ARGENTINA AGAINST THE ROPES

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Abstract:

The purpose of this article is to analyse ICSID´s latest award against the Argentine government, in view of the 35 cases already filed with the ICSID against Argentina. The article draws some conclusions on the possible consequences of non-compliance with ICSID's awards and analyses general Bilateral Investment Treaties ("BITs") clauses, focusing on the BIT that Argentina signed with the U.S.A.

Key points:

- The BITs provide for fair and equitable treatment of foreign investments in the host state and for full protection of, and security to, foreign investments, without the risk of expropriation and providing for compensation in the event of loss.
- Disputes are resolved by arbitration often under an ICSID tribunal.
- In the Azurix case, the tribunal found that the Argentine Government had failed to treat Azurix's investments in the manner required by the BIT.
- The BIT between Argentina and the USA contains the standard clauses subject to agreed exceptions.

I. Introduction

On July 14, 2006 an arbitral tribunal of the International Centre for the Settlement of Investments Disputes (which is an arm of the World Bank, based in Washington D.C.) ("ICSID") rendered the final award in ***Azurix Corp v. the Argentine Republic (ARB/01/12)***. According to the decision, Azurix Corp was awarded US$ 165 million plus interest at a semi annual rate of 2.44% for the period from March 12, 2002 to June 30, 2006.

The decision follows a similar ruling made last year on breach of contract charges brought against Argentina by CMS Energy Corp.

The government has the right to appeal the award and the process is expected to take another two years.

Over 35 cases at the ICSID, brought against Argentina, are pending decision, which means that unless the country reaches a settlement with each company or decides not to recognise ICSID´s rulings, the Argentine government will have to face heavy damages awards.

II. Bilateral Investment Treaties ("BITs")

A bilateral investment treaty ("BIT") is an instrument of international law that provides investors with certain protections with respect to their investments in a foreign state and in most cases a right to seek direct redress against governmental action that causes them a loss. The redress is available in the form of international arbitration against the host state, often under the auspices of the ICSID.[ii]

BITs developed to protect a country's foreign investments. By the late 60s and early 70s ideological and political conflict was enveloping developed countries and certain developing countries with respect to the expropriation of foreign investment.[iii] The first BIT was signed between the Federal Republic of Germany and Pakistan on November 25, 1959.

To improve the legal framework for foreign investments in Argentina, the national government signed treaties for the promotion and reciprocal protection of investments with countries, known as capital exporters. The main purpose of these treaties was the attraction of foreign investments enhancing the "*pacta sunt servanda"* principle.

The scope of application of the investment treaties is determined by the definition of "investments" and "investors".

The BITs' most common clauses are set out below[iv]:

i) Fair and Equitable Treatment and Full Protection and Security. Fair and equitable treatment is a general concept without a precise definition. It provides a basic standard unrelated to the host State's domestic law and serves as an additional element in the interpretation of treaty and trade agreement provisions on investment. Full protection and security is a principle which has its origin in the modern Friendship, Commerce and Navigation Treaties signed mainly by the United States until the 1960s. Although this principle does not create any liability for the host State, it "serves to amplify the obligations that the parties have otherwise taken upon themselves" and provides a general standard for the host State "to exercise due diligence in the protection of foreign investment." [v]

ii) National Treatment and Most Favoured Nation. This clause provides that treatment of the investors of a signing party is not to be less favourable than that granted to domestic investors; or than the treatment granted to the investors of the most favoured nation if this were more beneficial. Most treaties provide for specific exceptions. The most common are those regarding national security, public policy matters, preferences or privileges resulting from an international agreement related wholly or mainly to taxation and also privileges or preferences arising from an international free trade agreement. Some countries

such as the U.S list a series of exceptions to national and most favoured nation treatment in the protocol or annex to the treaties.

iii) Expropriation. Generally this clause provides that the investor has the right not to have investments expropriated or nationalised, directly or indirectly, except for a public purpose, in a non-discriminatory manner and upon payment of prompt, adequate and effective compensation in accordance with due process of law and the requirements of the BITs. Compensation is to be based on fair market value, must be paid without delay, include interest and be freely transferable.

iv) Compensation for losses. Most treaties and arrangements state that nationals or companies of either contracting party whose investments suffer losses in the territory of the other contracting party due to war or armed conflict, revolution, national emergency, civil disturbances or other similar events will receive treatment in regard to restitution, indemnification, compensation or other settlement on the same basis as accorded to Argentina or third country nationals.

v) Settlement of Disputes.

