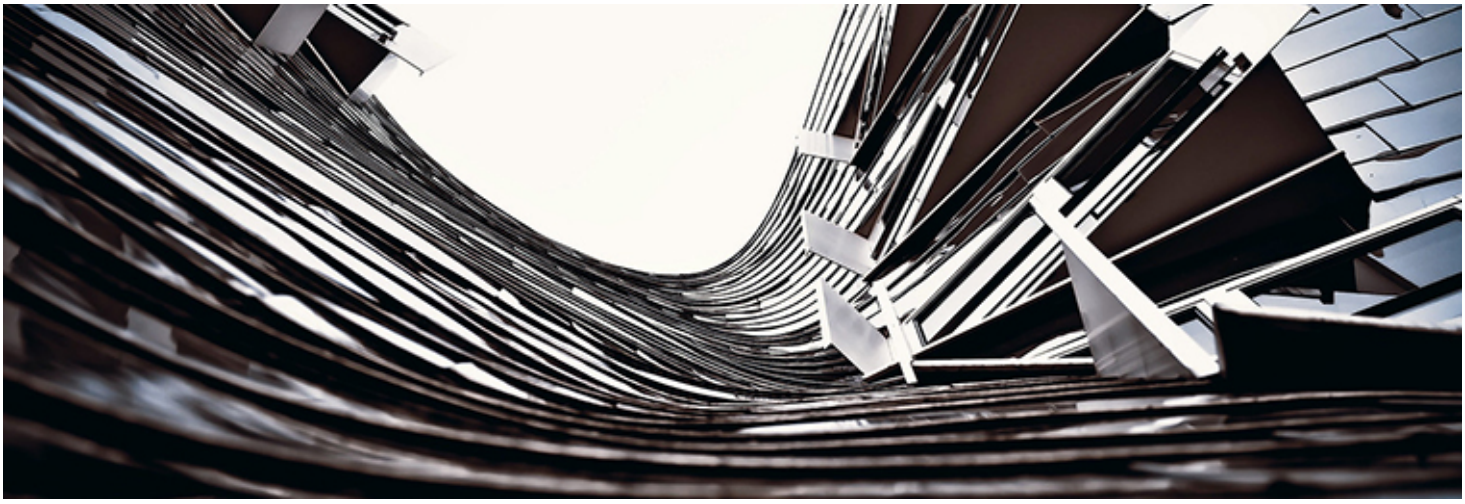

State defences to investment claims arising from COVID-19

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In our previous article (COVID-19 – a legitimate basis for investment claims?), we looked at whether measures taken by States in response to the COVID-19 pandemic could provide a legitimate basis for claims under bilateral investment treaties (BITs) or other investment protection instruments. We also looked broadly at defenses available to States under the terms of those instruments. In this article, we address in more detail some of the key defenses under customary international law that States may invoke to fend off such claims.

Overview

In response to the COVID-19 pandemic, States have been taking emergency measures to limit the impact of the virus. In our first article, we considered whether these emergency measures could give rise to claims by foreign investors for breaches of international law. Foreign investors who have been affected by such measures may, in certain circumstances, have a claim where their investment has been expropriated or where their business has been treated unfairly.

We also noted that some of the newer BITs and other investment protection instruments contain provisions that offer States some explicit lines of defense against such claims. For example, a number of recently concluded treaties contain a carve out for actions taken by the State to protect legitimate public welfare objectives, including public health. The availability of such defenses will be fact specific and will turn on the express wording of the BIT. In many instances, though, States may find that their BITs do not contain such carve outs; and they will need to turn to the defenses that

customary international law offers in such circumstances.

Customary international law

Customary international law is one of the three pillars of international law, sitting alongside treaties and general principles of law. It is a body of law arising from established practices that States consider to be binding, as opposed to rights and obligations arising from formal written conventions and treaties, or from other general principles. Thus, even in the absence of specific defenses agreed to in a BIT, a State may be able to invoke a range of defenses available under customary international law.

