

Argentina, the Expropriation of Repsol YPF, and the Case for Improved Investment Protection Accords

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It was clear already from the start in April 2012, when Argentinean President Cristina Fernandez de Kirchner introduced the bill that allowed the government to seize the 51-percent share in YPF held by Repsol, that this was not an ordinary, run-of-the-mill expropriation. It was, to use more popular jargon, an asset grab because the government did not offer the owner any compensation for the expropriated assets.

Even if it conformed to the economic populism and nationalism that has increasingly become the trademark

of the Argentinean President and her circle of political friends, the confiscatory nature of the affair was surprising because the value of the expropriation was, acknowledged the government, very big – much bigger than in the other investment disputes the Argentinean state has triggered by its disrespect for private property held by foreigners. The government grabbed assets that, using stock-market valuations before rumours of the pending expropriation started, were worth more than 10 billion US dollars. The company also had a highly valuable asset: rights to production in the new

SUMMARY

Argentina's expropriation of Repsol's shares in the Argentinean energy company YPF sent shock waves through the international investment community. Even if the action by the government conformed to the standard of economic populism and nationalism that it is increasingly known for, the confiscatory nature of the expropriation was surprising. Subsequent actions by the government have also shown that it acted on ideological faith rather than taking a legitimate measure in the public interest. In contrast to the public case for the expropriation, the trade deficit in energy has

continued to expand and the government has been forced to court international investors to team up with YPF to explore the rich shale reserves in Vaca Muerta.

A second shock wave went through the international investment community when the government issued a decree to open up for international investments in the energy sector and allowed YPF to sign an agreement with Chevron to transfer some of the assets that are subject to the legal dispute between Repsol and Argentina. These actions change and reinforce the legal character of the expropriation – and it prompts govern-

ments to put more attention to improving the standards for international investment protection.

The best approach now would be for the EU and the U.S. to negotiate a strong trade and investment accord that includes improved standards for investment protection. Other countries, especially those with a troubled record in investment disputes, may not be interested in revising their bilateral investment treaties with the EU and the U.S., but a transatlantic deal will change the politics of investment and incentivise other countries to agree to better standards.

shale fields in Patagonia that had recently been discovered. If the Vaca Muerta shale reserves were to be fully developed, the value of YPF's asset would become higher.

Furthermore, the government acted at a time of severe macroeconomic stress. After years of economic mismanagement, the country has been thrown back into a period of high inflation and macroeconomic instability, with rumours going around the market of a possible sovereign default. The country is in a desperate need to obtain foreign currency to pay for imports. To expropriate assets of the country's largest foreign investor at such a point contradicts the ambition to stabilise the economy and get more capital invested in and transferred to Argentina. And as YPF and the government lack capital to finance the exploration of the new Vaca Muerta fields, it should have been obvious that such a move against Repsol would only reinforce the downward spiral of the country's economy, put the future health of YPF at risk, as well as reduce the chances of attracting more investment capital to the country's otherwise fledgling hydrocarbon sector.

Yet populists like President Fernandez seldom embrace rational economic policy; they rather make the point of opposing economic orthodoxy. The government proposed a new law authorising the expropriation of Repsol's shares in YPF, and politically marketed it as a strategy to promote the public interest. A mistake, it was claimed, had been made at the time when the YPF was privatised in the 1990s. The government now needed to reclaim the ownership of the company because the country had lost its energy independence – since a few years Argentina runs a trade deficit in energy – and because it charged the company for favouring dividend pay-outs ahead of investment. Furthermore, it was said that YPF under Repsol's majority ownership was discussing with other foreign investors to team up with Repsol YPF in the expensive and technically difficult effort to materialise the rich shale reserves in Vaca Muerta. The government accused Repsol for first diluting and then selling the country's family silver.

One and half year after the expropriation there is a big divergence between what the government claimed when the assets were seized and its subsequent performance. The country's trade deficit has not been closed: in fact,

it has grown bigger.¹ Indeed, oil production has declined and estimates suggest that the trade deficit in energy is going to hit a record high this year, almost four times larger than the trade deficit in 2011. The government has not settled with the former owner of the expropriated assets. And the greatest contrast of all: the government has been forced to court foreign investors to team up with YPF to develop the exploration of the Vaca Muerta fields, in other words precisely what it claimed in April 2012 should not have been allowed.

