Fall 2023

Latin America Focus

New horizons

Contents

Cover: End or the World Route – Chilean scenic route located in Patagonia

Latin America 2023: New horizons

As we embark on our third year of *Latin America Focus*, the ever-evolving landscape in the region brings fresh opportunities and challenges for local, regional and international businesses.

After an extremely positive post-Covid growth spurt in 2022, so far 2023 has been a bit more challenging for the region with GDP growth slowing and political uncertainty increasing. Nevertheless, we see plenty of bright spots on the horizon and opportunities for those who know where to find them.

In our third compendium of market insight from the Latin America team at White & Case, we look at what those opportunities are and where challenges might arise for investors.

On the opportunity front, we examine the mining & metals industry in detail. Interest in the region's lithium reserves has soared with the continued growing demand for the mineral for the battery manufacturing process. The "lithium triangle" has turned into a "lithium quad" with Brazil joining Chile, Argentina and Bolivia as a significant supplier of lithium. However, the countries' differing approaches to regulation of the industry means that those looking to source lithium in the region will have to understand the market in each country to determine where, when and how to make significant investments.

The lithium market could potentially be the beneficiary of another Latin American trend: Nearshoring. In a world of escalating geopolitical volatility, there is a shift away from broader globalization towards a more localized approach to manufacturing and trade. Several countries in Latin America have implemented investment and tax treaties, which, along with the ongoing geopolitical shift, make the establishment of industrial plants in the region easier and more enticing than ever before.

In this issue, we also take a look at environmental, social and governance (ESG) considerations; compared to their counterparts in North America or Europe, Latin American companies have arguably been slower to respond to the trend to disclose their approach to ESG. However, within the region this varies widely depending on the industry, as our recent survey of private issuers has shown.

As ever in our volatile world, the threat of market shocks and their impact on businesses and industries remains constant. Three major Latin American airlines and a variety of other businesses recently went through lengthy and difficult insolvency procedures following the Covid crisis. The good news is that most of these businesses are now back on track and performing very well, thanks in part to the creative and unprecedented use of Chapter 11 of the US Bankruptcy Code as well as local insolvency regimes to restructure the debt and the capital structures of the effected companies.

Another bright spot for investors in Latin America in recent years is that international arbitration in the region continues to develop in remarkable fashion, providing foreign investors with recourse to fair and impartial justice when investment disputes arise.

We at White & Case continue to believe that the Latin American market holds long-term promise for the savvy investor. We hope that you find this issue of *Latin America Focus*, which contains articles from our top experts on the subjects referenced above, interesting and useful as you embark on additional business in the region.

Christian Hansen
Partner
Latin America Group Leader and Editor of *Latin America Focus*

Solar array in the Atacama Desert of northern Chile

Sustainability disclosures gain momentum among Latin American issuers

Sustainability disclosures among Latin American issuers vary widely in terms of completeness, granularity and format, impacting their business, financial performance and attractiveness to investors. Investors and regulators are calling for greater standardization, consistency and transparency about the real impact of ESG policies, say **Scott Levi**, **Karen Katri**, **Rafael Roberti** and **Danielle Herrick**.

After coming to the forefront in 2021 on the heels of mounting global concerns over climate change and social inequality, addressing environmental, social and governance (ESG) factors became the new normal for investors and businesses in 2022 and 2023. With ESG considerations rooted in mainstream markets, investors and regulators have demanded better reporting and compliance from businesses on their ESG performance.

As the number of ESG-badged equity and debt products has grown, so has the number of ESG metrics and benchmarks. This trend has driven calls for greater standardization, consistency and transparency regarding the real impact of ESG policies. Meanwhile, governments and economic blocs—against the backdrop of their commitments under the Paris Agreement and subsequent agreements at international climate conferences COP26 and COP27—have incentives to encourage ESG integration through means that include voluntary and mandatory disclosure regimes.

This trend has ushered in a sea change for public securities in various markets. Perhaps the most critical change has been to reporting of environmental metrics. The European Commission advanced proposals for the Corporate Sustainability Due Diligence Directive, which are expected to be adopted by the end of 2023, and which outline requirements for large businesses to conduct due diligence to identify and address adverse impacts on the environment, produce climate plans, and require directors to consider environmental impacts of business decisions.

The US Securities and Exchange Commission (SEC), meanwhile, put out long-awaited proposals to require climate change disclosure in the annual reports and registration statements of public companies. The proposed rules are far more prescriptive in nature than the principles-based regulation the prior administration embraced, and would require integration with the company's internal controls, audit and oversight functions.

The proposal points to increasing investor demand for disclosure on climate-related risks and the management of such risks. Many companies make these disclosures in their proxy statements, sustainability reports or on their websites, but the SEC has observed that these disclosures can vary widely in terms of completeness, granularity and format, and argues that third-party data providers and voluntary climate reporting frameworks have not met the need for climate risk-related disclosures.

The ESG movement in Latin America is evolving. According to a 2023 survey among more than 400 Latin American companies, a majority of issuers in each of Peru, Mexico, Costa Rica, Colombia and certain other countries consider themselves to have an ESG strategy, but only a minority of them prioritize climate change issues.

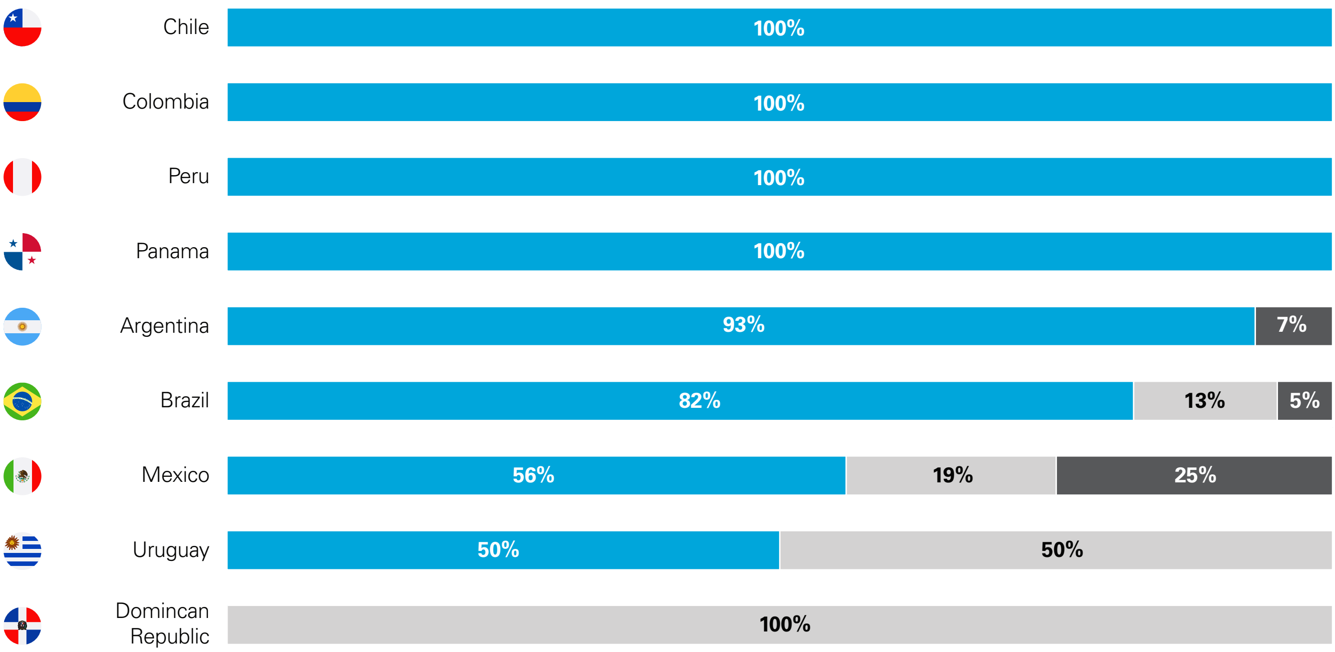
To better understand the landscape in environmental reporting for Latin American companies that are public in the US, in June 2023, White & Case conducted an in-depth review of environmental sustainability disclosures among 92 issuers headquartered in Latin America, who had already filed at least one annual report with the SEC.

92

In June 2023, White & Case conducted an in-depth review of environmental sustainability disclosures among 92 issuers headquartered in Latin America, who had already filed at least one annual report with the SEC

"As the number of ESG-badged products has grown, so has the number of ESG metrics and benchmarks, driving calls for greater standardization, consistency and transparency

Sustainability reports are the overwhelming norm among issuers in Latin America



Source: Own analysis, White & Case

Percentages may not sum to 100% due to rounding.

FACTORS DRIVING THE PACE OF SUSTAINABILITY IN LATIN AMERICA

The vast majority (80%) of the surveyed companies already have standalone sustainability reports. Those without sustainability reports generally opt for no sustainability disclosure (12%), with only a small percentage (7%) creating more generic or brief sustainability websites.

Sustainability reports are the overwhelming norm among issuers from large Latin American countries (100% of Chilean, Colombian and Peruvian issuers, 93% of Argentine issuers and 82% of Brazilian issuers), except Mexico, where a narrow majority of issuers published sustainability reports (56%).

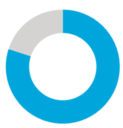
The industries with the greatest proportion of issuers publishing sustainability reports are agriculture/real estate, construction, paper production and telecom (100% each), followed by energy (93%), financial services and food and beverage (88% each), and lastly mining & metals (73%).

The industries with the least sustainability reporting are retail (66% issuing a sustainability report) and, in last place, technology (55% issuing a sustainability report).

RISK FACTOR DISCLOSURE

The surveyed companies tend to have robust risk factor disclosure, with a significant majority (80%), including environmental risk factors, and an even greater percentage (84%), including a climate change risk factor. The industries with issuers most frequently including risk factor disclosure are agriculture/real estate, construction and energy (100% for both general environmental and more specific climate change risk factors).

All other industries are very active in this space, with frequency of risk factor disclosure on environmental and climate change topics generally exceeding 70%, other than technology issuers, which disclose climate change risks a narrow majority of the time (55%), and environmental risks only in a minority of cases (33%).



80%

The vast majority of the surveyed companies have standalone sustainability reports

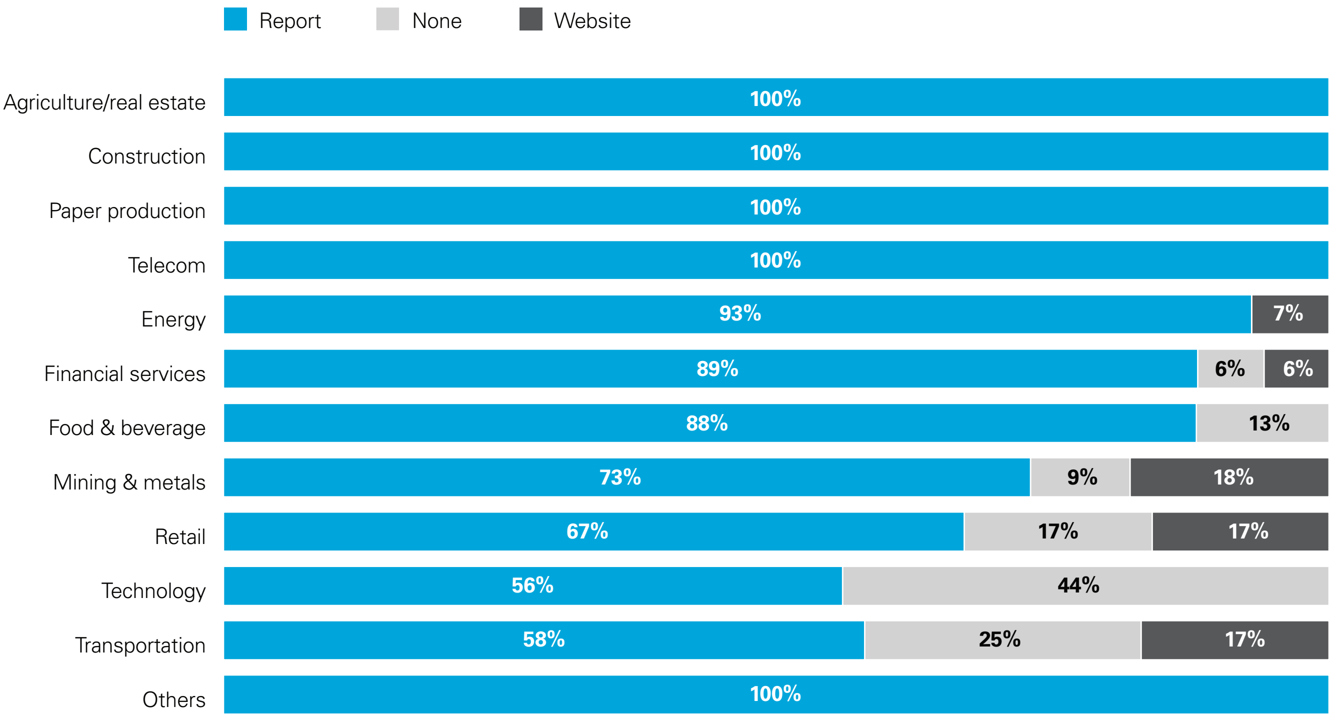
EMISSIONS REPORTING

A significant majority of the surveyed companies report their emissions to some degree (74%), with the largest subset reporting their scope 1, 2 (direct) and scope 3 (indirect) emissions at least in part (54%). Just under a fifth (18%) of these issuers report only scope 1 and 2 emissions, whereas a negligible fraction of them (2%) limit their reporting to scope 1 emissions. The remainder (26%) opt for no emission disclosure.

Emissions reporting up to scope 3 is most common among issuers in telecom (100%), food and beverage (87.5%) and financial services (72%). Otherwise, emissions reporting up to scope 2 is the highest in construction (100%), financial services (83%), energy (80%) and mining & metals (73%). The industries with the least emissions reporting are retail, transportation, technology and agriculture/real estate, with only 66%, 58%, 44% and 33%, respectively, reporting any type of emission.

