JONES DAY | One Firm Worldwide®

A publication jointly authored by the lawyers of Jones Day and Bofill Mir Abogados.

WHITE PAPER

August 2022

Chile's Proposed Constitutional Changes to Natural Resource Rights Could Have Devastating Effects on Foreign Investors: How Can International Law Protect Them?

Chile is currently considering a new Constitution—due to be put to a referendum in September—and foreign investors should be aware of its potential impact on their investments in the country. The proposed changes in the draft Constitution could reduce compensation awards for expropriated property, alter water rights, and freeze mining concessions. The draft would also grant wide discretion to the country's courts by allowing judges to decide on the amount of compensation owed for expropriated property. As to changes in the regulation of natural resources—if the draft is approved, the government would authorize only noncommercial water use and could institute a freeze on the granting of new mining concessions.

Given this uncertainty, foreign investors should prepare for potential litigation, build political capital with local communities, and consider available international treaty protections to safeguard their assets.

INTRODUCTION

Chile is currently considering a new Constitution, and foreign investors should take note. The proposed changes could, among other things, reduce compensation awards for expropriated property, alter water rights, and freeze mining concessions. These changes respond to public demand for more environmental, social, and governance ("ESG")-based policies; however, they may also clash with assurances given to investors.

This *White Paper* describes the proposed changes to the Constitution and suggests proactive steps investors can take to protect their in-country investments.

FACTUAL CONTEXT

The current version of the Chilean Constitution was adopted in 1980. It was amended for the first time in 1989 (via a referendum) and then again on more than 20 occasions from 1991 through 2021. The three most recent reforms (2019, 2020, and 2021) were carried out to facilitate the work of the current constitutional convention.

Following violent protests on November 15, 2019, several political parties signed the "Agreement for peace and the new Constitution."[1] This stipulated that a national referendum would be held to afford Chileans an opportunity to approve or reject a new constitutional text, to provide a mechanism pursuant to which it would be drafted, and to choose its framers. For this purpose, amendments to the current Constitution were enacted, modifying Chapter XV (which addresses the procedure for constitutional amendments), through the publication of Law 21.200 on December 24, 2019.[2]

The promised national referendum was subsequently held on October 25, 2020 (the "entry plebiscite"), which included two separate votes. The first was intended to decide whether a new Constitution should be drafted. The second offered voters two options regarding the body that would draft the new text, either: (i) a "Constitutional Convention" made up of directly elected citizens; or (ii) a "Mixed Constitutional Convention," made up of an equal number of interim members of Congress and directly elected citizens. In the end, 78% of voters approved the proposal to draft a new Constitution and create a "Constitutional Convention" made up of 155 citizens and no members of Congress. Following this majority decision, an additional election was held on May 15 and 16, 2021, to choose the members of the Convention.

The Constitutional Convention commenced work in July 2021, with a deadline to complete its task by July 5, 2022. The Convention started with a "blank sheet of paper," giving no consideration to the Constitutional norms currently in force. However, Chile's decision to implement an institutional process created certain limitations for the Constitutional Convention. The first is that newly drafted articles must be approved by two-thirds of the members of the Constitutional Convention. The second is that the new text must respect Chile's republican form of government and democratic regime as well as guarantee compliance with final court rulings and ratified international treaties currently in force. In addition, the powers of the Convention are limited to the drafting of the new Constitutional text. In the meantime, Chile's Congress and other government institutions continue to exercise their powers as usual.

On May 14, 2022, the plenary of the Convention concluded its discussions regarding the content of the new Constitution, and the first complete draft was published.[3] After that, the harmonization and transitory rules commissions finalized the document, and it was publicly presented to the President of the Republic on July 4, 2022.

As a final step, a new national referendum will be held on September 4, 2022 (the "exit plebiscite"). As before, voters will be given two options: either approve or reject the new Constitution. Voting in this national referendum is mandatory. If the final referendum rejects the new text proposed by the Convention, the current Constitution will remain in force.

MAIN CHANGES RELATED TO NATURAL RESOURCES IN THE NEW CONSTITUTION'S TEXT

Expropriation

The proposed text raises concerns regarding the new payment regime for regulatory takings or expropriations.

