

Document:-
A/CN.4/SR.2758

Summary record of the 2758th meeting

Topic:
<multiple topics>

Extract from the Yearbook of the International Law Commission:-
2003 vol. I

*Downloaded from the web site of the International Law Commission
(<http://www.un.org/law/ilc/index.htm>)*

company continued to exist even if it was in receivership; it ceased to exist only when it went into liquidation. The Special Rapporteur considered the exception in draft article 18, subparagraph (b), to be the most important one, and it was the one that three judges in *Barcelona Traction* had said reflected customary international law. He wondered how two contradictory rules of international law could be said to exist, and he was therefore opposed to including that exception in the draft articles. Presumably the third exception, covering cases in which the direct rights of shareholders were infringed, was addressed in an article that had yet to be introduced. Draft articles 17 and 18 could be referred to the Drafting Committee.

80. Mr. DUGARD (Special Rapporteur) confirmed that the third exception was dealt with in draft article 19.

81. Mr. CHEE, expressing surprise at Mr. Kateka's preference for deleting the wording in square brackets in draft article 17, paragraph 2, said it was his understanding that the wording was drawn directly from the *Barcelona Traction* judgment.

82. Mr. DUGARD (Special Rapporteur) confirmed that that was so, but said that the Commission needed to decide whether or not it wanted to follow that judgment in the present draft articles.

The meeting rose at 1 p.m.

2758th MEETING

Friday, 16 May 2003, at 10.05 a.m.

Chair: Mr. Enrique CANDIOTI

Present: Mr. Addo, Mr. Baena Soares, Mr. Brownlie, Mr. Chee, Mr. Dugard, Mr. Economides, Ms. Escarameia, Mr. Fomba, Mr. Gaja, Mr. Galicki, Mr. Kabatsi, Mr. Kamto, Mr. Kateka, Mr. Kolodkin, Mr. Koskenniemi, Mr. Mansfield, Mr. Melescanu, Mr. Momtaz, Mr. Pambou-Tchivounda, Mr. Pellet, Mr. Sreenivasa Rao, Mr. Rodríguez Cedeño, Mr. Rosenstock, Mr. Sepúlveda, Mr. Yamada.

Organization of work of the session (*continued*)*

[Agenda item 2]

1. The CHAIR invited the Chair of the Planning Group, Mr. Melescanu, to announce the composition of the Group.

2. Mr. MELESCANU (Chair of the Planning Group) said that the Planning Group would be made up of the following members: Mr. Addo, Mr. Baena Soares, Mr. Brownlie, Mr. Chee, Mr. Dugard, Mr. Economides, Ms. Escarameia, Mr. Fomba, Mr. Gaja, Mr. Galicki, Mr. Kabatsi, Mr. Koskenniemi, Mr. Mansfield, Mr. Pellet, Mr. Sreenivasa Rao, Mr. Rodríguez Cedeño, Mr. Rosenstock, Mr. Sepúlveda and Mr. Yamada. He urged the special rapporteurs and the Rapporteur of the Commission to take part in the Group's work.

Diplomatic protection¹ (*continued*) (A/CN.4/529, sect. A, A/CN.4/530 and Add.1,² A/CN.4/L.631)

[Agenda item 3]

FOURTH REPORT OF THE SPECIAL RAPPORTEUR (*continued*)

3. Mr. KOSKENNIEMI said that the fourth report of the Special Rapporteur (A/CN.4/530 and Add.1) examined in depth two rather contentious issues, the first one being that of the nationality of a corporation. On that point, the Special Rapporteur urged the Commission to adopt the *Barcelona Traction* principle, namely, that the State of nationality of a corporation was the State in which it was incorporated. The second issue related to the case covered in draft article 18, subparagraph (b): when the corporation had the nationality of the State responsible for causing injury to it. One's position on those problems depended on one's view of corporate activity today and the particular situation in question. The more he thought about big multinational corporations with global strategies, the more he was in favour of ensuring that the host State was not beset by a large number of claims from foreign shareholders. On the other hand, if he looked at the case of small companies in developing economies, he was inclined to say that the shareholders needed protection. As big corporations dominated today's global economy, he tended to prefer the first position, perhaps to the detriment of the protection of the shareholders of small companies. He would have liked to find language to introduce the ideas of "equity" and "reasonableness" in draft article 17 or 18, but, as the Special Rapporteur pointed out, such rules were largely covered by bilateral investment treaties, so that the rules being considered by the Commission were merely residual in nature. He did not believe that the Commission was bound by the decisions of ICJ and, in particular, by the *Barcelona Traction* judgment. Those judgments had only the value that the Court's reasoning in them had. He also

