Investment protection in Latin America: Mexico takes one step forward, Venezuela takes two steps back

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Mexico has signed the Convention on the Settlement of Investment Disputes between States and National of other States, better known as the Washington Convention or the ICSID Convention. This important development is expected to make Mexico considerably more attractive for foreign investors.

In contrast, the Venezuela National Constitutional Assembly, which was formed in mid-2017 – many say unconstitutionally and illegally – recently approved new restrictions on foreign investment.

**Mexico affirms its commitment to investment arbitration**

In recent years, numerous proposals have been debated to change international investment arbitration. Many of these proposals have arisen in Europe, including as part of the negotiations of the Comprehensive Economic and Trade Agreement (CETA) with Canada, a bilateral investment treaty (BIT) with Vietnam, and the Transatlantic Trade and Investment Partnership (T-TIP) with the United States. One European proposal calls for the establishment of an international investment court with permanent tribunals to replace the current investor-state arbitration regime, in which the ICSID has played a leading role and which administers as much as 80 percent of investor-state
Mexico's decision to sign the ICSID Convention (although ratification by the Mexican Senate is still pending) sends a positive signal to proponents of investor state arbitration. Currently, 162 countries (including Mexico) have signed the ICSID Convention; 153 of those also have ratified it. Only three countries have withdrawn from the ICSID system after denouncing the Washington Convention (Bolivia in 2007, Ecuador in 2009 and Venezuela in 2012).

Mexico is not entirely unfamiliar with ICSID. Indeed, Mexico has been a party in several investment arbitrations under the ICSID's Additional Facility Rules based on investment protection and arbitration provisions in several of its free trade agreements (FTAs), famously including the North American Free Trade Agreement (NAFTA). Ratification of the ICSID Convention by the Mexican Senate will provide investors with greater confidence resulting from the higher probability of enforcing arbitration awards issued under the ICSID Convention in a signatory state. In addition, Mexico will be eligible to participate in the governance of the ICSID system and appoint arbitrators and conciliators to ICSID Panels.

**Mexico continues to send positive signals to foreign investors**

In recent years, Mexico has taken a series of measures aimed at fostering greater openness in trade and investment – both foreign and domestic – including promoting alternative dispute resolution. According to the United Nations Conference on Trade and Development (UNCTAD), Mexico has 29 BITs currently in force and four other BITs that have not yet entered into force. In addition, Mexico has entered into 10 FTAs and other international agreements which contain investment protection provisions.

Mexico has also adopted free market policies in its domestic market, including by rolling back regulation and reducing the state's role in the economy to open up important sectors to private initiative. Mexico's efforts have been noted by international observers, including in UNCTAD’s Investment Policy Monitor, which in December 2017 highlighted Mexico's establishment of Special Economic Areas, negotiation of new international agreements (including a FTA with the European Union), renegotiation of existing agreements (eg., NAFTA), and adoption of measures permitting foreign investors to own larger shares of companies in the air transport sector.

While still pending ratification, Mexico's decision to sign the Convention sends a clear message that Mexico is committed to protecting foreign investment.

**Venezuela and foreign investment: background**

Venezuela stands in stark contrast to Mexico. In 1999, the Venezuelan government approved the Promotion and Protection of Investments Act, which adopted many of the principal investment protection standards of the time, including international arbitration under the ICSID Convention for investor-state disputes.

However, in 2012, Venezuela denounced the ICSID Convention, which effectively blocked many foreign investors from seeking recourse when Venezuela’s withdrawal from the Convention became effective six months later. Since then, avenues for relief have been very limited and depend on the specific language of the relevant BIT. Although most of Venezuela's BITs permit investors to bring claims under ICSID's Additional Facility Rules or through ad hoc arbitration under the Rules of the United Nations Commission on International Trade Law (the UNCITRAL Rules), some do not, in which case parties may be left without options. In the case of Venezuela, there are only 26 BITs in force, the last ones signed in 2007 and 2008 with Belarus, Russia and Vietnam.

After its withdrawal from the ICSID Convention, Venezuela approved a new law in 2014 – simply called Foreign Investments Act – which, rather than promoting or protecting investment, imposed new regulations on foreign investors. Indeed, virtually all of the protections in the prior law disappeared. For example, notwithstanding the existing challenges to repatriating dividends caused by Venezuela's notoriously onerous foreign exchange controls first enacted in 2003, the 2014 Act restricted the portion of dividends that foreign investors could remit abroad to 80 percent of profits, and authorized the government to impose even more stringent requirements in case of "extraordinary circumstances." Moreover, the 2014 Act requires that all foreign investment be subject to dispute resolution before the Venezuelan courts, with very limited exceptions.

**New restrictions on foreign investment in Venezuela in 2017**

The Venezuelan government approved the Constitutional Law of Productive Foreign Investment in late 2017.
Although in principle the new law does not establish percentage limits on the dividends that foreign investors can remit abroad, it states that the government can reduce the percentage to between 60 percent and 80 percent in "extraordinary economic situations." The new Act also contemplates fines of up to 2 percent of the total investment if an investor fails to comply with the Act's requirements. By way of example, the 2017 Act prohibits foreign investors from:

- making contributions to NGOs without the government's approval
- supporting to strikes or boycotts that may contribute to destabilize democratic institutions
- participating directly or indirectly in the national political debates and
- making statements on topics of national public interest in the media.

Additionally, the new Act offers special benefits to foreign investors who are willing to sign a “foreign investment agreement,” which imposes greater government control over the investment.

Notably, the 2017 Act maintains the 2014 Act's requirements that foreign investment disputes be tried before the Venezuelan courts. Even in the case of the few multinational integration schemes adopted by the Venezuelan government in Latin America and the Caribbean, the 2017 Act requires that local remedies be exhausted before recourse to international dispute resolution.

The 2017 Act is just the latest in a string of policies adopted by the Venezuelan government which discourage foreign direct investment in Venezuela. Add to this the continued deterioration of the rule of law and respect for property rights, and it is not surprising that Venezuela was recognized by the World Bank in 2018 as the third worst economy to do business in the world, surpassed only by Eritrea and Somalia.

Closing perspectives

Foreign investors often fear recourse to local tribunals of the investment's host country due to concerns about impartiality and independence. In comparison, arbitration, which is broadly recognized as the principal mechanism for the protection of foreign investment, has been an important part of states' efforts to attract foreign capital. Access to neutral mechanisms of dispute resolution has long been a key element of any country’s investment protection regime.

Not surprisingly, the existence of neutral dispute resolution mechanisms between the foreign investor and the host state is an important condition in any international investment project. A prudent foreign investor exploring a possible investment always starts by confirming that a state adheres to certain multilateral investment treaties, including the ICSID Convention, and that there is an applicable BIT.

For these reasons, there is little doubt that the Mexico's initiative to sign the ICSID Convention increases investor confidence and makes Mexico a more attractive country for foreign investment. In contrast, foreign investment in Venezuela continues to decline every year, and in 2017 had fallen to only 1 percent of total direct foreign investment in Latin America. A cautionary tale indeed.

Learn more about the topics in this article by contacting any of the authors.

This alert is also available in Spanish.

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