Previous Payment Regime for Expropriation. The current Constitution provides, at article 19, N°24, third paragraph, that any person who is subject to an expropriation has the right to be compensated for the property damage effectively caused. This must be determined by agreement between the State and the expropriated party or via a court decision. Additionally, such payment shall be made in cash when there is no agreement.

Proposed Payment Regime for Expropriation. The draft of the new Constitution modifies the above-described compensation regime for expropriation. In this regard, article 78 provides that: (i) the compensation paid will no longer equal the property damage effectively suffered by the expropriated party, but rather will provide compensation only for what the new draft refers to as a *fair price*; and (ii) payment of any compensation must be made before the taking of physical possession, but the draft allows the government to pay it after it has legally taken the property.[4]

This proposed change raises the following concerns:

- The compensation paid could be lower than the property damage effectively caused.
- The new rule grants too much discretion to the courts; it does this by allowing judges to conclude that the compensation owed for an expropriation or a regulatory taking is fair, even though it may not fully compensate an expropriated party for the property damage effectively caused. This would constitute a risk to the adequate protection of property rights.

Property Over Water

Under the current system, any individual may apply to the appropriate administrative authority, the General Directorate of Water ("*Dirección General de Aguas*") for a water-use right. The holder of any such duly granted right then has complete ownership of those rights and may commercialize them freely.

As explained below, the regulation of water use will change significantly if the new draft Constitution is adopted.

The Human Right to Water and Sanitation. The first issue to consider is that article 140 of the draft Constitution regulates the human right to water and sanitation.[5]

In particular, this article guarantees every person the right to water and sufficient, healthy, acceptable, affordable, and accessible sanitation. In addition, the government must guarantee this right to current and future generations.

Water as a Non-Appropriable Good. Article 78 of the draft Constitution provides that every person has the right to property in all its forms and over all types of goods, except those goods that: (i) nature has made common to all people; and (ii) the Constitution or the law declare non-appropriable.[6]

Relatedly, article 134 of the draft Constitution provides that the territorial sea and its seabed; beaches; waters, glaciers, and wetlands; geothermal fields; air and atmosphere; high mountains, protected areas, and native forests; subsoil; and other "goods" listed by the Constitution and the law are natural common goods.[7] Among these, the draft specifies that: (i) water in all its states; (ii) air; and (iii) those goods recognized by international law and those declared as such by the Constitution or law are non-appropriable.

Moreover, under article 142 of the draft, water use may be authorized by the government. However, such use may not be commercial, and such authorization is subject to the effective availability of water. This means that water-use rights ("*derechos de aprovechamiento de aguas*") that are currently in force effectively would be terminated.[8]

Mining

Natural Resources Regime Under the New Constitution. The draft Constitution also introduces new rules for the exploration, exploitation, and use of mineral resources.

Specifically, article 145 establishes the cornerstone of this regulation.[9] It provides that the government has the absolute, exclusive, inalienable, and imprescriptible property right of all mines and mineral, metallic and nonmetallic substances, deposits of fossil substances, and hydrocarbons existing in the national territory, notwithstanding the fact that someone else may own the land on which they are located.

The same rule also provides that exploration, exploitation, and use of the substances mentioned above will be subject to regulation that considers: (i) its finite and nonrenewable characteristics; (ii) intergenerational public interest; and (iii) the protection of the environment.[10]

The Regime for Exploration, Exploitation, and Use of Mining Resources. In contrast to the present Constitution, the draft Constitution does not expressly contemplate the possibility of the government granting concessions over mining resources.

In fact, during the Convention's deliberation process, an authorization regime for mining exploration, exploitation, or use not subject to property rights was proposed. The requirements for these authorizations would have been as follows: (i) duly specified conditions and requirements for the expiry and revocation of the authorization; and (ii) the holder of any such authorization would have been required to develop the requested mining activity. Such administrative authorizations would not have been subject to property right limitations.

The plenary of the Convention, however, rejected this proposal, so the draft Constitution does not contemplate either an authorization regime or concession rules for the exploration, exploitation, and use of mining resources.

This leads to an inescapable conclusion: The mining concession regime currently in force, over which owners have property rights over each concession, is devoid of constitutional protection in the draft. Unfortunately, the status of current mining concessions was not discussed by the transitory rules commission.

