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The Venezuela-Colombia BIT: An Original Development of Uncertain Impact

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On 3 February 2023, Colombia and Venezuela entered into an Agreement for the Reciprocal Promotion and Protection of Investments ("Treaty"), with the objective of "incrementing the flow of transborder direct investment." Both states are still to complete the ratification procedure for the Treaty to enter into force.

This is an interesting development, especially considering the concerns expressed by Venezuela regarding the investment protection system, including its denunciation of the ICSID Convention in 2012. Even states whose treaties are mostly used by local investors to sue foreign states are taking steps to regain more flexibility to implement their public policies by renegotiating investment treaties or adopting new ones with broader regulatory powers to address certain questions, such as health and environmental issues (*see e.g.* Netherlands Model Investment Agreement).

The Treaty follows this direction, although unconventionally, in its content and drafting style. While it provides for international arbitration, not only some elements in the definitions of "investment" and "investor" may limit access to the Treaty's protections, but also some of the substantive provisions are unusual and create exceptions rather than real protections. This post analyses the innovations of the Treaty and aims to uncover some possible practical consequences.

The notion of "investment"

On the one hand, the definition of "investment" refers broadly to "every kind of asset;" while on the other hand, it also includes specific requirements limiting its scope (art. 2.a.).

Direct investment. While several tribunals have admitted the protection of "indirect" investments –such as when the investor acquired the investment though a chain of corporate vehicles– (*see e.g. Siemens v. Argentina* § 137, *Venezuela Holdings v. Venezuela* § 165) the Treaty only protects those investments "acquired directly" by investors (art. 2.a.).

Origin of the capital. The Treaty also requires that the investment be acquired "with funds that do not have their origin in the [host state]" (art. 2.a.). It has been debated whether this requirement is implicit in investment treaties, however, Colombia and Venezuela have made their position clear (*see e.g. Mera Investment Fund Limited v. Serbia* § 147; *Gold Reserve v. Venezuela* § 261). In the context of long-term investments, it would be reasonable also to protect additional investments made with the profits generated locally by an existing investment – for example, the injection of capital into a local company. The inclusion of "returns invested" on the list of protected investments apparently implies this notion (*see e.g. Salini v. Morocco § 52*).

This interpretation may reconcile these two provisions.

Special requirements. The definition of "investment" also includes elements like those of the *Salini* test (§ 52): (i) commitment of capital, (ii) duration, (iii) a contribution to the economic development, and (iv) the expectation of a return (art. 2.a.).While other investment treaties include some of these requirements (*see e.g.* art. 10.28 US – Colombia TPA), most treaties prefer a more objective definition. On the one hand, these elements are reasonable, but on the other hand, they are not always straightforward, as some of them may be subjective, such as the contribution to the economic development.

Exclusions. The Treaty excludes from protection certain assets that are generally protected under other treaties, such as sovereign debt instruments and commercial loans (art. 2.a, 2nd paragraph, recitals iii and v.).

The notion of "investor"

The Treaty also contains some limitations to the notion of "investor", seemingly with the objective of avoiding abuses of personality to gain access to the Treaty.

Natural persons. The Treaty excludes dual nationals who hold the nationality of the host state (arts. 2.b(i), 2.f(i)). Notably, both Venezuela and Colombia have faced claims by dual nationals. The case law is split regarding the legitimacy of these claims, with some tribunals holding that absent an express prohibition in the applicable treaty, dual nationals may have legal standing (*see e.g. Pey Casado v. Chile* § 415; *Serafín García Armas et al v. Venezuela* § 199). Venezuela and Colombia seem to aim at closing this door, as they have done in other treaties (*see e.g.* art. I.g(i) Venezuela-Canada BIT, art. 2.5 Colombia-Spain BIT).

Also, to enjoy protection, (i) investors must hold the relevant nationality throughout the life of the investment (before acquiring the investment, without ever losing such nationality), and (ii) such nationality must be their "effective nationality" (art. 2.f(iv)). The latter is a principle of customary international law used in the field of diplomatic protection, which application to investment law is subject to debate, what may explain the reason for this express inclusion (*see e.g.* art. 10.28 US – Colombia TPA).

Juridical persons. In addition to legal incorporation in their home state, the Treaty requires companies to have "important commercial activities" in such a territory, and the condition that they be not controlled from the host state (art. 2.b(ii)). These requirements aim at avoiding abuses through the incorporation of shelf companies with no real activity in their country of incorporation, and with the only purpose of gaining protection under the Treaty.