* Resumed from the 2751st meeting.

¹ For the text of articles 1 to 7 of the draft articles on diplomatic protection and the commentaries thereto provisionally adopted by the Commission at its fifty-fourth session, see *Yearbook ... 2002*, vol. II (Part Two), chap. V, sect. C.

² Reproduced in *Yearbook ... 2003*, vol. II (Part One).

doubted that, in defining customary law, any conclusions could be drawn from lump-sum agreements or the provisions of bilateral investment treaties because such treaties were the result of bilateral negotiations and trade-offs and thus not amenable for generalizations.

4. Draft article 17, paragraph 1, was a reformulation of the principle contained in the *Barcelona Traction* judgment, pursuant to which the State of nationality was the State in which the corporation was incorporated. That principle had been criticized because a genuine link between the corporation and the State of nationality had been considered necessary. The Special Rapporteur's options were reformulations of the idea that the nationality of the corporation should be consistent with a social and economic context. In his view, the Special Rapporteur should have examined in greater depth the criterion of the domicile or *siège social* (see para. 31 of the report, option 3), which was the practice in international private law. The importance of the economic and social context for deciding on the nationality of the corporation was underscored by the global nature of the activities of big corporations and the fact that the place where they were incorporated could be chosen, for example, solely on the basis of tax considerations. In such a case, however, the corporation deprived itself of the possibility of diplomatic protection. He therefore endorsed the principle embodied in paragraph 1 and the rationale behind it. The words in brackets in paragraph 2 were unnecessary and could easily be deleted, whereupon draft article 17 could then be referred to the Drafting Committee.

5. He had no objection to the wording of draft article 18, subparagraph (a), which could be referred to the Drafting Committee. On the other hand, he had reservations about subparagraph (b), because, in the case in which a big corporation decided to be incorporated in a State and its shareholders suffered an injury owing to activities which that State had undertaken because of economic problems, he saw little reason to make life for the host State more difficult by allowing the State of nationality of the shareholders to exercise diplomatic protection on their behalf. He was thus opposed to referring subparagraph (b) to the Drafting Committee.

6. Mr. MOMTAZ said that the Special Rapporteur had dealt in depth with the important question of diplomatic protection of foreign corporations and their shareholders. It was no longer possible to study that question without taking account of contemporary economic realities. The time was long past when developing countries had shown distrust of foreign investors, fearing interference in their internal affairs by large financial groups. States now wished to attract foreign investment in order to promote their economic development and were ready to provide the necessary guarantees to achieve that objective. That concern was demonstrated not only in bilateral and multilateral foreign investment treaties, but also unilaterally, in foreign investment codes, which might usefully be studied in order to identify State practice in that area. Regardless of their level of development, all States were dependent on foreign investment, and international law must thus offer investors the necessary guarantees. The Commission must seek to ensure that the law coincided with the facts while maintaining a balance between the interests of States and those of investors. That was the background against which

the report defended the right of the State to exercise diplomatic protection on behalf of a corporation that had its nationality and also, subsidiarily, on behalf of shareholders who had its nationality. He thus endorsed draft article 17, paragraph 1, which reaffirmed the principle set forth in the *Barcelona Traction* judgment, but nonetheless thought it necessary to retain the text enclosed in square brackets in paragraph 2, replacing the conjunction "and" by the conjunction "or", since several countries did not require corporations incorporated under their law to have their registered office in their territory.

