NOTES

DIPLOMATIC PROTECTION OF CORPORATIONS AND SHAREHOLDERS—CAPACITY OF GOVERNMENT TO ESPOUSE CLAIMS OF SHAREHOLDERS OF A FOREIGN CORPORATION

Belgium lacked *jus standi* to exercise diplomatic protection of Belgian shareholders of a Canadian Corporation with respect to measures taken against that Corporation by Spanish Authorities in Spain—*Barcelona Traction, Light and Power Company, Limited (New Application: 1962) (Belgium v. Spain).*

INTRODUCTION

February 5, 1970, the International Court of Justice rendered its decision in the case concerning *Barcelona Traction.*[1] A Belgian claim which had been ripening for twenty-two years,[2] and which had been before the International Court for nine years,[3] was dispensed with in a one hundred and thirty-two page text[4] including eight opinions for the majority and one dissent.[5] The Court found

1. INTERNATIONAL LEGAL MATERIALS, Vol. 6, No. 2 (March 1970) pp. 227-359.

2. On February 12, 1948, Spanish authorities ordered seizure of the assets of Barcelona Traction, and of two of its subsidiary companies.

3. DECISIONS OF THE INTERNATIONAL COURT OF JUSTICE, A DIGEST, 2d ed. (1969) SYATAUW, J.J.G.; A.W. Sijthoff's Uitgeversmaatschappij, N.V., Leyden, pp. 160-169.

Chronology of events:
September 15, 1958—Belgium filed an application instituting proceedings.
May 21, 1960—Spain raised certain preliminary objections.
March 23, 1961—Letter of Belgium filed informing the Court that it was not going on with the proceedings.
April 10, 1961—The Court ordered the case to be removed from the list.
June 14, 1962—Date of new application.
March 15, 1963—Spain raised preliminary objections.
March 11 to May 19, 1964—Oral proceedings on preliminary objections.
July 24, 1964—Judgment rendered (preliminary objections); resumption of the proceedings on the merits.
July 1, 1968—Time limit for filing of the Spanish rejoinder. (The filing took place within the time limit.)
July 9, 1969—Belgium's final hearing.
July 23, 1969—Spain's final rejoinder.

4. *Supra*, note 1.

5. Judges Petren and Onyeama appended a joint declaration to the judgment; Judge Lachs appended a declaration. President Bustamente y Rivero and Judges Sir Gerald Fitzmaurice, Tanaka, Jessup, Morelli, Padilla Nervo, Gros and Ammoun appended separate opinions. Judge *ad hoc* Riphagen appended a dissenting opinion. *Supra*, note 1.

that Belgium's claim was procedurally defective inasmuch as that state lacked standing to espouse a claim for losses suffered by a Canadian corporation in which Belgian nationals held eighty-eight percent of the share capital. Since it was held that only the country of incorporation may espouse the claim of a multi-national corporation, the Belgian claim was not decided on the merits, and the substantive issues were never reached by the Court.

FACTS

Barcelona Traction, Light and Power Company, Limited was incorporated in 1911 at Toronto, Canada, where its headquarters are located. For the purpose of creating and developing an electric power and distribution system in Spain it formed subsidiary companies under Spanish law, operating in Spain. After the first World War the Barcelona Traction share capital came to be largely held by Belgian nationals.

In 1936 the Spanish Civil War interrupted servicing of the Corporation's sterling bonds. After the war Spanish authorities refused to permit transfer of currency necessary to resume servicing the bonds. In 1948 three Spanish holders of Barcelona Traction sterling bonds petitioned a Spanish court for a declaration adjudging the corporation bankrupt due to failure to pay interest on the bonds. A judgment was given declaring the corporation bankrupt and ordering a seizure of its assets. Spanish directors were substituted for the principal management personnel, and new shares of the corporation's subsidiaries were created and sold to a newly formed Spanish company, which thereupon acquired control of the undertaking in Spain.

