Kluwer Arbitration Blog

COVID-19 and Investment Treaty Claims

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At the time of writing, the number of confirmed cases of COVID-19 passed 600,000, across more than 200 countries and territories. The World Health Organization (the WHO) declared a Public Health Emergency of International Concern on 30 January 2020, *i.e.* an 'extraordinary event' which is 'serious, unusual or unexpected' carries trans-national implications, and may require immediate international action. On 11 March 2020, the WHO declared it a pandemic.

Measures have been announced by many States – on a daily basis – to attempt to contain and mitigate the spread of the disease, and many have declared states of emergency under their domestic laws. The measures mostly involve social distancing, including quarantines, isolation and travel restrictions. These measures have significant human costs, but they are also having a wider impact on economic interests. Europe, Italy, France and Spain, among others, have imposed nationwide lockdowns, and the UK has also imposed significant restrictions on movement. Businesses are closing across a range of sectors, and more are expected over the coming months.

Looking forward, further measures are likely to be imposed, and sooner rather than later. Economic measures are already being announced which are likely to have a significant impact on banks, such as mortgage suspensions. As economies slow and jobs are lost, energy companies may be asked to discount consumer prices or to suspend charges altogether. Businesses, including those run by foreign investors, may be forced to cease trading and operating, their supplies may be requisitioned, or they could be nationalized.

In these circumstances, States and foreign investors will be considering their positions under applicable investment treaties: will States be insulated for measures taken in response to the emergency presented by COVID-19, or will investors be indemnified for the substantial losses they will likely suffer?

If a COVID-19 measure is challenged by a foreign investor, there will be a threshold issue as to whether the measure is potentially in breach of the substantive provisions of an investment treaty. There may be strong grounds for a State to contend that the measure adopted is not a breach of fair and equitable treatment, or does not amount to indirect expropriation. Provided that it can be established that the measure is incompatible with the relevant obligation, a further question that arises is whether the State has a valid defence to a claim. States can defend against treaty claims by:

1. treaty exceptions; or

2. defences under customary international law.[1)]

Treaty exceptions

These are expressly set out in the BIT. If the exception applies, the treaty does not apply to the disputed measure. All will depend on the particular treaty.

In early treaties, specific exceptions were rare, although some included exceptions for measures "necessary for the maintenance of public order". One could see an argument to bring some measures taken to combat COVID-19 within the scope of measures for "public order", although ultimately it would depend on the particular circumstances.

Very few BITs contain general exceptions, or incorporate the general exceptions as set out in the GATT and GATS trade agreements. The general exceptions usually provide that the treaty will not prevent a party from adopting or enforcing measures to protect human life or health, provided that the measures are not arbitrary or discriminatory. Where possible, States are likely to seek to rely on these general exceptions provisions in relation to measures taken in response to COVID-19.

More recent investment treaties have stronger specific exceptions, which explicitly exempt non-discriminatory regulatory measures for lawful public welfare objectives, including public health, from indirect expropriation obligations. For example, the Canada-EU Trade Agreement (CETA) specifies that non-discriminatory regulatory measures designed and applied to protect legitimate public welfare objectives, including public health, do not constitute indirect expropriations, except in "rare circumstances". Those may protect States against indirect expropriation claims, but may not assist in relation to breaches of other provisions of investment treaties.

Some treaties do go further. For example, the recent China-Australia Free Trade Agreement provides that non-discriminatory measures for "legitimate public welfare objectives of public health … shall not be the subject of a claim" by an investor. Provisions such as these are likely to insulate COVID-19 measures from investment treaty claims.

Customary international law defences

Customary international law defences are not set out in the treaty, but have been codified in the ILC Articles on State Responsibility (termed "circumstances precluding wrongfulness"). The treaty continues to apply, but States will be exonerated from any claims for breach for as long as the facts giving rise to the defence continue to exist.

There are six circumstances precluding wrongfulness that are recognized under customary international law: of these, three are potentially relevant to COVID-19 measures:

- *force majeure;*
- distress; and
- necessity.

Necessity figured prominently in the treaty-based cases brought in the aftermath of the Argentine

financial crisis, but the other two defences have not featured prominently in investment treaty cases.

Force majeure

A successful claim of *force majeure* must fulfil five conditions:

1. there must be an unforeseen event or an irresistible force;
2. the event or force must be beyond the control of the State;
3. the event must make it 'materially' impossible to perform an obligation;
4. the State must not have contributed to the situation; and
5. the State must not have assumed the risk of the situation occurring.

