Kluwer Arbitration Blog

Pandemics, Emergency Measures, and ISDS

Nicholas J. Diamond (Georgetown Law) · Monday, April 13th, 2020

Extraordinary Times

These are extraordinary times in many regards. The spread of novel coronavirus ("COVID-19"), now considered a pandemic, continues to have a significant global impact on several fronts. For States, the pandemic of course presents significant *public health* challenges. As we are seeing, it also presents significant *economic* challenges, due to the convergence of disruptions in daily life, which have immediate implications for businesses and their workforce, with macro-level pressures on financial markets, accelerated by inflated global corporate debt as a share of gross domestic product.

In extraordinary times, States take extraordinary measures. In the current moment, States have adopted (and very likely will adopt additional) emergency measures to address the severe and interwoven public health and economic threats posed by the pandemic. History tells us that such measures often have downstream effects on investor-State dispute settlement ("ISDS"). Expanding on themes considered by others recently, this post briefly explores these issues.

Revisiting the Argentine Economic Crisis

Many readers will be familiar with the Argentine economic crisis (approximately 2001-2003) and its effect on ISDS. It provides an instructive lens through which to consider the current situation. To recall, in 1989, after several significant currency devaluations, Argentina passed an emergency measure privatizing state-run public services, catalyzing subsequent foreign investment across the gas, electricity, and water sectors. The convergence of several economic factors, however, resulted in a severe economic downturn, marked by a near-20 percent contraction of the Argentine economy over the 1998-2002 period.

In 2002, Argentina passed sweeping emergency measures. These measures, *inter alia*, abandoned the peg of the Argentine peso to the US dollar and ushered in a new system of exchange rates, which immediately affected existing foreign investment interests. Many disputes arose, wherein Argentina sought to have its breaches of obligations under the relevant investment treaties absolved of liability, due to the unique circumstances that were the impetus for the emergency measures.

Several disputes were decided based on the US-Argentina BIT which, in Article XI, excepts

measures taken for the maintenance of "public order". Other disputes were decided based on Article 25 of the International Law Commission's Responsibility of States for Internationally Wrongful Acts ("ARS"), which provides the customary international law defense of necessity. Under Article 25, the measure must be "the only way for the State to safeguard an essential interest against a grave and imminent peril" and it cannot "seriously impair an essential interest of the State . . . towards which the obligation exists, or of the international community as a whole". Article 25 does not permit a state to invoke necessity if either "the obligation in question excludes the possibility of invoking necessity" or "[t]he state has contributed to the situation giving rise to necessity". Finally, some disputes were decided based on both the US-Argentina BIT and Article 25 under ARS.

Some controversy existed with regard to the relationship between Article XI of the US-Argentina BIT and Article 25 of ARS. For example, the annulment committee in *CMS*, although it did not annul the award, criticized the tribunal for assuming, absent further analysis, that both Article XI and Article 25 had the same requirements. The annulment committee in *Sempra* took a similar view, but actually annulled the award. Later, the annulment committee in *Enron* also annulled the award, based on the view that the tribunal had insufficiently applied Article 25. Overall, nearly all of the disputes, whether based on US-Argentina BIT, another investment treaty, or Article 25 of ARS, were decided in favor of the claimants, resulting in Argentina having to pay compensation for its breaches. In particular, how the tribunals viewed the relationship between Article XI and Article 25 impacted the outcome. The tribunals that read into Article XI the "only way" requirement from Article 25 ultimately ruled against Argentina. Those that did not see this relationship acknowledged Argentina's broad regulatory autonomy and, in part for this reason, ruled in the State's favor.

The Effects of COVID-19 Emergency Measures

As discussed in a previous post, States affected by the pandemic have adopted emergency measures that take various forms. While some emergency measures began as voluntary, many have now become compulsory. Broadly, these measures include, *inter alia*, restrictions on intra-State movement (e.g., quarantines, curfews), restrictions on inter-State movement (e.g., flight and other travel restrictions), and cancellations of events above a specified number of attendees (e.g., sporting events). If the trend toward compulsory measures is any indication, future measures may even more significantly impact business operations. Such measures could affect foreign investment interests in, *inter alia*, the construction, utilities, aviation, entertainment, and pharmaceutical sectors.

It is foreseeable that investment disputes will arise regarding, in particular, indirect expropriation and fair and equitable treatment (FET), given the dramatic effect that compulsory measures in the above-mentioned categories have on business operations. This may present challenges for States seeking to delicately balance the scope and strength of their emergency measures, due to obligations arising under full protection and security (FPS) clauses, which tribunals have construed as requiring both physical security and legal protection. In this sense, insufficient State action or outright inaction may prove equally problematic. Relatedly, States have recently been considering economically focused emergency measures. If future emergency measures seek to specifically stimulate national economic interests, disputes may likewise raise national treatment and most-favored-nation (MFN) treatment, particularly if foreign investors have been disproportionately

impacted.

Potential State Responses

States would have several legal theories and defenses to potentially raise in such disputes. A pandemic would be a novel factual backdrop for disputes and, specifically, for the context in which defenses would be raised and considered. While tribunals are no strangers to public health-related issues, a pandemic is qualitatively different because of its pervasive and simultaneous impact on human rights, economic interests, and national security. As the case law arising out of the Argentine economic crisis demonstrates, however, tribunals have been reluctant to entertain the relevance of human rights considerations, focusing instead on the economic dimensions of the disputes. Equally, as that case law demonstrates, the relationship between exceptions provisions and necessity under customary international law may bear on the outcomes of future disputes.