Proceedings were brought without success in the Spanish courts by various companies or persons.[6] Claims of nationals against the Spanish Government were presented to that government by the British, Canadian, United States and Belgian governments, commencing in 1948; the interposition of the Canadian government ceased in 1955.[7]

In 1962 the Belgian government submitted a new application[8] to the International Court of Justice, and asserted that the

6. According to the Spanish government, 2,736 orders were made in the case and 494 judgments given by lower and 37 by higher courts before it was submitted to the International Court of Justice.

7. No reason was indicated for cessation of the Canadian claim.

8. Belgium filed an application in 1961. Subsequently, the parties agreed

Court had jurisdiction, by virtue of Article 17 of the Treaty of Conciliation, Judicial Settlement and Arbitration between Belgium and Spain of 19 July 1927,[9] and Article 37 of the Statute of the Court.[10] Thus, the Court could entertain the claim presented on behalf of natural and juristic persons alleged to be Belgian nationals and shareholders in the Barcelona Traction Corporation. The application sought reparation for damage allegedly caused to Belgian shareholders by the conduct, said to be contrary to international law, of the Spanish state toward the Canadian corporation.

The Spanish government contended before the Court that the Belgian government utterly lacked capacity to submit any claim in respect of alleged wrongs done to a Canadian corporation. The Belgian government, on the other hand, based its argument that it was not without capacity to submit its claim on the fact that eighty-eight percent of the Corporation's share capital was held by Belgian nationals.

THE DECISION

As to the right of Belgium to espouse claims of Belgian shareholders in a company incorporated in Canada, the Court rejected Belgium's claim by fifteen votes to one.[11] Drawing a familiar analogy, the Court observed that in municipal law the concept of the company was founded on a firm distinction between the rights of the shareholder and those of the company. A wrong done to the company frequently caused prejudice to its shareholders, but this did not imply that both company and shareholders were entitled to claim redress. An act infringing the company's rights did not necessarily involve responsibility toward the shareholders, even if their interests were affected.

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to negotiate the Belgian claims and Belgium notified the Court that it was not going on with the proceedings. On April 10, 1961, the Court removed the case from the general list. Negotiations failed and were discontinued. Belgium reinstituted proceedings by an application of June 19, 1962. *Supra*, note 3.

9. 80 League of Nations Treaty Series 17, 32. Art. 17, Para. 4: ". . . either Party may, on the expiry of one month's notice, bring the question directly before the . . . Court . . . by means of a request."

10. "Whenever a treaty or convention in force provides for reference of a matter to a tribunal to have been instituted by the League of Nations, or to the Permanent Court of International Justice, the matter shall, as between the Parties to the present Statute, be referred to the International Court of Justice." Statute of the International Court of Justice, Art. 37, 59 STAT. 1055 (1945 Part 2).

11. *Supra*, note 5.

In justifying the analogy to municipal legal institutions, the Court felt it had to refer to those rules generally accepted by municipal legal systems. The municipal rule restated is that an injury to the shareholder's interest resulting from an injury to the right of the company is insufficient to found a claim. The international parallel enunciated by the Court concerns a situation where an unlawful act is committed against a company representing foreign capital. There, the Court said, the general rule of international law is that the corporate state of domicile alone may seek redress. The Court further noted that no rule of international law expressly confers such a right on the shareholder's state, if different from the corporation's state.

ANALYSIS

The Court ostensibly avoided an opportunity for charting new ground in international law, and instead preferred to rely on the traditional rule to negate the Belgian claim. The Court reasoned that adoption of the theory of diplomatic protection of shareholders would open the door to numerous competing diplomatic claims, which would create an atmosphere of confusion and uncertainty in international economic and legal relations. The danger would be all the greater inasmuch as the shares of the companies whose activities are international are widely scattered and frequently change hands.

The Court considered whether there were special circumstances under which the general rule might not take effect. Two situations were suggested: (a) the case of the company having ceased to exist; and (b) the case of the company's state of incorporation lacking capacity to take action. Regarding the first possibility (in which case the shareholder's country could espouse his claim[12]), the Court observed that although Barcelona Traction had lost all its assets in Spain, and had been placed in receivership in Canada, it could not be contended that the corporate entity had ceased to exist.

