

NOTE

RESCUING INTERNATIONAL INVESTMENT ARBITRATION: INTRODUCING DERIVATIVE ACTIONS, CLASS ACTIONS, AND COMPULSORY JOINDER

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INTRODUCTION

THE rapidly expanding network of international investment arbitration (“IIA”) has reached a state of crisis that could threaten the foreign investment system. The number and economic influence of arbitration claims have exploded over the past two decades, along with denunciations of IIA.¹ Many involved in IIA believe that crucial parts of the system could disintegrate over the next few years if systemic reforms are not implemented.² Given IIA’s role in the growth of international investment, especially in developing countries, such a result could restrict international capital flows, improvements in the livelihoods of residents of developing nations, returns on investment in developed countries, and global economic growth itself.³

The future of international investment could rest on whether the World Bank-affiliated International Convention for the Settlement

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¹ Detlev Vagts, Foreword *to* The Backlash Against Investment Arbitration, at xxiii, xxv–xxvi (Michael Waibel et al. eds., 2010).

² Luke Peterson, Out of Order, *in* The Backlash Against Investment Arbitration, *supra* note 1, at 483, 484–85.

³ See R. Doak Bishop et al., Foreign Investment Disputes, *in* Foreign Investment Disputes 1, 7–8 (R. Doak Bishop et al. eds., 2005).

of Investment Disputes (“ICSID”)⁴ or the bilateral investment treaties (“BITs”) that usually operate within ICSID’s framework are reformed within the next few years. After listing the mounting complaints against it, a former official at the U.S. Agency for International Development and current Visiting Researcher at Harvard Law School concluded, “If ICSID, the principal foreign investment forum, does not adequately resolve foreign investment disputes, a backlash against foreign investment—one of the main factors for economic development—looms.”⁵

Numerous well-informed observers have warned of this developing crisis in the last few years. “[T]he rise of investment treaties and investment-treaty arbitration has attracted critical attention from the users of the dispute-settlement mechanism (that is, investors and host states) as well as various interest groups that claim to represent ‘civil society’ and the ‘public interest.’”⁶ This chorus has “contributed to a considerable amount of literature intimating that investment law may be in a veritable ‘legitimacy crisis.’”⁷ Critiques of both the substantive (“this crisis is caused by the vagueness and indeterminacy of the standard investor rights, leading to problematic predictability in the application of investment treaties”) and procedural (“relating to the overlap between different arbitral institutions and control mechanisms and the resulting inconsistencies in the decisions of different arbitral tribunals”) aspects of IIA have gained heavy traction.⁸

As prominent IIA scholar Susan D. Franck explains, “The legitimacy of investment treaty arbitration is a matter of heated debate. Asserting that arbitration is unfairly tilted toward the developed world, some countries have withdrawn from World Bank

⁴ Convention on the Settlement of Investment Disputes, Aug. 27, 1965, 17 U.S.T. 1270, 575 U.N.T.S. 159 [hereinafter ICSID]. Also known as the “Washington Convention,” ICSID is one of the IIA vehicles whose popularity is rapidly increasing. Carolyn B. Lamm et al., *Interim Measures and Dismissal Under the 2006 ICSID Rules*, in *The Future of Investment Arbitration* 89, 89 (Catherine A. Rogers & Roger P. Alford eds., 2009) (“Between 1995 and 2005, the number of pending ICSID cases jumped from 5 to 113 . . .”).

⁵ Ilija Mitrev Penusliski, *A Dispute Systems Design Diagnosis of ICSID*, in *The Backlash Against Investment Arbitration*, supra note 1, at 507, 507.

⁶ Charles N. Brower & Stephan W. Schill, *Is Arbitration a Threat or a Boon to the Legitimacy of International Investment Law?*, 9 *Chi. J. Int’l L.* 471, 473 (2009).

⁷ *Id.*

⁸ *Id.*

dispute resolution bodies [including ICSID] or are taking steps to eliminate arbitration.”⁹ The impact of even a partial IIA breakdown could be high since “[w]ith a four-fold increase [over the last decade] in the number of disputes, billions of dollars at stake, and national sovereignty and international relations on the line, investment treaty arbitration has become a vital aspect of the debate about the international political economy.”¹⁰

Not everyone agrees that IIA has facilitated a large proportion of international investment.¹¹ This Note will side with those who believe that the rapid expansion of IIA has not merely coincided with the rapid expansion of international investment and that treaty-based IIA in particular casts a long shadow over international investment decisions though other IIA mechanisms are often employed.¹²

IIA allows private parties to press claims against foreign governments directly, a highly unusual arrangement in international

⁹ Susan D. Franck, *Development and Outcomes of Investment Treaty Arbitration*, 50 *Harv. Int'l L.J.* 435, 435 (2009).

¹⁰ *Id.*

¹¹ See, e.g., Mary Hallward-Driemeier, *Do Bilateral Investment Treaties Attract FDI? Only a Bit . . . and They Could Bite 18–22* (World Bank Pol’y Research Working Paper No. 3121, 2003), available at <http://ssrn.com/abstract=636541>.

¹² Investment awards get special treatment compared to most kinds of international dispute settlement, which have weak enforcement mechanisms. August Reinisch, *The Proliferation of International Dispute Settlement Mechanisms: The Threat of Fragmentation vs. the Promise of a More Effective System? Some Reflections from the Perspective of Investment Arbitration*, in *International Law Between Universalism and Fragmentation* 107, 112 (I. Buffard et al. eds., 2008) (“Investment and, in particular, ICSID awards enjoy a very high level of enforceability.”). Investment awards enjoy enforceability systems around the world superior even to that provided by the widely-accepted 1958 New York Convention, assuming their governments are parties to ICSID. *Id.* (“The awards rendered pursuant to most ad hoc investment arbitrations as well as those administered by arbitration institutions, such as ICC [International Chamber of Commerce], LCIA [London Court of International Arbitration], SCC [Stockholm Chamber of Commerce] or the like, are usually . . . enforceable in domestic courts . . .”). ICSID has the highest status of all. Awards made as part of its framework “enjoy an even higher effectiveness. The enforcement of ICSID awards is directly regulated by the ICSID Convention, which provides that awards shall be enforced in all Contracting States, like judgments of their own domestic courts.” *Id.* Note that not all awards made under BITs are ICSID awards. Countries that do not automatically enforce, for instance, International Court of Justice rulings have passed legislation requiring compliance with international investment arbitration awards. See, e.g., Pierre-Hugues Verdier, *Enforcement of International Judgments and Decisions in Canadian Courts*, 103 *Am. Soc’y Int’l L. Proc.* 48, 48 (2009).

law.¹³ Private parties, most often corporations in wealthy developed nations, have direct recourse to binding international arbitration when foreign governments allegedly harm the private parties' investments hosted within the governments' borders.¹⁴ For example, if a U.S. corporation takes a 10% stake in an Argentinean corporation that manufactures clothing in Argentina and the Argentinean government subsequently confiscates one of the factories built by the Argentinean corporation, the U.S. corporation—but not the Argentinean corporation—may file a claim in IIA for the decrease in value of its investment¹⁵ caused by the confiscation.¹⁶

The protections afforded by IIA have encouraged international investors to risk their capital overseas,¹⁷ particularly in developing nations whose domestic legal systems are often viewed as suspect.¹⁸ The creators of modern IIA invented “the first institution designed specifically as a forum to administer foreign investment disputes” when they established ICSID in 1965,¹⁹ but they did not foresee the explosion in the number and size of claims over the past 15 years or the trend toward American-style litigation practices in a system with primarily civil law roots.²⁰

Inconsistency in claim resolution produced by the patchwork of international arbitration institutions²¹ and the alleged favoritism

¹³ Bishop et al., *supra* note 3, at 1–2.

¹⁴ *Id.* at 5–8.

¹⁵ This Note does not deal with the myriad methods available to calculate such damages nor would its proposal disturb those calculations.

¹⁶ Usually termed “uncompensated expropriation.”

¹⁷ Efraim Chalamish, *Do Treaties Matter? On Effectiveness and International Economic Law*, 32 *Mich. J. Int'l L.* 325, 328 (2011) (reviewing Karl P. Sauvant & Lisa E. Sachs, *The Effects of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows* (2009)) (“FDI [foreign direct investment] flows [show] an asymmetric trend, according to which the majority of investment flows go from developed economies to developing economies. . . . [G]lobal imbalances in foreign investments have raised various fundamental questions with respect to the governance of cross-border-investment activity, such as investor-protection standards . . .”).

¹⁸ Bishop et al., *supra* note 3, at 7–8.

¹⁹ *Id.* at 5.

²⁰ Carrie Menkel-Meadow, *Correspondences and Contradictions in International and Domestic Conflict Resolution: Lessons from General Theory and Varied Contexts*, 2003 *J. Disp. Resol.* 319, 340–41.

²¹ Richard H. Kreindler, *Parallel Proceedings: A Practitioner's Perspective*, in *The Backlash Against Investment Arbitration*, *supra* note 1, at 127, 129.

perceived by developing and now even some developed nations²² toward private investors over host governments pose perhaps the two most pressing problems today. Major proposals for reform have so far failed to get far off the ground before crashing back to earth. As far back as 1998, the Organization for Economic Cooperation and Development (“OECD”) tried to create a Multilateral Agreement on Investment (“MAI”), modeled after the General Agreement on Tariffs and Trade (“GATT”), that would have rationalized IIA to deal with the developing situation.²³ The creation of a unified IIA system that addresses a wide range of concerns while satisfying competing interests has remained politically unworkable.²⁴ Although top-to-bottom reform may not be feasible, substantial change is necessary to rescue IIA.

As a less ambitious alternative to comprehensive reform, this Note proposes the introduction into IIA of the derivative action,²⁵ class action,²⁶ and compulsory joinder²⁷ concepts, which it will collectively call “derivative doctrine” due to their compulsion of some private parties to be legally represented by others. The goal is not to reduce IIA’s role, but rather to make it more efficient and more fair, sometimes by expanding its role. As American-style practices have become more prominent within IIA, American-style solutions may be required. The alternative may be the dissolution of the system.

First, this Note argues that by transforming the way IIA handles claims, derivative doctrine would greatly reduce inconsistency in claim resolution, consolidate the rapidly expanding volume of litigation into fewer claims, and mitigate fairness concerns.

Second, by reducing concerns about corporate governance in countries with weak domestic corporate governance protections,

²² Vagts, *supra* note 1, at xxvi.

²³ *Id.* at xlvii.

²⁴ Chalamish, *supra* note 17, at 328 (“Despite its growing importance, the global community has largely failed in its relentless efforts to provide multilateral regulation of foreign investment.”).

²⁵ 7C Charles Alan Wright, Arthur R. Miller & Mary Kay Kane, *Federal Practice and Procedure* § 1839 (3d ed. 2011).

²⁶ 21 Am. Jur. Trials § 625 (1974).

²⁷ Jean F. Rydstrom, Who Must Be Joined in Action as Person “Needed for Just Adjudication” Under Rule 19(a), *Federal Rules of Civil Procedure*, 22 A.L.R. Fed. 765 (1975). Since there is no need to distinguish the two doctrines in this Note, it uses “class action” to include compulsory joinder from here on.

IIA “derivative actions” would encourage increasingly important portfolio investors²⁸ to expand international investment, which would benefit both them and developing nations. These IIA derivative actions, which would not qualify as derivative actions in American corporate law despite some similarities, would be rooted in preexisting and increasingly accepted IIA protections rather than being imported wholesale from Anglo-American law. These derivative actions could also prevent future conflicts as portfolio investors, whose recourse to IIA is currently limited, continue their trend toward self-assertion. Exploitation of minority shareholders by corporate boards or controlling shareholders is a major concern of corporate governance, and many countries lack adequate safeguards.²⁹

Third, the limited unification of IIA promoted by derivative doctrine could serve as a basis for tighter unification in the future.³⁰

Part I describes the background of treaty-based IIA and derivative doctrine. Section I.A briefly outlines the IIA system, its major players, its methods, and its goals. Section I.B describes the current IIA doctrine of allowing the separate arbitration of each direct and indirect claim brought by each controlling³¹ or minority shareholder, particularly as expressed in the decisions of arbitral tribunals set up under ICSID and various BITs. Section I.C describes derivative doctrine in outline, how it differs from the current IIA claims doctrine, and how it would work within IIA.

Part II outlines IIA’s crisis and how it relates to the current claims doctrine. Building on the Introduction, Section II.A sketches the growing and broad frustration with IIA among the world’s governments. Section II.B describes, as helping to feed that frustration, the two general problems to which the current claims

²⁸ Portfolio investors are those who hold a diverse range of securities and do not own a large proportion of any one enterprise. Someone saving for his retirement through a mutual fund is a typical portfolio investor.

²⁹ See *infra* Section III.D.

³⁰ A simple claim preclusion rule, by itself, would not allow the compulsory consolidation of parties afforded by class actions nor would it address the corporate governance concerns of portfolio investors.

³¹ In this Note, a “minority shareholder” is one that is not a controlling shareholder. A controlling shareholder does not necessarily have a majority stake. See, e.g., ICSID, *supra* note 4, art. 25(2)(b) (using the term “foreign control” and leaving tribunals to decide if an entity meets that definition).

doctrine contributes, and Section II.C examines the seven specific problems surrounding the current doctrine, the unsettled questions they have raised, and how they contribute to the two general problems.

Part III details the derivative doctrine solution. Section III.A presents a short framework of the solution while Sections III.B and III.C show how derivative doctrine would address the specific problems and general problems, respectively, described in Part II. Section III.D elaborates on the further advantages of derivative doctrine, particularly for portfolio investment. Section III.E sketches methods of implementing class actions and IIA derivative actions, and Section III.F briefly rebuts some remaining arguments against the adoption of derivative doctrine.

I. THE IIA SYSTEM AND THE CURRENT DIRECT AND INDIRECT CLAIMS DOCTRINE

A. IIA Enabling Institutions, Protections, and Goals

In a rare exception to the norm, international investment law allows private parties to pursue claims directly against foreign governments through international bodies.³² This development replaced the traditional system under which an allegedly harmed private investor had to convince its own government to pursue a claim on its behalf, often a difficult and politicized process.³³ BITs preceded ICSID³⁴ and initially lacked ICSID's facility for private parties' pressing of claims against foreign governments directly, but the requirement of state espousal of investors' claims was eventually displaced. Today, if a government hosting a qualifying international investment takes an action that adversely affects a foreign investor's rights as defined by a BIT or certain other treaty instruments, the investor can file a claim that will be heard by an arbitral panel.³⁵ Signing and ratification of ICSID and other treaty instru-

³² Bishop et al., *supra* note 3, at 1–3.