Financial entities. Companies that finance an investor under the Treaty are excluded from the definition of "investor" (art. 2.b *in fine*). This may be intended to limit project finance related claims, like that of *Portigon v. Spain* in its decision on Jurisdiction (decision not public). However, this provision does not address the situation of an entity financing a company which is *not* an investor under the Treaty, but an investor from the host state or a third country.

Reporting. Investors "shall inform" of their investments to the authorities of the host state, with the purpose of monitoring investment flow (art. 4.d). This is an uncommon provision and, whilst mandatory, there seem not to be concrete consequences in case of failure to comply with it. This mechanism could build an important data base, although it is unclear how the states will use it.

Substantive protections

The Treaty refers to some of the classic protections, but at the same time includes important exceptions. It does not include a provision on "fair and equitable treatment", one of the most common protections in investment treaties. Other protections like "full protection and security", "most favoured nation treatment", and the "umbrella clause" are also absent. Notably, art. 9 contains a provision on the "free transfer of funds", which for the most part is classic, save for the exceptions in its recital "c", as the drafting is not very clear and may raise questions regarding its application. These features are a significant departure from the current practice of investment law.

Exceptions. The menu of exceptions is ample. States will not be prohibited from adopting measures for the protection of (i) human, animal or vegetable life, (ii) the environment, and (iii) non-renewable natural resources, as long as they are not discriminatory (art. 5.a). Likewise, states will not be prohibited from adopting measures for the protection of the financial sector, as long as they are reasonable (art. 5.c). None of these measures can be adopted in an arbitrary or unjust manner (art. 5.c). Further, states are also not prevented from adopting measures with the purpose of enforcing environmental and labour legislation and regulation, as long as they are proportionate to their objectives (art. 14). The Treaty also carves out tax related disputes (art. 3 last paragraph).

No discrimination. Art. 5 is titled "No Discrimination", a label that usually refers to a provision that the host state may not adopt measures in a discriminatory manner. However, the body of art. 5 only says that the host state may adopt certain measures, as long as they are not discriminatory, but there is no general prohibition of discriminatory measures. It will be for arbitrators to interpret whether the intention of Venezuela and Colombia was to include such a general protection at all.

National treatment. Similarly, art. 6 is entitled "National Treatment", a construction usually used for a provision according to which a state cannot subject foreign investors to a treatment less favourable than that granted to its own investors; in other words, it operates as a "floor" of protection (*see e.g.* art. 17-03 of Colombia-Mexico-Venezuela FTA (1994)). However, art. 6 refers to "national treatment" as a "ceiling." It states that foreign investors will not receive "unjustified" more favourable treatment than that granted to local investors (art. 6a). Here again, it will be interesting to see how this provision is interpreted in practice.

Expropriation. The Treaty contains an "expropriation" clause, with the usual requirements of public interest, due process, non-discrimination, and payment of compensation (art. 7.a). However, it also provides that non-discriminatory measures to "protect legitimate objectives of welfare, such as health, security and environment […] do not constitute an expropriation" (art. 7.c). A plain reading of this provision might suggest that in case of certain non-discriminatory takings (for example, related to health), the other requirements of due process and payment of compensation are not applicable. It seems odd to qualify the term "expropriation" based on the purpose of the measure, rather than on whether private property is taken or not (which is a factual question). However, to the extent that a taking has occurred, it is hard to understand that compensation would not be paid. Such interpretation would furthermore be against the very content of both states' constitutions (*see* art. 58 Colombian Constitution and article 115 Venezuelan Constitution).

Denial of benefits. A state may deny the benefits of the Treaty to a company if (i) it is directly or indirectly controlled by (or under a significant degree of influence of) natural or legal persons *of a third state* (different to Venezuela or Colombia), and said company does not carry out substantial business activities in the *host state*, or (ii) it is directly or indirectly controlled by (or under a significant degree of influence of) natural or legal persons of *the state denying the protections*, and it does not carry out substantial business activities in the other state party (art.13).

Usually, a "denial of benefits" clause requires the investor to have substantial business activities in its place of *incorporation*, thus targeting vehicles which are a mere formality exclusively created to gain treaty protection. The Treaty's requirement for the investor to prove activities in the host state is strange, as someone with a qualifying investment will most likely have activities there. Nonetheless, the requirement of commercial activities in the place of incorporation is present in the definition of "investor" (art. 2.b(ii)).

