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Investment Arbitration and Discretion: ICSID interpretation regarding the exercise of regulatory powers by the Executive branch in Argentina

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Discretionary powers have always been somehow a controversial issue. In Argentine law, this topic has certainly generated legal debate among doctrinaires and jurisprudence; especially, the limitations and the extent of those faculties. Notwithstanding that, the exercising of discretionary powers by Argentine public authorities has not only been scrutinized by Argentinean judicial tribunals, but also by arbitration tribunals in the context of investment arbitration cases. The following lines will try to explain, in the first place, the concept of "discretionary powers" and its legal treatment under Argentine law. Also, to briefly describe the analysis delivered by different arbitration tribunals from the International Centre for Settlement of Investment Disputes ("ICSID") concerning the scope and limits of discretionary powers exercised by Argentine public authorities. As it will be observed, in some cases, arbitral tribunals set major limitations to the exercising of those powers, while in other cases, tribunals have tolerated them. Finally, a personal opinion on the rulings rendered by ICSID tribunals on this matter.

Keywords: *discretionary powers, investment, disputes, investment arbitration, regulatory powers.*

INTRODUCTION

Throughout the last twenty years, the Argentine Republic has been one of the most sued Nations in investment arbitration disputes before the ICSID. Most of the cases ruled against this country involved the analysis of measures issued by the Argentinean State, such as expropriation laws, regulatory decrees, powers given by contracts celebrated with foreign investors, and the scope and reasonability related to the exercise of regulatory powers by the Executive Branch. Some tribunals have delved into an appreciation of the Executive Branch's powers. More specifically, the analysis addressed the ways the Executive Branch has exercised what is known as "discretionary powers", which the Executive Branch has alleged to have with no clear boundaries or limits, to regulate matters such as natural gas or electricity rates, among others. Firstly, it is important to recall that the Argentine Republic has provided a lot of arguments in order to justify political and economic measures challenged by foreign investors before ICSID tribunals; such a state of necessity, lack of commitment to maintain certain policies, regulatory risks taken by investors, public interest or users' protection. Indeed, one of the arguments repeatedly alleged by the Argentine Republic in its filings had to do with the fact that the measures adopted by the National Government entailed the exercise of discretionary powers by the Executive Branch. Given that, throughout this paper, I will describe certain precedents involving the Republic of Argentina and how the ad-hoc tribunals have interpreted the limits to the exercise of the so-called "discretionary powers" by the executive branch when dealing with foreign investments. As it will be shown below, in some cases, investment arbitration tribunals have imposed certain constraints on the exercise of discretionary powers, based on the principles of reasonability and proportionality. On the contrary, other ICSID tribunals have been more contemplative towards the measures issued by the Argentinean Executive Branch while exercising discretionary powers.

THE ARGENTINEAN STATE'S DISCRETIONARY POWER

What do the discretionary powers involve? This question has attracted a substantial amount of interest over time. The exercise of discretionary powers usually entails a decision-making process by which the Executive Branch itself or an administrative entity is entitled to choose

between two or more alternatives that in turn are equally valid, legal, and fair when applying a legal or regulatory rule to a certain case, as opposed to regulated powers-which mandate a predetermined solution-.According to Common Law, the discretionary power can be construed as the ability to select one of such alternatives being a part of that process, that is supposed to lead to the issue of the final decision most comprehensively attaining the assumed goal, in line with the adopted administrative policy, within the limits determined by the law in force[1]. As far as the Argentine legal regime is concerned, although the concept of "discretionary powers" is not defined by law, the National Supreme Court of Justice held that the exercise of discretionary powers takes place when "*the lawmaker authorizes the authority who is entrusted to apply that law in a specific case to undertake a subjective standard that will integrate the legal framework whereby the conditions for the exercise of the powers previously granted for that case or of its particular content, are not imposed beforehand.* "In conclusion, the Tribunal has found that the exercise of discretionary powers is the ability of the entity enforcing a certain law or regulation in a particular case, by means of a previous delegation or authorization by such law or regulation to analyze between one or more alternatives and choose between each one of them, all of them equally valid. However, the exercise of discretionary powers is subject to certain conditions and limitations. One well-known limit to the public administration's discretion is provided by the general principles of Law, in particular, the principle of reasonableness and proportionality. Absent such premises, the exercise of discretionary powers would be unreasonable and may be deemed arbitrary. In all cases, the exercise of discretionary powers is subject to further control by the judiciary, which shall analyze whether that measure has been enacted within the limits of reason. Such control entails a "*means-to-ends*" review, where the exercise of the discretionary power shall be justified if the administrative act does not oppose the purpose of a specific rule or the legal framework, or the purported public interest. This concept is quite similar to the principle of proportionality that,