³³ *Id.* at 3–4.

³⁴ West Germany and Pakistan signed the first modern BIT in 1959. Jeswald W. Salacuse, BIT by BIT: The Growth of Bilateral Investment Treaties and Their Impact on Foreign Investment in Developing Countries, 24 *Int'l Law* 655, 658 (1990).

³⁵ Bishop et al., *supra* note 3, at 11.

ments are up to each government and thus IIA, though widespread, is not a global system.³⁶

ICSID, administered by the Washington, D.C.-based International Centre for the Settlement of Investment Disputes, creates a multilateral procedural framework for the protection of international investors.³⁷ BITs provide substantive protections, often adopting ICSID language to define those protections; carve out certain industries or natural resources from IIA protection; sometimes establish differing procedures for the resolution of international investment disputes, such as requiring “cooling off” periods before aggrieved parties may file claims; and indeed generally determine the scope of treaty, including ICSID, protection.³⁸

Both ICSID and BITs generally provide for what are usually three-person arbitral tribunals, almost always consisting of distinguished practitioners or scholars in the field of IIA. Each party chooses a panelist, and then those panelists or the parties themselves choose a third to serve as president. All have equal votes. Annulment committees are chosen in the same way.³⁹ Arbitral tribunals possess enormous power and, by majority vote, are able to order sovereign governments to pay private investors any amount in compensation justifiable under investment treaties.⁴⁰ Their decisions are non-appealable and unreviewable except by annulment committees, which can only annul all or part of tribunals’ decisions, rescuing defending governments from liability for the time being but allowing claimants to pursue their claims anew with another tribunal.⁴¹

³⁶ *Id.* at 2.

³⁷ *Id.* at 5.

³⁸ Martina Polasek, *The Threshold for Registration of a Request for Arbitration Under the ICSID Convention*, 5 *Disp. Resol. Int’l L.* 177, 184–86 (2011).

³⁹ See, e.g., ICSID, *supra* note 4, arts. 37(2)(b), 51(3).

⁴⁰ These amounts can be huge. For example, just from claims stemming from its reaction to its 2001–02 financial crisis, Argentina’s liability under arbitration through BITs “could be greater than U.S. \$8 billion, more than the entire financial reserves of the Argentine government in 2002. Some have speculated that the total value of potential claims against Argentina could reach U.S. \$80 billion.” William W. Burke-White & Andreas von Staden, *Investment Protection in Extraordinary Times: The Interpretation and Application of Non-Precluded Measures Provisions in Bilateral Investment Treaties*, 48 *Va. J. Int’l L.* 307, 311 (2008).

⁴¹ Bishop et al., *supra* note 3, at 11.

Other international bodies such as the International Court of Justice (“ICJ”) and those created by regional treaties such as the North American Free Trade Agreement (“NAFTA”) have their own binding methods of dealing with international investment disputes.⁴² The private International Chamber of Commerce (“ICC”) has its own commercial arbitration service.⁴³ This Note focuses on ICSID and BITs as the most influential forms of IIA arbitration,⁴⁴ but the proposal here could easily extend to other IIA institutions.

The following are traditionally the most common types of claims under IIA: uncompensated or insufficiently compensated expropriation of property,⁴⁵ discriminatory treatment as compared to investors from other foreign nations or to domestic investors, breach of contract when the host government is a party, violation of stabilization clauses in which governments promise not to alter the legal or regulatory environment affecting the investment at issue, denial of justice as when a local court refuses to hear a valid lawsuit, and unjust enrichment when governments commit certain acts adversely affecting an international investment.⁴⁶ Although once neglected, another type of claim now increasingly used—though controversial due to its vagueness—is denial of “fair and equitable treatment.”⁴⁷ Tribunals have also found that each government owes “full protection and security” against damages to investor value by the government or by those over whom the government has authority.⁴⁸

Though international investment law protects many sorts of international investments, including those between fully developed and wealthy countries, the paramount goal of IIA is simple: to en-

⁴² Id. at 12.

⁴³ Id.

⁴⁴ Id. at 11 (“Two arbitral institutions [ICSID and the ICC] and a set of ad hoc arbitral rules are responsible for most foreign investment disputes that are arbitrated . . . ICSID is a division of the World Bank.”).

⁴⁵ See id. at 14 (“An expropriation may be direct and *de jure*, which is to say it is executed by an act or decree of the government that expressly takes property or rights, or it may be indirect and *de facto*—a creeping expropriation that results from a series of acts . . .”).

⁴⁶ Id. at 15–16.

⁴⁷ One, but certainly not the only, take on what this standard encompasses can be found in Campbell McLachlan et al., *International Investment Arbitration* 226–47 (2007).

⁴⁸ Id. at 247.

courage more foreign investment in developing countries with potentially unreliable or biased political and legal systems.⁴⁹

B. Direct and Indirect Claims Doctrine in IIA

Many think of an international investment as a foreign direct investment. A common definition of a foreign direct investment is a financial stake taken “to acquire a lasting interest in an enterprise operating in an economy other than that of the investor, the investor’s purpose being to have an effective voice in the management of the enterprise.”⁵⁰ This is not the only type of investment protected by international investment law.

1. Tribunal Decisions Favor Direct and Indirect Coverage of Minority Shareholders

Tribunals have established that the typical BIT, as well as ICSID, covers direct and indirect claims made not only by controlling shareholders but also by minority shareholders even though “investment” is not defined in the ICSID treaty language.⁵¹ A direct claim is one based on actions taken directly against a person or an entity, such as a shareholder or group of shareholders whose shares are expropriated. An indirect claim is one in which a shareholder pursues relief even though the allegedly harmful action affected only the legal rights of the company in which the shareholder invested.

ICSID has particular influence because of its affiliation with the World Bank, which developing nations’ governments often wish to avoid antagonizing.⁵² ICSID’s open “investment” term has left tribunals to develop their own case law on what is an “investment,” unless the parties to BITs define it,⁵³ while relying on the treaty’s language granting tribunals jurisdiction solely over “any legal dis-

⁴⁹ Bishop et al., *supra* note 3, at 7–8.

⁵⁰ World Bank, *World Development Report 1985*, at ix (1985); accord Deanne Julius, *Foreign Direct Investment 1* (1991).

⁵¹ Christoph H. Schreuer, *The ICSID Convention: A Commentary*, in *Foreign Investment Disputes*, *supra* note 3, at 324 (“The concept of investment is central to the Convention. Yet, the Convention does not offer any definition or even description of this basic term.”).

⁵² Bishop et al., *supra* note 3, at 11.

⁵³ Schreuer, *supra* note 51, at 324–26.

pute arising directly out of an investment.”⁵⁴ This ambiguity has allowed for the protection of minority shareholders by international arbitrators under ICSID in the face of objections by some who say that minority shareholders should not be allowed to bring claims under the convention, though they may be able to do so under a BIT depending on its language.⁵⁵

Not only are direct and indirect claims covered, but as a logical result, so are direct and indirect investments. A direct investment is one made directly in the affected enterprise while an indirect one is made through one or more intermediaries.⁵⁶ For example, a foreign corporation that owns 40% of another foreign corporation that owns 35% of a domestic enterprise has an indirect investment in the domestic enterprise.

Not all tribunal decisions are made public, but as far as is publicly known,⁵⁷ no BIT or ICSID arbitral tribunal has dissented from the position that both controlling and minority shareholders’ direct and indirect claims and investments are covered by both ICSID and every BIT under which these questions have arisen.⁵⁸

⁵⁴ ICSID, *supra* note 4, art. 25(1).

⁵⁵ Gabriel Bottini, *Indirect Claims Under the ICSID Convention*, 29 U. Pa. J. Int’l L. 563, 565 (2008) (arguing that ICSID *per se* does not grant protection to minority shareholders and that a BIT must explicitly grant ICSID access to minority shareholders before such shareholders can proceed with a claim).

⁵⁶ *Id.* at 569.

⁵⁷ See James Crawford, *Ten Investment Arbitration Awards That Shook the World: Introduction and Overview*, 4 Disp. Resol. Int’l 71, 72 (2010) (discussing the crucial importance that publicly released decisions can have).

⁵⁸ The following are some important tribunal decisions allowing claims by foreign shareholders; note that one claim may have several decisions issued over time on the same or different issues. CMS Gas Transmission Co. v. Arg. Republic, ICSID Case No. ARB/01/8, Decision on Application for Annulment, ¶ 69 (Sept. 25, 2007); *Compañía de Aguas del Aconquija, S.A. v. Arg. Republic*, ICSID Case No. ARB/97/3, Award, ¶ 1.1.7 (Aug. 20, 2007); *Total S.A. v. Arg. Republic*, ICSID Case No. ARB/04/1, Decision on Objections to Jurisdiction, ¶¶ 78–81 (Aug. 25, 2006); *Suez, Sociedad General de Aguas de Barcelona S.A. v. Arg. Republic*, ICSID Case No. ARB/03/17, Decision on Jurisdiction, ¶ 49 (May 16, 2006); *Gas Natural SDG, S.A. v. Arg. Republic*, ICSID Case No. ARB/03/10, Decision on Preliminary Questions on Jurisdiction, ¶ 35 (June 17, 2005); *Camuzzi Int’l S.A. v. Arg. Republic*, ICSID Case No. ARB/03/2, Decision on Objections to Jurisdiction, ¶ 47 (May 11, 2005); *Sempra Energy Int’l v. Arg. Republic*, ICSID Case No. ARB/02/16, Decision on Objections to Jurisdiction, ¶ 41 (May 11, 2005); *Siemens A.G. v. Arg. Republic*, ICSID Case No. ARB/02/8, Decision on Jurisdiction, ¶¶ 137–142 (Aug. 3, 2004); *Azurix Corp. v. Arg. Republic*, ICSID Case No. ARB/01/12, Decision on Jurisdiction, ¶¶ 72–76 (Dec. 8, 2003); *CMS Gas Transmission Co. v. Arg. Republic*, ICSID Case No. ARB/01/8, De-

Tribunals have come to no consensus concerning how large a stake a minority investor must have before qualifying for protection or if there should be any minimum. Although old BITs are always interpreted to cover minority shareholders, new BITs tend to cover minority shareholders more explicitly.⁵⁹ Recent regional treaties do as well.⁶⁰ Although wording of BITs varies, interpreting even older BITs to include minority shareholdings seems at least plausible,⁶¹ and the consistent position on minority shareholders taken by tribunals regarding ICSID could be considered intuitive. Protection for indirect investments seems less intuitive, but is entrenched. ICSID's Article 25(2) says that a protected investor is:

(a) any natural person who had the nationality of a Contracting State other than the State party to the dispute . . . but does not include any person who . . . also had the nationality of the Contracting State party to the dispute; and

cision on Objections to Jurisdiction, ¶¶ 40–65 (July 17, 2003); *CME Czech Republic BV v. Czech Republic*, Case No. 403/VERMERK/2001/CME UNCITRAL Arbitration Rules, Partial Award and Separate Opinion, ¶ 418 (Sept. 13, 2001), 9 ICSID Reports 113 (2006); *Lauder v. Czech Republic*, In the Matter of an UNCITRAL Arbitration, Final Award, ¶ 177 (Sept. 3, 2001), 9 ICSID Reports 62 (2006); *Goetz v. Republic of Burundi*, ICSID Case No. ARB/95/3, Award Recognizing Settlement, ¶ 89 (Feb. 10, 1999); *Lanco Int'l, Inc. v. Arg. Republic*, ICSID Case No. ARB/97/6, Preliminary Decision: Jurisdiction, ¶ 10 (Dec. 8, 1998). For pointing out many of these passages, I am indebted to Bottini, *supra* note 55.

⁵⁹ See, e.g., 2004 U.S. Model Bilateral Investment Treaty, <http://www.state.gov/documents/organization/117601.pdf> (last visited Feb. 11, 2012); 2007 Model FIPA (Canadian Model Foreign Investment Promotion and Protection Agreement), *cited in* Catherine Yannaca-Small, OECD, *International Investment Law: Understanding Concepts and Tracking Innovations*, A Companion Volume to *International Investment Perspectives* 51 (2008); see also Noah Rubins, *The Notion of 'Investment' in International Investment Arbitration*, *in* *Arbitrating Foreign Investment Disputes* 283, 296 (Norbert Horn & Stefan Kroll eds., 2004). For a short discussion of the attitude toward BITs and statistics on their continued adoption in the immediate wake of the financial crisis, see United Nations Conference on Trade and Development, *Recent Developments in International Investment Agreements* (2008–June 2009), IIA Monitor No. 3, UNCTAD/WEB/DIAE/IA/2009/8 (2009), available at http://www.unctad.org/en/docs/webdiaeia20098_en.pdf.

⁶⁰ See, e.g., the Energy Charter Treaty, art. 1(6), Dec. 17, 1994, 34 I.L.M. 381, 383 (1994); North American Free Trade Agreement, art. 1139, Dec. 17, 1992, 32 I.L.M. 605, 647–48 (1993).

⁶¹ See C.F. Amerasinghe, *The Jurisdiction of the International Centre for the Settlement of Investment Disputes*, 19 *Indian J. Int'l L.* 166, 177–81 (1979) (exploring tribunal interpretations of older BITs' grants of jurisdiction and ICSID).

(b) any juridical person which had the nationality of a Contracting State other than the State party to the dispute . . . and any juridical person which had the nationality of the Contracting State party to the dispute . . . and which, because of foreign control, the parties have agreed should be treated as a national of another Contracting State for the purposes of this Convention.⁶²

No qualification other than foreign nationality is placed on “person,” suggesting that any international investor is covered. Tribunals have consistently held that this language, plus the “any legal dispute arising directly out of an investment” clause,⁶³ covers both direct and indirect claims on the part of minority shareholders even when the company in which those shareholders invested pursues domestic remedies or even presses its own IIA claim. Under Article 25(2)(b), a company can be domestically incorporated but still covered by the convention if under foreign control.

