

Reforming International Investment Arbitration in Latin America

Constitutionalism in Latin America

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As a general rule, foreign investment in developing regions has a two-fold purpose. While it firstly fosters the practice of transnational business, at the same time, it should also promote economic development in the nation that is the target of the investment. Nowhere is this truism more important than in the Latin American public policy domain. In spite of the fact that Latin America is not the largest recipient of foreign direct investment, representing only 10.3% of the global sum, over the last few years, numerous global investors have initiated investment arbitration proceedings against Latin American nations. As of 2005, more than half of the pending investment arbitration claims submitted to the International Center for Settlement of Investment Disputes (ICSID), had been filed against Latin American nations. Of those, Argentina has attracted the most attention with 42 claims filed against it through the ICSID arbitration mechanism, mostly as a result of its economic crisis of 2001. Additionally, international investors have filed other claims using other investment arbitration centers including the London Court of International Arbitration (LCIA) and the International Chamber of Commerce International Court of Arbitration (ICC).

While it may seem logical to view this abundance of investor arbitration claims as a negative indication of the condition of the Latin American investment climate, such an interpretation is not entirely warranted and can even denote the beneficial effects of ICSID not only for foreign investors but also for the vitalization of democratic and good governance institutions in this region. To further strengthen this objective, it is incumbent upon ICSID and other similar institutions

hosting investor-state arbitration proceedings to dispel the persistent notion of bias and lack of transparency in the arbitral process. This can be done through an equitable revision of the eligibility criteria for investment arbitration, the removal of all confidentiality mechanisms and increased consideration of national economies in rendering judgments.

The Latin American Context

Latin American legal frameworks and government policies towards foreign investors are similar to those of other developing countries. This lack of overt legal distinction from comparable States naturally leads to the question: Why are the majority of investment arbitration claims being filed against Latin American Governments? In addition to Argentina's economic and currency crisis in 2001, one of the principal causes for a great number of arbitration claims, the liberalization of Latin American economies that has occurred over the last 10-15 years can also be considered another significant factor. It is widely known that the opening of economies brings increased foreign direct investment. Greater foreign presence, in turn, increases the potential for arbitration claims. As a result, it is safe to say that a portion of recent arbitration claims against Latin American States can be attributed to the increased internationalization of Latin American economies that has occurred over the past decade.

Latin American jurisdictions--notwithstanding the region's traditional skepticism towards international arbitration embodied in the Calvo Doctrine¹--have engaged in extensive bilateral treaties (BIT) to encourage foreign direct investment in, among others, the gas, energy and telecommunications industries. Argentina, Chile, Columbia, Costa Rica, Ecuador, Guatemala, Honduras, Panama, Paraguay, Peru, and Uruguay ratified the ICSID Convention. Bolivia, Nicaragua, and Venezuela also ratified the Convention, but later withdrew. In total, Latin American countries that have ratified BITs with other nations include Argentina (54 BITs), Chile (38 BITs), Ecuador (23 BITs), Mexico (18 BITs), Peru (28 BITs), and Venezuela (21 BITs). Additionally, Chile, Mexico, Peru, Colombia, and the Central American countries have signed free trade agreements with the United States, all providing for investment arbitration.²

In spite of the disproportionate number of arbitration proceedings relative to investment projects world wide, it should not be assumed that virtually all tribunal judgments are made against the Latin American countries. For instance, until the year 2004, of eighteen awards on the merits issued by ICSID arbitral tribunals, the claimants (i.e., the investors) prevailed in ten awards, whereas in eight awards, their claims were dismissed and the states prevailed.³ More recent data available from investment arbitration cases filed under ICSID, United Nations Commission on

¹ The Calvo Doctrine, named after Argentine jurist, Carlos Calvo, is a foreign policy doctrine which holds that jurisdiction in international investment disputes lies with the country in which the investment is located, thus rejecting the possible jurisdiction of international bodies such as ICSID or the ICC.

² Bernardo Cremades, "Disputes Arising Out of Foreign Direct Investment in Latin America: A New Look at the Calvo Doctrine and other Jurisdictional Issues," 59 Disp. Resol. J. 78, 81-82 (2004)

³ World Bank, World Development Report 2004: Making Services Work for Poor People 167 box 9.4.

International Trade Law rules, and other arbitration centers show a similar picture; out of forty-six cases where there was a partial or final award on the merits and where jurisdiction was upheld, investors prevailed in twenty-seven, but lost to the states in nineteen, including four in favor of the United States and four in favor of Mexico under NAFTA. In spite of this, in the context of international investment arbitrations, the issue of economic development of countries has rarely been considered, although there are many circumstances where economic development could be analyzed by the arbitral tribunals.