[1] Szot, Adam, 'Discretionary powers of the public administration in law application processes and its judicial control' (*Research Gate,* 2017)
<https://www.researchgate.net/publication/319243221_Discretionary_powers_of_the_public_administration_in_law_application_processes_and_its_judicial_control > accessed 15 March 2022

according to scholars, "*implies a means-ends relationship between the aims pursued by specific action of the government and the means employed to achieve this end.*[2]"

The following sections will describe firstly, arbitral awards and decisions where the tribunals lay limits to the exercise of discretionary powers. Secondly, I will review arbitration rulings in which the tribunals reached a different conclusion by admitting the exercise of discretionary powers by the Executive Branch. Lastly, I will draw a conclusion based on the review of the cases and deliver an opinion regarding the tribunals' interpretation of the discretionary powers.

DECISIONS SETTING LIMITATIONS TO THE EXECUTIVE BRANCH'S DISCRETIONARY POWER

In *CMS Gas Transmission Company v the Argentine Republic,*[3] the claimant –a majority shareholder of natural gas transportation utility– promoted an arbitration proceeding to obtain compensation for the losses suffered due to the "specification" and freeze of natural gas prices and rates as a result of the passing of a Law by Argentinean Congress in the year 2002 –known as the Public Emergency and Exchange System Reform Law-, which remained in force in the years to come. As a general remark, Law No. 25,561, originally set to remain in force only for two years (i.e., until 10 December 2003), abrogated article 1 of Law No, 23,928, which stipulated the convertibility of Argentine pesos to U.S. dollars at an exchange ratio of 1:1 –known as the "Convertibility regime"-. Therefore, as the "Convertibility regime was no longer in force, U.S. dollar obligations were converted to Argentine pesos, a measure known as the "pesification". Thus, pursuant to article 8 of Law No. 25,561,dollar-based rates of public utilities were converted to Argentine pesos at a rate of 1:1[4].In addition, these rates were frozen without providing an indexation mechanism. In *CMS*, the parties, among other matters, disputed the rationale and purpose of the mechanics set forth in the gas regulatory framework to increase rates. In particular, the claimant argued that Law No. 24,076 – which provides the

[2] Nicholas Emiliou, *The Principle of Proportionality in European Law: A Comparative Study* (Kluwer Law International 1996) 23-24

[3] *CMS Gas Transmission Company v the Argentine Republic*, ICSID Case No. ARB/01/08 (2005)

[4] Public Emergency Law of 2002, Law No. 25,561, B.O. Jan. 6, 2002, article 8 (Argentine Republic)

regulatory framework for natural gas transportation and distribution –established a five-year review of the natural gas rates, which had to be carried out through automatic adjustment following the use of only two factors: increased efficiency and investment. On the contrary, Argentina opposed to claimant's position and suggested that such a mechanism could be broader and include other elements relevant to the rate's determination; and that this decision would ultimately rely on, and be subject to, the exercise of discretionary powers.

