Recent Trends in Bilateral Investment Treaties

Argentina has recently reached an agreement with some of the creditors that had favorable arbitration awards against it. Under administrative decision 830/2013 of October 8, 2013, the government reassigned the 2013 budget in order to include the agreement reached with certain companies.

The agreement is worth US$677 million, and it involves a 25% haircut off the original awards payable in Argentine bonds. The four creditor companies involved are to reinvest 10% of that money in the Argentine bonds issued for the tax amnesty (bonds for investment in infrastructure projects in Argentina with a 4% annual yield).

The arbitration awards were obtained in the International Centre for Settlement of Investment Disputes (ICSID). The good news is that Argentina, which was a somewhat reluctant debtor, agreed to negotiate.

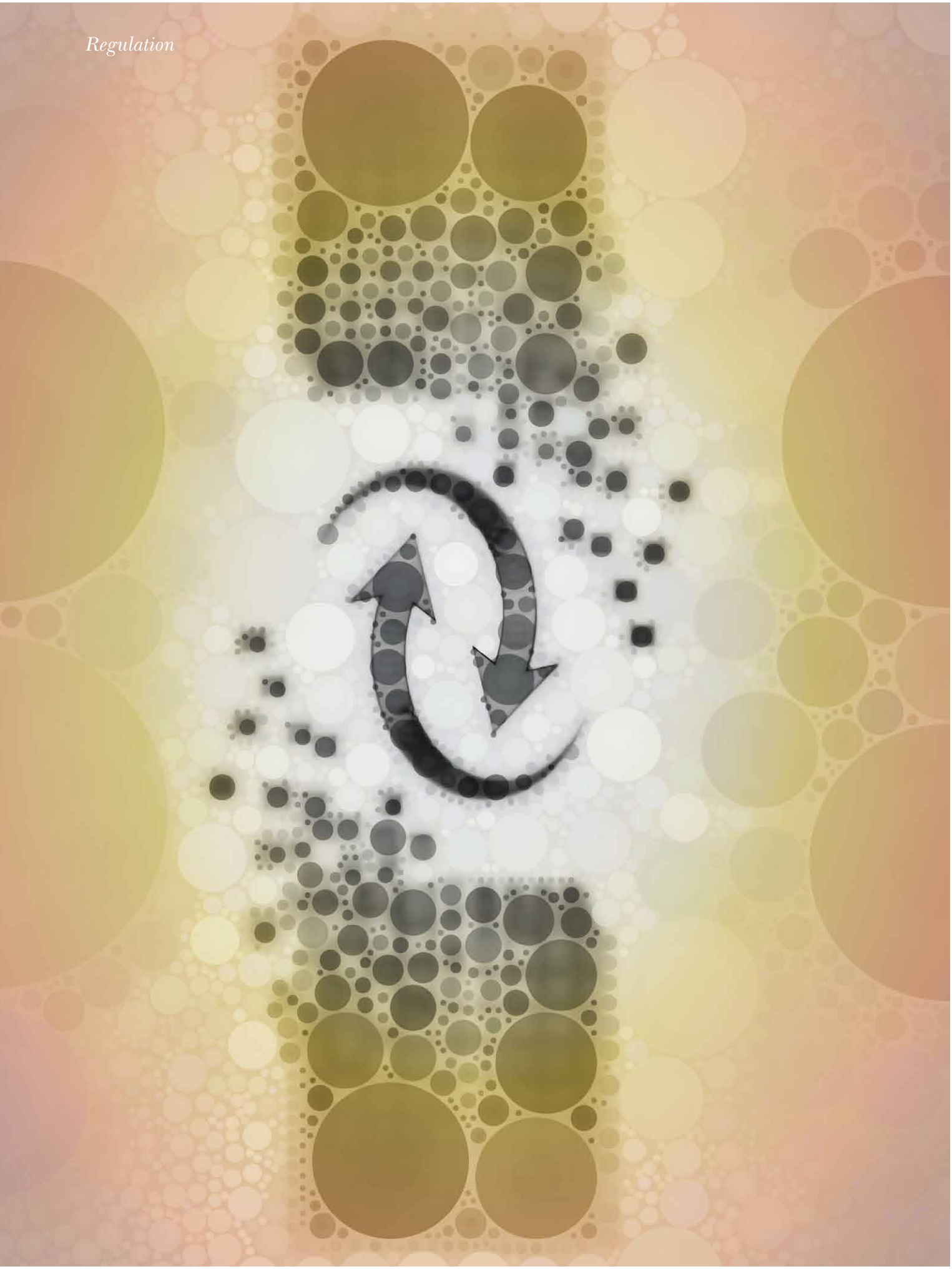
The four companies with which the government closed these deals had complaints that originated in the Argentine crisis of 2001. These companies are Azurix (a water and sewer service provider in the province of Buenos Aires, whose contract was terminated in 2002), Blue Ridge (which ran the CMS Gas Transmission Company, also terminated in 2002), Vivendi (which operated Aguas del Aconquija in Tucuman) and Continental Casualty Company (CNA shareholder Labour Risk Insurance had Argentine Treasury Bonds in pesos convertible to the dollar).

After 12 years of litigation, these companies finally settled their claims. This is a good indication of how the ICSID is beneficial for investment in general, because if these treaties are only "declarative" and not operational then they have no use. This development has reportedly released a loan from the World Bank to Argentina. However, it's not all good news. Argentina still has approximately US$20 billion in debt disputes pending at the ICSID. The most notable case is the expropriation of the controlling shareholding in YPF, the local oil & gas company, for which compensation has not yet been paid.

We believe now is a good opportunity to review the current trends and developments in investment disputes and investment treaties.

