# Nationality of corporations and the exercise of diplomatic: *Shareholder's rights under international law*

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## I. INTRODUCTION

Latest acquisitions by Brazilian and Mexican companies of majority shares of some bankrupt United States companies[1], poses important legal aspects of doing business in Latin America, which have been analyzed under International Law. Thus, Latin American countries must consider the institution of diplomatic protection as one of their possibilities to protect their shareholders rights in foreign corporations, furthermore, when Bilateral Investment Treaties (BIT) or any other kind of agreements does not exist[2] and the state where the corporation is doing business decides to take actions against it, violating corporation or shareholders rights.

Nevertheless, diplomatic protection can only be exercised by the State of nationality of the corporation and, determine it becomes under some circumstances an important question that cannot be solved declaring the corporation has the nationality

[1] See the article "Has the Global Crisis Whetted Latin America M&A Appetites" In: Inter-American Dialogues, Monday September 28 – 2009 (www.thedialogue.org/)

[2] Most of the treaties – bilateral or multilateral – governing protection of foreign investments contain a specific provision determining the jurisdiction where a case can be brought when a dispute arise. Majority of States prefer to choose Arbitration Tribunals rather than the ICJ, because, Bilateral – or multilateral – Investment Treaties object is the protection of natural or legal persons investments in foreign countries and, the ICJ – in spite of being the UN main judicial organ – can only decide on disputes between States. Additionally, Arbitration Tribunals spend less time than the ICJ in the resolution of a case; while the ICJ might spend several years – minimum seven or eight when both parties does not challenge the jurisdiction – making a decision, an Arbitration Tribunal can spend one or two years.

of the majority of its shareholders. This paper tries to show how International Law, based on ICJ decisions (hereinafter "the Court") has developed this matter, in an attempt to criticize shareholders protection under International Law. First part provides the historical background of diplomatic protection regarding legal persons, contextualizing my further analysis. Second part focuses on Latin America and the United States shareholders rights, showing their main similarities, as another basis for the analysis in last section. Finally, third part –as a conclusion– will plea for a return to the "genuine connection" theory, inclination for the "shareholder primacy" model, and the settlement of disputes brought before the Court on the grounds of equity.

## II. DIPLOMATIC PROTECTION REGARDING LEGAL PERSONS

International law, define as the set of rules and norms which regulate the conduct of States[3], essential characteristic is that only States –and in some extent international organizations– have standing to present claims, seeking for reparation of damages committed by wrongful acts of other State. Exercise of diplomatic protection[4] by states on behalf of its own nationals, as one of the rule exceptions, is quite new in comparison to other international law institutions; therefore, it has not greatly developed. Indeed, the Court has only analyzed only this institution in four cases, regarding to legal persons.

[3] Rebecca M.M. Wallace. *International Law*. Sweet & Maxwell, London. 2005. p. 1.

[4] As defined early by the old Permanent Court International of Justice in the *Mavrommatis Palestine Concessions Case* "It is an elementary principle of international law that a State is entitled to protect its subjects, when injured by acts contrary to international law committed by another State, from whom they have been unable to obtain satisfaction through the ordinary channels. By taking up the case of one of its subjects and by resorting to diplomatic action or international judicial proceedings no his behalf, a State is in reality asserting its own right – its right to ensure, in the person of its subjects, respect for the rules of international law." See, PICJ Series A (1924), No. 2, 12

## A. Barcelona Traction

In the *Barcelona Traction Case*[5]–hereinafter "*BT*"–, the Court was addressed to determine whether or not Belgium, the State of nationality of the majority of the shareholders of the Barcelona Traction Co., a company incorporated in Canada, has standing to exercise diplomatic protection on behalf of its shareholders.

