NOTE

The Tide of the Times? A Sectoral Approach to Latin America's Resistance to the Investor-State Arbitration System

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Following a period of openness to foreign direct investment and the integration of arbitration agreements into relationships with foreign investors through international treaties and investment contracts, the last decade has witnessed the resurgence of resistance by Latin American nations to the investor-state arbitration system. What has fomented this recent resistance? While the literature has proffered a set of that primarily focus on country-level ideological positions and structural economic issues, these theories are largely disjointed and empirically limited in their explanatory power. This Note introduces principles from leading sector analysis to develop a singular theoretical framework that explains the empirical puzzle of Latin American resistance to investor-state arbitration. Specifically, this Note asserts that the market structure of the sector that is the target of investment plays a critical role in its capacity for collective action and causally affects the extent to which the sector can influence the host state in its stance vis-à-vis the investor-state arbitration system. Using a comparative historical analysis of Argentina and Venezuela, this Note finds strong qualitative evidence to support a sectoral approach to understanding Latin America's tumultuous relationship with the investor-state arbitration system while controlling for existing explanations. Ultimately, this Note provides important theoretical and empirical contributions to one of the most salient issues facing the investor-state arbitration system.

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You'll go, together we'll go, by the tide of the times.

- Pablo Neruda, "Sonnet LXXXI"

I. INTRODUCTION

Much like the sea, Latin America's historical relationship with the investor-state arbitration system has been tumultuous and oscillating. Following a period of openness to foreign direct investment and the integration of arbitration agreements into relationships with foreign investors through international treaties and investment contracts, the last decade has witnessed the resurgence of resistance by Latin American nations to the investor-state arbitration system. On January 24, 2012, Venezuela became the third country to withdraw from the International Centre for Settlement of Investment Disputes (ICSID), following Bolivia and Ecuador.[1] Additionally, stemming from a series of ICSID awards issued against them in reaction to an economic crisis, Argentina, traditionally a strong proponent of the investor-state arbitration system, expressed resistance to ICSID and contemplated withdrawal.[2] Given the tempestuous historical relationship between Latin America and the investor-state arbitration system, these denunciations have sparked debate regarding whether the system will collapse in the region.[3] What has fomented Latin America's recent resistance to the investor-state arbitration system?

While the existing literature has proffered a set of explanations that largely focus on country-level ideological positions and structural economic issues, these reasons are disjointed and empirically limited in their explanatory power. Thus, the purpose of this Note is to introduce and develop a causal argument that unifies the empirical puzzle of Latin America's resistance to the investor-state arbitration system. This Note explains the region's resurgence of hostility toward the investor-state arbitration system by drawing on principles from leading sector analysis. This Note argues that the market structure of the sector that is the target of investment plays a critical role in its capacity for collective action and causally affects the extent to which it can influence the host state in its stance vis-à-vis the investor-state arbitration system. Specifically, sectors with high capital intensities and high economies of scale will be more successful in pressuring states to adopt policies that run counter to the investor-state arbitration system.

This theory is tested using a comparative historical analysis of two disciplined configurative case studies,[4] Argentina and Venezuela. While Argentina and Venezuela significantly differ on ideological and structural economic grounds, the policy choices leading up to their resistances to the investor-state arbitration system were causally affected by sectors with strong collective action capacities. Understanding the political dynamics between states and sectors targeted for investment provides a unifying insight into explaining Latin America's present tension with the investor-state arbitration system. Accordingly, this Note makes a significant theoretical contribution to the international investment law literature by

1. Press Release, Int'l Ctr. for Settlement of Inv. Disputes [ICSID],Venez. Submits a Notice under Article 71 of the ICSID Convention (Jan. 26, 2012), *available at* https://icsid.worldbank.org/a-pps/ICSIDWEB/Pages/News.aspx?CID=57&ListID=74f1e8b5-96d0-4f0a-8f0c-2f3a92d84773&va-riation=en_us.

2. *See* Harout Samra, *Five Years Later: The CMS Award Placed in the Context of the Argentine Financial Crisis and the ICSID Arbitration Boom*, 38 U. MIAMI INTER-AM. L. REV. 667, 694–95 (2007).

3. *See* Diana Marie Wick, *The Counter-productivity of ICSID Denunciation and Proposals for Change*, 11 J. INT'L BUS. & L. 239, 248 (2012); Ignacio A. Vincentelli, *The Uncertain Future of ICSID in Latin America*, 16 L. & BUS. REV. AM. 409, 430–31 (2010).

4. *See* ALEXANDER L. GEORGE & ANDREW BENNETT, CASE STUDIES AND THEORY DEVELOPMENT IN THE SOCIAL SCIENCES 75 (2005).

explaining an existing empirical puzzle through a new and singular theoretical framework. Additionally, this Note contributes to the empirical literature on Latin American investment by analytically focusing on state-sector relations, a factor that has been empirically neglected, and by comparatively analyzing two Latin American states in a structured and systematic fashion.

This Note is organized as follows: Section II builds a conceptual framework of Latin American investment by tracing the history of the region's relationships with the investor-state arbitration system. Section III reviews the literature on the most recent period of Latin American resistance to the investor-state arbitration system and identifies its limitations. Section IV introduces a theoretical framework of sector-level collective action efforts by drawing on principles from leading sector analysis. Section V tests this theory using a comparative analysis of Argentina and Venezuela, focusing on how dynamics between the energy sectors fomented economic policies that have led to hostility with the investor-state arbitration system. Section VI concludes, offers policy implications looking forward, and identifies areas of future research.

II. THE WAXING AND WANING OF LATIN AMERICA TO INVESTOR-STATE ARBITRATION

A. "El No de Tokyo"

Latin American nations have been characterized by a longstanding reluctance to accept investor-state arbitration as a means of dispute settlement.[5] The root of this reluctance is the Calvo Doctrine, which was "conceived against the background of gunboat diplomacy."[6] Two fundamental principles constitute the core of Calvo:

> [f]irst, that sovereign states, being free and independent, enjoy the right, on the basis of equality, to freedom from 'interference of any sort' . . . by other states, whether it be by force or diplomacy, and second, that aliens are not entitled to rights and privileges not accorded to nationals, and that therefore they may seek redress for grievances only before the local authorities.[7]

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5. Alexia Brunet & Juan Agustin Lentini, *Arbitration of International Oil, Gas, and Energy Disputes in Latin America*, 27 NW. J. INT'L L. & BUS. 591, 593 (2007).

6. RUDOLF DOLZER & CHRISTOP SCHREUER, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW 212 (2008).

7. Denise Manning-Cabrol, *The Imminent Death of the Calvo Clause and the Rebirth of the Calvo Principle: Equality of Foreign and National Investors*, 26 LAW & POL' Y INT'L BUS. 1169, 1171–72 (1995)

Many Latin American countries incorporated aspects of the Calvo Doctrine in their domestic and constitutional laws.[8] Furthermore, Latin American countries have incorporated a Calvo clause into contracts with foreigners. This clause provides that any dispute with the host country or its companies shall be submitted to domestic courts and forbids recourse to diplomatic protection by the aggrieved party.[9]

Specifically with respect to ICSID, no Latin American nation initially ratified the Washington Convention.[10] In fact, when the Convention was first discussed in different regional meetings of the World Bank, Latin American countries, in bloc, opposed the idea of establishing a specialized forum for governments and foreign investors.[11] This initial resistance of Latin America to the Washington Convention has been dubbed "El No de Tokyo."[12] Paul Szasz identified five main reasons why Latin America was resistant to ratify the Washington Convention. First, "not all governments [were] uniformly eager to attract foreign private investment."[13] Second, Latin American countries feared that by adopting the Washington Convention they would be undermining the well-established international law principle of non-intervention.[14] Third, by allowing only foreigners to arbitrate their disputes against host states, they were breaching the well-established principle of international law regarding equal treatment of foreigners and nationals.[15] Fourth, the Latin American countries rejected the argument that their domestic courts were not efficient and fair fora to try these claims.[16] Lastly, Latin American countries were suspicious of arbitral proceedings, as opposed to judicial proceedings, primarily because of the "past association with foreign intervention, of arbitration between a government and a private person."[17] "During the first decades of its existence, virtually all Latin American countries stayed away from ICSID,

(citing DONALD R. SHEA, THE CALVO CLAUSE: A PROBLEM OF INTER-AMERICAN AND INTERNATIONAL LAW AND DIPLOMACY 19 (1955)).