Denial of benefits and corruption. A state may also deny the benefits of the Treaty if it has been proven, in judicial or administrative proceedings, that the investor has incurred in corruption with respect to the investment (art. 13.b(ii)). However, it must be noted that this provision does not refer to the broad concept of "illegality", but specifically to "corruption", which is one of the possible forms of illegality. While the consideration of corruption to limit protection is fair and reasonable, this clause is likely to give rise to debate.

The fact that corruption may be determined in administrative proceedings, outside of a court, may raise concerns, as it could allow the same administrative body that issued the measures giving rise to the dispute make such determination with the purpose of avoiding responsibility. Pursuant to the principle of good faith, arbitrators will be extremely cautious before allowing states to use this discretion to invoke *ex-post-facto* accusations to stop an arbitration. Considerations of due process will be paramount.

Regarding the timing to deny benefits, it is debated whether a state may do so once arbitration proceedings have been commenced (*see e.g. Plama v. Bulgaria* §§ 161-162, *Masdar v. Spain* § 239, *Pac Rim v. El Salvador* § 4.83, *Ulysseas v. Ecuador* § 172). The Treaty gives a clear answer to this question, by allowing the states to deny the benefits "at any time", even when an arbitration has already been launched (art. 13.b).

International arbitration

The dispute resolution clause of the Treaty does not come with big surprises. Predictably, dispute resolution between the treaty parties –Venezuela and Colombia– can only be carried out through diplomatic channels, without an inter-state arbitration option (*see* art. 11; *see also*, art. 16). Concerning investor–state arbitration, the parties may try to resolve the dispute amicably and, if after six months from the notification of the dispute, the parties cannot resolve it, the investor may submit it to arbitration under the UNCITRAL Rules, although, for some reason, the old 1976 rules and not the new ones, which notably include the transparency rules. Moreover, the parties involved in an investor-state dispute may opt for resolving their conflict through a binational arbitration center. As far as the author is aware, such a center does not currently exist, suggesting that Colombia and Venezuela are considering establishing a binational arbitration institution.

To access arbitration, the investor must waive its right to initiate or continue "any" domestic proceedings in relation to the measures which are alleged to be in breach of the Treaty (art. 12.c(ii)). Waiver clauses usually do not apply to local proceedings which do not entail a claim for damages (such as injunctions), but the Treaty takes a stricter approach.

There is also (i) a three-year limitation period, as well as (ii) a "fork in the road" clause, according to which, the investor's decision to pursue a treaty claim before the domestic courts or through international arbitration, excludes the other alternative (arts. 12.c(ii), 12.d).

Joint Committee

The Treaty establishes a "Joint Committee" composed of representatives of both countries, which may "make recommendations", as well as "supervise and facilitate the execution and application" of the Treaty (arts. 15.e(iii), 15.f(ii)). It is still unclear what sort of recommendations the Joint Committee will make, or how it will carry out its mission. The wording does not suggest that the Joint Committee will issue mandatory interpretations, like in the case of NAFTA or the new USMCA (*see* art. 1131(2) NAFTA, art. 14.D.9 USCMA).

Concluding remarks

The Treaty between Venezuela and Colombia is certainly an original and significant aimed at sending a positive message to potential investors, and probably the whole international community, although its effectiveness will depend on many other factors such as both states' economic and political outlook, opportunities in specific sectors, the local legal framework, and trust in the judicial system and in the central administration, among others.

The Treaty contains limitations in the definitions of "investment" and "investor," but does renew the option of arbitration to solve investment disputes, which reflects confidence in arbitration despite the significant number of investment arbitration cases involving both countries. Venezuela has been involved in nearly 60 reported cases, while Colombia has faced about 20 reported cases.

The main novelties of the Treaty concern substantive protections, arguably aimed at regaining sovereignty over issues regularly affected by investment disputes. Regarding substantive protections, the instrument reflects the Parties' intention to provide investors with minimal leverage and hardly any specific provisions for safeguarding their investments, when compared to the prevailing legal framework.

In pursuing this sovereign policy decision, the Parties have adopted an instrument which appears as one of the most restrictive ones. The Treaty's potential effectiveness and impact on investment flows between the two countries remain to be seen. Time will also say about the Treaty's potential to become the general pattern for both states, as well as a model for other states, at regional and perhaps global level.

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