Barcelona Traction

Student Materials

- Decided by the International Court of Justice in February 1970
- Key topics: upholding international law (international legal enforcement); investment (historical development)

Learning Objectives

- Understand and apply:
  - the right to diplomatic protection
  - limits on standing at international bodies
  - the concepts of judicial economy and *obiter dictum*

- Analyze and evaluate:
  - the difference between a bilateral obligation and an *erga omnes* obligation
  - when and why courts sometimes refuse to rule on legal questions
  - why states created Investor-State Dispute Settlement

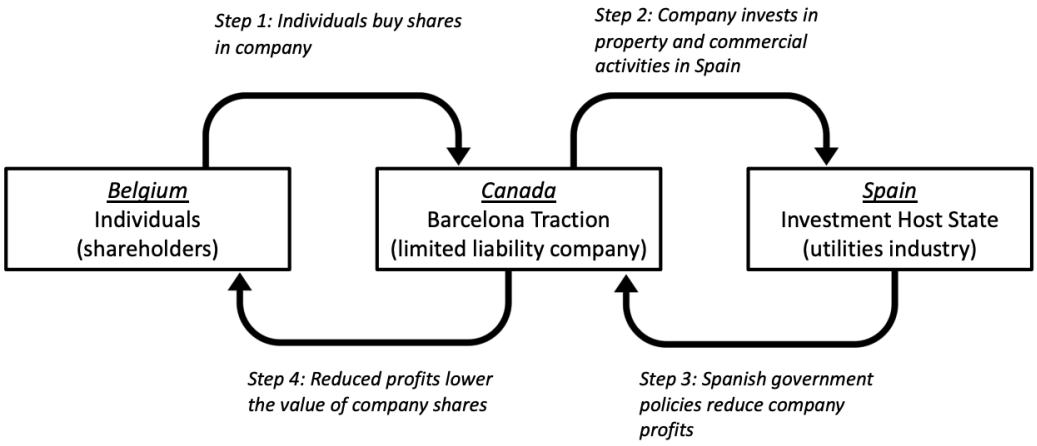
Background Information

This dispute involved three kinds of actors located in three different states:

- individual investors located in Belgium;
- Barcelona Traction, a firm that was incorporated as a limited liability company in Canada; and
- the Spanish government.

As shown in Figure 1, many Belgian investors purchased shares in Barcelona Traction (*Step 1*). Under Canadian laws, Barcelona Traction's status as a limited liability company meant that there was a legal division between the shareholders and the company. This division is often referred to as a "corporate veil." While the company has its own distinct legal rights and responsibilities, sometimes domestic courts ignore this division (thereby "lifting the corporate veil"), like in cases of corporate fraud.

Figure 1: Important Actors and Actions in the *Barcelona Traction* Dispute



Barcelona Traction invested its capital in property and commercial activities in Spain (*Step 2*). Namely, it provided electricity and related services to the city of Barcelona. In 1948, new policies passed by the Spanish government reduced the company's profitability (*Step 3*).[1] These changes pushed the company into insolvency (meaning that the company could not pay its debts), dramatically lowering the value of company shares (*Step 4*).

Beginning in 1948, the Canadian government invoked its right to diplomatic protection by contacting the Spanish government and attempting to negotiation a solution on behalf of Barcelona Traction. These efforts were unsuccessful and ultimately abandoned by Canada after many years. Individual investors in Belgium were upset by this outcome and pressured the Belgium government to intervene on their behalf. Ultimately, Belgium sued Spain at the International Court of Justice, arguing that Spain had violated customary international law on protecting foreign investment. To file this lawsuit, Belgium asserted its own right to diplomatic protection—Belgium argued that it had the right to protect Belgian shareholders from mistreatment by Spain.