8. *See* SURYA P. SUBEDI, INTERNATIONAL INVESTMENT LAW: RECONCILING POLICY AND PRINCIPLE 14–15 (2008); Jeanne M. Cook, *International Arbitration in the Latin American Context-A Comparative Look at Arbitration in Mexico and the United States*, 3 VINDOBONA J. INT'L COM. L. & ARB. 41 (1999).

9. *See* Bernardo M. Cremades, *Disputes Arising Out of Foreign Direct Investment in Latin America: A New Look at the Calvo Doctrine and Other Jurisdictional Issues*, 59 DISP. RESOL. J. 78, 80 (2004).

10. *See* Vincentelli, *supra* note 3, at 417.

11. *Id.* at 417–18.

12. ANDREAS F. LOWENFELD, INTERNATIONAL ECONOMIC LAW 540 (2d ed. 2008) (noting that "at the Annual Meeting of the World Bank in Tokyo in 1964, all Latin American States voted 'no' — the first time in the Bank's history that a final resolution had met with substantial opposition on a final vote").

13. Paul C. Szasz, *The Investment Disputes Convention and Latin America*, 11 VA. J. INT'L L. 256, 260 (1971).

14. *Id.*

15. *Id.* at 261.

16. *Id.* at 262.

17. *Id.* at 263.

preferring to adopt a system of 'internationalization' of foreign investment contracts to ensure foreign investors' respect for their investments."[18]

B. Coming to (Washington) Consensus

Over time, Latin American nations have increasingly become open to foreign direct investment and integrating arbitration agreements into relationships with foreign investors through the ratification of international treaties and contract clauses.[19] The debt crisis of the 1980s, coupled with the unsustainability of import-substitution[20] as a model for industrial policy, fomented the opening of Latin American economies in order to acquire capital.[21] Accordingly, Latin American nations subscribed to the Washington Consensus, a package of economic policies emphasizing neoliberal theory.[22] To complement the opening of markets and liberalization of the economy, Latin American nations encouraged and attracted foreign direct investment by entering into international investment treaties such as the Panama Convention, New York Convention, and the Washington Convention, as well as bilateral investment treaties (BITs).[23]

C. Resurgence of Resistance

Recent events, however, have suggested that the Latin American attitude toward the investor-state arbitration system is shifting back toward its historically resistant roots. The lion's share of ICSID's caseload has consisted of claims against Latin American states.[24] Investors from industrialized Europe and the United States have been on the opposite side of many of these cases. Bolivia was the first state to withdraw from ICSID; it gave notice of its denunciation of ICSID in 2005, which became

18. Vincentelli, *supra* note 3, at 410.

19. *See* Deborah Ko, *The Reemergence of Latin America's Rejection of International Arbitration*, 20 ALTERNATIVE RESOL. 7, 7 (2010-2011).

20. Import-substitution is a national economic strategy and industrial policy that seeks to develop the domestic economy by emphasizing the replacement of imports by domestically produced goods through a variety of protectionist and interventionist policies. *See, e.g.*, Jeswald W. Salacuse, *From Developing Countries to Emerging Markets: A Changing Role for Law in the Third World*, 33 INT'L L. 875, 877–80 (1999).

21. Edward A. Fallone, *Latin American Laws Regulating Foreign Investment*, *in* Paul Vishny (ed.), INTERNATIONAL TRADE FOR THE NON SPECIALIST, 2d edition, pp. 523 (ALI-ABA 1997); M. C. MIROW, LATIN AMERICAN LAW: A HISTORY OF PRIVATE LAW AND INSTITUTIONS IN SPANISH AMERICA 230 (2004).

22. *See generally* John Williamson, *What Washington Means by Policy Reform*, *in* LATIN AMERICAN READJUSTMENT: HOW MUCH HAS HAPPENED? (John Williamson ed., 1990).

23. *See* Ko, *supra* note 19, at 8–9; ANDREW NEWCOMBE & LLUÍS PARADELL, LAW AND PRACTICE OF INVESTMENT TREATIES: STANDARDS OF TREATMENT 50 (2009).

24. *See* Ko, *supra* note 19, at 10.

effective in 2006.[25] In 2009, Ecuador gave notification of its denunciation of ICSID, with the denunciation taking effect in 2010.[26] Following a serious balance of payments crisis, Argentina, traditionally a strong proponent of the investor-state arbitration system, expressed resistance to ICSID and contemplated withdrawal.[27] Nicaragua has also been identified as a nation that may denounce ICSID.[28] In reaction to the recent resurgence of resistance by Latin American nations to the investor-state arbitration system, there has been a revived interest among scholars in an attempt to explain the motivations of dissident states and the future implications for the system in the region.

III. EXISTING EXPLANATIONS FOR LATIN AMERICAN RESISTANCE TO INVESTOR-STATE ARBITRATION

A. Ideological Explanations

The most developed explanations for the resurgence of Latin American resistance to investor-state arbitration draw from the same ideological motivations that underpinned the region's initial reluctance. These explanations emphasize the prevalence of leftist political regimes in Latin America and the espousal of a discourse that is deeply rooted in conflict with the neoliberal economic discourse that is at the foundation of the investor-state arbitration system. Accordingly, "there is no deeply ingrained business arbitration culture in Latin America."[29] M. Sornarajah notes that,

> [a]ttitudes towards foreign investment are shaped by conflicting legal paradigms in investment disputes. . . .The paradigm of the free market being beneficial to economic development clashes with the paradigm of state sovereignty and the state's ability to regulate all economic activity.[30]

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25. Press Release, ICSID, Denunciation of ICSID Convention of the Republic of Bol. (May 16, 2007), *available at* https://icsid.worldbank.org/apps/ICSIDWEB/Pages/News.aspx?CID=11-3&ListID=74f1e8b5-96d0-4f0a-8f0c-2f3a92d84773&variation=en_us.

26. Press Release, ICSID, Denunciation of ICSID Convention by Ecuador (Jul. 9, 2009), *available at* https://icsid.worldbank.org/apps/ICSIDWEB/Pages/News.aspx?CID=97&ListID=74f1e8b5-96d0-4f0a-8f0c-2f3a92d84773&variation=en_us.

27. *See* Samra, *supra* note 2.

28. Alexis Mourre, *Perspectives of International Arbitration in Latin America*, 17 AM. REV. INT'L ARB. 597, 608 (2006).

29. Brunet & Lentini, *supra* note 5, at 610–20 (citing Horacio A. Grigera-Naón, *Recent Trends Regarding Commercial Arbitration in Latin America*, *in* ENFORCEMENT OF ARBITRATION AGREEMENTS IN LATIN AMERICA 109 (Bernardo Cremades ed., 1999)).

30. M. SORNARAJAH, THE SETTLEMENT OF FOREIGN INVESTMENT DISPUTES 77 (2000).

Focusing on Bolivia and Ecuador's withdrawal from ICSID, Ignacio Vincentelli contends that,

> [t]hese announcements . . . are driven by a personal conviction that FDI, even if it does foster development and prosperity, is wrong, promotes imperialism, and thus deserves no effective protection. In this sense, an effective system of protection of FDI, such as ICSID, could be seen as an undue waiver of sovereignty.[31]

These explanations are consistent with dependency theory[32] and structuralism,[33] both of which are theories of economic development originating in Latin America that assert that the prevailing international economic market structure establishes and perpetuates the domination of developed nations over developing nations and encourages the continued underdevelopment of the developing nations.

The literature has looked to regime rhetoric and domestic institutions as evidence to support these ideological explanations. Bolivian President Evo Morales has been especially wary of the investor-state arbitration system as a threat to state sovereignty. While urging other Latin American countries to withdraw from ICSID as well, he stated, "[we] emphatically reject the legal, media and diplomatic pressure of some multinationals that . . . resist the sovereign rulings of countries, making threats and initiating suits in international arbitration."[34] Additionally, Deborah Ko notes that Latin American states have relied upon constitutional provisions that invoke public policy considerations in order to justify their rejection of international arbitration.[35] For instance, Carlos Alfaro and Pedro Lorenti note that the current state of Argentine constitutional law will doubtlessly favor the Constitution's supremacy over the ICSID Convention and, subsequently, the protection of alleged "matters of public policy," even at the expense of denying enforcement to an ICSID award.[36]

However, ideological explanations for Latin American resistance to the investor-state arbitration system are limited in their explanatory power

31. Vincentelli, *supra* note 3, at 423.

32. *See generally* FERNANDO HENRIQUE CARDOSO & ENZO FALETTO, DEPENDENCY AND DEVELOPMENT IN LATIN AMERICA (1979); ANDRE GUNDER FRANK, CAPITALISM AND UNDERDEVELOPMENT IN LATIN AMERICA (1967); J. Samuel Valenzuela & Arturo Valenzuela, *Modernization and Dependency: Alternative Perspectives in the Study of Latin American Underdevelopment*, 10 COMP. POL. 535 (1978).