So far as the second possibility was concerned (again in which case the shareholder's country could espouse his claim[13]), the Court said that even if the Canadian government ceased to act on behalf of Barcelona Traction, it nevertheless retained its capacity to do so. The Court elaborated that whatever the reason for the Cana-

12. *Supra*, note 1 at 266.
13. *Id.* at 267.

dian government's change of mind, that fact could not constitute a justification for the espousal of claims by another government.[14]

Belgium also maintained that, on the basis of equity, a state ought to be able to take up protection of its national shareholders in a company victimized by a violation of international law. The Court apprehended that the adoption of this theory would open the door to competing claims on the part of different states which could create an atmosphere of insecurity in international economic and legal relations. Accordingly, in the instant case, where the company's national state *was* able to act, the Court was of the opinion that *jus standi* was not conferred on the Belgian government by considerations of equity.

Here the Court speculates that if a state should be able to take up protection of its nationals on the basis of equity, then competing claims by different states would create an atmosphere of insecurity in international economic and legal relations. Unfortunately, this nebulous admonition fails to focus on the need for protection of shareholders who, by reason of the state of incorporation's failure to espouse their claims, are left without protection or means of redress. Equity could have been the basis for protection of Belgian shareholders by Belgium. Rather than approaching this significant issue, and filling the vacuum of non-protection with a viable theory of international law that would afford protection to shareholders of multi-national corporations, the Court has adopted a reason of little relevance to circumvent a salient issue of the case.

The world nearing half-past mid-twentieth century has seen the growth of a beneficial era of foreign investment. There has been an enormous flow of capital which has come to be outpaced only by the increasing demand for that capital. Through the medium of multi-national corporations, small investors and nations have been mutually benefitted by the growth which this capital flow has made possible. The yield on foreign capital has been maximized while standards of living in developing nations have improved.

Concurrently, nationalistic movements directed against alleged economic exploitation by foreign interests have become prominent. Many of these movements have evolved into stable, recognized governments characterized by fiercely pragmatic ap-

14. *See* note 7, *supra.*

proaches to conservation of local resources. But in exercising greater control over their resources, some host countries have demonstrated waning sensitivity to the interests of foreign investors. However, the extent to which a government can interfere with foreign capital has been balanced somewhat by the countervailing force of the foreign investor's government in providing diplomatic protection for overseas holdings.

If a host state injures the share interest of a foreign investor through wrongful acts perpetrated against a corporate personality within host territory, and the corporation is a juristic person of a third state, the investor's only recourse is diplomatic protection exercised by his government. This, of course, is the most immediate and desirable protection from any standpoint. The shareholder's own government is more disposed to safeguard and promote the interests of its national than is a foreign state not connected by bonds of nationality. The underlying rationale for this proposition is put forward by Judge Riphagen in the lone dissenting opinion to *Barcelona Traction*. He stated, ". . . in 'classic' cases of diplomatic protection, the interest of a state in 'its' international commerce merges with its interest in the welfare of its *national* persons, both in respect of their power to *administer* their property and their right to *draw profits* therefrom."[15]

The legal question, whether a state may espouse the claim of its national for a wrong done to the national's share interest in a corporation of a third state has never been definitively answered by international doctrine.[16] One writer has, in terms of international practice, answered affirmatively.[17] It has been suggested that from the standpoint of international arbitration the question would likewise be answered.[18]

The legal question has been answered affirmatively by the American Law Institute in the Restatement of Foreign Relations Law.[19] The Restatement provides that a state is liable for damage to alien stockholder interests in a corporation of a third state if (1) "a significant portion of the stock" is alien owned, (2) the

15. *Supra*, note 1 at 353.

16. J. Merry Jones, *Claims on Behalf of Nationals Who Are Shareholders in Foreign Companies*, XXVI BRIT. Y.B. INT'L L. 225 (1949).

17. *Id.* at 232 ff.

18. Jimenez de Archega, *Diplomatic Protection of Shareholders in International Law*, 4 PHIL. INT'L L.J. (Jan.-June 1965) pp. 71, 78, 81.

19. RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES (1965), § 173.

corporation fails to obtain reparation for reasons which the shareholders cannot control, and (3) the corporation has not waived or settled its claim.[20] Thus, the Restatement envisages a triangular relationship between the culpable state, the state of corporate domicile and the state of the shareholder. The rule clearly anticipates the situation where the shareholder's state must come forward to espouse the claim of the shareholder.

Barcelona Traction addressed itself to the same legal question, but came to the opposite conclusion. The case squarely held that a shareholder's state lacked standing to espouse his claim in respect of wrong suffered by a corporation when the state of corporate domicile was neither the state perpetrating the wrong, nor the state of the shareholder's domicile. To this extent, the case is dispositive of the issue. As a matter of international law, the opinion of the International Court of Justice is final, though not binding on states other than Belgium and Spain under the fundamental rule of consent to jurisdiction.[21] Hence, other states might bring the question before the Court. Also, Belgium and Spain might again bring the question before the Court if the fact pattern is changed.[22] It is clear that the law in this area is not fixed and certain; and it is equally clear that the opportunity for constructive change is possible.

The *Barcelona* decision left the parties (Belgium and Spain) where they were at the outset of the controversy. The question now becomes, what did it do for the Belgian shareholders who have not yet had the merits of their claim heard by a competent tribunal? Under the international rule that only the state of incorporation may exercise diplomatic protection for the purpose of seeking redress,[23] the Belgian shareholders were forced to look to Canada to espouse the corporate claim against Spain. This proved unavailing between 1948 and 1955, when Canada dropped its interest in the case.[24] After fifteen years it is open to question what, if any, progress could now be made along these lines by renewed claims.

Assuming the existence of valid claims against the Spanish

20. *Id.* at 524.

21. Art. 36, *supra*, note 10 at 1060.

22. *Id.* at 1062. Art. 59: "The decision of the Court has no binding force except between the parties and in respect of that particular case."

23. Beckett, *Diplomatic Claims in Respect of Injuries to Companies,* 17 TRANS. GROT. SOC. 175 (1931).

24. The interposition of the Canadian government ceased entirely in 1955.

government, the Belgian shareholders possess no effective remedy. This vacuum in a vital precinct of international justice is disturbing. Since neither Belgium nor Canada can or will bring the shareholders' claim, and since individual shareholders lack procedural capacity—internationally—to bring claims against a state,[25] the conclusion is inescapable that the shareholders are powerless under international law, having no effective remedy for their injuries.

Concern for citizens of all states prompts an expression of disappointment at the vacuum created by *Barcelona Traction*. It is plain that citizen-investors, investors in international corporations who happen to be of a nationality different from either the corporation or the offending state, must rely on the state of corporate domicile to espouse their claims. As multi-national corporate enterprises become the dominant vehicle for international investment by small investors of diverse nationalities, the need for protecting the interests of individual investors is apparent. When the situation envisaged by Section 173 of the Restatement[26] arises, where the corporation fails to obtain reparation, to whom shall the individual look for redress? Under the rule of *Barcelona*, the individual investor is foreclosed from securing the protection of his national state.

The Court seems to take cognizance of the dilemma in which international shareholder-investors may find themselves when corporate losses occur. *Barcelona* suggests that shareholders may now secure protection by recourse to treaty stipulations or special agreements concluded between the small investor and the developing state in which the investment is placed.[27] This sage advice

25. Art. 34, *supra*, note 10 at 1054: "Only states may be parties in cases before the Court."

26. *Supra*, note 19: Sec. 173—Alien Shareholder of Corporation Having Nationality of Third States.

> When an alien corporation, in which an alien of a different nationality is directly or indirectly a shareholder, is injured by conduct attributable to a state that is wrongful under international law, the state is responsible for the consequent injury to the alien to the extent of his interest in the corporation, if . . .
>
> (a) a significant portion of stock of the corporation is owned by the alien or by other aliens who are not nationals of the state to which the conduct is attributable or of the state to which the corporation is a national, and
>
> (b) the corporation fails to obtain reparation for the injury, and
>
> (c) such failure is due to causes over which the alien or such other alien shareholders cannot exercise control, and
>
> (d) a claim for the injury to the corporation has not been waived or settled by the corporation or by the state at which it is a national.