Spain made many legal arguments to try to get the ICJ to dismiss the case. In the edited judgment below from 1970, the ICJ considers the issue of standing—that is, whether Belgium had capacity to challenge Spain's actions in an international court. Spain acknowledged that its actions—which it believed were legal—had a direct effect on Barcelona Traction, a Canadian company. However, Spain's actions only had an indirect effect on Belgian shareholders. Therefore, Spain believed that Belgium could not argue

[1] Namely, the Spanish government imposed currency controls that made it difficult for the company to pay off its debt. When the company then defaulted on its debt, a Spanish court transferred ownership of the company to bondholders. However, these details do not matter for understanding the ICJ ruling.

that Spain had violated international law because it could not claim a legal interest in the case. Belgium disagreed with this logic for multiple reasons:

- Belgium argued that the division between a corporation and its shareholders was artificial and should thus be ignored by the ICJ;
- Belgium argued that the "corporate veil" could be "lifted" because the company was in insolvency and was not adequately protected by Canada; and
- Belgium argued that its economic interest in the well-being of its individual investors gave it a legal interest in the dispute.

The ICJ carefully considered these various arguments and ruled in favor of Spain. The ICJ ruled that Belgium lacking standing to sue Spain.

Despite its age, the *Barcelona Traction* ruling remains an important case for multiple reasons. It was the first case in which an international court discussed the concept of an *erga omnes* legal obligation. The ICJ also clarified limits on standing that continue to affect modern cases. Finally, the ruling highlighted several issues in international investment law, including the limited ability of shareholders and corporations to seek legal remedies for possible violations of international law. These issues ultimately caused many developed states to pressure less-developed states into signing bilateral investment treaties that included access to Investor-State Dispute Settlement. Barcelona Traction thus helps us to understand why modern investment law looks the way that it does, and what the implications would be of removing Investor-State Dispute Settlement from future investment treaties.

Relevant Legal Texts

[None for this edited portion of the judgment.]

Judgment

The ICJ began by distinguishing between bilateral legal obligations—which are made to an individual state—and *erga omnes* obligations—which are made to the international community as a whole. While the concept of an *erga omnes* obligation had been discussed by law scholars, this judgment is the first time that an international court explicitly mentioned the concept.

> When a state admits into its territory foreign investments or foreign nationals, whether natural or juristic persons, it is bound to extend 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 very nature the former are the 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*.
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> Such obligations derive, for example, in contemporary international law, from the outlawing of acts of aggression, and of genocide, as also from the principles and rules concerning the basic rights of the human person, including protection from slavery and racial discrimination. Some of the corresponding rights of protection have entered into the body of general international law … Others are conferred by international instruments of a universal or quasi-universal character.

The Court then argued that international law on the treatment of foreign nationals did not create *erga omnes* obligations. This meant that Belgium could only sue Spain if Belgium could prove that it had a legal right that was violated by Spain.

> Obligations the performance of which is the subject of diplomatic protection are not of the same category. It cannot be held, when one such obligation in particular is in question, in a specific case, that all states have a legal interest in its observance. In order to bring a claim in respect of the breach of such an obligation, a state must first establish its right to do so …
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> In the present case it is therefore essential to establish whether the losses allegedly suffered by Belgian shareholders in Barcelona Traction were the consequence of the violation of obligations of which they were the beneficiaries. In other words: has a right of Belgium been violated on

> account of its nationals' having suffered infringement of their rights as shareholders in a company not of Belgian nationality?
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> Thus it is the existence or absence of a right, belonging to Belgium and recognized as such by international law, which is decisive for the problem of Belgium's capacity.

The ICJ then noted that its ruling had to rely on two bodies of law. First, it had to consider customary international law on the treatment of foreign nationals. Second, it had to consider domestic ("municipal") law on the relationship between corporations and shareholders.

> In seeking to determine the law applicable to this case, the Court has to bear in mind the continuous evolution of international law. Diplomatic protection deals with a very sensitive area of international relations, since the interest of a foreign state in the protection of its nationals confronts the rights of the territorial sovereign, a fact of which the general law on the subject has had to take cognizance in order to prevent abuses and friction. From its origins closely linked with international commerce, diplomatic protection has sustained a particular impact from the growth of international economic relations, and at the same time from the profound transformations which have taken place in the economic life of nations. These latter changes have given birth to municipal institutions, which have transcended frontiers and have begun to exercise considerable influence on international relations. One of these phenomena which has a particular bearing on the present case is the corporate entity.
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> In this field international law is called upon to recognize institutions of municipal law that have an important and extensive role in the international field. This does not necessarily imply drawing any analogy between its own institutions and those of municipal law, nor does it amount to making rules of international law dependent upon categories of municipal law. All it means is that international law has had to recognize the corporate entity as an institution created by states in a domain essentially within their domestic jurisdiction … In view of the relevance to the present case of the rights of the corporate entity and its shareholders under municipal law, the Court must devote attention to the nature and interrelation of those rights.

