Kluwer Arbitration Blog

World Arbitration Update: "Balancing the Protection of Foreign Investors and States Responses in the Post-Pandemic World" – Book Launch Program

Sameena Syed, Yulia Levashova (Nyenrode Business University), and Pascale Accaoui Lorfing (CREDIMI – University of Burgundy) · Sunday, November 20th, 2022

The current era of emergencies, which includes climate change, environmental challenges, armed conflicts, and health crises, has a profound impact on foreign direct investment (FDI). A panel held on 27 September 2022 as part of the second edition of the World Arbitration Update (WAU) engaged with the effect of such global emergencies on international investment law (IIL) by focusing on ideas related to "*Balancing the Protection of Foreign Investors and States Responses in the Post-Pandemic World*", a book published by Kluwer earlier this year and co-edited by Dr. Yulia Levashova and Dr. Pascale Accaoui Lorfing (also authors of book chapters). The book provides a comprehensive understanding of the impact of Covid-19 crisis on the IIL regime from both a State and an investor perspective. It draws focus to the analysis of investor rights and State defences from a multi-jurisdictional and regional standpoint, including Latin America, India, Korea, the United States and Russia. The book's detailed examination of the effects of a pandemic on States and investors demonstrates how any crisis can alter the balance between investors' legal protection under IIAs and the State's regulatory authority to implement emergency measures.

The panel was moderated by Dr. Alvaro Galindo (Universidad de las Americas; Carmigniani Pérez Abogados) with speakers Ms. Munia El Harti Alonso (Xtrategy LLP), Dr. Pascale Accaoui Lorfing (Research Associate CREDIMI – University of Burgundy), Dr. Yulia Levashova (Nyenrode Business Universiteit), and Dr. Crina Baltag (Stockholm University).

Risk Allocation – "Emergency Provisions" in Contracts and IIAs

Ms. El Harti Alonso addressed "emergency provisions," a concept that encompasses several different kinds of specific clauses that may be found in commercial contracts and international investment agreements (IIAs) (e.g. necessity and armed conflict clauses, as considered by the tribunal in *CMS v. Argentina*, para 353). She examined such emergency provisions through the lens of risk allocation because, fundamentally, the very existence of emergency provisions is premised on risk allocation (see e.g. *Strabag v. Lybia* referring to force majeure, para 791). She explained that such provisions are usually drafted by both contracting parties, or/and by the States that are parties to the relevant IIA. She elaborated that, in the FDI context, risk allocation provisions in related commercial contracts may be also invoked in an investor-State dispute, as the

investment tribunal may "identify and give effect to the risk allocation agreed by the parties in each contract" (see e.g. *Strabag v. Lybia*, para 791). This may include commercial contracts entered by an investor with a State – owned enterprise. With respect to IIAs *per se*, in *Guris v. Lybia* the tribunal went further and extended the risk allocation mechanism of the related commercial contract to its analysis of the IIA itself, in particular as to the emergency provision of the BIT such as the war losses clause of the 2004 Syria-Italy BIT (*Guris v. Lybia*, para 322). Ms. El Harti Alonso pointed out the triangular nature of IIAs, noting that in a Bilateral Investment Treaty (BIT), the host state and home state (rather than the investor) are the sole drafters of the clause. The State, through its role in drafting the clause, can be deemed to concomitantly have "assumed the risk of that situation [of force majeure (FM)] occurring" (*Guris v. Syria*, para 322, *ibid*). Such complexity is illuminated through the state's triple identity, as elaborated by Patrick Pearsall in his article 'The Role of the State and the ISDS Trinity' (2018), where he explained that in the IIL regime the host state wears a triple hat as "*treaty drafter, protector of investment and respondent.*"

Covid-19 and Fundamental Change Of Circumstances

Art. 62 of the Vienna Convention on the Law of Treaties (VCLT) sheds light on change of circumstances (CoC) in the international treaty regime and, as a general rule, provides that CoC may not be invoked as a ground to terminate or withdraw from treaties unless:

1. there has been fundamental change of circumstances;
2. such a change was not foreseen by the parties while concluding the treaties;
3. previously existed circumstances were the essential basis of consent of the parties to be bound by the treaty; or
4. the effect of the change is radically to transform the extent of obligations still to be performed under the treaty.

Dr. **Galindo** explained the legal effects of Art. 62, primarily focusing on the role of *travaux préparatoires* of the VCLT. He highlighted that CoC and consequences of *pacta sunt servanda* may apply in certain crisis situations. States may invoke Art. 62 VCLT to withdraw from IIAs upon a fundamental CoC occurring as a result of the crisis. However, it must be noted, the threshold to invoke CoC is high, as demonstrated in the *Gab?íkovo-Nagymaros Project ICJ case* as the conditions mentioned above must be cumulatively satisfied. With further nuance, Dr. Galindo added that going forward, attention must be paid to the strategy used by tribunals when resolving Art. 62 VCLT in connection to IIAs.