The current interpretation is well established. Some commentators and defending host states have argued that the famous *Barcelona Traction*⁶⁴ ICJ case rules out any protections for minority shareholders,⁶⁵ but multiple tribunals have responded to this argument by concluding that *Barcelona Traction* was about diplomatic protection under customary international law, not treaty protection under international investment law.⁶⁶

AAPL v. Sri Lanka was the first claim brought by a shareholder.⁶⁷ It and *Azurix v. Argentine Republic*,⁶⁸ *Camuzzi Interna-*

⁶² ICSID, supra note 4, art. 25(2).

⁶³ Id. art. 25(1).

⁶⁴ *Barcelona Traction, Light and Power Company, Limited (Belg. v. Spain)*, 1970 I.C.J. 3 (Feb. 5).

⁶⁵ See, e.g., Bottini, supra note 55, at 575–76.

⁶⁶ See, e.g., *CMS Gas Transmission Co. v. Arg. Republic*, ICSID Case No. ARB/01/8, Decision on Application for Annulment, ¶ 69 (Sept. 25, 2007); *Total S.A. v. Arg. Republic*, ICSID Case No. ARB/04/1, Decision on Objections to Jurisdiction, ¶ 78 (Aug. 25, 2006).

⁶⁷ ICSID Case No. ARB/87/3, Final Award, ¶ 3 (June 27, 1990). “In accordance with the *AAPL* tribunal’s reasoning, therefore, an investor pursuing an indirect action can only seek damages for a decrease in the value of its shares that resulted from a measure attributable to the host state and that violated the applicable BIT.” Bottini, supra note 55, at 585–86. For recognition of *AAPL* as the first dispute brought by a shareholder, see, e.g., Stephan W. Schill, *W(h)ither Fragmentation? On the Literature and Sociology of International Investment Law*, 22 *Eur. J. Int’l L.* 875, 875 (2011).

⁶⁸ ICSID Case No. ARB/01/12, Decision on Jurisdiction, ¶¶ 72–76 (Dec. 8, 2003).

tional S.A. v. Argentine Republic,⁶⁹ *Sempre Energy Int'l v. Argentine Republic*,⁷⁰ *Siemens A.G. v. Argentine Republic*,⁷¹ *Suez, Sociedad General de Aguas de Barcelona S.A. v. Argentine Republic*,⁷² *Total S.A. v. Argentine Republic*,⁷³ and *CMS Gas Transmission Co. v. Argentine Republic*⁷⁴—all more recent claims against Argentina—granted treaty coverage to minority shareholders and explained that shareholders' rights arose under treaty, not domestic law or contract. Therefore, foreign shareholders are parties separate from the local company in which they invested and have their own, independent sources of legal rights and remedies.⁷⁵ The treaty sources of rights and remedies generate each international investor's ability to pursue its own claim and are unaffected by any efforts of the local company,⁷⁶ or of other investors, to obtain relief even though relief granted to the company will generally produce a rise in the value of investors' shares.⁷⁷

This also means that foreign shareholders cannot bring claims for violations of the rights of their company as American derivative actions allow shareholders to do but only for violations of their

⁶⁹ ICSID Case No. ARB/03/2, Decision on Objections to Jurisdiction, ¶ 47 (May 11, 2005).

⁷⁰ ICSID Case No. ARB/02/16, Decision on Objections to Jurisdiction, ¶ 41 (May 11, 2005).

⁷¹ ICSID Case No. ARB/02/8, Decision on Jurisdiction, ¶¶ 137–142 (Aug. 3, 2004).

⁷² ICSID Case No. ARB/03/17, Decision on Jurisdiction, ¶ 49 (May 16, 2006).

⁷³ ICSID Case No. ARB/04/1, Decision on Objections to Jurisdiction, ¶¶ 78–81 (Aug. 25, 2006).

⁷⁴ ICSID Case No. ARB/01/8, Decision on Application for Annulment, ¶ 69 (Sept. 25, 2007); ICSID Case No. ARB/01/8, Decision on Objections to Jurisdiction, ¶¶ 40–65 (July 17, 2003).

⁷⁵ See Bottini, *supra* note 55, at 568 (“Often the problem arises when the party to the contract that constitutes the main investment is a local company—albeit with foreign shareholders—so that the nationality criterion will not be met since any dispute that arises will be between the host state and one of its nationals.”). But ICSID allows for foreign-controlled local companies to be treated as foreign nationals. ICSID, *supra* note 4, art. 25(2)(b).

⁷⁶ One commentator noted, “[T]he distinction between the investor's rights as shareholder and the foreign enterprise's rights of control over its property can be somewhat blurred.” Wolfgang Peter, *Arbitration and Renegotiation of International Investment Agreements* 352 (2d ed. 1995).

⁷⁷ Bishop et al., *Applicable Substantive Law: Options for the Applicable Law, in Foreign Investment Disputes*, *supra* note 3, at 690 (“Invoking treaty rights in an international arbitration shifts the frame of reference from contractual liability under the applicable law to State responsibility under international law, even if contractual and domestic law issues generally may remain relevant.”).

own rights. Argentina has unsuccessfully argued that in the absence of direct action against shareholders, such as uncompensated expropriation of shares, only companies have the right to pursue claims in arbitration and that shareholders have been pursuing claims that are not truly independent and rather are for the violation of their companies' rights.⁷⁸

As the *CMS* tribunal put it in a famous decision:

[T]he rights of the [foreign] claimant [*CMS*] can be asserted independently from the rights of *TGN* [the company in which *CMS* invested] . . . and because the Claimant has a separate cause of action under the Treaty in connection with the protected investment, the Tribunal concludes that the present dispute arises directly from the investment made and that therefore there is no bar to the exercise of jurisdiction on this count.⁷⁹

Currently, whether foreign shareholders can press claims when host governments violate contractual obligations toward the shareholders' local corporation is a matter of some debate. Umbrella clauses in BITs have sometimes been interpreted to provide standing for such claims.⁸⁰ Such clauses have not been interpreted to allow governments to press claims for contractual violations by their private counterparties.⁸¹ For example, the Annulment Committee in *CMS* stated:

⁷⁸ See *Azurix*, ICSID Case No. ARB/01/12, Decision on Jurisdiction, ¶¶ 42–44, 67–74; *CMS*, ICSID Case No. ARB/01/8, Decision on Objections to Jurisdiction, ¶¶ 36–65; *Goetz v. Republic of Burundi*, ICSID Case No. ARB/95/3, Award Recognizing Settlement, ¶¶ 88–89 (Feb. 10, 1999); *Siemens*, ICSID Case No. ARB/02/8, Decision on Jurisdiction, ¶¶ 137–40; *Total*, ICSID Case No. ARB/04/1, Decision on Objections to Jurisdiction, ¶¶ 33, 77.

⁷⁹ *CMS*, ICSID Case No. ARB/01/8, Decision on Objections to Jurisdiction, ¶ 68.

⁸⁰ Such protection has not been accepted in *SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/01/13, Decision on Jurisdiction, ¶¶ 158–67 (Aug. 6, 2003). It found partial acceptance in *Joy Mining Machinery v. Arab Republic of Egypt*, ICSID Case No. ARB/03/11, Award, ¶¶ 43–63 (Aug. 6, 2004). It found total acceptance in *Consorzio Groupement L.E.S.I.-DIPENTA v. People's Democratic Republic of Algeria*, ICSID Case No. ARB/03/8, Award, ¶¶ 24–25 (Jan. 10, 2005), and *SGS Société Générale de Surveillance S.A. v. Republic of the Philippines*, ICSID Case No. ARB/02/6, Decision on Jurisdiction, ¶¶ 115–28 (Jan. 29, 2004).

⁸¹ Commentary on this issue and whether tribunals have come to the correct conclusions appears in several books and articles. See, e.g., Rudolf Dolzer & Margrete Stevens, *Bilateral Investment Treaties* 81–82 (1995); F.A. Mann, *British Treaties for the Promotion and Protection of Investments*, 52 *Brit. Y.B. Int'l Law*, 241, 246 (1981);

(c) The effect of the umbrella clause is not to transform the obligation which is relied on into something else; the content of the obligation is unaffected, as is its proper law. If this is so, it would appear that the *parties* to the obligation (*i.e.*, the persons bound by it and entitled to rely on it) are likewise not changed by reason of the umbrella clause.

(d) The obligation of the State covered by Article II(2)(c) will often be a bilateral obligation, or will be intrinsically linked to obligations of the investment company. Yet a shareholder, though apparently entitled to enforce the company's rights in its own interest, will not be bound by the company's obligations⁸²

Therefore, foreign shareholders may pursue indirect claims when actions are taken against the local companies in which they invested,⁸³ but they are not liable for any obligations imposed on those companies.⁸⁴

Other landmark cases have come down firmly on the side of protecting minority shareholders and their indirect claims by including them within the definition of "investor." The Annulment Committee in *Compañía de Aguas del Aconquija, S.A. v. Argentine Republic* decided that *Compagnie Générale des Eaux (CGE)*, a French minority shareholder, was an investor and refused to restrict jurisdiction to controlling shareholders alone.⁸⁵ An ICSID tribunal in *Lanco International v. Argentine Republic* also refused to impose

Christoph Schreuer, *Travelling the BIT Route—Waiting Periods, Umbrella Clauses and Forks in the Road*, 5 *J. World Inv. & Trade*, 250, 250–51 (2004); Jarrod Wong, *Umbrella Clauses in Bilateral Investment Treaties: Of Breaches of Contract, Treaty Violations, and the Divide Between Developing and Developed Countries in Foreign Investment Disputes*, 14 *Geo. Mason L. Rev.* 135, 142–50 (2006).

⁸² *CMS*, ICSID Case No. ARB/01/8, Decision on Application for Annulment, ¶ 95.

⁸³ Not even ownership or privity is always required for coverage. In *Azurix*, ICSID Case No. ARB/01/12, Decision on Application for Annulment, ¶ 108 (Sept. 1, 2009), the committee said: "[E]ven where a foreign investor is not the actual legal owner of the assets constituting an investment, or not an actual party to the contract giving rise to the contractual rights constituting an investment, that foreign investor may nonetheless have a financial or other commercial interest in that investment."

⁸⁴ The current isolation of shareholder awards from corporations' contractual and other liabilities is a controversial area. Such isolation could be included or excluded from any imported derivative doctrine.

⁸⁵ ICSID Case No. ARB/97/3, Decision on Annulment, ¶ 50 (July 3, 2002).

such a restriction and granted treaty coverage to minority shareholders, allowing them protection under BITs.⁸⁶

Some more recent tribunal decisions have come to the same conclusion through different reasoning. They did not attempt to define ICSID's "investor" term to include minority shareholders but simply concluded or accepted that BITs covered them.⁸⁷ Examples include *Sempra Energy International v. Argentine Republic*,⁸⁸ *Camuzzi*,⁸⁹ *Gas Natural SDG, S.A. v. Argentine Republic*,⁹⁰ and *Lauder v. Czech Republic*.⁹¹ In a prominent example of a minority shareholder's indirect claim through an indirect investment, a German company, Siemens AG, invested via an intermediary German company in a local company of the host state and was found to be covered.⁹²

2. *Conflicting Awards*

Because investors affected by the same host government actions can pursue their own claims with their own tribunals, conflicting awards result, as does multiple recovery for the same harm. Concurrent claims are not that unusual. In *Goetz v. Republic of Burundi*,⁹³ *SGS Société Générale de Surveillance S.A. v. Islamic Re-*

⁸⁶ ICSID Case No. ARB/97/6, Preliminary Decision: Jurisdiction, ¶ 10 (Dec. 8, 1998).

⁸⁷ "This new world of arbitration is one where the claimant need not have a contractual relationship with the defendant and where the tables could not be turned: the defendant could not have initiated the arbitration, nor is it certain of being able even to bring a counterclaim." Jan Paulsson, *Arbitration Without Privity*, 10 ICSID Rev. Foreign Inv. L.J. 232, 232 (1995).

⁸⁸ ICSID Case No. ARB/02/16, Decision on Objections to Jurisdiction, ¶¶ 90–94 (May 11, 2005). There has been a newer development, but one that preserves the principle of covering minority shareholders. Lise Johnson, *Award Against Argentina Annulled*, Inv. Treaty News, Sept. 2010, at 24, available at http://www.iisd.org/itn/wp-content/uploads/2010/09/IISD_ITN_newsletter_SEPT_WEB.pdf.

⁸⁹ ICSID Case No. ARB/03/2, Decision on Objections to Jurisdiction, ¶¶ 57–58, 64, 67.

⁹⁰ ICSID Case No. ARB/03/10, Decision on Preliminary Questions on Jurisdiction, ¶ 32–35 (June 17, 2005).

⁹¹ In the Matter of an UNCITRAL Arbitration, Final Award, ¶ 159 (Sept. 3, 2001), 9 ICSID Reports 62 (2006).

⁹² *Siemens*, ICSID Case No. ARB/02/8, Decision on Jurisdiction, ¶ 150.

⁹³ ICSID Case No. ARB/95/3, Award Recognizing Settlement, ¶ 46.22.4 (Feb. 10, 1999).

public of Pakistan,⁹⁴ *Salini Costruttori S.p.A. v. Jordan*,⁹⁵ and in some of the cases against Argentina,⁹⁶ there have been concurrent tribunals or other proceedings based on the same harms allegedly inflicted by the host nations.

Since not all tribunal awards are public, the frequency with which conflicting awards occur is not known. In fact, as litigation explodes, the growing fear of multiple recovery and conflicting awards may be more of a problem for IIA's credibility than the phenomenon itself, which may be rare.

The paradigmatic example occurred in what are termed the Czech Republic cases. In *CME v. Czech Republic*⁹⁷ and *Lauder v. Czech Republic*,⁹⁸ two different tribunals considered the same actions taken by the government of the Czech Republic and infamously came to opposite conclusions. Ronald Lauder was the controlling shareholder in CME, which owned almost the entirety of broadcaster CNTS, incorporated in the Czech Republic, and thus Lauder was the same de facto party in each arbitration. Lauder was a U.S. national and CME was a Dutch company, so two states' nationals and two BITs were involved. "One cannot think well at the same time of *CME v. Czech Republic* and *Lauder v. Czech Republic*, for example—though their concatenation tells us something," wrote Cambridge Professor of International Law James Crawford.⁹⁹ He described the conflict:

The *CME* tribunal held that the treatment of CME breached the obligation of fair and equitable treatment, the obligation not to impair investments by unreasonable and discriminatory measures, and the obligation of full security and protection. The total amount awarded in damages was US\$269,814,000, roughly

⁹⁴ See Yuval Shany, *Contract Claims v. Treaty Claims: Mapping Conflicts Between ICSID Decisions on Multisourced Investment Claims*, 99 *Am. J. Int'l L.* 835, 840 (2005).