The Court did not discuss the domestic ("municipal") law of a specific state, but rather described a general trend across domestic legal systems. Namely, it noted that domestic law recognized that a limited liability company was a legal entity that has rights and responsibilities, independent of its shareholders.

Seen in historical perspective, the corporate personality represents a development brought about by new and expanding requirements in the economic field, an entity which in particular allows of operation in circumstances which exceed the normal capacity of individuals. As such it has become a powerful factor in the economic life of nations. Of this, municipal law has had to take due account, whence the increasing volume of rules governing the creation and operation of corporate entities, endowed with a specific status. These entities have rights and obligations peculiar to themselves.

There is, however, no need to investigate the many different forms of legal entity provided for by the municipal laws of states, because the Court is concerned only with that exemplified by the company involved in the present case: Barcelona Traction—a limited liability company whose capital is represented by shares.

Municipal law determines the legal situation not only of such limited liability companies but also of those persons who hold shares in them. Separated from the company by numerous barriers, the shareholder cannot be identified with it. The concept and structure of the company are founded on and determined by a firm distinction between the separate entity of the company and that of the shareholder, each with a distinct set of rights. The separation of property rights as between company and shareholder is an important manifestation of this distinction. So long as the company is in existence the shareholder has no right to the corporate assets.

It is a basic characteristic of the corporate structure that the company alone, through its directors or management acting in its name, can take action in respect of matters that are of a corporate character. The underlying justification for this is that, in seeking to serve its own best interests, the company will serve those of the shareholder too. Ordinarily, no individual shareholder can take legal steps, either in the name of the company or in his own name. If the shareholders disagree with the decisions taken on behalf of the company they may, in accordance with its articles or the relevant provisions of the law, change them or replace its officers, or take such action as is provided by law. Thus to protect the company against abuse by its management or the majority of shareholders, several municipal legal systems have vested in shareholders (sometimes a particular number is specified) the right to bring an action for the defence of the company, and conferred upon the minority of shareholders certain rights to guard against decisions affecting the rights of the company *vis-à-vis* its management or controlling shareholders. Nonetheless the

> shareholders' rights in relation to the company and its assets remain limited, this being, moreover, a corollary of the limited nature of their liability …

The Court noted that the rights of a company were not automatically the rights of the company's shareholders. As long as the company existed, it was a separate entity under domestic law (and hence under international law). Just because shareholders were indirectly harmed by a state's treatment of a company did not mean that these shareholders had rights that were violated by the state.

> Notwithstanding the separate corporate personality, a wrong done to the company frequently causes prejudice to its shareholders. But the mere fact that damage is sustained by both company and shareholder does not imply that both are entitled to claim compensation. Thus no legal conclusion can be drawn from the fact that the same event caused damage simultaneously affecting several natural or juristic persons … Whenever a shareholder's interests are harmed by an act done to the company, it is to the latter that he must look to institute appropriate action; for although two separate entities may have suffered from the same wrong, it is only one entity whose rights have been infringed.
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> However, it has been argued in the present case that a company represents purely a means of achieving the economic purpose of its members, namely the shareholders, while they themselves constitute in fact the reality behind it. It has furthermore been repeatedly emphasized that there exists between a company and its shareholders a relationship describable as a community of destiny. The alleged acts may have been directed at the company and not the shareholders, but only in a formal sense: in reality, company and shareholders are so closely interconnected that prejudicial acts committed against the former necessarily wrong the latter; hence any acts directed against a company can be conceived as directed against its shareholders, because both can be considered in substance, i.e., from the economic viewpoint, identical. Yet even if a company is no more than a means for its shareholders to achieve their economic purpose, so long as it is *in esse* it enjoys an independent existence. Therefore the interests of the shareholders are both separable and indeed separated from those of the company, so that the possibility of their diverging cannot be denied.
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> It has also been contended that the measures complained of, although taken with respect to Barcelona Traction and causing it direct damage, constituted an unlawful act *vis-à-vis* Belgium, because they also, though indirectly, caused damage to the Belgian shareholders in Barcelona