Cases like this can cure the most ardent political romantic who believes politics to be a clean and ethical business. In July this year, the government introduced a new decree on hydrocarbon sovereignty that allows certain foreign investors to escape some of the consequences of the country's capital restrictions. Moreover, it gives certain foreign investors the right to sell 20 percent of its production on external markets.² And it paved the way for a series of events that would allow YPF to transfer some of its Vaca Muerta rights to foreign energy companies.

This decree has been controversial, to say the least. It has been argued, for instance by a group of former Energy Ministers in Argentina, that it violates relevant laws. A columnist in Argentina has dubbed it the "Chevron decree" because its awkward approach to reforming the investment regime in Argentina's energy sector seemed to fit one particular company a bit too handsomely. Indeed, the day after the decree was announced, YPF signed an agreement with a subsidiary of Chevron, with the effect of Chevron investing about 1.5 billion US dollars to develop a shale oil field in Vaca Muerta together with YPF.

This paper concerns investment policy and how the European Union should design investment treaties now that

1. Fredrik Erixon, 2013, "So who is eating Argentina's lunch now?", Euractiv, April 23, 2013, accessed at <http://www.euractiv.com/energy/repsol-expropriation-eating-arge-analysis-519304>

2. The Argentina Executive Power introduced on July 11, 2012 the new Decree 929/2013 on "Hydrocarbon Exploitation Investment Promotion Regime". A short summary is provided by Ernst & Young at [http://www.ey.com/Publication/vwLUAssets/Argentina_new_promotional_investment_system_for_the_oil_and_gas_industry/\\$FILE/2013G_CM3656_AR%20new%20system%20for%20oil%20and%20gas%20industry.pdf](http://www.ey.com/Publication/vwLUAssets/Argentina_new_promotional_investment_system_for_the_oil_and_gas_industry/$FILE/2013G_CM3656_AR%20new%20system%20for%20oil%20and%20gas%20industry.pdf)

it has been tasked by EU Member States to advance both the investment liberalisation and the investment protection agenda. These are areas in need of urgent attention. Foreign direct investments have grown rapidly in the past decades, but the legal structure for investment protection is grossly inadequate. The case of Argentina's expropriation of Repsol's majority holding in YPF serves as a good example of why reform is needed. Investment protection is especially important to facilitate commercial integration with unpredictable political regimes, or countries with a troubled record of investment disputes. Yet countries that are challenged in investment tribunals for violating agreed investment treaties have the flexibility to stall a legal process and act in a way that undermines the legal rights of the complaining investor. On occasion there is also a misuse of the system by the complainants. Ironically, the system now presumes that host countries in some cases need to add political weight in investment disputes to ensure due process and that governments honour the awards and damages that jurors of tribunals have decided. What, then, should the EU do to promote a better rules-based system for foreign direct investments?

ARGENTINA'S TURN TO ECONOMIC NATIONALISM

In recent years, the Argentinean government has managed its economic and commercial policy in the spirit of economic nationalism. The professed objective is to reindustrialise the country, restore the balance of payments, and reduce the inflation through a policy based on import substitution. But the actual actions by the government seem rather to confirm that the country's current leadership is acting on ideological faith in its drive to seize control over the economy.

Since 2003, the government has increased its role in the economy by nationalising several major companies. The expropriation of the Repsol's holdings in YPF was not a one-off event. Far from it. The government has seized control over several private entities, including raiding the private pension fund *AFJP* as well as turning the airline company *Aerolíneas Argentinas* into a government-run and severely loss-making entity for the young, hard-left ideological entourage that increasingly takes up positions in the Kirchner state dominion. The state has also taken

control of the post office, radio spectrums, and water utilities, to pick a few other examples. Most recently, the *Tren de La Costa* and *ALL*, i.e. the train and railway companies running the passenger and cargo operations, were nationalised.

Argentina is however shooting itself in the foot in its quest for national self-sufficiency. The current inward-looking policies are cutting off the country from the rest of the world. Restricting trade and imports has not boosted the domestic economy and will only reinforce the structural obstacles that prevent higher long-run economic growth in Argentina. Nor is the deteriorating business environment likely to attract the much needed foreign investments.