⁹⁵ *Id.* at 844.

⁹⁶ *Camuzzi*, ICSID Case No. ARB/03/2, Decision on Objections to Jurisdiction, ¶¶ 86–91; *CMS*, ICSID Case No. ARB/01/8, Decision on Objections to Jurisdiction, ¶¶ 83–86; *Siemens*, ICSID Case No. ARB/02/8, Decision on Jurisdiction, ¶¶ 111–17.

⁹⁷ UNCITRAL Arbitration No. 403/VERMERK/2001/CME, Partial Award and Separate Opinion, ¶ 418 (Sept. 13, 2001), 9 ICSID Reports 113 (2006).

⁹⁸ In the Matter of an UNCITRAL Arbitration, Final Award, ¶ 77 (Sept. 3, 2001), 9 ICSID Reports 62 (2006).

⁹⁹ Crawford, *supra* note 57, at 72.

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equivalent to the annual health budget of the Czech Republic. By contrast the primary wrong-doer, Lauder's Czech partner, was held in an ICC arbitration liable to pay a 'mere' US\$20 million.

In further contrast, the *Lauder* tribunal held that there was no expropriation and no violation of the duty to provide fair and equitable treatment. It held that the Czech Republic took a discriminatory and arbitrary measure against Lauder But this breach was too remote to qualify as a relevant cause or the harm caused and did not itself cause any damage. No damages were awarded; each party bore their [sic] own costs and half the costs of the tribunal.¹⁰⁰

Though the respondent itself, the Czech Republic, had refused to allow the consolidation of the two proceedings, their widely differing results¹⁰¹—and the perception that the two tribunals were racing to judgment—is probably the most prominent example of how arbitrary international arbitration can be. Not only can different parties obtain differing awards arising from the same facts, but one de facto party can do the same.¹⁰²

3. *Tribunals Sometimes Recognize Problems But Have Not Offered Solutions*

Tribunals have taken note of some of the conundrums that the current claims doctrine produces but have failed to propose solutions. For example, *Sempra* said that “international law and decisions offer numerous mechanisms for preventing the possibility of double recovery” but offered no examples.¹⁰³ Neither did *Suez*, where the tribunal said that “any eventual award in this case could be fashioned in such a way as to prevent double recovery.”¹⁰⁴

Tribunals have not fallen into current doctrine blindly but have consciously chosen to accept and maintain it. In a law journal article, an Argentinean official summarized his country's continually

¹⁰⁰ Id. at 92.

¹⁰¹ Since one tribunal had made an award, the other tribunal might have claimed it refused to grant an award in order to avoid double recovery, but that was not the other tribunal's reasoning.

¹⁰² Crawford, *supra* note 57, at 92–93.

¹⁰³ *Sempra*, ICSID Case No. ARB/02/16, Decision on Objections to Jurisdiction, ¶ 102.

¹⁰⁴ *Suez*, ICSID Case No. ARB/03/17, Decision on Jurisdiction, ¶ 51.

failing arguments against recognition under ICSID of independent shareholder claims when the corporation was the entity harmed directly.¹⁰⁵ One tribunal clearly summarized the argument against recognizing separate causes of action for shareholders before rejecting it.¹⁰⁶

C. Derivative Doctrine versus IIA's Claims Doctrine

1. Class Actions

American-style class actions require plaintiffs pressing similar claims to join together and act as one party to obtain relief in certain circumstances.¹⁰⁷ Where American law consolidates factually identical claims into one legal action and their claimants into one effective claimant, international investment law leaves each claim and claimant independent. This allows potentially dozens or hundreds of separately adjudicated claims and their claimants to arise out of identical facts.¹⁰⁸

2. Derivative Actions

Under the derivative action concept in American corporate law, if a corporate board is not pursuing relief effectively, a non-controlling shareholder may sue in the stead of the board while binding all other shareholders and the corporation itself to the outcome.¹⁰⁹ The shareholders take the place of the board and thus represent the corporation in the matter of the litigation.¹¹⁰ Strictly

¹⁰⁵ Bottini, *supra* note 55, at 566 (“If the shareholder is going to directly receive compensation for a measure affecting the revenues of the local company, shouldn’t it be liable for at least some of the obligations of the local company that were related to the affected revenues?”).

¹⁰⁶ *Camuzzi*, ICSID Case No. ARB/03/2, Decision on Objections to Jurisdiction, ¶¶ 11–44.

¹⁰⁷ See 32B Am. Jur. 2d Fed. Courts §§ 1548–49 (2007).

¹⁰⁸ Gus Van Harten, *Investment Treaty Arbitration and Public Law* 97–100 (2007).

¹⁰⁹ See Wright et al., *supra* note 25, § 1821.

¹¹⁰ As far back as 1932, a Delaware court wrote that a derivative suit combines two suits together:

A bill filed by stockholders in their derivative right . . . has two phases—one is the equivalent of a suit to compel the corporation to sue, and the other is the suit by the corporation, asserted by the stockholders in its behalf, against those liable to it. The former belongs to the complaining stockholders; the latter to

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speaking, a derivative action is in equity, not law.¹¹¹ This suit is based on an alleged breach or breaches in the board's fiduciary duties of loyalty and care to the shareholders.

The IIA derivative doctrine proposed here would not allow shareholders to represent their corporations in litigation, nor would derivative doctrine introduce those fiduciary duties directly into IIA. Instead, it would use the fair and equitable treatment, full protection and security, and possibly the overarching and constantly evolving customary international law protections¹¹² already established in IIA to implement remedies for host governments' failure to provide minimal corporate governance protections that leads to concrete harms to minority shareholders.¹¹³

Here is a crucial point. Governments should be liable only for blatant failure to protect minority shareholders and only when this results in concrete harm to specific investors so that tribunals do not begin to dictate details of corporate governance law to signatory states. Perhaps the best way to ensure this is for nations to adopt clear, universal standards through treaty modification, but international tribunals have come to consensus before, and IIA tribunals may find their way to predictability through their own decentralized process as international fora have in the past. Indeed, as is so often the case in common law court systems at least, trial and error may be the best method.

Some companies obtain some of the advantages of strong corporate governance protection by cross-listing on U.S. exchanges, but far from all foreign companies can do so or choose to do so.¹¹⁴

3. Preclusion and the Forced Representation of Derivative Doctrine

Currently, the outcome of any shareholder's IIA claim does not bind any other shareholder or arbitration forum, even if the claim

the corporation. The complaining stockholders are allowed in derivative bills to bring forward these two causes of action in one suit.

Cantor v. Sachs, 162 A. 73, 76 (Del. Ch. 1932).

¹¹¹ Wright et al., supra note 25, § 1821.

¹¹² For a brief introduction to the application of customary international law to IIA, see McLachlan et al., supra note 47, at 221–25.

¹¹³ See infra Subsection III.D.1.

¹¹⁴ See John C. Coffee, Jr., Racing Towards the Top?: The Impact of Cross-Listings and Stock Market Competition on International Corporate Governance, 102 Colum. L. Rev. 1757, 1761 (2002).

arose from exactly the same facts as other claims. The outcome of the corporation's claim also does not affect, nor is it affected by, any shareholder's claim.¹¹⁵ Each claim is arbitrated independently by its own set of arbitrators who sometimes come to different conclusions concerning essentially identical claims based on the same laws and rules.¹¹⁶ In addition, different arbitral panels at times apply different laws and rules to identical claims if different claimants choose to press those claims in different fora.¹¹⁷ If a claimant loses in one forum, it may refile the same claim in another. Multiple recovery for the same harm, multiplicity of litigation, forum shopping, and unlike outcomes to like cases result.¹¹⁸

Derivative doctrine would require the binding consolidation in IIA of corporate and shareholder claims arising from the same facts. Therefore, it would force the initiating corporation or shareholder to choose one forum for his claims,¹¹⁹ as under American corporate law. The current multiplicity of fora would continue to exist, yet for each set of harms, claimants would be allowed to forum-shop only once, by deciding where bringing their claims would be to their best advantage. Each forum would be required to respect judgments made by other fora as binding, as is common elsewhere in international law and in domestic legal systems.

¹¹⁵ See Van Harten, *supra* note 108, at 97–103 (discussing the “individualization” of investors’ claims).

¹¹⁶ Under typical treaty-based arbitration, there is a discretionary annulment process for awards but no appellate system to create uniformity. See generally James Crawford, *Is There a Need for an Appellate System?*, in *Investment Treaty Law 13* (Federico Ortino et al. eds., 2006).

¹¹⁷ See Van Harten, *supra* note 108, at 113–15.

¹¹⁸ See *id.* at 115–17.

¹¹⁹ Alternatively, the initiating corporation or shareholder may be forced into a forum if multiple claimants file in different fora and cannot agree voluntarily to consolidate into a specific forum.

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4. BIT Language Enables Binding Across Nationalities

The diversity of BITs¹²⁰ may seem to grant foreign investors from different nations, but invested in the same enterprise in the same country, differing rights by the country hosting their investments depending on the language of each BIT. It may seem that binding foreign shareholders across nationalities into one proceeding is infeasible given that the shareholders will have differing procedural and substantive rights. Some argue that, on the contrary, non-standard most favored nation (“MFN”) clauses typically grant de facto identical procedural and substantive rights to all foreign shareholders by allowing them to use the most favorable language on any given legal issue from any BIT that the host nation has signed.¹²¹ This part of IIA could come to almost universal uniformity if trends continue.¹²²

II. GENERAL CRISIS IN IIA AND THE CLAIMS DOCTRINE

A. Building Frustration

The currently established claims doctrine has frustrated an increasing number of developing nations and now also some developed countries.¹²³ Claims have begun to proliferate against developed nations and even threaten to undermine “their macroeconomic policies or other general regulatory measures” since a change in government regulation can be considered grounds for harm to an international investment in IIA.¹²⁴ As the number of treaties covering international investments and those

¹²⁰ The number of bilateral investment treaties (“BITs”) grew from 385 in 1989 to 1857 in 1999. U.N. Conference on Trade and Development, *Bilateral Investment Treaties 1959–1999*, at iii, UNCTAD/ITE/IIA/2 (2000), available at <http://www.unctad.org/en/docs/poiteiid2.en.pdf>. The number grew to 2265 by 2003. U.N. Conference on Trade and Development, *World Investment Report 2004: The Shift Towards Services*, at xvii, UNCTAD/WIR/2004 (2004), available at http://www.unctad.org/en/docs/wir2004_en.pdf. By 2009, it was approximately 2600. Christopher M. Ryan, *Discerning the Compliance Calculus: Why States Comply With International Investment Law*, 38 *Ga. J. Int’l & Comp. L.* 63, 66 (2009).

¹²¹ Stephan W. Schill, *Multilateralizing Investment Treaties Through Most-Favored-Nation Clauses*, 27 *Berkeley J. Int’l L.* 496, 501–02 (2009).

¹²² See *infra* Subsection III.E.1.

¹²³ Michael Waibel et al., *The Backlash Against Investment Arbitration*, *supra* note 1, at xxxvii, xlviii–l.

¹²⁴ *Id.* at l.

investments themselves have grown dramatically, arbitral tribunals have had more opportunities to award claims against governments and to come to differing conclusions on analogous claims, especially since arbitral decisions have no precedential value and there is no court of appeals or equivalent.¹²⁵

A system working quietly in the background and virtually unknown to those outside its field fifteen years ago¹²⁶ has garnered influence, developed internal contradictions, and attracted political vitriol that threatens to destroy it.¹²⁷ Critics say that some of the standards used to decide claims are vague and unfair and that tribunals have failed to resolve the numerous problems that have arisen in this newly prominent, somewhat self-contained world of law.¹²⁸

B. General Problems

Adopting derivative doctrine would mitigate the two general problems described below that contribute to the frustration sketched above. Derivative doctrine would not address all IIA concerns, such as the alleged vagueness of some of the standards used to arbitrate claims. Only a so-far-elusive comprehensive reform of IIA could hope to address all concerns simultaneously. American corporate law concepts have already made major inroads into IIA, however, and adoption of derivative doctrine would continue this preexisting trend, with adaptations and limitations appropriate to IIA.¹²⁹ A description of the seven specific problems that contribute to the two general problems follows in Section II.C. These problems could be addressed by derivative doctrine.

¹²⁵ August Reinisch, *The Issues Raised by Parallel Proceedings and Possible Solutions*, in *The Backlash Against Investment Arbitration*, supra note 1, at 113–18.

¹²⁶ Van Harten, supra note 108, at 3 (“Little more than a decade ago, investment treaty arbitration was virtually unknown beyond the circles of those who were involved, one way or another, in the negotiation of investment treaties.”).

¹²⁷ Waibel et al., supra note 1, at *l*.

¹²⁸ See generally Louis T. Wells, *Backlash to Investment Arbitration: Three Causes*, in *The Backlash Against Investment Arbitration*, supra note 1, at 341–52.

¹²⁹ Menkel-Meadow, supra note 20, at 340–41.

*1. Unfairness to Host Nations and Possible Market Inefficiency**a. Unfairness*

Since most claims are brought against the governments of developing nations,¹³⁰ they tend to suffer most from the problems of IIA.¹³¹ IIA grants international investors international law opportunities for litigation and recovery. These opportunities are denied to host nations' domestic investors, while international investors are allowed recovery through domestic actions brought by the local company in which they invested. In addition, as domestic shareholders in their own nations' enterprises, international investors do not have access to the rights granted by treaty in international investment law against their own, usually wealthy Western governments. In these aspects, the current situation discriminates against developing world host governments and their domestic investors in favor of foreign investors and wealthy Western governments, who are less dependent on international investment and do not grant their domestic investors such unusual rights. They also face fewer IIA claims and usually can better afford to pay any claims they lose, which is especially important as the number of claims continues to grow.¹³²

b. Possible Inefficiency

The advantages of having both domestic and international investment law remedies available can induce investors to make international investments when, under identical legal regimes, they would have made only domestic investments.¹³³ This regulatory arbitrage is true for both Western investors and those in the developing world. This can distort the marketplace and push capital into less economically optimal areas as investors pursue the legal ad-

¹³⁰ Van Harten, *supra* note 108, at 3–4 (“Since [the mid-1990s], the system has expanded rapidly. In the last ten years investors have launched more than 150 claims under investment treaties . . . This has generated a fourteen-fold spike in the rate of claims at the World Bank’s Centre for Settlement of Investment Disputes (ICSID) . . .”).

