

## The Rise of International Investment Arbitration in Latin America\*

By Omar E. García-Bolívar and Jon Schmid\*\*

Over the last few years, investors from around the world have filed investment arbitration claims against Latin American States. As of November, 2004, of the 85 pending investment arbitration claims submitted to the International Center for Settlement of Investment Disputes (ICSID), 51 have been filed against Latin American States. Of those, 34 have been filed against Argentina, three against Chile, three against Ecuador, two against Peru, one against El Salvador, one against Bolivia, one against Trinidad and Tobago, one against Venezuela and five claims were filed against Mexico through the ICSID additional facility under NAFTA. In addition, international investors have filed claims against Latin American States using other investment arbitration centers including the London Court of International Arbitration and the International Chamber of Commerce International Court of Arbitration.

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. This article explains this paradox and notes the beneficial effects of ICSID for foreign investors in Latin America.

### Investment Treaties

During the 1990s, many Latin American governments signed investment treaties, most of them bilateral (BITs), as part of an overall economic development strategy that emphasized the improving investment climate to attract foreign investment. To ease investor concerns over the reliability, transparency and sophistication of domestic legal frameworks, Latin American governments sought to provide potential investors with internationally binding legal alternatives to domestic courts. This acceptance of international arbitration to settle investment disputes represented a shift from reliance on the Calvo doctrine, which had subjected disputes to the jurisdiction of local courts.

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\* The ideas expressed here represent those of the author and do not necessarily reflect those of BG Consulting ([www.bg-consulting.com](http://www.bg-consulting.com))

\*\* Omar E. García-Bolívar ([omargarcia@bg-consulting.com](mailto:omargarcia@bg-consulting.com)) is President of BG Consulting, a member of the panel of arbitrators of ICSID and an international arbitrator. Jon Schmid ([jonschmid@bg-consulting.com](mailto:jonschmid@bg-consulting.com)) is Manager of Public Sector Services at BG Consulting

As part of the safeguards established by investment treaties, investors from signatory States were granted, among others, protection against direct, indirect and regulatory expropriation, and protection against unfair treatment.

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.

Investment treaties also mandate treatment protection standards for foreign investors such as national treatment, most favored nation and fair and equitable treatment of investors. These provisions have been used to protect foreign investors against abuses such as discrimination, absence of due legal process and biased procedures.

Investors may enforce their rights under treaties by filing claims against the host State with an international forum such as ICSID. 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 BIT.

ICSID's reputation as an impartial forum in which to solve investment disputes in a timely manner has been reinforced by the record of successes. Of the 30 ICSID claims concluded between 1987 and 2003, 12 were settled before tribunals issued a final award. Of the 18 final awards issued by ICSID arbitral tribunals under BITs during the same period, investors prevailed in 10 and States prevailed in eight. In the case of disputes brought in under NAFTA, investors prevailed in two and the States prevailed in four.

Within the context of ICSID, investors have been protected against expropriation and unfair treatment. For example, in *Santa Elena v. Costa Rica* and *Metalclad Corp. v. United Mexican States*, it was determined that a regulatory measure that gradually deprived owners of the value of their property was effectively an expropriation and that full compensation was to be paid. In *MTD Equity Sdn.Bhd and Mtd Chile S.A. v. Republic of Chile*, the Tribunal ruled that investors covered by BITs, are entitled to "...treatment in an even-handed and just manner, conducive to fostering the promotion of foreign investment."

ICSID arbitration also provides investors with the guarantee that its awards are final, binding and enforceable. Moreover, if a State were to fail to comply with an ICSID decision, being thus in violation of the ICSID Convention, the investor's home State could refer the dispute to the International Court of Justice. Besides the legal enforcement mechanisms provided to investors, the adverse effect that failure to comply with ICSID decisions has on the violating country's investment climate further

discourages noncompliance with arbitral decisions. Since investors could perceive noncompliance with ICSID decisions as an indication of the insecurity of investments within the violating State, failure to adhere to arbitral decisions increases investors' perception of risk thus decreasing the likelihood of a State attracting coveted foreign investment. In addition, a State's failure to obey ICSID rulings may also decrease a country's credit rating especially regarding funds from multilateral organizations such as the World Bank, with which ICSID is affiliated and diminish the value of its commercial instruments such as government bonds.

Even though many countries in Latin America have adopted BITs to help attract foreign investors, some countries, like Brazil, still maintain legal sovereignty over foreign businesses. Brazil has been able to buck the trend because many foreign businesses want to invest in Latin America's largest economy and perceive that risks are low.

### **Investment Treaties in Latin America**

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 begs the question: Why are the majority of investment arbitration claims being filed against Latin American States?

There are two main reasons: Argentina's economic and currency crisis in 2001; and the liberalization of Latin American economies that has occurred over the last decade.

Of these factors, the economic crisis in Argentina is the most significant source of arbitration claims. For example, in 2003, roughly half of ICSID treaty arbitrations were against Argentina, nearly all of which were at least partially attributable to the 2001 economic crisis.

The liberalization of Latin American economies further explains the recent regional surge in arbitration. 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. This is 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.

The assumption that a high number of investor disputes in Latin America indicate a lack of investor protection 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.

### **The Business Case for Investment Treaties**

Horror stories of unfair treatment of foreign investors are well-known. The corruption and sluggishness present in the legal systems of many developing countries are enough to deter investment even in cases where the business case is otherwise overwhelmingly strong. Non-legal solutions, such as diplomatic actions by the country of the investor, often give rise to political actions that can remove the control of the dispute from the investor.

Access to international investment arbitration can mitigate investors' risks. Investors usually base their investment decisions on the potential for future profits. Costs are an essential component of the foreign investment decision.

Particularly relevant to the international-bound investor are non-commercial risks such as expropriation, non-convertibility of local currency and violation of international minimum standards such as due process of law. If these risks are high, an investor might seek investment guarantees or political risk insurance through bilateral or multilateral entities such as OPIC or MIGA or through the private sector, all of which may be difficult to obtain or prohibitively expensive. In this context, investment treaties reduce non-commercial risks by providing a transparent and just means of resolving potential disputes. Through this, transaction costs are decreased.

International investment arbitration helps investors by ensuring a more fair and predictable environment in Latin American markets. International investment protection offers a mechanism for economic growth whereby Latin American countries attract foreign direct investment and benefit from the related economic spillovers.