The Tribunal sided with Argentina on the natural gas rate update mechanism rationale and concluded that Argentina had in fact the power to deliver a broader revision of the rates update scheme. Nevertheless, it also concluded that this power would have to be exercised by accounting for the guiding principles of a reasonable rate of return, stability, coherence, and foreseeability. Pursuant to the Tribunal's interpretation, the Argentine Republic had dismantled the transportation rate structure at its own will, disobeying such "*guiding principles*" mentioned before. The Tribunal selected for the case *ENRON Corporation Ponderosa Assets, L.P. v Argentine Republic*[5] reached a similar conclusion via the award granted on May 22nd, 2007. As well as in *CMS* precedent, the claimant requested compensation from the Argentine Republic for the losses suffered due to the "pesification" and freezing of natural gas rates' values established by the Argentinean Congress following the 2001 crisis. In this case, the argument between the parties revolved around whether natural gas rates should be calculated in US dollars and the mechanics for increases in such values. According to the claimant's position, rates were in fact fixed in US Dollars and were supposed to adjust pursuant to the mechanics set forth in the gas regulatory framework, regardless of the State's decision to abrogate the convertibility regime. On the other hand, the Argentine Republic argued that the calculation of rates in US Dollars could only be in force during the validity of the "convertibility regime"; so, once the regime was abrogated, the claimant had no right to that type of adjustment mechanism nor to claim that such rates would be fixed in US Dollars. The Tribunal concluded that the Argentinean Executive Branch indeed had a wide margin of appreciation when it came to the review and adjustment of the natural gas rates regime. Nonetheless, the Tribunal stated that "*Broad as the regulatory authority of States and governments*

[5] *Enron Corporation Ponderosa Assets, L.P. v Argentine Republic* (2007) ICSID Case No. ARB/01/3

might be at present, it can only be exercised within the limits of law and duly taking into account the rights of individuals."

As we can see, the Tribunal sets a clear threshold for the discretionary power of the Argentinean administration. In this case, that limit was fixed stating that the Argentinean Executive Branch could only take unilateral action of that nature within the boundaries of the law. Absent such premises, such measure would be deemed arbitrary or unreasonable. The third case under analysis is the decision on liability issued in *Suez, Sociedad General de Aguas de Barcelona S.A., Vivendi Universal S.A., and AWG Group Limited v The Argentine Republic*[6], on July 30th, 2010. In this case, the claimant requested compensation due to acts and omissions by Argentina which resulted in damages towards such a company, which held a majority stake interest in a local concessionaire of wastewater treatment services. Like the other cases previously analyzed, the parties contested whether rates under this concession would have to be calculated in US Dollars, or in Argentine Peso, due to the abandonment of the convertibility regime. The claimant asserted that rates under its concession were supposed to be calculated under an "*equilibrium principle*", which meant that the concessionaire was entitled to a recovery of all costs plus a return on invested capital. According to the Tribunal, the "*equilibrium principle*" had not been established in the public utility regulatory framework, and it was the concessionaire the one to assume the business risks of the operation. Indeed, the Tribunal recognized that the Argentinean Executive Power held a broad regulatory power concerning the rate structure, investment standards, and performance. However, it also stated that the claimant, as a participant in a regulated industry "*had the legitimate expectation that the Argentine authorities would exercise that regulatory authority and discretion within the rules of the detailed legal framework that Argentina had established for the Concession.*"

Thus, according to the Tribunal's ruling, the Argentinean authorities had refused to act in accordance with the legal framework by not increasing the rates' values and, therefore, violated the claimant's legitimate expectations, and ultimately found that Argentina had breached the fair and equitable treatment ("FET") standard protected under the BIT.

[6] *Suez, Sociedad General de Aguas de Barcelona S.A., Vivendi Universal S.A. and AWG Group Limited v the Argentine Republic* (2010) ICSID Case No. ARB/03/19

Moreover, the Tribunal concluded that the actions carried out by the Argentine republic constituted an "abuse of regulatory discretion.", therefore setting a clear limit to the exercise of discretionary power of the Argentinean Executive Branch, which is the provisions stipulated in a detailed legal framework and the violations of the legitimate expectations of the investor. As Kingsbury and Schill established, the legitimate expectations of the investor can set bounds for the administration's discretionary power.[7] To summarize, the tribunals in the cases considered above shared a similar opinion concerning the exercise of discretionary powers by the Argentinean Executive Branch. While the arbitrators understood that, pursuant to the respective regulatory framework, the Executive Power indeed had a wide margin of appreciation regarding the rates' system; they certainly set clear limits to the exercise of those powers, with the principles of proportionality and reasonableness as the cornerstone for those limitations.