¹³¹ This is not meant to suggest that developing nations do not benefit from IIA overall.

¹³² Penusliski, *supra* note 5, at 517 (referring to the proportion of claims against developing nations and the growth of foreign investment disputes).

¹³³ Vagts, *supra* note 1, at xxiv–xxvi.

vantages afforded international investments instead of the best market-based business opportunities, which may be domestic. Yet mainstream thinking in international investment law holds that the additional protections balance the disadvantages of investing in developing nations rather than provide unwarranted inducement.¹³⁴

2. Unfairness to Less Active Minority Shareholders and Market Inefficiency

a. Unfairness

Since only those minority shareholders active, informed, and wealthy enough to pursue claims can recover even when other shareholders are equally injured, many minority shareholders are left out of arbitration remedies.¹³⁵ This is especially important as institutional funds made up of portfolio investors, such as Americans saving for their retirements, have become increasingly important sources of capital. Such funds tend to be highly diversified,¹³⁶ reducing or removing the incentive for portfolio managers to pursue claims when any one of their investments has been harmed by a host government. This reduces competition for capital and tends to leave the field open for larger, wealthier, and better-connected minority shareholders.

¹³⁴ Chen Huiping, Comments on the MAI's General Principles for the Treatment of Foreign Investors and Their Investments: A Chinese Scholar's Perspective, *in* *Multilateral Regulation of Investment* 67, 79–80 (E.C. Nieuwenhuys & M.M.T.A. Brus eds., 2001) (explaining the rationale behind the use of international law to equalize the treatment of foreign and domestic investors). Some object to different treatment of investors based on their nationality, but this Note analyzes IIA from the perspective that the measure of a legal regime's goodness lies primarily in its effect, not in its conformity to abstractions, especially in a crisis. See St. Thomas Aquinas, *Summa Theologiae* I-II, q. 90, art. 2 (David Burr trans., 1996), available at <http://www.fordham.edu/halsall/source/aquinas2.asp> (“Thus Aristotle, in defining legal matters, mentions both happiness and the political community, saying, ‘We term “just” those legal acts which produce and preserve happiness and its components within the political community.’”).

¹³⁵ There are no statistics on this question, but the conclusion seems highly likely to be correct.

¹³⁶ There are even stronger legal requirements for diversification. 60A Am. Jur. 2d *Pensions and Retirement Funds* § 459 (2003).

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b. Inefficiency

Market inefficiencies abound as portfolio investors and other small minority shareholders shun financially attractive international investment opportunities they otherwise would pursue if they had stronger legal protections.

C. Specific Problems

The current IIA claims doctrine creates or contributes to at least seven specific problems.

1. Endless Chain of Claimants

By covering minority shareholders and their indirect investments, IIA creates potentially endless chains of claimants. For example, if foreign corporation *A* owns 40% of foreign corporation *B*, which owns 35% of domestic corporation *C*, all three corporations may file separate claims based on governmental action harming the value of *C*.¹³⁷ Each claimant may file its own claim with its own arbitral panel and may often choose from various fora (such as those constituted under ICSID, a BIT, or alternative international institutions). Cooperation is not required and is impossible when proceedings and awards are kept secret.¹³⁸

Only the uneven and voluntary implementation of consolidation prevents a host nation from having to defend against a series of claimants filing claims arising from the same harm.¹³⁹ Since potential claimants are not bound as in class actions, consolidation does not affect claims filed after the first set of claims has been adjudi-

¹³⁷ See Amerasinghe, *supra* note 61, at 177–81 (implying this possibility because of the expansive definitions given “investment”).

¹³⁸ Secrecy is usually left up to the parties. Michael Young & Simon Chapman, Confidentiality in International Arbitration: Does the Exception Prove the Rule? Where Now for the Implied Duty of Confidentiality Under English Law? 27 *ASA Bull.* 1, 26, 27 (2009).

¹³⁹ Even relatively straightforward claims by shareholders do not necessarily have straightforward answers. See Bishop et al., Restitution and Compensation in Expropriations, *in* *Foreign Investment Disputes*, *supra* note 3, at 1310 (“What amount should a foreign investor that holds a minority interest be allowed to recover for a partial expropriation of its local company’s property or interests?”).

cated but before the expiration of the statute of limitations.¹⁴⁰ Each claim is often heard anew, with the host nation having to mount a separate defense each time, unable to rely on victory over previous claims to grant it success in future ones arising from exactly the same harm.¹⁴¹

2. Multiple Recovery

The chain of claimants also creates the possibility of multiple recovery as foreign investors with overlapping investments file separate claims. In addition, the local company in which they invested may file its own independent claim in IIA if it is foreign controlled and a lawsuit in domestic courts if not.¹⁴² In fact, if it is foreign controlled, it can file in both domestic courts and under IIA, and IIA fora do not have to wait for the outcome of domestic litigation before acting unless the applicable BIT so requires.¹⁴³ Under standard economic theory, investors receive compensation, usually in the form of higher stock prices, when their enterprise is compensated, but investors can easily receive double recovery if both they and their enterprise win their claims.¹⁴⁴ This may be especially likely if a local company with foreign investors receives damages from domestic courts while foreign shareholders receive awards from international tribunals.¹⁴⁵ Secrecy that often surrounds domestic court judgments, out-of-court settlements, and tribunal awards may sabotage a forum's voluntary attempts to avoid multiple recovery.

3. Multiple Venues, Forum Shopping

The nature and number of venues for claimants to bring cases against host governments have multiplied in the past twenty years,¹⁴⁶ giving prospective claimants more and more opportunities

¹⁴⁰ Under American law, parties may opt out of class actions but sometimes can lose access to relief if they do so. For the proposal of this Note to work, parties must have strong incentives not to opt out.

¹⁴¹ Reinisch, *supra* note 125, at 114–17.

¹⁴² McLachlan et al., *supra* note 47, at 87–88.

¹⁴³ *Id.*

¹⁴⁴ See *id.* at 80.

¹⁴⁵ See *id.* at 83, 87–88.

¹⁴⁶ See Andrea K. Bjorklund, *Private Rights and Public International Law: Why Competition Among International Economic Law Tribunals Is Not Working*, 59

for forum shopping¹⁴⁷ that are increasingly perceived as unfair to host nations, which are often developing countries facing claims from investors in wealthy developed nations.¹⁴⁸

If an investor is a national of one nation with a BIT with the host country and is invested in a corporation that is a national of another nation that has its own BIT with the host nation, the investor can file two claims, one under each BIT.¹⁴⁹ This gives many potential claimants the choice of several different paths to recovery, sometimes under different criteria, depending on the venues, and the host nation must defend itself wherever investors assert claims against it.

4. *Inconsistent Results*

Arbitral tribunal decisions carry no precedential weight, and there is no appellate court to provide authoritative guidance in interpreting treaties, customary international law, or previous tribunal decisions. Only in the past decade have arbitration decisions begun to be made public on a routine basis, though there is still no requirement to do so, and the contradictions have become glaring in some observers' eyes.¹⁵⁰

For example, contradictions continue within the largest batch of IIA cases in history. Economically troubled Argentina faces the greatest number of claims of any nation in the world and, so far, has refused to pay judgments against it. "Forty-eight cases were filed against Argentina alleging breaches of its obligations under bilateral investment treaties ('BITs'). Most cases were related to the measures taken by Argentina as a consequence of the

Hastings L.J. 241, 241 (2007) ("It is a buyer's market for foreign investors seeking remedies for wrongs they have allegedly suffered at the hands of host governments.").

¹⁴⁷ Id. ("An [international] investor can usually seek relief in the courts of the host state, but, increasingly also has more cosmopolitan options to consider, including investor-state arbitration [and possibly] regional or multilateral dispute settlement Sorting out how these tribunals relate to each other is difficult.").

¹⁴⁸ See Van Harten, *supra* note 108, at 3–4.

¹⁴⁹ Again, *CME v. Czech Republic* and *Lauder v. Czech Republic* are the archetypal examples.

¹⁵⁰ Reinisch, *supra* note 125, at 113–15.

2001/2002 [financial] crisis.”¹⁵¹ In addition to other arguments, Argentina has advanced the necessity defense,¹⁵² arguing that the measures it took that harmed foreign investments were necessary to maintain public order and security. “The Article XI defence was subject to different and even contradictory treatment in the awards rendered in *CMS*, *LG&E*, *Enron*, *Sempra*, and *Continental Casualty*, the five cases that have addressed the defence to date.”¹⁵³

5. Equally Worthy Non-Parties Recovering Nothing

If a shareholder files a claim and wins, only that shareholder recovers damages. Other shareholders, including those with equal or greater stakes and harmed by the same host government action, receive nothing. There is no way under the current ICSID and BIT system to provide for class actions or analogous litigation types. Not only is this unfair, it is wasteful: each minority shareholder must file its own claim if it wants a remedy, and each claim must be litigated separately unless the unreliable process of voluntary consolidation occurs.

6. Local Investors' Treatment Differs from That of Foreign Investors

Since the typical foreign investor has invested in a locally incorporated company, it can benefit from that company's litigation of a dispute in the local courts, or in international fora, or both.¹⁵⁴ Sometimes, an investor will see what relief the local courts grant and then seek further satisfaction in an international body—sometimes in more than one.¹⁵⁵ Domestic investors have no such option, even if they are joint investors in the same enterprise as foreign investors.

¹⁵¹ Federico Godoy, *State of Necessity and Non-Precluded Measures—Implications of the Sempra and Enron Annulment Decisions*, 16 Int'l Bar Ass'n Legal Prac. Div. Arb. News, no. 1, 2011, at 167, 167.

¹⁵² The necessity defense is exemplified in article XI of the U.S.-Argentina BIT. Treaty Concerning the Reciprocal Encouragement and Protection of Investment, U.S.-Arg., art. XI, Nov. 14, 1991, 31 I.L.M. 124 (1992).

¹⁵³ Godoy, *supra* note 151, at 167.

¹⁵⁴ Van Harten, *supra* note 108, at 115.

¹⁵⁵ *Id.* at 113–15.

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There is a presumption that domestic courts are often biased against foreign investors but not domestic ones and that international investment law can remedy this problem as well as other defects in many countries' legal and political environments.¹⁵⁶ Of course, such bias and defects sometimes, but not always, exist. International arbitration tribunals are often more favorable to affluent investors than local courts, which apply domestic law that is often less protective of private investment than international investment law.¹⁵⁷ Not only do domestic investors not get these multiple bites at the apple, they must content themselves with domestic law even if they would choose to take their one bite via international law if they could.

7. *No Closure*

The multiple fora, endless chain of claimants, and lack of precedent and coordination among tribunals can lead to claims that arise from the same facts dragging on for years with no preclusive decision or final court available to cut off litigation.¹⁵⁸ The twenty-five-year battle between the United States and Canada over softwood lumber is the archetypal case in point.¹⁵⁹

III. THE DERIVATIVE DOCTRINE SOLUTION

A. *Overall Framework*

Replacing the direct and indirect claims doctrine with derivative doctrine could solve or mitigate most of the seven specific problems and mitigate both of the general problems discussed above.¹⁶⁰

¹⁵⁶ See Susan Rose-Ackerman & Jennifer L. Tobin, Do BITs Benefit Developing Countries?, *in* *The Future of Investment Arbitration*, supra note 4, at 131, 134–35.

¹⁵⁷ Vagts, supra note 1, at xxvi.

¹⁵⁸ For an explanation of how finality might not necessarily benefit governments or investors in some cases, see V.V. Veeder, The Necessary Safeguards of an Appellate System, *in* *Investment Treaty Law*, supra note 116, at 9–10.

¹⁵⁹ Bjorklund, supra note 146, at 275–76 (“The Lumber IV dispute is a classic case study of fragmentation in economic dispute resolution and the ensuing problems. Different claimants sought different relief under different legal theories before different tribunals.”).

¹⁶⁰ For a brief explanation of derivative actions, see 18 C.J.S. Corporations § 482 (2007).

Replacing the relatively new¹⁶¹ and increasingly controversial claims doctrine with doctrines closer to time-tested, widely used, and relatively non-controversial ones used in domestic markets would resolve some conceptual ambiguities¹⁶² raised by the former and, more important, would tend to promote uniformity, predictability, fairness, and efficiency in IIA's handling of claims. The idea is less radical than it may sound since American corporate law has already transformed international investment law in certain areas.¹⁶³

Derivative doctrine would prohibit all indirect claims, thus eliminating the possibility of the corporation and its shareholders pursuing remedies for the same harm separately, but would open a new way for minority shareholders to receive compensation if, due to the host government's lack of regulation, the corporation itself failed to pursue a claim. The class action aspect of derivative doctrine would ensure that all claims arising from the same facts are adjudicated together, reducing waste and eliminating contradictory outcomes. When different shareholders have different rights, class actions are still feasible, following the model of American multi-state tort actions.¹⁶⁴

Adoption of derivative doctrine would not necessarily have to take place by treaty, despite its absence from IIA now, given the already accepted fair and equitable treatment and full protection and security standards. If a treaty change were necessary, modification of ICSID would likely be the most efficient vehicle and would have to affect non-ICSID IIA insofar as every IIA forum must be required to respect the decisions of other fora.¹⁶⁵

¹⁶¹ Bottini, *supra* note 55, at 565–66 (“Recourse to ICSID arbitration under a BIT, although a much extended phenomenon nowadays, is also a relatively recent one. That explains why the issue of indirect actions generally did not have to be dealt with by the first ICSID tribunals ruling on investment disputes.”).

¹⁶² Why not treat a claim as a derivative action when it is brought by a shareholder based on a drop in share value due to host government malfeasance solely against the shareholder's corporation?

¹⁶³ See Menkel-Meadow, *supra* note 20, at 340–41.

¹⁶⁴ See *infra* Section III.E.

¹⁶⁵ See Charles H. Brower, II, Reflections on the Road Ahead, *in* The Future of Investment Arbitration, *supra* note 4, at 340–48. (explaining the conflicting outcomes caused, in part, by the multiplicity of IIA fora).

