

**Comments and reform proposals with regard to Draft provision 10  
(Shareholder claims)  
of UNCITRAL Secretariat note on Possible reform of Investor-State  
dispute settlement (ISDS): Draft provisions on procedural and cross-  
cutting issues, A/CN.9/WG.III/WP.231**

**Individual Investor/Shareholder Claims and  
Derivative Claims on behalf of an Enterprise in ISDS**

January 2024

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## 1. Introduction

1. This comment addresses the issues in Draft provision 10 on Shareholder claims in the UNCITRAL Secretariat note on Possible reform of investor-State dispute settlement (ISDS): Draft provisions on procedural and cross-cutting issues, A/CN.9/WG.III/WP.231.<sup>1</sup>
2. Draft provision 10 provides for both (i) claims by an investor in an enterprise on its own behalf (individual claims); (ii) investor claims on behalf of an enterprise (derivative claims).
3. Draft provision 10 includes both types of claims under the same heading. In the approach below, the requirements for individual claims and a derivative claim are set out in separate draft provisions, for reasons set out below.
4. Like Draft provision 10, the draft individual claims provision below requires direct loss for claims. The provision below, however, is drafted as a clarification. A significant range of governments have interpreted their existing treaties as excluding reflective loss claims, with limited success in ISDS. Direct loss is defined with more detail than in Draft provision 10 and some additional aspects are addressed.
5. The separate provision on derivative claims below provides for broader availability of such claims than in Draft Provision 10. This is in accordance with general investment treaty practice on derivative claims. At the same time, the provision is presented as a distinct provision for separate consideration.
6. This introduction first explains the use of the terms “investor” and “enterprise” in the provisions, and their relationship to the frequent focus on “shareholders” and “companies” in policy discussions. It also explains the rationale for a separate provision on derivative claims. The comment then sets out (i) a draft clarification on the Direct Loss requirement for individual claims; and (ii) a draft derivative action provision. Each is followed by commentary.
7. Both governments at the OECD and the Working Group have engaged in previous analysis and discussion of the issues addressed in Draft provision 10.<sup>2</sup> This comment refers in particular to the 2021

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<sup>1</sup> This note has been prepared by the OECD Secretariat. Contact: [david.gaukrodger@oecd.org](mailto:david.gaukrodger@oecd.org). The views expressed herein are those of the author and do not necessarily reflect the views of the OECD or of governments that participate in OECD-hosted dialogue on international investment policy. It cannot be construed as prejudging ongoing or future negotiations or disputes arising under investment treaties. This document and any map included herein are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.

<sup>2</sup> See UNCITRAL Secretariat note on shareholder claims and reflective loss (A/CN.9/WG.III/WP.170), available at <https://undocs.org/en/A/CN.9/WG.III/WP.170>; David Gaukrodger, [Shareholder Claims for Reflective Loss in Investment State Dispute Settlement: A “Component-by-Component” Approach to Reform Proposals](#), OECD Informal Discussion Paper (Dec. 2021).

See OECD, “The impact of investment treaties on companies, shareholders and creditors” in OECD Business and Finance Outlook 2016; OECD Working Papers on International Investment by David Gaukrodger (Investment Treaties as Corporate Law: Shareholder Claims and Issues of Consistency (2013/03), Investment Treaties and Shareholder Claims for Reflective Loss: Insights from Advanced Systems of Corporate Law (2014/02) and Investment Treaties and Shareholder Claims: Analysis of Treaty Practice (2014/03)), all available at <https://www.oecd.org/daf/inv/investment-policy/oecdworkoninternationalinvestmentlaw.htm>.

Informal Discussion Paper by the OECD Secretariat discussed in an informal UNCITRAL meeting in December 2021 (hereinafter the “Informal Discussion Paper”).<sup>3</sup> Explanatory diagrams derived from previous work are included in Annex A.

### 1.1. Investor/shareholders and enterprise/company

8. Shareholders have brought the vast majority of claims for reflective loss in ISDS and domestic law. Much of the policy discussion, including at the OECD and UNCITRAL, has addressed shareholders and companies. The 2021 Informal Discussion Paper referred to shareholders. Derivative actions are also generally brought by shareholders of companies (on behalf of the company).

9. However, similar issues may arise with claims by investors with investments in other types of entities. To address these broader contexts, many investment treaties refer instead to investors and enterprises. Both Draft provision 10 and the provisions below follow this approach.

10. Investment treaties that refer to enterprises often define the term, making clear that it refers to a range of entities including companies or corporations. A typical definition is as follows:

**enterprise** means an entity constituted or organised under applicable law, whether or not for profit, and whether privately or governmentally owned or controlled, including a corporation, trust, partnership, sole proprietorship, joint venture or other association.

11. While this broader approach is advisable, it may be useful to bridge the gap with the many policy discussions referring to shareholders of companies. In addition, as noted, the shareholder/company context dominates in practice. For convenience, the explanatory text below occasionally refers to investor/shareholder or the enterprise/company. Some governments have done the same in submissions in ISDS.<sup>4</sup> This is solely for explanatory purposes and should not be understood to affect the definition of investor or enterprise.

### 1.2. A separate article for derivative claims

12. There are several reasons to set forth an article on derivative claims separately from the requirement of direct loss for individual claims. First, the two provisions address claims on behalf of different economic interests. A claim by an investor/shareholder provides a remedy that only benefits that claimant (and its owners). In contrast, a derivative claim on behalf of the enterprise provides a remedy that

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For summaries of inter-governmental discussions, see OECD Roundtable on Freedom of Investment 19 (15–16 October 2013) – Summary of the Roundtable discussions, available at <https://www.oecd.org/daf/inv/investment-policy/19thFOIroundtableSummary.pdf>; see also summary of the OECD Roundtable on Freedom of Investment 18 (20 March 2013), available at <https://www.oecd.org/daf/inv/investment-policy/18thFOIroundtableSummary.pdf>.