7. Article 18, subparagraph (b), provided for an exception to the nationality rule, for example, in the case where the host State required the foreign corporation to be incorporated in accordance with its internal law. Shareholders injured by a wrongful act of the host State must then be able to enjoy the diplomatic protection of their national State. However, that exception might jeopardize the principle of equal treatment of national shareholders and those having the nationality of another State, thereby contravening the international rules governing treatment of foreigners. Admittedly, if foreign shareholders had no remedies other than those open to nationals, they would run up against the difficulties already identified in cases where there was no voluntary link between the injured persons and the State responsible for the wrongful act. But that rule remained controversial and could thus not be considered to be a customary rule. Instead, it belonged to the domain of progressive development of the law and, as such, deserved closer consideration. That exception was necessary, for shareholders could not be left defenceless and deprived of any possibility of protection by the State of which they were nationals. However, he preferred not to support it at that early stage, considering that the matter merited more reflection, perhaps in order to consider a saving clause aimed at limiting the consequences of its implementation—in other words, limiting the number of claims submitted by States whose nationals had been injured.

8. Furthermore, he noted a contradiction between paragraphs 22 and 25 of the report. In paragraph 22 it was stated that, in the *Barcelona Traction* judgment, ICJ was not codifying international law but resolving a particular dispute, with the result that its "rule" was to be seen as a judgement on particular facts and not as a general rule applicable to all situations; whereas paragraph 25 stated that the Court was concerned with an evaluation of customary international law. The latter point of view should prevail, since it strengthened the authority of the *Barcelona Traction* judgment, which constituted the basis for draft article 17 and draft article 18, subparagraph (a).

9. Mr. YAMADA said that the Special Rapporteur had endeavoured to modify the principles set forth in *Barcelona Traction*, taking account of the criticisms to which it had been subjected. Nevertheless, despite its shortcomings, that judgment was an accurate statement of the contemporary state of the law with regard to the diplomatic protection of corporations and a true reflection of customary international law in that regard.

10. Drawing attention to recent foreign investment protection practices through procedures provided for in bilateral and multilateral treaties, the Special Rapporteur

wondered whether the Commission might feel compelled to formulate rules according more fully with the reality of foreign investment and encouraging foreign investors to turn to diplomatic protection rather than to the protection offered by investment treaties. In his view, diplomatic protection should not be accorded precedence, since it posed difficult political and diplomatic problems for the State entitled to exercise it. During his 40 years in the Japanese Ministry of Foreign Affairs, he had never encountered any case in which Japan had exercised diplomatic protection or in which a foreign State had exercised it against Japan. On the other hand, consular protection was a much more widespread practice. He thus considered that investors were better protected by the special arrangements under their investment treaties than by diplomatic protection.

11. The distinction between a corporation and its shareholders was now more important than it had been in the past. There were significant instances of aggressive takeovers, mergers and liquidations, while shares constantly changed hands at a very rapid pace. In such circumstances, it would assist the orderly conduct of economic activity to shield shareholders behind the veil of the company.

12. He had no criticism to make on the substance of draft articles 17 and 18 but thought that they might need some drafting amendments. The text of draft article 17, paragraph 1, should also be aligned with that of draft article 3, paragraph 1, which the Commission had provisionally adopted at the preceding session.³ He thus proposed the following wording: “The State entitled to exercise diplomatic protection in respect of an injury to a corporation is the State of nationality of that corporation.” Similarly, the definition of the State of nationality of a corporation, in draft article 17, paragraph 2, might be reformulated. It might also be useful to explain in the commentary that “corporation” meant a limited liability company whose capital was represented by shares. He had no strong views concerning the bracketed phrase. However, if it was to be kept, it should be a cumulative condition.

13. He had no problems with the two exceptions provided for in article 18. Accordingly, he proposed that draft articles 17 and 18 should be referred to the Drafting Committee.

14. In conclusion, he asked the Special Rapporteur whether, in the third part of the report, dealing with legal persons, he intended to examine the case of other entities such as other types of commercial corporation or entities with non-commercial purposes and, if so, whether he thought there was enough case law and practice to warrant codification.