Chilean issuers top the list among those reporting up to scope 3 (100%), Wind turbines in the Atacama Desert in the northern region of Chile

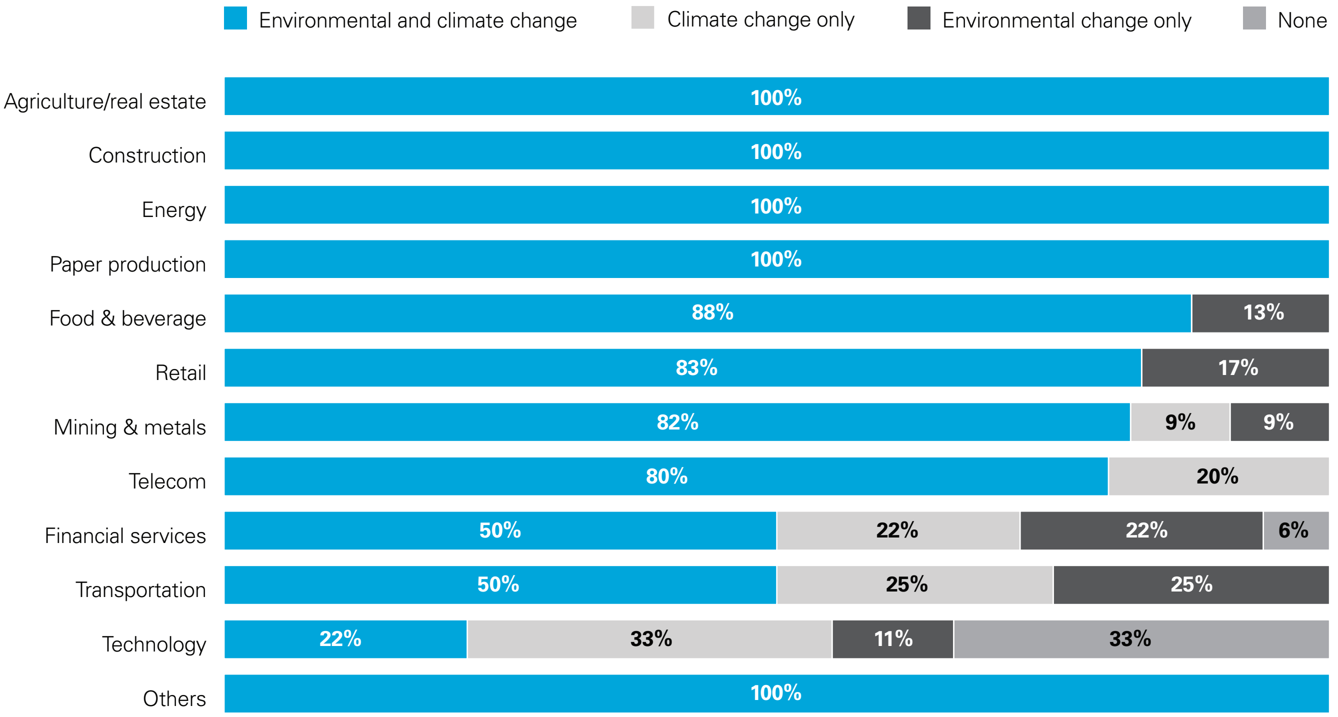
Issuers in agriculture/real estate, construction, paper and telecom industries lead in sustainability reporting



Source: Own analysis, White & Case

Percentages may not sum to 100% due to rounding.

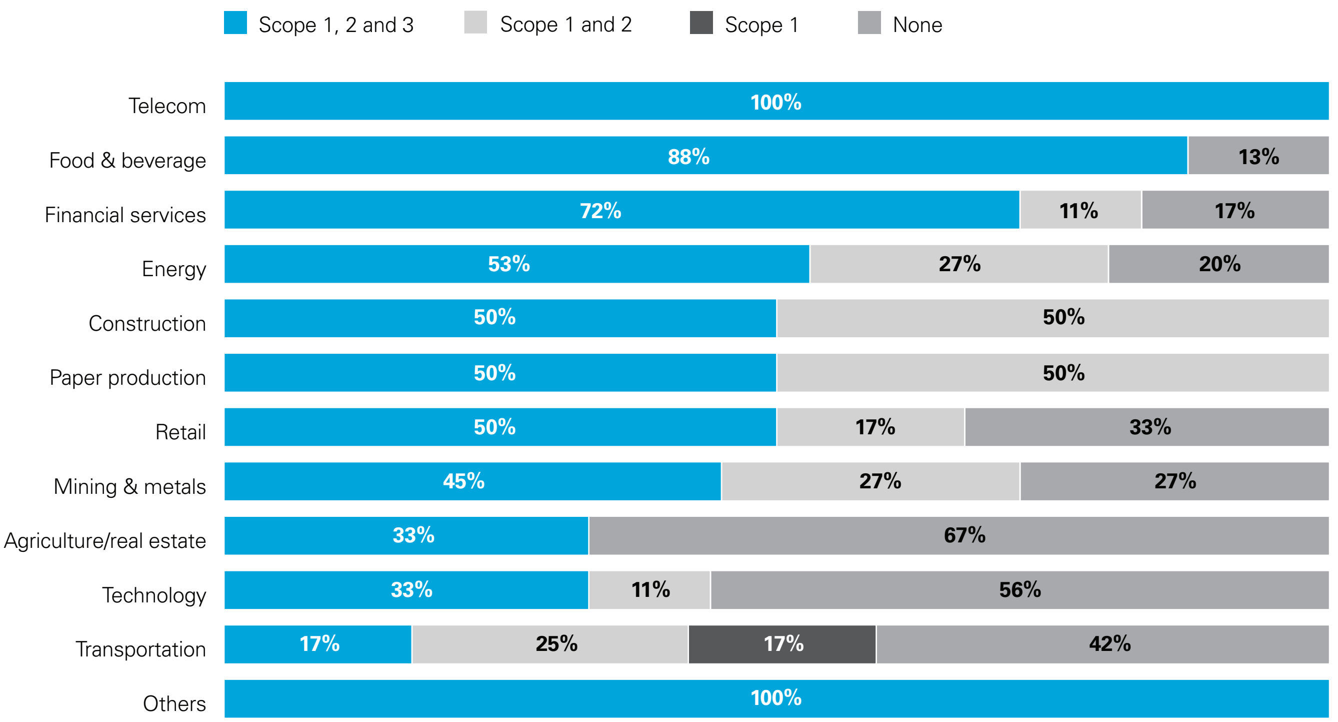
Issuers in agriculture/real estate, construction and energy sectors demonstrate the highest frequency of disclosing risk factors related to environmental and climate change issues



Source: Own analysis, White & Case

Percentages may not sum to 100% due to rounding.

Emissions reporting up to scope 3 is most common among issuers in telecom, food and beverage and financial services sectors



Source: Own analysis, White & Case

Percentages may not sum to 100% due to rounding.

Los Glaciares National Park in the Austral Andes of southwest Argentina, near the Chilean border

followed by Colombians (75%) and Peruvians (66%). However, among issuers reporting up to scope 2, issuers in Colombia and Peru are eclipsed by Argentina (78%), and Peruvian issuers are eclipsed by Brazilians (72%).

Among Latin America's large countries, Mexico is generally on the lower end among issuers reporting up to scope 2 (56% of its issuers) or reporting any emissions at all (63% of its issuers). The countries with the lowest record of emissions reporting are Uruguay and Panama (each with only 50% of issuers) reporting any emissions at all. The Dominican Republic is in last place, with its sole issuer not reporting any emissions. In all cases, it should be noted that the reach of scope 3 emissions varies among issuers, who limit the activities associated with their business for which they report emissions in different ways.

EMISSIONS TARGETS

A relatively narrow majority (60%) of the surveyed companies sets some type of time-bound emissions target. The types of targets vary greatly, ranging from modest reductions in emissions with longer lead times, to carbon neutrality or net-zero emissions within various aspects of the business with time objectives anywhere from under ten years to more than 25 years. The industries with the greatest proportion of issuers setting time-bound targets are paper production (100%), followed by food and beverage (88%), and then energy and telecom (each 80%). The industries with the lowest portion of surveyed Latin American issuers setting such targets are financial services (44%), agriculture/real estate (33%) and technology (11%).

In line with their high standards of emissions reporting, Chilean issuers top the list among those setting time-bound emissions targets (89%), followed, with a noticeable difference, by Argentine issuers (64%) and Brazilian issuers (62%).

Despite having higher standards of emission reporting, Colombian and Peruvian issuers tend not to set time-bound emissions targets, with 50% and 33%, respectively, establishing such goals. Consistent with their lower standards of emissions reporting, issuers from Panama, Uruguay and the Dominican Republic also have lower rates of setting of emissions targets, with 50%, 25% and no issuers, respectively, setting such targets. Mexican issuers set time-bound emissions targets proportional to their rate of emissions reporting up to scope 2 (56%).

ENVIRONMENTAL SUSTAINABILITY REPORTING STANDARD

Among Latin American issuers providing sustainability reporting, the most commonly used sustainability reporting standards are the Global Reporting Initiative (GRI) and the Sustainability Accounting Standards Board (SASB). The standards created by the Task Force on Climate Disclosure (TFCD) are used by a small minority of issuers. The remainder of surveyed Latin American companies, to the extent they use any standard at all, report under a wide umbrella of frameworks, including the International Integrated Reporting Council, the Stakeholder Capital Metrics of the World Economic Forum, the Brazilian GHG Protocol Program, the United Nations Global Compact and Ipieca. Several of the surveyed issuers reported fewer than one standard.

61%

Of surveyed companies have followed either GRI, SABS–or both–reporting standards

ENGAGEMENT WITH LOCAL AND INDIGENOUS COMMUNITIES

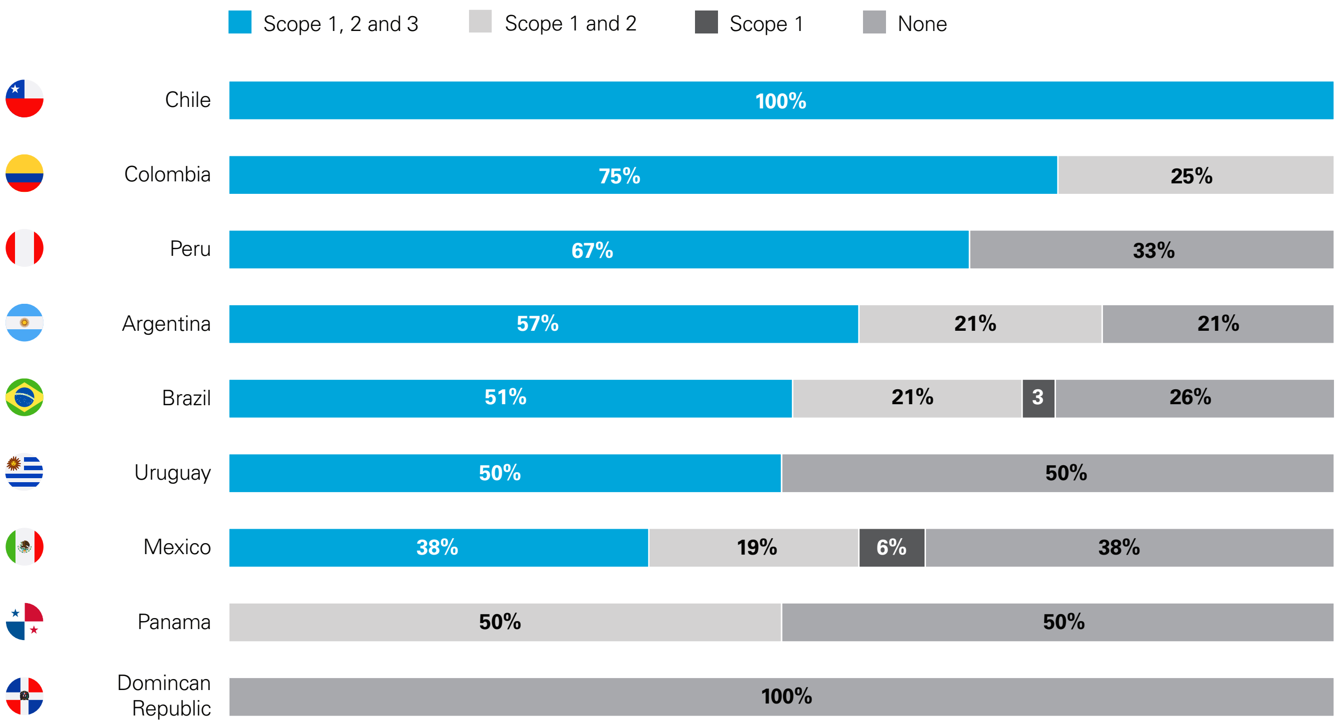
Despite the prominence of environmental disputes with indigenous communities among Latin American companies, few seemed to consider this a material subject for investors. A very small minority (12%) of companies had any type of disclosure on environmental disputes, with even fewer (10%) disclosing remediation efforts in regard to environmental disputes.

Within this small group of companies, most of those disclosing a dispute were Brazilian (64%), whereas the companies disclosing remediation were split among various countries, with 22% in each of Brazil, Chile, Colombia and Peru, and the remaining 11% in Argentina.