See Webinar on Shareholder Claims and Reflective Loss (July 2020), programme and presentations at <https://uncitral.un.org/en/shareholderclaimswEBinar>; video at <https://www.youtube.com/watch?v=EcMPWdZns3A&feature=youtu.be> (hereinafter “Joint Webinar on Reflective Loss”).

See Julian Arato, Kathleen Claussen, Jaemin Lee & Giovanni Zarra, [Reforming Shareholders Claims in ISDS](#) (2019).

<sup>3</sup> See David Gaukrodger, [Shareholder Claims for Reflective Loss in Investment State Dispute Settlement: A “Component-by-Component” Approach to Reform Proposals](#), OECD Informal Discussion Paper (Dec. 2021).

<sup>4</sup> *GAMI v. Mexico*, Submission of the United States (non-disputing party) (30 June 2003) §§ 11-12 (referring to “investor/shareholders”).

benefits all investors and constituents in an enterprise. Second, because the two beneficiaries differ, different types of investment are promoted by the two rules.

13. Third, clarifying that direct loss is required restores a rule that is applied universally in domestic law around the world. It is also applied in general international law at the ICJ. In contrast, the form of derivative action mechanism used in modern investment treaties is practically unique to ISDS and is designed to address a particular context. Fourth, a clarification may suffice to address reflective loss given the absence of express treaty text on the issue. In contrast, introduction of a derivative action in treaties that do not provide for one would generally require a treaty amendment.

14. Fifth, a range of governments have opposed reflective loss claims under investment treaties without a derivative action. Thus, while some governments may wish to combine a clarification that reflective loss is excluded with inclusion of a derivative action, others may seek a different approach.

15. Treatment of the two different claims in separate provisions also facilitates discussion of important aspects of different claims in manageable provisions.

## **2. First clarification/provision: an investor in an enterprise can only bring on its own behalf claims for its Direct Loss**

### **Article 100. Definition**

**enterprise** means an entity constituted or organised under applicable law, whether or not for profit, and whether privately or governmentally owned or controlled, including a corporation, trust, partnership, sole proprietorship, joint venture or other association;

### **Article 101. Claims by investors in enterprises claiming on their own behalf**

For greater certainty,

1. A covered investor claiming on its own behalf in relation to an investment in an enterprise may only claim for Direct Loss. It must demonstrate Direct Loss in addition to the existence of an applicable treaty obligation.
2. For a claim to be for Direct Loss, the covered investor's claimed injury must be separate and distinct from any alleged injury to an enterprise in which it has invested. A diminution in the value of a shareholding or investment in the enterprise, or in distributions to investors from the enterprise, which is the result of a loss suffered by the enterprise, is not injury which is separate and distinct from the damage suffered by the enterprise.
3.
  - a. The requirement of Direct Loss is not satisfied by the fact that a respondent state allegedly has a treaty obligation to the covered investor or that the alleged obligation may have a different basis than an obligation to the enterprise.
  - b. To the extent if any that the treaty may apply to claims for loss of opportunity, once an enterprise is constituted, the loss of an opportunity to conduct business activities carried out or expected to be carried out by the enterprise cannot constitute Direct Loss for a covered investor in the enterprise.
4. Notwithstanding art. 101(1), when a Contracting Party directly expropriates all the assets of an enterprise, a covered investor in the enterprise can claim for its reflective loss incurred as a result of the expropriation.
5. The respondent shall have the power to obtain a decision on a preliminary objection that the covered investor in an enterprise has not demonstrated that it satisfies the requirements of art. 101 or art. 104. The respondent may also raise the scope of recoverable losses during the merits or remedies phase of a proceeding. Where the issue is raised belatedly without justification, the adjudicators may award costs.
6. Decisions and awards shall clearly distinguish between different enterprises, and between investors and enterprises.

### 3. Commentary on the first provision

16. The provision is set out as a clarification for several reasons. As noted in the 2021 Informal Discussion Paper, a broad range of governments from different economies have opposed reflective loss claims in ISDS, often without success. The clarification aligns treaty interpretation with those views. The clarification also aligns ISDS with other law. There is also no textual barrier to the clarification; investment treaties generally do not address the scope of damages for which investors in enterprises can claim.<sup>5</sup> Governments that agree that the provision would modify their existing treaty could omit the reference to the clarification and adopt the provision as an amendment.

#### 3.1. Retention of the requirement of Direct Loss for claims by an investor/shareholder on its own behalf

17. Like Draft provision 10(1), art. 101 requires Direct Loss for claims by an investor/shareholder on its own behalf.

18. The many arguments in favour of a direct loss requirement have been examined over the 10 years since governments at the OECD began consideration of shareholder claims in 2013. UNCITRAL Secretariat working paper 170 observes that the current availability of shareholder claims for reflective loss in ISDS is closely linked with several concerns identified by the Working Group that deserve reforms.<sup>6</sup> These concerns related to claims for reflective loss include the increased number of cases and multiple proceedings in ISDS; the cost and duration of ISDS proceedings; the lack of consistent outcomes and interpretations; and double recovery, possibly leading to excessive damages. The note also pointed out that permitting reflective loss claims can distort corporate law and finance. It took note that these elements relating to shareholder claims for reflective loss could contribute to undermine the predictability and legal certainty for States, investors and shareholders alike, potentially leading to increases in cost of ISDS. It also noted that they may in particular have a negative impact on the predictability of the ISDS system from the respondent State's perspective, as it is difficult to assess whether there would be any additional claims and who the claimants might be.

