which such claims should be permitted as a policy matter.

In many jurisdictions, investment treaties are being subjected to intensive policy analysis and political debate for the first time. The investment treaty system itself has been criticised for excessive fragmentation and some have called for broad reform. The impact of treaties on investment and governments will rightly remain the core focus of such debates. But given the increasingly-recognised critical role of the company in fostering investment and economic development, ensuring that treaties optimally harness the company should be a key consideration in treaty reform.

Notes

1. Although groups other than shareholders, such as company creditors, also suffer reflective loss when a company is injured and may be able to bring claims for reflective loss, the discussion below focuses on shareholder claims because they have been far more numerous to date.
2. Gaukrodger (2014b: 12). For example, the Netherlands-Malawi BIT, art. 1 provides that "'investments' means every kind of asset invested in accordance with the national laws and regulations of the Contracting Party in the territory of which the investment is made and in particular, though not exclusively, includes: ... ii. rights derived from shares, bonds and other kinds of interest in companies". The Energy Charter Treaty (ECT) expressly includes "shares, stock, or other forms of equity participation in a company or business enterprise". ECT art. I(6)(b).

   Corporate debt is also frequently expressly included as a covered investment, as also illustrated by the Netherlands-Malawi treaty. The ECT similarly supplements its "all assets" definition of covered investment with a specific reference (in art. I(6)(b)) to "bonds and other debt of a company or business enterprise". Many treaties are also summary in their treatment of creditors and do not address whether they can recover reflective loss.
3. The one exception is expropriation, for which a monetary remedy and valuation metric are generally specified.
4. See, e.g., *Suez, Sociedad General de Aguas de Barcelona S.A. and Interagua Servicios Integrales de Agua* S.A. *v. Argentine Republic* (ICSID Case No. ARB/03/17), Decision on Jurisdiction (16 May 2006) § 49.
5. See *Impregilo S.p.A. v. Argentina*, Award (2011), § 138 ("It follows from Article 1(1)(b) of the Argentina-Italy BIT that Impregilo's shares in AGBA were protected under the BIT. If AGBA was subjected to expropriation or unfair treatment with respect to its concession – an issue to be determined on the merits of the case – such action must also be considered to have affected Impregilo's rights as an investor, rights that were protected under the BIT.").
6. Alexandrov (2005: 45) (finding that ISDS tribunals considering shareholder claims "all considered it to be beyond doubt that a shareholder's interest in a company includes an interest in the assets of that company, including its licenses, contractual rights, rights under law, claims to money or economic performance, etc.") ICSID refers to the International Centre for Settlement of Investment Disputes which is the leading administrator of investment arbitrations.