DECISIONS TOLERATING THE EXERCISE OF DISCRETIONARY POWERS

Although investment arbitration tribunals have set significant limits to the Argentinean executive branch's exercise of discretionary powers, in some cases it appears that other ICSID tribunals have tolerated the exercise of discretionary powers. In this section, I will describe two investment arbitration cases in which the tribunals acknowledged the wide discretionary powers of the Argentinean Executive Branch. The cases in consideration are *Total S.A. v the Argentine Republic*[8] and *El Paso Energy International Company v the Argentine Republic*[9]. Both claimants owned investments in the energy sector –hydrocarbons and electricity – and were requesting compensation for the damages suffered by certain measures adopted by the Argentine Republic after the economic crisis occurred between the years 2001 and 2002. One of the measures challenged by the claimants within the arbitration procedure was the "pesification" of the capacity payments in the electricity sector. In a nutshell, capacity payments compensate generators for the capacity they make available, regardless of whether

[7] Benedict Kingsbury & Stephan W. Schill, 'Investor-State Arbitration as Governance: Fair and Equitable Treatment, Proportionality and the Emerging Administrative Law' (*TDM,* 2011) <https://www.transnational-dispute-management.com/article.asp?key=1700> accessed 15 March 2022

[8] *Total S.A. v the Argentine Republic* (2010) ICSID Case No. ARB/04/1

[9] *El Paso Energy International Company v the Argentine Republic* (2011) ICSID Case No. ARB/03/15 (2011)

the generator is called into dispatch to effectively supply electricity. According to the electricity regulatory framework, the cost of unsupplied electricity should be a factor to consider when estimating the remuneration to the generators for the electricity sold[10]. As the Tribunal in *El Paso* concluded: "*capacity payments, [along] with the proceeds from the sales, were the two pillars of the new Framework.*" In *Total,* the parties disputed the rationale and purpose of capacity payments. While the claimant emphasized that capacity payments were aimed at recovering the investment costs of generators, Argentina opposed Total's position and suggested that "*there is no rule supporting the assertion that the purpose of capacity payments is mainly the coverage of capital costs or investment recovery*".[11] In *Total*, The Tribunal sided with Argentina on the capacity payment claim stating that: "*Article 36 of the Electricity Law does not explicitly provide for such payments; it is telling that the cost of unsupplied energy is an element considered in determining the uniform energy rate* (…) *The Tribunal notes that the SoE's regulatory powers to fix a capacity payment are so broad that the authority could even abolish such payments. This was meant to happen in June 2001 (shortly before Total entered the electricity sector, convertibility was abandoned and the later enactment of measures challenged by Total) by Decree 804/01, later abrogated by Law 25.468, as pointed out by both parties.*"[12] However, I respectfully consider that the Tribunal erred in its conclusions regarding capacity payments in *Total*. Specifically, the *Total* Tribunal wrongly stated that the Energy Secretariat's "*regulatory powers to fix a capacity payment are so broad that [it] could even abolish such payments.*" According to the *Total* Tribunal, "*this was meant to happen in 2001 by means of Decree No. 804/01.*" While the Energy Secretariat does enjoy certain discretion in regulating capacity, such discretion does not extend to altering Law No. 24.065. In any case, Decree No. 804/01 should not qualify as an example of discretionary powers, but as a change of law, as such decree is a delegated decree. Accordingly, Article 76 of the Argentine Constitution authorizes the Executive Power to issue delegated decrees on certain matters of administration or public emergency but is limited to a fixed period of time and within the fundamentals set by the delegating law. In fact, delegated decrees have been equally ranked with laws passed by National Congress. In addition, the Argentine