In the World Bank's *Doing Business Index*, Argentina dropped down from place 139 in 2012 to 185 in 2013.³ The business environment is considered less favourable in Argentina compared to neighbouring countries like Chile (Doing business index ranking 48), Peru (60), Mexico (61), Columbia (91), Uruguay (104) and Brazil (123). According to the World Bank, Argentina's fall in the business climate rankings is partly due to increases in the "time, cost and number of documents needed to import by expanding the list of products requiring non-automatic licences and introducing new preapproval procedures for all imports".⁴

More generally, investors are concerned about the high levels of inflation. In February 2013, the International Monetary Fund (IMF) decided to censure Argentina following systematically faulty reports on the inflation rates, a malpractice related to the fact its international debt is adjusted to the inflation.⁵ Argentina now has until the end of September to report accurate statistics on inflation rates and gross domestic product to the IMF. The relationship between Argentina and IMF has been complicated since the country's economic collapse in 2001. In

3. World Bank, 2013, *Doing Business 2013 Database*, accessed at <http://www.doingbusiness.org/reports/global-reports/doing-business-2013>

4. World Bank, 2013, *Doing Business, Country Info Argentina*.

5. International Monetary Fund, 2013, *Argentina and the IMF, Country info*, accessed at <http://www.imf.org/external/country/arg/>

a related case, the IMF decided in July 2013 not to file an *amicus curiae* with respect to the on-going legal process in the United States where creditors are fighting the Argentinean government over debt repayments.

Argentina has lately become rather notorious for its disrespectful treatment of foreign investors. It is respondent in 25 of the pending cases in the World Bank's International Centre for Settlement of Investment Disputes (ICSID) out of a total number of 170 pending cases (as of September, 9).⁶ Most of the ICSID cases are related to energy and construction contracts, notably the production, distribution and supply of natural gas; water services, hydrocarbon and electricity concessions and oil production, but also debt instruments, leasing and financial services as well as highway construction contracts. There are actually reports that Argentina is contemplating leaving the ICSID altogether, like Bolivia, Venezuela and Ecuador have already done. The Chief Legal Advisor of the Argentine treasury reportedly called ICSID "a tribunal of butchers" recently.⁷ There are also rumours that President Fernandez is considering a law that would terminate the bilateral investment treaties that Argentina has signed with other trading partners.⁸

When it comes to customs procedures, Argentina is a founding member of the MERCOSUR customs union, formed in 1991 between Argentina, Brazil, Uruguay and Paraguay, with Venezuela joining in 2012. Argentina's external tariffs are in principle to be aligned with the Common External Tariff schedule of MERCOSUR. Most of MERCOSUR's multilateral MFN-rates range between 0 and 35%.⁹ However, the member countries have a certain policy space with respect to tariffs on for example computer and telecommunications equipment, and sugar. Also, in December 2011, the member countries decided to allow each member to raise its applied tariff rates on

100 tariff lines to maximum 35%. Argentina implemented this decision in January 2013.

Each of the MERCOSUR countries still has their own bound tariff schedules in the WTO. Although Argentina bound its tariffs in the WTO at the time of its accession in 1995, there is a significant difference between its bound tariffs and the applied levels, causing uncertainties for its trading partners. Argentina's average bound MFN-rates are 31.8%. However, the average applied MFN-tariffs increased from 10.4% in 2006 to 11.4% in 2012. The bound rates for agricultural goods are 32.4% while the applied rates are around 10.1%. As for non-agricultural products, the difference between the bound rates (31.7%) and the applied rates (around 11.5%) is also significant.¹⁰

In addition to the high tariffs, Argentina maintains a number of trade-restrictive regulations that are causing delays and costs. Whereas administrative measures to process and register imports are both necessary and allowed in the WTO, there are widespread concerns regarding the arbitrary and non-transparent application of the rules regulating imports to Argentina.

Since 1st of February 2012, all imported consumption goods are subject to prior approval. The Advanced Sworn Import Declaration imports procedure, or *DJAI*, implies that companies must submit a request to the authorities and then wait for permission before placing an order abroad. The previous Prior Automatic Import Licence system, *LAPI*, was suspended in September 2012.¹¹

The *DJAI* system was implemented in addition to a non-automatic licensing system. After threats of Dispute Settlement procedures in the WTO, initiated separately by the EU, Japan, the U.S. and Mexico, the non-automatic licences were partly repealed in January 2013 by the Argentinean government. Up until then, such licences were applied to an increasing number of tariff lines (around

6. International Center for Settlement of Investment Disputes, 2013, List of pending cases (as of September 9), accessed at <https://icsid.worldbank.org/ICSID/FrontServlet?requestType=GenCaseDtlsRH&actionVal=ListPending>

7. MercoPress (2013-01-31) 'Argentina in the process of quitting from World Bank investment disputes centre'

8. Hogan Lovells (2013-02-04) 'International Arbitration Alert'

9. The MFN tariff rate is the rate faced by countries that do not have preferential access to the Argentinean market – that is, access based on the most-favored nation principle.