(i). *Disputes between Contracting Parties*

All BITs provide for the referral of disputes between States (concerning the interpretation or application of the treaty) to *ad hoc* arbitral tribunals, at the request of either Party. The arbitration has to be preceded by consultations. All BITs require that disputes will, whenever possible, be settled amicably through consultations or diplomatic channels. There are differences only in the time period BITs allow for the dispute to be solved through consultations before it is submitted to arbitration procedures. This time period varies between three, six and 12 months, while in some cases there is no limit.

Typically, BITs set rules for the constitution of the *ad hoc* tribunal. They generally provide that each Party appoints an arbitrator, usually within a two-month period. These arbitrators are required to select a national of a third State to serve as Chairman of the tribunal within a period that varies from 30 days to two, three or five months depending on the treaty, although a two-month period seems the most usual formulation. These treaties also include procedures for those cases where the Parties cannot agree on appointments or where other circumstances prevent the tribunal from being constituted.

Some treaties include a reference to the governing law that arbitral tribunals are to apply. The typical provision states that the arbitral tribunal will decide in accordance with the provisions of the agreement and the principles of international law.

(ii). *Disputes between a Contracting Party and an Investor*

All BITs include provisions dealing with disputes between a contracting party and an investor, generally known as investment disputes. The treaties provide for arbitration as the means to settle these types of disputes. This constitutes a departure from traditional treaty practice in this field where no such mechanism was provided and thus, a foreign investor was limited to bringing a claim against the host state in a domestic court or having its home state assume its claim against the host state (diplomatic protection).

For disputes between a Contracting Party and an Investor, the BITs include a reference to a specific institutional arbitration mechanism in contrast to that found for disputes between contracting parties (where the Parties are referred to *ad hoc* arbitral tribunals without pre-established procedures). The Parties are referred to arbitration under the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention) or under ICSID Additional Facility Rules where either the host or home state of the foreign investor is not an ICSID contracting party[vi]. Following what is increasingly the practice in modern investment treaties, most agreements include alternative forms of arbitration. This might prove particularly relevant where ICSID arbitration is unavailable due to jurisdictional constraints. The vast majority refer to arbitration under UNCITRAL rules[vii].

Most treaties require that the investor and host state try to solve the dispute amicably through consultations and negotiations before submitting it to arbitration. In some cases a certain period of time has to elapse before the dispute can be submitted to arbitration (three, six or 18 months, depending on the treaty).

For treaties signed by Argentina, the proceedings differ in two ways as follows:

1. The first treaties signed by Argentina provided for arbitration only if the investor had not first had recourse to local courts.

2. [In later treaties?] the Investor can elect how to settle the dispute - although recourse to arbitration precludes recourse to local courts. This principle is called ("fork-in-the-road") and states that election by the investor of either international arbitration or domestic remedies "shall be final."

vi) Free Transferability. BITs usually include a clause that requires the host country to guarantee to investors of the other contracting party the free transfer of funds related to investments. Although almost all treaties define in great detail which

types of payments will be included in the transfer clause, most treaties emphasise that the guarantee of transfers of funds is not limited to this list. Three types of payments are generally included in the definition of transfers of funds that will be guaranteed: returns (profits, interests, dividends and other current incomes); repayment of loans; the proceeds of the total or partial liquidation of an investment.[viii] In addition, other types of payments are often listed, for example: additional contributions to capital for the maintenance or development of an investment; bonuses and honoraria; wages and other remuneration accruing to a citizen of the other contracting party; compensation or indemnification; and payments arising out of an investment dispute.

The clauses outlined above are not exhaustive. The variety of clauses in the BITs is almost limitless and turns on factors arising from each country's legal framework for the protection of foreign investments.

III. Azurix Corp v. the Argentine Republic.

a. Summary

In 1999, Azurix was awarded the concession for the distribution of portable water and the treatment and disposal of sewerage in the Province of Buenos Aires, Argentina. In late 2001, the concession agreement was terminated by Azurix claiming breaches of contract from the Buenos Aires government

In September 2001, Azurix filed a request for arbitration against Argentina with the ICSID. The company claimed that the Province of Buenos Aires (the "Province") refused to keep rates in line with the framework outlined in the concession contract and did not provide the promised infrastructure. It claimed:

- expropriation without compensation under the terms of the Bilateral Investment Treaty the Argentine Republic signed with USA ("The Bit");
- breach of the fair and equitable treatment clause: Article II. (2) (a);
- failure to observe obligations: Article II (2) (c);
- arbitrary or discriminatory measures: Article II. (2) (b); and
- breach of full protection and security: Article II. (2) (a).