[10] Electricity Regime Law, 1992, art. 36
[11] Total S.A. (n 10), 271
[12] Total S.A. (n 10), 311

Constitution stipulates in article 31 that "This Constitution, the laws of the Nation that in furtherance thereof are issued by the Congress, and the treaties with foreign powers are the supreme law of the Nation". Similarly, in *El Paso*, the claimant alleged that capacity payments nominated in USD were aimed to cover long-term investment and system expansion, which was rejected by the Republic of Argentina. According to the Tribunal's point of view, not only there was not a right to a certain amount of capacity payments, but also the Secretary of Energy, as enforcement authority of the electricity regulatory framework, had a wide margin of appreciation when it came to calculating capacity payments. As it can be observed, in both cases the ICSID tribunals took a different approach to the analysis of discretionary powers exercised by the Argentine executive power than the one provided by the tribunals mentioned in section 3 of this article. Pursuant to the tribunals' conclusions, the Argentinean executive branch had a broad discretionary faculty when it came to the fixation of capacity payments. Even though the *Total* Tribunal delivered an incorrect interpretation of the scope of Decree 804/2001 –as it has been already pointed out, the truth is that both tribunals understood that the Executive Branch enjoyed a broad regulatory power to fix capacity payments. It is relevant to highlight that in *Total*, the Tribunal stipulated that abolishing the capacity payments, a measure that should normally be considered unreasonable, was an actual alternative given by the electricity regulatory framework to the Secretary of Energy.

CONCLUSION

So far, international investment arbitration precedents show an ambivalent position concerning the discretionary powers of the Argentinean Executive Branch. While some tribunals have strongly rejected the way in which those powers have been executed, other tribunals avoided setting limits to the exercise of discretionary powers.

In our opinion, the interpretation rendered by the arbitrators in *ENRON*, *CMS,* and *Suez* cases is correct. The utilization of the principle of reasonability is accurate because it sets a precise limit to the exercise of discretionary powers, especially when the regulatory acts or omissions of the public authorities harm or somehow, hinder legitimate expectations of foreign investors.

On the contrary, the decisions issued in the *Total* and EL PASO cases are more questionable and subject to interpretation. In our view, the tribunals erred when defining discretionary powers with the change of law (particularly, in *Total* precedent) and were too permissive by allowing an extensive interpretation of the regulatory powers given by the electricity framework to the enforcement authority. Therefore, the fact that the arbitrators in both cases endorsed the exercising of broad discretionary powers to the extent of permitting the elimination of the capacity payments is quite controversial. As I have mentioned before, it seems not correct to confuse the exercise of discretionary powers with the power to change or overrule a law. Such cases show different interpretations when analyzing the legitimate exercise of discretionary powers. It is important to acknowledge that, when balancing legitimate exercise of discretionary powers, one should consider and assess the impact that such measure may pose on an investment protected by a particular BIT. If so, to the extent that other requirements under the BIT are met, a protected investor would be enabled to request the protection of its investment pursuant to the rules under which its investment is supposed to be safeguarded. In a nutshell, there is no doubt the Argentine Executive Power is entitled to exercise certain discretionary powers, a legal concept recognized by Argentinean and foreign regulatory frameworks, as well as by legal theorists and case law. Nevertheless, there are two clear limits to take into consideration when exercising these powers. The first one is given by the general principles of law, as explained in Section No. 2 of this article, together with the boundaries imposed by ICSID tribunals in cases described in Section No. 3 of this paper. However, another limitation that has to be acknowledged when exercising discretionary powers is the impact that this decision, while legitimately executed, may have on a foreign investment protected by BIT. This is, within the margin of appreciation that discretionary powers given to the Executive Power, it is imperative that this political body chooses the less harmful alternative to the foreign investment while considering the BIT provisions, to prevent future litigation in international tribunals.