10. World Trade Organisation, 2013, *Trade Policy Review: Argentina*. Secretariat Report March, 2013, accessed at http://wto.org/english/tratop_e/tp377_e.htm

11. This section builds on European Commission, 2013, Tenth Report on Potentially Trade Restrictive Measures, September 2013, accessed at http://trade.ec.europa.eu/doclib/docs/2013/september/tradoc_151703.pdf

600), including products like textiles, yarn, fabrics, iron, steel, metal, auto parts, chemicals, machinery and consumers goods. It could take between 60 and 180 days for companies to obtain non-automatic licences, and sometimes they were denied without justification. Also, the Argentinean authorities would occasionally issue licences after informal undertakings from foreign companies to invest in local production sites in Argentina, or to export other goods to a value equivalent of the imports.¹²

Argentina applies a similar system to services. The Advance Sworn Statement on Services, *DJAS*, obliges companies and private persons to fill in an online form to request prior approval before purchasing services from foreign providers if the value is above \$100,000. Such authorisation is required in many services sectors, including professional and technical services, personal, cultural and recreational services and also royalties.

Moreover, imports of around one thousand products are subject to reference pricing. This means that custom duties will be charged based on the reference value of an imported product, regardless of the agreed price between buyer and seller. Should the initial indicated price of the imports be lower than the reference price, companies can apply for a lower tariff to be levied. They must then contact the customs agency as well as the Argentinean consulate or embassy in the exporting country.

Since 2005, Argentina restricts the ports of entry for a significant number of products covering 20 chapters in the Harmonised System of classification, for instance textiles, shoes, electrical machinery, iron, steel, metals, manufactures and watches. These categories of goods must pass through specific custom controls in designated ports before entering the country.

All agricultural imports must obtain a “certificate of free circulation”. Since 2005, this type of licence must be granted by the National Food Institute before goods can enter into Argentina. Again, informal pressures from the authorities have in practice obliged certain importers to engage in exports of an equivalent value from Argentina,

the objective being to level the balance of payments.

Furthermore, imports of used machinery or capital goods are generally prohibited. Imports can be allowed if strict criteria are met, but the capital goods are then taxed by up to 38%. Certain industries are however exempted, notably machinery for the graphic and textile industries, printing machine tools and equipment for the mining industry.

Argentina doubled its total exports between 2005 and 2011, much thanks to the high prices on fuel and agricultural products. There are however export duties on many industrial and agricultural products, ranging from 5% to 100%. Export duties actually accounted for around 20.5% of total tax revenues in 2011. Meanwhile, exports of high-end industrial goods are encouraged by tax-incentives. In addition to the general registration requirement covering essentially all exports, there is a specific register for grain, meat and dairy products.

Moreover, price controls apply to agricultural products in order to assure better proceeds for exports as well as to control the revenue from export duties. Export restrictions are occasionally placed on agricultural products if considered necessary in order to guarantee domestic supply. Other types of regulations apply for instance to mining companies, which are obliged to use Argentinean transportation companies, as well as creating a department for import substitution. To encourage domestic production, companies can now export 20% of oil or gas tax free if they commit to invest \$1bn over five years.

Moreover, severe currency controls are in place since 2011 – and they have perverted the money and currency markets in Argentina, leading to significant black market premiums on foreign currency. With respect to investment, repatriation of investment in Argentinean companies or real estate is since October 2011 only authorised if the foreign currency entered and was liquidated through the Single Free Exchange Market. If this is not the case, the investor must seek approval from the Central Bank in order to repatriate FDI.

Finally, Argentina is also using its procurement policies to promote domestic companies and producers. It is not a

12. United States Trade Representative, 2013, Argentina Trade Summary, accessed at http://www.ustr.gov/sites/default/files/Argentina_0.pdf

member of the WTO Government Procurement Agreement and currently runs 'Buy Argentine Labour' programmes at provincial and municipal levels. This implies that domestic or local producers are allowed preference margins between 5% and 7%.