> **Global Reporting Initiative (GRI) and Sustainability Accounting Standards Board (SABS) are the most commonly used sustainability reporting standards among Latin American issuers**

Solar hot water tank, Argentina

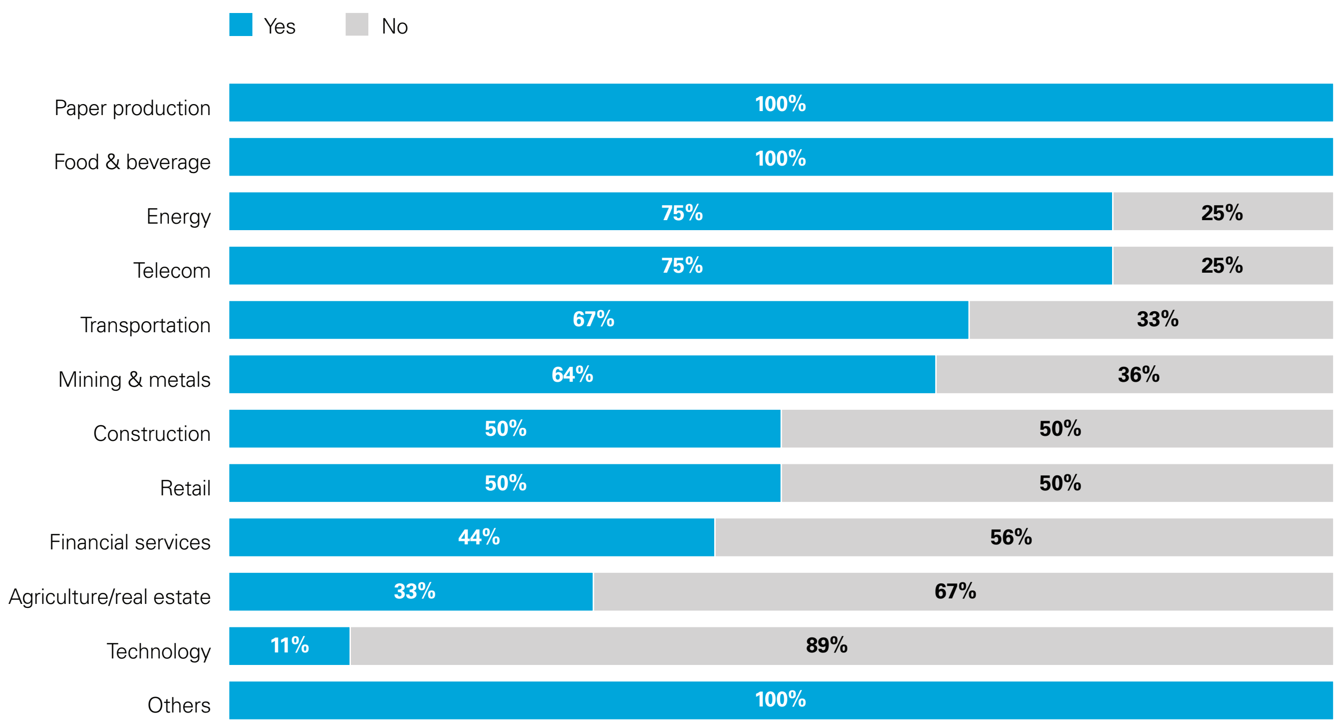
Chilean issuers top the list of Latin American countries reporting up to scope 3 emissions



Source: Own analysis, White & Case

Percentages may not sum to 100% due to rounding.

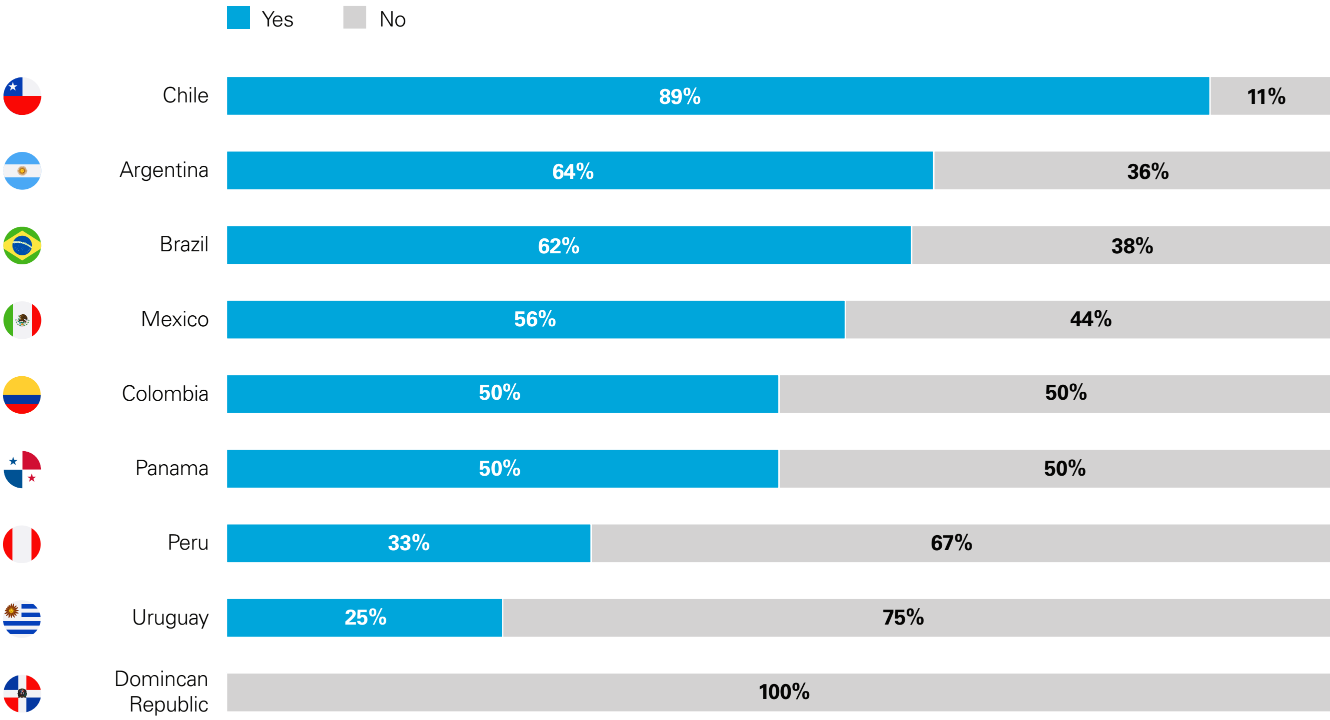
Emissions reporting up to scope 3 is most common among issuers in telecom, food and beverage and financial services sectors



Source: Own analysis, White & Case

Percentages may not sum to 100% due to rounding.

Chilean issuers top the list among countries setting time-bound emissions targets



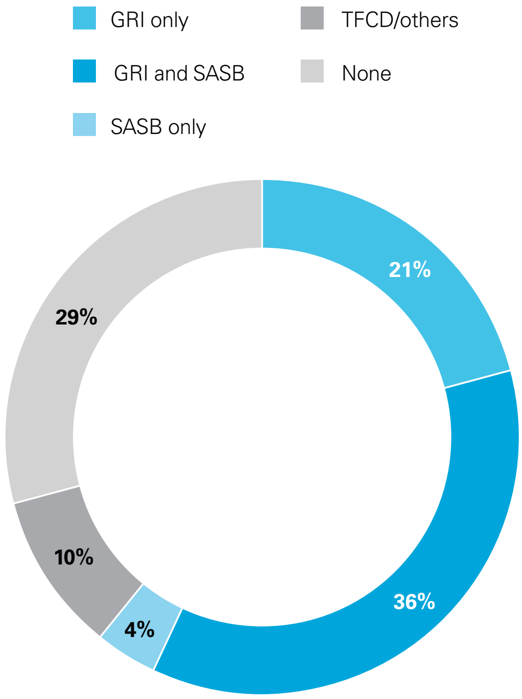
Source: Own analysis, White & Case

Percentages may not sum to 100% due to rounding.

Disclosures were higher in more industrial sectors, such as construction (50% of issuers reporting a dispute and/or remediation), energy (40% of issuers reporting a dispute and 33% reporting remediation), agriculture (30% of issuers reporting a dispute and/or remediation), paper production (50% of issuers reporting a dispute but none reporting remediation), and mining & metals (18% of issuers reporting a dispute and 36% of issuers reporting remediation).

The survey underscores a compelling opportunity for Latin American issuers to enhance the depth and thoroughness of their reporting. Companies that are more consistent and transparent in their sustainability disclosures are poised to stand out as more appealing investment options in the evolving landscape of sustainable finance. As ESG factors continue to hold a prominent place on the agenda of investors worldwide, embracing a more comprehensive approach to sustainability reporting not only aligns with responsible business practices but also positions these companies for greater investor trust and engagement in the future.

GRI and SABS are the most commonly used sustainability reporting standards among Latin American issuers

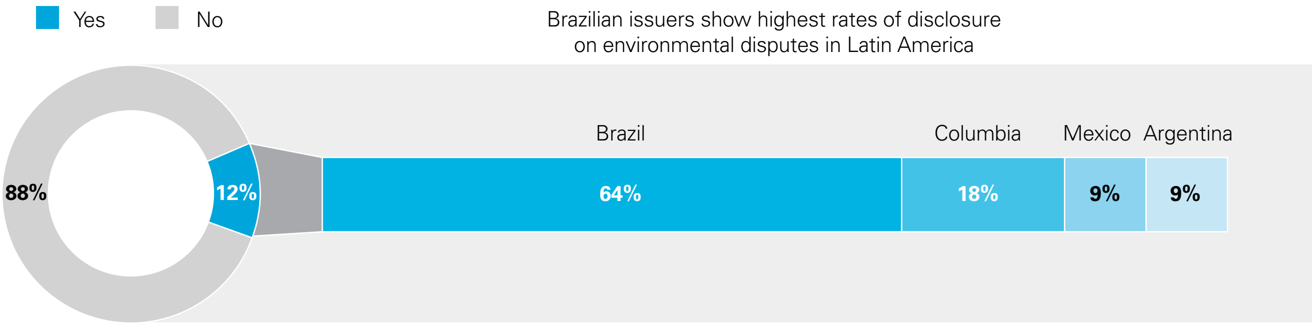


Source: Own analysis, White & Case

“

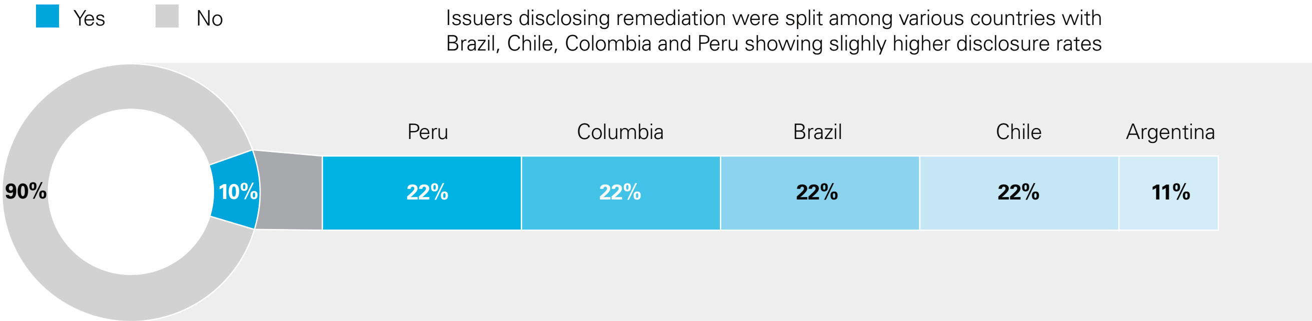
Companies that are more consistent and transparent in their sustainability disclosures are poised to stand out as more appealing investment options

Only 12 % of surveyed Latin American issuers disclose environmental disputes



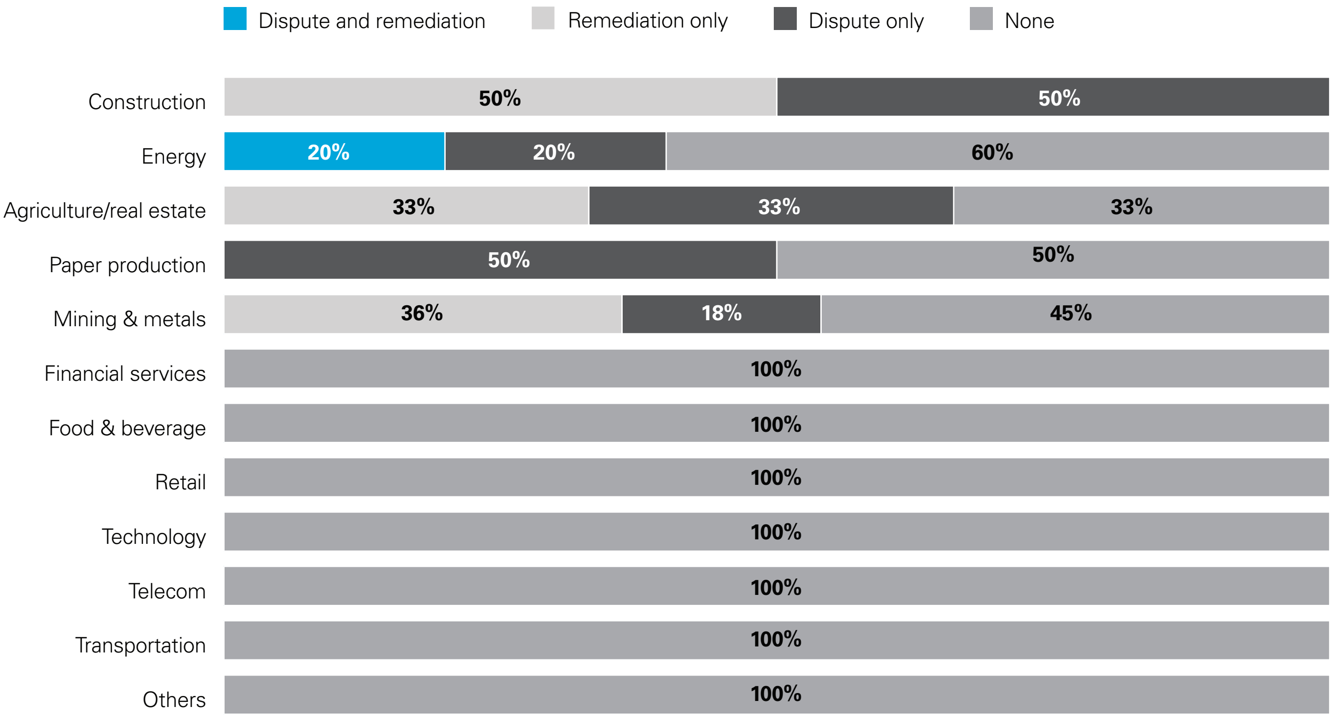
Source: Own analysis, White & Case

Only 10 % of surveyed Latin American issuers disclose remidiation efforts in relation to environmental disputes



Source: Own analysis, White & Case

Issuers in the industrial sectors, such as agriculture/real estate, construction and energy showed higher levels of reporting disputes and remediation



Source: Own analysis, White & Case

Percentages may not sum to 100% due to rounding.

