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Multiparty Investment Arbitration and Derivative Claims: Initial Thoughts on the NAFTA Case of B-Mex and Others v Mexico

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The last decade has seen multiparty arbitration emerge as a contentious issue in investment treaty arbitration. Beginning with *Abaclat v Argentina*, investment tribunals have grappled with whether similarly-situated, but otherwise unrelated investors with distinct investments, can bundle their claims in a single arbitration. While decisions on this issue continue to evolve, a new ground for challenging multiparty arbitrations has emerged in the context of derivative claims in the NAFTA case of *B-Mex and others v Mexico*. Under NAFTA Article 1117, a foreign investor enjoys the derivative right to bring a claim on behalf of a local enterprise, if the investor 'owns *or* controls' the enterprise 'directly or indirectly'. In the currently-pending *B-Mex* case, a group of 37 US shareholders have asserted their right to pursue a derivative claim on behalf of Mexican companies on the grounds that they collectively own/control the companies through their ownership of a majority of the companies' shares. In this post, I offer a brief account of jurisdictional issues concerning the multiparty nature of the proceedings and present brief (initial) observations on the viability of Mexico's objections.

Relevant case facts

The case concerns Mexico's allegedly arbitrary and discriminatory interference with the claimants' investments in five casinos in the Mexican gaming industry. Three US nationals were responsible for identifying the investment opportunity and making the initial investment.

They channeled their investments through corporate entities established in the US and Mexico. Each casino was owned by a locally-incorporated company (the '**Mexican Companies**'). In all, the principal investors in the Mexican Companies comprised the three US nationals and five US-incorporated companies owned by the US nationals (the '**Original Claimants**').

The notice of intent to submit to arbitration listed only the Original Claimants as the intended claimants. The remaining 29 shareholders in the Mexican companies (the '**Additional Claimants**') were included subsequently as claimants in the request for arbitration. Mexico contends that this later addition of the Additional Claimants was made necessary because the Original Claimants, by themselves, lacked ownership/control over the Mexican Companies. This contention is better explained by describing the shareholding structure of the Mexican Companies.

Broadly speaking, shares in the Mexican Companies were designated into two classes – Class A and Class B. Class A shareholders enjoyed limited voting rights. Class B shareholders had broad

voting rights and could control shareholder resolutions through a majority vote. The Original Claimants owned between 41% and 82% of all shares in the Mexican companies. However, in four out of the five Mexican Companies, the Original Claimants owned less than 50% of the Class B shares. By joining the Additional Claimants to the arbitration, the claimants' combined shareholding increased to between 56% and 82%, and their cumulative ownership of Class B shares (and the associated voting rights) crossed the 50% threshold.

Mexico has challenged the claimants' standing on two grounds. *First*, Mexico contends that ownership of a local company requires full (and not majority) ownership of shares. *Secondly*, Mexico asserts that a group of unrelated shareholders – in this case the Original Claimants and the Additional Claimants – cannot be said to collectively control a company simply because they own a majority of the company's shares.

Proof of collective ownership – full or majority shareholding?

In its bid to defeat the claimants' standing, Mexico argues that investors can collectively present a derivative claim under the ownership limb of Article 1117's 'own *or* control' only if they enjoy 'full ownership' over the local enterprise. Absent full ownership, investors must prove control to pursue a derivative claim (Reply on Jurisdictional Objections).

NAFTA does not define the terms 'own' or 'control'. NAFTA tribunals have presumably considered it unnecessary to enunciate a test of ownership, because proof of majority shareholding in a local enterprise carries with it the presumption of control (*Caratube v Kazakhstan*). The *B-Mex* tribunal might find it relevant to clarify whether majority ownership tantamounts to ownership under NAFTA. Judicial economy would dictate that if the tribunal found positively on this issue, it would not need to consider Mexico's objections to claimants' standing based on collective control.

The phrase 'own(ed) or control(led)' appears in investment treaties in various contexts – including in the definition of 'investment', denial of benefits clauses, and investor standing to bring an investment claim. Yet, it is notoriously undefined. Definitions have begun to emerge recently, particularly in treaties concluded by Japan (see example, Japan-Australia Economic Partnership Agreement, art 14.17.[/fn] These treaties define ownership of an enterprise as ownership of a majority of the enterprise's shares. The definition seems to be borrowed from the General Agreement on Trade in Services (GATS). Under GATS Article XXVIII, a company is deemed to be owned by the person who owns more than 50% of the company's equity interests. Control, on the other hand, covers situations in which a person has the power to appoint a majority of the company's directors or otherwise direct the company's actions.