It is important to have the full background of Argentina's economic policy when one considers its expropriation of Repsol's assets in YPF and its subsequent actions. The expropriation was neither a one-off event nor is it inconsistent with the general trend of Argentina's trade and investment policy. Inarguably, there is a clear pattern of policy suggesting the grabbing of Repsol had nothing to do with promoting a legitimate public interest – or that the Argentinean government, as it has claimed, should be entitled to seize assets without compensating the owner.

President Fernandez, along with other representatives of the government, has claimed that the government had the right to expropriate Repsol's assets because of the latter had misbehaved as owner. All too often, that type of view is recycled by many critics of bilateral investment treaties or investment protection, who claim that such instruments give foreign multinationals too much power in developing or emerging markets. Such views, even when it appears in a less extreme form, tend to be short on facts: they rather feast on quite abstract or ideological opinions that pit the interest of foreign investors against larger public interests like environmental, developmental or human right objectives.

Yet this an uninformed opinion. Investment protection rules are hardly designed to ensure full and swift compensation to investors when their assets have been expropriated in illegitimate ways. There are only a few cases when companies have misused the system. Such treaties are not a guard against regulation writ large, or regulations that are generally detrimental to the climate of business and competition. They offer protection on the basis of basic non-discrimination/national treatment principles and recourse to an international tribunal when an investor have failed to effect a negotiated solution with countries that cannot offer solid conditions for a fair and swift legal process in their own judicial system. Nor are BITs generally a safe way for companies to win cases against states: in ICSID tribunals, states have won roughly half of the cases

brought against them. The ICSID system is clearly in need of institutional reform to address the backlog of cases and deal with other matters, such as the appointment procedure of jurors. Yet investment protection agreements are important for those companies that make investment in countries where the judicial system does not offer good conditions for due process and where the government behave unpredictably or worse.

And taking the side of Argentina, as some ideological critics of investment protection has done, in a case where violations of property rights obviously have been committed on the borders of stupidity. What do they think they really defend? Axel Kicillof, the deputy minister of the economy that engineered the expropriation of YPF, put the government's view succinctly in a fiery speech about the expropriation: rule of law, he charged, is only a concept to protect big business.¹³ He, like other representatives of the government, have repeatedly mocked principles of due process and espoused a view where the judicial system should not put any limits at all on the discretionary right of the government to seize property – from foreigners as well as Argentineans. The main casualty from the government's rogue behaviour is not foreign multinationals – but Argentineans that are deprived of their assets or chances to get a better material standard because of the government's economic nationalism.

Kicillof claims that the expropriation of *Aerolíneas Argentinas* was an exemplary act, saving the company from "lobotomised" foreigners who could not run the company.¹⁴ The deputy minister speaks, of course, in his own interest: he took a central management position in the airline once the government had expropriated the company. And he, and others, has used the company's bank account to build up a system of support to friends of the President and La Campora, the youth league lead by the President's son, Máximo Kirchner, that campaigns for an Argentina run on Hugo Chavez's principles. Since the airline company was expropriated by the state, its losses have nothing but grown.¹⁵

13. Hilary Burke & Magdalena Morales, 2012, Leftist economist mastermind Argentina's YPF grab, Reuters April 20, 2012, accessed at <http://www.reuters.com/article/2012/04/20/us-argentina-ypf-kicillof-idUSBRE83J14X20120420>

14. Ibid.

15. Douglas Farah, 2013, *La Cámpora in Argentina: The*

SELLING THE SKIN BEFORE THE BEAR IS CAUGHT

The government's recent actions, the promulgation of a new decree and the agreement on a contract between YPF and Chevron about assets that are the subject of the investment dispute between Repsol and the Argentinean government, have changed the politics of the expropriation. Arguably, it has also changed the legal character of the investment dispute and reinforced Repsol's case against the Argentinean government. Furthermore, it prompts the EU to consider what other instruments of foreign economic policy that should be used to ensure that European firms are not disadvantaged in international investor-state disputes. Let us discuss these issues in greater detail.

Contested politics of expropriation

First, the actions by the Argentinean government have proven that its defensive arguments were either only valid for a limited period of time – or direct fraudulent already from the beginning of the process. It was said by some government representatives at the time that a reason for grabbing Repsol's assets was that the company had intended to contract away the rights that it controlled to Vaca Muerta to other foreign energy majors as part of an ambition to raise the funding necessary to enable exploration and production. This, the argument went, was part of a longer history of mismanagement of the YPF, which had weakened oil production and turned the country into a net importer of energy. The government claimed that YPF under Repsol's majority ownership had favoured dividend pay-outs rather than investing profits in new production capacity.