Finally, and as mentioned above, the draft considers subsoil a natural common good, along with beaches, water, glaciers, etc. It further confirms that goods that "nature has made common to all people" cannot be subject to property rights under article 78.[11] A logical interpretation of this wording is that subsoil minerals cannot be subject to property rights, even via the granting of a concession.

HOW CAN FOREIGN INVESTORS PROTECT THEIR INVESTMENT?

To mitigate the ill effects of any possible government intervention, foreign investors in Chile should consider taking proactive steps to monitor resource nationalism and protect their investments both domestically and under international law.

Push for the Maintenance of a System of Judicial Remedies Against Government Acts

The current Constitution contains the "protection remedy" ("*recurso de protección*"), which aims to protect any person from government acts that may infringe certain fundamental rights, among them property rights. The draft Constitution also contemplates a new remedy that is similar to the existing "protection remedy." In addition, Chilean legislation provides the option of public–civil actions such as claims for "public law annulment" ("*nulidad de derecho público*"), which have been expressly included in the draft Constitution.

Build and Strengthen Involvement with Local Communities

Investors should be actively involved with local communities where relevant assets are located to build and bolster their relationship with both those communities and local government. Adverse government actions against foreign investors often arise from community dissatisfaction with the foreign investor and pressure on local and central governments to take action.

Savvy investors, therefore, should work with community leaders, local governments, and NGOs to contribute to community needs. This can be achieved through building housing and infrastructure; supporting health care, education, and recreation; and providing technical support for environmental initiatives. Local community support can be an invaluable asset for investors in the long run. Given all the proposed changes with respect to property rights over water and natural resources regimes, it is very likely that investors may soon be required to seek consent from their local communities to approve any projects that may potentially affect their rights. Foreign investors, therefore, should initiate steps now to work closely with their local communities on various mitigation and environmental conservation measures.

Safeguard Evidence for Potential Legal Claims

While monitoring political developments and considering legal options to protect their investments in Chile, companies should also take steps to build and maintain a record of all key evidence required to litigate potential claims before both local courts and international tribunals. This includes any and

all contracts with the state or state-owned entities, licenses, concessions, agreements and authorizations, computer hard drives, servers, and other electronic repositories. If conditions begin to deteriorate, it would also be helpful to conduct witness interviews and prepare sworn statements with employees and relevant third parties. This is especially important now given the U.S. Supreme Court's holding in *ZF Automotive US, Inc. v. Luxshare, Ltd.* that 28 U.S.C. § 1782—which authorizes district courts to order testimony or document production "for use in a proceeding in a foreign or international tribunal"—is no longer available for international commercial arbitration and *ad hoc* investor–state arbitration proceedings.

Assess Available International Law Protections

Subject to the specific circumstances of each investment, foreign investors should consult counsel and review applicable international treaty protections. *See* "Assessing Available Protections to Foreign Investors under International Investment Treaties in Chile" and "Steps that Foreign Investors Should Take to Ensure the Availability of International Treaty Protections," below, for a detailed analysis of potential international law protections.

ASSESSING AVAILABLE PROTECTIONS TO FOREIGN INVESTORS UNDER INTERNATIONAL INVESTMENT TREATIES IN CHILE

Chile is a party to more than 65 bilateral investment treaties ("BITs"), free trade agreements ("FTAs"), and international treaties with investment provisions. Chile has signed at least 10 FTAs containing investment protection provisions since 2000, including treaties with the United States, Argentina, Canada, Mexico, Peru, and Republic of Korea. Additionally, Chile is a party to the Comprehensive and Progressive Agreement for Trans-Pacific Partnership ("CPTPP") together with Australia, Brunei, Canada, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, and Vietnam. Applications to join the CPTPP are currently also pending from the United Kingdom, China, Taiwan, and Ecuador. These international treaties provide a range of legal protections to investors from states that are party to them, including the right to initiate international arbitration directly against the state in which the investment is located should a treaty breach occur and the right to seek monetary damages in a neutral forum.

Investment Treaties Offer Varying Degrees of Protection

International investment treaties generally include certain basic provisions, such as protection against unlawful expropriation without compensation, the right to fair and equitable treatment, and guarantees of national treatment and most-favored-nation treatment under international law.