19. These problems and others generated by reflective loss claims were also identified in work by governments at the OECD. Governments opposing reflective loss claims have underlined that allowing reflective loss claims by some investors harms other investors, and can be expected to lower overall investment:

Awarding damages to shareholders for losses incurred by enterprises undermines one of the most fundamental rules of corporate law in all three NAFTA Parties. Allowing shareholders to recover reflective losses under Article 1116 will weaken the corporation's separate legal personality, create unpredictability for investors, creditors, banks, and others

<sup>5</sup> For convenience, the provision is at time referred to below as setting out rules without repeating that it is a clarification.

<sup>6</sup> As noted in UNCITRAL Secretariat note, shareholders incur "reflective loss" through an injury to "their" company. [cite] An injury to a company typically leads to a loss in the value of shares in the company. It is a reflective loss because it is due to the company injury. Reflective loss is thus distinct from direct loss.

who participate in the foreign direct investment market, create unfair conditions of competition among these different sorts of investors, and hence, inevitably decrease the opportunities for investment in the NAFTA Parties.<sup>7</sup>

20. In contrast to the many costs associated with reflective loss claims, no policy reason has been identified in favour of the current approach in ISDS generally allowing reflective loss claims.<sup>8</sup> While claimants benefit and the number of ISDS cases expands, other investors lose and governments face increased costs.

21. The 2021 Informal Discussion Paper noted that many governments have interpreted their investment treaties to bar reflective loss claims but have not been successful in ISDS on the point. A clarification that direct loss is required will be of particular assistance to those governments and to others with similar views.

### 3.2. Other characteristics of the rule

22. Like Draft Provision 10, the provision is a loss-based rule. Direct Loss for an investor in an enterprise is defined as loss that is separate and distinct from enterprise injury. Direct Loss can form the basis of a claim by an investor in an enterprise. The definition of Direct Loss by reference to the loss at issue and its relationship to enterprise losses is derived from leading cases and analysis in common law and civil law jurisdictions.<sup>9</sup> Governments have also defined direct loss in similar terms in ISDS.<sup>10</sup> A focus

<sup>7</sup> *Clayton v. Canada*, [Canada's Counter-Memorial on Damages](#) (9 July 2017) para. 26.

<sup>8</sup> See UNCITRAL Secretariat Working Paper 170, para. 12 (noting finding of a “lack of an identifiable policy rationale for the general acceptance of reflective loss claims under investment treaties”) (citation omitted).

<sup>9</sup> See, e.g., “Dubai-Fall”, BGH 10 November 1986, WM 1987 13) (German Supreme Civil Court); Cour de cassation, chambre criminelle, Nos. 97-80664, 99-80387, 99-84855 (13 Dec. 2000) (three decisions) (French Supreme Civil Court); *Sevilleja v Marex Financial Ltd.*, [2020] UKSC 31 (UK Sup. Ct.); *Brunette v. Legault Joly Thiffault, s.e.n.c.r.l.*, 2018 SCC 55 (Canadian Sup. Ct.); *Kauffman v. Dreyfus Fund, Inc.*, 434 F.2d 727, 732 (3d Cir. 1970) (emphasis added) (citations omitted), leave to appeal (cert.) denied, 401 U.S. 974 (1971), quoted in *In re Dein Host, Inc.*, 835 F.2d 402 (1st Cir., 1987); *Starr Int'l Co. Inc. v. United States*, 856 F.3d 953 (Fed. Cir. 2017) (“We conclude that Starr and the shareholders represented by Starr lack standing to pursue the equity-acquisition claims directly, as those claims belong exclusively to [the company]”), leave to appeal (cert.) denied, (U.S. 26 Mar. 2018), <https://www.supremecourt.gov/search.aspx?filename=/docket/docketfiles/html/public/17-540.html>.

<sup>10</sup> See *Clayton v. Canada*, [Canada's Counter-Memorial on Damages](#), para. 34 (“The [shareholder] Claimants have not met their burden under Article 1116 to demonstrate the loss or damage they incurred as investors, separate and distinct from the alleged losses of their enterprise, Bilcon of Nova Scotia. As such, their claim for compensation in their Memorial must be dismissed.”); see also *Alicia Grace v. United Mexican States*, [Non-disputing Party Submission of the Government of Canada Pursuant to NAFTA Article 1128](#) (24 Aug. 2021), p. 8, footnote 25 (“A claim is direct if it concerns treatment of and loss by the shareholder that is separate and distinct from the treatment of the enterprise itself.”); *Legacy Vulcan v Mexico*, Non-Disputing Party Submission of the Government of Canada Pursuant to NAFTA Article 1128 (7 June 2021), para. 29, footnote 28 (“A claim is direct if it concerns treatment of and loss by the shareholder that is separate and distinct from the treatment of the enterprise itself. On the other hand, a claim is derivative if the shareholder was affected simply as a consequence of the treatment of the corporation. In the latter case, a shareholder does not have any independent right of action under international law with respect to reflective losses it may have suffered as a result of the treatment of the corporation.”); see also *GAMI v. Mexico*, [Submission of the United States](#) (non-disputing party) (30 June 2003) §§ 11-12, 14 (describing customary international law as a loss-based rule); id, [Escrito de Contestación of Mexico](#), p. 63 n.158 (24 Nov. 2003) (quoting and agreeing with US submission).



on the nature of the loss focuses the inquiry on a relatively straightforward economic inquiry about the relationship of the alleged claimant loss to enterprise/company loss. The determination of whether loss is Direct Loss can often be made at an early stage.

23. The clarification is a “bright line” rule. Investor/shareholder claims for reflective loss are excluded as a matter of law. Adjudicators must decide if the investor/shareholder has established Direct Loss. If not, there is no basis for an individual investor/shareholder claim. Adjudicators do not have discretion in applying the rule.