7. See *Kagan v. Edison Bros. Stores Inc.*, 907 F.2d 690, 693 (7th Cir. 1990) ("The [shareholder and company creditor] investors are asking us to disregard [the company's] corporate form.... Although the [shareholder] plaintiffs want us to allow them to recover for injuries mediated through [the company], they most assuredly do not want us to hold them liable for [the company's] debts. They seek the best of both worlds: limited liability for debts incurred in the corporate name, and direct compensation for its losses. That cushy position is not one the law affords. Investors who created the corporate form cannot rend the veil they wove."); *Alford v. Frontier Enterprises, Inc.*, 599 F.2d 483 (1st. Cir. 1979) ([the shareholder] "is attempting to use the corporate form both as shield and sword at his will. [T]he corporate form effectively shielded [him] from liability" but the shareholder contended that he "can disregard the corporate entity and recover damages for himself. Of course, this is impermissible."); see generally Gaukrodger (2013: 15-24) (surveying advanced corporate law systems; shareholders generally benefit from limited liability but cannot claim for reflective loss).
8. OECD (2013a: 5); Gaukrodger (2013); *Day v. Cook*, [2001] EWCA Civ. 592 (Ct. App. 2001) § 1.
9. Reflective loss is also referred to as derivative loss or injury particularly in common law legal systems.
10. For a recent survey of shareholder cases of these various types, see, e.g., Valasek and Dumberry (2011: 73 et seq.).
11. See, e.g., *Total S.A. v. Argentina*, Decision on Objections to Jurisdiction (2006) § 80 ("Having found, however, that the assets and rights that Total claims have been injured in breach of the BIT fall under the definition of investments under the BIT, it is immaterial that they belong to Argentine companies in accordance with the law of Argentina. Total asserts its own treaty rights for their protection, regardless of any right, contractual or non-contractual that the various companies [in which it owns shares] might assert in respect of such assets and rights under local law before the courts of other authorities of Argentina, in order to seek redress or indemnification for damages suffered as a consequence of actions taken by those authorities."); Gaukrodger (2013: 27-29). Some commentators have suggested that reflective loss claims should be restricted to, *inter alia*, cases where the company's recourse in the domestic courts is impaired. Douglas (2009: 397) (suggesting that the availability of reflective loss claims in ISDS should be restricted, but that, under certain conditions, they should be available where the company has been deprived of a remedy to redress its injury or of the capacity to sue, or has been subjected to a denial of justice in the domestic courts).
12. Such non-pecuniary primary or judicial review remedies include i) the annulling of a governmental measure or decision; ii) injunctions (requiring a party to do or to refrain from doing something); and iii) declarations of the rights and obligations of the parties, or a declaration that a particular administrative decision was illegal without otherwise stating any consequences.
13. OECD (2012: 10); Gaukrodger and Gordon (2012: 24-27 & Annex 4).
14. There are many manifestations of the increasingly financial nature of investor-government relations under these rules. Claimants and governments now routinely hire financial experts to support or oppose claims for damages and lost profits. A new Journal of Damages in International Arbitration was launched in 2014 and devotes substantial attention to treaty claims against governments. Third-party financing by institutional investors of investment treaty claims against governments on a contingency basis has become common.
15. See *CMS Gas Transmission Company v. Argentina*, Award (2005); *Total, S.A. v. Argentina*, Award (2010).
16. See El Economista (2012).
17. *Gaubert v. United States*, 855 F.2d 1284, 1291 (5th Cir. 1989).
18. Gaukrodger and Gordon (2012: 19).
19. For examples relating to NAFTA-style treaties, see, e.g., *Renco Group, Inc. v. Peru*, Peru's Reply on Waiver §§ 22-24 (17 Aug. 2015); *Renco Group, Inc. v. Peru*, Second Submission of United States of America (non-disputing party), § 12 (1 Sept. 2015); *GAMI v. Mexico*, Submission of the United States (non-disputing party) (30 June 2003); *GAMI v. Mexico*, Escrito de Contestación of Mexico, §§ 166-67, pp. 61-64 (24 Nov. 2003) (agreeing with and quoting US submission); *Pope & Talbot v. Canada*, Canada Statement of Defence (Phase 3 – Damages) (18 Aug. 2002) §§ 49-54.
20. See Garg et al. (2016: 78).
21. See Carim (2016: 63).
22. See Cooperation and Facilitation Investment Agreement Between ______ and the Federative Republic of Brazil, § 1.4 (Version 2.3.1, 3 March 2016) (on file with the OECD Secretariat). It also allows only for state-to-state claims and excludes ISDS. Shareholders have no power to bring claims.

23. For example, laws in some jurisdictions also provide for entities such as certain types of partnerships that do not require the same practically irrevocable commitment of capital to the enterprise as is provided by shareholders. Partners have the power to dissolve the partnership.

24. See Blair (2003: 391) ("Partitioning has two aspects: Individual participants in the business are not held personally responsible for the debts or liabilities of the business (this aspect is commonly referred to as limited liability in the context of business corporations), *and* participants and third parties are assured that the pool of assets used in the business will be available to meet the needs of the business first (such as, to pay the claims of the business's creditors) before these assets can be distributed to shareholders") (footnotes omitted; emphasis in original).

25. The term "entity shielding" was formulated in Hansmann et al. (2006) and is used in Kraakman et al. (2009). Entity shielding is sometimes referred to as affirmative asset partitioning. See Armour, Hansmann and Kraakman (2009a: 6, n.12); Mayer (2013: 184-85) (noting use of both terms).

26. See Gaukrodger (2013: 17) (noting emphasis in German case law and scholarship on the principle that the company's assets are bound for the purpose of the business [*Zweckwidmung des Gesellschaftsvermögens*]); see also Clark (1986: § 1.2.3) (noting that because any partner can dissolve a partnership by express will at any time and withdraw its investment, "[t]he partnership's life is thus a precarious one, and this fact will give pause to those wanting to launch a large enterprise with large start-up costs"; contrasting the corporate entity in which individual shareholders cannot withdraw their investment, leading to a more stable existence that is "more likely to preserve the going concern value of large projects"); Blair (2003).

