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WHITE PAPER

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Investment Arbitration in Latin America: Elections, Trade Agreements, and the ICSID

Investors considering opportunities in Latin America during 2018 have a number of factors to consider. Presidential elections in seven countries particularly in Brazil, Mexico, and Colombia could substantially alter the region's politics via nationalistic or populist policies, resulting in intensified regulation or other conditions elevating the risks associated with foreign investment.

In addition, some concerns relating to arbitration proceedings remain. Despite persistent criticism in recent years, the International Centre for Settlement of Investment Disputes remains a viable option for resolving disputes involving Latin American countries.

This Jones Day *White Paper* reviews the most pressing emerging issues regarding investment and arbitration issues in Latin America.

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In November 2017, S&P Global Ratings declared Venezuela in default after it failed to make a $200 million coupon payment on its sovereign bonds. Many saw this coming. Since 2014, the country has been mired in a recession that significantly worsened in 2017. With no signs of legitimate economic or policy change in the country, Venezuela will likely continue to default, which will propel litigation between the country and its bondholders in 2018.

Venezuela, however, is not the only country that foreign investors should be watching this year. In 2018, seven Latin American countries are voting for a president, and others are holding legislative elections. Observers believe that 2018 could be a transformative year in the region because the rise of "outside" and unestablished candidates could create a riskier environment for investors, who for decades, have relied upon the International Centre for Settlement of Investment Disputes ("ICSID") to resolve investment disputes. However, with general hostility from LatAm countries over the past decade and impending elections, investors are questioning whether ICSID remains the preferred option.

IMPACT OF KEY 2018 ELECTIONS

The presidential elections in Brazil, Mexico, and Colombia could influence the region's political landscape. Candidates that would have been unsuccessful or quickly dismissed in previous elections are leading in the polls. Many of these leading candidates hold nationalist, populist, and protectionist attitudes. As other countries have seen, LatAm voters appear to have grown tired of entrenched politicos and corruption scandals that have plagued their governments.

Over the past decade, corruption scandals have affected Brazil more than any other LatAm country, and 2018 looks to be no different. Luiz Inacio Lula de Silva, known as "Lula," is barred from running in the October presidential election because of a corruption conviction from when he previously served as president. Lula has appealed the ruling but so far has been unsuccessful. In spite of his scandal, Lula remains the most popular candidate, according to polls. If Lula cannot run, however, then no candidate will be able to garner enough votes without building political coalitions with other parties. Candidates could tweak their policy positions by comprising on government regulation issues to build coalitions.

In Mexico, the region's second largest economy, nationalist Andrés Manuel López Obrador is the front-runner for the July election. Bolstered by President Trump's comments toward Mexico, López Obrador is promoting a "Mexico First" agenda as he promises to implement more protectionist policies. He also plans to increase poverty reduction spending. These regulatory policies could lead to more "de facto" expropriations of foreign investments. His social welfare spending could also increase Mexico's debt, which should cause potential concern for bondholders.

In Colombia, which holds presidential and legislative elections in 2018, the FARC is participating in elections for the first time as a result of the Peace Agreement reached with current president Juan Manuel Santos. The FARC plans to run for several legislative positions. Now a legitimate political party, the FARC receives much of its backing from rural, indigenous communities, and supports anti-imperialist policies that could be worrying for investors if the FARC increased its legislative influence.

ICSID: THE PREFERRED AVENUE FOR INVESTORS

Historically, LatAm investors have favored investor-state arbitrations before ICSID. An ICSID award is valuable because (i) it is enforceable in over 150 countries and (ii) each contracting ICSID state must recognize an award as if it were a final judgment from that state's court. ICSID arbitrations are so popular among foreign investors in LatAm that nearly one out of three ICSID cases involve a LatAm government respondent.

By being forced to defend against many ICSID claims, LatAm governments have generally not viewed ICSID favorably. Many governments believe that ICSID has a pro-investor bias and unfairly encroaches on sovereignty as any regulation that affects foreign investments could be considered a "de facto" expropriation. The elections of nationalist candidates in 2018 could bolster these feelings.

Since 2007, Bolivia, Ecuador, and Venezuela withdrew from the ICSID Convention, and over the past decade, the Union of Southern American Nations ("UNASUR") has worked to establish a regional arbitration center. In 2016, the UNASUR members proposed a final draft of the procedures; however, they have yet to adopt them.

With the withdrawal of certain countries and potential for others to follow in the coming years, some have questioned whether ICSID remains the optimal choice for investors in LatAm, especially for investors in countries where the country has withdrawn. Article 72 of the ICSID Convention provides a rationale for still subjecting withdrawing states to ICSID. Article 72 provides:

> Notice by a Contracting State pursuant to Articles 70 or 71 (i.e., denunciation of the Convention) shall not affect the rights or obligations under this Convention of that State (…) arising out of consent to the jurisdiction of the Centre given by one of them before such notice was received by the depositary.

Thus, one could argue that a withdrawing state is still subject to ICSID if it has previously given its unilateral consent in another form, such as in a bilateral investment treaty ("BIT") or contract. Investors have been somewhat successful in making similar arguments.