The plea of *force majeure* is a strict one, and States have rarely been successful when invoking it. The outbreak of COVID-19 potentially amounts to an unforeseen event or an irresistible force triggering a situation of *force majeure*, but States are likely to have some difficulty demonstrating material impossibility of performance (3). This will depend on the specific obligation at issue, and the particular circumstances at play, but in most cases, States are likely to have a choice (even if a difficult one) in respect of compliance.

Necessity

To successfully plead the defence of necessity, a State must fulfil four requirements:

1. a grave and imminent peril;
2. that threatens an essential interest;
3. the State's act must not seriously impair another essential interest;
4. the State's act was the 'only way' to safeguard the interest from that peril.

In addition, the plea is excluded if:

5. the obligation in question excludes reliance on necessity; and
6. the State contributed to the situation of necessity.

On the basis of publicly available information, it seems arguable that the outbreak and spread of COVID-19 meets the requirement of grave and imminent peril (1). It is an unfolding event which poses an imminent threat of a grave harm to the world's population.

It also appears arguable that it threatens an essential interest (2) of the State, or of the international community as a whole. The well-being of a States' population and the continued functioning of its public services have been accepted as constituting 'essential interests' in investment treaty arbitration (see *National Grid v Argentina*, §245).

The measure must not seriously impair an essential interest (3) of another State or of the international community as a whole. Investment tribunals have readily accepted that a State's interest in the well-being of its population outweighs the interests of investor home States (or those of investors themselves). The balance must be considered in the particular circumstances, but it is

likely to be arguable, in certain cases, that COVID-19 measures do not seriously impair essential interests of investors.

The measure must be the 'only way' (4) to protect the essential interest from the impending harm at the time. If there are other (lawful) ways to address the threat, even if these are more costly or inconvenient, the plea will fail. This sets a high threshold. Whether it is met will ultimately turn on an assessment of the measures adopted, by reference to the information available at the time, and taking account of the whole package of measures, as well as alternative measures which could have the same effect, even if they are more costly.

Whether necessity is precluded by the substantive obligation (5) turns on the obligation in question. Investment treaty obligations are unlikely to preclude reliance on necessity.

There is considerable uncertainty as to the scope of the requirement of non-contribution (6). Some tribunals have approached the requirement as a purely causal one such that 'well-intended but ill-conceived policies' are sufficient to exclude reliance on the plea (*Impregilo v Argentina*, §356). Others have interpreted it more narrowly, as requiring some degree of fault (*Urbaser v Argentina*, §711). Depending on how broadly this is interpreted, it might be argued that States' under-funding or under-resourcing of health care systems is a substantial contributing factor, potentially precluding reliance on necessity.

On the basis of the information available at the present time, it might be difficult for States to rely on necessity in respect of measures taken to combat COVID-19. The plea has been interpreted in very restrictive terms by tribunals and it could be difficult for States to establish all of the requisite elements.

Distress

To successfully plead the defence of distress, the State must show:

1. threat to life;
2. a special relationship between the author of the act, whether this is a State organ or an individual whose acts are attributable to the State, and the persons in question;
3. that there was no other reasonable way to deal with the threat;
4. that it did not contribute to the situation; and
5. that the measures were proportionate.

The element of threat to life (1) is likely to be made out, on the basis of the existing threat posed by COVID-19 to the lives of individuals within the State's jurisdiction. As to the requisite "special relationship" (2), a tribunal could consider that an important aspect of the 'special relationship' between the organ imposing a measure and the individuals whose lives are under threat is control: is the fate of those individuals under the control of the relevant organ? In circumstances where *only* the central government has the authority to put in place measures of containment or mitigation in these types of emergencies, it appears arguable that there is a special relationship: to some extent, the fate of the population is within the control of the central authorities.

Whether the other requirements are likely to be met will depend on the particular measure adopted, its impact, and the particular circumstances. The requirement of "reasonableness" (3) is a lower

standard than for the plea of necessity which requires that the measures be the 'only way' to deal with the emergency. This requires a case by case assessment, in an appropriate context, including the whole package of measures adopted. The non-contribution requirement (4) is also a lower standard than for necessity: good faith policies that contributed to the crisis do not exclude reliance on the plea. Finally, the measures must be proportionate (5), comparing the measure against the interest protected. This is likely to require an assessment of the impact of the measure on the investor, compared to the impact on the population overall in the event that the measure was not adopted.

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.

References

On the application of these under public international law, *see* also F Paddeu and F Jephcott, **?1** "COVID-19 and Defences in the Law of State Responsibility Parts I and II", *EJIL Talk*, 17 March 2020.

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