24. The provision sets out two clarifications of the meaning of Direct Loss that are not included in Draft provision 10. The first states that an investor/shareholder right or cause of action -- or an alleged obligation or duty owed to an investor/shareholder -- is generally not sufficient for a claim in the absence of Direct Loss. It also clarifies that possible differences between the treaty cause of action and the enterprise claim are irrelevant to the loss-based rule. The clarification reflects the general approach to the requirement of direct loss in domestic law.<sup>11</sup>

25. The second clarification addresses the approach of the ISDS tribunal in *Clayton v. Canada*.<sup>12</sup> In *Clayton*, a company applied for environmental approval of a project. The company’s application was denied. The tribunal found that shareholder reflective loss claims are barred under NAFTA, a first in ISDS. However, the tribunal then found that an “opportunity” to obtain a satisfactory procedure for the approval request was lost not by the company that sought the regulatory approval, but only by a group of companies all controlled by the claimant controlling shareholders.<sup>13</sup> The result was that the shareholders could recover themselves essentially in the same manner as if reflective loss claims had been permitted.<sup>14</sup> The tribunal did not cite law or precedent on its approach to the character of the loss. A clarification is warranted because the tribunal’s approach could open up risks that a range of reflective loss could be recharacterised as Direct Loss, negating the effect of the direct loss requirement, with limited scope for review under current law.<sup>15</sup>

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<sup>11</sup> See, e.g., Victor Joffe et al., *Minority Shareholders*, (3d ed. 2009) §§ 1.151-152 [(“The no reflective loss principle is not concerned with barring causes of action as such, but with barring recovery for certain types of loss. ... It is irrelevant that the duties owed by the defendant to the company and to the claimant may be different in content.”) (citations omitted)].

Some courts have distinguished cases in which a shareholder has a commercial contract with the third party that injures the company. The provision addresses treaty-based claims and does not address shareholder-government contracts.

<sup>12</sup> *Clayton v. Canada*, Award on Damages (10 Jan. 2019).

<sup>13</sup> The lost opportunity was also at times described as an opportunity to invest rather than an opportunity to obtain a satisfactory procedure. Domestic courts have rejected shareholder efforts to recharacterise their reflective loss as a “loss of opportunity”. See, e.g., *Rivers v. Wachovia Corp.*, 665 F.3d 610 (4th Cir. 2011) (rejecting a shareholder effort to disguise a classic claim for a decline in the value of shares as a “lost profit opportunity” as “too clever by half”).

<sup>14</sup> See Sylvie Tabet (General Counsel, Trade Law Bureau, Government of Canada), Shareholder Reflective Loss (undated) (power point presentation given at the Joint Webinar on Reflective Loss, slides 18-19 (stating that the *Clayton* tribunal failed to apply the rule that shareholders can only bring claims for direct damages properly), available at [https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/tabet\\_english.pdf](https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/tabet_english.pdf); see also Joint Webinar on Reflective Loss, available at <https://www.youtube.com/watch?v=EcMPWdZns3A&feature=youtu.be>.

<sup>15</sup> See *Kappes v. Guatemala*, Decision on Respondent’s Preliminary Objections (13 Mar. 2020), paras. 160-61 (noting but not deciding claims by shareholders that even if claims for reflective loss are impermissible, they could still recover under the *Clayton* approach to direct damages because “[l]ike the claimants in *Clayton*, Claimants here have lost their opportunity to develop the Tambor project, which was an opportunity of theirs rather than of [the company]”).

26. The clarification takes no position on whether claims for lost opportunities are possible under any investment treaty. If they are, it clarifies that, once a company is constituted, the loss of an opportunity to conduct business activities carried out or expected to be carried out by the company cannot constitute Direct Loss for a covered shareholder of the company.

27. The rule refers to inclusion of a respondent government power to obtain a ruling on a shareholder claim for reflective loss at a preliminary stage. Many of the leading cases in the field have terminated reflective loss claims at a preliminary stage. This results in substantial cost savings and can dissuade meritless claims.

28. The rule includes an instruction to adjudicators to distinguish clearly between different enterprises and between investors in an enterprise and the enterprise. As noted above, there has been confusion in this area in ISDS cases. A direction for adjudicators to distinguish between companies and their shareholders can help resolve whether claims involve Direct Loss. It can also facilitate the resolution of derivative claims, addressed further below.

### 3.3. Direct expropriation of all assets of the enterprise

29. A government may directly expropriate shareholders of an enterprise by taking their shares. Such action causes Direct Loss to shareholders who lose their shares.

30. A government may also directly expropriate an enterprise by appropriating all of its assets. The enterprise suffers Direct Loss: it no longer owns the assets that the government has appropriated. It normally has a claim for expropriation of its assets if compensation is insufficient. Shareholder/investors in the enterprise also suffer a loss equivalent to a loss from a taking of their shares, but it arises from the enterprise loss of its assets. The shareholder/investor loss is not separate and distinct from the enterprise loss. It does not constitute Direct Loss under the definition in art. 101(2).<sup>16</sup>

31. Article 101(4) establishes the direct expropriation of all of the assets of an enterprise as an exception to the requirement for Direct Loss for individual shareholder claims. Covered shareholder/investors in the enterprise are exceptionally permitted to claim for their reflective loss where their economic loss is equivalent to a loss of their shares. The direct expropriation of all assets of an enterprise is relatively rare. The claim is not available in cases of indirect expropriation.

32. This exception may give rise to possible multiple claims for the same injury to the enterprise. The enterprise may claim and different covered shareholders may claim. However, the government has appropriated all of the value of the enterprise in this context which may make it difficult or impossible for the enterprise to claim.

Draft provision 10 takes a different approach. It provides for a derivative claim by a covered controlling shareholder on behalf of the enterprise rather than individual shareholder claims in this context. See Draft provision 10, art. 10(2)(a). This would limit claims in this context to foreign controlling shareholder/investors in foreign-controlled enterprises. A derivative claim is preferable in this context to allow all corporate constituencies to benefit; the derivative action below would be available. However, investor/shareholders who have lost all value of their investment may need individual protection if there is no derivative claim provision or no foreign controlling investor/shareholder. Art. 101(4) allows all covered investors to claim.