Azurix claimed full compensation which included: (i) the unamortised value of all investments made, including the US$ 438.55 million canon payment and Azurix's additional capital contributions through 2002 of US$ 114,864,000, which were lost as a result of the Argentine government's actions, (ii) discrete damages in excess of US$ 55 million and (iii) costs.

The counterparty claimed that Azurix did not meet minimum investment requirements and was guilty of substandard service.

b. Considerations of the Tribunal

In analysing the merits of the case, the tribunal held that, although the concessionaire's management was affected by the Province's actions, such actions were not sufficient to conclude that Azurix´s investment had been expropriated under the terms of The Bit. Azurix did not lose the attributes of ownership and at all times continued to control the concession.

On the other hand, the tribunal in its award concluded that the Province had breached the standard of fair and equitable treatment set forth on Article II 2 (a) of The Bit. It based its conclusion on:

- the Province's choice to terminate the concession agreement, alleging that Azurix had abandoned the concession when both parties had negotiated the termination by mutual consent;
- the government's decision to freeze rates, breaching several clauses of the concession agreement; and
- the Province's failure to complete the installation of an algae-removing plant and its accusation that Azurix had not maintained the minimum standards of water provision, resulting in its instructing customers to stop paying the bills.

The tribunal was struck by the Province´s conduct after Azurix gave notice of termination of the concession agreement. Despite Azurix's request to terminate the agreement, the Province had refused what was a reasonable request in light of the Province and its agencies previous behaviour. The Province's refusal to accept the termination and its insistence on terminating the concession agreement by itself on account of the abandonment of the concession agreement was found to be a clear breach of the fair and equitable treatment standard.

The tribunal also found that the Province had taken arbitrary measures against Azurix and that it had failed to provide full protection and security to Azurix, as required. In this particular case, the tribunal concluded that there was a link between fair and equitable treatment and the obligation to afford the investor full protection and security.

c. Tribunal's Decision

The tribunal unanimously decided that the Argentine Government had:

1. not breached Article IV (1) of the BIT;
2. breached Article II (2) (a) of the BIT by failing to accord fair and equitable treatment to Azurix's investment;
3. failed to accord full protection and security to Azurix's investment under Article II (2) (a) of the BIT; and

4. breached Article II (2) (b) of the BIT by taking arbitrary measures that impaired Azurix's use and enjoyment of its investment.

Regarding compensation, the tribunal awarded Azurix on account of the fair market value of the concession the amount of US$ 165,240,753 (one hundred sixty-five million two hundred forty thousand seven hundred fifty-three US dollars) It also awarded interest compounded semi-annually on the above amount, from March 12, 2002 to June 30, 2006, at the rate of 2.44% (the average rate applicable to US six-month certificates of deposit during that period).

IV. Bilateral Investment Treaty between Argentina and U.S.A.

This article outlines the key provisions of the treaty for investors.

Treaty between Argentina and U.S.A

The treaty was signed in Washington on November 14, 1991 and came into force on October 20, 1994. It has 14 articles and a protocol.

The first article contains a broad definition of "investment" that includes all types of investments owned or controlled, directly or indirectly, by U.S. nationals or companies. Debt, equity, service and investment contracts, tangible and intangible property, intellectual property rights, licenses and permits, and other contract rights and claims, are all covered.

Only a few sectors of commercial activity are excluded by Argentina from the treaty protections. These are: real estate in the border areas; air transportation; shipbuilding; nuclear energy centres; uranium mining; insurance, and fishing. Mining was originally included in the treaty as a restricted sector but removed by a subsequent agreement.

In addition, the remittance rights guaranteed by the treaty are narrowed for investments made by U.S. investors pursuant to a debt/equity conversion program.

1. Most favoured nation clause

In Article 2, the treaty gives protection against discriminative treatment. It guarantees a standard of treatment which will be no less favourable than that accorded to the nationals of the host country or the treatment granted to nationals of the most favoured nation, whichever is more favourable.

Notwithstanding the above, each party has the right to make exceptions for certain subjects.

The article provides that a fair and equitable treatment should be applied to investments. The standards of protection and treatment must not fall below that required by international law.