Aerial view of Lençóis Maranhenses in Brazil

Unlocking opportunities: Nearshoring in Latin America for US investors

Narciso Campos, **Elizabeth González Gasca** and **Carlos Vejar** look at why nearshoring could be a boon to Latin America, as the pull of globalization slows.

Nearshoring is the buzzword of the moment, and one of the most popular destinations for US investors is Latin America—with good reason.

The data suggest that this is not merely a trend derived from the recent political and health events, but rather a structural shift. There are signs that show that the investment that nearshoring has brought to Latin America so far is just the beginning, and that it will increase substantially in the future.

The once unquestioned wave of post-World War II globalization has faced profound scrutiny in recent years, driven by both political and practical concerns.

As the White & Case report "A world of clubs and fences: Changing regulation and the remaking of globalization" highlights, cross-border flows have increased markedly since the 1980s. According to World Bank, foreign direct investment soared 20-fold between 1980 and 2020, global trade rose from 35 percent of world GDP to 58 percent and average global real income grew by 120 percent. But new pressures have since arisen, ranging from unease about the social consequences of open borders, to the way governments are responding to national and international security threats.

One response is to reconsider the commitment to open economies, and this has been exacerbated by systemic shocks, including the COVID-19 pandemic and Russia's invasion of Ukraine.

Global production and trade were disrupted due to the pandemic and the restrictions in the flow of people and goods, coupled with changing demands, resulted in shortages throughout the world. A good example was the shortage of electronic chips, caused by a bottleneck of production resulting from the increase in demand for smartphones and computers amid the pandemic.

20x

Foreign direct investment soared 20-fold between 1980 and 2020, according to World Bank

A 2021 survey by Ipsos and the World Economic Forum showed the positive sentiment toward globalization decreased substantially from pre-pandemic levels. It currently ranges from 72 percent in Malaysia to 27 percent in France.

An alternative to our current globalization model is the integration of production lines, value chains and sourcing from countries close to large consumption markets. There is also a trend known as "friend-shoring" characterized as increasing trade among countries with similar political values.

IS THIS REAL?

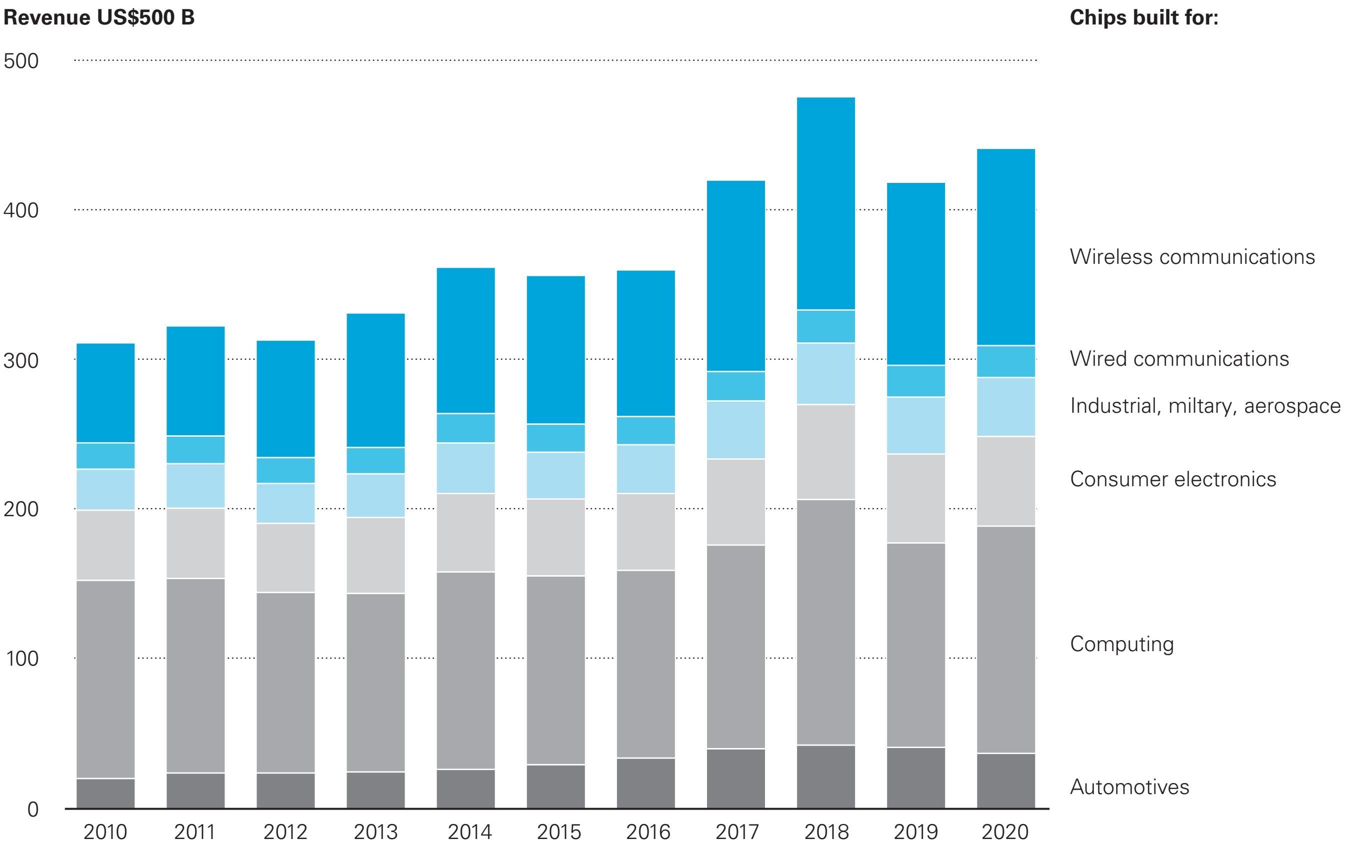
So far, the nearshoring trend has seemingly resulted in higher foreign direct investment in the Latin American region. For example, Mexico reported a 12 percent increase in FDI for 2022, and the highest investment figure of the past seven years.

This has resulted in higher demand for industrial space in the region. The Mexican Central Bank reports that the view among large corporations is that the greater impact of nearshoring is yet to be seen. Most industrial companies expect the increase in demand to be reflected between 2024 and

> **"Nearshoring is the buzzword of the moment, and one of the most popular destinations for US investors is Latin America**

Need for chips

Sales of semiconductor have grown over the past decade



Note: Data does not include foundry-only businesses such as TSMC or Globalfoundries.

Source: Bloomberg

2025, and a large number of survey participants expected the benefits to be observed after 2026.

This seems to make sense: The relocation of industrial production lines takes time. Infrastructure needs to be developed and plants need to be built, permits acquired, workers retained, companies incorporated and so on, before commencing production.

RELOCATING SMARTLY: INVESTMENT PROTECTIONS

Proximity to a large consumptions market, such as the US and the North American region as a whole, is not enough for Latin American countries to take advantage of the relocation opportunities that may arise in the future. Rule of law, investment protections and tax matters are very relevant to any relocation decisions.

The US has free trade agreements with 12 countries in the region: Chile, Colombia, Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama and Peru, as well as Canada. It also has trade and investment framework agreements or trade and investment council agreements with Argentina, Brazil, the Caribbean Community, Ecuador, Uruguay and Paraguay.

The European Union currently has five free trade agreements with 11 Latin American countries, and an economic partnership agreement with 14 Caribbean states, known as CARIFORUM.

Trade agreements in general provide investment protection

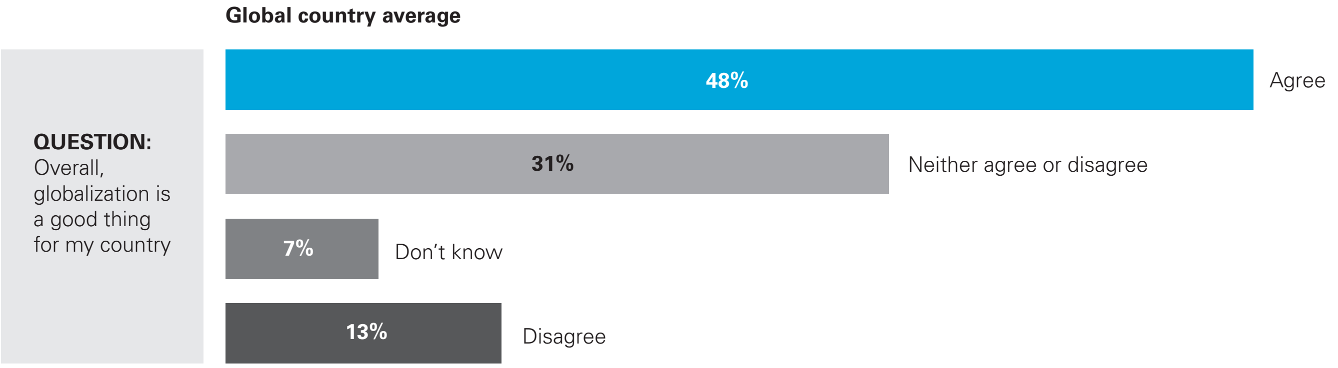
12

The US has free trade agreements with 12 countries in Latin America

and certainty for investors as they relocate into the region. Another important aspect of the investor protections is concerning intellectual property. The host countries should be able to provide the necessary assurances to foreign investors that their valuable IP will be protected while it is being used in each country.

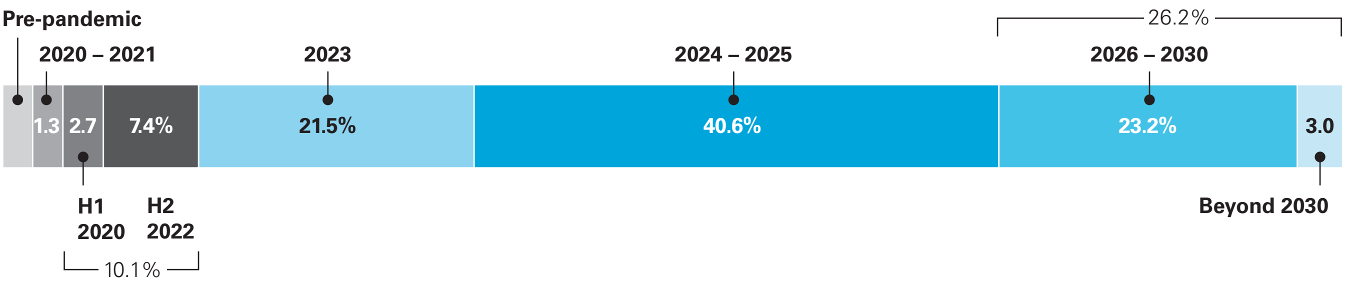
These agreements go well beyond World Trade Organization investment provisions, and may include access directly or through separate instruments, to investor-state arbitration, which is probably a last resort mechanism to recover damages caused by state entities against foreign investments in their territories. Mexico, for example, has 14 free trade agreements with 52 countries and 30 bilateral investment treaties.

Global views on globalization benefits



Source: Ipsos and World Economic Forum

Actual and anticipated impact of relocation on business, by period



Note: Among the companies interviewed, 36.7% reported not having observed or expecting to observe any impact of the relocation on their company.

Source: Prepared by Banco de México with data from the Business Manager Interview Program (Programa de Entrevistas a Directivos Empresariales).

RELOCATING SMARTLY: TAX

A clear understanding on tax implications of the relocation is also very relevant. The tax treaty network in Latin America plays a key role in preventing double taxation. For instance, Mexico has 61 tax treaties, covering most of the largest economies in the world.

Transfer pricing rules are essential to offer certainty in the proper allocation of profits. The Latin American region, and particularly Mexico, has significant experience of dealing with rules in full alignment with Organization for Economic Cooperation and Development transfer pricing guidelines that were adopted since the 1990s, as well as all its amendments and improvements made from time to time. In Mexico, the legal framework provides the opportunity for taxpayers to file for unilateral advance pricing agreements or bilateral with other jurisdictions, for instance, with the US or any other jurisdiction with a double tax treaty with Mexico.

The maquila regime in Mexico has resulted in the development of a large manufacturing base, especially close to the border with the US, with foreign trade programs that allow exporters to import free of tax and duties of goods for subsequent export.

Some countries in Latin America have begun setting up incentives for plants and investors that relocate in certain regions. Mexico launched a tax incentive program to attract investment for the zone of Itsmo de Tehuantepec, including corporate income tax exemptions for the first three years of operations, followed by the reduction of 50 percent, and up to 90 percent of income tax payments, in a second phase of three years, plus additional benefits regarding indirect taxes.

These incentives, coupled with the expanding suite of treaties, make Latin America an attractive proposition for companies wishing to nearshore operations in the region. The global political situation looks likely to remain uncertain for some years yet, and a more localized approach to business could well be the more prudent approach in the future.

Valle de la Muerte at sunset in the Atacama Desert, Chile

Behold the Lithium Quad? Latin America's race for lithium market share

Lithium is one of the most important minerals when it comes to the energy transition, and Latin America is one of the most important regions for producing lithium. **Fernando de la Hoz** and **Rebecca Campbell** compare the key jurisdictions and look to the future.