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<sup>16</sup> Rather than seek to adjust the loss-based rule to include expropriation of enterprise assets as direct shareholder/investor loss, art. 101(4) addresses direct expropriation of enterprise assets as an exception to the loss-based rule. This permits a straightforward definition of Direct Loss based on an economic criterion.

## 4. Second provision: a derivative claim in ISDS on behalf of the enterprise

### Article 200: Derivative Claim on Behalf on an Enterprise

#### Definitions

[For greater certainty, the Contracting Parties recognise that an enterprise may be an investment under the definition of investment.]

**enterprise** means an entity constituted or organised under applicable law, whether or not for profit, and whether privately or governmentally owned or controlled, including a corporation, trust, partnership, sole proprietorship, joint venture or other association.

**locally established enterprise** means a juridical person that is constituted or organised under the laws of the respondent.

An enterprise is:

(a) “**owned**” by an investor if more than 50 percent of the equity interests in it is beneficially owned by the investor; and

(b) “**controlled**” by an investor if the investor has the power to name a majority of its directors or otherwise to legally direct its actions in accordance with the laws and regulations of a Party.

### Article 201: Submission of a Derivative Claim to Dispute Settlement

An investor of a Party may submit, solely under the conditions set out in art. 202, a claim on behalf of a locally established enterprise that it owns or controls (i) that the respondent has breached [relevant provisions of the Treaty], and (ii) that the locally established enterprise has incurred loss or damage by reason of, or arising out of, that breach.

For greater certainty, in order for a claim to be submitted to dispute settlement under art. 201(1), an investor of the Party of the claimant must own or control the enterprise on the date of the alleged breach and the date on which the claim is submitted to arbitration.

### Article 202: Conditions and Limitations on Consent

1. An investor may only submit a claim pursuant to art. 201 if the investor

a. delivers to the respondent, with the submission of a claim, written waivers by the claimant and the locally established enterprise, of any right to initiate or continue before any court or administrative tribunal under the law of a Contracting Party, or any other dispute settlement procedures, any proceeding with respect to any measure alleged to constitute a breach referred to in art. 201;

b. specifies the name and address of the claimant and the name, address, and place of incorporation of the locally established enterprise; and

c. provides evidence of the basis for investor's alleged ownership and control of the locally established enterprise and the information available to it concerning the beneficial ownership and corporate ownership structure of the locally established enterprise.

2. The requirements of art. 202(1)(a) do not apply in respect of a locally established enterprise if the investor demonstrates that the respondent state has deprived the investor of control of the locally established enterprise, or has otherwise prevented the locally established enterprise from fulfilling those requirements.

### **Article 203. Objections to a Derivative Claim under Article 201**

The respondent shall have the power to obtain a decision on a preliminary objection that the covered investor in an enterprise has not demonstrated that it satisfies the requirements of art. 201. The respondent may also raise the issue at a later stage of a proceeding. Where the issue is raised belatedly without justification, the adjudicators may award costs.

### **Article 204: Awards**

If a claim is submitted to dispute settlement under art. 201 and if an award is made in favour of the enterprise: (a) any remedy awarded shall be made in favour of the enterprise; and (b) the award shall provide that it is made without prejudice to any right that any person may have under applicable domestic law with respect to the relief provided in the award.

## 5. Commentary on derivative claim provision

### 5.1. Basic elements of a derivative action

33. The basic elements of an enterprise remedy regime as set out in recent investment treaties can be described as follows:

1. A covered investor/shareholder can under certain conditions bring a claim on behalf of a locally established enterprise (a derivative claim).
2. The investor/shareholder must own or control the locally established enterprise.
3. The standards for control or ownership of locally established enterprise can be defined. They can be left to the discretion of adjudicators.
4. The claimant must claim a breach of relevant provisions of the treaty that causes loss to the locally established enterprise.
5. Both the covered investor/shareholder and the enterprise must waive alternative forms of recourse.
6. Any remedy is awarded to the locally established enterprise. It is not awarded to the claimant shareholder.

34. Diagrams of derivative claims are set out in Figures A.6 and A.7 in Annex A.

### 5.2. The foreign control or ownership requirement for the derivative claim in ISDS

35. The derivative claim in investment treaties is designed to apply to cases of foreign direct investment, i.e., investment involving foreign control of an entity. This is typically achieved by a requirement for foreign control or ownership.

36. There are different possible approaches and standards for foreign control or ownership. Most derivative claim provisions in investment treaties require that the investor/shareholder demonstrate ownership or control of the enterprise. Art. 201 adopts this approach as does Draft provision 10.

37. Art. 200 above defines both ownership and control. Ownership is established if an investor beneficially owns more than 50 percent of the equity interests in the enterprise. Control of an enterprise established if the investor has the power to name a majority of its directors or otherwise to legally direct its actions in accordance with the laws and regulations of a Party.<sup>17</sup> These definitions provide greater certainty than an open-ended reference to ownership and control with the meaning left to adjudicators.

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<sup>17</sup> See Agreement between Japan and the Republic of Chile for a Strategic Economic Partnership (2016), art. 105(2).

### 5.3. Scope of derivative action

38. Draft provision 10 establishes a relatively narrow scope for derivative claims. It allows for derivative claims in only two circumstances. One requires that the enterprise must have sought a remedy in the host state to redress its loss and have been subject to treatment akin to a denial of justice under customary international law.

39. The second context where Draft provision 10 makes a derivative action available is where assets of the enterprise have been directly and wholly expropriated by the host state. As set forth above, it may be preferable also to allow individual investor/shareholder claims for reflective loss in this rare situation. Article 101(4), discussed in section \_\_ above, does this.