27. See Armour, Hertig and Kanda (2009: 118) ("both creditors *and* shareholders can benefit from appropriate restrictions on the ability [of shareholders] to divert … assets, because such restrictions are likely to reduce a firm's costs of debt finance") (emphasis in original).

28. Blair (2003) ("[O]nce the funds paid to purchase those shares had been committed, limits were imposed – sometimes severe ones – on the ability of investors to withdraw funds from the business. The commitment of capital by shareholders … helped protect the at-risk investments made by other corporate participants. … [T]he capital contributed or pledged in the form of equity shares helped secure a pool of 'bonding assets', which made it easier to draw in other risky contributions to the enterprise."). See generally Hansmann et al. (2006) (broad historical survey); Lamoreaux and Rosenthal (2006) (impact in Europe).

    Lock-in of shareholder capital is not without costs. For example, it can allow those in control of the firm to behave opportunistically toward minority shareholders because the latter are generally unable to withdraw their investment. However, as noted, in all advanced systems of corporate law, lock-in is made available in the business corporation and is widely chosen by market participants. Corporate and other law seeks to manage the potential costs of lock-in through many devices such as the imposition of fiduciary duties on directors or constraints on transactions by the company with related parties.

29. Armour, Hansmann and Kraakman (2009a: 22).

30. Hansmann et al. (2006: 1340-41) ("It would be practically impossible in most types of firm to create effective entity shielding without special rules of law."; efforts to do so would suffer from high transactions costs and likely insuperable moral hazard) (footnotes omitted); see also Armour, Hansmann and Kraakman (2009a: 8) ("Entity shielding doctrine [imposed by law] is needed to create common expectations, among a firm and its various present and potential creditors, concerning the effect that a contract between a firm and one of its creditors will have on the security available to the firm's other creditors.").

31. See Hansmann et al. (2006: 1338) ("[E]ntity shielding, unlike [limited liability], can be achieved only through the special property rules of entity law. For this reason, we believe that entity shielding is the sine qua non of the legal entity …") (footnotes omitted); Armour, Hansmann and Kraakman (2009b: 37).

32. The percentage of foreign shareholders in listed companies has increased significantly in recent years. See Gaukrodger (2013: 49) (citing research showing that half of the listed companies in the United Kingdom and Belgium, 40% of the companies in France and Germany and around 30% of the companies in Spain and Italy have a large foreign shareholder); The Economist (2016b) ("the proportion of shares in Britain's firms owned by foreigners zoomed passed the 50% mark in 2015").

33. Category II may include some institutional investors who prefer to diversify their risk across many companies and incur a loss in some companies rather than bring high cost claims as a shareholder.

34. If it is assumed that creditors can also claim for reflective loss in ISDS, they could be categorised into similar categories. Likely reflective loss claimants among creditors may be fewer because, as noted

above, creditors generally suffer less reflective loss than shareholders (providing the company is solvent); creditor interests and losses may also be dispersed if, for example, the company's bonds are widely held. If it is assumed that creditors cannot claim for reflective loss in ISDS, they would all be "excluded claimants" whose fortunes would lie solely with company recourse.

35. Claims arising out of the Fortis bailout and sale by the Belgian government appeared to involve a potential scenario of this type although there is little public information about the claims. Claims by Belgian shareholders in the Belgian bank against the Belgian government were reportedly rejected by the Belgian courts applying the no reflective loss principle; only the company could bring the claim (L'avenir (2011); Le Soir (2011)). A major Chinese shareholder in Fortis brought a treaty claim. Under the unique combination of rules outlined above, the claim would not be subject to a similar defence. The issue was not raised in preliminary proceedings and the treaty claim was rejected at that stage based on the timing of key events and the date of entry into force of the relevant treaty. *Ping An Life Insurance Co. of China Ltd. v. Belgium*, ICSID, Award (30 April 2015).

36. In some exceptional situations, such as where it is expected that an existing important shareholder would support the company, a transfer of shares to a third party may affect the creditworthiness of the company even under national law.