15. Mr. DUGARD (Special Rapporteur) confirmed that he intended to include a provision dealing with other legal persons in that part of the report. At the current stage of his work, he envisaged a provision stating that the rules enunciated in the articles dealing with corporations also applied, *mutatis mutandis*, to other legal persons.

16. Mr. Sreenivasa RAO said that the Special Rapporteur had squarely raised the question of the rights of the

State of nationality of the shareholders in a company registered or incorporated in a foreign jurisdiction and had rightly accorded the dictum of ICJ in the *Barcelona Traction* case primary attention in his analysis. His own view was that many of the criticisms of the Court’s judgment were beside the point: the main point at issue was not who deserved diplomatic protection more—the developing countries or the shareholders of a company—but how the institution of diplomatic protection operated in the case of legal persons and under what circumstances the State of nationality of shareholders should be entitled to espouse their claims.

17. First, it was clear that a company which was registered or incorporated in a country had the nationality of that country. Moreover, companies did not register or incorporate in more than one country, even if they operated effectively from another country. Second, it was equally well understood that the personality of the company thus constituted was different from the personality of its shareholders, who bore only limited liability. In those circumstances, when an injury was caused to the corporation, the basic principle was that the State of incorporation would be entitled to exercise diplomatic protection in accordance with international law. The point had been made that many countries did not espouse the claims of companies, even if they were incorporated in their jurisdiction, unless some special bond or common interest existed between them and the companies concerned. That was not unusual, however, and did not apply only in the case of legal persons. As the Special Rapporteur noted in paragraph 76 of his report, ICJ had emphasized in *Barcelona Traction* the discretionary nature of the exercise of diplomatic protection by the State of nationality. It was difficult, therefore, to envisage any exception to the basic principle on grounds of special circumstances affecting the incorporation of companies.

18. The argument that a “genuine link” was a valid basis for the country with preponderant or effective control of the company to espouse the claims of its shareholders as shareholders was equally unconvincing. The genuine link principle arose under the law of diplomatic protection only in the case of persons with more than one nationality. It could not be extended to corporations or legal persons, which could not have dual nationality, and this possibility should not be envisaged. For that reason, he agreed with the many speakers who had suggested that the words in square brackets in draft article 17, paragraph 2, should be deleted. He agreed, in that connection, with the comment in paragraph 53 of the report that the presence of a registered office in the State of incorporation was a consequence of incorporation and not independent evidence of a connection with that State. For the reasons noted, he had no difficulty with draft article 17, paragraph 1, or with paragraph 2, subject to the deletion of the words in square brackets.

19. The next issue for consideration was the extent to which the Commission should entertain an exception or exceptions to the basic rule that the State of nationality of the shareholders in a corporation was not entitled to exercise diplomatic protection on their behalf. The exception in draft article 18, subparagraph (a), was based on the dictum of ICJ in the *Barcelona Traction* case and had the support of most members of the Commission, including

³ See footnote 1 above.

himself. In that regard, he joined Mr. Kateka in recommending that the Commission should show the same caution as the Court and allow the right to diplomatic protection only in the event of the “legal demise of a company” [p. 41, para. 66] and not in the event of its “paralysis” or “precarious financial situation” [*ibid.*]. On the question as to which law should determine the fact of legal demise, the Special Rapporteur indicated in paragraph 64 of his report that a company “died” when it was wound up according to the law of its State of incorporation.

20. Turning to the exception in draft article 18, subparagraph (b), some members of the Commission were—rightly, in his opinion—hesitant to endorse it. With regard to the reasons of equity invoked in favour of that exception, particularly where the company’s nationality did not result “from voluntary incorporation” but was “imposed on it by the government of the country or by a provision of its local law as a condition for operating there, or of receiving a concession” [separate opinion of Judge Fitzmaurice, p. 73, para. 15], it had rightly been pointed out that the company had a choice not to invest in such a country. If it did so, in full knowledge of the consequences, there appeared to be little compulsion. In addition, it should be noted that most recent investment protection agreements provided effective legal remedies for investors in the case of any denial of justice or wrongdoing by the State of incorporation resulting in injury to the corporation. That trend towards recourse to international arbitration, including ICSID, raised the question whether any additional remedy at the international level in the form of diplomatic protection was needed. He therefore tended to agree that the exception in draft article 18, subparagraph (b), could be safely excluded without in any way compromising the position of corporations. The deletion of that exception would also obviate the need for the Commission to speculate on the conditions or limitations under which it should be applied.