The International Law Commission's Articles on Responsibility of States for Internationally Wrongful Acts (2001) [1] (ILC Articles) codify six defenses that States may invoke to avoid responsibility. These defenses are referred to in the Articles as "circumstances precluding wrongfulness", and they apply in addition to any exception or defense provided for in the applicable BIT.

Of the six defenses recognized by the ILC Articles, the most likely grounds to be invoked in relation to COVID-19 related claims are:

- force majeure (Article 23);
- distress (Article 24), and
- necessity (Article 25).

The law on necessity is relatively well-developed in the context of investment claims, having been a core defense of the Republic of Argentina to the raft of claims it faced following the country's 2001-2002 economic crisis. Force majeure and distress, meanwhile, are legal concepts that have been invoked far less frequently as a matter of international law. As a result, there are fewer awards which examine the scope of these defenses.

Force majeure (Article 23)

Article 23 of the ILC Articles provides an exception from liability when a State's breach arises from force majeure. The provision states:

> "1. The wrongfulness of an act of a State not in conformity with an international obligation of that State is precluded if the act is due to force majeure, that is the occurrence of an irresistible force or of an unforeseen event, beyond the control of the State, making it materially impossible in the circumstances to perform the obligation.
>
> 2. Paragraph 1 does not apply if:
>
> a. the situation of force majeure is due, either alone or in combination with other factors, to the conduct of the State invoking it; or
> b. the State has assumed the risk of that situation occurring."

It is relatively uncommon for the force majeure defense to be relied on by States in the context of investment disputes. In 2003, Venezuela failed in its attempt to invoke force majeure to defend a claim related to road tolls.[2] Venezuela had sought to argue that it was unable to comply with its contractual obligation to increase toll fees due to civil unrest in the country. The tribunal in that case considered that a State can rely on the defense only when three conditions are met:

- impossibility of performance;
- unforeseeability of the event; and
- the force majeure event was not attributable to the State.

In respect of COVID-19, States will bear the high burden of establishing that the pandemic itself rendered performance of its obligations impossible.

Distress (Article 24)

The defense of distress is available where a State is required to take action to prevent a loss of life. In order to succeed with a defense of distress, the State would need to show that there was some special relationship between it and the

person or persons whose lives were in danger. As the Commentary on the ILS Articles states, the defense of distress "does not extend to more general cases of emergencies, which are more a matter of necessity than distress". [3] This requirement may prove problematic for States to establish where measures are implemented to protect the whole population, rather than a specific class of persons.

Necessity (Article 25)

If the defense of force majeure will require a State to show that it was prevented from fulfilling its obligations because of COVID-19, rather than that it was required to take affirmative action, and if the defense of distress may require a showing of a narrow relationship requiring specific action, the defense of necessity will likely be deemed more appropriate by States in the current context. The defense of necessity presupposes that a State was required to take certain actions to mitigate or avoid serious harm.

At least a dozen investment awards, the majority of which relate to Argentina and its 2001-2002 economic crisis, have considered the defense of necessity. They provide helpful analysis on the scope and the limits of this defense. Tribunals are largely in agreement on the cumulative conditions that must be met in order for a State to be able to invoke this defense successfully[4]. The key conditions include:

a. The act in question must be the only way for the State to safeguard an essential interest against a grave and imminent peril

   The question of whether an interest is essential will be extremely fact specific.[5] However, as a general rule, public health is likely to qualify as an "essential interest" that must be safeguarded in order to protect the fundamental needs of the population, and potentially even the continued existence of the State itself. Indeed, the tribunals in the *Suez I*, *Suez II* and *Impregilo* cases acknowledged that the provision of water and sewage services is vital to the health and well-being of a large population, and is therefore an essential interest of a State.[6]

   Given the scale of the pandemic and the advisory statements issued by the WHO, it is likely that tribunals would consider that COVID-19 would give rise to a "grave and imminent peril". The analysis of this aspect will, however, turn on the specific circumstances in any given State and at any given time.