There are plenty of reasons to believe that this defense was invented in order to seize properties as part of an ideological programme and because the value of the Vaca Muerta rights had increased when the government understood the vast scale of the shale findings. Now the government has made it clear by its very own actions that

it never was possible for YPF alone to finance the entire operation of exploring these fields. It needed foreign partners to supply capital and knowledge. For those who believed that the government had a legitimate reason for seizing properties because RepsolYPF had initiated a process to team up with other companies, it should now be obvious that the government has not been prepared to follow the intent and logic of its own argument.

The government also claimed at the time of the expropriation that it would boost oil production and turn its trade deficit in oil and gas into a surplus, which would help to generate much-needed foreign currency to the country. It said that the previous owner had pursued a strategy of depleting the company of capital, which had led to underinvestment, but that this would change once the government had taken control of the firm. A government-mandated report on YPF set out a very ambitious but entirely implausible investment strategy, suggesting investments of about 40 billion US dollars over a couple of years.

However, the Argentinian government has been proved wrong on its claims. Argentina's total oil production declined in 2012, once one factor in the effects of the oil strikes in 2011. Oil production by YPF fell after the government seized Repsol's shares, according to Argentina's Department of Energy. After the expropriation, the government's strategy for how to expand production has collapsed.

The government has been forced to acknowledge that YPF needs international partners for production in Vaca Muerta. A big reserve like Vaca Muerta simply require several investors as the amounts involved are very big – especially so when the reserves only can be accessed by unconventional methods. Yet the government had not been able to sign up any foreign partners for this endeavour until the Chevron investment was announced.¹⁶ Likewise, the government has also had to reverse its position on some pertinent price controls, like raising the artificially depressed wellhead gas prices, which clearly undermined the economic and commercial case for investing in new production. And in the new decree, it is offering

16. A Memorandum of Understanding was signed with Chevron in the autumn of 2012.

Rise of the New Vanguard Generation and the Road to Ruin.
Alexandria, VA: International Assessment and Strategy Center.
Access at http://www.strategycenter.net/research/pubID.308/pub_detail.asp

innovative ways around other capital and market restrictions that previously deterred investors for putting more money into the country's energy production.

However, the expropriation is the chief cause why the country now cannot raise more foreign direct investment. It stands in the way for a successful effort to develop the rich shale reserves. And it has put Argentina's government in a difficult position. Given the need to access foreign sources of capital to invest in new oil production – which is important for Argentina's economy – it is difficult to see how the government could engineer a solution that would be more favourable to the Argentinian government, let alone the Argentinian economy, than the actual situation before YPF was expropriated.

In a worst-case scenario, YPF will not be able to start real and extensive production in critical new fields because it cannot fund new investments with international partners. In a best-case scenario, investors that do agree to team up with YPF will demand much stronger guarantees and higher yields in return for investing capital in a very unpredictable investment environment, plagued by the recent expropriation and, among other things, regulations and foreign exchange restrictions making it difficult to repatriate capital. The government is now banking on the Chevron investment and asserts that other companies will follow – and that Chevron will make a larger investment in due course. But Chevron is not acting upon a desire to do what is best for Argentina: it has formed the judgement that an investment is worth the risk it is exposing itself to, simply because the conditions it has been offered for the investment are too good to deny. As other oil firms declined to invest when YPF courted them, the risk-reward profile has now changed in favour of making an investment.

The legal character of the dispute

Second, the government's new decree, and the contract between YPF and Chevron, also changes the legal character of the investment dispute under the Bilateral Investment Treaty between Argentina and Spain. Like other investment protection accords, the BIT between Argentina and Spain has provisions related to expropriation. It can also draw on jurisprudence built up through cases in

previous ICSID tribunals as well as from other treaties of international law. Spanish investors have been granted protection in Argentina, and vice versa¹⁷, on the basis of fair and equitable treatment in accordance with non-discrimination/national treatment and most-favoured nation principles. It is pretty obvious that these rights have been violated – indeed, it was only Repsol's shares in YPF that were expropriated – and that the country has denied the company its right to full and swift compensation stipulated by the BIT.