Initially, the Court determined the law applicable as one of the main problems. Therefore, it recognized the corporate entity as an institution created by states and that, whenever legal issue arise concerning the rights of States with regard to the treatment of companies and shareholders, as to which international rights has not established its own rules, it has to refer to the relevant rules of municipal law[6]. Thus, when damage is sustained by company and shareholders, both does not have right to claim compensation, because in spite of being two different entities, only the rights of one of them are infringed, i.e. company[7]. Thereby, state of nationality of shareholders could exercise diplomatic protection on their behalf when (i) the company ceases to exist in the State of incorporation; (ii) the State of incorporation causes an injury over the company[8], and; (iii) shareholders direct rights are violated. As neither of the requirements established by the Court took place in the case, only Canada can exercise diplomatic protection. As a result, the Court rejected, the requirement for the existence of a "genuine connection" between the person – natural or legal – and the State seeking to protect him, previously established in the *Nottebohm Case*[9].

[5] Barcelona Traction, Light and Power Company, Limited (Belgium v. Spain) ICJ Reports 1970

[6] Ibid 34, 32.

[7] Not a mere interest affected, but solely a right infringed involves responsibility, so that an act directed and infringing only the company's right does not involves responsibility towards the shareholders, even if their interests are affected. ICJ Reports 1970, 46, 36.

[8] Ibid 37, 33.

[9] Nottebohm Case (second phase) ICJ Reports 1955.

Nonetheless, the Court gave a – remote – possibility, regarding to possible considerations on equity[10] as an exception to the rules mentioned above for the exercise of diplomatic protection on behalf of the shareholders. As a later analysis stated, "*one is more than ever disappointed by the Court's lack of appreciation of the very specific facts of the case, the narrow reasoning and the almost complete adherence to conceptualism as opposed to equity.*"[11]

The second important issue analyzed, concerned on how to determine the nationality of a corporation[12], issue where the concepts of "incorporation" and "seat of management" play an important role among others[13]. Incorporation refers to the process to create a corporation according to the laws of certain state, which will accept the corporation as a person itself; while seat of management is the place where the executive decisions of corporation business are taken. Anglo – American rule traditionally have attributed corporations the nationality of the State where it has been incorporated, whereas in countries under the continental system, the nationality depends on where the corporation has its seat of management – *siège social* –[14].

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[10] Equity for the Court constitutes the right to equal treatment nationals from one State have, when nationals from others States receive a different and better treatment. Therefore, if Belgian shareholders were receiving a discriminatory treatment in comparison with other foreign shareholders in companies doing business in Spain but not incorporated there, Belgium could have standing to exercise diplomatic protection on behalf of it national shareholders.

[11] F.A. Mann. *Foreign Investment in the International Court of Justice: The ELSI Case*. 86 Am. J. Int'l. L (1992) 92.

[12] The Court clarified that the answer to the question of how to determine the nationality only refers to a Limited Liability Company, basically, because Barcelona Traction possess this legal persons characteristic. Confront, ICJ Reports 1970, 34, 32.

[13] The Court only mentioned these two criteria; however, three are the main ones for determining the nationality of legal persons: (i) place of incorporation, (ii) siège social – seat of management – and, (iii) control or substantial interest. The last one confers the nationality of a corporation to the state of the shareholders how own a majority or a substantial portion of its shares. See: Ricardo Letelier Astorga. *The Nationality of Juridical Persons in the ICSID Convention in Light of its Jurisprudence*. Max Planck Yearbook of United Nations Law. Volume 11 (2007) pg. 429.

[14] Cynthia Day Wallace. *The Multinational Enterprise and Legal Control: Host State Sovereignty in an area of Economic Globalization*. Martinus Nijhoff, New York. 2002. p 131.

The Court chose the theory of incorporation as the most pertinent, adding as a second element a registered office in the state of incorporation, basically because these two criteria have been confirmed by long practice and numerous international instruments[15]. Nevertheless, any reference to the basis of its decision was made[16].

After this decision, only in three more opportunities analysis in the protection of the shareholders rights were made. With the exception of the *Elettronica Sicula*[17] case, some remarks are important.

**B. ILC Draft Article on Diplomatic Protection**

In year 2006, the International Law Commission (hereinafter "ILC") in its 58th session, submitted to the UN General Assembly a *Draft Article on Diplomatic Protection*, which contain the most relevant rules for the exercise of diplomatic protection on behalf of natural and legal persons. Articles 9 to 13, governs the issues regarding legal persons[18]. No substantial changes were made by ILC here; nonetheless three comments are important.