33. *See generally* U.N. Dep't of Econ. Affairs, *The Economic Development of Lat America and its Principal Problems*, U.N. Doc. E/CN.12/89/Rev.1, U.N. Sales No. 50.II.G.2 (1950).

34. Damon Vis-Dunbar et al., *Bolivia Notifies World Bank of Withdrawal from ICSID, Pursues BIT Revisions*, INV. TREATY NEWS, May 9, 2007.

35. Ko, *supra* note 19, at 14.

36. Carlos E. Alfaro & Pedro M. Lorenti, *The Growing Opposition of Argentina to ICSID Arbitral Tribunals*, 6 J. WORLD INV. & TRADE 417, 427 (2005); *see also* Katia Fach Gómez, *Latin America and ICSID: David versus Goliath?*, 17 LAW & BUS. REV. AM. 195, 203 (2011).

because they struggle to explain two sets of empirical outcomes. First, ideological explanations cannot account for nations that have historically expressed pro-investment and pro-arbitration sentiments and policies that radically shift away from this position without a significant change of political regime. Argentina exemplifies this trend as a nation that has demonstrated openness to foreign investment and a willingness to utilize arbitration as a method of dispute resolution; however, following a balance of payments crisis, Argentina became hostile and resistant to ICSID.[37] Second, ideological explanations fail to account for states adopting alternative arbitral systems other than ICSID. For instance, while Venezuela has been rhetorically hostile toward investor-state arbitration generally and ICSID specifically, Venezuela has recently entered into BITs with Cuba, Iran, Russia, and Belarus.[38] All of these BITs include a provision regarding the settlement of investor-state disputes, which eliminates the ICSID option in favor of other combinations. These combinations include: (1) state courts or ad hoc arbitration under the United Nations Commission on International Trade Law (UNCITRAL) Rules (Venezuela/Cuba 2004),[39] (2) the additional option of a Stockholm Chamber of Commerce arbitration (Venezuela/Russian Federation 2008),[40] and (3) in the case of Venezuela/Iran 2006, the option between ad hoc UNCITRAL arbitration and International Chamber of Commerce in Paris followed by the reference to ICSID "if both parties are members of this Convention."[41] A crystallized theory of ideology would predict withdrawal from all international arbitration systems as well as place an emphasis on local courts in lieu of arbitration tribunals.

B. Institutional Explanations

Related to ideological explanations, but analytically distinct, institutional explanations focus on critiques of how the structure and design of investor-state arbitral institutions produce discriminatory and unfavorable outcomes for Latin American nations. Thus, institutional theories suggest that the recent rejection of investor-state arbitration by Latin American states should be understood "as a signal to the

37. *See* Christina L. Whittinghill, Comment, *The Role and Regulation of International Commercial Arbitration in Argentina*, 38 TEX. INT'L L. J. 795 (2003) (utilizing Argentina as a case study due to its willingness to enter into BITs in the past).

38. *See* Gómez, *supra* note 36, at 215.

39. Agreement about the Promotion and Reciprocal Protection of Investments between the Bolivarian Republic of Venezuela and the Republic of Cuba, Cuba-Venez., Dec. 11, 1996.

40. Agreement between the Bolivarian Republic of Venezuela and the Government of the Russian Federation about the Promotion and Reciprocal Protection of Investments, Russ.-Venez., Nov. 7, 2008.

41. Agreement about the Promotion and Reciprocal Protection of Investments between the Bolivarian Republic of Venezuela and the Islamic Republic of Iran, Iran-Venez., Mar. 2, 2006.

international community that the current legal frameworks are inadequate."[42] Accordingly, institutional theories suggest that constitutionally-based arguments against international arbitration are, in fact, a result of the insufficiency of these forums to protect certain fundamental principles.[43] A common criticism of investor-state arbitration is that the system protects investors "from the exercise of public authority."[44] The system uses private arbitration "in the regulatory sphere," which conflicts with "principles of judicial accountability and independence in democratic societies."[45]

Critiques of ICSID may provide some insight into the limitations of ideological explanations with respect to nations like Venezuela withdrawing from ICSID, but opting to use other investor-state arbitration systems. ICSID has been criticized for the absence of an appeals process,[46] the alleged lack of impartiality against states,[47] and the high cost associated with ICSID litigation.[48] Synthesizing these critiques, President Morales complained of ICSID that, "[t]he governments of Latin America, and I think the world, never win the cases. The multinationals always win."[49] The lack of transparency in arbitration hearings in matters that involve the public interest was one reason Bolivia gave for denouncing ICSID.[50]

However, institutional explanations also struggle to explain empirical variation within Latin America, both cross-sectionally and longitudinally. Given that investor-state arbitral institutions apply uniformly across all signatory countries, institutional explanations fail to explain why some nations, such as Chile, have categorically embraced international arbitration, despite the alleged institutional deficiencies of the investor-state arbitration system. Furthermore, institutional explanations fail to explain variation over time in a particular country; Argentina is a relevant example. Institutional explanations would predict more consistent and

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42. Ko, *supra* note 19, at 15.

43. *See generally* Jacob Katz Cogan, *Noncompliance and the International Rule of Law*, 31 YALE J. INT'L L. 189 (2006).

44. Ben Juratowitch, *The Relationship Between Diplomatic Protection and Investment Treaties*, 23 ICSID REV. 10, 28 (2009).

45. GUS VAN HARTEN, INVESTMENT TREATY ARBITRATION AND PUBLIC LAW 4 (2007).

46. *See* Carlos G. Garcia, *All the Other Dirty Little Secrets: Investment Treaties, Latin America, and the Necessary Evil of Investor-State Arbitration*, 16 FLA. J. INT'L L. 301, 340–41 (2004).

47. *See* Wick, *supra* note 3, at 271. *But see* Susan Franck, *Empirically Evaluating Claims about Investment Treaty Arbitration*, 86 N.C. L. REV. 1 (2007).

48. *See* Garcia, *supra* note 46, at 352, 355–56; K.V.S.K. NATHAN, THE ICSID CONVENTION: THE LAW OF THE INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES 53 (2000).

49. *Another Bolivian Nationalisation: Power Grab*, THE ECONOMIST (May 6, 2010) http://www.economist.com/node/16064027?story-id=16064027&CFID=126619125&CFTOKEN=96005616.

50. Fernando Cabrera Diaz, *Bolivia Expounds on Reasons for Withdrawing From ICSID Arbitration System*, INVESTMENT TREATY NEWS (May 27, 2007), http://www.iisd.org/pdf/2007/itn_may27_2007.pdf.

systematic resistance to the investor-state arbitration system than is empirically evidenced by current state positions.

C. Structural Explanations

A third set of explanations focus on how structural features of the host state's economy affect a state's relationship to the investor-state arbitration system. Structural theories largely focus on two causal mechanisms. First, "[w]hen the immediacy and effects of economic crisis collide with long term obligations under bilateral investment treaties, necessity provides an explanation for rejection of international arbitration terms."[51] Thus, states that experience economic crisis are more likely to be resistant to the investor-state arbitration system because of a desire for policy autonomy in reacting to the crisis.[52] Furthermore, these states contend that they should not be punished by the investor-state arbitration system due to a *force majeure*. Within Latin America, Argentina has been the empirical focus of this theory.[53] Following a massive balance of payments crisis and the implementation of the Public Emergency and Exchange Regime Reform Act, a number of investors brought claims against Argentina.[54] Thus, commentators contend that the balance of payments crisis caused Argentina's dramatic shift from a proponent of foreign direct investment and international arbitration to an opponent that contemplated withdrawal from the investor-state arbitration system.[55]

Second, structural theories focus on state resistance to foreign investment and international arbitration in sectors that are of significant national economic importance to the host state. This emphasis on resource nationalism largely focuses on the energy sector, particularly with extractive industries. Alexia Brunet and Juan Agustin Lentini note that,

> [r]esource nationalism is exemplified by the global trend of placing the world's oil reserves under the control of national oil companies and out of reach of the international oil companies, except on a low-margin, service-contract basis. This trend is prompting some Latin

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51. Ko, *supra* note 19, at 14; *see also* Gómez, *supra* note 36, at 226.