Furthermore, as the government acted – through its decree and its majority holding in YPF – to monetise through transfer of title its new holdings in a way that contradicts one oft-repeated reason for the expropriation, it further calls into question the legitimacy of the expropriation. Expropriation is not entirely prohibited in investment treaties. It is an action that is regulated and that can only occur when there is a legitimate ground for that particular action. This is an important point as Argentina now clearly errs on the wrong side of the conditions for legitimate expropriation. Rather than acting on a legitimate basis for expropriation, the government's actions suggest retribution and combative ideological principles to have been the guide for the expropriation. As previous cases have shown, the intent of the expropriating government is of interest when damage should be determined.

Moreover, international law and jurisprudence clearly suggest that an expropriation that is illegitimate and violates an established agreement should be corrected through restitution of assets. By contracting away value previously held by Repsol, YPF is making restitution more difficult. The Argentinean government has through its decree, and action as majority shareholder in YPF, acted in a way that further contradicts the investment treaty and ICSID jurisprudence. The government has, to use a popular phrase, sold the skin before the bear was caught. It has transferred property it has obtained in a way that is legally disputed – and disputed on such solid grounds (direct expropriation without compensation) that the gov-

17. For those who claim BITs to be an instrument of developed countries to control developing countries, it could be of interest to note that Argentinian investors have brought successful cases against the Spanish government.

ernment knows it is in the wrong by the legal standards it has agreed to in BITs and transposed into domestic law. The government is clearly not acting in good faith.

Consequences for international investment policy

Finally, the new government decree and the agreement between YPF and Chevron further complicate the international politics of investment protection policy. The system for international investment protection, including ICSID, is grossly inadequate. Cases proceed slowly and it often takes many years before final rulings on awards and damages are issued. As a result, defending countries that cannot resist the temptation to act in a rogue way are seldom punished for it.

But among cooperation-minded countries and multinational firms there have been an understanding that competing firms should avoid taking advantage of a stalled legal process in order to promote their own interests by capitalising on property under dispute. That understanding has been important to protect the integrity of investment protection agreements. Countries that have clearly violated principles of the treaties have felt the economic consequences of their actions. Their access to capital markets have been affected and efforts to court new foreign investors have not been very successful. Consequently, the opportunity cost of behaving in a bad way has increased.

An article in the Fortune Magazine succinctly outlined this view with regard to the agreement between YPF and Chevron. It argued:

“There is an unwritten code among the big energy companies -- “It’s always us vs. them.” In this case, “us” refers to the large privately controlled energy companies, such as BP (BP), Chevron, ExxonMobil (XOM), and Repsol, while “them” refers to the energy-rich nation-states and their state-controlled energy companies. In practice, the saying means that if a privately controlled energy company is screwed over by a nation in some way, be it by expropriation, the ripping up of contractual agreements, or through a surprise hike in royalty

rates, the other energy firms promise not to try and capitalize on the others’ misfortunes. This has helped the privately controlled energy companies retain their dominance amid a tricky political economic backdrop.

So it came as a bit of a shock to the industry when Chevron announced last fall that it had signed a memorandum of understanding with YPF to hunt for oil shale in Argentina’s energy-rich province of Neuquen. That’s because only a few months prior, the Argentine government, under the direction of President Cristina Fernandez, “renationalized YPF, which at the time was controlled by the Spanish energy giant, Repsol, and known as RepsolYPF. The grounds for the expropriation were dubious, but Argentina isn’t really known for its adherence to international law -- or to contractual agreements of pretty much any kind. This is the nation that, after all, has defaulted on its debt seven times, three of which occurred in the last 30 years.”¹⁸

In other words, for the integrity of investment protection accords, it is important that competing firms show restraint and act upon a larger systemic interest for all involved parties to have access to good investment protection. This is not disputed by Chevron: in fact, it has made a submission to the United States Trade Representative suggesting the U.S. and the EU to negotiate a strong international investment treaty with the effect of ensuring investors’ rights are protected in cases of expropriation. Furthermore, Chevron has used rightly investment treaties to defend its own rights against violations by governments.

The incident, however, prompts two policy observations. The first one is pretty straightforward: there is a strong case suggesting that new investment treaties should tighten up the rules for prompt and adequate compensation in the event of expropriation. Such rules should also provide restrictions on governments that have seized property and transferred this property to other entities. The way Argentina has acted recently clearly demonstrates why such improvements are needed.