2. Expropriation clause

Article 4 provides that investments will not be expropriated or nationalised either directly or indirectly through measures tantamount to expropriation. These measures may only take place to serve a public purpose, in a non-discriminatory way and upon payment of fair compensation, which will be adequate, paid promptly and based on the real market value of the expropriated investment. The compensation must be paid before the act of expropriation is carried out or becomes known, whichever is earlier. It will include interest at a reasonable rate as from the date of expropriation; be fully realisable (which means a protection against payment in bonds or other non-cash forms); and be freely transferable at the prevailing market rate of exchange on the date of expropriation.

In case of an expropriation, the investor affected has the right to have a court consider the case promptly in order to determine if an expropriation effectively occurred, and if so, whether the expropriation and compensation complies with the regulations of the treaty and the principles of international law.

3. Repatriation of profits and investments

Article 5 provides that each party will allow all transfers related to an investment to be made freely and without delay. The transfers include: a) profits; b) compensations; c) payments arising from conflicts regarding investments; d) payments made under contracts, including capital and interest from loans related directly to an investment; e) the produce arising from the total or partial liquidation of an investment or its selling.

Transfers must be made in a freely convertible currency at the prevailing market rate of exchange on the date of transfer (except for transfers resulting from compensations for an expropriation, in which case the exchange rate is that in effect on the expropriation date).

However, both countries may maintain laws and regulations that require the submission of reports regarding transfers or which establish income tax on dividends or other transfers.

4. Settlement of disputes

Articles 6, 7 and 8 set out international arbitration procedures for the resolution of disputes between the host country and the investor. They specifically provide that the resolution of disputes between the country and the investor will be made through consultation or negotiations. If no settlement is reached, the investor may submit the dispute before the Argentine courts (or before another previously agreed jurisdiction) or, six months after the dispute first arose, to the binding arbitration of:

(i) the ICSID established by the Convention on the Settlement of Investment

Disputes between States and Nationals of other States, adopted in Washington on March 18,1965 (CIADI Agreement), as soon as Argentina becomes a party to the convention;

(ii) the Additional Facility of the ICSID, if it is not available;

(iii) the Arbitration Rules of the United Nation Commission on International Trade Law (UNCITRAL);

(iv) any other arbitration institution, or in accordance with any other arbitration rules, as may be mutually agreed between the parties to the dispute.

Any arbitration under paragraphs (ii), (iii) and (iv) must be conducted in a country that is a member of the New York Convention. The arbitral awards will be final and binding.

According to Article 9, these provisions do not apply to the investment disputes arising under EximBank or OPIC insurance programs.

The treaty also provides that it "does not preclude" Argentina's application of measures that are necessary for the maintenance of public order, the fulfilment of its obligations with respect to the maintenance or restoration of international peace or security or the protection of its own essential security interests.

V. Conclusions

The rights provided under the BITs regime are not theoretical. In total, Argentina is facing claims for breaching the BITs of around US$ 16 billion. While most of the claims are based on breach of expropriation clauses - with which the ICSID seems to disagree, they also claim breach of fair and equitable treatment as did Azurix. The country will most likely have to face many negative awards. However, it is pretty clear that Argentina may choose to ignore those awards and there is no mechanism to enforce them. From a political point of view, it is important to emphasise the international discredit for the nation if it does not comply with a treaty, regardless of its responsibility thereof.

One of the few safe harbours that potential as well as current investors have in Argentina is the BITs, whose main purpose is to improve the legal framework in order to attract foreign investments. A non compliance by Argentina of an award could be the final deterrent for foreign direct investment. It is absolutely clear that Argentina is not able to grant companies any type of economic stability or protection against different types of governmental abuses. A decision by the country not to comply with awards rendered under the BITs regime would cause a devastating effect in the country's quest to attract foreign investments.

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[ii] Freshfields Bruckhaus Deringer, *The Argentine crisis- foreign investor's rights,* January 2002.

[iii] OECD, *Investment Compact Regional Roundtable on Bilateral Investment Treaties for the Protection and Promotion of Foreign Investment in South East Europe,* 28-29 May 2001, Dubrovnik, Croatia.

[iv] Trade Unit of the OAS for the FTAA Working Group on Investment, *Investment Agreements in the Western Hemisphere: A Compendium.*

[v] Dolzer and Stevens, *Bilateral Investment Treaties,* 61.

[vi] The ICSID Convention came into force in 1966. See ICSID Doc. 15, *ICSID Basic Documents* (Jan. 1985).

[vii] U.N. Commission on International Trade Law, Decision on UNCITRAL Rules, U.N. Doc. A/CN.9/IX/CRP.4/Add.1, amended by U.N. Doc. A/CN.9/SR.178 (1976).

[viii] Argentina- Jamaica do not list repayment of loans.