21. He therefore supported referring only draft article 18, subparagraph (a), to the Drafting Committee.

22. Mr. DUGARD (Special Rapporteur), referring to Mr. Sreenivasa Rao’s comments on draft article 18, subparagraph (b), asked what would happen in a situation where the foreign shareholder had no access to any alternative remedy. The shareholder did have such a remedy if his State of nationality was a party to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, but many countries were not. Should one simply accept a situation of that kind?

23. Mr. Sreenivasa RAO said that the Special Rapporteur was right in pointing out that many countries were still not parties to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States. However, if one looked at the investment agreements concluded in recent years, such as those concluded by India, they invariably provided for foreign applicable law and compulsory arbitration clauses. The ICSID mechanism was one of the alternatives and applied automatically when both countries were parties to it, but there were other arbitration procedures available to the company.

24. Mr. DUGARD (Special Rapporteur) said that Mr. Sreenivasa Rao was referring to the progressive Indian

system, but the fact remained that there were many countries which did not have laws of that kind, with the result that the shareholder in a company incorporated in a foreign country was frequently left without any remedy at all. That was why he had suggested that there should be a residual right of protection.

25. Mr. CHEE said he agreed with Mr. Sreenivasa Rao that provision for arbitration under bilateral investment treaties was the usual practice. However, arbitration was just one of several possibilities. It was possible that, in addition to arbitration clauses, other legal language that was common to different countries might be included in such treaties, since applicable law also played a role. If so, the interpretation and application of the treaty could give rise to differences.

26. Mr. Sreenivasa RAO, while acknowledging that such clauses were not easy to apply, said that investment treaties were nevertheless favourable to most investors. Moreover, some of those treaties also envisaged possibilities of diplomatic protection whereby, rather than going to court, the State of nationality of the shareholders could approach the Ministry of Foreign Affairs of the country causing the injury in order to present their grievances.

27. Mr. SEPÚLVEDA congratulated the Special Rapporteur on his excellent report, which was not only conceptually rich and intellectually precise but also innovative in many respects. He was particularly glad to see that the Special Rapporteur had offered the Commission a number of options, together with a critical analysis. He likewise endorsed the idea of preparing draft articles embodying the principles laid down in the *Barcelona Traction* case. However, he had none of the doubts that regularly plagued the Special Rapporteur, who first recalled that the decisions of ICJ were not binding on the Commission, then emphasized that the *Barcelona Traction* decision was not sacrosanct and subsequently invited the reader to consider a range of possibilities for departing from the course followed by the Court. He acknowledged that *Barcelona Traction* was undoubtedly a significant judicial decision, only to downgrade its significance by saying that the underlying reasoning was hardly persuasive and that it showed a lack of concern for the protection of foreign investment. Instead of such soul-searching, he himself frankly preferred the Special Rapporteur’s conclusion that, 30 years on, the *Barcelona Traction* decision was widely viewed not only as an accurate statement of the law on the diplomatic protection of corporations but also as a true reflection of customary international law.

28. The principle embodied in that decision was reflected in draft article 17, which he endorsed, although he would make a few comments that might help to define its scope.

29. First, as was indicated in article 1 of the draft articles provisionally adopted by the Commission at its previous session, it must be assumed that the injury that prompted the State of nationality to exercise diplomatic protection of a corporation was caused by an internationally wrongful act committed by a State, something which was linked to the topic of State responsibility.