Beyond these basic provisions, investment treaties vary in the level of protection they provide. Foreign investors should review their corporate structures to ensure that their investments are protected by one or more favorable treaties in the event of a dispute with the host government. When evaluating investment treaties, investors need to consider carefully which provides the optimal range of protections for their specific circumstances. For example, so-called "denial of benefits" provisions (clauses in investment treaties generally designed to exclude from treaty protections nationals of third states that, through mailbox or shell companies, seek to benefit from provisions that the state parties to the treaty did not intend to grant them) may, in certain circumstances, disqualify an investor from treaty protections.

Chile's Draft Constitution and Treaty Compliance

Various provisions in Chile's proposed Constitution may violate treaty protections. For example, the draft Constitution grants judges discretion to determine the "fair value" of an expropriated investment for purposes of determining the quantum of compensation, supplanting the previous regime, whereby private parties were permitted to determine compensation based on "property damage effectively caused." Given the ambiguity of this new "fair value" compensation standard, investors should be aware of how applicable BITs and international treaties deal with compensation for expropriated property. A treaty might require that more than "fair value" be paid, affording investors protection that the proposed Constitution does not.

The most common substantive treaty protections are the protection against expropriation without fair compensation and the guarantee of fair and equitable treatment, but the scope of these protections differs depending on the treaty. The Chile–Switzerland BIT (1999), for instance, provides that expropriation, nationalization, or any other measures having the same nature or the same effect on Swiss investments may be taken only "for the public benefit, in a non-discriminatory manner, and by authorization of a formal law . . . provided that provisions

be made for effective and adequate compensation … [and] subject to review by due process of law." It places no further requirements on payment of compensation save that it "shall be settled in a freely convertible currency accepted by the investor and paid without delay to the person entitled thereto without regard to its residence or domicile."

Contrast this with the Chile–United Kingdom BIT (1996), which additionally provides that "compensation shall amount to the genuine value of the investment expropriated immediately before the expropriation or before the impending expropriation became public knowledge"—a more specific and favorable standard for investors seeking compensation for their expropriated property. The specificity of any given BIT's language with respect to compensation affects the exposure of an investment subject to that BIT under the proposed Constitution, which by itself requires only a "fair price" in exchange for expropriation, but which also purports not to displace pre-existing treaty rights.

Whereas an agreement like the Chile–United Kingdom BIT seems to provide more protection than the proposed Constitution does, one like the Chile–Switzerland BIT may not. Investors should determine, with the assistance of counsel, the scope of their applicable treaty and whether it provides additional protection beyond the proposed constitutional floor.

An investor's business structure and the nature of its investments will also affect whether any particular treaty provides protection. For instance, whereas the Chile–UK BIT defines investors only as natural persons who are nationals of either Chile or the UK and corporations constituted under either Chilean or UK law, the Chile–Switzerland BIT additionally includes corporations constituted in other states as long as they are effectively controlled by Chilean or Swiss nationals, or by legal entities domiciled in and with their principal place of dealing in either Chile or Switzerland.

So too do treaties differ in the scope of investment that they cover. The Chile–United States FTA, for instance, defines a covered investment to include any investment in its territory. This is broader than either the Chile–UK or Chile–Switzerland BITs, which both limit investment to participation in companies. Thus, even though fair and equitable treatment is typically guaranteed, the scope of that guarantee will vary depending on the treaty.

These are possible examples of how tribunals may analyze disputes if the proposed changes go into effect. Given the nuances of each treaty, a proper analysis requires a case-by-case review of the treaty with experienced counsel, the specific government action, and the investment itself.

Jurisdictional and Admissibility Provisions

Investors should also take note of the jurisdictional and admissibility provisions in the treaties to which their investments are subject. These provisions determine the forum in which dispute resolution will take place and may also depend on the procedural posture of the case. For instance, under article VII of the Chile–United Kingdom BIT, disputes that proceed past consultation between the parties may be submitted to the International Centre for the Settlement of Investment Disputes ("ICSID") for arbitration under the Convention on the Settlement of Investment Disputes between States and Nationals of other States. However, this avenue is foreclosed if the investor has already submitted the dispute to courts of "the contracting Party which is a party to the dispute." In the case of a UK investor seeking compensation from the Chilean government for expropriated property, this would mean that suing in Chilean court would most likely foreclose arbitration at ICSID.