Despite the discouraging statistics with regards to arbitration claims however, it would be incorrect to assume that a high number of investor disputes in Latin America indicate a lack of investor protection. Such reasoning fails to account for the economic changes that led to these disputes. The abundance of investment treaties has served to promote impartial reconciliation within participating States and thus represent an improvement of investor protection in these countries. Furthermore, the fact that investors are filing for arbitration illustrates that investment treaties are not merely a ploy to lure foreign businesses, but a functioning resolution mechanism to which States are being held accountable.

Throughout the past decade, Latin American nations, in order to attract greater foreign investment and as part of an overall economic development strategy, signed mostly bi-lateral investment treaties or free-trade agreements that contained provisions that provided for mechanisms that resolved disputes in investment contracts. In doing so, Latin American governments sought to ease investor doubts

about the transparency and efficiency of the local courts by providing an alternative to these courts. One of the acts against which arbitration specifically seeks to protect against is expropriation.⁴ In this context, expropriation is typically forbidden unless the property is taken for a public purpose, without discrimination, in accordance with legal principles and adequate, prompt and effective compensation is paid. Such protection has been extended to cover indirect expropriation, under which a property is seized without official declaration, and regulatory expropriation, under which excessive regulations imposed upon the property render it useless. Given that expropriation is defined as a unilateral act without the consent of the party subject to seizure, it is usually done so with little or no direct compensation for a party's loss. Such a process is currently in evidence in Venezuela, where the Chavez government's recent announcement of the expropriation of both the local assets of Mexican cement maker CEMEX and those of Argentine steelmaker Ternium Sidor. Although resolutions in both cases are not imminent and far from certain, it is certainly expected that should both disputes continue, arbitration would result given that any compensation that the Venezuelan government offered would be far inferior to the market value of the assets seized.

Precisely because of circumstances such as that currently ongoing in Venezuela, investment treaties also mandate treatment protection standards for foreign investors such as national treatment that produces a fair and equitable

⁴ Omar García-Bolívar, "Investor-State Disputes in Latin America: A Judgment on the Interaction Between Arbitration, Property Rights Protection and Economic Development," 13-WTR L. & Bus. Rev. Am. 67, 74

business climate for investors. These provisions have been used to protect foreign investors against abuses such as absence of due legal process and biased procedures. Investors may enforce their rights under treaties by filing claims against the host country with an international arbitration forum. In most cases, this right to international arbitration is based on the agreement between the investor's State and the recipient State and usually established by means of a bilateral treaty.

Latin American legal frameworks and government policies towards foreign investors are similar to those of other developing countries. This in turn begs the question: why does investor-state arbitration suffer from such a poor popular perception in Latin America? Clearly, the rise of leftist ideologies that espouse skepticism of the arbitral process plays a role. The traditionally confidential nature of the proceeding and the public policy implications that it portends for a domestic economy also weigh heavily in shaping the perception of arbitration as elitist and undemocratic. In this regard, the introduction of written and amicus briefs into ICSID arbitration proceedings should be viewed as a welcome development in an area in need of great transparency.⁵ Notwithstanding the reticence of many multinational companies to waive confidentiality, these factors, combined with the popular perception of capitalist entities such as the World Bank and large multinationals monetarily punishing already-poor or underdeveloped economies only feeds on the idea that development is an illusory vicious circle from which nations cannot escape.

⁵ Ibironke Odumosu, "The Antinomies of the (Continued) Relevance of ICSID to the Third World," 8 San Diego Int'l L.J. 345, 384

Bilateral Investment Treaties

In practical terms, the impact of international investment arbitration in Latin America has been uncertain. Studies show that the relation between Bilateral Investment Treaties (BIT) and the flow of Foreign Direct Investment (FDI) is weak.⁶ Signing BITs and agreeing to international investment arbitration does not guarantee that foreign investors will create business in a given country. At most, the international investment law framework creates a positive investment climate, which diminishes the negative risk associated with the costs of doing business. In addition to the existence of a business opportunity, along with other business related factors, this framework could move the investors to choose a particular country over another as a location to invest. But there are increasingly more indications that the mere acceptance of international investment law is not sufficient to attract foreign investments.

For example, in Latin America, the largest recipient of FDI is Brazil. Of a total of \$67 billion of FDI inflow into Latin America in 2005, Brazil attracted more than \$18 billion. Yet, Brazil is not a signatory of the ICSID Convention and has not ratified any BIT. Despite this, the lack of adherence to the international investment law has not affected Brazil's foreign investments attractiveness.⁷

⁶ See Mary Hallward-Dreimeier, "Do Bilateral Investment Treaties Attract Foreign Direct Investment? Only a Bit...and They Could Bite," (World Bank Policy Research Working Paper Series, Paper No. 3121, 2003), available at <http://ssrn.com/abstract=636541>.

