

CONGRESS OF HONDURAS APPROVES REPEAL OF SPECIAL ECONOMIC ZONES ("ZEDES") WHICH MAY LEAD TO INVESTOR-STATE DISPUTES

On April 21, 2022, the Congress of Honduras unanimously repealed the law which allowed for the creation of special economic zones with their own autonomous legislation and exempted from certain taxes, known as Zones for Employment and Economic Development ("ZEDEs"). This law was enacted in 2013 to attract and promote foreign investment in the country, and the Congress' recent decision has now left ZEDE's investors and administrators in a legal limbo.

THE CREATION OF ZEDES AND ITS ROLE IN THE PROMOTION OF FOREIGN INVESTMENT IN HONDURAS

The Constitution of Honduras was modified in June 2013 to enable the creation of ZEDES through popular consultation or by the decision of the President. This initiative was implemented on September 6, 2013 when the Congress of Honduras approved the Organic Law on Employment and Economic Development Zones through Decree No. 120-2013 ("**ZEDEs Law**").

The legal framework of ZEDES was aimed at creating so-called "model cities", with the purpose of "*attracting domestic and foreign investment, the best national and international talents and establishing its own civil service regime grounded in meritocracy*" (Article 5 of ZEDEs Law). ZEDES were to be defined by the Honduran Secretary for Economic Development as areas within the national territory subject to a "special regime" establishing an independent political system with a high level of autonomy in terms of public administration, taxation policy, security, and dispute resolution. This special regime comprised: (i) the possibility of enacting autonomous legislation and having an independent administration (Articles 1, 3 and 8 of ZEDEs Law); (ii) a special taxation system for economic activities developed within ZEDES, to be determined by the zone administrators and guided by the principle of low taxation (Articles 4 and 29 of ZEDEs Law); and (iii) mandatory recourse to arbitration for all contractual and business disputes (Article 20 of ZEDEs Law).

Key issues

- The Congress of Honduras unanimously repealed the law which allowed for the creation of special economic zones known as "ZEDEs".
- It is uncertain whether the Honduran government will consider the rights and legitimate expectations of investors in ZEDES in its transition plan, but the clear opposition to ZEDES shown thus far is not encouraging.
- Foreign investors should monitor the situation closely and consider their rights under BITs and FTAs in any negotiations or amicable consultations that may occur in the following weeks.

Since the enactment of the ZEDES Law, several ZEDES were created in Honduras. The main ZEDES were in Ciudad Morazán (located in the Cortés Department), Orquidea (located in the Colón Department) and Próspera (located in the Bay Islands Department). The development of these ZEDES involved significant investments in the agricultural, real estate and health industries in Honduras.

ZEDE'S LAW REPEALED IN LATE APRIL 2022

ZEDES have been the subject of criticism by a sector of the Honduran society and some political leaders since their enactment in 2013. Concerns put forward by ZEDES opponents mostly relate to sovereignty, transparency and environmental considerations. However, those concerns only very recently materialized into a concrete threat to the continuity of the ZEDES.

On April 21, 2022, the Congress of Honduras unanimously passed Decree No. 32-2022 that repealed the ZEDES Law. The Congress also sought to cancel the provisions of the Honduran Constitution that enabled the creation of ZEDES, but such amendment would require a second vote by the Congress next year.

CURRENT SITUATION

At the moment, the immediate future of ZEDES is uncertain. While ZEDES continue to exist under Article 329 of the Honduran Constitution, the withdrawal of the ZEDES Law abolished the legal framework underlying investments in ZEDES and rights and expectations that may have arisen under their autonomous system of differential legal, judicial and taxation regimes.

The Honduran government's approach to the transition from the ZEDES system to an ordinary treatment for companies currently operating in ZEDES is yet to be determined. A provision aiming at preserving the rights of foreign investors was proposed by the National Party and discussed during congressional deliberations, but was ultimately not included in Decree No. 32-2022 by the examining committee.

Investors operating in ZEDES under legal stability agreements entered into with the Honduran Administration benefit from enhanced protection. Article 45 of the ZEDES Law includes a "sunset clause" ensuring that provisions of the ZEDES Law would remain in force throughout the relevant period of time provided for under legal stability agreements. Accordingly, in these circumstances the provisions of ZEDES Law are to remain in force for at least 10 years following the repeal. However, it remains uncertain whether the Honduran government will abide by its obligations under this "sunset clause" or rather force an expedited transition to ordinary treatment.

PROTECTIONS POTENTIALLY AVAILABLE UNDER BILATERAL INVESTMENT TREATIES AND FREE TRADE AGREEMENTS

These developments should serve as a timely reminder to all investors in Honduras of the protections potentially available to them and their investments under Honduras' network of bilateral investment treaties ("**BITs**") and free trade agreements ("**FTAs**"). BITs and FTAs typically afford foreign investors with protections against arbitrary governmental measures that substantially affect or

deprive them of the economic use of their investment in the territory of the host State.

Honduras has more than 20 BITs and FTAs in force with third States throughout the world, granting enhanced protections to the investments made in Honduras by nationals of the contracting States. Therefore, many investors currently benefit from protection under these instruments.

To determine if an investment is protected under one of the BITs or FTAs currently in force in Honduras, it is crucial that investors engage qualified international counsel to perform a legal analysis of the investment treaty protections available to their investments in the country and of the potential implications of the withdrawal of the ZEDES Law.

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