In 2010, two years after Bolivia withdrew, a U.S. company filed an ICSID claim against Bolivia arguing that jurisdiction was proper from an underlying BIT. The tribunal never issued a final ruling on the jurisdictional issue, as the case settled for $357 million, but the result should encourage investors that states can still be forced to defend or negotiate ICSID-filed claims after withdrawing.

Additionally, Venezuela is a party to over 20 BITs that reference ICSID. An investor in Venezuela could argue that ICSID still has jurisdiction because the BIT provides for it, and Venezuela has yet to denounce that specific BIT that consents to ICSID. Notably, Venezuelan bond noteholders would also need to argue that a bond purchase classifies as an "investment." However, previous aggrieved bond noteholders recouped their losses by bringing ICSID claims so they should not be immediately discouraged. For example, in 2016, Italian bondholders of Argentinian defaulted bonds received cash payments equivalent to 150 percent of the original principal amount in a settlement adopted by ICSID.

There has also been an uptick in claims against LatAm countries that previously had not been common respondents, indicating that regional investors continue to feel optimistic about ICSID. Within the past three years, Panama has defended against six ICSID cases. Before 2014, Panama only had two claims brought against it. Similarly, in 2016, investors filed three ICSID claims against Colombia. Peru also saw three new ICSID claims since 2016.

Lastly, Mexico signed the ICSID Convention in January 2018, signaling that, in spite of some negative news surrounding ICSID, the second largest LatAm country puts its faith in the ICSID system, which should ease investor worries. These are all positive signs that in spite of 2018's increase in nationalist, protectionist candidates, ICSID still is a solid option.

ALTERNATIVE OPTIONS TO ICSID AWARDS

ICSID arbitrations are usually not the only option for investors, and non-ICSID arbitrations might make more sense in certain cases. An investor should look at the underlying BIT or the investment protection chapter of a trade agreement.

BITs. Many LatAm BITs provide for ad hoc investor-state arbitration under UNCITRAL or the Additional Facility ICSID Rules. Although neither option would render an ICSID award, it is a viable option for investors that seek a quicker resolution of their dispute, or for investors with claims against a withdrawing state that do not want to face potential jurisdictional challenges from the host country.

In Venezuela, 18 of its 20 BITs provide for alternative (i.e., non-ICSID) arbitrations under UNCITRAL Rules or Additional Facility ICSID Rules. These arbitrations would render an award that could still be enforced under the New York Convention. These awards could be subjected to more robust national court review and challenged in the courts of the "seat" of the arbitration. The award would also not receive automatic execution status; however, it should be more easily enforceable than enforcing a domestic court judgment abroad.

Even for the countries that have denounced a significant number of BITs, including Bolivia and Ecuador, most BITs contain survival clauses adding extended protections for investors even after the denunciation. Bolivia's BITs with the UK and France had 20-year survival clauses, and its BITs with Argentina, Netherlands, and Peru had 15-year survival clauses.

Trade Agreements. Since the 1990s, trade agreements have become the primary treaty method for investor protection. The investment chapter of a trade agreement usually references ad hoc investor-state arbitration. Over the past decade, LatAm countries have signed dozens of trade agreements providing such procedures.

For example, in 2013 alone, Colombia signed free trade agreements with investor protections with the European Union and four other countries, and the Dominican Republic-Central America-U.S. Free Trade Agreement ("CAFTA") allows parties to initiate ICSID arbitration.

The free trade agreement dominating headlines, however, is the North American Free Trade Agreement ("NAFTA"). NAFTA currently provides for investor-state dispute settlement. However, President Trump has threatened to withdraw from NAFTA unless the United States receives heavy concessions from Mexico. Negotiations are ongoing, and one of the contentious issues is investor protection. Surprisingly, intense aversion to investor protection is not coming from Mexico. Robert Lighizer, the U.S. Trade Representative, publicly opposes foreign investment protection. The current proposal is to have an "opt in" mechanism for investor protection; however, it is unclear how this will be resolved. Nonetheless, with Mexico's accession to ICSID, there is perhaps less of a concern over how this resolves, but it is still worth keeping an eye on in 2018.

CONCLUSION

In spite of heightened criticism, ICSID should be the preferred avenue for investors in Latin America. The main benefit to ICSID awards is that they are enforced as final judgments in courts of the contracting states. Although there is a risk that 2018 can lead to more protectionist LatAm policies and aversion to ICSID, Venezuela was the last country to denounce ICSID, over six years ago, and Mexico recently signed the treaty. And, even though Argentina has faced the most amount of ICSID claims, it has yet to withdraw, indicating that the governments are still confident in the institution.

Additionally, even if investors are worried about jurisdictional challenges with ICSID, they usually will have the option of ad hoc arbitration under a BIT or trade agreement. And although this arbitration would not render an ICSID award, the arbitral award would still likely be easier to enforce than a domestic court judgment and is the second best alternative for aggrieved investors in 2018.

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