*B. Addressing the Specific Problems**1. Solution to the Endless Chain of Claimants*

Since a foreign-controlled corporation can press an IIA claim against its host nation, under derivative doctrine, its foreign shareholders would not be able to pursue recovery separately. Instead, there would be one claimant, the entity directly harmed by host government action. Typically this would be the corporation in which foreign investments were made, but could be the foreign shareholders if their shareholdings were targeted directly—as when a government expropriates the shares of investors from only one foreign country as part of a diplomatic dispute—rather than the corporation or its assets. Class action doctrine would require shareholders subjected to the same harms to pursue their claims as one.¹⁶⁶

If the corporation were the one harmed directly but corporate officers were unable or unwilling to pursue a claim either in domestic court or in IIA, a minority shareholder or group of minority shareholders¹⁶⁷ could file a claim similar to an American derivative action, but only if the host government had failed to provide those shareholders minimal protection from the malfeasance or inaction of the corporate board.¹⁶⁸ Private IIA claims can be made only against governments, not against other private parties. In addition, if corporate officers were in fact pursuing a claim, but in a defective manner due to corruption or laxity, a derivative claim filed by minority shareholders could ask the tribunal or other body hearing the claim to repair the defects.¹⁶⁹ A domestic government would be free to sanction the corporation or corporate officers if the shareholders won their claim.¹⁷⁰

There would also be no need to create a chain of claimants. For example, the foreign corporation *A* that owns 40% of another foreign corporation *B* that owns 35% of a domestic enterprise *C*

¹⁶⁶ 21 Am. Jur. Trials §§ 1–3 (1974).

¹⁶⁷ Controlling shareholders control their boards and therefore do not face a conflict between their wishes and those of their boards.

¹⁶⁸ 18 C.J.S. Corporations § 482 (2007).

¹⁶⁹ This would be analogous to long-established American corporate law. See, e.g., *Moldonado v. Flynn*, 413 A.2d 1251, 1261–62 (Del. Ch. 1980).

¹⁷⁰ Any sanction that cost the minority shareholders more than they were awarded would be counterproductive, of course.

would be compensated by the rise in its stock value when either the domestic enterprise *C* was compensated if the corporate board pursued remedies itself, or when the direct shareholder *B* was compensated through a derivative action.

Another way of conceptualizing this idea is as a securities fraud action made derivatively against the host government for failing to police its native corporate boards rather than against the corporate board itself.

If the host government has dissolved the local corporation, former shareholders should still be able to sue so that host nations are not tempted to use dissolution to circumvent claims.

All shareholders bound together in the derivative or class action would be compensated in accordance with their shares.¹⁷¹ This would bring a greater proportion of the growing number of portfolio investors with small stakes in any given enterprise into the fold of IIA protection.¹⁷²

2. Solution to Multiple Recovery

Potential multiple recovery when both the corporation and one or more shareholders pursue claims¹⁷³ is one of the paramount drawbacks of the current system. Reducing the number of potential claimants to one, the corporation, or to one class would mitigate this problem.

To solve it, however, would also require the different bodies that enforce international investment law to honor decisions made in other fora. For example, if a claimant loses before a tribunal constituted under a BIT, it should not be allowed to file a claim based on the same facts before the London Court of International Arbitration. Not only can different arbitrators and judges come to different conclusions even when applying the same laws to the same facts (as students of domestic legal systems well know), the same claim can easily receive different treatment in different fora since

¹⁷¹ See 21 Am. Jur. Trials, *supra* note 166, §§ 46–48, at 702–08.

¹⁷² See *infra* Section III.D for the importance of corporate governance protections for minority shareholders.

¹⁷³ See Van Harten, *supra* note 108, at 115 (describing briefly the most famous example in which a corporation and its controlling shareholder both pursued claims, though double recovery was avoided thanks to the claims' public nature).

different substantive and procedural rules are used by different bodies. Claimants simply should be required to choose one forum.

For this solution to be truly effective, each venue of international investment protection must honor the preclusive power of the others just as the different judicial systems within a nation do. Though one unified system of international investment protection theoretically could be created, such an effort has so far failed, and there are advantages to maintaining the choices that claimants currently have while forcing them to choose one.¹⁷⁴ Though preclusion across fora is not essential to the derivative doctrine concept, it is a natural extension of its preclusive effects. This effect could be achieved through BIT modification, ICSID modification, or simply by the voluntary agreement of IIA fora, who would then have to have access to the non-public decisions of other fora.

3. Solution to Multiple Venues, Reduction in Forum Shopping

As noted above, employing a form of *res judicata* across fora, as employed domestically in the United States and other countries, would allow claimants to shop for a forum only once for any particular claim. A problem would arise when claimants differ in their perceptions of the advantages of various fora and file in different ones, just as the tort victims of a large corporation in the United States might file thousands of suits in hundreds of different courts, both state and federal. Part of adoption of derivative doctrine would have to include a mechanism for determining into which forum a class or derivative action would be consolidated.¹⁷⁵ This mechanism could be modeled after that of the United States, the United Kingdom, or another nation with a widely admired and emulated court system. An appeals body with the power to harmo-

¹⁷⁴ Reinisch suggests that “consolidation of related arbitration proceedings” should be encouraged but does not suggest a systematic, mandatory way of achieving that goal. Reinisch, *supra* note 125, at 119–20.

¹⁷⁵ A possible undesired result is a reduction of the restraining effect that forum shifting can have. See Paul B. Stephan, *Redistributive Litigation—Judicial Innovation, Private Expectations, and the Shadow of International Law*, 88 *Va. L. Rev.* 789, 814 (2002) (“I note in particular how U.S. law has bolstered substantive rules limiting judicial creativity with forum-shifting procedures, particularly the removal jurisdiction of the federal courts, as a means of constraining inappropriate judicial behavior. International arbitration presents a parallel strategy.”).

nize questions of law would be highly valuable in implementing any such system, but another method could be used.¹⁷⁶

4. Solution to Inconsistent Results of Claims Arising Out of the Same Facts

This problem should be eliminated with the reduction in potential claimants and potential fora to one each. Another kind of inconsistent result, arising from the lack of binding precedent in the international arbitration system, would be unaffected by adoption of derivative doctrine.¹⁷⁷ Here, too, an appeals body would be highly useful.¹⁷⁸

5. Solution to Equally Worthy Non-Parties Recovering Nothing

Derivative doctrine uses the class action concept and generally would make all similarly situated potential parties actual parties to the action.¹⁷⁹ All would recover proportionally if the claim were successful with no privileging of those active and wealthy enough to pursue a claim in international arbitration.

Portfolio investors and other less active shareholders would benefit from any successful litigation pursued—and paid for—by more active minority shareholders. When a class or derivative action is unsuccessful, costs could be allocated as they currently are under the American corporate law system.¹⁸⁰

¹⁷⁶ See *infra* Section III.E.

¹⁷⁷ This kind of inconsistency occurs when cases involving materially indistinguishable facts yield different legal results, because different arbitrators or fora apply different law or interpret the same law differently.

¹⁷⁸ For a summary of the most troublesome inconsistencies in arbitral decisions and a short discussion of the possible solutions, including the creation of an appeals body, see D. Brian King, Consistency of Awards in Cases of Parallel Proceedings Concerning Related Subject Matters, *in* *Towards a Uniform International Arbitration Law?* 293 (Anne Véronique Schlaepfer et al. eds., 2005).

¹⁷⁹ It is true that members of a class may opt out of litigation in the United States, but they generally lose their right to possible recovery.

¹⁸⁰ Different states have different methods, but generally, small shareholders who were not the instigators of the suit pay nothing though the corporation in which they invested may have to pay the cost of defending itself. See Wright et al., *supra* note 25, § 1841.

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6. No Solution to Local Investors' Treatment Differing From That of Foreign Investors

Adoption of derivative doctrine by itself would do nothing to solve or mitigate this problem. Only foreign investors are potential claimants, and only they could bring a derivative doctrine suit in IIA and be bound by one.¹⁸¹ Allowing or requiring domestic investors to press a derivative claim or class action in IIA or join in one filed by foreign investors would have international bodies arbitrating investment disputes between governments and their own nationals, circumventing domestic regulators and courts.¹⁸² Domestic investors would likely rather be left to pursue domestic remedies separate from an international investment law action based in derivative doctrine, rendering such an action less than truly comprehensive but still a major step toward consistency and consolidation.

7. Partial Solution to No Closure

This problem would be solved or at least mitigated, as litigation can famously drag on even in relatively efficient domestic legal systems. Implementing the preclusive effects of claims both horizontally (all potential claimants are bound) and vertically (only one case in one international investment protection forum may be pursued) would go a long way toward providing closure.

C. Addressing the General Problems

1. Unfairness to Host Nations and Possible Market Inefficiency

a. Unfairness

On the one hand, derivative doctrine would reduce the multiplicity of IIA litigation facing developing nations, shorten the average

¹⁸¹ “‘Free trade’ refers to the sale of goods and services across borders without any restrictions being placed on foreign producers that are not also imposed on domestic producers.” Edward A. Fallon, *Latin American Laws Regulating Foreign Investment*, SB04 ALI-ABA 323, 326 (1996). What about the other way around? There is no simple solution to this problem in IIA.

¹⁸² Proposals for reform tend to advocate more deference to local courts. See Andrea K. Bjorklund, *Reconciling State Sovereignty and Investor Protection in Denial of Justice Claims*, 45 *Va. J. Int'l L.* 809, 815 (2005) (“[T]he tribunal should first determine whether the challenged [domestic] judicial practice in a particular case departed from national law so markedly that it denied justice to the alien.”).

length of that litigation, reduce forum shopping, and provide greater predictability in outcomes. Foreign shareholders outside the jurisdiction of host governments could no longer possibly profit through multiple recovery for the same harms. On the other hand, adoption of derivative doctrine would not alter the greater availability of rights available to international investors, who have recourse to both domestic and IIA fora—though many consider this disparity part of the essential and beneficial nature of IIA.

b. Possible Inefficiency

The imbalance in rights between international and domestic investors would remain, continuing its possible market-distorting effects. Those who believe that this imbalance corrects for the alleged tendency of domestic regulators and courts in host nations to favor domestic investors tend to believe that the imbalance reduces market distortion rather than increases it.¹⁸³

2. Unfairness to Less Active Minority Shareholders and Market Inefficiency

a. Unfairness

Through class actions and derivative actions, recovery would be shared proportionally by all shareholders, instead of by only those active and wealthy enough to pursue claims. This would promote fairness for small minority shareholders, particularly portfolio investors. Derivative actions would also allow minority shareholders to prod host governments into policing lax or corrupt corporate boards.

b. Inefficiency

Market inefficiencies would be reduced as stronger legal protections more closely approximating domestic legal protections induce portfolio and other investors into financially attractive international investment opportunities. This would promote portfolio di-

¹⁸³ This Note does not attempt to resolve this debate.

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versification, widely considered a wise investment strategy,¹⁸⁴ and attract more capital to developing nations.

D. Further Advantages of Derivative Doctrine, Particularly for Corporate Governance and Portfolio Investors

1. Derivative Doctrine Would Assist Portfolio Investors

Helping to rescue IIA from its current crisis is derivative doctrine's first broad advantage. Derivative doctrine's second broad advantage is increased protection of minority shareholders, including the large and growing number of portfolio investors¹⁸⁵ who desire guarantees of protection not only from the direct actions of host governments but also from entrenched company boards, officers, and controlling shareholders in foreign nations.¹⁸⁶ In turn, these nations would profit from more portfolio investment.¹⁸⁷

Just as many developing nations have adopted aspects of American corporate law, including corporate governance rules, into their domestic legal systems to improve their economies and attract more foreign capital, the replacement of direct and indirect actions by shareholders¹⁸⁸ with the derivative doctrine alternative would extend that trend through the medium of IIA.¹⁸⁹ Consolidation of

¹⁸⁴ Both for individuals' investments and for nations' economies, diversification—deriving income from various independent industries—is considered good policy. See United Nations Development Programme, Human Development Report 2005: International Cooperation at a Crossroads: Aid, Trade and Security in an Unequal World 120–22 (2005) (explaining the advantages to nations of economies not too dependent on any one sector, such as agriculture alone).

¹⁸⁵ “The typical portfolio investor is a minority shareholder, or a bondholder, of a foreign business enterprise.” Fallone, *supra* note 181, at 325.

¹⁸⁶ See 18 C.J.S. Corporations § 482 (2007) (“A derivative action is an action by a stockholder to enforce a right that belongs to the corporation, or to obtain relief for harm done to the corporation by officers, directors, or third parties, where the corporation itself refuses to seek redress.”).

¹⁸⁷ See Mary E. Kissane, *Global Gadflies: Applications and Implications of U.S.-Style Corporate Governance Abroad*, 17 N.Y.L. Sch. J. Int'l & Comp. L. 621, 624–25 (1997) (“Non-Anglo American systems of Continental Europe [and Japan] are built on a small number of stocks trading in illiquid markets where large shareholders dominate and no ‘takeover market’ exists for control of companies.”).

¹⁸⁸ Some commentators have suggested that these current claims are weak forms of derivative actions. Crawford, *supra* note 57, at 93, refers to “[t]he legal and practical implications of what amounts to derivative actions by minority shareholders.”

¹⁸⁹ Another commentator said: “No one is suggesting that all the substantive guarantees contained in BITs and FTAs [free trade agreements] are now part of CIL [cus-

the rights of corporations and their shareholders, similar to the manner in which they are domestically in the United States with its highly successful corporate law system,¹⁹⁰ would increase the chances of collective recovery on behalf of all potential claimants. So would the ability to prompt host governments to police corporate boards.¹⁹¹

Under derivative doctrine, foreign investors would not be able to enforce the fiduciary duties of loyalty and care, but they would be able to recover from host governments who fail to do so when it results in clear, quantifiable harm to investors. Those duties require corporate boards to look after the financial interests of their shareholders and avoid conflicts of interest.¹⁹² If an IIA derivative suit is unnecessary, it should be rejected by IIA arbitrators. If the board is not properly safeguarding foreign investor value (perhaps because it has been captured by local shareholders, does not wish to anger domestic government authorities, has been corrupted, or is otherwise not pursuing the legally defined interests of the corporation and its investors), the claim should succeed but only if the host government has not lived up to its regulatory role. A claim in which the board violated its duties but the host government met the criteria for proper regulation should fail since it is the government that is being claimed against. Adoption of derivative actions would allow international arbitrators to enforce host governments' obligations to promote corporate boards' and officers' duties to minority shareholders.¹⁹³ Many minority shareholders in developing nations who are unable to pursue derivative actions due to such actions' lack of recognition by domestic law or lack of funds would also

tomary international law] or general principles of law." José E. Alvarez, *A Bit on Custom*, 42 N.Y.U. J. Int'l L. & Pol. 17, 31 (2009).