First, the two criteria established by the Court in the *BT* in order to determine the nationality of a corporation were not taken into account. On the contrary, the State of incorporation was established as the only criterion and, the seat of management as subsidiary only when two events occur[19].

[15] ICJ Reports 1970, 40, 34.

[16] i.e. examples where it can be established that incorporation and registered office, as long practice and some international instruments, that can confirm the use of this criteria.

[17] Elettronica Sicula S.p.A. (ELSI), Judgment, ICJ Reports 1989. Here the Court did not apply the subsidiary criteria established previously for the exercise of diplomatic protection on behalf of shareholders, more exactly, because between the parties –U.S. and Italy– a BIT was signed, including in the provisions the shareholders rights protection abroad.

[18] Nationality of a corporation – article 9 –, continuous nationality of a corporation – article 10 –, protection of shareholders – article 11 –, direct injury to shareholders – article 12 –, and other legal persons – article 13 –

[19] Article 9. *State of Nationality of a Corporation*. For the Purposes of diplomatic protection of a corporation, the State of nationality means the State under whose the corporation was incorporated. However, when the corporation is controlled by

Second, the three exceptions for the exercise of diplomatic protection on behalf of the shareholders established in the *BT* were preserved, making some differences between them. For ILC, the exercise of diplomatic protection when (i) company ceases to exist in the State of incorporation or (ii) the State of incorporation causes an injury over the company – article 11 –, still as exceptions for the exercise of the diplomatic protection. Nevertheless, for the second exception ILC added as requisite, incorporation in the State of nationality as precondition for doing business there.

Third, the application of rules governing the exercise of diplomatic protection for legal persons will apply, pursuant to article 13, to other than corporations. The reason behind this article could be found – again – in the *BT*, where the Court said it was concerned only with the question of the diplomatic protection of shareholders in a Limited Liability Company –as happened in the later cases–. Thus, the ILC accepted the rules governing legal persons are abstract and fit exactly to a LLC, while it application to other kind of entities may be different depending, among others, on the facts and claims presented by the parties in each case.

**C. Ahmadou Sadio Diallo**

The last opportunity in which the Court made a reference, was in the *Diallo Case*[20], brought before this judicial organ in 1998 and decided – preliminary objections – by the Court in year 2007, ratifying the *BT* holding in its .

Application of domestic laws to determine both company and shareholders rights and therefore, who can exercise of diplomatic protection suppose an application of the legislation of the State of incorporation. In addition, as Guinea filed the application arguing

nationals of other State or States and has no substantial business activities in the State of incorporation, and the seat of management and the financial control of the corporation are both located in another State, that State shall be regarded as the State of nationality. (underline out of the text)

[20] Ahmadou Sadio Diallo (Preliminary Objections), ICJ Reports 2007.

the violation of Mr. Daillo's rights as *associé*[21] and shareholder, the Court remembered and preserved the requirements established in the *BT*, later ratified by the ILC draft article.

On the other hand, two changes were made by the Court. First, did not accept considerations of equity[22] for the protection of the shareholders rights – without taking into account the exceptions established by the ILC draft article –, even when Guinea proved their existence. Second, the Court restricted article 11(b) of the ILC draft article – incorporation as a precondition for doing business in the State –, establishing that "*such application required the demonstration that the article 11(b) exception had become customary international law.*"[23]

## III. SHAREHOLDERS RIGHTS

Exhaustive studies examining the variety of rights shareholders possesses in some legal systems, has been made by dozen of authors; nevertheless, the purpose in this section goes in a different direction, in an effort to make a brief mention of the shareholders rights in Latin American countries and the United States and the existent similarities in this field.

Following the legal tradition Latin American countries share – i.e. civil law tradition –, shareholders rights are determined by the laws – in it positive meaning – enacted by the legislature[24]. Making a synopsis of the different laws regulating the subject under analysis and, disregarding the particularities provisions contains – e.g.