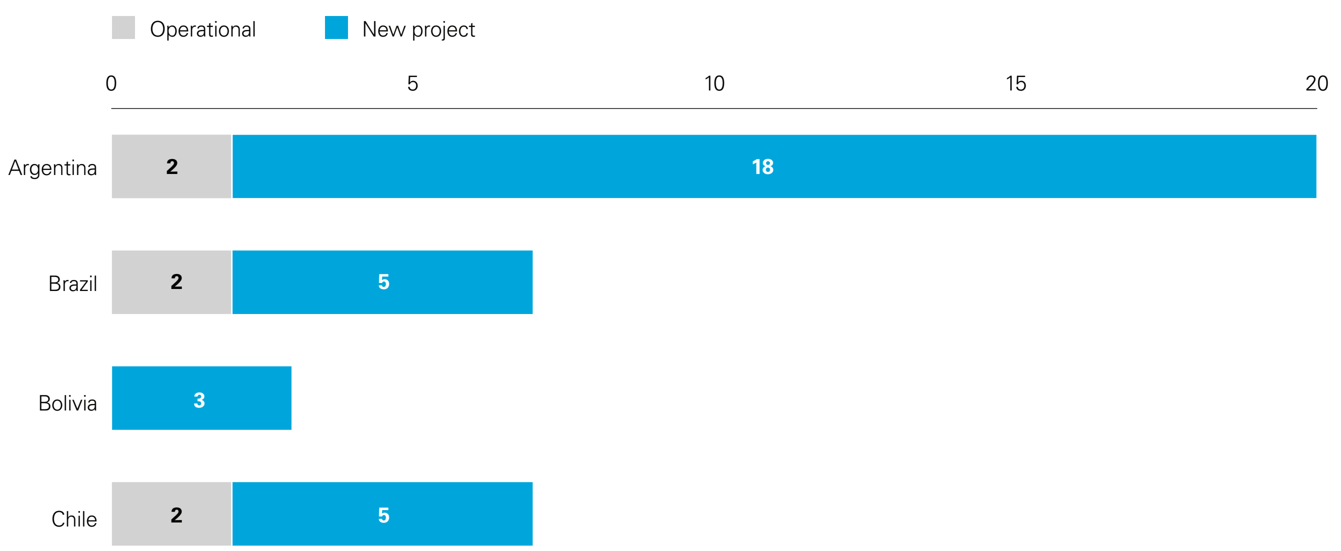
As governments and companies race to secure supplies of lithium for critical battery supply chains, interest in Latin America's considerable lithium reserves has surged. Miners, OEMs and other manufacturers look to Chile, Argentina and Bolivia for future supply.

This "lithium triangle" has historically been led by Chile, which alone was responsible for roughly 30 percent of global mined lithium production in 2022. But in the past 18 months, Brazil has seen several projects begin development or come to market, expanding the triangle into a quad.

Demand pressures in the lithium market are intense because of massive growth from a relatively low base, high degrees of uncertainty for investment and market outlooks, and market segmentation. Lithium is not one product, but several. Lithium carbonate is primarily used for lithium iron-phosphate (LFP), whereas the slightly more expensive lithium hydroxide is typically used for nickel cathode chemistries seen in the premium EV market. Extraction is similarly divided between hard rock spodumene, which normally has higher concentrations of lithium content and brines, the latter of which lacks a universal extraction process, as geology, water tables and the technology uses vary. Miners scrambling to bring new supply online are constrained and affected by geology and difficulties forecasting future balances of supply and demand, as demand for hydroxide and carbonate can diverge in some cases.

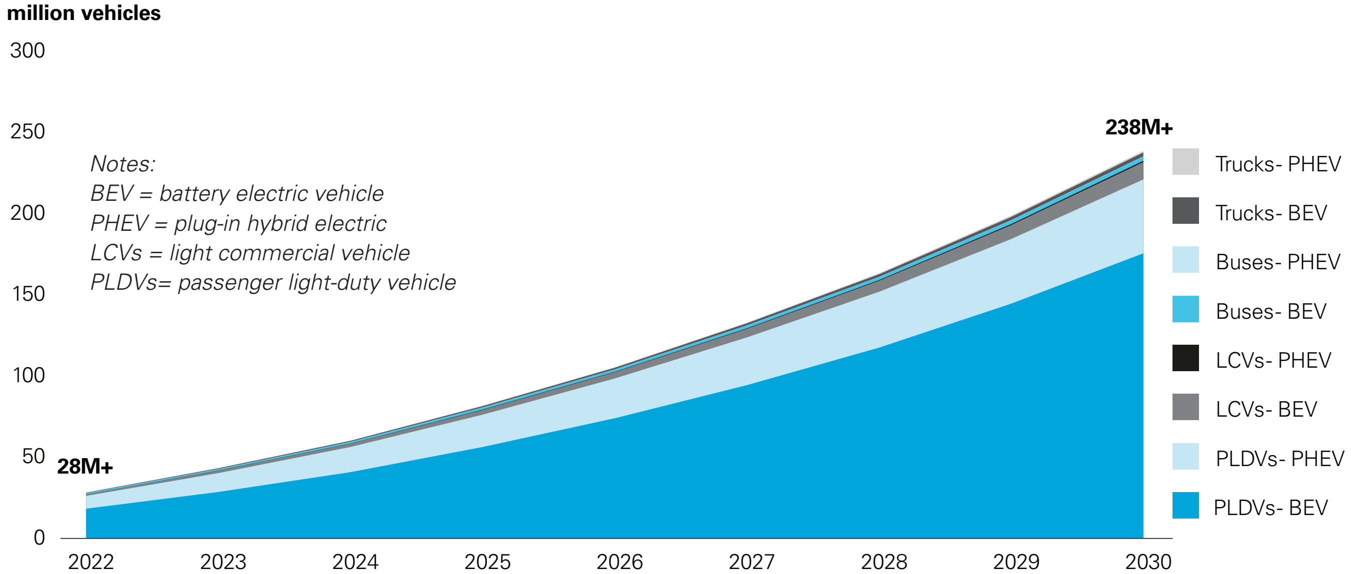
National policies also segment markets. Members of the lithium "quad" in Latin America are taking

Project pipeline in lithium quad as of 2023



Source: Fitch Solutions

Stock of EV by type based on current policies in 2023



Source: IEA

Closeup of
cylindrical batteries

different approaches in hopes of securing more investment into lithium mining and refining projects, offering real-time case studies for miners and businesses navigating political risks and volatile markets. In each case, pressures to localize more of the lithium value chain after extraction, tax from national resource wealth, and the growing importance of preferential trade access to large export markets are changing how miners and new market entrants assess the value and prospects of developing new mines, refining facilities and cathode plants for battery supply chains in the region.

CHILE: THE REGION'S LITHIUM LEADER

Among the quad, Chile has the largest, most established lithium sector. The massive increase in prices seen last year coincided with the beginning of newly elected president Gabriel Boric's term.

Last April, Boric's government launched a "soft" nationalization program requiring lithium miners developing new projects to partner with and cede a majority share to Codelco, Chile's state-owned copper miner. Existing contracts for projects owned and operated by SQM and Albemarle, the two existing operators, are exempt until they expire in 2030 and 2043 respectively, introducing a significant degree of uncertainty over renegotiation. Since lithium is considered a strategic resource in Chile, the state will maintain an active role in its development.

In May of this year, the government also raised royalties on copper and lithium miners, raising the maximum tax burden from 44 percent to 47 percent as well as a 1 percent ad valorem tax on any operations producing 50,000 tonnes or more, and an additional tax of 8 percent to 26 percent on earnings linked to miners' operating margins. Depreciation as well as supply and work costs are taken into consideration for tax purposes.

Miners have broadly responded to the hike by lobbying for faster permitting times. At the time of writing, talks with Chilean lawmakers continue. New regulations also mandate all lithium projects use direct lithium extraction (DLE) techniques to minimize their water consumption extracting lithium from brine, adding a degree of technical difficulty for new projects.

Though these policies may reduce investment, they exploit the geopolitics surrounding critical minerals to bolster Chile's competitive position. The Inflation Reduction Act (IRA) provides tax credits to consumers purchasing cars with batteries using mineral inputs from the US or any country with which the US has a free trade agreement (FTA). Recognizing the crucial role Chile plays on the copper and lithium markets, the US Senate ratified a US-Chile tax treaty that has languished for more than a decade to limit the withholding taxes paid by US investors and companies investing and operating in Chile. The ongoing process to ratify the treaty and parallel efforts to deepen Chile's deep and comprehensive free trade agreement (DCTFA) with the EU underscore the importance of trade and interstate agreements for the economics underpinning critical minerals projects.

Chinese companies have similar cause to re-examine additional investments into Chilean lithium projects to ensure they retain their competitiveness and ensure the eligibility of their products for IRA tax credits. Chinese firms already have a presence in the sector, as SQM is 23.8 percent owned by Tianqi. EV automaker BYD has begun engineering works to construct a US$290 million lithium cathode factory, building on a prior tender from last year to stand up a brine extraction operation. The project would allow BYD to export into the US market while helping Chile retain more of the value chain.

In short, the current Chilean government is betting that the demand and importance of lithium for the energy transition coupled with its market position and trade relationships give it more latitude to raise taxes and place key projects under state control.

ARGENTINA: THE MARKET-LED MODEL

By contrast, Argentina is using a decentralized, market-led model to develop its lithium sector. Every province of Argentina has the constitutional authority to regulate and tax its own natural resource

General tax provisions affecting metal mining investments

	Mining royalty on revenues or profits[1]	Corporate income tax rate	Sales tax on capital purchases[2]	Real estate transfer tax	Capital asset tax[3]	Gross receipts tax	Financial transaction tax
Argentina	3%	35%[4]			0.75%	1%	1%
Bolivia	3-6%	40.9%					0.3%
Brazil	2-3%	34.%	8%	4%		2.48%	1.5%
Chile	14%*	27%[4]					
Colombia	5-12%	30%[3]		7.93%		0.75%	0.4%
Domincan Republic	5%	40%		3%			
Guatemala	1%	25%		3%	0.9%		
Guyana	5%	25%					
Mexico	7.5%*	30%[4]					
Peru	20.4%*	29.5%		3%			
Suriname	6.5%	36%					

Source: Data compiled from government sources by authors (see Data Appendix).

*Notes: * All royalties are revenue-based except for profit-based ones indicated by.* Top rates are used for profit-based royalties and company income taxes.*

1 Non-refundable VAT and other sales/excise taxes.

2 Excludes a capital tax that operates as a minimum tax under the company income tax.

3 Inflation adjusted. Note that the Dominican Republic only has partial indexation applied to capital gains and depreciable assets.

4 In 2022 Colombia raised its company income tax rate to 35 percent instead of reducing the rate from 31 percent in 2021 to 30 percent as planned. The simulations below use the 30 percent rate.

Source: "Taxation of the Mining Industry in Latin America and the Caribbean: Analysis and Policy", Inter-American Development Bank IDB, 2023

wealth. Unlike Chile, the sector is also unconsolidated, with 17 lithium miners, including Livent, Rio Tinto, Ganfeng Lithium and Albemarle operating in-country.

Effective tax rates on projects are lower than in Chile, with income taxes set at 35 percent, VAT at 21 percent and gross revenue royalties of 2 to 3 percent. Crucially, the national investment law in Argentina stipulates that fiscal agreements for projects are ensured for 30 years from the day a feasibility study is submitted, with the lone exception being any changes to VAT. The law also limits any provincial government's ability to raise royalties.

The devolution of regulatory and tax powers to provinces have led to mixed outcomes. For example, recent regional constitutional reforms undertaken by the government in the Province of Jujuy have triggered significant protest from the region's indigenous population because of changes that would permit miners to proceed with projects on or affecting indigenous lands after three weeks of public comment and debate. Justice minister Martín Soria requested the Supreme Court strike down the reform in June due to indigenous concerns, an issue that remains outstanding.

As the presidential election heads to a runoff on November 19, there is as yet no clear frontrunner but Peronist candidate Sergio Massa, Argentina's current Economy Minister, outperformed expectations receiving 36.6 percent of the vote in the first round leading far-right populist Javier Milei and the conservative former Security Minister Patricia Bullrich who received 29.9 percent and 23.8 percent of the initial vote respectively. Massa has pledged to lead a national unity government should he clear the 40 percent threshold and achieve a 10 percent lead over his competitors in the next round. Whatever shape the new government takes, it will face significant challenges taming inflation and managing the Argentine peso amid sky-high inflation and interest rates, ongoing devaluation and high inflation. Thus far, the state regulates lithium like any other metal and has not labeled it a strategic resource. This could change in the future by necessity depending on the approach to macroeconomic stabilization adopted after the elections.

US$ 4.7tn

The combined GDP of Brazil, Argentina and Chile on a PPP-adjusted basis is in excess of US$4.7 trillion

Even with these constraints, Argentina maintains a healthy pipeline of new lithium projects. Trade agreements similarly boost the attractiveness of the country's projects. Argentina has a standing FTA with the EU through its membership in Mercosur. Although there is not yet an FTA between the US and Argentina, officials have consistently argued that the existing trade and investment framework agreement (TIFA) meets the criteria established in the IRA's text, a condition that could similarly be met through a new bilateral trade agreement negotiated by the US executive branch through the USTR and US Commerce Department. Ongoing negotiations between the EU and Mercosur could also boost the competitiveness of projects to supply European markets, as well as encourage miners to localize refining and cathode production since the quality of lithium hydroxide can vary due to degradation over long sea voyages.

BOLIVIA: THE ODD MAN OUT

Bolivia has historically been the odd man out in the region, despite possessing some of the world's largest lithium reserves, though they may be eclipsed by a recent discovery in the United States. Lithium was declared a strategic resource and national priority in 2008 in Bolivia, launching a process whereby all pilot projects and lithium extraction would be state-run. Public-private partnerships would then be used to produce and commercialize battery metals, allowing the government and national mining arm Yacimientos del Litio Boliviano (YLB) to access international expertise and funding.

Prior to 2023, little progress was made in developing projects in Bolivia. That changed in the past ten months as firms look to secure new long-term supply: China's Citic Guoan Group and CATL have won contracts to develop projects with YLB, with CATL reportedly committing US$1.4 billion to its project. Both projects entail standing up DLE plants. Additionally, YLB signed a lithium agreement with Uranium One Group, a subsidiary of Russia's state-owned nuclear giant Rosatom. However, none of these companies have successfully deployed DLE elsewhere, and western offtakers are unlikely to buy any products sourced from a Russian state-owned enterprise given reputational and sanctions risks. Bolivia has yet to be fully incorporated into Mercosur and lacks an FTA with the US, but it does maintain a complementary agreement with Mexico reducing tariff barriers to potentially sell lithium hydroxide or cathodes into the USMCA trade area.

In Bolivia, the national approach to sector development remains state-led, with some similarities to Chile. However, the lack of clear trade advantages and limited expertise and experience within the government and state-owned enterprises to operate and financially manage mining operations pose significant challenges. Should lithium prices significantly increase again, it could encourage the state to take a more aggressive position negotiating transfers of IP and know-how until it can reduce or displace foreign investment into the sector. Even with the spurt of development, Bolivia's lithium sector will likely lag behind its neighbors.