Police Powers

States generally enjoy broad regulatory autonomy, or police powers, to enact measures to protect the health, safety, and welfare of their citizens. Indeed, the tribunal in *PMI v. Uruguay* recognized that "[p]rotecting public health has since long been recognized as an essential manifestation of the State's police power". Moreover, several tribunals, including *Tecmed* and *Saluka*, confirm that exercise of a State's police powers via non-discriminatory measures of general applicability does not require compensation. As such, States likely have significant latitude in the current moment, even where emergency measures significantly burden a single sector. For example, border control measures that disproportionately impact the aviation sector are, *ceteris paribus*, likely squarely within the State's police powers, given the nature of pandemics. However, tribunals may require the challenged measures to be proportionate, suggesting that potentially overbroad measures may be problematic for a police powers argument.

Relatedly, as in *Azurix*, whether and to what extent the State may have contributed to the public health crisis, could bear on how a tribunal may weigh and balance a police powers argument. Note that these considerations would apply equally under Article 25(2)(b) of ARS. Importantly, a tribunal could defer to a State's regulatory judgment, but still question whether its actions exacerbated the ongoing crisis. Moreover, as in *Azurix*, it may even deprioritize the purpose for taking the measures, focusing instead on the effects. Possible risks for States in this regard are many. Indeed, this would likely be the most significant hurdle for States, not least because a seemingly endless spectrum of State actions could be relevant in this regard and nothing would in principle preclude a tribunal from considering all of them.

Tribunals may point to insufficient preparedness efforts in the preceding years, despite being "on notice" of the risks, based on the severity of prior epidemics or pandemics. They may point to insufficient or inconsistent public messaging from governmental health authorities during the pandemic, which could have exacerbated the spread of COVID-19. They may point to delayed public health response efforts, due to ignoring early risk signals, especially where paired with over-burdensome measures that seek to counterbalance the effects of the delay. They may point to failures to fulfill obligations under the International Health Regulations ("IHR"), including notification requirements when a threat emerges within a State and failing to take required health

system capacity-building steps, which could have militated against both the rapid spread and the severe public health consequences. Finally, they may point to non-adherence to WHO recommendations during a declared public health emergency of international concern under the IHR, especially where the State cannot justify why its regulatory judgment necessitated deviation.

Exceptions Provisions

As discussed in a previous post, investment treaties may contain general exceptions permitting a State to enact measures in certain circumstances that would otherwise breach treaty obligations. If the applicable investment treaty contained an exception for measures adopted to maintain the public order, as in the US-Argentina BIT, States may raise this exception to seek to avoid liability. Relatedly, many investment treaties except measures taken for the maintenance of national security, and some except measures taken to protect human rights or public health specifically.

In principle, a State could argue that its emergency measures fall within the definition of such terms, assuming such language exists in the applicable investment treaty. Indeed, in *Continental*, Argentina successfully relied on a public order exception to shield its emergency economic measures from liability. Tribunals have weighed various considerations in the context of exceptions provisions. As example, in *Continental*, the tribunal weighed whether the measures were praised by the international community, which could well be a factor to consider around the pandemic, given disagreement over appropriate State responses. The role of experts may, as in *CMS*, bear on how tribunals make such determinations, especially with regard to the complex epidemiological considerations involved in responding to the pandemic.

Customary International Law

States may raise, as Argentina did, the defense of necessity under ARS. A few prongs of Article 25 of ARS are worth highlighting, including whether a State contributed to the situation of necessity, mentioned above. First, some tribunals, like *Sempra*, set a high threshold for whether an "essential interest" had been imperiled, weighing whether the situation giving rise to the challenged measures "compromised the very existence of the State and its independence", although this is not the prevailing approach. Other tribunals, like *LG&E*, set a lower threshold, permitting a severe economic crisis to qualify, absent needing to determine whether it imperiled the State's existence. Notably for public health, in the context of the Argentine economic crisis, several tribunals considered the provision of water and sewage services in Buenos Aires to be an essential interest. The close nexus between public health and economic interests may provide further support for characterizing the circumstances as a threat to an essential interest. In the current moment, the cumulative impact of the pandemic on human rights, economic interests, and national security would likely satisfy this lower threshold.

Second, regarding whether the challenged measures were the "only way" to protect the essential interest, tribunals have generally set a high threshold, based on whether *any* other means might be available, without regard to cost or convenience. For the pandemic, this prong may prove problematic. Individual measures, such as large-scale lockdowns of cities or States, are by definition broad and burdensome, and tribunals may question whether they were the *only* available course of action for the State. It is, however, unlikely that a single measure would be challenged;

more likely a package of measures would be challenged, as in the case law relating to the Argentine economic crisis. If that case law is any indication, tribunals would have to weigh and balance discrete measures within a package to arrive at a determination based on the package as a whole. Whether a single, particularly ill-advised measure might prove fatal for an entire package is an open question and represents an underappreciated risk for States.

Looking Ahead

We are, by most accounts, far from the end of this pandemic. It is too soon to ascertain its ultimate effects on ISDS, but as additional emergency measures are adopted, and foreign investment interests continue to be affected, the likelihood of litigation will likely grow. Moving forward, to militate against the attendant litigation risks, States could focus on adopting evidence-based public health measures that are no more restrictive than necessary and do not disproportionately burden foreign investment interests. Equally, because the foundation for packages of measures has arguably already been established in many States, States could scale back earlier discrete measures, as appropriate, to ensure that their cumulative response efforts do not conflate temporally distinct phases of the pandemic requiring different approaches.

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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