¹⁹⁰ See Andrei Shleifer & Robert W. Vishny, *A Survey of Corporate Governance*, 52 J. Fin. 737 (1997).

¹⁹¹ See Kissane, *supra* note 187, at 624 ("Anglo American systems of corporate governance, such as those of the U.S. and the U.K., are generally characterized by listed, liquid stock markets and dispersed shareownership, where control can be wrested from management. Historically, this approach to corporate governance has been more confrontational, relying on competing pressures and divisions of responsibility to drive performance.").

¹⁹² 3 William Meade Fletcher, *Fletcher Cyclopedia of the Law of Corporations* § 837.60 (2010).

¹⁹³ See Shleifer & Vishny, *supra* note 190, at 741–44, for an explanation of those duties and why they are needed.

benefit as foreign investors monitor governments' policing of corporate boards.

This proposal will strike some as simply an American derivative suit in disguise: foreign investors go after the host government when corporate officers violate their fiduciary duties, and the host government likely goes after the corporate officers if it loses in IIA. Yet the key components of maintaining the public-private dispute nature of IIA and finding a failure in host government's regulation before a claim can succeed distinguish this proposal from American shareholder derivative suits. Further, since governments would have to defend against claims, they would have an incentive to regulate properly. To acknowledge the similarities, however, this Note refers to its proposal as "IIA derivative actions."

2. *Averting a Possible Future Portfolio Investment Crisis*

Since Latin America is a triple locus of increasing adoption of American corporate law,¹⁹⁴ increasing resistance to IIA,¹⁹⁵ and increasing numbers of IIA claims,¹⁹⁶ focus on this region is appropriate.¹⁹⁷ Argentina, Bolivia, Ecuador, and Venezuela are the states that have taken the lead in denouncing IIA and even withdrawing from parts of it.¹⁹⁸

Though many aspects of Anglo-American corporate law have been adopted virtually worldwide, Latin America has been increas-

¹⁹⁴ Distaste for foreign investment has faded away. See Fallone, *supra* note 181, at 327 ("Historically, the fear of economic imperialism led Latin American nations to adopt laws restricting foreign direct investment within their borders.").

¹⁹⁵ Bolivia, Ecuador, Peru, Nicaragua, Venezuela, and Argentina have all taken steps to reduce their exposure to international investment law or have threatened to do so. Michael Waibel et al., *The Backlash Against Investment Arbitration*, *supra* note 1, at xxxvii, xlix.

¹⁹⁶ Over 40 of the cases in front of ICSID are against Argentina for its response to the financial crisis of 2001–02. William W. Burke-White, *The Argentine Financial Crisis*, *in* *The Backlash Against Investment Arbitration*, *supra* note 1, at 407, 408.

¹⁹⁷ The government of Ecuador took the most radical steps. Hernán Pérez Loose, *International Arbitration by the State: Developments in Ecuador*, 16 *IBA Arb. News*, no. 1, 2011, at 119 & n.1. But now there seems to be "an effort to neutralize the negative impact that the prior measures had on foreign investment." *Id.* at 119. This kind of instability bodes ill for the future of IIA.

¹⁹⁸ For a description of the actions they have taken and their reasons, see Chalamish, *supra* note 17, at 336–38.

ingly receptive to U.S. corporate law since the 1990s, with considerable success.¹⁹⁹ A continued lack of strong corporate law protecting minority shareholders, however, has contributed to concentrated ownership and the resulting absence of dispersed shareholding in Latin American nations.²⁰⁰ “[W]ith few exceptions, majority shareholders in Latin American corporations can, as a matter of statutory right, impose their will on the minority.”²⁰¹ Lack of protection for minority investors could be Latin America’s biggest corporate law problem.²⁰² Portfolio investors are demanding more protection, and providing it could be a fine way for developing nations to get the kind of dispersed investors that American corporations take for granted. “In the past decade, minority shareholders [sic] rights have become a more sensitive issue, especially with ever-increasing foreign investment from mutual funds and other foreign entities, which are wary of investing in companies without certain basic rights that minority shareholders expect in the United States and other jurisdictions.”²⁰³ Portfolio investors are increasingly important and assertive,²⁰⁴ and the nations that provide the protections portfolio investors expect at home are more likely

¹⁹⁹ See Fallone, *supra* note 181, at 344.

²⁰⁰ See Jose W. Fernandez et al., *Corporate Caveat Emptor: Minority Shareholder Rights in Mexico, Chile, Brazil, Venezuela and Argentina*, 32 *U. Miami Inter-Am. L. Rev.* 157, 160 (2001) (“[Major shareholders’] dominant position when convening a shareholder’s meeting, adopting resolutions or distributing dividends has been bolstered by the lack of shareholder’s derivative suits or class action mechanisms analogous to those available in the United States, although certain ‘abuse of right’ concepts have appeared in recent legislation.”).

²⁰¹ *Id.*

²⁰² One observer “further states that as a result of such pattern [sic] of equity ownership ‘a focus of the corporate governance concern in the region is possible divergence of interests between majority and minority shareholders.’” *Org. for Econ. Cooperation & Dev.*, *White Paper on Corporate Governance in Latin America* 48 (2003), *cited in* Francisco Reyes, *Corporate Governance in Latin America: A Functional Análisis*, 39 *U. Miami Inter-Am. L. Rev.* 207, 223 (2008).

²⁰³ Fernandez et al., *supra* note 200, at 160–61.

²⁰⁴ See John H. Farrar, *The New Financial Architecture and Effective Corporate Governance*, 33 *Int’l Law.* 927, 945–46 (1999) (“Institutional investors increased their market share of UK-listed equities from 17.9 percent in 1957 to 60.4 percent in 1992, and are acquiring about two percent of the UK equity market each year. Institutions hold over sixty percent of listed loan capital. These are the highest international percentages but there are similar trends in Australia, New Zealand, Canada, and the United States . . .”).

to garner their investments.²⁰⁵ Fortunately, a few Latin American nations have already implemented derivative actions, but a great deal of more work needs to be done.²⁰⁶ IIA could do some of this work, even simply by calling attention to the corporate governance problem affecting minority shareholders through the incorporation of the derivative action method of redress, whether or not such actions are employed often.

Professor Edward Fallone identifies several factors initially facilitating the rise of portfolio investing in Latin America,²⁰⁷ including increased demand for capital.²⁰⁸ As he notes, “Portfolio investors will be concerned with the rights afforded to minority shareholders under the host nation’s corporate laws.”²⁰⁹ Yet what he says about Latin America’s lagging in minority protection²¹⁰ remains true, despite ongoing efforts to incorporate such protections into the domestic laws of Latin American nations.²¹¹ Integrating derivative doctrine into IIA would substitute to some extent for this insufficient minority shareholder protection and could forestall a crisis, similar to the one IIA is experiencing now, involving international portfolio investment.

Much evidence shows that corporate governance models have been successfully borrowed by developing nations and that such adoption is positively correlated with economic development, sug-

²⁰⁵ Institutional portfolio investors are more vigilant than they have been in the past, likely rendering them more aware of the legal regimes of the countries in which they consider investing. “While the growth of institutional holdings and their potential power is well documented, until the last decade there was little evidence that such power had been exercised in any significant way Nowadays, however, there is direct and indirect industry-wide and firm-level monitoring.” *Id.* at 947.

²⁰⁶ See Fernandez et al., *supra* note 200, at 179–80.

²⁰⁷ Fallone, *supra* note 181, at 327–29.

²⁰⁸ See *id.* at 329 (“[Privatization of] significant portions of [Latin American] econom[ies] through the sale of state-owned enterprises has also created unprecedented opportunities for passive investment.”).

²⁰⁹ *Id.* at 343.

²¹⁰ *Id.* at 344 (“In addition, corporate laws in Latin America have rarely afforded many protections to minority shareholders.”).

²¹¹ *Id.* (“[T]here remains today a great deal of variance between the protections available to an investor who is a minority shareholder in a Latin American corporation and an investor who is a minority shareholder in a U.S. corporation.”).

gesting that adoption into IIA would also be successful.²¹² In recent years, “international business participants have come to recognize that the structure of corporate governance is more than a local custom to be accepted by default. Rather, such local structures are increasingly recognized as substantive factors affecting the relative desirability of particular markets.”²¹³ Success has not been universal, as demonstrated by some Eastern European nations after the fall of Communism.²¹⁴ But “[c]orporate governance ratings prepared by private agencies encourage companies to adopt measures that the agencies consider desirable. These templates for desirable corporate governance invariably draw on Anglo-American elements.”²¹⁵

The OECD has issued an influential document²¹⁶ calling for the adoption of certain corporate governance laws around the world, including derivative actions.²¹⁷ Model corporate governance schemes do not have to rely on the American experience despite the inevitable similarities among effective corporate governance systems in the modern global economy. Private action cannot substitute for a robust regime of public protection,²¹⁸ and that can include encouragement of local governments’ efforts by international investment law.²¹⁹

²¹² The OECD recommends that developing nations adopt strong corporate governance protections. See Ad Hoc Task Force on Corporate Governance, OECD Principles of Corporate Governance 5, Doc. SG/CG(99)53 (1999).

²¹³ Kissane, *supra* note 187, at 621.

²¹⁴ Amir N. Licht, *Legal Plug-Ins: Cultural Distance, Cross-Listing, and Corporate Governance Reform*, 22 *Berkeley J. Int’l L.* 195, 196 (2004). For more on this failure, see Bernard Black et al., *Russian Privatization and Corporate Governance: What Went Wrong?*, 52 *Stan. L. Rev.* 1731 (2000); Merritt B. Fox & Michael A. Heller, *Corporate Governance Lessons from Russian Enterprise Fiascoes*, 75 *N.Y.U. L. Rev.* 1720 (2000); Edward Glaeser et al., *Coase Versus the Coasians*, 116 *Q. J. Econ.* 853 (2001).

²¹⁵ Licht, *supra* note 214, at 197.

²¹⁶ Ad Hoc Task Force on Corporate Governance, *supra* note 212. See generally World Bank, *Corporate Governance: A Framework for Implementation* (2000).

²¹⁷ See Licht, *supra* note 214, at 213 (“Although the OECD Principles are non-binding, there is considerable convergence toward them as an optimal corporate governance framework.”).

²¹⁸ But cf. *id.* at 197 (“An alternative to corporate governance improvement through public action is improvement through private action by particular corporations.”).

²¹⁹ The influence and power of the international investment law enforcement system should not be underestimated given its unusual vectors of authority. “International investment law fundamentally differs from traditional or customary forms of interna-

Drawing on empirical research, another author notes the following:

1. The separation of ownership and control in listed public corporations is far from universal.
2. Many of the largest firms are controlled by families.
3. The widely held corporation is most common in countries with good regimes of shareholder protection.
4. Family control is more common in countries with poor shareholder protection.
5. State control is common, particularly in countries with poor shareholder protection.
6. In family-controlled firms there is little separation between ownership and control.
7. Pyramids and deviations from one share-one vote are most common in countries with poor shareholder protection.
8. Corporations with controlling shareholders rarely have other large shareholders.²²⁰

The lack of separation of ownership and control in supposedly public companies is particularly worrisome since that is the foundation of corporate governance law in the first place.²²¹ Derivative suits are an effective way to apply some brakes to boards and controlling shareholders, reducing their abuse of minority shareholders.²²² Rather than waiting for each nation to implement a strong, functional system²²³ that foreign investors may not be able or wish to access,²²⁴ IIA can provide some protection now to international

tional law in several respects. First, unlike customary international law, international investment law does not principally derive its authority from the measure of 'consistent State practice' and *opinio juris*." Ryan, *supra* note 120, at 66.

²²⁰ Farrar, *supra* note 204, at 943–44 (citing a working paper later published as Rafael La Porta et. al., *Corporate Ownership Around the World*, 54 *J. Fin.* 471, 471 (1999)).

²²¹ *Id.* at 944 ("Much of modern corporate governance theory has been premised on the Berle and Means hypothesis of the separation of ownership and control."); see also Adolf A. Berle & Gardiner C. Means, *The Modern Corporation and Private Property*, at xi (1968).

²²² See Shleifer & Vishny, *supra* note 190, at 738, for the importance of corporate governance mechanisms.

²²³ But the writer cautions against adopting American-style corporate law provisions uncritically. Farrar, *supra* note 204, at 944.

²²⁴ See Michael Trebilcock & Jing Leng, *The Role of Formal Contract Law and Enforcement in Economic Development*, 92 *Va. L. Rev.* 1517, 1574 (2006) ("[C]ountries

investors around the world, especially as multinational investment continues to grow.²²⁵

Many have been calling for the implementation of such law nation-by-nation. “Sir Ronald Hampel, who chaired one of the recent UK committees, has said: ‘I believe an umbrella set of governance principles internationally would be helpful, within which it would be possible for national environments and companies to develop detailed governance structures appropriate to their circumstances.’”²²⁶ It is not hard to see that international investment law can help in this process and provide backup remedies where the process fails.²²⁷ If derivative doctrine comes under consideration by international jurists, other reforms based on American corporate law could be considered at the same time.²²⁸

E. Methods of Implementing Derivative Doctrine

1. Class Actions

Modification of a multilateral treaty such as ICSID could certainly import class actions into IIA, but treaty modification is a slow and laborious process. Many nations might also wish to see how IIA class actions work in practice before committing themselves to them wholesale.

There is a simpler solution. Any country, perhaps one facing or fearing a multiplicity of related claims, could sign or modify a BIT with another country requiring mandatory claim consolidation. Because of MFN clauses, class actions could then become available to

with poorer investor protection, measured by both the character of legal rules and the quality of legal enforcement, have smaller and narrower capital markets; this is particularly evident when minority shareholders are subject to serious agency costs (opportunism) by managers or controlling shareholders.”).

²²⁵ This protection is surely needed. See Farrar, *supra* note 204, at 944.

²²⁶ *Id.* at 953 (citing *Company Director (Australia)*, Feb. 1999, at 16).