BRAZIL: THE NEW KID ON THE LITHIUM BLOCK

In the past two years, Brazil has become a fast-growing source of additional supplies of lithium to the market. Bowing to market realities, the government issued an executive order in 2022 exempting lithium exports from an approval process run by the Science and Technology Ministry's nuclear energy committee to facilitate more investment.

Although president Lula da Silva's election victory last year prompted concerns of heightened resource nationalism risks, the government has adopted an investor-friendly approach modeled on Australia, looking to speed up permitting processes to draw in more investment while committing to ensure stability for investment agreements and simplifying regulations where possible. However, a complex tax system, lack of tax incentives for mining projects and considerable litigation risks from notoriously arduous labor laws and regulations pose challenges.

Brazil's lithium sector is centred in Minas Gerais, a region with many large iron ore projects. The regional government has similarly pledged to support private firms to access to the infrastructure, energy and labor needed through the regional investment and trade promotion agency. Brazilian projects extract hard rock spodumene rather than the brine found in the Atacama Desert and benefit from the wide array of extant mining activity taking place in Minas Gerais. This reduces the technical complexity and, in some cases, the capex intensity of new projects, lowering the barriers to entry for small and mid-sized miners looking to develop prospects.

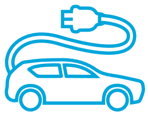
Trade is again a key feature of Brazil's approach to sector development. As a member of Mercosur, Brazil already has preferential access to the EU. Though there is no US-Brazil FTA in effect, the two countries have signed a mutual recognition agreement allowing Brazilian exporters certified as authorized economic operators to meet the standards of the US Customs-Trade Partnership Against Terrorism program, reducing inspection times and customs requirements to enter the US market.

There is little impetus to reach an FTA with the US given the limited upside to the Brazilian economy, but ongoing diplomacy between the two countries concerning forestry and carbon sink management, and similar ecological and environmental issues leaves the door open to a later agreement similar to what Argentina is pursuing for IRA eligibility.

THE GREAT LITHIUM GAME

The demand for lithium is intense, with demand consistently beating expectations since the pandemic began. According to the International Energy Agency, less than 5 percent of cars sold globally were battery electric vehicles (EVs) or plug-in hybrids in 2020. Three years on, this proportion is expected to reach 18 percent in 2023, and as much as 60 percent by 2030. OEMS have scrambled for supply over the last two years. They lack confidence in

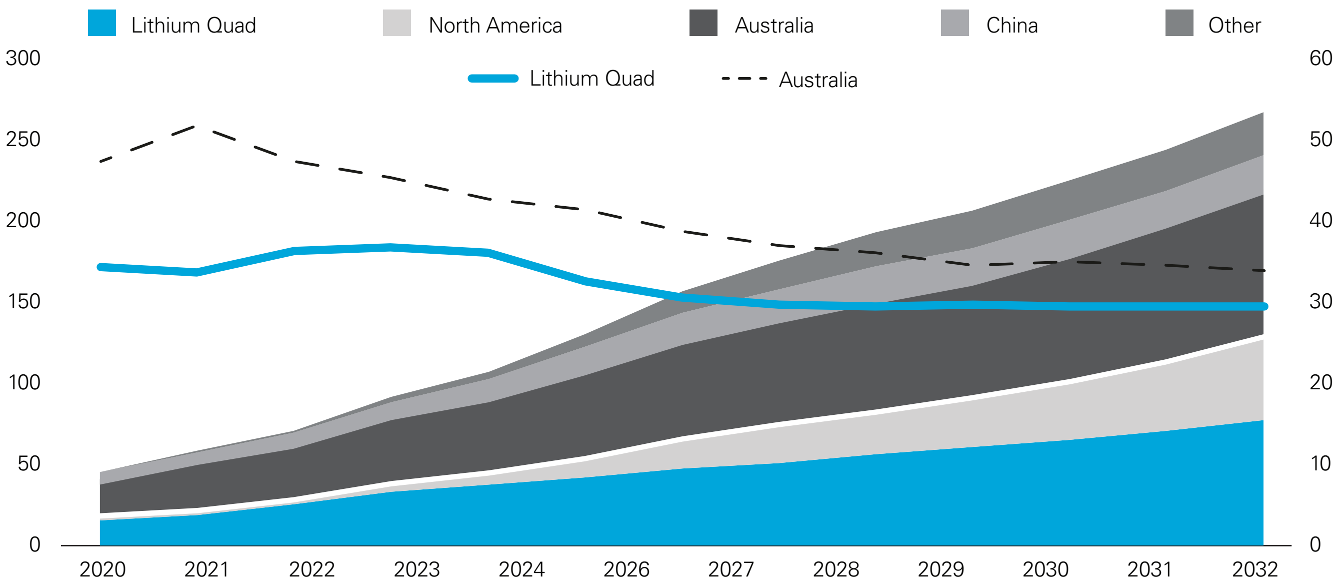
> **What sets the lithium boom apart from traditional commodity boom-bust cycles is the degree to which the market is immature and national policies can create long-term competitive advantages**



60%

The share of EVs sold globally is projected to account for 60 percent by 2030

The Quad may lag Australia past 2030 despite immense resource wealth



Source: Fitch Solutions

the availability of feedstock, and seek to minimize their exposure to highly volatile, often opaque spot markets. Latin America's "lithium quad" is enjoying the benefits.

With markets concerned about the potential for large deficits of lithium supplies emerging in the next five years, projects everywhere draw interest. But every investment boom into new supply eventually falls back to earth as supply matches and then overtakes demand, forcing marginal producers with higher costs and fewer efficiencies across the supply chain to cut costs, borrow and expand, or otherwise fold and sell out of the market. These dynamics are further complicated for lithium because of the lack of an effective benchmark price or futures market, denying miners the ability to hedge against price volatility and locking them into pricing mechanisms negotiated directly with offtakers that can drive a hard bargain for firms desperate for financing. What sets the lithium boom apart from traditional commodity boom-bust cycles is the degree to which the market is immature and national policies can create long-term competitive advantages, including through the localization of processing and refining.

Each member of the quad has a different approach with different implications for miners as well as something many other emerging market exporters lack: large bases of domestic consumers. Brazil, Argentina and Chile comprise three of the four largest economies in Latin America with a collective GDP on a PPP-adjusted basis in excess of US$4.7 trillion. Even with its challenges attracting investment, Bolivia's GDP is greater than that of Zimbabwe and Namibia combined, two countries leading the way among other emerging markets for lithium supply growth. Localizing the production of lower-cost EV models and investments into energy infrastructure can help sustain interest in lithium projects even as each government seeks to leverage its resource wealth in different ways even as today's projects are for export.

Geopolitics are also central to understanding the drivers of risks and opportunities for businesses looking to invest. President Lula has expressed interest in pursuing a Mercosur-China trade deal after completing negotiations with the EU, a move that would create opportunities for Chinese firms to build new supply chains to sell to Latin American consumers. Chinese OEMs lead producing and selling smaller EV models that are selling at a discount of US$10,000 or more compared to Western equivalents. Chile's longstanding trade ties with the US are also cause for Chinese firms to invest before American, Canadian or European counterparts are willing to commit large amounts of capital in politically risky conditions.

Latin America's critical minerals future is bright. So long as demand continues to rise, investors and miners will look for opportunity. Members of the "quad" will have to adapt accordingly as exporters elsewhere find new ways of attracting investment, take advantage of new trade arrangements, or exploit other advantages, such as physical proximity to end-users.

> **"Geopolitics are also central to understanding the drivers of risks and opportunities for businesses looking to invest**

The authors would like to thank Nick Trickett for his contribution to the development of this article.

Airplane at sunrise

Navigating turbulence: Latin American airlines in chapter 11

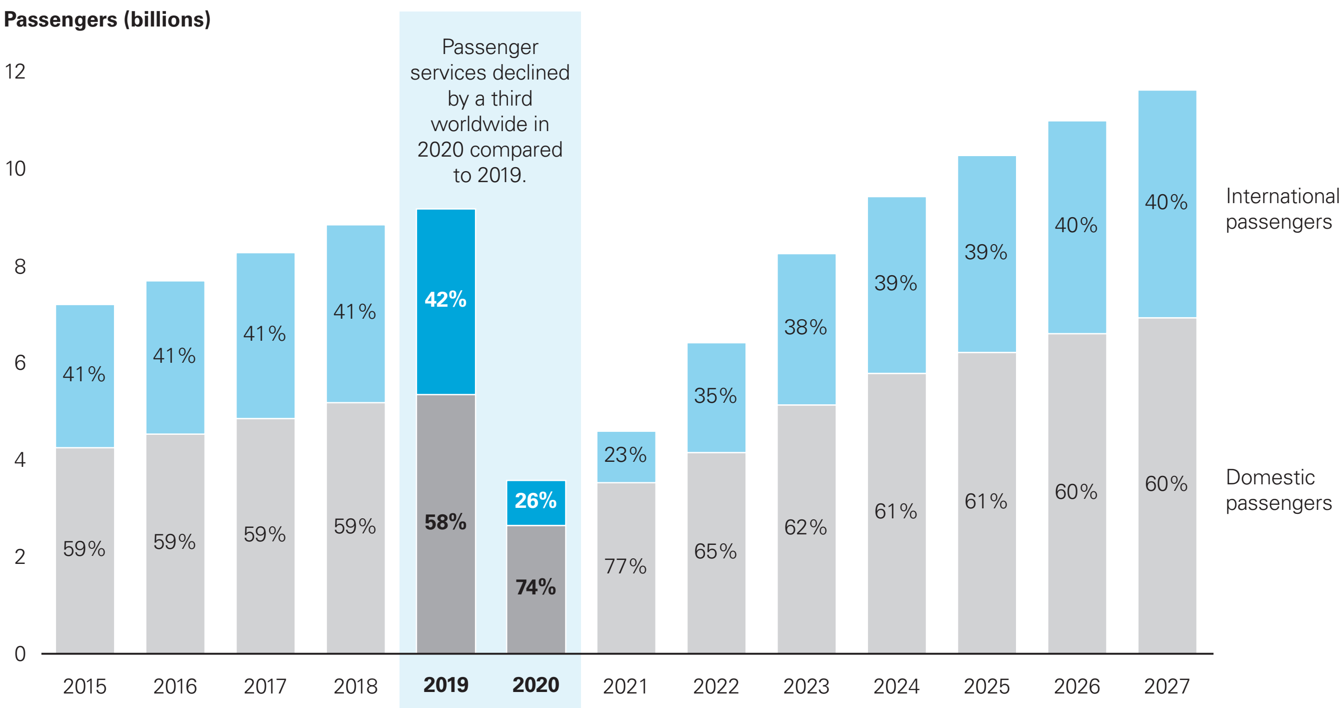
US chapter 11 is a powerful restructuring tool for foreign-based airlines, with effects across the globe. There can be little doubt that, as international companies continue to face financial distress, they will continue to turn to the benefits and protections of the US Bankruptcy Code for relief as **Todd Wolynski**, **Richard Kebrdle**, **Richard Graham** and **Claire Tuffey** explain.

Few sectors were more affected by the global COVID-19 pandemic than passenger air service. With countries around the world in lockdown, passenger services declined drastically—dropping by a third worldwide in 2020 compared to 2019, and almost halving in Latin America and the Caribbean, although the number of cargo flights rose slightly.

Passenger numbers between April and June 2020 were particularly impacted, with numbers for Latin America's biggest airlines plummeting from millions to just a few thousand in those three months compared to the previous year. International Civil Aviation Organization and ADS-B Flightaware data show revenue losses between 2019 and 2020 exceeded US$372 billion globally and US$21 billion in Latin America and the Caribbean.

> **Few sectors were more affected by the global COVID-19 pandemic than passenger air service**

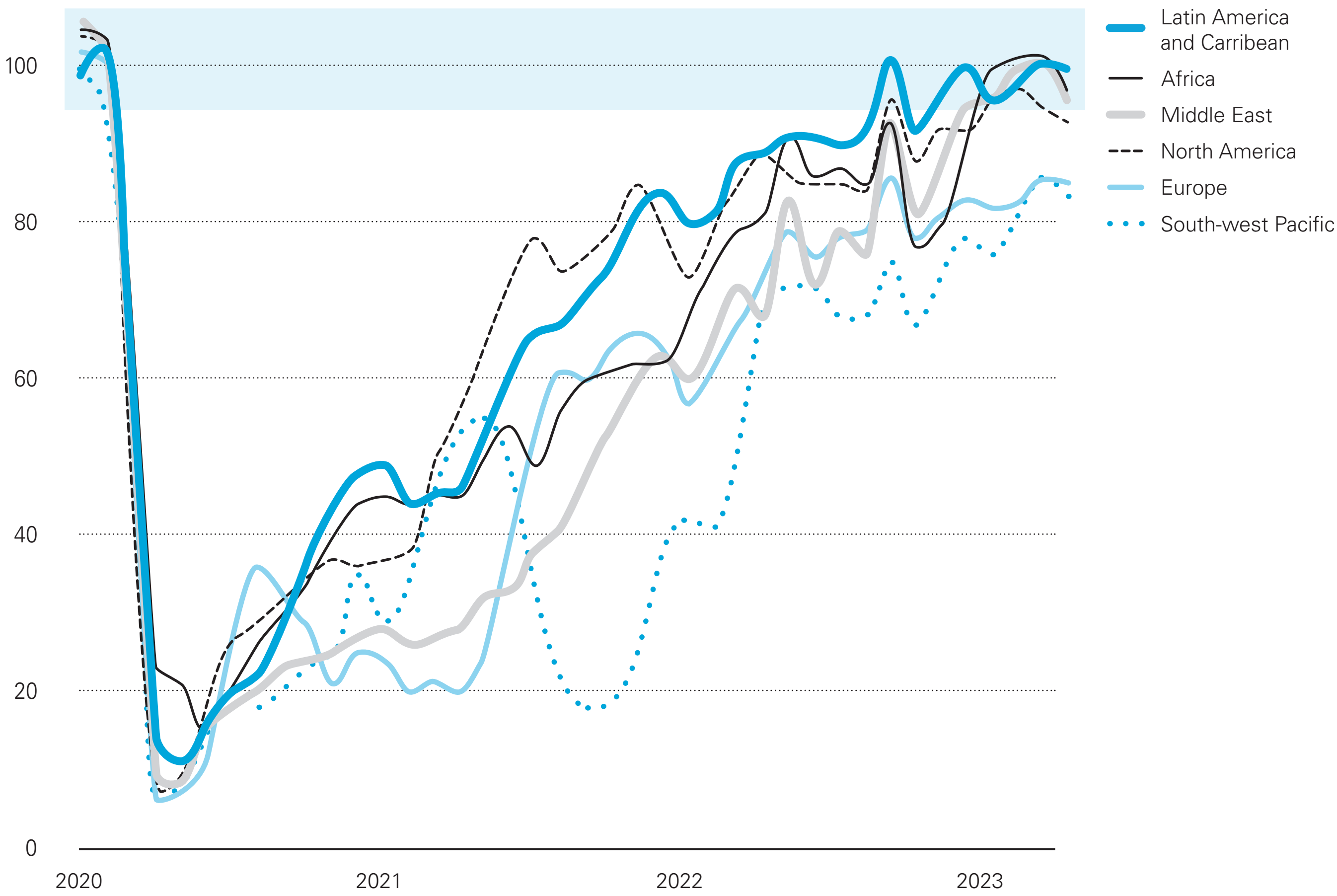
Medium-term global passenger traffic by type



Source: ACI World

Latin America, Africa and the Middle East have recovered to pre-pandemic passenger traffic levels

Revenue passenger kilometers (rebased to same month in 2019)



Source: Financial Times

In the wake of the pandemic, several foreign airlines have relied on chapter 11 protection in the US to restructure in lieu of local insolvency laws. Chapter 11 enables distressed companies to, among other things, restructure obligations, obtain new funding, renegotiate or reject leases and other burdensome contracts, abandon or sell assets, and stay enforcement actions both within and outside of the United States.

