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Investment Treaty Claims in Pandemic Times: Potential Claims and Defenses

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In response to the escalating COVID-19 crisis, States around the world have taken a variety of measures seeking to stem the spread of COVID-19 and to provide for medical supplies and protective equipment, including emergency declarations empowering governments to take control of private businesses, closure of borders, quarantines, stay-at-home orders, suspension of mortgage and utility payments, closure of non-essential businesses, and in some cases, export controls. While States have begun to undertake measures to support their citizens and businesses, it is likely that some foreign investors may seek relief and/or compensation for any losses resulting from State measures. In this post we analyze the main substantive treaty standards that could become the basis for claims arising out of State measures regarding COVID-19, and address potential public health defenses for host States. If investors are able to establish violations of substantive treaty obligations, States may also have defenses based on treaty-specific exceptions or under customary international law.

Fair and Equitable Treatment (FET) and Full Protection and Security (FPS)

The fair and equitable treatment standard is one of the most invoked substantive standards in investment treaty arbitrations, and encompasses both procedural and substantive elements.

Procedurally, fair and equitable treatment requires a State to afford due process to investments. One tribunal has determined that a State is required to "act in a consistent manner, free from ambiguity and totally transparently" in relation to foreign investors (*Tecmed v. Mexico*, ¶ 154). Under such a strict view, State responses downplaying the risks of COVID-19 and subsequently reversing course and imposing drastic measures could violate the fair and equitable treatment standard. For example, in *Azurix v. Argentina* the State's misrepresentation of its failure to remove algae contributed to a water quality crisis and was a consideration for finding a breach of fair and equitable treatment standard (¶¶ 143, 374).

Substantively, tribunals differ on the degree of deference they afford to States when evaluating measures aimed to protect public interests. Under a proportionality approach, State conduct could violate the fair and equitable treatment standard if the tribunal determines that a State's interference with the investment was not proportionate in light of the public interest pursued by State policy (*Occidental v. Ecuador II*, ¶ 338). Moreover, a tribunal is more likely to find that a discriminatory measure, such as any arbitrary border closures, violates the fair and equitable treatment standard.

A related standard, often contained in the same treaty provision, obligates the host State to provide "full protection and security" for investors and their investments. Once aware of risks to investments, the host State is required to "take all measures of precaution to protect the investment" in its territory. (*AMT v. Congo*, ¶ 6.05; *see also Wena Hotels v. Egypt*, ¶¶ 85, 131). While such "protection and security" is predominantly concerned with the State's due diligence obligations to ensure physical security of investments, some tribunals have given weight to the term "full" and indicated that "security" cannot be confined to physical security (*Biwater Gauff v. Tanzania*, ¶ 729). A State's failure to take early measures to contain the spread of the virus could violate this obligation to provide "full protection and security" if such failure necessitated avoidable and drastic State measures at a later time period that harmed the investments significantly. See, for example, *Azurix v. Argentina*, where the State's disinvestment in infrastructure contributed to the crisis on water quality (¶¶ 144, 408).

Expropriation

Expropriation claims under investment treaties include both direct expropriation and indirect expropriation. While direct expropriation—the State's outright seizure or assumption of legal title over the assets without adequate compensation—is relatively rare nowadays, State measures having the equivalent effect, resulting in effective control or interference with the use, value, or benefit of the investment, can constitute indirect expropriation.

To determine whether an indirect expropriation occurred, some tribunals adopt a "sole effects" approach, looking at whether the investor is being deprived of the "use or reasonably-to-be-expected economic benefit of property." (*Metalclad v. Mexico*, ¶ 103). Even under this relatively expansive approach, the loss of value must "amount to a deprivation of property" before a claim for indirect expropriation can be established (*Charanne v. Spain*, ¶ 464).

Moreover, while "ephemeral" deprivation of property would not constitute indirect expropriation, and such determination is likely context-specific, tribunals have found the suspension of an export license for four months (*Middle East Cement v. Egypt*, ¶ 107), and investor's loss of control of property for one year (*Wena Hotels v. Egypt*, ¶ 82) can constitute indirect expropriation. If the seizure of a private production lines to produce medical equipment, as the Spanish government now is empowered to do and the U.S. has done under the Defense Production Act, lasts for a sufficiently long period

of time without adequate compensation, investors could have a claim for unlawful indirect expropriation.

As more countries follow Spain's lead in taking control of private hospitals and clinics, investors in the healthcare industry could also have indirect expropriation claims if turning over control was involuntary. Similarly, if the State does not return control after the end of the outbreak or if the State's control left permanent harm to the investment, investors could also have a claim for indirect expropriation.

A series of State measures over a period of time amounting to such a result can also constitute indirect expropriation in the form of a "creeping expropriation" (*Generation Ukraine Inc. v. Ukraine*, ¶ 20.22). Therefore, under this approach if a series of COVID-19 measures, such as border closures or lockdown orders, results in the investment shutting down permanently, the investor could have a claim for indirect expropriation.

Some tribunals consider not only the effect of State measures, but also its purpose and characteristics (*Feldman v. Mexico*). Under such an approach, it is less likely that State measures aimed to protecting its population from COVID-19 would amount to indirect expropriation.

On the other hand, as States are weighing nationalization options, foreign investors could have a strong claim for expropriation if a State, taking advantage of plummeting commodity and stock prices, nationalizes or engages in a forced bailout of businesses not directly related to its responses to COVID-19, such as airlines, utilities and natural resources companies. Forced bailout at a low price by the State can give rise to compensation claims when the values of such companies recover at a later point (*See Ping An v Belgium*: Belgian government's forced bailout of Fortis gave rise to BIT claims).

National Treatment

The national treatment standard deals with situations where the host State affords less favorable treatment, either *de facto* or *de jure*, to a foreign investor compared to a domestic investor in similar situations. Analysis under this standard generally depends on a tribunal's interpretation of "similar situations." While border closures to non-citizens may on its face raise a national treatment claim, a tribunal could consider justification such as the more fundamental right of a citizen to enter its own country.

In determining comparable investments, tribunals may look to competitive relationships of different products or industries (*Cargill v. Mexico*, ¶ 211). Therefore, bailout measures that only support certain domestic industries but not industries with significant foreign investments with a competitive relationship may constitute a violation of the national treatment standard.

Public Health Defenses

In defending an investment treaty claim, a State could seek to justify its measures to protect the public health. Some more recent investment treaties, such as Canada-EU Trade Agreement, offer a carve-out for non-discriminatory regulatory measures aimed to protecting legitimate public welfare objectives, such as public health. Some tribunals could analyze a State's pursuit of public health interests and therefore adopt a balancing approach in evaluating a claim for breach of substantive treaty obligations.

Overall, tribunals almost certainly will need to consider the pursuit of public health as a legitimate State goal. But investors may be able to argue that (1) the State measures in pursuant of public health were discriminatory, and therefore cannot be justified on that ground; (2) public health was used as a pretext for another motive in the attempt to justify certain aspects of a State's COVID-19 related measures, such as community pressure (*Tecmed v. Mexico*) or electoral motivations (*Azurix v. Argentina*), as would be the case if a State nationalizes airlines, utilities companies, or natural resources industries controlled by foreign investors during COVID-19; (3) State actions worsened the extent of the crisis and therefore harmed the investments at a later time (*Azurix v. Argentina*); or that (4) States could have adopted measures to fulfill both investment obligations and its obligations to protect the public health (*AWG v. Argentina*).

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The Kluwer Arbitration Blog is closely following the impact of COVID-19 on the international arbitration community, both practically and substantively. We wish our global readers continued health and success during this difficult time. All relevant coverage can be found here.

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