Mexico hinges its contention on the claim that the 'control' limb would be rendered redundant if ownership were to include majority ownership. This contention is arguably unsustainable. Indeed, situations of ownership and control can overlap – as in the case of full or majority ownership. But, a steady line of jurisprudence clarifies that 'control' reaches beyond ownership and covers situations of *de facto* control, such as when minority shareholders have sufficient voting strength to assert control (*Thunderbird v Mexico*), or when foreign investors exert substantial influence over the management of the enterprise (*Vacuum Salt v Ghana*). This is unsurprising given that shareholding in modern corporations is widely dispersed, and different voting rights attach to different classes of shares. Decision-making power is thus not necessarily connected to majority share ownership. Control – as distinct from ownership – allows jurisdiction over a local enterprise's claims when control rests in the hands of a foreign investor, even though ownership

might not. The *Aguas del Tunari v Bolivia* tribunal similarly explained the difference between ownership and control as:

"the Tribunal views this provision as meaning "owned [established by majority ownership] or controlled [established by minority ownership plus voting rights]."

Whether ownership is restricted to cases of full ownership is the less contentious of the two objections raised by Mexico. As the tribunal's Procedural Order No. 5 indicates, the tribunal has sought detailed analysis of the legal standards for proving collective control from the parties in their post-hearing briefs.

Collective control by a group of majority shareholders

Having asserted that 'control' and not 'ownership' should determine claimants' standing in the case, Mexico argues next that a group of shareholders that collectively own more than 50% of an enterprise's voting rights cannot be said to 'control' the enterprise, unless they are bound by a legal instrument, such as a shareholders' agreement, to vote collectively.

Exclusive control v control by a group of shareholders

In the early stages of the written proceedings, Mexico reserved its right to challenge multiparty arbitration under NAFTA Article 1117 'by a group of claimants contending that they collectively control an enterprise' (Memorial on Jurisdiction). Relegated to a footnote in Mexico's memorial, it was unclear at that stage whether Mexico was arguing for an objective bar against multiparty arbitration. Such an objection would not be novel. It has arisen in the context of 'control' under the ICSID Convention Article 25(2)(b) (which allows jurisdiction over claims by a foreign-controlled local enterprise). The tribunal in *Vacuum Salt v Ghana*acknowledged that 'an issue may exist' as to whether 'control' is limited to 'exclusive control' or covers collective control by a group of shareholders. That tribunal left the question unanswered, but some authors (see example Douglas) have asserted that the ICSID Convention's use of a singular 'national' requires control to lie in the hands of one controlling foreign investor. [1)]

Article 1117 does not expressly permit multiparty arbitration. NAFTA parties have previously opposed multiparty arbitration, but such a challenge has not been based on any objective bar in the text of Article 1117. In *Loewen v USA*, for instance, the US conceded that Article 1117 'does not expressly provide that only one investor may file such a claim' (US Memorial on Jurisdiction). In that case, the US's objection to multiparty arbitration was born out of the case facts and the structure of the claimants' corporate relationship. The claimants in *Loewen* comprised the local enterprise's direct shareholder (The Loewen Group) and its ultimate indirect shareholder (Raymond Loewen). The two claimants did not appear jointly in the arbitration; they retained separate counsels and presented separate submissions. Furthermore, the claimants were in a vertical corporate relationship with the local enterprise. As each claimant could independently sustain a claim on behalf of the enterprise, the US feared that allowing multiparty arbitration in such a situation would create the possibility of claimants offering divergent and conflicting theories on behalf of the same enterprise, which it would have to separately defend. Accordingly, the US suggested that limits to multiparty arbitration should be read into NAFTA Article 1117 so as to 'prevent multiple claims on behalf of the same enterprise', and only the direct shareholder should be allowed to present the derivative claim. [2)]

The US's line of objection is of limited assistance in this case. As described, the US was opposed to the pursuit of multiple claims on behalf of the same company. That objection does not apply when a group of horizontal shareholders – as in *B-Mex* – pursue a derivative claim. No single investor enjoys independent standing to present the claim, as the collective might of all investors is necessary to demonstrate ownership/control over the enterprise.

NAFTA tribunals have not limited standing under Article 1117 to cases of exclusive control. Horizontal shareholder groups have successfully pursued derivative claims, but in the relatively few examples of such cases, the group has normally comprised shareholders who had collectively decided to invest in the host State (see example *Azinian v Mexico*).

As arguments have developed in the case, it has become clear that Mexico is not seeking to limit standing under Article 1117 to situations of exclusive control. Instead, Mexico seeks to distinguish between collective control by related and unrelated shareholders (Post-Hearing Brief). Mexico concedes that related shareholders can be said to exercise control if they are collectively the majority shareholders of a local enterprise. Unrelated majority shareholders, in Mexico's view, need to additionally prove their obligation to vote as a bloc through the existence of a binding agreement.