18. Cyrus Sanati, 2013, Chevron is making a mistake in Argentina, Fortune, July 19, 2013, accessed at <http://finance.fortune.cnn.com/2013/07/19/chevron-argentina-ypf/>

Many governments – especially those with a troubled record of defending cases of expropriation – may not be willing to enter into new agreements that raise the standards of investment protection. And other governments may not be prepared to walk away from current investment treaties because they have a stock of investment that needs the protection under current treaties. This is a dilemma – and the only reasonable way out of it is that cooperative governments negotiate new investment agreements that raise the quality of investment protection and at the same time gives contracting parties benefits not offered under current treaties. As discussed later, such benefits may materialise in other fields than investment protection (e.g. trade or investment liberalisation).

Second, the EU should be prepared to expand its foreign economic policy instruments in order to incentivise other countries to follow the rules established in international and bilateral agreements. It is no news that erring countries tend to listen more carefully to demands by the U.S. government to ensure that U.S. firms get treatment in accordance with signed agreements. In an inadequate and incomplete system as the one for international investment protection, it should be a task for EU authorities – in Brussels or the Member States – to defend the interests of its own firms and not accept that they are in effect treated less respectfully than firms of other nationalities.

The U.S. government has not always acted rationally in such circumstances: in a recent case involving Argentina it resorted to punitive trade sanctions that affected U.S. consumers as much as Argentinean exporters. And those Argentinean exporters that were affected could realistically not be held responsible for the error committed by their government. Compared to the EU, with its limited competence, as well as the individual member states, the U.S. government has a thicker portfolio of instruments and represents a much greater panoply of interactions with foreign countries. Consequently, it speaks with greater authority in investment disputes.

CONCLUDING COMMENTS

It is increasingly argued that international investment treaties give disproportionate protection to multinational firms – at the expense of governments, especially govern-

ments in developing countries. This is a distorted view of reality and it misses a central tenet of the political economy of investments. An investor usually carries influence before an investment has been made, when a country wants to attract an inward investment. But once the investment has taken effect, the power balance changes. The investor then has an interest to protect a stock of investment while the offending government usually faces the cost of changes in the flow of foreign direct investment.

Invest protection accords are necessary to ensure investment integration with countries that have a record of unpredictable changes in the policy conditions for an investment. Argentina is a case in point. It is one of the most frequent defenders in investment tribunals established under the World Bank's ICSID. It frequently resorts to populist and nationalistic policies that are far away from accepted behaviour. Therefore, it was in one way not surprising that it expropriated Repsol's share in YPF: it was an ideological move determined by the government's odd views of how to run (or ruin) an economy. However, given the scale of the expropriation, and the refusal to compensate the owner, Argentina had taken yet another step away from the standards of investment protection prescribed in investment protection accords. And the way it acted subsequently has underlined the need for improvements to be made with respect to the efficiency of investment protection standards.

The first step in that direction could be a new investment treaty between the United States and the European Union. Such an agreement is envisioned under the current negotiations on a transatlantic trade and investment accord. It is understood by both sides that current developments in international investment behaviour necessitates improved standards and institutional arrangements. And has been argued in this paper, it is especially important that new accords tighten the flexibilities that defending governments now have to act in a way that stalls due process and erode the rights of claimants by transfer the property to other entities. Justice delayed, is justice denied. And the further away from the principle of restitution of the country's move, the more it undermines the capacity of the system to effect swift legal processes.

The EU-U.S. trade and investment negotiations are an important venue for improved standards in investment

protection because they are two larger economies that act as systemic externalisers in the world economy. If they take the leadership of negotiating new protection standards as part of a larger trade and investment agreement that gives additional benefits to signatories, they will also have a good chance to persuade other countries to agree on improved protection standards. In contrast to other alternative courses of action, a transatlantic trade and investment agreement will have consequences for countries that prefer status quo, or that in other ways do not like the concept of improved protection standards in investment accords. The opportunity costs to stand outside such an agreement, or not be part of efforts to expand the results of such an agreement through bilateral, regional, plurilateral or multilateral efforts could be substantial, even for notorious countries like Argentina. Argentina has strong export interests both in the U.S. and the EU. Now the Argentinean government can act uncooperatively in investment matters without fearing any, or too big, consequences for its export interests. A successful transatlantic agreement to liberalise and improve rules for trade and investment could change such belligerent attitudes.

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