⁷ U.N. Conference On Trade And Development [UNCTAD], World Investment Report 2005, 63, fig.II.12, available at http://www.unctad.org/en/docs/wir2005_en.pdf

Obviously, BITs are not the cause of weak legal reforms or law enforcement in developing countries. But they might not be helpful on reform efforts and might even make things worse by opening a discriminatory and unfair system of investment protection composed of two paths: a strong international path for some foreign investors and a weak domestic path for the rest of businesses and locals. Additional research on the impact of international investment law in local governance and legal reforms would be helpful in ushering in need reforms to the BIT framework. For now, it should be stated that considerable doubt exists concerning the positive externalities the system of international investment law brings to developing countries in general, and to Latin American countries in particular.

Yet, while international investment arbitration law helps investors by ensuring a more fair and predictable environment in Latin American markets, it need not be seen as a mechanism exclusively at the service of large multinational entities. Protective frameworks such as this also offer a mechanism for economic growth whereby Latin American countries attract foreign direct investment and benefit from the related economic spillovers. In the end, by pledging its future to open markets and foreign investment under equitable standards, Latin American nations may be taking another step in the development of a more prosperous society. To that end, institutions such as ICSID and the London Court of International Arbitration should stipulate the need for three essential conditions upon which judgments emitted by a tribunal can be considered valid and binding.

Equitable Conditions in Formulation and Purpose of Contract

As noted previously, international investment law has been motivated by two reasons: protection of foreign investors and economic development of countries. Foreign investors have found, in international investment law, a shield that not only protects their property rights and sets minimum international standards of treatment, but also a mechanism to make that protection enforceable under the form of international investment arbitration. Yet in spite of this, international investment arbitration should not be seen as being solely biased against the interests of countries or in favor of investors, but rather as another tool that facilitates foreign aid and investment. To clarify this particular point, legal experts have suggested that for an investment to be qualified as foreign and, hence, entitled to access the investment dispute settlement mechanism of ICSID, certain conditions should be met: a) the project must have a certain duration; b) there must be a certain regularity in the earnings and the return; c) there should be a typical element of risk on both sides; d) there should be a substantial commitment to develop certain activities; and e) the operation must be significant for the development of the host state, as stated in the Convention's preamble.⁸ Thus by confining the scope of investment arbitration to the specific criteria listed, international institutions such as ICSID help to ensure that equitable conditions that

⁸ Convention on Settlement of Investment Disputes Between States and Nationals of other States, Oct. 14, 1966, 17 U.S.T. 1270 (also known as the Washington Convention)

benefit both sides exist before an arbitration tribunal can assert jurisdiction over a particular dispute.

Confidentiality

Another important element worth considering in reforming the international investment framework is the complete elimination of confidentiality from all arbitration procedures. Although articles 25(4) and 32(5) of the UNCITRAL Rules that govern arbitration proceedings deal with the confidentiality of hearings and awards respectively, these rules should be waived in circumstances dealing with investment arbitration.⁹ Unlike commercial arbitration, investment arbitration necessarily implicates a national government, which is in turn theoretically accountable to its citizenry for the state of the local economy and finances. Thus in the interests of public accountability and transparency, the perception of investment arbitration as a shady and secretive process that conspires to perpetuate underdevelopment in the developing world needs to end.

Amount of Awards

Analysis of economic development issues should also be considered for determining the amount of the arbitral awards. For developing countries under financial stress, exorbitant awards could have a tremendous impact on economic development policies and affect their implementation. Perhaps for this reason, tribunals should consider issues such as the level of poverty of the country in

⁹ United Nations Commission on International Trade Law Arbitration Rules (1976), available at <http://www.uncitral.org/pdf/english/texts/arbitration/arb-rules/arb-rules.pdf>

question, amount of public debt, and fiscal deficit, along with the relevant arguments on the merits and impose awards--when needed--that protect foreign investment but do not impair the economic development of the recipient countries.

For example, in an investment arbitration case against Ecuador, the investor, American Petroleum Company Occidental was awarded \$71 million.¹⁰ For a country with 12 million people living below an annual income of \$3,260 per capita, with a long term debt of \$16 billion, a GDP of \$30 billion, and a debt service ratio of 31 percent, an award of that magnitude could mean significantly less money devoted to economic development.¹¹ If one were to add the arbitration costs to the amount of the awards, the impact could be greater. Costs of investment arbitrations are high and on average, the cost of these cases range around \$2 million in fees with around \$400 thousand in pure costs under the low range. As a result of these devastating economic effects, it is little wonder that left-wing President Rafael Correa unilaterally modified in December 2007 the terms of Ecuador adherence to ICSID by declaring that future disputes regarding the exploitation of environmental and natural resources would no longer be under ICSID's jurisdiction.¹² A month earlier,

