PPP projects in Latin America: resolving disputes through investor-state arbitration

Latin America Alert

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Public-private partnership (PPP) projects in Latin America are on the rise. There is a great need for infrastructure investment across the region, but often, Latin American governments cannot commit public finances to fund the huge investment costs such projects entail.

PPPs offer a solution – harnessing the power of private finance to provide multiple public services. However, in the course of such projects disputes may sometimes emerge. Investment protections may be found in the PPP contracts, but also under international law. Indeed, except in Brazil, investors find they may be able to settle disputes around PPP projects via investor-state arbitration, the use of which may increase as the number of PPP projects in the region grows.

Latin America addresses its need for major infrastructure investment

The need for huge investment in Latin America is illustrated by these facts: more than 60 percent of Latin America’s roads are unpaved, compared with 46 percent in emerging economies in Asia and 17 percent in Europe. Two-thirds of sewage is untreated. Losses of electricity supply from outdated transmission and distribution networks are among the highest in the world. Yet, in 2017, Latin American countries spent a smaller share of GDP on infrastructure than any other region except sub-Saharan Africa.¹
Access to good transportation, electricity and telecommunication networks along with water and sanitation, healthcare and education facilities are fundamental pillars for sustainable development and community empowerment. However, building and maintaining such networks often requires substantial investments in terms of financial costs and professional expertise. Many Latin American countries often do not have the capacity to finance such projects, or implement them.

**Turning to PPPs**

Latin American countries have been increasingly turning towards public-private partnerships as a way of structuring public infrastructure investment. PPPs involve partnering with private companies (often with the support of international development institutions) to develop and provide what typically have been thought of as distinctly public works and services.

The importance and growth of PPP projects in Latin America cannot be underestimated. For context, in 2016 PPP projects in Latin America and the Caribbean attracted US$33.3 billion in investment, representing 47 percent of global investment in infrastructure with private participation.²

Across Latin America, experience with PPPs varies. On one end of the spectrum, legislative and regulatory frameworks for PPPs have recently been implemented in Argentina, El Salvador and Nicaragua. At the other end of the spectrum, countries such as Chile, Colombia and Brazil have extensive experience with PPPs. In the five years prior to March 2017, Chile had implemented 70 PPP projects, Colombia had awarded almost 40 projects to the private sector, and Brazil had reached financial closure for around 270 projects.³ Mexico is extending PPPs to areas beyond traditional infrastructure projects, for example sports arenas, educational facilities and prisons. In the US commonwealth of Puerto Rico, PPPs are being used to rebuild the island in the wake of Hurricane Maria, under the Public-Private Partnership act of 2009.

Notably, too, PPPs enjoy wide political support across Latin America. It is expected that the number of PPP projects will continue to grow in the region.

**Investor-state arbitrations on the horizon**

As the number of PPP projects undertaken in the region grows, so will the potential for disputes.

Instability and perceived corruption remain a concern among foreign investors, who typically must ponder how best to protect their investments when considering whether to embark on a PPP project. For instance, investors want to know that, in the event of a dispute, justice will be served in the local courts. If investors do not have this confidence, they may insist that the dispute resolution provision in PPP contracts stipulates that disputes arising in connection with the project will either be resolved by international arbitration or subject to a neutral foreign jurisdiction.

Foreign investors involved in a PPP project, either directly as the PPP contract counterparty or as direct or indirect shareholder in those entities, should also consider protections offered by international law, specifically the protections offered by bilateral investment treaties (BITs).

BITs are treaties signed between two countries, giving the nationals of one of the signatory states (referred to as the home state) rights in respect of their investment in the territory of the other signatory state (referred to as the host state). BIT protections typically include:

- right to a fair and equitable treatment, usually understood to include the investors' legitimate expectations
- the obligation on the host state not to depart from any commitments or undertakings entered into with foreign investors
- the obligation not to adopt arbitrary or unreasonable measures
- the obligation not to impair qualifying investments and
- the protection against direct or indirect expropriation.

BITs usually also include provisions allowing foreign investors to claim directly against the host state through arbitration (these are referred to as Investor-State Dispute Settlement – or ISDS – provisions) if the host state breaches any of the protections offered by the BIT. Most BITs allow qualifying investors to bring an arbitration
claim against the host state under a variety of arbitration rules, including arbitration under the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention) or under the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL). In addition, certain BITs allow the possibility of bringing treaty claims under the ICSID Additional Facility Rules when only one of the states involved (the investor's home state) has ratified the ICSID Convention.

But which arbitration rules should investors opt for?

The arbitration proceedings available to foreign investors will depend in part on the terms of the BITs signed between the host and home states. In this context, investors are advised to consider, when possible, channelling their investments through an entity incorporated in a state that is party to a BIT with the host state.