> Traction. This again is merely a different way of presenting the distinction between injury in respect of a right and injury to a simple interest. But, as the Court has indicated, evidence that damage was suffered does not *ipso facto* justify a diplomatic claim. Persons suffer damage or harm in most varied circumstances. This in itself does not involve the obligation to make reparation. Not a mere interest affected, but solely a right infringed involves responsibility, so that an act directed against and infringing only the company's rights does not involve responsibility towards the shareholders, even if their interests are affected.

The ICJ then noted that domestic law did not create an absolute separation between a company and its shareholders. In some special circumstances, shareholders could be accountable for the acts of their company, and vice versa. This practice of disregarding the difference between a company and its shareholders is often described as "lifting the corporate veil."

> Forms of incorporation and their legal personality have sometimes not been employed for the sole purposes they were originally intended to serve; sometimes the corporate entity has been unable to protect the rights of those who entrusted their financial resources to it; thus inevitably there have arisen dangers of abuse, as in the case of many other institutions of law. Here, then, as elsewhere, the law, confronted with economic realities, has had to provide protective measures and remedies in the interests of those within the corporate entity as well as of those outside who have dealings with it: the law has recognized that the independent existence of the legal entity cannot be treated as an absolute. It is in this context that the process of "lifting the corporate veil" or "disregarding the legal entity" has been found justified and equitable in certain circumstances or for certain purposes. The wealth of practice already accumulated on the subject in municipal law indicates that the veil is lifted, for instance, to prevent the misuse of the privileges of legal personality, as in certain cases of fraud or malfeasance, to protect third persons such as a creditor or purchaser, or to prevent the evasion of legal requirements or of obligations.
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> Hence the lifting of the veil is more frequently employed from without, in the interest of those dealing with the corporate entity. However, it has also been operated from within, in the interest of—among others—the shareholders, but only in exceptional circumstances.

The Court acknowledged that international law might also allow a court to disregard the legal "veil" that separates a company from its shareholders. It speculated that two "special circumstances" might allow this to occur.

> In accordance with the principle expounded above, the process of lifting the veil, being an exceptional one admitted by municipal law in respect of an institution of its own making, is equally admissible to play a similar role in international law. It follows that on the international plane also there may in principle be special circumstances which justify the lifting of the veil in the interest of shareholders … In this connection two particular situations must be studied: the case of the company having ceased to exist and the case of the company's national state lacking capacity to take action on its behalf …

The Court considered the first possible "special circumstance"—perhaps the "veil" could be lifted if the company no longer existed. However, the Court noted that Barcelona Traction still existed under Canadian law.

> Barcelona Traction has lost all of its assets in Spain, and was placed in receivership in Canada, a receiver and manager having been appointed. It is common ground that from the economic viewpoint the company has been entirely paralyzed. It has been deprived of all its Spanish sources of income, and the Belgian government has asserted that the company could no longer find the funds for its legal defence, so that these had to be supplied by the shareholders.
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> It cannot however, be contended that the corporate entity of the company has ceased to exist, or that it has lost its capacity to take corporate action. It was free to exercise such capacity in the Spanish courts and did in fact do so. It has not become incapable in law of defending its own rights and the interests of the shareholders. In particular, a precarious financial situation cannot be equated with the demise of the corporate entity, which is the hypothesis under consideration: the company's status in law is alone relevant, and not its economic condition … Only in the event of the legal demise of the company are the shareholders deprived of the possibility of a remedy available through the company; it is only if they became deprived of all such possibility that an independent right of action for them and their government could arise.
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> In the present case, Barcelona Traction is in receivership in the country of incorporation … Though in receivership, the company continues to exist. Moreover, it is a matter of public record that the company's shares were quoted on the stock-market at a recent date … A manager was appointed in order to safeguard the company's rights; he has been in a position directly or indirectly to uphold them. Thus, even if the company is limited in its activity after being placed in

> receivership, there can be no doubt that it has retained its legal capacity and that the power to exercise it is vested in the manager appointed by the Canadian courts.