Bilateral Investment Treaties – Opportunities and Risks

Bilateral investment treaties (BITs) became very popular in the 90s. Argentina executed 55 BITs (all of them in the period 1990-2000) and because of this Argentina was subject – for investment disputes – to the jurisdiction of the ICSID. Many other Latin American countries executed BITs during the 90s: Bolivia 16, Ecuador 18, Venezuela 22, Chile 48, Perú 28 and México 15.



These BITs are agreements between states that aim to promote investment between the signatory countries, protecting investors in one of the states when investing capital into a signatory country. This is a treaty between sovereign states with the purpose of protecting individuals and corporations when doing business in countries with an additional element of uncertainty or risk. These undertakings have the benefits of the treaty and can claim the protection of the BITs.

The common traits of the BITs are based on four issues: admission of the investment, treatment of the investor, expropriation and dispute resolution. This last is perhaps the most controversial issue, because it involves a dispute between a state and a private undertaking, and they are treated equally for these purposes.

The principal raison d'etre of the BITs is very clear: the protection of the investment of a national of one state into another state. This is intended to enhance foreign investment and allow for the possibility of resolving an investment dispute through an independent third party (arbitrator). These are tools that were absent in previous international legislation or international common uses.

There are certain fundamental elements under the BITs that constitute the rational application of the above mentioned purpose of protecting investment in another state. These traits are the following:

The rights of the investor to enter and establish a business in a member state. This means the right to establish a presence on a level playing field with local players and the right not to be arbitrarily interfered during the lapse of the investment.

The obligation of the recipient state to treat the foreign investor the same as other foreign investors. This is an application of the Most Favored Nation principle.

The right to a free transfer of currency derived of profits, services, loans, compensation, etc.

Limits to expropriation. Expropriation will only be valid when it is for a public cause, non-discriminatory, and duly compensated in a freely convertible and transferrable hard currency.

The Argentine experience has yielded some important criticisms of international arbitration and suggestions for reform of these mechanisms.

The resolution of disputes between investor and the recipient state through international arbitration. Normally the arbitration is under the rules and auspices of ICSID (when negotiation is impossible).

After more than a decade of their existence and application, we can conclude that these instruments have advantages and disadvantages. While they provided for a seemingly secure environment for investment, in practice it took more than a decade to receive some kind of compensation, and market conditions, not investment treaties, drive investment in one direction or the other. For example, Brazil has never had a BIT in force, but Brazil has received the vast majority of foreign direct investment in the past decade in Latin America.

The Argentine Files

Argentina imposed in 1991 a fixed one-to-one convertibility between the peso and the dollar, so one peso was freely convertible to one dollar. That system worked well in the 90s but in 2001, after 10 years of convertibility, the country's economy collapsed.

Argentina defaulted on its foreign debt, which exceeded US$130 billion and included bonds under eight different jurisdictions. During the crisis, the Argentine Congress passed Law 25,561, the Public Emergency and Foreign Exchange System Reform Law. This ended the convertibility regime and imposed a restructuring of contracts, both public and private, in foreign currency under Argentine law. It also provided that prices and fees for public utilities would be set in pesos and not adjusted by U.S. inflation or the U.S. dollar.

Upon termination of convertibility the exchange rate was approximately 3 pesos to the dollar. This emergency legislation caused many foreign companies that had invested in Argentina to raise claims with Argentina before the ICSID. At one point Argentina accumulated nearly 50 cases with compensation claims for more than US$50 billion (without taking into account the defaulted public debt).

Faced with all these claims the Argentine government established an Assistance Unit

for the Defense in Arbitration ("AUDA") in order to defend itself. Since the origin of complaints was basically the same, the arguments in defense of Argentina were often similar. The main argument was that after the 2001 crisis the emergency measures adopted were forced and unavoidable. The changes also equally affected domestic and foreign investors, and so just as many foreign companies' profits were diminished dramatically, many Argentine companies also went bankrupt. The crisis was so severe that it was a unique situation in the history of Argentina. The country's lawyers also invoked Article 11 of the BIT between Argentina and the U.S., which provides "this Treaty shall not preclude the application by either Party of measures necessary for the maintenance of public order, the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests." This article was included as a way to limit the protection of investors in situations of particular importance, as it provides the possibility to preclude the application of the BIT when the recipient government's rules intend to protect national security and public order. It is a kind of force majeure.

Some ICSID tribunals have recognized the emergency situation Argentina faced in the aftermath of the crisis. They have also supported the defense argument by noting that the population as a whole was seriously affected by the crisis, so that the situation required immediate and urgent action by the Argentine authorities.

The Argentine experience has yielded some important criticisms of international arbitration and suggestions for reform of these mechanisms.

Conclusions

There are still many cases pending in the ICSID against Argentina and other Latin American countries. The bulk of the Argentine cases stem from the 2001 crisis, but there is one recent case originated in the expropriation of the local oil and gas company YPF.

In spite of all the criticism, and the fact that countries with no actual BIT in force (such as Brazil) have received substantial FDI in the past decade, the truth is that foreign companies, when deciding an investment in a certain country, first look at the market conditions (the growth opportunities as such), and then the double taxation treaties (DDTs) and BITs. These two conditions (DDTs and BITs) do not per se determine an investment, but in countries with higher political risk the existence of BITs can be significant.

The ICSID system has proven successful to resolve investment disputes in many cases with favorable awards to the recipient countries, but at the same time has been criticized because in fact it is almost impossible to enforce arbitration awards against a country receiving FDI.

The fact that Argentina has agreed to negotiate some cases is a good sign, but it is also a door that has been opened, and there are still many cases pending resolution.