52. I have argued that the depth of the "socioeconomic trough" has a strong causal effect on nations undergoing radical policy reform. *See* Tom Brower, Presentation at the Virginia Social Science Association Annual Conference: State Capacity Formation as Functions of Economic Crisis and International Actors: Ghana 1981-1992 (Apr. 5, 2008) (on file with author). *See also* Thomas Callaghy, *Lost Between State and Market: The Politics of Economic Adjustment in Ghana, Zambia, and Nigeria*, *in* ECONOMIC CRISIS AND POLICY CHOICE: THE POLITICS OF ADJUSTMENT IN THE THIRD WORLD 257, 263 (Joan M. Nelson ed., 1990).

53. *See* Ko, *supra* note 19, at 15; Wick, *supra* note 3, at 249; Gómez, *supra* note 36, at 226.

54. *See* Mourre, *supra* note 28, at 609.

55. *See id.*; *see also* Samra, *supra* note 2.

> American countries to make deliberate attempts to limit foreign investment in their energy sector.[56]

Resource nationalism arguments synergize well with ideological theories described above that emphasize the primacy of national control of the economy. Empirically, resource nationalism theories have focused on the three states that have withdrawn from ICSID — Bolivia, Ecuador, and Venezuela — nations where resource extraction is at the heart of their economies.[57] Alexis Mourre contends that Venezuela, Bolivia, and now Ecuador have challenged "the current system as a whole for reasons that are as much political as economic."[58] The nationalization and renegotiation of oil concessions are not related to a crisis or state of emergency; rather, they "can be explained by the new wealth brought to those countries by the sharp increase in oil prices."[59]

However, structural theories that focus on economic crisis and resource nationalism as causal mechanisms are subject to two criticisms. First, theories of economic crisis proffered by the literature are largely reductionist. In this model, economic crisis is conceptualized as monolithic and a "black box" where scant attention is paid to its origins and causes. Without a systematic approach to uncovering the actual causal mechanism of how economic crisis foments resistance to investor-state arbitration, these explanations have low internal validity and suffer from the logical fallacy of *post hoc ergo propter hoc*. Second, theories of resource nationalism struggle to explain resistance to investor-state arbitration by states where extractive industries are not of significant importance to the national economy. This is particularly the case in nations where the sector targeted for investment is either privatized or relatively underdeveloped in the host state. To address the shortcomings of ideological, institutional, and structural explanations, the next section introduces a new approach to understanding Latin American resistance to investor-state arbitration that seeks to provide a systematic and unified explanation currently lacking in existing theories.

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56. Brunet & Lentini, *supra* note 5, at 591.
57. *See* Gómez, *supra* note 36, at 227.
58. Mourre, *supra* note 28, at 612.
59. *Id.* at 612–13.

IV. A THEORY OF SECTORAL COLLECTIVE ACTION

A. Leading Sector Analysis

Developed by D. Michael Shafer, leading sector analysis broadly asserts that a state's capacity[60] depends on the attributes and domestic political economy of the leading sector.[61] He defines a sector as:

> [a] type of economic activity . . . that constitutes an enduring, coherent whole defined by a distinctive combination of four variables — capital intensity, economies of scale, production flexibility, and asset/factor flexibility.[62]

Distinguishing a national sector from a nation's factor endowment is essential, as the latter has been central in the political economy and international trade literatures.[63] However, a national sector and a nation's factor endowment are analytically distinct. Similar factor endowments may have drastically different sectoral trajectories. For instance, despite both being nations with factor abundances of land, Sri Lankan tea and Costa Rican coffee are considered different types of sectors with different political and economic ramifications for the state.[64]

Building on two core variables — capital intensity and the extent of economies of scale — Shafer describes two ideal types or sectoral "syndromes": high/high and low/low.[65] High/high and low/low sectors exhibit radically different industrial structures. While oligopolistic industrial structures and a small number of firms dominate high/high sectors, low/low sectors are more competitive and are characterized by a large number of small firms.[66] Moreover, sectors' capacities for collective action vary according to firm size and number. Drawing from the public choice literature, the small number of firms in an oligopolistic market structure makes organization easy, as each firm's contribution has a

60. *See* Deborah Brautigam, *State Capacity and Effective Governance*, *in* AGENDA FOR AFRICA'S ECONOMIC RENEWAL 81, 83 (Benno Ndulu & Nicolas van de Walle eds., 1996) (defining state capacity as "the measure of the ability of a government to implement its policies and accomplish its goals").

61. D. MICHAEL SHAFER, WINNERS AND LOSERS: HOW SECTORS SHAPE THE DEVELOPMENTAL PROSPECTS OF STATES 2–3 (1994).

62. *Id.* at 10.

63. *Id.* at 19, n.21; *see generally* RONALD ROGOWSKI, COMMERCE AND COALITIONS: HOW TRADE AFFECTS DOMESTIC POLITICAL ALIGNMENTS (1989).

64. SHAFER, *supra* note 61, at 19.

65. *Id.* at 10.

66. *Id.* at 25.

proportionally large return.[67] Conversely, low/low sectors present daunting collective action problems: the number and diffusive nature of firms makes organization difficult, and free riding is encouraged due to the relatively low contribution and equally low return.

The final step in establishing this theoretical framework connects state and sector. Varying sectoral capacities for collective action have a causal effect on state capacity and autonomy, and therefore, on policy implementation. State autonomy is defined as "the extent to which leaders are capable or organizationally capable of insulating themselves from societal pressures by controlling channels of interest representation and autonomously defining national tasks."[68] While states have a certain level of "absolute capacity" — autonomy that is endogenous because of an apolitical and technically competent bureaucracy — sectoral interests constrain the exogenous "relative capacity" of states.[69] Accordingly, high/high sectors will be relatively more successful in pressuring states to adopt policies that favor their sector than their low/low counterparts due to their relatively higher capacity for collective action.

B. Argument

Sectors that are targeted for investment that are characterized by high capital intensity and high economies of scale will be more successful in their collective action efforts to influence states to adopt legal and economic policies that are beneficial to the sector. In turn, these state policies run counter to the investor-state arbitration system. When faced with investor arbitration claims based on these policies, states will likely be resistant to the investor-state arbitration system in order to retain the capacity and autonomy to tailor policies to continue to attract support from these highly organized sectors. Thus, the organizational characteristics of the sector play a strong causal role in shaping a host state's position vis-à-vis the investor-state arbitration system.

This Note contends that Argentina and Venezuela's resistance to the investor-state arbitration system can be explained by the collective action capacities of the sector that was targeted for investment. The high collective action capacity of the energy utility sector pressured Argentina

67. *See generally* MANCUR OLSON, JR., THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS (1965); TOWARDS A POLITICAL ECONOMY OF DEVELOPMENT: A RATIONAL CHOICE PERSPECTIVE (Robert H. Bates ed., 1988).

68. Stephan Haggard & Chung-In Moon, *The South Korean State in the International Economy*, *in* THE ANTINOMIES OF INTERDEPENDENCE 131, 141 (John Ruggie ed., 1983).

69. SHAFER, *supra* note 61, at 13–18. *See* RICHARD F. DONER, THE POLITICS OF UNEVEN DEVELOPMENT: THAILAND'S ECONOMIC GROWTH IN COMPARATIVE PERSPECTIVE (2009); Peter Evans, *The State as Problem and Solution: Predation, Embedded Autonomy, and Structural Change*, *in* THE POLITICS OF ECONOMIC ADJUSTMENT: INTERNATIONAL CONSTRAINTS, DISTRIBUTIVE CONFLICTS, AND THE STATE 139 (Stephan Haggard & Robert R. Kaufman eds., 1992).

to adopt economic policies and provide legal guarantees in order to attract foreign direct investment that were ultimately the cause of Argentina's balance of payments crisis, the subsequent adoption of the Emergency Law, and the filing of a plethora of arbitral claims by investors. The invocation of a necessity defense by Argentina, ICSID judgments denying this defense, and Argentina's consequent resistance to these unfavorable judgments suggest a causal link between the collective action capacity of the energy utility sector and a desire on the part of Argentina to retain the capacity to tailor policies to attract future investment from highly organized sectors. In Venezuela, the high collection capacity of the petroleum sector deterred efforts to keep the sector open to foreign investment. The unpopularity of the Apertura Petrolera (Petroleum Opening) and pressure of the Venezuelan petroleum sector fomented nationalization of the sector and subsequent arbitration claims by multinational oil companies. Venezuela's resistance to these claims and ICSID more generally are thus a function of the collective action capacity of the petroleum sector. The next section tests these arguments through a comparative historical analysis and process tracing methods.