   Even where a State can establish that a measure has been adopted to safeguard an essential interest against a grave and imminent peril, the State must also demonstrate that the measures implemented were "the only way" to safeguard the interest against the peril. Satisfying this part of the test was one of the hardest challenges Argentina faced before investment tribunals. The difficulty, as underlined by the tribunal in the *Enron* case, is that "there are always many approaches to address and correct such critical events, and it is difficult to justify that none of them were available in the Argentine case." [7] It remains to be seen how States – and tribunals – will engage with this vital limb of the test in respect of COVID-19.

b. The State's act must not seriously impair an essential interest of another State or of the international community as a whole

   Tribunals need to conduct a balancing act between allowing States to take measures to protect their own essential interests while ensuring that such measures do not impinge on other essential interests. To date, tribunals have given States considerable latitude in interpreting this balancing act, and have been reluctant to find that one State's actions have seriously impaired some other essential interest of another State or of the international community. Tribunals may react differently to actions such as a ban on exports of essential medical equipment (possibly impairing another State's ability to protect public health) than to actions focused on reducing local disease transmission.

c. The State cannot invoke necessity if it has contributed to the situation of necessity

   The Argentine cases included significant discussion of whether the factors precipitating the crisis were endogenous or exogenous.[8] While COVID-19 itself is an external factor not caused by an act of the State, a State's conduct in response to the pandemic will call into question whether any acts or omissions of the State exacerbated the situation of necessity. Tribunals have found that any causal contribution by the State must be sufficiently substantial, and not merely incidental or peripheral.[9] It is likely that the reasonableness and

> proportionality of a State's conduct will be considered not only on its own terms, but also by reference to the conduct of other States in comparable circumstances. [10]

Finally, if a situation of necessity is found, it will also be relevant to assess the period during which it was applicable. Measures adopted outside that period may not be covered by this defense. By emphasizing the exceptional nature of this defense, the tribunal in the *LG&E* case thus held that "[e]mergency periods should be only strictly exceptional and should be applied exclusively when faced with extraordinary circumstances."[11]

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The three defenses presented here are subject to a final, over-arching provision found in Article 27 of the ILC Articles. This provision requires States to comply with their obligations "if and to the extent that the circumstance precluding wrongfulness no longer exists", and establishes the possibility of compensation, in certain circumstances, for any material loss caused by the measures adopted. The rule, however, does not specify if compensation is payable during the state of necessity. Some tribunals, such as the one in the *LG&E v. Argentina*, "decided that the damages suffered during the state of necessity should be borne by the investor"[12], while others, such as that in the *BG v. Argentina*, considered that even if a situation of necessity is established, States have an obligation to compensate.[13]

Police powers – an additional line of defense?

It is also worth noting that in recent years, a number of States have sought to invoke the police powers doctrine as a defense to claims arising from regulatory changes. This doctrine, known in its French original "*ordre public et lois de police*" protects the State's bone fide right to regulate in such matters as the maintenance of public order, health or morality. Measures taken in the proper exercise of police powers may not be considered expropriatory and may not give rise to a right to compensation even when they cause economic damage to an investor.

Protecting public health has long been recognized as an essential manifestation of the State's police power. The question of the applicability of police powers in the investment arbitration context was considered in *Philip Morris v Uruguay*.[14] The tribunal found that a plain packaging requirement for tobacco products did not breach international law as the measures were taken by the State to protect public health in a valid exercise of police powers. In doing so, the tribunal noted that, in 1903, the Claims Commission in the *Bischoff Case* dismissed a claim for damages in respect of the requisition of a carriage to combat smallpox. In terms that could still be considered interesting today, that Commission stated: "[c]ertainly during an epidemic of an infectious disease there can be no liability for the reasonable exercise of police powers."[15] Any State seeking to invoke the police powers defense will, under that standard, need to show that it acted reasonably and proportionately.