As recent airline cases demonstrate, these are powerful tools for financial and operational restructurings. Despite these benefits, however, proceeding under chapter 11 also presents distinct challenges for non-US carriers with international operations.

Unlike the US and countries in Europe, Asia-Pacific and other jurisdictions, which provided billions of dollars in grants and loans to their aviation industries, Latin American countries provided limited or no state aid to airlines to offset losses from the COVID-19 pandemic. As a result, many Latin American airlines, including Avianca, Aeroméxico and LATAM, have since filed for chapter 11 protection in the US.

WHY CHAPTER 11?

Chapter 11 provides useful tools that may not be available, or as tested, in other insolvency regimes, and which may be of particular interest to airlines in financial distress. These essential elements make it an attractive restructuring option for Latin America-based airlines.

ELIGIBILITY

The jurisdictional requirements for chapter 11 are easily satisfied.

US$21 billion

Revenue losses in passenger air travel in Latin America and the Caribbean exceeded US$21 billion between 2019 and 2020

A company may file chapter 11 as long as it owns some property in the US. There is no requirement that the company be domiciled or organized under the laws of the US or that it have significant business operations in the US. Therefore, all of the affiliated entities in a business enterprise regardless, of their jurisdictions—including offshore financing entities—can file together in one court before the same judge. Unlike many Latin American insolvency regimes, a voluntary chapter 11 filing does not require that the company be insolvent, but only that the company be experiencing financial distress.

That said, a chapter 11 petition may be subject to dismissal if filed in bad faith or if connections to the US are too remote to effectively implement reorganization under US law.

Passenger levels, thousands

Company	April–June 2019	April–June 2020	Percentage change
Avianca	7,548	21	(100%)
LATAM	16,875	640	(96%)
Aeroméxico	5,217	529	(90%)

Source: Eric Deichmann & Michael Oestreich, Case Study: Aviation

DEBTOR-IN-POSSESSION FINANCING AND NEW MONEY

A valuable tool in chapter 11 is the ability of a debtor to obtain financing while under bankruptcy protection under section 364 of the Bankruptcy Code—commonly referred to as debtor-in-possession (DIP) financing. DIP financing provides a company with sufficient capital to continue operating its business while it attempts to implement a restructuring. DIP financing often takes priority over existing debt and equity claims. Recent chapter 11 cases involving Latin American airlines have relied on DIP financing not only for new money, but also to keep existing shareholders in the capital structure.

WORLDWIDE AUTOMATIC STAY

Upon filing a chapter 11 petition, a statutory automatic stay takes immediate effect to enjoin substantially all creditor enforcement actions against the debtor and its property, wherever located, during the entire case under section 362 of the Bankruptcy Code. An automatic stay is not available in many Latin American jurisdictions, where local law often requires a court order to initiate a limited stay period that is effective only in that country.

Similarly, US bankruptcy protection also allows debtors to bind foreign creditors to the chapter 11 process. In the Avianca case, for example, the Bankruptcy Court imposed sanctions against more than 150 creditors who continued to litigate pre-petition claims in Colombia and Brazil one year after confirmation of the airline's chapter 11 plan. By filing proofs of claim in the chapter 11 cases, those creditors had submitted to the jurisdiction of the Bankruptcy Court. The court determined that it would conditionally disallow such claims unless the creditors discontinued their foreign lawsuits within 30 days of the date of the order.

TOOLS FOR FLEET RESTRUCTURING

Critical among the benefits of chapter 11, the Bankruptcy Code also enables an airline to right-size its fleet by eliminating burdensome aircraft-related debt obligations and exercising rights to purchase aircraft on favorable terms. Chapter 11 is particularly useful for fleet restructuring because aircraft lessors and other significant stakeholders are familiar with the process and many aircraft and engine leases, as well as debt agreements, are governed under New York law, and may include New York forum selection clauses.

Generally, section 1110 of the Bankruptcy Code provides special protections for lessors, vendors and secured parties holding interests in aircraft or associated machinery, such as engines, appliances, parts and related documents. These protections mitigate otherwise applicable provisions of the

Aircraft at dawn, São Paulo/
Guarulhos airport

Santos Dumont Airport in
Rio de Janeiro at night

Bankruptcy Code, thereby reducing the risks and lessening the financing costs associated with qualifying aircraft equipment.

Importantly, section 1110 applies only to chapter 11 cases of US air carriers and certain water carriers. Similarly, less robust relief may apply to air carriers in countries party to the Aircraft Protocol to the Cape Town Convention (CTC), if the carrier's home country, or "insolvency jurisdiction," has adopted the strong "Alternative A" insolvency provision of Article 11 of the Aircraft Protocol.

Although the US is a signatory to the CTC, it has not adopted Alternative A, and the relevant choice of law and treaty rules that would allow the application Alternative A in a chapter 11 case of a non-US air carrier has not been fully opined on by any US Bankruptcy Court.

In the case of Latin America-based airlines and other non-US carriers, aircraft lessors are arguably left only with the substantially weaker protections afforded by section 365(b)(5) of the Bankruptcy Code, which generally applies to all equipment lessors and offers less protection. Creditors with security interests in aircraft equipment may have no special protections at all.

In the face of such uncertainties, foreign-based airlines and their aircraft lessors and financiers often negotiate stipulations to provide some enhanced protection to lessors and secured parties pending ultimate determinations about whether aircraft leases and financing arrangements should continue post-bankruptcy and, if so, in what form.

Unfortunately for financiers and lessors of aircraft equipment during the COVID-19 pandemic, the ordinarily robust demand for such equipment largely disappeared.

1/3
Passenger services declined by a third worldwide in 2020 compared to 2019

As a result, most of these protections were of limited value because obtaining surrender of the equipment was no guarantee of a good recovery.

Given this lack of leverage, the stipulations negotiated during the pandemic provided for modified rent payments on a "power-by-the-hour" basis at new market rates, with certain additional payments for maintenance, so that the airline would have to pay only according to usage pending its decision to keep or reject each lease. If an airline decided to keep an aircraft, its lease terms could be renegotiated on market terms. Alternatively, if the aircraft was not needed or the lessor refused to renegotiate, the lease could be rejected and, if needed, replacement aircraft could be sought in the market, with lease rejection damages generally becoming unsecured claims against the bankruptcy estate. Other key agreements were similarly restructured to match changed capacity, including aircraft purchase agreements and associated maintenance contracts.

CONFLICTING LAWS IN CROSS-BORDER INSOLVENCY CASES

The chapter 11 cases of Avianca, Aeromexico and LATAM best illustrate many of the benefits of chapter 11, as well as the challenges and creative solutions that inevitably arise to resolve conflicts between the Bankruptcy Code and foreign local law applicable to foreign debtors. Fundamental among these conflicts is the tension between the absolute priority rule contained in the Bankruptcy Code on the one hand, and on the other, the exclusive right of existing shareholders under many foreign laws to approve the terms of, or participate in, or exercise preemptive rights in, a capital raise.

Under section 1129(b) of the Bankruptcy Code, a class of creditors or equity holders generally may not recover at the expense of a dissenting class of more senior creditors. Unless creditors are paid in full or agree otherwise, therefore, existing shareholders generally cannot retain value in a chapter 11 case.

Nevertheless, shareholders may buy back into the capital structure by providing new value on market terms. This type of equity conversion has featured prominently in foreign airlines' chapter 11 cases, with varying results. In Avianca and Aeromexico, for example, the debtors obtained approval of DIP facilities containing an equity conversion option—in the first case at the lenders' option and the second at the debtors' option. In Aeromexico, existing shareholders agreed to approve the capital increase required for the DIP conversion.

In LATAM, however, the Bankruptcy Court declined to approve a similar structure. Agreeing with the objections raised by the Ad Hoc Group of LATAM bondholders, who held New York law-governed notes, the Bankruptcy Court determined that LATAM's proposed equity subscription election gave rise to improper sub rosa plan treatment in violation of the absolute-priority rule. As initially proposed, the DIP facility included an equity conversion option, which was reserved solely for the tranche provided by shareholders in exchange for, among other things, a waiver of their preemptive rights under Chilean law to participate in any issuance of equity.

As proposed, the DIP would have provided new equity to existing shareholders at a pre-determined discount to plan value, and, because this discount applied regardless of the plan proposed by the debtors, controlled by the same shareholders, the DIP facility constituted a sub rosa plan. This is a rare instance of a US bankruptcy court denying a DIP financing request based on an illegal sub rosa plan, and the decision is expected to have a dramatic impact on future bankruptcy cases.

As demonstrated most recently in the cases of three of the largest airlines in Latin America, chapter 11 is a powerful restructuring tool across a variety of circumstances and with effects across the globe. There can be little doubt that, as international companies continue to face financial distress, they will continue to turn to the benefits and protections of the US Bankruptcy Code for relief.

Recent chapter 11 cases of Latin American airlines

In re Avianca Holdings, S.A., Case No. 20-11133 (Bankr. S.D.N.Y.), Colombian airline Avianca, the second-largest airline in Latin America, filed for chapter 11 on May 10, 2020, citing the pandemic and the Colombian government's shutdown of its airspace. Avianca's plan of reorganization was approved by all classes of creditors and successfully absolved approximately US$3 billion in debt, enabling the airline to infuse fresh capital amounting to approximately US$1.7 billion. It emerged from chapter 11 on December 1, 2021.

In re Grupo Aeromexico, S.A.B. de C.V., Case No. 20-11563 (Bankr. S.D.N.Y.), Mexico's flagship carrier and leading airline, filed for chapter 11 on June 30, 2020, and emerged on March 17, 2022. Through the chapter 11 process, Aeroméxico overhauled, updated and restructured its aircraft fleet, saving almost US$2 billion related to ongoing fleet obligations, and reached comprehensive settlements with all of its unionized labor groups.

In addition, the exit financing approved in the chapter 11 cases provided Aeroméxico with US$720 million of new equity capital through the issuance of new equity and up to US$762.5 million of new debt capital through the issuance of senior secured first-lien notes. The airline also financed a transaction by which the owner and operator of Aeroméxico's loyalty program became a wholly owned subsidiary of Aeroméxico.

In re LATAM Airlines Group S.A., Case No. 20-11254 (Bankr. S.D.N.Y.) commenced chapter 11 proceedings on May 26, 2020. Seeking to restore operational stability, the debtor group sought approval of US$2.45 billion in DIP financing, with a significant portion—US$900 million—to be provided by its largest shareholders, who received a lucrative option to convert their debt into shares of the new LATAM.

A group of LATAM creditors objected to this arrangement. They engaged in a week-long hearing, after which the court ruled against the proposed equity value transfer to existing shareholders.

Subsequently, LATAM introduced a modified DIP financing proposal that was uncontested and successfully secured approval on September 17, 2020. In April 2022, when the debtors sought to extend or refinance its US$2.45 billion DIP facility, members of the bondholder group committed to providing the debtors with more than US$400 million on a junior basis as part of a new DIP Facility. Junior creditors contested the claims held by the senior bondholders, but on the eve of the confirmation hearing, these objections were settled, and the bondholder group received payment in full, plus reimbursement of their expenses.

On November 3, 2022, LATAM Airlines Group officially exited bankruptcy protection following the successful completion of its financial restructuring to emerge as a more efficient group with a modernized fleet, a strengthened financial position of more than US$2.2 billion of liquidity and US$3.6 billion or 35 percent less debt.

Mata Atlântica,
Brazil's Atlantic Forest

From crisis to resolution: The evolving landscape of ESG arbitration in Latin America

Rafael Llano, **Francisco Jijon** and **Marièle Coulet-Diaz** explore the growing influence of ESG in the Latin American arbitration landscape, how it is disrupting the nature of international disputes and highlight the delicate balance between long-term investment goals and three key areas: environmental protection; social responsibility; and governance.