V. CONVERGING PATHS OF INVESTOR-STATE ARBITRATION RESISTANCE: ARGENTINA AND VENEZUELA

A. Research Design and Case Selection

To test the validity of the causal role of sectoral analysis on state resistance to investor-state arbitration in Latin America, this Note utilizes a most different systems comparative analysis using Mill's Method of Agreement,[70] with Argentina and Venezuela as disciplined configurative case studies.[71] Comparative historical analysis and process tracing[72] are utilized to establish the causal relationship between sectoral collective action, state capacity and autonomy, and the ramifications on state policy choice and position vis-à-vis the investor-state arbitration system. As a most different systems analysis, the selection of country cases aims to explain similar empirical outcomes despite significantly different starting

70. JOHN STUART MILL, A SYSTEM OF LOGIC 454 (Vol. 1, 1843).

71. *See* GEORGE & BENNETT, *supra* note 4 ("*Disciplined configurative* case studies use established theories to explain a case . . . . A disciplined configurative case can contribute to theory testing because it can ' impugn established theories if the theories ought to fit it but do not,' and it can serve heuristic purposes by highlighting the 'need for new theory in neglected areas.' ").

72. *See* Jason Seawright & David Collier, *Glossary to* RETHINKING SOCIAL INQUIRY: DIVERSE TOOLS, SHARED STANDARDS 300 (Henry E. Brady & David Collier eds., 2004) (defining process tracing as an "[a]nalysis of processes of change that seeks to uncover causal mechanisms and causal sequences"); Timothy J. McKeown, *Case Studies and the Limits of the Quantitative Worldview*, *in* RETHINKING SOCIAL INQUIRY: DIVERSE TOOLS, SHARED STANDARDS 139, 141 (Henry E. Brady & David Collier eds., 2004).

points. Venezuela and Argentina share a common resistance to the investor-state arbitration system, evidenced by Venezuela's withdrawal from ICSID and Argentina's contemplated withdrawal and general defiance to ICSID judgments and awards in the aftermath of their balance of payments crisis. However, no single theoretical explanation in the literature described above can explain both outcomes. Instead, an unsatisfactory patchwork of explanations has been proffered to explain these similar empirical outcomes: Venezuela has been largely explained by regime ideology and resource nationalism, while Argentina has been explained solely by its economic crisis. Thus, this case selection allows for the testing of a new theoretical framework that can present a singular explanation for the empirical puzzle of Latin American resistance to investor-state arbitration.[73] Each of the following case studies first introduces the targeted sector for investment and traces its collective action efforts to shape state policy. Next, a causal link is drawn between these sector-driven policies and the host states' resistance to the investor-state arbitration system, evidenced by both international arbitration claims brought against the state in light of the aforementioned policies and additional domestic and international measures.

B. Argentina: From Cynosure to Cacerolazo[74]

1. Opening Investment to the Energy Utility Sector

Historically, Argentina has demonstrated a willingness to utilize arbitration as a method of dispute resolution.[75] However, Argentina seemed ready to withdraw from the investor-state arbitration system after investors brought many claims against it because of measures it implemented in 2002 in response to its balance of payments crisis.[76] To analyze Argentina's tension with the investor-state arbitration system, understanding the origins of the financial crisis is essential. President Carlos Menem was elected in 1989 in the wake of considerable economic distress, including hyperinflation, a large number of costly, inefficient parastatal organizations, and balance of payments issues.[77]

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73. Bolivia and Ecuador are other plausible cases to test this theory; however, because they share many ideological and structural similarities to Venezuela, utilizing them would not be fruitful for hypothesis testing. They are, however, important as robustness tests.

74. A form of protest characterized by banging pots and pans that was practiced during Argentina's economic crisis in 2001–2002.

75. *See* Whittinghill, *supra* note 37.

76. *See* Samra, *supra* note 2.

77. *See* Paolo Di Rosa, *The Recent Wave of Arbitrations against Argentina under Bilateral Investment Treaties: Background and Principal Legal Issues*, 36 U. MIAMI INTER-AM. L. REV. 41, 44 (2004); Samra, *supra* note 2, at 673 (noting that Argentine President Carlos Menem "inherit[ed] a distressed country").

Two key economic reforms were promulgated in response to these problems. First, the Convertibility Law created a fixed exchange rate regime with the dollar on a one-to-one basis.[78] Second, the public sector was significantly restructured by means of a divestiture program. Most of the formerly state-owned industries were privatized through long-term concessions and licenses.[79] The government specifically sought to attract foreign investors to acquire many of these businesses.[80] The energy utilities sector, particularly gas,[81] was specifically targeted for divestiture and foreign direct investment due to the perception that "there existed a dearth of operators in the local market with sufficient experience and financial solvency to operate the public utilities with the requisite degree of skill and level of infrastructural investment."[82]

However, the energy utilities sector is characterized by high capital intensity and high economies of scale, resulting in an oligopolistic market structure. Thus, Argentina faced strong collective pressure from this sector to create a legal and economic environment in order to attract foreign investment. Accordingly, in addition to the Convertibility Law to address inflationary pressures, Argentina repealed restrictions on foreign investment and established various legal guarantees to investors.[83] Argentine officials, with the help of U.S. investment banking firms, advertised such measures by conducting "road shows" that promised safe, long-term investments.[84] The promised reforms included provisions designed to "shield investors against potential variations in tariff rates, inflation, and currency exchange rates."[85] Of particular note, Argentina provided a measure enabling concessionaires to calculate their tariffs in dollars and then, for billing purposes, to convert this dollar figure to pesos at the prevailing exchange rate.[86] Additionally, Argentina provided "enabling adjustments to the tariffs based on variations in the concessionaires' costs, [and] indexation clauses tied to American producer and consumer price indices."[87] Due to the considerable policy concessions

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78. Law No. 23.928, March 27, 1991, [LXI-B] A.D.L.A. 1752, amended by Law No. 25.445, June 21, 2001, [LXI-D] A.D.L.A. 4043 (Arg.); *see* Becky L. Jacobs, *Pesification and Economic Crisis in Argentina: The Moral Hazard Posed by a Politicized Supreme Court*, 34 U. MIAMI INTER-AM. L. REV. 391, 398–99 (2003).

79. *See* Di Rosa, *supra* note 77, at 44.

80. *See id.* at 44–45.

81. *See* CMS Gas Transmission Co. v. Argentine Republic, ICSID Case No. ARB/01/8 Objections to Jurisdiction, ¶ 19, 42 I.L.M. 788 (2003) [hereinafter *CMS Jurisdiction*].

82. Di Rosa, *supra* note 77, at 44–45.

83. *See id.* at 45.

84. *Id.*

85. *Id.*

86. *Id.*

87. *Id. See also* Robert M. Ziff, *The Sovereign Debtor's Prison: Analysis of the Argentine Crisis Arbitrations and the Implications for Investment Treaty Law*, 10 RICH. J. GLOBAL L. & BUS. 345, 350 (2011).

made as a result of the sector's strong collective action capacity, foreign investment flocked to the Argentine energy utility sector.

2. The Balance of Payments Crisis and Enactment of the Emergency Law

Despite the reform measures, Argentina's package of economic reforms and inducements for investment was ultimately unsustainable due to the considerable foreign exchange cost of sustaining the fixed exchange rate regime.[88] As public doubt in the peso increased, many Argentines began to convert their savings from pesos to dollars, effectively creating a run on currency deposits with which the Argentine government could not keep pace.[89] In response, Argentina passed the Public Emergency and Exchange Regime Reform Act (Emergency Law).[90] The Emergency Law declared a state of public emergency and allocated certain economic and social powers to the executive branch, including the ability to renegotiate government contracts.[91] The Emergency Law had three major implications for the energy utility sector and the investor-state arbitration system. First, the fixed exchange rate regime established by the Convertibility Law was terminated, leading to a significant devaluation of the peso against the dollar.[92] Second, the Emergency Law "pessified" utility revenues by mandating that utility rates continue to be calculated in dollars and converted to pesos under the one-to-one conversion rate.[93] However, because the peso was now floating against the dollar at a three-to-one rate, energy utility companies began receiving a two-thirds reduction in income.[94] Lastly, the Emergency Law froze the tariff rates at the January 2002 levels.[95] The frozen rates prevented periodic adjustments that were established in the regulatory framework laws and by the concession contracts, despite the fact that companies were due for periodic revisions or adjustments.[96] Faced with a significant reduction in income, substantially lower purchasing power, and debt denominated in dollars,

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88. *See* Clifford Krauss, *Former Argentine President Warns of Economic Peril*, N.Y. TIMES, Aug. 16, 2000, at C4; Samra, *supra* note 2, at 676.