37. Compare Alexandrov (2005: 45) (finding that ISDS tribunals considering shareholder claims "all considered it to be beyond doubt that a shareholder's interest in a company includes an interest in the assets of that company, including its licenses, contractual rights, rights under law, claims to money or economic performance, etc.") *with* Ferran (2009: 147) (Under UK law, "[t]he shareholder's financial interest is in the company itself and it does not amount to a direct interest in the company's assets.").

38. See Gaukrodger (2014a: 24-25) (discussing uncertainties about transfer or retention of rights to bring an ISDS claim in connection with a transfer of shares).

39. See Gaillard (2015: 226-27) ("C'est en effet de manière généralement simpliste qu[e] [la jurisprudence en vertu de traités d'investissement] considère que l'actionnaire doit être traité comme la société elle-même, au pro rata de sa participation. En d'autres termes, un actionnaire à 80% aurait subi 80% du dommage de la société et un actionnaire à 3%, 3% de ce dommage. Sur ce point, une appréciation plus fine serait bienvenue. … [L]a situation des créanciers de la société concernée doit également être prise en compte.") [It is in effect in a generally simplistic manner that ISDS arbitral cases have considered that a shareholder must be treated like the company itself, using its pro rata share ownership. In other words, an 80% shareholder is found to suffer 80% of the company injury and a 3% shareholder, 3% of the company injury. On this issue, a more refined analysis would be welcome. … [T]he situation of the creditors of the company at issue must also be taken into consideration.") [Author's translation]

40. *Ioan Micula et al. v. Romania*, ICSID, Award (11 Dec. 2013).

41. See, e.g., *Mid-State Fertilizer Co. v. Exchange National Bank of Chicago*, 877 F.2d 1333, 1335-36 (7th Cir. 1989) (trying to apportion the recovery after a corporate injury according to who bears the effects between equity investors, debt investors, employees and others "would be a nightmare").

42. Hansmann et al. (2006: 1352-53).

43. The issue of damages will often arise only if the tribunal has already found that the government caused the injury to the company. The tribunal may hesitate to reduce shareholder recovery for the benefit of the government on the basis of creditor injury.

44. This section is adapted from Gaukrodger (2014a).

45. See Ferran (2009: 349) ("unsecured creditors may demand higher interest to compensate them for the risk of being postponed to the secured debt in the event of the borrowing company's insolvency").

46. Id. ("the existence of security raises the expected cost of default for unsecured creditors by reducing the available asset pool and thus creates incentives for these parties to monitor more extensively"), quoting Schwartz (1981).

47. See Gaukrodger (2013: 49-50, 42, Figure 5).

48. No view is expressed about the likelihood of success of such claims at any stage.

49. The discussion focuses on companies with a single board. Some corporate law systems, such as in Germany, provide for two separate boards with different responsibilities. These differences do not affect the basic delegation of management responsibility by shareholders addressed here.

50. See Strine (2012) ("in the American corporate law tradition, stockholders who are not directly controlling board action are entitled to pursue only their own self-interest, without owing any fiduciary duties to other stockholders or the corporation itself").

51. See, e.g., Ferran (2001: 245-247) ("Secondary policy considerations also come into play to explain the absolute nature of the rule that [a shareholder] cannot sue for reflective loss where the company also has a cause of action. If a company agrees a compromise settlement with a defendant, principles of certainty and fairness dictate that shareholders should not then be able to re-open the case by seeking to pursue the defendant in a personal capacity. Shareholder complaints about the terms of a compromise should properly be directed at those who agreed the compromise on the company's behalf, not the original wrongdoer.")

52. As outlined by US appellate courts, this hindrance of amicable settlement is one of the reasons why shareholder claims for reflective loss are generally barred under national law. See, e.g., *Potthoff v. Morin*, 245 F.3d 710, 717 (8th Cir. 2001) ("The rule is a salutary one: if a shareholder, dissatisfied with the dealings entered into between his corporation and a third party, automatically possessed a personal right of action against the third party, then corporations would be paralyzed."; dismissing shareholder suit arising out of termination of license to company by local government port authority; only the company could claim) (quoting *In re Dein Host,* Inc.*,* 835 F.2d 402, 406 [1st Cir.1987]).

53. See Johnson (2013) (quoting former senior executive noting that "it is strange that shareholders are negotiating an issue such as this around the side of [Repsol's CEO]").