²²⁷ There are other, ancillary problems that could be mitigated by a more efficient, if less flexible, international arbitration system. Menkel-Meadow, *supra* note 20, at 345.

²²⁸ There is an alternative to treaty modification, but it would be a radical one in this case. See Bishop et al., *Sources of “Non-National” Law: The Lex Mercatoria, in Foreign Investment Disputes*, *supra* note 3, at 733 (“An alternative route to . . . investment protection is the adoption of some version of substantive private law on a transnational basis—something which is not international law but which, like international law, escapes from the sovereign control of the host state. This . . . often goes under the label ‘*lex mercatoria*.’”).

all private investors of any nation that has a BIT with that country if tribunals interpret MFNs in that way (recall that tribunals' interpretation of MFNs has not reached a consensus). In any case, class actions could be included in BITs whenever and however pairs of nations saw fit, and if the results were on balance positive, the concept should spread.

When different shareholders have different rights regardless of the use or non-use of MFN clauses, class actions can still be feasible following one of the approaches that courts have chosen to govern American multistate tort actions.²²⁹ For example, one body could hear consolidated claims arising from the same facts but apply different legal standards to different subgroups of plaintiffs and award differing relief as appropriate.

Tribunals could begin implementing class actions on their own when BIT language does not preclude them, but this may be too radical a step to take without the permission of political authority.²³⁰

2. IIA Derivative Suits

Since expanding IIA into regulating private-to-private disputes—that is, disputes between host nation corporate boards and foreign investors—is outside its public-private arbitration role,²³¹ IIA should be restricted to arbitrating claims that host govern-

²²⁹ In a typical American multistate tort action, one plaintiff suffers harm in more than one state, but the states have different legal rules governing the tort claim. A court must sort out what the defendant or defendants are liable for under each state's laws or choose to apply one state's law. This most often arises when libelous material is distributed in more than one state. For a brief introduction to the concept and to the different approaches taken by courts, see E.H. Schopler, Comment Note—Conflict of Laws with Respect to the “Single Publication” Rule as to Defamation, Invasion of Privacy, or Similar Tort, 58 A.L.R.2d 650 (2011).

²³⁰ Domestic courts might even be able to throw out arbitral awards if tribunals began recognizing derivative doctrine on their own. Matthias Scherer, *The Recognition of Transnational Substantive Rules by Courts in Arbitral Matters, in Towards a Uniform International Arbitration Law?*, supra note 178, at 91, 93 (“Courts may have to review the substance of an award in relation to transnational rules if the award is based only on such rules, rather than on a given statute or law.”).

²³¹ Other treaties allow for private-to-private arbitration and could be used as an alternative basis.

ments are not enforcing the fiduciary duties of corporate boards to foreign investors.²³²

At least two preexisting substantive protections could be used to accommodate claims that host governments are not doing enough to protect foreign minority shareholders from corrupt or lax corporate boards: fair and equitable treatment (“FET”) and full protection and security (“FPS”). The elasticity of these protections, and the clear unfairness and inefficiency of allowing corporate boards and often the controlling shareholders that dominate them to exploit minority shareholders, make any one of them a reasonable place to locate minority shareholder protection.²³³

For example, FPS requires governments to police those over whom they have authority.²³⁴ It would need to be restricted, however, to clearly defined circumstances involving egregious failure by governments to protect minority shareholders, in order to prevent a rash of claims every time a minority shareholder felt maltreated. Nor should minority shareholders expect IIA derivative actions to be a panacea, but rather a remedy for the worst excesses and a potential impetus for governments concerned about risking IIA claims.²³⁵ Those governments’ inclinations otherwise may be to allow domestic corporate boards to exploit foreign minority shareholders.

²³² Though rooted in fiduciary duties, which would be new to IIA, the latter would still conform to the treaty-based public-private model. “Such arbitrations are sometimes referred to as ‘direct recourse arbitrations,’ because the investor seeks direct recourse against the State in respect of its own allegedly wrongful conduct affecting the investment—or ‘arbitration without privity,’ because there is no necessary contractual relation between the respondent State and the investor.” Bishop et al., *Applicable Substantive Law: Options for the Applicable Law, in Foreign Investment Disputes*, supra note 3, at 690.

²³³ For a description of how tribunals have employed these evolving standards, see McLachlan, supra note 47, at 226–50.

²³⁴ See supra Section I.A.

²³⁵ For an influential discussion of the value and limitations of derivative actions in the United States, see Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 Va. L. Rev. 247, 309–15 (1999).

*F. Other Arguments Against Adoption of Derivative Doctrine**1. Perceived Disparity of Rights Across Foreign Nationalities in BITs*

Because BITs tend to grant the same substantive rights and also contain MFN clauses often interpreted to grant the same rights to all foreign investors by allowing a foreign investor to use the language most favorable to it in any BIT ratified by the host nation, it is increasingly rare for investors from different nations who are invested in the same enterprise to have differing rights when it comes to any particular claim.²³⁶ These clauses help create “uniformity in international investment relations and in implementing multilateralism despite the apparent fragmentation of investment treaties into a myriad number of bilateral treaties,” and these “most-favored-nation (MFN) clauses . . . are regularly incorporated in BITs.”²³⁷ Since the “MFN clauses oblige the State granting MFN treatment to extend to the beneficiary State the treatment accorded to third States in case this treatment is more favorable than the treatment under the treaty between the granting State and the beneficiary State,” they “break with general international law and its bilateralist rationale that, in principle, permits States to accord differential treatment to different States and their nationals and instead ensure equal treatment between the State benefiting from MFN treatment and any third State.”²³⁸ MFNs have been found to apply to significant procedural differences, which are rare in any case.²³⁹ BITs sometimes exclude certain industries or otherwise carve out some international investors from protection, but in such cases those investors cannot press claims and IIA does not apply to them.

²³⁶ Schill, *supra* note 121, at 499 (“[U]nlike genuinely bilateral treaties that order two-party relationships only, BITs do not stand isolated in governing the relation between two States. Rather, they develop multiple overlaps and structural interconnections that result in a relatively uniform and treaty-overarching regime for international investments.”).

²³⁷ *Id.* at 501.

²³⁸ *Id.* at 502.

²³⁹ See, e.g., *Emilio Agustín Maffezini v. Kingdom of Spain*, ICSID Case No. ARB/97/7, Decision of the Tribunal on Objections to Jurisdiction, ¶ 56 (Jan. 25, 2000).

Though the interpretation described above is not yet universal, MFN clauses themselves are nearly universal, included “almost ubiquitously in the more than 2,600 modern international investment agreements—mostly bilateral, but also some regional—concluded between states at dizzying rates particularly since the 1990s.”²⁴⁰ They serve as a partial substitute for comprehensive IIA reform just as derivative doctrine would. Since attempts to reach “multilateral agreement on investment have repeatedly failed—largely due to the opposition of developing countries and public interest groups within developed countries—MFN clauses . . . serve to level the playing field between foreign investors operating under different bilateral investment treaties (BITs) and regional investment treaties.”²⁴¹ Some have disputed MFN clauses’ ability to grant jurisdiction, as opposed to substantive and procedural rights once jurisdiction is found, but this is a result not of MFN clauses’ language but of the “interpretive approach” taken by each tribunal,²⁴² and this anomaly could be rectified by arbitrators consistently choosing the most permissive approach or by including the permissive approach in future BIT language or in ICSID treaty modification. In any case, remaining differences seem headed for extinction: “[I]nternational investment protection is developing into a uniform governing structure for foreign investment based on uniform principles with little room for insular deviation.”²⁴³

2. *Germans Do Not Use It*

It is true that derivative suits are not necessary for a successful corporate governance system. The German model is often looked to as one that rivals America’s in success, but “[m]inority shareholder activism in the form of shareholder suits is virtually nonexistent in Germany. Individual investors, distrustful of the stock markets, own only 7% of stock in German companies.”²⁴⁴

²⁴⁰ Julie A. Maupin, *MFN-Based Jurisdiction in Investor-State Arbitration: Is There Any Hope for a Consistent Approach?*, 14 *J. Int’l Econ. L.* 157, 158 (2011).

²⁴¹ *Id.* at 158–59.

²⁴² *Id.* at 161.

²⁴³ Schill, *supra* note 121, at 499.

²⁴⁴ Kissane, *supra* note 187, at 652.

The American model seems better suited for international investment law than the German.²⁴⁵ Germany is a relatively homogeneous nation culturally, racially, and linguistically, with a low level of corruption and a large, activist, well-organized corporatist state. Like the United States, the world covered by international investment law is highly diverse culturally, racially, and linguistically. The world has greatly varying levels of corruption in different areas and with many developing nations that host investments without well-organized governments with strong regulatory systems. Derivative actions are a way to allow some measure of initiative to private actors where public initiative is lacking and to provide access to generally honest, informed international arbitrators.

Derivative actions suit a more contentious and competitive business culture, the sort of culture that is taking over IIA, lamentable as some may find this. “[M]any commentators have noted that American litigation processes are transforming European and civil law traditions in international arbitrations, choking them with discovery, motions, and other adversarial practices, like cross-examination and other proceedings that are said to be displacing European actors (both lawyers and arbitrators) with Americans,” and this transformation is occurring across the board: “[A]lthough intended to be ‘alternative’ international bodies for dispute settlement, the ICSID and WTO are also said to be looking more and more like American-style adjudicative fora, rather than international arbitral or even mediative bodies.”²⁴⁶ In addition, if encouraging more portfolio investing is a goal, Germany’s lack of derivative actions argues against the effectiveness of its system since it has so few individuals invested in its stock market.

3. *Loss of Cultural Identity*

Some fear a loss of cultural identity as yet more American innovations spread overseas.²⁴⁷ “Prominent authors go as far as considering that it is unfeasible to import rules from a system pertaining to the Common Law tradition into a Civil Law system, due to an

²⁴⁵ Strictly speaking, class actions do not exist in Germany, and collective action suits face severe restrictions. Rhonda Wasserman, *Transnational Class Actions and Inter-jurisdictional Preclusion*, 86 *Notre Dame L. Rev.* 313, 348–49 (2011).

²⁴⁶ Menkel-Meadow, *supra* note 20, at 340–41.

²⁴⁷ Reyes, *supra* note 202, at 210.

assumed lack of compatibility between them.”²⁴⁸ Latin America in particular had been thought resistant to Anglo-American corporate law because “certain Latin American social, religious and cultural values are antagonistic to those prevailing in Common Law jurisdictions [A] legal institution that works properly within the individualistic and protestant philosophy will not be equally useful in countries characterized by a gregarious and cooperative behavior.”²⁴⁹ But, for good or for ill (and probably a mixture of both), Anglo-American corporate law continues its ascendance anyway. “The triumphal arrival of the Common Law in Latin America is not less overwhelming than that of the very language in which it has expressed itself since medieval times.”²⁵⁰ If developing nations want the advantages of more investment and the eventual achievement of American levels of prosperity and economic dynamism, some additional adoption of aspects of American legal and economic culture may be inevitable.²⁵¹

CONCLUSION

First, just as derivative doctrine has played a positive role in American corporate law, the solution or mitigation of the specific problems caused by the direct and indirect claims doctrine by its replacement with IIA derivative doctrine would reduce litigation and improve fairness and predictability for developing world host nations. Market efficiency would improve as streamlining and greater uniformity decrease distortions of the marketplace. Efficiency would also improve as less active minority shareholders see less need to avoid countries without strong domestic protections

²⁴⁸ Id.

²⁴⁹ Id. It may be useful to keep in mind that Catholic Venice invented capitalism, albeit with a much more communitarian spirit. For the latest scholarship, see Jean-Claude Barreau, *Un Capitalisme à Visage Humain: Le Modèle Vénitien* (2010).

²⁵⁰ Reyes, *supra* note 202, at 213. Part of Anglo-American law’s successful spread is linguistic. The “supremacy of the English language in the academic scenario is an aspect that must not be overlooked The establishment of [English] as the new *Lingua Franca* is probably the single most significant contribution for the propagation of the Common Law institutions in Continental Europe and elsewhere.” Id. There is no reason to think this trend will not continue.

²⁵¹ “In the field of Private Law, this dissemination of Anglo-Saxon legal institutions is also linked to the preeminent scholar[ly] works of the so-called Law and Economics movement.” Id. at 213–14.

for minority shareholders because IIA would push host governments to supply those protections while providing remedies when governments fail to do so. Most important, with some developing nations threatening to withdraw from the international investment law system and rumblings coming from developed countries,²⁵² the improved fairness provided by derivative doctrine could help rescue international investment law from its current crisis.²⁵³

Second, increased protection for portfolio investors through IIA derivative actions could circumvent a future international portfolio investment crisis. This increased protection may be necessary to attract more portfolio investment into those developing nations that need it, benefiting both the investors and the host nations' residents. IIA derivative suits would serve shareholders and lead to the regulation of corporate boards more efficiently.

And last, international investment law has tremendous potential to continue the encouragement of investment and development in the countries that need it most, as well as to facilitate the global flow of capital to where it promotes economic growth best. It is a system worth saving as long as globalization exists. "Investment arbitration is not simply a means of resolving disputes. It has been called the only existing example of 'global administrative law' and the adjudicatory mechanism for a new international 'constitutionalism.'"²⁵⁴

²⁵² "In May 2007, Bolivia became the first country to denounce the ICSID Convention . . ." Menaker, What the Explosion of Investor-State Arbitrations May Portend for the Future of BITs, *in* *The Future of Investment Arbitration*, supra note 4, at 157. Ecuador has restricted the disputes it will allow ICSID to hear. It remains to be seen if Argentina will pay the many claims it has lost. *Id.* at 161–62.

²⁵³ As threatening to liberty and diversity as it may be, if we are to have a global system in some area, that area will need some form of global governance. "As Slaughter indicates, one could produce almost endless examples from the global economy, the environment, global organized crime, terrorism, and so on. These problems suggest a need for global governance." Kenneth Anderson, Squaring the Circle? Reconciling Sovereignty and Global Governance Through Global Government Networks, 118 *Harv. L. Rev.* 1255, 1256 (2005) (reviewing Anne-Marie Slaughter, *A New World Order* (2004)).

²⁵⁴ Catherine A. Rogers & Roger P. Alford, The Adequacy of Existing Rules for Investor-State Arbitration, *in* *The Future of Investment Arbitration*, supra note 4, at 1.

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