40. Derivative claims provisions in existing investment treaties generally have a broader scope than the version in Draft provision 10. The derivative claims provision in art. 201 is in accordance with existing treaty practice and is thus broader than the one in Draft provision 10.

41. As set forth in OECD analysis provided to the Working Group, a derivative claim provision encourages foreign direct investment because it applies only to foreign-controlled enterprises. This contrasts with allowing investor/shareholder claims for reflective loss, which encourages foreign portfolio investment by covered shareholders but can cause losses to the enterprise and other investors, thus dissuading some investment.<sup>18</sup>

42. Article 202(1)(a) requires provision of waivers of alternative recourse by both the investor/shareholder and the enterprise. The language is similar to that in the CPTPP, USMCA and CETA. Articles 202(1)(b) and (c) require the provision of information including about the corporate structure of the claimant and enterprise.

43. Article 203 includes the same provisions as in art. 101(4) above on the power of respondents to obtain an early decision on whether the criteria for the claim have been satisfied.

44. Article 204 provides that “if an award is made in favour of the enterprise” any remedy awarded shall be made in favour of the enterprise any award.” This is a fundamental provision that profoundly distinguishes derivative claims from individual claims for reflective loss. It is found in all derivative action provisions.<sup>19</sup>

45. Treaties with derivative actions often contain a specific consolidation provision for certain individual and derivative claims under the treaty. The provision is limited to claims under the single treaty at issue. It thus has no effect on overlapping claims under other treaties. Given broader attention to consolidation in the Working Group, the provision is omitted here at this stage.

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<sup>18</sup> See David Gaukrodger, [Investment Treaties and Shareholder Claims: Analysis of Treaty Practice](#), OECD Working Papers on International Investment, 2014/03, pp. 29-32.

<sup>19</sup> Draft provision 10(3) is similar in providing for payment to the enterprise, but refers to derivative claim awards “in favour of the shareholder”. Since derivative claims are by definition brought “on behalf of the enterprise” and with remedies only for the enterprise, it appears preferable to refer to awards “in favour of the enterprise” as in art. 204 above.

Annex A. Explanatory diagrams

Figure A.1. Domestic Law: “No Reflective Loss” principle bars shareholder claims for reflective loss

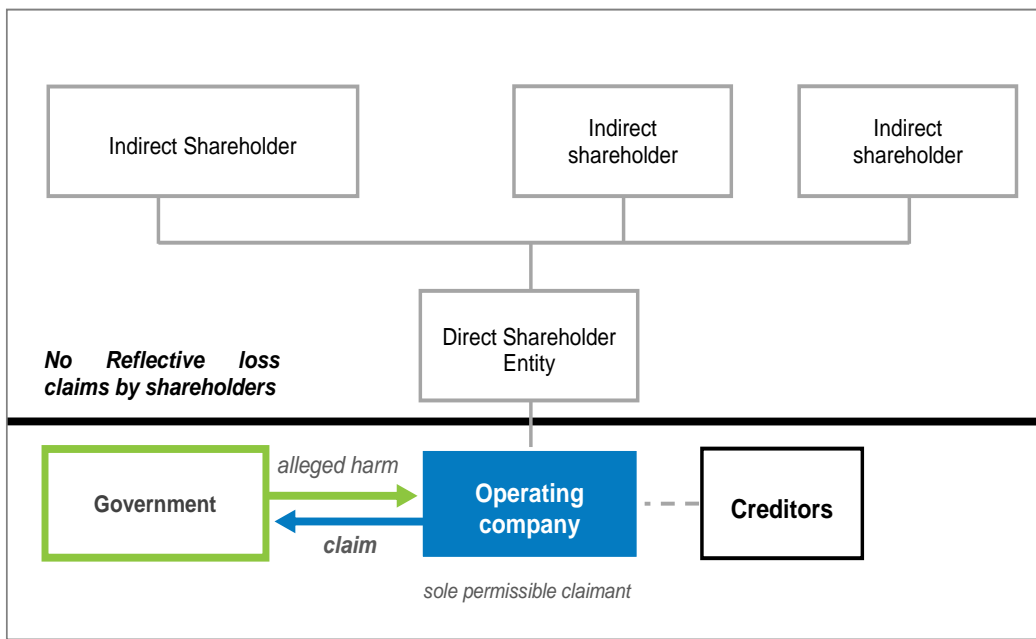
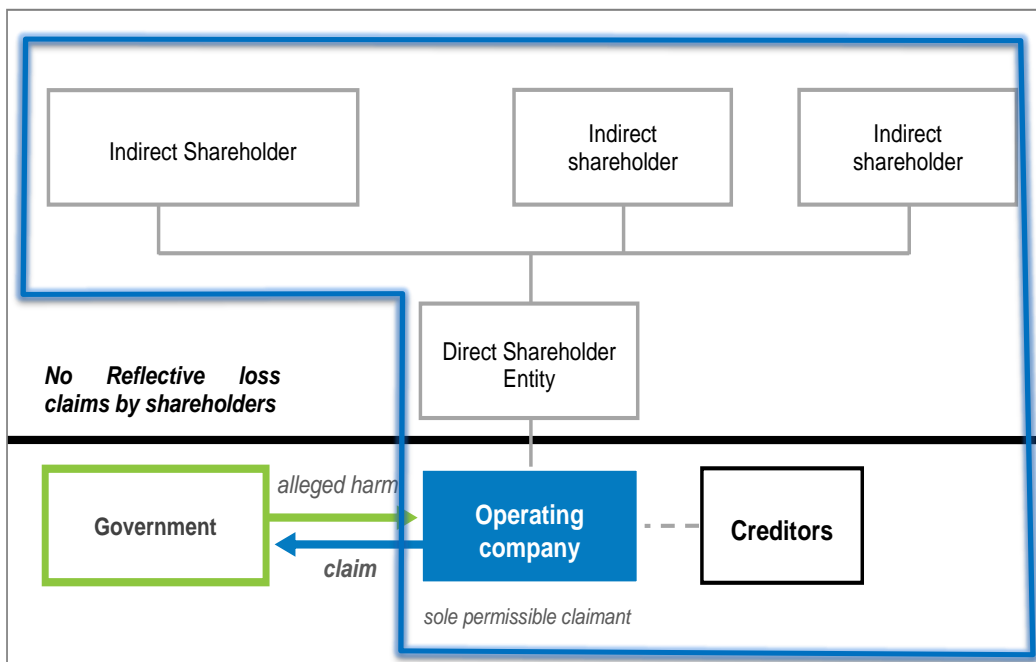
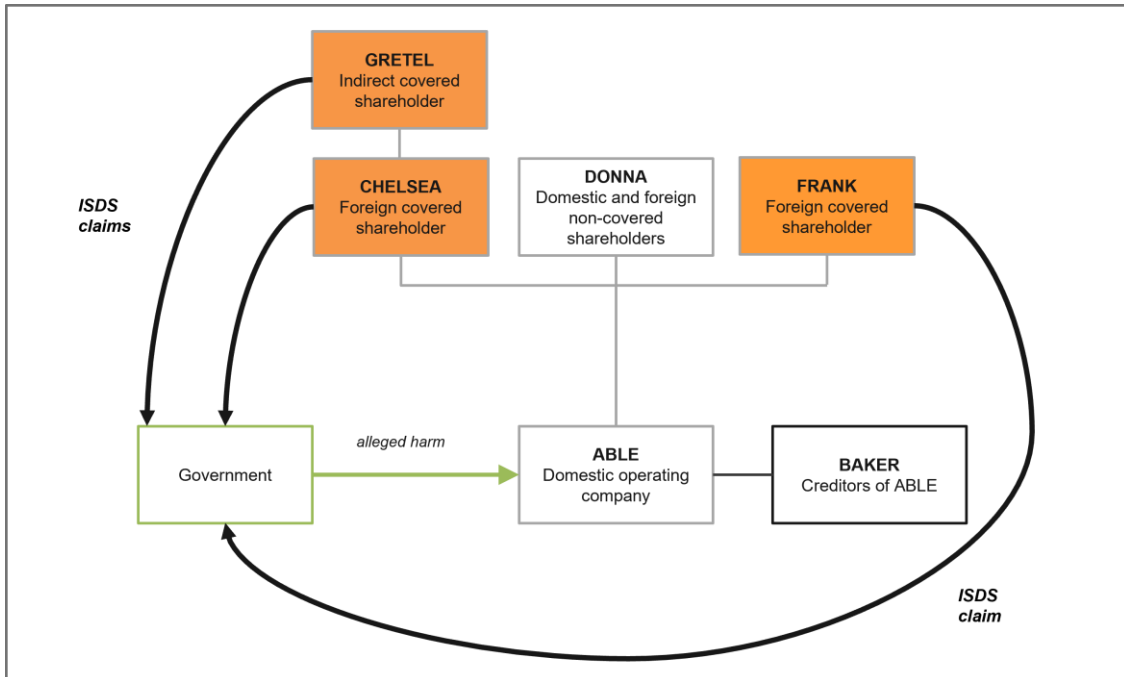