89. Eric David Kasenetz, Note, *Desperate Times Call for Desperate Measures: The Aftermath of Argentina's State of Necessity and the Current Fight in ICSID*, 41 GEO. WASH. INT'L L. REV. 709, 714 (2010) (quoting Samra, *supra* note 2, at 676); Clifford Krauss, *Argentine Economy: Postponing the Inevitable*, N.Y. TIMES, Dec. 4, 2001, at A10.

90. Law No. 25561, Jan. 7, 2002, [29810] B.O. 1 (Arg.).

91. *See* Sarah F. Hill, *The "Necessity Defense" and the Emerging Arbitral Conflict in its Application to the U.S.-Argentina Bilateral Investment Treaty*, 13 LAW & BUS. REV. AM. 547, 548–59 (2007).

92. Law No. 25561, art. 8; Di Rosa, *supra* note 77, at 47.

93. Daniel A. Krawiec, Sempra Energy International v. the Argentine Republic: *Reaffirming the Rights of Foreign Investors to the Protection of ICSID Arbitration*, 15 LAW & BUS. REV. AM. 311, 318 (2009).

94. Di Rosa, *supra* note 77, at 47.

95. *Id.* at 48.

96. *See id.*

energy utility companies soon defaulted.[97] These defaults fomented a number of arbitration claims against Argentina.

3. International Arbitration Claims: CMS and Sempra

The government's decisions to terminate the Convertibility Law and adopt "pessification" are now the subject of the largest number of BIT claims raised against any government to date.[98] In every case, Argentina has challenged ICSID jurisdiction.[99] Additionally, Argentina has considered withdrawing from ICSID as a result of a series of ICSID award findings for investors.[100] This Note focuses on two claims, *CMS* and *Sempra*, as evidence to support the causal link between the energy utility sector's collective action capacity and Argentina's newfound resistance to the investor-state arbitration system.

CMS, a Michigan-based corporation, initiated the first case in 2001.[101] CMS purchased a twenty-nine percent equity stake in Transportadora de Gas del Norte (TGN), an Argentine gas company that held a license for the transportation of gas.[102] CMS claimed that the legislation, regulations, and TGN licensure fashioned a legal framework for the conversion of tariffs and allowed the tariffs to be "adjusted every six months in accordance with the U.S. Producer Price Index."[103] Thus, according to CMS, the suspension of the tariff adjustment formula for gas transportation by the Public Emergency Law constituted a violation of the United States-Argentina BIT.[104]

As a result of failed objections to ICSID jurisdiction, Argentina's strongest defenses rested on the customary international law principle of necessity and Article XI of the United States-Argentina BIT.[105] Argentina cited to a number of international cases recognizing the acceptance of economic necessity[106] and the Draft Articles on Responsibility of States for Internationally Wrongful Acts.[107] Specifically, Argentina argued that:

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97. *See id.*; Ziff, *supra* note 87, at 351.

98. Ziff, *supra* note 87, at 351–52.

99. Brunet & Lentini, *supra* note 5, at 610.

100. *See* Samra, *supra* note 2, at 694–95.

101. RICARDO ORTIZ, THE BILATERAL INVESTMENT TREATIES AND THE CASES AT ICSID: THE ARGENTINE EXPERIENCE AT THE BEGINNING OF THE XXI CENTURY 51 (Jan Stehle trans., 2006), *available at* http://fdcl-berlin.de/fileadmin/fdcl/Publikationen/FOCO-ICSID-engl-2006.pdf.

102. *CMS Jurisdiction*, *supra* note 81, ¶ 19; CHRISTOPHER F. DUGAN ET AL., INVESTOR-STATE ARBITRATION (2008).

103. *CMS Jurisdiction*, *supra* note 81, ¶ 20.

104. *See id.* ¶¶ 1, 19–20.

105. *See* CMS Gas Transmission Co. v. Argentine Republic, ICSID Case No. ARB/01/8, Award of the Tribunal, ¶¶ 20, 308 (May 12, 2005), 44 I.L.M. 1205 (2005) [hereinafter *CMS Award*].

106. *See* Hill, *supra* note 91, at 558.

107. *See, e.g.*, Gabcikovo-Nagymaros Project (Hung. v. Slovk.), 1997 I.C.J. 3, ¶ 51 (Feb. 5, 1997) (holding that state of necessity is recognized by customary international law for "precluding the wrongfulness of an act not in conformity with an international obligation").

(1) the balance of payments crisis was an instance of "grave and imminent peril";[108] (2) Argentina did not "substantive[ly]" contribute to the creation of the state of necessity;[109] (3) the situation was prompted "for the most part by exogenous factors";[110] (4) the measures adopted "were the only measures capable of safeguarding the essential economic interests affected";[111] and (5) Argentina neither discriminated against the foreign investors nor breached the essential interests of another state by adopting such measures.[112]

The tribunal ruled in favor of CMS for Argentina's breach of the BIT, reasoning that Argentina failed to accord CMS "fair and equitable treatment" as promised in the BIT.[113] In doing so, the tribunal rejected Argentina's defense of necessity under customary international law and the emergency provision in Article XI of the United States-Argentina BIT.[114] The tribunal concluded that although the crisis was "severe," it did not preclude wrongful actions.[115] Furthermore, the government's emergency measures were not the only means available to avert the crisis, and the government itself substantially contributed to the crisis with its economic policies.[116] Although the tribunal concluded that it did not have jurisdiction over general economic policy adopted by the Republic of Argentina, it did have jurisdiction to examine whether "specific measures affecting the Claimant's investment or measures of general economic policy having a direct bearing on such investment have been adopted in violation of legally binding commitments made to the investor in treaties, legislation or contracts."[117]

In a similar vein, Sempra Energy International, an American energy company, acquired a forty-three percent equity stake in the Argentine gas distribution companies Sodigas Sur S.A. and Sodigas Pampeana S.A.[118] On September 11, 2002, Sempra filed a request for ICSID arbitration under the U.S.-Argentina BIT. Focusing on the "pesification of tariffs,"[119]

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108. *CMS Award*, *supra* note 105, ¶¶ 309–12.
109. *Id.* ¶ 312.
110. *Id.*
111. *Id.*
112. *Id.*
113. *Id.* ¶¶ 266, 281.
114. *Id.* ¶¶ 315–78.
115. Hill, *supra* note 91, at 559.
116. *Id.*
117. *CMS Award*, *supra* note 105, ¶ 33.
118. Camuzzi International S.A. v. Argentine Republic, ICSID Case No. ARB/03/2, Decision on Objections to Jurisdiction, ¶ 9 (May 11, 2005), https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC510_En&caseId=C10. Camuzzi requested — and the tribunal granted — that both Sempra's claims and Camuzzi's claims be heard and decided by a single ICSID tribunal.
119. Sempra Energy International v. Argentine Republic, ICSID Case No. ARB/02/16, Award of the Tribunal ¶¶ 116–121 (Sept. 28, 2007), https://icsid.worldbank.org/apps/ICSIDWEB/ca-

Sempra alleged that Argentina had modified its regulatory framework in a way that "severely affect[ed] Sempra's investment in [these] two natural gas distribution companies" in violation of the U.S.-Argentina BIT.[120] Specifically, Sempra complained that these regulatory changes violated the U.S.-Argentina BIT because such changes amounted to expropriation, a denial of fair and equitable treatment, violation of the treaty's umbrella clause, arbitrary and discriminatory treatment, and failure to give full protection and security.[121]

As in *CMS*, Argentina relied upon the customary international law principle of necessity, contending that it has not contributed to the state of necessity since most of the relevant factors were exogenous and the measures adopted were the only means to safeguard an essential interest against a grave and imminent peril.[122] The tribunal noted the recent decision on liability and subsequent award on damages in the *LG&E* case, which dealt with mostly identical questions concerning emergency and state of necessity, but came to a contrasting decision on liability to CMS.[123] Importantly, the tribunal in *Sempra* distinguished the *LG&E* decision[124] on liability from *CMS* and the decision in *Enron*[125] in the assessment of the facts.[126] Ultimately, the tribunal agreed with *CMS* and *Enron*, denying Argentina's necessity defense.[127] Although the tribunal agreed that there was a severe crisis and that it was unlikely that business could have continued as usual, there was "no convincing evidence that events were actually out of control or had become unmanageable."[128] Furthermore, in comparing recent global experience in handling economic crisis, the tribunal concluded that Argentina's argument that the Emergency Law was the only available policy option was difficult to justify.[129]

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ses/Pages/casedetail.aspx?CaseNo=ARB/02/16&tab=DOC [hereinafter *Sempra Award*]; *see also* ORTIZ, *supra* note 101, at 51.