1. ICSID Convention

ICSID arbitration proceedings are likely to be the preferred option among foreign investors because of this distinct advantage: the ICSID Convention requires the national courts of contracting states to recognize and enforce ICSID awards automatically, as if they are judgments issued by the national courts.

However, ICSID arbitration is only available to investors when both the home state and the host state have ratified the ICSID Convention. As of August 27, 2018, 162 states have signed the ICSID Convention, of which 154 have ratified it, including most Latin American countries. Notably, Mexico signed the ICSID Convention on January 11, 2018 and ratified it on July 27, 2018. The ICSID Convention came into force in Mexico on August 26, 2018. This means that foreign investors in PPPs in Mexico whose rights are protected by the relevant BIT may now benefit from the enforcement mechanism of the ICSID Convention.

2. Arbitrations under the ICSID Additional Facility Rules or UNCITRAL Rules

The ICSID Additional Facility Rules allow ICSID to administer arbitration over disputes that fall outside the scope of the ICSID Convention because only one of the relevant states (either the host state or the home state of the foreign investor) is a party to the ICSID Convention. As a final alternative, BITs may also provide ad hoc arbitration under the UNCITRAL Rules.

Much like an international commercial arbitral award, neither an ICSID Additional Facility award nor an UNCITRAL award benefit from automatic recognition and enforcement. They must be judicially recognized and converted to a court judgment whenever enforcement is sought and are subject to the assertion of the defenses available under the New York Convention, including the challenge that the award is contrary to the public policy of the state where recognition is sought.

Depending on the terms of the applicable BITs and their sunset clauses if they have been terminated, arbitrations under ICSID Additional Facilities or, more likely, UNCITRAL may be particularly relevant to PPP projects in countries that have denounced the ICSID Convention – namely Bolivia, Ecuador and Venezuela. In the case of Ecuador, it is worth noting it has terminated all its BITs and approved a Law for the Promotion of Economic Development, which provides that the Ecuadorian State must agree to domestic or international arbitration to resolve disputes regarding investment agreements which value exceed US$10 million. Investors may initiate proceedings before a number of arbitral institutions, namely the Permanent Court of Arbitration; the International Chamber of Commerce; or the Interamerican Commercial Arbitration Commission. The arbitration will be governed by the UNCITRAL Rules or the relevant institutional rules.

Investor protection in Brazil

Unlike in the majority of countries in Latin America, ISDS is not available to foreign investors in respect of their investments in Brazil. Foreign investors in PPP projects in Brazil will thus not be able to claim directly against the State of Brazil.

Brazil has not signed the ICSID Convention. Between 1994 and 1999, Brazil signed 14 BITs but they were never approved because they were deemed unconstitutional by Brazil's National Congress, which felt that ISDS provisions limit states' rights to regulate while granting extraordinary benefits to foreign investors. These BITs were withdrawn in 2002.
Brazil's policy on entering into international treaties to attract foreign investment changed in 2015, when Brazil approved a Model Promotion of Cooperation and Facilitation Investment Agreement (CFIA).

Since then, Brazil has signed eight CFIsAs (six in 2015 and two in 2018), but to date only the CFIA between Brazil and Angola has entered into force. It is yet to be seen if CFIsAs will be more widely adopted and subsequently entered into force. However, it is worth noting that, even if they do, and unlike the typical BITs, CFIsAs:

- preserve Brazil's "right to regulate"
- do not include some of the traditional protections safeguarded in BITs, such as right to fair and equitable treatment and
- provide for state-to-state arbitration in the event that disputes are not resolved amicably.

**Conclusion**

The number of PPP projects in Latin America will grow, and inevitably so will the disputes arising thereunder.

Foreign investors planning to take part in PPPs in the region should consider the investment protection measures offered by the states in which they are planning to invest. Those who may not be persuaded that they will find justice in local courts in the event of a dispute may seek to insist that the dispute resolution clauses of the PPP contracts refer any disputes to either arbitration or the courts of a foreign jurisdiction.

As for protections under international law, except in Brazil, BITs may (depending on nationality/place of incorporation) provide foreign investors with ISDS provisions, giving them an important tool to protect their investments.

In Brazil, ISDS is not available to investors. With the exception of Angolan investors investing in Brazil, foreign investors taking part in PPPs in Brazil must turn to the remedies available in the jurisdiction agreed upon in the PPP project contracts. Angolan investors in Brazil (and nationals of states that are party to a CFIA with Brazil when, and if, it enters into force) will need to rely on their home states to take matters forward on their behalf in the event that disputes are not amicably resolved. It remains to be seen how effective CFIA will be in protecting foreign investments in PPP projects in Brazil.

This article is also available in Spanish.

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