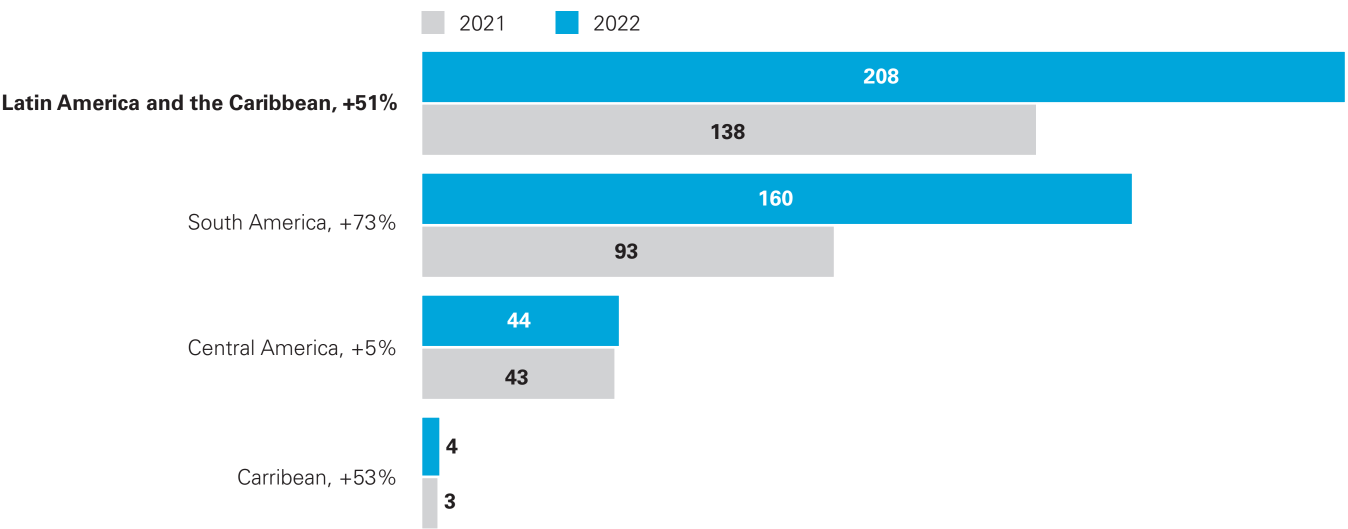
Latin America is at a pivotal moment. While the COVID-19 pandemic caused diverse impacts on investment and long-term concessions in Latin America, the region rebounded successfully with overall investment rising by 50 percent in 2022. Foreign investment is critical to economic development in Latin America, including through investments related to long-term state contracts or concessions in sectors such as energy, infrastructure, public utilities and transportation. At the same time, Latin America is also facing new challenges, related to these critical investments, at the heart of which are environmental, social and governance (ESG) concerns.

While ESG concerns are increasingly driving societal expectations as to sustainable and responsible investment practices, reshaping the global regulatory and investment environment, they are also an emerging battleground for international disputes.

> “Stakeholders in Latin America must navigate a delicate balance between the promotion of investment and the environmental and social impact that such investments may have

Foreign direct investment grows in Latin America and the Caribbean

By subregion, billions of dollars, percent



Source: UNCTAD

BALANCING MACROECONOMIC DEVELOPMENT WITH ENVIRONMENTAL AND SOCIAL IMPACT

Since the end of the Cold War, the Washington Consensus served as a guiding principle for development and investment in Latin America in response to the macroeconomic crises in the region of the early to mid-1980s.

Over decades, Latin American states sought to induce investment in their economies across key sectors through diverse means, including by developing robust legal frameworks designed to attract and protect foreign investments. In this context, Latin American states signed more than 700 investment treaties with foreign states promising to provide varying standards of protection to foreign investors. These typically include fair and equitable treatment, non-discrimination and legal expropriation. Investment treaties also provide that, if the host state fails to afford the committed protection, investors can bring investment arbitration claims against the state to seek reparation.

In recent years, however, the dynamics of globalization evolved significantly. In the context of a broad debate against globalization, Latin American governments have increasingly adopted laws and regulation to protect the environment and combat climate change. For example, in 1991, Colombia approved a new constitution, which enshrined the right to a healthy environment and confirmed the state's duty to "guarantee" sustainable development and "prevent and control" environmental degradation. Similarly, in 2008, Ecuador adopted a new constitution that, among other things, included various environmental protections, including becoming the world's first constitution to enshrine a legally enforceable right to nature.

ESG as emerging battleground for international disputes

Environmental: Latin America is host to nearly half of the planet's biodiversity, as well as a wealth of natural resources. Latin American economies historically have relied on extractive industries, and meanwhile remain the second most vulnerable region to climate consequences in the world. Governments and investors in the region now face a tension between the need to protect the region's ecosystem and attract new investments (while maintain existing ones), which is expected to intensify as environmental concerns gain momentum.

Social: Investment in Latin America often flows to big infrastructure and to extractive industry projects. These sectors, in particular, often have significant impacts on the community and environment of the area in which they are located. Moreover, Latin America's heritage, including indigenous cultures, colonial legacy and struggles for independence, adds context that may affect business operations in the region. Tensions have arisen between the protection of local/indigenous communities' rights and the protection of the rights of investors who have invested in projects located in areas where such communities are present. These tensions are expected to increase as policies and legal mechanisms are developed to protect minority rights.

Governance: Over recent years, Latin American countries have been at the center of a series of complex governance scandals that impacted the established political order and assumptions and triggered a regional crisis. The region's endemic challenge of corruption and related threats to democracy and the rule of law were magnified by the COVID-19 pandemic and a wave of political polarization and resistance to globalization, putting the region at the forefront of political governance risks. To ensure long-term stability, investors must carefully consider and manage corruption risks in assessing their investment opportunities.

NAVIGATING COMPLEXITY

Environmental issues can be fraught with controversy. Even where there is a consensus as to the importance of environmental protection, disagreements arise as to the appropriateness of environmental protection measures, how the regulatory framework is or is not applied, or how risks are allocated among different actors. Stakeholders in Latin America must navigate a delicate balance between the promotion of investment and the environmental and social impact that such investments may have.

Various tools have emerged to reduce uncertainty. For example, by granting legal stability guarantees, states undertake to maintain the existing legal and regulatory regime applicable to a particular investment or compensate investors for the economic consequences of future changes to that framework. Investors and local communities can also agree to a social license, whereby they establish conditions to undertake a project sustainably.

Mitigating the risks of future disruption can facilitate investment and create a framework for resolving disagreements. On the other hand, such efforts can also create complexities and disagreements as to the scope of stakeholder obligations. For states, limitations on regulatory powers may be unwelcome, and tensions can arise when a government disagrees with the policies of its predecessors or communities. For investors, this can mean extra layers of political risk.

INTERNATIONAL DISPUTES

Where differences arise that cannot be resolved amicably, international investors potentially have access to different investment protections that may be set forth in applicable laws, contracts and investment treaties. Many Latin American states established such frameworks to attract foreign investment, and these can be instrumental in establishing the scope of an investor's rights as well as providing a mechanism for resolving investment disputes.

As regards investment treaties, for example, investors may sometimes be able to bring international claims against a state that they consider to have breached its undertaking to treat their investment fairly and

Blue Island,
Punta Rucia,
Dominican Republic

equitably, non-discriminatorily and to refrain from illegal expropriations, among other standards. Claims also can be brought for the acts of local officials that can be attributed to the state. Thus, investment arbitration can be a potent dispute resolution mechanism with international arbitrators capable of adjudicating whether states are liable to investors in connection with environmental measures.

Some investment treaties specifically contemplate the possibility of disputes arising in connection with environmental measures, and some have included general provisions addressing the limits of the state's liability. While the scope and drafting of these provisions differ across treaties, tribunals have found they are not intended to provide states with carte blanche to renege on their other obligations under said treaty, including the investment protections granted to foreign investors.

States involved in investment arbitrations also have used environmental protection arguments to justify particular policies and measures against investor claims. For example, states have argued that measures were necessary to safeguard its essential interests against a grave or imminent peril, among other defenses. Investors in such cases may make arguments about the reasonableness of the state's conduct and whether it was pretextual, overbroad or discriminatory, which the tribunal will have to consider.

On the other hand, some states have sought to take advantage of disputes under investment treaties to bring counterclaims alleging violations of environmental obligations by the investor; indeed, this has been attempted even in cases that did not initially appear to relate to environmental issues. For example, in one case arising from an investment in the hydrocarbon sector, the state counterclaimed that the investor had caused significant environmental harm, among other things, in breach of domestic environmental law, for which the tribunal ultimately found the investor liable. Whether arbitral tribunals have jurisdiction over such counterclaims remains controversial, with tribunals reaching conflicting decisions.

THE BALANCE BETWEEN LONG-TERM CONTRACT CONTINUITY AND INSTITUTIONAL CONTROL

Governance and lack of business integrity have posed a major challenge to investors, especially in developing markets such as Latin America. As international observers note, the challenges associated with corruption—including, among others, democratic decline, increased investment risk, lack of legal certainty and protection, and an unpredictable regulatory environment—impact investment decisions, business operations, and long-term stability and growth. They also exacerbate political polarization and popular distrust of the government, providing a breeding ground for extreme leaders to turn the situation to their advantage, often at the expense of the rule of law and democratic institutions.

As Latin America continues to attract foreign investment, investors considering opportunities in the region should carefully assess investment risk associated with corruption in these markets, and whether they may be entitled to the investment protection framework afforded by investment treaties.

ENDEMIC CHALLENGES

Latin America has been a region historically marked by cycles of nationalization and privatization. With the return of many Latin American countries to nationalist economies, threats to assets acquired by foreign investors loom in the horizon. Political transitions may also lead to "witch-hunts" against good faith investors that have acquired the business of predecessor companies under investigation. In the context of a political transition, an investor can protect its investment with a prudent contingency plan (including structuring foreign investment protections for any potential treaty dispute) while

50%

FDI in Latin America rose by more than 50 percent from 2021 to 2022

Avenue Paulista,
São Paulo, Brazil

maintaining operational and commercial progress.

To maximize the long-term success of the investment across political transitions, and to manage near-term challenges, investors should seek investments with solid fundamentals in the country such as those anchored in long-standing legal and economic frameworks. Some long-term assets present lower risks because they are backed by strong economic and regulatory frameworks.

Governance risks can be managed preventively at the outset of an investment, and as part of the legal strategy to protect the investment in an arbitration and after an award. A proactive approach to addressing governance issues, considering the strategic observations mentioned below, is central to avoiding disputes related to corruption allegations.

Investors who put the right level of emphasis on these risk factors from the outset of a transaction usually achieve the best outcomes, both in the transaction itself and in protecting long-term assets during its operation. Arbitration is deeply entrenched in the private and public sectors and is a key mechanism for international disputes arising out of unfolding transitions in the region, including in the face of corruption scandals.

PREVENTATIVE STRATEGY

Implementing an anti-bribery and corruption compliance framework, including through thorough due diligence, regular trainings and controls, is crucial to managing "governance" investment risks. These risks could exist both in the original investment of the predecessor company or arise during the operation of a new or preexisting investment.

There are several steps companies can take when structuring their investment to ensure its international protection. Legal due diligence at the outset of the investment may play a critical role in the investment's future operation to evaluate the risk profile of the investment target, identify "black spots" and mitigate liabilities, and help bring assets to a higher level of governance to ensure stability over the long term. Purchasers of existing investments may include contractual protections in deal documents to limit their liability for pre-acquisition risks.

Investors may also secure the protection afforded by international investment treaties (such as bilateral treaties and regional treaties signed by the country hosting the investment), which may grant foreign investors a series of rights aimed at protecting their investments and afford them access to international arbitration to resolve disputes against host states. Some investment treaties contain provisions that condition the protection afforded in the treaty to the investment's compliance "with the host state's laws" or "in accordance with the laws and regulations" of the host state. While there is no unanimous approach, these provisions have been understood to limit the scope of application of the investment treaty and the state parties' consent to arbitration to "legal investments," thereby excluding "illegally acquired assets that are not considered to be an investment."

Due diligence and a compliance framework may not eliminate corruption-related risks. But applying international corporate best practices and retaining specialized external advisors, including local counsel, can prove critical to deter unfounded corruption challenges, or otherwise structure a strong defense, as they help establish the investor's diligence and reasonable expectations at the time of making the investment.

INTERNATIONAL DISPUTES

Recent international disputes have been enlightening for democracies in Latin America. Issues of illegality and corruption are attracting increased attention in the landscape of Latin American arbitration, with greater regularity today than ever before. The delicate relationship between foreign investment, corruption risks and international arbitration has come under more scrutiny over past years, as there is a surge of new international disputes—encompassing both commercial and investor-state arbitration scenarios—where allegations of corruption constitute a key element into which arbitrators need to delve.

700

Latin American countries signed more than 700 investment treaties with foreign states

Allegations of corruption can impact international arbitration disputes at two main stages: by prompting a determination from the arbitrators on corruption allegations, thus requiring them to investigate possible acts of corruption; or after the arbitration proceeding has concluded and an award has been rendered, and the corruption allegations are raised in order to seek to avoid recognition and enforcement of an award.

The increasing importance of corruption in the context of international disputes raises key questions, including as to whether an arbitral tribunal should investigate suspicions of corruption that may affect the parties' claims in the absence of a request of a party to do so; the level of evidence required to demonstrate corruption in international arbitration; and the effect of a finding of corruption on a contractual or investment arbitration claim.

While corruption may be easy to allege in international arbitration—as well as in other settings—it remains difficult to prove, as there will hardly ever be direct evidence. Various "red flag" lists with indicators of illicit conduct deployed by business organizations, international bodies, non-governmental organizations, and academia have been tailored and adapted in the context of international arbitration proceedings. If fundamental or multiple red flags are present that raise a suspicion of corruption, arbitrators increasingly take a closer look to establish whether corruption was present.

Preventive actions, including legal due diligence with a focus on corruptions risks, can help an investor defend its investment against allegations of corruption, including as a response by a state or state entity faced with international claims. Depending on the stage and circumstances of the case, a finding of corruption by the arbitral tribunal could result in the tribunal lacking jurisdiction, the claims being found inadmissible or denied on the merits, or an award being set aside.

The authors thank partner Jonathan C. Hamilton and associates John Dalebroux and Alejandro Martinez de Hoz for their valuable contributions to this article.

WHITE & CASE

whitecase.com