120. Sempra Energy International v. Argentine Republic, ICSID Case No. ARB/02/16, Decision on Objections to Jurisdiction, ¶¶ 1, 20 (May 11, 2005) https://icsid.worldbank.org/apps/ICSIDWEB/cases/Pages/casedetail.aspx?CaseNo=ARB/02/16&tab=DOC.

121. *See Sempra Award*, *supra* note 119, ¶¶ 270–324.

122. *Id.* ¶ 334.

123. *Id.* ¶ 346, 346 n.128.

124. LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc. v. Argentine Republic, ICSID Case No. ARB/02/1, Decision on Liability (Oct. 3, 2006) https://icsid.worldbank.org/apps/ICSIDWEB/cases/Pages/casedetail.aspx?CaseNo=ARB/02/1&tab=DOC. The *LG&E* decision, while sharing near identical facts and claims to *CMS*, ultimately had a different result. *See id.* ¶ 267. However, this outcome is generally considered an anomaly in respect to this line of Argentine arbitral cases.

125. Enron Creditors Recovery Corporation (formerly Enron Corporation) and Ponderosa Assets, L.P. v. Argentine Republic, ICSID Case No. ARB/01/3, Decision on Jurisdiction (January 14, 2004).

126. *Sempra Award*, *supra* note 119, ¶ 346.

127. *Id.* ¶¶ 346, 348.

128. *Id.* ¶ 349.

129. *Id.* ¶ 350.

Accordingly, the tribunal held that Argentina violated Sempra's right to fair and equitable treatment[130] and the umbrella clause of the BIT.[131] Ultimately, the defenses of Argentina and the holdings of the tribunals in *CMS* and *Sempra* provide strong support to the argument that Argentina not only significantly contributed to its economic crisis due to strong collective action pressures by the energy utility sector, but that it also seeks to retain a modicum of policy autonomy in order to be able to provide future incentives and inducements to foreign investors. Thus, the roots of Argentina's economic crisis and subsequent resistance to ICSID judgments can be traced back to the collective action capacity of the energy utility sector.

C. Venezuela: Apertura y Clausura[132]

1. Petroleum Sector Opening and Nationalization

In terms of oil resources, Latin America has the second largest oil reserves globally, with Venezuela alone holding the sixth largest crude oil reserves in the world at nearly 100 billion barrels.[133] In the 1990s, Venezuela became increasingly open to foreign investment in the energy sector.[134] Under the program known as Apertura Petrolera (Petroleum Opening), Venezuela promoted international investment in oil projects.[135] Foreign direct investment in the Orinoco Belt was encouraged by offering generous terms, including a royalties cap of one percent, an extremely low income tax rate of thirty-four percent, and contracts which allowed disputes to be arbitrated in New York.[136] Ultimately, the Apertura resulted in "thirty-two operating service agreements . . . and four risk profit sharing agreements with twenty-two separate foreign oil companies."[137] Exxon Mobil, ConocoPhillips, Chevron, Total, BP, and Statoil invested more than $16 billion in the Orinoco Belt, which produced 600,000 barrels per day of heavy crude oil.[138]

Although the Apertura increased foreign investment, the program also received significant domestic criticism within Venezuela. Specifically, domestic oil producers were incredibly unhappy with the Apertura due to

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130. *Id.* ¶ 303.

131. *Id.* ¶ 313.

132. "Opening and Closing."

133. Ko, *supra* note 19, at 7.

134. *See* Larry B. Pascal, *Developments in the Venezuelan Hydrocarbon Sector*, 15 LAW & BUS. REV. AM. 531, 533 (2009); Emily A. Witten, *Arbitration of Venezuelan Oil Contracts: A Losing Strategy?*, 4 TEX. J. OIL GAS & ENERGY L. 55, 56 (2008).

135. *See id.*; *see also* B. Seth McNew, *"Full Sovereignty over Oil": A Discussion of Venezuelan Oil Policy and Possible Consequences of Recent Changes*, 14 LAW & BUS. REV. AM. 149, 151 (2008).

136. Witten, *supra* note 134, at 56.

137. Pascal, *supra* note 134, at 533.

138. Jim Landers, *Driving a Hard Bargain*, DALLAS MORNING NEWS, Aug. 2, 2006, at 1D.

the package of investment incentives offered to multinational oil companies, but not to domestic producers. Under the Apertura, foreign investors were classified as service providers, rather than oil producers.[139] Not only did this classification allow for more than simple involvement in the oil industry, it also allowed for considerable tax and royalty breaks unavailable to "oil producers."[140] As service contractors, multinational oil companies did not pay the 67.7 percent income tax rate; instead, they only paid the thirty-four percent income tax rate applicable to non-oil activities.[141] Moreover, multinationals received a *de facto* exception from paying royalties because royalties were to be paid by the producer, the Venezuelan oil parastatal, Petroleos de Venezuela S.A (PDVSA), rather than the service providers, the multinational oil companies.[142]

The oligopolistic market structure of the Venezuelan petroleum sector enabled relatively low collective action costs and consequently facilitated relatively strong industry pressures against the Venezuelan state. In February 1999, the Venezuelan National Assembly promulgated a new law granting President Hugo Chávez sweeping powers to issue decrees governing many sectors of the economy.[143] Under this law, President Chávez enacted a series of decrees and policies aimed toward recovering greater state control over the country's natural resources.[144] In 2001, President Chávez enacted a new Organic Hydrocarbons Law (Hydrocarbons Law) that raised royalty rates to thirty percent, increased income tax to fifty percent, promised PDVSA majority control of all new projects, and required joint ventures for foreign investment.[145] Additionally, Article IV of the Hydrocarbons Law confirmed the "public policy" principle, which affirms a state's sovereign power to expropriate or nationalize hydrocarbon-related activities in the public interest.[146] According to this provision, the state may expropriate resources and revoke permits when necessary.[147] In 2004, the Venezuelan government

139. *See* McNew, *supra* note 135, at 152–53.

140. *Id.* at 153.

141. *Id.*

142. *Id.*

143. Pascal, *supra* note 134, at 533.

144. *See id.*; Thomas J. Pate, Note, *Evaluating Stabilization Clauses in Venezuela's Strategic Association Agreements for Heavy-Crude Extraction in the Orinoco Belt: The Return of a Forgotten Contractual Risk Reduction Mechanism for the Petroleum Industry*, 40 U. MIAMI INTER-AM. L. REV. 347, 376 (2009).

145. *See* Brian Ellsworth, *Oil Companies in Venezuela Face More Control by State*, N.Y. TIMES, Apr. 15, 2005, at C3; Robert Collier, *Chavez Drives a Hard Bargain, but Big Oil's Options are Limited*, S. F. CHRON., Sept. 24, 2006, at A1; Pate, *supra* note 144, at 376; *Investing in Venezuela*, OIL & GAS J., Apr. 10, 2006, at 17. With respect to the taxes, President Chávez declared that foreign oil companies had to pay them or leave. The Associated Press, *Venezuela Seeks Taxes from Oil Companies*, N.Y. TIMES, May 9, 2005, at A4.

146. Luis E. Cuervo, *The Uncertain Fate of Venezuela's Black Pearl: The Petrostate and its Ambiguous Oil and Gas Legislation*, 32 HOUS. J. INT'L L. 637, 660 (2010).

147. *See id.* at 660–61.

announced the Plena Soberanía Petrolera (Full Petroleum Sovereignty Plan),[148] which aimed at achieving complete national sovereignty over Venezuela's energy reserves.[149] Additionally, the government reinterpreted tax rates from Apertura-era deals and assessed foreign investors four billion dollars in back taxes.[150] The policy reversal fomented by the petroleum sectors collective action efforts planted the seeds of future arbitration claims and sparked Venezuela's resistance to the investor-state arbitration system.

2. Resistance at Home and Abroad

While companies such as Chevron, Statoil, Total, ENI, BP and Sinopec agreed to the renegotiation of equity in Orinoco projects, ExxonMobil and ConocoPhillips rejected the new terms assigning PDVSA majority ownership.[151] In 2007, Venezuela President Hugo Chávez nationalized three projects in the country's Orinoco River area dealing with the upgrade of heavy oil into export quality crude, effectively "kicking out" oil giants ExxonMobil and ConocoPhillips.[152] ExxonMobil filed an arbitration claim against Venezuela with ICSID regarding its Cerro Negro and La Ceiba projects, seeking fair market value of the expropriated assets,[153] while ConocoPhillips continued its negotiations with PDVSA.[154] "In an effort to forestall these claims in international arbitration, Venezuela declared that arbitration clauses in its existing oil contracts would not be honored, and that those companies who sought to invoke them would be precluded from further investment in the country."[155] Eventually, ConocoPhillips also brought arbitration claims against Venezuela that same year.[156] Venezuela challenged both ExxonMobil and ConocoPhillips on jurisdictional grounds.[157] ICSID tribunals concluded

148. *Id.* at 666.