27. *Supra*, note 1 at 272.

represents little more than a polite conciliatory gesture to Belgian investors who hold eighty-eight percent of a bankrupt corporation. Conceivably, the advice may serve as useful moral instruction in the self interest of capital investment, but it falls far short of answering the need for an enlarged scope of legal protection for international shareholders. Conventional treaties and kindred agreements were the means of shareholder protection at the end of the nineteenth century,[28] when there was no international tribunal on which to rely. Today there is an International Court of Justice. The dilemma of protection for international investors ought to have been resolved in terms of modern international law, rather than under archaic principles reminescent of a by-gone era.

CONCLUSION

The need for protection of international investment by the investor's own state has arisen because of the threat of improper interference with capital investment by developing states. When the small investor has, through the medium of an international corporation, invested capital abroad, which is jeopardized by the host state, and the corporation's state of domicile will not intervene to exercise diplomatic protection on behalf of shareholders, the investor-shareholder must of necessity look to his own state for diplomatic protection. A rule sanctioning diplomatic protection under these circumstances would, in its most salutary effect, fill the present vacuum with substantive legal protection for international investors.

Comparing the small investor with the large international investor it should be noted that there are no extra-legal devices (e.g. economic coercion or influence) to protect the small investor and his investments abroad. The small investor is therefore not likely to risk capital abroad unless there is a reasonable likelihood that his government will intervene in the event of loss. But since the Court in *Barcelona* rejected the petition of the shareholder's government, the only remaining remedy for the small investor has been lost. As a result, it is not difficult to foresee that the European or American small investor will be less inclined to invest in the multi-national corporations which have been instrumental in direct-

28. Investors agreed with host governments as to claims jurisdiction and the means of settling disputes as a general practice. *See, e.g.* Orinico Steamship Co., Ralston, Venezuelan Arbitrations of 1903, where a claim would only be allowed on the basis of a claims protocol.

ing capital to developing African, Asian, and Latin American countries.

As it is, international investors are left virtually defenseless in protecting their foreign investments. With the knowledge that international law will not permit a shareholder's national state to exercise diplomatic protection in a situation of triangular relationship between the state of incorporation, the place of investment and injury, and the shareholder's state, the investor will become discouraged from placing capital abroad through the medium of a multi-national corporation not domiciled in his state. Few will risk capital without protection or possible remedy. A climate of distrust and fear, reinforced by strong feelings of insecurity, shrouds the future of the international capital market. Not only will investment in multi-national corporations be diminished, but the development of emerging nations will be impaired. As the corporation becomes less able to attract capital from investors, the amount of capital available to aid developing nations will be greatly reduced. Under these circumstances, the prospects for international development are indeed poor.

Yet it could be urged that the portents for international investment are not abysmal. At the risk of pandering an optimistic idealism, it may be said we are now approaching a renaissance of public and private international law where protection of shareholders requires reliance on treaty stipulations and special agreements directly concluded between the small investor and the host state. Recent literature seems to proceed along this line.[29] This solution would require the development of new concepts in international law inasmuch as treaties have heretofore been concluded between states, but not individuals and states.[30] Absent this development, which may be difficult to achieve, a much quicker and more readily attainable solution for the small investor may lie in adoption of the Restatement rule.[31] Thus, nations whose citizens own a significant portion of the shares of a multi-national corporation would be allowed to represent those citizens before the International Court of Justice. The starting point for this solution is a complete reversal of *Barcelona.*

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29. Hynning, *Treaty Law for the Private Practitioner,* 23 U. CHI. L. REV. 36 (1955).

30. Fawcett, *The Legal Character of International Agreements,* XXX BRIT. Y.B. INT'L L. 381 (1953).

31. *Supra,* note 26.