The Court then considered the second possible "special circumstance"—perhaps the "veil" could be lifted if a company's national state could not take action to protect the company. The Court noted that Canada was Barcelona Traction's national state. It then noted that Canada could (and did) take action to protect the company.

> The Court will now turn to the second possibility, that of the lack of capacity of the company's national state to act on its behalf. The first question which must be asked here is whether Canada—the third apex of the triangular relationship—is, in law, the national state of Barcelona Traction.
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> In allocating corporate entities to states for purposes of diplomatic protection, international law is based, but only to a limited extent, on an analogy with the rules governing the nationality of individuals. The traditional rule attributes the right of diplomatic protection of a corporate entity to the state under the laws of which it is incorporated and in whose territory it has its registered office. These two criteria have been confirmed by long practice and by numerous international instruments. This notwithstanding, further or different links are at times said to be required in order that a right of diplomatic protection should exist. Indeed, it has been the practice of some states to give a company incorporated under their law diplomatic protection solely when it has its seat … or management or centre of control in their territory, or when a majority or a substantial proportion of the shares has been owned by nationals of the state concerned. Only then, it has been held, does there exist between the corporation and the state in question a genuine connection … However, in the particular field of the diplomatic protection of corporate entities, no absolute test of the "genuine connection" has found general acceptance. Such tests as have been applied are of a relative nature, and sometimes links with one state have had to be weighed against those with another …
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> In the present case, it is not disputed that the company was incorporated in Canada and has its registered office in that country. The incorporation of the company under the law of Canada was an act of free choice. Not only did the founders of the company seek its incorporation under Canadian law but it has remained under that law for a period of over 50 years. It has maintained in Canada its registered office, its accounts and its share registers. Board meetings were held

there for many years; it has been listed in the records of the Canadian tax authorities. Thus a close and permanent connection has been established, fortified by the passage of over half a century. This connection is in no way weakened by the fact that the company engaged from the very outset in commercial activities outside Canada, for that was its declared object. Barcelona Traction's links with Canada are thus manifold …

The Belgian government admitted the Canadian character of the company in the course of the present proceedings. It explicitly stated that Barcelona Traction was a company of neither Spanish nor Belgian nationality but a Canadian company incorporated in Canada. The Belgian government has even conceded that it was not concerned with the injury suffered by Barcelona Traction itself, since that was Canada's affair.

The Canadian government itself, which never appears to have doubted its right to intervene on the company's behalf, exercised the protection of Barcelona Traction by diplomatic representation for a number of years … From 1948 onwards the Canadian government made to the Spanish government numerous representations which cannot be viewed otherwise than as the exercise of diplomatic protection in respect of the Barcelona Traction Company. Therefore this was not a case where diplomatic protection was refused or remained in the sphere of fiction. It is also clear that over the whole period of its diplomatic activity the Canadian government proceeded in full knowledge of the Belgian attitude and activity.

The Court then noted that the Canadian government was no longer working to protect the company. The Court argued that states had the right to give diplomatic protection, but individuals and companies did not have a right to receive diplomatic protection.

It is true that at a certain point the Canadian government ceased to act on behalf of Barcelona Traction, for reasons which have not been fully revealed … The Canadian government has nonetheless retained its capacity to exercise diplomatic protection; no legal impediment has prevented it from doing so: no fact has arisen to render this protection impossible. It has discontinued its action of its own free will.