149. Pascal, *supra* note 134, at 548.

150. *Investing in Venezuela*, *supra* note 145, at 17.

151. Ko, *supra* note 19, at 11; *see also* Vincentelli, *supra* note 3, at 448 nn.219–20 (summarizing cases settled and decided on the merits).

152. Kristen Hays, *Diplomat Stresses Venezuelan Control*, HOUSTON CHRON., July 12, 2007, at Bus. 1; Ko, *supra* note 19, at 10.

153. Mobil Corp. v. Bolivarian Republic of Venez., ICSID Case. No. ARB/07/27, Decision on Jurisdiction, ¶¶ 1, 23, 30–36 (June 10, 2010) [hereinafter *Mobil*]; *see also* Raul Gallegos & Ana Campoy, *Exxon is First to go Legal Route in Venezuela Dispute*, WALL ST. J., Sept. 14, 2007, at A9.

154. Benedict Mander & Sheila McNulty, *Venezuela Plays Down Exxon's Assets Freezes*, FINANCIAL TIMES (LONDON), Feb. 9, 2008, at Companies Int'l 9; Ko, *supra* note 19, at 11.

155. Editorial, *Hugo Chavez vs. Exxon*, CHICAGO TRIB., Feb. 14, 2008, at C26 (describing Venezuela's suspension of crude sales to Exxon based on "judicial-economic aggression"); Ko, *supra* note 19, at 11.

156. ConocoPhillips Co. v. Bolivarian Republic of Venezuela, ICSID Case No. ARB/07/30 ¶¶ 1, 6, 212–15 (Sept. 3, 2013) (Decision on Jurisdiction and the Merits of September 3, 2013 [hereinafter *Conoco*]).

157. *Id.* ¶ 216; *Mobil*, *supra* note 153, ¶¶ 43–50.

that Venezuela breached its obligation to negotiate in good faith for compensation for its taking of ConocoPhillips assets in three projects,[158] and awarded ExxonMobil 1.6 billion dollars in a unanimous decision.[159]

In addition to its defenses in investor-state arbitration, Venezuela has adopted measures on both the domestic and international fronts that illustrate its resistance to the investor-state arbitration system due to pressures stemming from the petroleum sector's collective action efforts. Domestically, the Venezuelan Supreme Tribunal Decision 1541/200862 is of particular salience. In this case, the Venezuelan Republic presented a request for interpretation of Article 258.2 of the 1999 Constitution.[160] In a record time of four months, the Constitutional Chamber of the Venezuelan Supreme Tribunal of Justice issued a decision on the matter.[161] The Court ultimately concluded that Article 22 of the Law for the Promotion and Protection of Investment does not contain a unilateral general declaration of consent to ICSID arbitration. Thus, like Argentina, Venezuela has challenged the validity of ICSID arbitration under its national constitution.[162]

On the international front, Venezuela's resistance to the investor-state arbitration system is evidenced in two hostile and rhetorically-charged events. In May 2008, Venezuela gave the Netherlands notice of termination of their BIT.[163] "The Venezuelan-Dutch BIT . . . had been highly criticized by the Venezuelan government, which argued that non-Dutch companies incorporated in Holland had fraudulently intended to profit from it."[164] The breaking point was ExxonMobil's 2007 arbitration claim against Venezuela.[165] Although ExxonMobil is an American corporation, it invoked ICSID protection under the Netherlands-Venezuela BIT, arguing that the oil project in Venezuela was meant to be developed by a Dutch shell company. Of greatest significance, however, is Venezuela's denunciation and subsequent withdrawal from ICSID in

158. *Conoco*, *supra* note 156, ¶ 404.

159. Kejal Vyas & Daniel Gilbert, *Exxon Mobil Awarded $1.6B in Venezuela Case*, WALL ST. J. (Oct. 9, 2014), *available at* http://www.wsj.com/articles/exxon-mobil-awarded-1-4-billion-in-venezuela-case-1412879396 (last visited Aug. 21, 2015).

160. CONSTITUTION OF THE BOLIVARIAN REPUBLIC OF VENEZUELA, art. 258 (Venez.) ("The law shall encourage arbitration, conciliation, mediation and any other alternative means for resolving conflicts.").

161. El Tribunal Supremo de Justicia (The Supreme Tribunal of Justice), http://www.tsj.gov.ve/decisiones/scon/Octubre/1541-171008-08-0763.htm (last visited Dec. 10, 2013).

162. *See* Brunet & Lentini, *supra* note 5, at 625.

163. Gómez, *supra* note 36, at 216; *see also* Luke Eric Peterson, *Venezuela Surprises the Netherlands with Termination Notice for BIT*, INV. ARB. REP. (May 16, 2008), http://www.iareporter.com/articles/20091001_93; Emmanuel Gaillard, *The Denunciation of the ICSID Convention*, 237 N.Y. L.J. 1, 3 (2007).

164. Gómez, *supra* note 36, at 216.

165. *See Mobil*, *supra* note 153.

January 2012.[166] The roots of this withdrawal, however, can be traced back to the sociopolitical organization of the Venezuelan petroleum sector that, due to its market structure and collective action capacities, was able to influence the Venezuelan state to adopt a set of policies that not only favored the petroleum sector, but also ran counter to the investor-state arbitration system.

VI. LOOKING FORWARD: HAVE THE TIDES OF TIME SHIFTED?

After a sustained period of openness to foreign direct investment and acceptance of the investor-state arbitration system, recent resistance to the system by a number of Latin American states suggests a potential shift. Although the literature has vigorously addressed the question of Latin America's relationship with international arbitration, these reasons have largely been a patchwork of country-specific explanations that are ultimately limited in their explanatory power. In light of the limitations of existing explanations, this Note has introduced a singular theory of sector-state relations in order to explain Latin America's resurgent resistance to investor-state arbitration. Using a comparative analysis of Argentina and Venezuela's recent histories with international arbitration, there is strong and robust qualitative evidence to support the causal relationship between the collective action capacities of sectors targeted for investment and state policies that ultimately run counter to the investor-state arbitration system. Understanding the underlying political dynamics of international investment ultimately provides insight into an important regional issue that has been largely couched in incendiary rhetoric.

The introduction of a sectoral approach to understanding Latin America's recent resistance to the investor-state arbitration system suggests that the system's demise in the region is unlikely. However, particularly for foreign investors in sectors with high capital intensities and high economies of scale, understanding the political dynamics of their investment is critical. The potential for policy reversal via nationalization, regulatory expropriation, or the violation of the fair and equitable treatment standard is expected to be higher in these sectors due to the collective action capacity of the sector to pressure policy choice at the state level. The implications for investors have been mixed thus far. For instance, despite having strong claims that would likely prevail on the merits, many multinational oil companies that have experienced expropriation in Venezuela have opted against bringing arbitral claims.[167] Although the line of Argentine cases stemming from the promulgation of the Emergency Law have generally ruled in favor of the investor,

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166. *See supra* note 1.
167. *See, e.g.*, *supra* note 151.

Argentina has been particularly resistant with respect to the enforcement of these judgments. Thus, investors in high/high sectors must be aware of the additional political risks, take additional steps to acquire assurances from the host state, and be willing to spend time and financial resources arbitrating potential policy reversals. As time passes, it will be particularly telling if Latin American nations that are deeply engrained in the energy sector push for renegotiation of BITs or elect to not renew them at all.

While this Note provides important theoretical and empirical contributions to the existing literature on international arbitration in Latin America, future research should be pursued in order to further test the reach of leading sector analysis. Extending the application of the sectoral approach to Bolivia and Ecuador is a logical first step, as similar sector-state relationships to Venezuela should be expected in order to provide robustness to the theoretical framework introduced and tested in this Note. Identifying sectors with low capital intensities and diseconomies of scale that have been targeted by foreign investors, tracing the sector-state dynamics, and analyzing that state's position with respect to the investor-state arbitration system would complete the theoretical analysis presented in this Note. However, given that most foreign direct investment focuses on energy and infrastructure, those potential cases provide an empirical challenge. Lastly, extending this theoretical analysis beyond Latin America should be undertaken in order to assess the empirical scope of a sectoral approach to understanding state relationships to the investor-state arbitration system.