[21] In the decision available at the website of the ICJ (www.icj-cij.org), despite find the english version of the decision, this is the language used by the Court there.
[22] ICJ Reports, 2007, 27, 77.
[23] Alberto Álvarez Jimenez. *Foreign Investors, Diplomatic Protection and the International Court of Justice's Decision on Preliminary Objections in the Diallo case*. 33 N.C.J. Int'l L. & Com. Reg. (2007 – 2008) 437.
[24] Shareholders rights are governed in Mexico by the General Law of Commercial Companies, Chile by the Law of Corporations, Brazil by the Brazilian Law of Corporations, Venezuela by the Capital Markets Law, Argentina by the Law of Commercial Corporations (which modified the Title Third of the Commercial Code), Colombia by the Commercial Code.

required quorum, percentage of shares required to name one director, votes required in the shareholders meetings to make decisions –, is possible to conclude that some of the rights shareholders possesses are generally accepted by all the Latin America countries. Thus, the rights to demand a general meeting, withdrawal, to name a director, inspection of books, dividends, compensation after the company liquidation, and modification of bylaws, among others are common rights of the shareholders in Latin America. Moreover, similarities can be found not only in the recognition of the shareholders rights, also in the prohibition to modify or avoid some of the shareholders rights determined by the legislature[25].

On the other hand, an analysis of the shareholders rights in the United States seems not to be really easy, basically, because every state has the power to legislate in all the issues concerning corporations and other kind of legal entities[26]; thereby, is possible to think about a disparity in the rights shareholders possesses. Nevertheless, there have been some attempts towards a convergence in this field by the American Bar Association and its Model Business Act[27], which thirty one states have adopted. According to this, one can say in the United States, the main shareholders rights are the dissolution of the company power, withdrawal, appraisal rights, amendment of bylaws, removal of directors, distribution, inspection of books and records.

It seems – as a conclusion –, Latin America and the United States grant shareholders –in spite of some differences– have the same rights[28],

[25] In Mexico, among others, shareholders cannot be deprived of their dividends, preemptive rights and special agreements between them; in Brazil is possible to find the right to participate in the corporation profits or assets, supervise the management of the company, subscription rights, to seek and appraisal; Venezuela provides the right to call for a shareholders' meeting, withdrawal, name directors, preemptive rights, dividends.

[26] Majority of states in their legislations try to do a basic guideline allowing corporations' bylaws regulate all this matters.

[27] Model Business Corporation Act, 3rd Edition.

[28] Inclusively, this idea can be understand as a confirmation of what the ICJ stated in Barcelona Traction, "It is well known that there are rights which municipal law confers upon the latter distinct from those of the company, including the right to any declared dividend, the right to attend and vote at general meetings, the right to share in the residual assets of the company on liquidation." (ICJ Reports 1970, 36, 47)

which shows there is no disparity in the treatment they receive by States in the region.

## IV: CONCLUSION: SEEKING MORE PROTECTION FOR THE SHAREHOLDERS RIGHTS UNDER INTERNATIONAL LAW

### A. Shareholders rights, customary law and obligations erga omnes

Aware that cases brought before the ICJ in the field of foreign investment constitutes an exception, a change in the way the most important tribunal inside the UN understand the shareholders treatment can be supported. The constitution of some shareholders rights as customary law in close connection with Human Rights Law, a return to the "genuine connection" theory and the shareholders primacy in the company, are some of the reason for this change and support the critique to how The Court protect shareholders rights, as well as the implication it has in Latin America – among others developing countries – when BIT does not exist and their shareholders rights abroad are violated.

Article 38 of the Statute of the Court[29], serves as the classic starting point to the study of International Law sources, which international custom is one of them. From the definition, (i) evidence of general practice (ii) accepted as law, are the two conditions for its validity. The first condition looks towards proving States practice; as the ILC noted[30] and later the Court did[31], the evidence can be proven by treaties, decisions of international courts, decisions of national courts, national legislation and the practice of international organizations. The second condition, known as *opinion iuris* too, requires States recognition of the practice as obligatory; this constitutes the essential

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The ICJ reference to these rights shows how the Court acknowledge the existence of this rights – among others – as generally accepted by the States.