The Court would here observe that, within the limits prescribed by international law, a state may exercise diplomatic protection by whatever means and to whatever extent it thinks fit, for it is its own right that the state is asserting. Should the natural or legal persons on whose behalf it is

> acting consider that their rights are not adequately protected, they have no remedy in international law. All they can do is to resort to municipal law, if means are available, with a view to furthering their cause or obtaining redress. The municipal legislator may lay upon the state an obligation to protect its citizens abroad, and may also confer upon the national a right to demand the performance of that obligation, and clothe the right with corresponding sanctions. However, all these questions remain within the province of municipal law and do not affect the position internationally.
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> The state must be viewed as the sole judge to decide whether its protection will be granted, to what extent it is granted, and when it will cease. It retains in this respect a discretionary power the exercise of which may be determined by considerations of a political or other nature, unrelated to the particular case. Since the claim of the state is not identical with that of the individual or corporate person whose cause is espoused, the state enjoys complete freedom of action. Whatever the reasons for any change of attitude, the fact cannot in itself constitute a justification for the exercise of diplomatic protection by another government …

At this point, the Court had decided that Belgian shareholders did not have a legal right that was violated by Spain. So the next question that the Court asked was whether Belgium had a legal right that was violated by Spain. Namely, did Belgium's economic interest in the dispute give it a legal interest?

> The Belgian government would be entitled to bring a claim if it could show that one of its rights had been infringed and that the acts complained of involved the breach of an international obligation arising out of a treaty or a general rule of law. The opinion has been expressed that a claim can accordingly be made when investments by a state's nationals abroad are thus prejudicially affected, and that since such investments are part of a state's national economic resources, any prejudice to them directly involves the economic interest of the state.
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> Governments have been known to intervene in such circumstances not only when their interests were affected, but also when they were threatened. However, it must be stressed that this type of action is quite different from and outside the field of diplomatic protection. When a state admits into its territory foreign investments or foreign nationals it is … bound to extend to them the protection of the law. However, it does not thereby become an insurer of that part of another state's wealth which these investments represent. Every investment of this kind carries certain risks. The real question is whether a right has been violated, which right could only be the right of

> the state to have its nationals enjoy a certain treatment guaranteed by general international law, in the absence of a treaty applicable to the particular case …
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> It follows from what has already been stated above that, where it is a question of an unlawful act committed against a company representing foreign capital, the general rule of international law authorizes the national state of the company alone to make a claim.

Finally, the Court acknowledged that it was problematic that international law did not have more developed rules for multinational corporations. However, the Court emphasized that allowing Belgium to sue would threaten the principle of consent. In particular, the Court noted that Belgium had not signed an international treaty with either Canada or Spain that gave rights to shareholders.

> Considering the important developments of the last half-century, the growth of foreign investments and the expansion of the international activities of corporations, in particular of holding companies, which are often multinational, and considering the way in which the economic interests of states have proliferated, it may at first sight appear surprising that the evolution of law has not gone further and that no generally accepted rules in the matter have crystallized on the international plane. Nevertheless, a more thorough examination of the facts shows that the law on the subject has been formed in a period characterized by an intense conflict of systems and interests. It is essentially bilateral relations which have been concerned, relations in which the rights of both the state exercising diplomatic protection and the state in respect of which protection is sought have had to be safeguarded. Here as elsewhere, a body of rules could only have developed with the consent of those concerned. The difficulties encountered have been reflected in the evolution of the law on the subject.
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> Thus, in the present state of the law, the protection of shareholders requires that recourse be had to treaty stipulations or special agreements directly concluded between the private investor and the state in which the investment is placed. States ever more frequently provide for such protection, in both bilateral and multilateral relations, either by means of special instruments or within the framework of wider economic arrangements. Indeed, whether in the form of multilateral or bilateral treaties between states, or in that of agreements between states and companies, there has since the Second World War been considerable development in the protection of foreign investments. The instruments in question contain provisions as to jurisdiction and procedure in case of disputes concerning the treatment of investing companies by

> the states in which they invest capital. Sometimes companies are themselves vested with a direct right to defend their interests against states through prescribed procedures. No such instrument is in force between the parties to the present case.

The Court therefore refused to rule on whether Spain's acts against Barcelona Traction violated international law.

> Since no [standing] before the Court has been established, it is not for the Court in its judgment to pronounce upon any other aspect of the case, on which it should take a decision only if the Belgian government had a right of protection in respect of its nationals, shareholders in Barcelona Traction.