Whether the requisitioning of a carriage in Caracas at the turn of the 20th century will prove a helpful precedent in the context of 21st century State measures to combat COVID-19 remains to be seen. It has, however, been over 100 years since the world faced a pandemic of this scale in the form of Spanish influenza. So perhaps a case from over 100 years ago may still hold valid lessons for us today.

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Our next article in this series will focus on claims that may be brought under the recently concluded trade between the US, Mexico and Canada, known as USMCA or NAFTA 2.0.

Please contact us if you would like further information.

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[1] UN General Assembly, Responsibility of States for internationally wrongful acts : resolution / adopted by the General Assembly, 8 January 2008, A/RES/62/61.
[2] *Autopista Concesionada de Venezuela, C.A. v. Bolivarian Republic of Venezuela* (ICSID Case No. ARB/00/5).
[3] ILS Articles, Article 24, para. 7.
[4] *CMS Gas Transmission Company v. The Argentine Republic* (ICSID Case No. ARB/01/8), Award, 12 May 2005, para. 317; *Enron Corporation and Ponderosa Assets, L.P v. Argentine Republic* (ICSID Case No. ARB/01/3), Award, 22 May 2007, para. 304; and *BG Group Plc. v. Republic of Argentina* (UNCITRAL), Award,

24 December 2007, para. 410. *Enron Corporation and Ponderosa Assets, L.P v. Argentine Republic* (ICSID Case No. ARB/01/3), Award, 22 May 2007, para. 313.

[5] *LG&E Energy Corp., LG&E Capital Corp., and LG&E International, Inc .v. Argentine Republic* (ICSID Case No. ARB/02/1), Award, 25 July 2007, para. 251.

[6]*Suez, Sociedad General de Aguas de Barcelona S.A., and InterAguas Servicios Integrales del Agua S.A. v. The Argentine Republic* (ICSID Case No. ARB/03/17), Decision on Liability, 30 July 2010, para. 238; *Suez, Sociedad General de Aguas de Barcelona, S.A.and Vivendi Universal, S.A. v. Argentine Republic* (ICSID Case No. ARB/03/19), Decision on Liability, 30 July 2010, para. 260, and *Impregilo S.p.A. v. Argentine Republic* (ICSID Case No. ARB/07/17), Award, 21 June 2011, para. 346.

[7] *Enron Corporation and Ponderosa Assets, L.P v. Argentine Republic* (ICSID Case No. ARB/01/3), Award, 22 May 2007, para. 308. See also *CMS Gas Transmission Company v. The Argentine Republic* (ICSID Case No. ARB/01/8), Award, 12 May 2005, para. 323.

[8] *Enron Corporation and Ponderosa Assets, L.P v. Argentine Republic* (ICSID Case No. ARB/01/3), Award, 22 May 2007, para. 311.

[9] *CMS Gas Transmission Company v. The Argentine Republic* (ICSID Case No. ARB/01/8), Award, 12 May 2005, para. 328.

[10] *Continental Casualty Company v. The Argentine Republic* (ICSID Case No. ARB/03/9), Award, 5 September 2008, para. 227; and *Urbaser S.A. and Consorcio de Aguas Bilbao Bizkaia, Bilbao Bizkaia Ur Partzuergoa v. The Argentine Republic* (ICSID Case No. ARB/07/26), Award, 8 December 2016, para. 714.

[11]*LG&E Energy Corp., LG&E Capital Corp., and LG&E International, Inc .v. Argentine Republic* (ICSID Case No. ARB/02/1), Award, 25 July 2007, para. 229.

[12] Ibid, para. 264.

[13]*BG Group Plc v. The Republic of Argentina*, Final Award, 24 December 2007, para. 409.

[14]*Philip Morris Brand Sàrl (Switzerland), Philip Morris Products S.A. (Switzerland) and Abal Hermanos S.A. (Uruguay) v. Oriental Republic of Uruguay* (ICSID Case No. ARB/10/7).

[15] Germany – Venezuela Mixed Claims Commission, *Bischoff Case* (1903) 10 RIAA 420.

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