54. See Buck (2014) ("Negotiators from the company and the Argentine government signed off on the complex settlement in Buenos Aires on Friday, but the deal still needs the approval of the Repsol board and shareholders …").

55. See Voon et al. (2014: 58) ("A central uncertainty has been whether ownership requires some form of active participation or beneficial ownership or includes merely passive ownership of an investment by a corporate subsidiary or shell company. Several tribunals have dismissed the argument that an investor must have a beneficial or active ownership interest in order to 'own' an investment. In the absence of any such requirement in the text of the relevant [investment treaty], most tribunals have taken a broad view of ownership that extends to passive and formal legal ownership. This would cover formal legal ownership by shell companies or corporate subsidiaries to whom ownership in the investment has been transferred to gain the protection of an [investment treaty]."); see also, e.g., *ADC Affiliate Limited and ADC & ADMC Management Limited v. Republic of Hungary*, ICSID, Award § 359 (2 Oct. 2006) ("the [Cyprus-Hungary] BIT is governing, and in its Article 1(3)(b) Cyprus and Hungary have agreed that a Cypriot "investor" protected by that treaty includes a "legal person constituted or incorporated in compliance with the law" of Cyprus, which each Claimant is conceded to be. … [I]nquiry stops upon establishment of the State of incorporation"); *Saluka Investments B.V. v. Czech Republic*, UNCITRAL, Partial Award, 17 March 2006 §§ 240-41 ("The Tribunal has some sympathy for the argument that a company which has no real connection with a State party to a BIT, and which is in reality a mere shell company controlled by another company which is not constituted under the laws of that State, should not be entitled to invoke the provisions of that treaty. Such a possibility lends itself to abuses of the arbitral procedure, and to practices of "treaty shopping" which can share many of the disadvantages of the widely criticised practice of "forum shopping."; finding, however, that the BIT reference only to the state of incorporation governs.)

    Note by Turkey:
    The information in this document with reference to "Cyprus" relates to the southern part of the Island. There is no single authority representing both Turkish and Greek Cypriot people on the Island. Turkey recognises the Turkish Republic of Northern Cyprus (TRNC). Until a lasting and equitable solution is found within the context of the United Nations, Turkey shall preserve its position concerning the "Cyprus issue".

    Note by all the European Union Member States of the OECD and the European Union:
    The Republic of Cyprus is recognised by all members of the United Nations with the exception of Turkey. The information in this document relates to the area under the effective control of the Government of the Republic of Cyprus.

56. Some treaties also make it easy to obtain treaty coverage for entities incorporated in other jurisdictions as well. The Netherlands Model BIT provides that Dutch-incorporated companies are Dutch nationals for treaty purposes and also provides that any company controlled by a Netherlands holding company has Netherlands nationality for purposes of bringing treaty claims. Under this model, holding companies in any jurisdiction can benefit from treaty coverage provided they are directly or indirectly controlled by a Dutch holding company. The Netherlands and other EU Member States are reviewing their model investment treaties.

57. The exact moment when such a shift will be found to be abusive is unclear, but the existence of a risk is sufficient to encourage structuring in advance.

58. See, e.g., *Phoenix Action, Ltd. v. Czech Republic*, ICSID, Award (15 April 2009) ("international investors can of course structure *upstream* [i.e., in advance] their investments, which meet the requirement of participating in the economy of the host State, in a manner that best fits their need for international protection, in choosing freely the vehicle through which they perform their investment").

59. OECD (2013b: 18-19) ("Given the policy issues raised by claims for reflective loss, it is important to identify countervailing policy arguments that would support the availability of shareholder claims for reflective loss because they are widely available under current law. The Chair invited the group to identify the reasons that could explain the allowance of such claims in ISDS. Discussing the issue, no strong arguments were put forward to explain the differences taken in investment treaties versus the approach taken by the same countries in their corporate law systems. The lack of an identifiable policy rationale for existing law was an important finding and merited further attention.")

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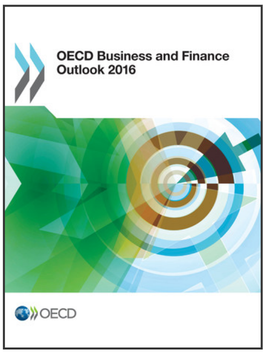

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