The State's National Security Interest and Force Majeure

In the intricate IIL regime, States' efforts to maintain national security are in the limelight. To safeguard national security interests, States may recourse to the provisions regulating essential security interest (ESI) or/and to the defence of force majeure (FM). **Dr. Accaoui Lorfing**'s chapter and presentation examine what constitutes FM, drawing attention to three sources that may provide guidance: (i) FM as defined by customary international law (CIL) as provided in the ILC's Draft Article on Responsibility of States for Internationally Wrongful Acts (2001) (ARISWA) Art. 23; (ii) FM as defined by national legislation and soft law; and (iii) FM clauses in contractual practice.

She emphasized the non-mandatory nature of FM clauses in national legislation, recalling that States may draft these clauses to prioritize either restrictive or expansive FM definitions. In terms of the obligation to notify the other party on FM, usually national legislation makes no mention of it, whereas soft law requires it. As such, she advised that these clauses should be drafted with a greater caution to include a list of qualified events as exemplified in the ICC model Clause on FM of 2020. This will assist parties in avoiding the situation in which a tribunal must determine what constitutes an FM situation and whether the FM clause applies in the case at hand.

States take measures for the protection of ESI i.e., national security, environment, climate change and human rights by including essential security exception clauses in IIAs. Dr. Accaoui Lorfing emphasised that ESI exception clauses have been included in an increasing number of the new-generation IIAs. As a result, tribunals will have to take these clauses into account more frequently in the future by carefully analysing their scope and the measures falling under an exception clause precluding liability, particularly in relation to the environment, human rights, and climate change. As the decision in *Eco Oro v. Colombia* case demonstrates, tribunals do not always give due consideration to the exception provision contained in an applicable IIA (para 829).

Legitimate Expectations of an Investor and the Right to Regulate

When States take measures during a crisis situation, such measures may interfere with the legitimate expectations of foreign investors under the fair and equitable treatment (FET) standard. **Dr. Levashova** addressed the tension of FET in relation to States' right to regulate (RTR). She drew upon her research to explain that RTR has been recognized by tribunals in the assessment of the legitimate expectations of an investor and comprised of several elements. These are:

1. States have inherent powers to RTR under customary international law;
2. States can modify their laws as a part of the RTR; and
3. the State's legitimate objective in serving the public interest is among factors that is assessed as part of an overall balancing exercise.

She elucidated that, in recent cases such as *Renergy S.a? r.l. v. Kingdom of Spain* and *Sevilla Beheer B.V. and others v. Kingdom of Spain*, tribunals have underscored that the assessment of legitimate expectations implies an inherent balancing of a state's RTR and the investor's rights. However, the manner in which tribunals perform the balancing exercise varies and there is no particular methodology followed in weighing the investor's expectation and the State's regulatory conduct. She pointed out to a lack of clarity regarding the hierarchy and allocation of weight among these factors in a tribunal's final determination regarding the breach of legitimate expectations. Thereafter, she drew the attention to a State's legitimate objective in serving the public interest and stated that it is only one among other intermediary factors in tribunals' assessments. This sometimes might be problematic specifically in cases that involve a strong public interest, as was demonstrated in an assessment of FET standard in *Eco Oro v. Colombia* case.

While discussing the investor's expectations of stability that may by a subject to protection, Dr. Levashova underlined that the scope of permitted regulatory changes is subject to ambiguity. She emphasized that FET claims arising out of the instability of a regulatory framework as a result of State measures aimed at dealing with any type of emergency are especially relevant in the context

of a health, economic or environmental crisis. Finally, she explained that prevalent number of tribunals underlined that a State has an obligation to ensure a stable economic and legal regime, and that the FET protects only against drastic changes or fundamental changes, while pointing out that this definition that may and is interpreted in different ways does not clarify the scope of permitted regulatory changes.

New Horizon – Moving Forward

Considering various emerging crises, it is critical to understand what comes next in the IIL regime. In this regard, **Dr. Crina Baltag** stressed that the book co-edited by Dr. Levashova and Dr. Accaoui Lorfing addresses the issue of a health crisis in a timely manner given the existing IIL framework and its critics. Dr. Baltag observed that the IIL framework is clearly evolving. As reforms are visible especially in the context of the next-generation of IIAs that include the elaborated RtR provisions, as well as specific exceptions and carve-outs.

In discussing new horizons in the IIL regime, she identified four lessons that can be learned from the pandemic and in the context of ongoing ISDS reform:

1. *Collaboration:* During the Covid-19 pandemic, there was clear cooperation between investors and States. Many States implemented the measures in such a way that allowed investors to successfully deal with the impact of these measures on their investments. She stated that, such collaborations are an important takeaway from the pandemic.
2. *Tools vested with investors and State:* She addressed the tools available to both States and foreign investors to cope with a health crisis, such as the Covid-19 pandemic. States, in her opinion, should always follow a transparent process when dealing with investors.
3. *Novel elements and changes*: She elucidated that Art. 62 VCLT is an unexplored tool in IIL that may become more relevant in the future.
4. *States' responses*: In addressing the States' responses to a crisis, more attention must be paid to FM clauses in national and soft law, as well as State responsibility in the IIL regime pertaining to preclusions, as reflected in ARISWA Chapter V.

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In sum, the webinar elucidated the legal nuances of the IIL regime in relation to crisis situations, such the Covid-19 pandemic. The discussions contained a timely analysis of the mechanisms that States can use to deal with an emergency, as well as the legal tools available to foreign investors under contracts and IIAs to protect their investments.

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