30. Second, the nature and consequences of the injury could vary considerably. The draft articles on State responsibility for internationally wrongful acts⁴ created a special category of offences, namely, serious breaches of peremptory norms of international law. Without going so far as to transpose that type of provision, it would be useful, perhaps in the Special Rapporteur's commentary, to mention that there was such a thing as particularly serious injury. For example, confiscation of the property of a company carried out with no view to the public interest, in violation of the law and without appropriate compensation, could not be placed on the same footing as the pressure that might be brought to bear by a host country on a company to compel it to appoint someone of a given nationality to an executive position. Hence the usefulness of differentiating between injury arising from a serious and systematic breach of an international obligation and injury which was comparatively less serious. Obviously, the consequences of such a classification would also have to be specified, particularly with regard to compensation.

31. Third, the nature of the injury could differ radically depending on whether it was to a legal person (economic loss, for example) or to a natural person (the violation of a fundamental right or an attack causing bodily harm, for example). A natural person could also suffer economic loss, although evaluating the non-material damage done to a legal person would be more difficult.

32. It was important to retain the two criteria stated in article 17, paragraph 2, namely, that the corporation must both be incorporated and have its registered office in the territory of the State that granted it nationality, so as to avert artificial situations such as flags of convenience and the use of tax havens. True, it was difficult to establish the existence of a "genuine link", and that was why the Special Rapporteur might give examples in his commentary of particular instances such as the payment of taxes to the State where the office was located or the employment of nationals of that State.

33. As far as terminology was concerned, it would be more accurate to use the words *está facultado para ejercer* rather than the words *tendrá derecho a ejercer* in the Spanish text of draft article 17.

34. He fully endorsed the introductory part of draft article 18 and the first exception provided for in subparagraph (a), but he thought that the second exception should not be retained because, as was indicated in paragraph 5 of the report, there was a clear-cut distinction between the shareholders and the company: a legal relationship was established solely between the company and the State that granted it nationality, and, according to a general principle of law, that State could not bear responsibility for damage caused to its own nationals. It could also not be said that the only relief available to a company on the international plane was action by the State of nationality of the shareholders, and it was wrong to say, as Mervyn Jones did in the quotation in paragraph 65 of the report, that if the normal rule was applied, foreign shareholders were at the mercy of the State in question; they might suffer serious

loss and yet be without redress.⁵ That would imply that there was no domestic legal system and that the rule of law had given way to power-based rule. That system did exist in many countries, of course, and a number of examples could be given, but it must be borne in mind that the investor must assume some responsibility for risk assessment. Concern to ensure equitable treatment to nationals and foreigners should be reason enough to do away with the exception in draft article 18, subparagraph (b).

35. In conclusion, he said that bilateral or multilateral investment treaties usually provided that recourse to international arbitration ruled out all other recourse procedures. In order to shed new light on the Commission's work, the Special Rapporteur might review the major arbitral awards which related to foreign investment and in which diplomatic protection was frequently mentioned.

Organization of work of the session (*continued*)

[Agenda item 2]

36. The CHAIR said that he had completed his consultations on the subject and suggested that Mr. Koskenniemi should be appointed Chair of the Study Group on the Fragmentation of International Law. If he heard no objection, he would take it that the Commission agreed with that suggestion.

It was so decided.

The meeting rose at 11.30 a.m.

2759th MEETING

Tuesday, 20 May 2003, at 10.05 a.m.

Chair: Mr. Enrique CANDIOTI

Present: Mr. Addo, Mr. Al-Baharna, Mr. Baena Soares, Mr. Brownlie, Mr. Chee, Mr. Daoudi, Mr. Dugard, Mr. Economides, Ms. Escameia, Mr. Fomba, Mr. Gaja, Mr. Galicki, Mr. Kabatsi, Mr. Kamto, Mr. Kateka, Mr. Kolodkin, Mr. Mansfield, Mr. Melescanu, Mr. Momtaz, Mr. Pambou-Tchivounda, Mr. Pellet, Mr. Rodríguez Cedeño, Mr. Rosenstock, Mr. Yamada.

⁴ See 2751st meeting, footnote 3.

⁵ See M. Jones, "Claims on behalf of nationals who are shareholders in foreign companies", *BYBIL*, 1949, p. 225, especially p. 236.