Arbitration before international tribunals such as ICSID tribunals may be preferable to international investors for a variety of reasons, but this is especially true in light of other provisions in the proposed Chilean Constitution weakening judicial independence. It is thus important for investors to be aware of the consequences that filing suit in any particular jurisdiction will have on the availability of alternative remedies and to prepare their litigation strategies accordingly.

Depending on which treaty the investment is subject to, litigation strategies may differ. The Chile–Swiss BIT gives complainants an option between ICSID and the courts of the country in which the investment is located. The Chile–United States FTA, meanwhile, gives the complainant an unrestricted choice of forum. The availability of favorable fora for dispute resolution is just one of the factors that an investor might consider in evaluating their exposure under Chile's proposed Constitution. These factors differ in both substantive content and specificity from treaty to treaty.

STEPS THAT FOREIGN INVESTORS SHOULD TAKE TO ENSURE THE AVAILABILITY OF INTERNATIONAL TREATY PROTECTIONS

While it is impossible to determine what specific disputes may arise, foreign investors should take concrete steps to ensure that their investments are protected by one or more favorable treaties.

Depending on the circumstances, foreign investors can initiate international legal proceedings against Chile through the investment protection clauses in international treaties. Investors should analyze their existing corporate structure to determine what investment treaties and agreements apply. Unprotected investors could decide to restructure their investments to maximize protections under existing bilateral or multilateral investment agreements. The act of restructuring an investment to gain treaty protection is not prohibited as such, but several arbitral tribunals have held that investors cannot restructure to gain treaty protections *after* a dispute has become foreseeable. Thus, restructuring has the best chance of being recognized as legitimate if it takes place *before* any alleged breach.

CONCLUSION

Given the uncertainty of Chile's approaching constitutional referendum, foreign investors should prepare for litigation, begin building political capital with local communities, and consider available international treaty protections to safeguard their assets now.

CONTACTS

Michelle Bradfield
Partner, Global Disputes
Jones Day, London
+44.20.7039.5126
michellebradfield@jonesday.com

James Egerton-Vernon
Partner, Global Disputes
Jones Day, Washington
+1.202.879.3610
jegertonvernon@jonesday.com

Mercedes Fernández
Partner-in-Charge Madrid
Jones Day, Madrid
+34.91.520.3939
mfernandez@jonesday.com

Antonio González
Partner, Global Disputes
Jones Day, Mexico City
+52.55.3000.4051
agonzalez@jonesday.com

Melissa Stear Gorsline
Partner, Global Disputes
Jones Day, Washington
+1.202.879.5421
msgorsline@jonesday.com

Fahad A. Habib
Partner, Global Disputes
Jones Day, San Francisco
+1.415.875.5761
fahabib@jonesday.com

Marcello Hallake
Partner, Energy
Jones Day, São Paulo/New York
+55.11.3018.3933/+1.212.901.7058
mhallake@jonesday.com

Maria I. Pradilla Picas
Associate, Global Disputes
Jones Day, Washington
+1.202.879.4640
mpradillapicas@jonesday.com

Ricardo H. Puente
Partner, Global Disputes
Jones Day, Miami
+1.305.714.9726
rpuente@jonesday.com

Sylvia Tonova
Partner, Global Disputes
Jones Day, London
+44.20.7039.5218
stonova@jonesday.com

Jorge Barrera
Partner, Head of Public Law and Regulated Markets
Bofill Mir Abogados
+56 2 2757 7691
jbarrera@bofillmir.cl

Javiera Cid
Associate, Public Law and Regulated Markets
Bofill Mir Abogados
+56 2 2757 7688
jcid@bofillmir.cl

Jorge Rodillo
Senior Associate, Public Law and Regulated Markets
Bofill Mir Abogados
+56 2 2757 7815
jrodillo@bofillmir.cl

ENDNOTES

1 The agreement can be found here.
2 The full constitutional reform can be found here.
3 A complete version of the first draft can be downloaded here.
4 Draft Articles 78.4 and 78.5.
5 Draft Articles 140.1 and 140.2.
6 Draft Article 78.1.
7 Draft Articles 134.1, 134.2 and 134.3.
8 Draft Transitory Norm 35.
9 Draft Article 145.1.
10 Draft Article 145.2.
11 Draft Article 78.1.