[29] Article 38. The Court, whose function is to decide in accordance with international law such disputes as are submitted to it, shall apply: … (b) International custom, as evidence of a general practice accepted as law.

[30] International Law Commission. Yearbook 1950 (II). p. 368.

[31] Legality of the Threat of Use of Nuclear Weapons, Advisory Opinion, ICJ Reports 1996.

problem, the burden of proof for the State alleging the existence of customary law[32].

On that order of ideas, some shareholders rights exist under International Law as customary rules that all the States must follow and, therefore, all the international tribunals –including the Court– must consider them as a source of law to apply when a dispute arise. The dozens of BITs and similarities between the United States and Latin America –section two of the paper– constitutes the necessary burden of prove as evidence of a general practice in the acceptance of the shareholders rights as customary law[33]. Thus, rights such as name a director, dividends, withdrawal, inspection of books, preemptive rights and compensation after the company liquidation, are customary international law[34] not only in the United States and Latin America. Even, these rights create –according to the Court *dictum* in the *BT*– obligations *erga omens*[35], which bound all the States.

[32] In the Asylum Case (Colombia v. Perú) ICJ Reports 1950, the Court did not accepted asylum as customary law, basically, because Colombian government lack to prove Peruvian constant and uniform use of asylum as law.

[33] "In many cases the Court is willing to assume the existence of an opinion iuris on the basis of evidence of a general practice, or a consensus in the literature, or the previous determinations of the Court or other international tribunals. However, in a significant minority of the cases the Court has adopted a more rigorous approach and has called for more positive evidence of the recognition of the validity of the rules in question in the practice of states." See: Ian Brownlie. *Principles of Public International Law*. Fourth Edition. Oxford University Press, New York. 1990. p. 7.

[34] The highest publicists – as another source of law – have consented that the general practice does not refers to a specific number of States, everything depends if the customary law is international or regional.

[35] See, ICJ Reports 1970, 32, 33. The Court noted: "*When a State admits into its territory foreign investments or foreign nationals, whether natural or juristic persons, it is bound to extent to them the protection of the law and assumes obligations concerning the treatment to be afforded them. These obligations, however, are neither absolute nor unqualified. In particular, an essential distinction should be drawn between the obligations of a State towards the international community as a whole, and those arising vis-à-vis another state in the field of diplomatic protection. By their nature the former are concern of all States. In view of the importance of the rights involved, all States can be held to have a legal interest in their protection; they are obligations erga omnes.*" (underline out of the original text)

In addition, is not only the existence of shareholders rights as obligations *erga omnes*, what make them essential. Their relation with the Human Rights[36] field, shows how their character of economic rights does not limit the possibility people have to file a claim when their rights are in connection with rights such as life, compensation[37], property or equal protection. Yet, the real connection between shareholders rights and the Human Rights, depend on the particular facts of the case and the attorney arguments to demonstrate the violation.

**B. Genuine connection (Nottebohm case)**

Lacunas international law have in the protection of the shareholders rights when they are violated, derive –as it was mentioned in first section– from the decision made by the Court in the *BT*, on not apply the existence of a genuine connection[38] – call by others "genuine link" –, as did it twenty years before in the *Nottebohm* case.

In the case, the Court dealt with the question of, whether or not Liechtenstein can exercise diplomatic protection on behalf of Mr. Nottebohm, who held citizenship in Germany as well, in order to protect his rights because of the actions taken by Guatemala. The problem trying to answer the question consisted in that Mr. Nottebohm obtained his Liechtenstein nationality after many years living in Guatemala and, his only connection with this State was the residence of his brother and some taxes he paid to the Liechtenstein government.

Guatemala argued Liechtenstein was not entitled to extend its protection to Nottebohm against Guatemala, because "*nationality is a legal bond having as its basis a social fact of attachment, a genuine connection of existence, interest and sentiments, together*

[36] In the actual world, Human Rights play a very important role in contemporary legal consciousness, to a certain extent, as the identity around the world. See: Duncan Kennedy. *Three Globalizations of Law and Legal Thought 1850 - 2000*. Cambridge University Press. 2006. p 63.
[37] See Article 10 of the American Declaration of Human Rights
[38] ICJ Reports 1970, 70, 42.