Unrelated majority shareholders and proof of collective control

At the heart of Mexico's argument lies the difference between *proof of the ability to exercise collective control* and *proof of actual exercise of collective control*. Majority shareholding indicates only the ability to exercise collective control. Whether a group of shareholders actually exercise collective control depends on the existence of a formal or informal agreement to act together.

This is an accepted distinction in domestic corporate laws. Under domestic definitions of 'control' or 'controlling shareholder(s)', a group of persons are treated as controlling shareholders only when they are 'acting in concert' (see example Companies Act, Listing Rules and Takeover Code). Proof of concert requires a case-specific analysis. Concert is presumed for related shareholders, such as family members or business associates. Otherwise, concert is proved through a formal shareholders' arrangement or tacit evidence of concert, such as repeated pattern of bloc voting.

By contrast, proof of actual exercise of collective control is not required in the only known treaty description of collective control – the Iran-US Claims Tribunal's Claims Settlement Declaration (art VII(2). At the Iran-US Claims Tribunal, a group of shareholders could bring an indirect claim on behalf of a company if their ownership interest was collectively sufficient to control the company. As the ability to exercise collective control, without more, was sufficient to prove control under the treaty, the Tribunal has consistently found it of no import that collective control is based on the aggregation of individual shares of different shareholders (see example *Mcharg and others v Iran*).

Investment treaties, whilst occasionally defining control, do not expressly address the issue of collective control. Control is commonly defined as the *ability* to exercise substantial or decisive influence over a company's management, including by way of ownership of a majority of the company's voting rights (see example Energy Charter Treaty, art 1(6), Australia-India BIT, art 1(h), Netherlands-Argentina BIT, Protocol).

Given that the NAFTA does not define 'control', the *B-Mex* tribunal could distinguish the example

of the Iran-US Claims Tribunal, and import the test of 'concert' from domestic laws. Some support for this view can be found in the case-law on 'collective control' in the similarly-undefined test of control in ICSID Convention Article 25(2)(b). In *Sempra v Argentina* and *Camuzzi v Argentina*, the tribunal decided that a foreign investor could aggregate its shares with another foreign investor to establish control, if the evidence proved that the shareholders were acting in 'alliance' or operating 'jointly'.

Other tribunals have found the ability to exercise collective control sufficient to prove control. In *Transgabonais v Gabon*, the tribunal held that ICSID Convention Article 25(2)(b)'s test of 'control' is met if foreign investors collectively own a majority of a local company's voting rights; proof of actual control through a shareholders' agreement is not required. Notwithstanding, the tribunal conceded that the existence of foreign control by a plurality of entities is a question of 'pure fact'. Ultimately, the tribunal held that allegations of 'dissonant conduct among the different foreign nationals' could affect a finding of control.

What amounts to collective control requires further in-depth analysis, but preliminary research suggests that actual exercise of control by unrelated investors has a role to play in jurisdictional assessments. It is also clear that, contrary to Mexico's assertion, collective control does not require proof of formal agreement. The question might ultimately be one of burden of proof. Under the *Sempra/Camuzzi* approach, the claimants would have the burden of demonstrating actual control. Under the *Transgabonais* approach, actual control by majority owners of voting rights is presumed unless the respondent establishes otherwise.

Conclusion

Mexico's objections in the case have created the opportunity for an investment tribunal to address not only the issue of collective control, but also clarify comprehensively the legal standards for proving ownership and control. It has been shown that Mexico's arguments regarding 'ownership' as being 'full ownership' are unlikely to hold water. Such a reading would depart from established jurisprudence. It has also been shown that the NAFTA does not limit control to situations of exclusive control. Where the tribunal is likely to break new ground is on the issue of proving collective control by unrelated shareholders. The tribunal should not be persuaded by Mexico's argument that only a formal agreement can prove collective control. There is no authority for such a proposition in domestic or international law. However, it would not be erroneous for the tribunal to build into the test of control, proof of actual exercise of collective control. Whether the tribunal would require such proof from the claimants at the outset, or whether majority share ownership would create a presumption of collective control in the absence of evidence to the contrary, is yet to be seen.

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References

?1 Douglas, Z. (2009). *The International Law of Investment Claims*. Cambridge: Cambridge University Press. doi:10.1017/CBO9780511581137.

?2 The tribunal did not pronounce on the US's objections.

This entry was posted on Tuesday, November 20th, 2018 at 12:14 am and is filed under Derivate Contracts, Derivative Claims, Investment Arbitration, Investment Treaties, Investor-State arbitration, Multiple parties, NAFTA
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