Figure A.2. Domestic Law: Who is protected by the enterprise claim? – All Investors



**Figure A.3. ISDS: Multiple Possible Reflective Loss Claims**



**Figure A.4. ISDS Reflective Loss Claim: Who is Protected?**

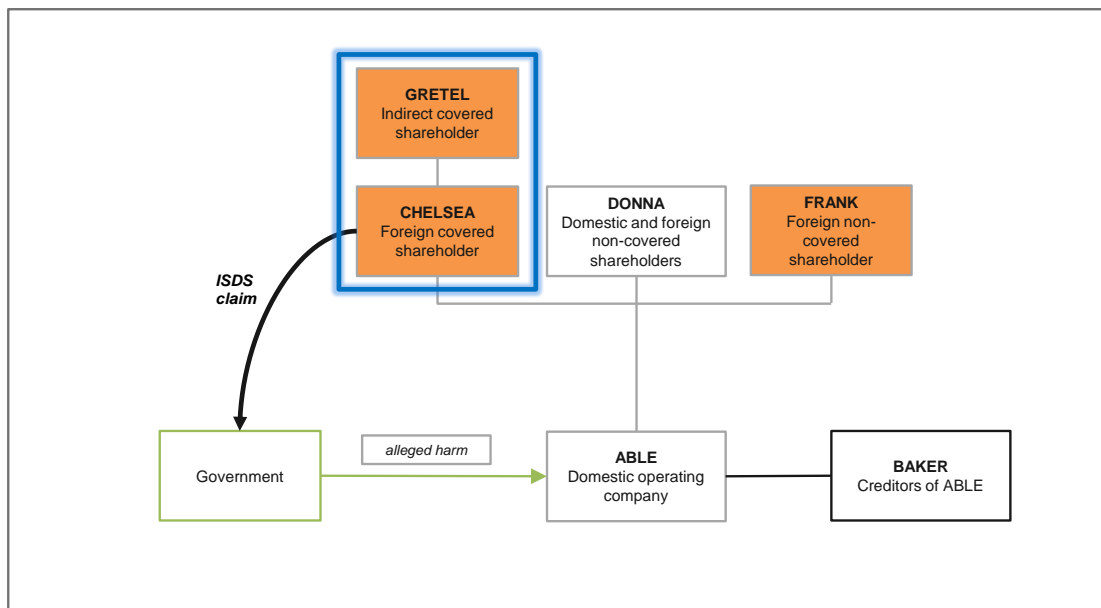
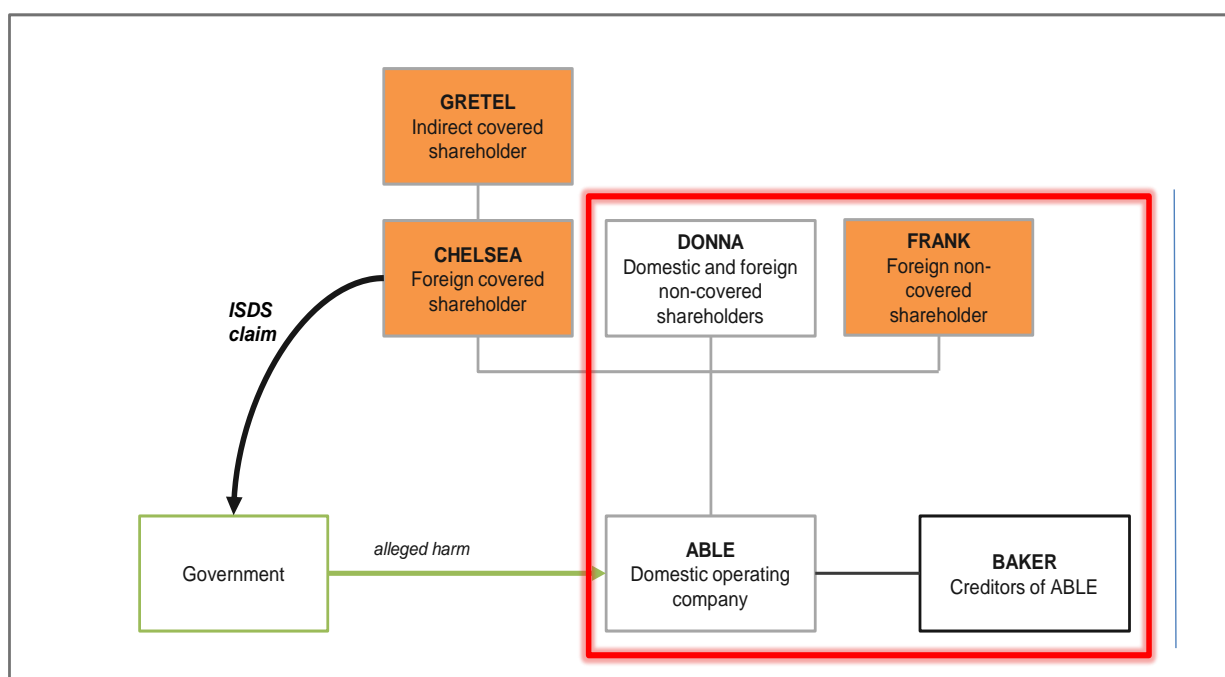
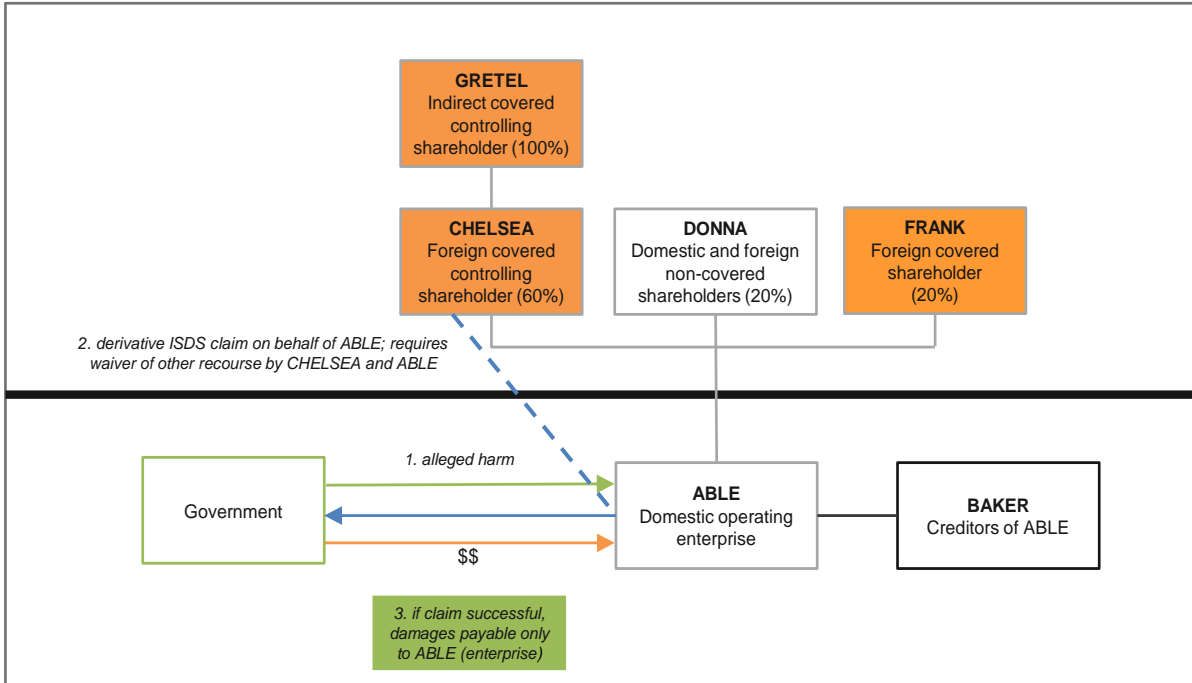




Figure A.5. ISDS Reflective Loss Claim: **Who is not Protected?**



**Figure A.6. ISDS: Derivative Claim on behalf of an Enterprise – structure**



**Figure A.7. ISDS: Derivative Claim on behalf of an Enterprise : Who benefits?**