¹⁰ U.N. Conference on Trade and Development [UNCTAD], Occasional Note: International Investment Disputes on the Rise, U.N. Doc. UNCTAD/WEB/ITE/IIT/2004/2 (Nov. 29, 2004), available at http://www.unctad.org/sections/dite/iia/docs/webiteiit20042_en.pdf

¹¹ World Bank Indicators Database, <http://devdata.worldbank.org/data-query/>

¹² "Ecuador's Notification under Article 25(4) of the ICSID Convention," available at <http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=OpenPage&PageType=AnnouncementsFrame&FromPage=Announcements&pageName=Announcement9>

Bolivia's Evo Morales had gone a step further by denouncing the entire ICSID mechanism and withdrawing the country from the Convention completely.¹³

Obviously, an arbitrator's principal function is to rule on disputes, not to solve economic issues. However, when the facts are examined and the legal instruments allow for the consideration of economic development issues, a careful analysis of the interests of host countries should be undertaken and, if possible, weight should be given to the impact an award might have on the welfare of the local citizenry. The essential dilemma lies in where arbitrators should draw the line so that the rights and interests of the investors are protected, as established in the relevant international investment law, while economic development issues are considered. Stretching that line too far from the established law might impair the predictability expected in international investment law. Yet not considering issues of economic development in the analysis of investment arbitration cases might also damage not only the compliance of the awards but the evolution of international investment law as well.

Conclusion

Economic development needs to be financed and historically, developing countries have obtained that financing through the revenues yielded by the sale of their commodities in international markets, through loans granted either by

¹³ "Bolivia submits notice of Denunciation under Article 71 of the ICSID Convention," available at <http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=OpenPage&PageType=AnnouncementsFrame&FromPage=Announcements&pageName=Announcement3>

international commercial banks or through bilateral aid provided by the wealthy countries. Not until recently have developing countries accepted the argument that foreign investments could be a means to finance economic development both directly and indirectly through its positive externalities. In the past, foreign investments were either despised, rejected or heavily regulated because they were considered instruments of neo-colonialism or dominance.

In the 1990s, Latin America countries began to support public policies favorable to foreign investment. As part of policies aimed at reducing the size of the state and opening space for private investors, countries adopted the Washington Consensus, a comprehensive package in which states became signatories to the ICSID Convention and executed BITs with capital exporting countries where investment arbitration was consented. Although the Washington Consensus yielded some effects, it came under heavy criticism in the region mainly because those policies failed to cure the endemic inequality of the western hemisphere, and made the rich richer while the poor remained poor, if not poorer. Under this scenario, the rationale behind the international investment law could be questioned.¹⁴ If the good of foreign investments comes into doubt because it is not beneficial to the economic development of the countries, the use of the international investment law would inevitably be at risk. Countries could start judging the pros and cons of the system and eventually reject their outcomes by failing to comply, or more likely, by

¹⁴ Kuczynski, Pedro-Pablo and John Williamson. "After the Washington Consensus: Restarting Growth and Reform in Latin America." The Institute for International Economics, March 2003, summary available at <http://www.cid.harvard.edu/cidtrade/issues/washingtonpaper.html>

denouncing previous commitments assumed under the form of international agreements or by not entering into new instruments of international investment law.

To prevent this scenario, the whole system of international investment law, including international investment arbitration, needs to be more balanced. The criteria that define the subject matter capable of investment of arbitration need to be re-evaluated so that it only takes into account equitable projects with defined scopes that seek to contribute to the economic infrastructure of a country. Furthermore, issues relating to confidentiality in investment arbitration need to give way to public policy considerations that project transparency and accountability as a clear way of strengthening good business practices and democratization in the host regions. Arbitrators also need to give more weight to considerations of economic development in the context of their awards, whenever this is feasible. For example, arbitrators need to look at the objective of international investment law in broad terms and find out the real purpose of that legal framework: is it only to protect foreign investments or is it to protect foreign investments because they are beneficial to the economic development of the recipient country? If the purpose of the international investment law is merely to protect foreign investments, the results of the arbitrators' analysis would be totally different from an approach that also considers the economic development of the host state.

For countries harboring skepticism about the benefits of international investment law in general, and of international investment arbitration in particular,

the importance of clearly stating their economic development objectives through objective criteria vis-à-vis foreign investment cannot be underestimated for the sake of impartiality and equality of bargaining positions. Similarly, within the treaties, the impact of foreign investments on economic development should expressly be made part of the criteria to be taken into account by the arbitral tribunals when admitting a claim, upholding jurisdiction, and awarding monetary compensations.

Foreign investment law has matured to a point where it is in need of reform. Up to this point, this area of international law has generated a large number of treaties, jurisprudence and legal principles. But a more evenhanded approach, inspired by a close examination of its roots, is necessary if the international investment law approach is to be the thriving legal mechanism at the service of both contracting parties that it was always meant to become.