*with the existence of reciprocal rights and duties*"[39]. Thus, the Court established Nottebohm connection with Germany, by some business and the family he had there, establishing Germany as the State entitled to exercise diplomatic protection on his behalf. Majority of the doctrine construed this requirement of a genuine link between injured person – either natural or legal –, as the only precondition for the exercise of diplomatic protection.

During the proceedings in the *BT*, the Court did not give any reason to not apply the genuine connection theory in the case and allow Belgium to exercise diplomatic protection on behalf of its shareholders. Nevertheless, is curious the Court justifies Canada standing to exercise diplomatic protection because *a close and permanent connection has been established*[40], as it had its registered office and board meetings there for several years. For the Court, when shareholders invest in a corporation doing business abroad they undertake risks, including the risk that the corporation may in the exercise of its discretion decline to exercise diplomatic protection on their behalf[41].

Bearing in mind that shareholder's rights – as it has been stated in this paper –, are customary international law and obligations *erga omnes*, the risk mentioned above cannot be accept because all the States have the duty to protect the basic shareholders rights and are not able to, discretionally, violate those rights.

Thus, application of the genuine connection theory can be useful for the Latin American countries when their nationals possess majority of the shares in foreign companies, because such companies will be genuine connected with the Latin American countries by virtue of its nationals holding most of the shares[42]. In addition, the possibility to bring the

[39] ICJ Reports 1955, 23.

[40] ICJ Reports 1970, 71, 42.

[41] Chittharanjan F. Amerasinghe. *Diplomatic Protection*. Oxford University Press, New York. 2008. p. 125.

[42] This idea can also be found in some of the studies on the Barcelona Traction case, and the critics after the Court decision. See: Lawrence Jahoon Lee. Barcelona Traction in the 21st Century: Revisiting its customary and policy underpinnings 35 years later. 42 Stan. J. Int'l L. (2006) 327. Also: Amerashinge.

claim against the state, where the company is incorporated –i.e. possess its nationality and does not want to exercise diplomatic protection– can arise, because with that solely act, the State of nationality of the corporation is not carrying out an obligation *erga omens*.

### C. Shareholders as owners and grounds of equity

As basis for the require change in the protection shareholders receive today – when there are no BITs or special provisions in the international field –, is necessary to look towards the new corporate law theories, more exactly, those which view shareholders as the owners of the corporation[43]. Conscious that this theory is not running around the world, basically, because shareholders do not possess significant rights in the corporation; the acceptance of some of their rights as customary law is the required impulse this theory needs. Conscious too, shareholders generally do not act like owners of the corporation, it is generally accepted, that without them these kind of entities – i.e. legal persons – might not have sense; when only the shareholders have the duty – and right – to vote or hire directors and make the decisions of the corporation. Institute shareholders possess an prominent connection with the corporation and their rights are not subsidiary of the company rights, allows the Court to make it decision applying equity, a general principle of law recognized by civilized nations[44]. Even when Article 38 of the Statute of the Court does not refers to the general principles of law in first place, it has been settled that The Court is free to apply the different rules Article 38[45] provides in order to bring about an appropriate settlement[46], because what is important here is to make an equitable decision that does not affect neither company rights nor shareholders rights.

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[43] David J. Berger. *One Practiotioner's Random Thoughts on Shareholder's Rights in the Modern Corporation*. In: *The Accountable Corporation*. Westport, Connecticut. 2006. p. 125.

[44] See Article 38(c), Statute of the International Court of Justice.

[45] Following Article 38 of the Statute of the Court, Treaties and Customary Law precede the General Principles of Law, nevertheless this enumeration does not required the application of the Treaties and Customary Law before General Principles of Law could be applied.

[46] Continental Shelf (Tunisia v. Lybian Arab Jamahiriya), ICJ Reports 1982, 71, 60.