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The Covid-19 Pandemic and Liability under Investment Treaties By Muthucumaraswamy Sornarajah

COVID-19 can increase liability for countries under international investment treaties. Professor M. Sornarajah, Emeritus Professor at the National University of Singapore, discusses in this *SouthViews* the imminent challenges faced under such treaties by developing countries. The text is based on his presentation at the South Centre webinar on “Responsible Investment for Development and Human Rights: Assessing Different Mechanisms to Face Possible Investor-State Disputes from COVID-19 Related Measures” held on 30th June 2020. The recording of the webinar is available here: <https://www.youtube.com/watch?v=yXPswKuywvA>.

The Covid-19 pandemic will affect the international law on investment more than any other event in its history. The two competing interests of the state’s right to regulate in the public interest and the need for investment protection will come into direct conflict. In that conflict, the outcome will favour the state’s right to regulate and make investment protection a secondary interest. This will end the neoliberal trend that prioritized the interest of market forces predicated/based on the theory that public interests are best fostered through permitting a free rein to market forces, which included foreign investment and its protection.

The pandemic is a crisis like no other. The World Health Organization (WHO) declared it to be a “public emergency of international concern”.¹ Every crisis that has occurred - the Argentine economic crisis in 1998-2004, the global economic crisis of 2008 and the Arab Spring - have brought about a spate of arbitrations against states. They have involved expansionist creation of new law that have brought discontent with the system of investment arbitration. The pandemic presents similar problems except that they affect virtually every state in the world. The measures taken to meet the pandemic by the affected states have been roughly similar. Lockdowns were imposed; offices were shut down; requirement of social distancing meant that schools, restaurants

¹ The WHO first declared the pandemic to be a “public health emergency of international concern” (PHEIC). PHEIC is the abbreviation given for the highest type of public health emergency. WHO expects to maintain this status for a long time (“Virus Effects to Last for Decades”, *The Hindu*, 1 August 2020). It has advised the world to live with the virus. Most of the measures taken by the states to deal with the pandemic are consistent with the recommendations of the WHO which adds to the legal justification of the measures and explains the world-wide uniformity in the measures taken.

and other public spaces were closed; public transport did not operate; factories were diverted to the production of ventilators; hotels were taken over to be quarantine centres; private hospitals were taken to provide for the increasing number of patients; price controls were instituted for medicines; ports were shut down to prevent entry of foreigners carrying the disease.

These various measures taken by states could amount to breaches of investment treaty provisions because they would affect foreign investors. The taking over of foreign owned hotels as quarantine centres could amount to expropriation. The prevention of exports or diversion of production capacity to produce ventilators could amount to the violation of fair and equitable treatment. The United Nations Conference on Trade and Development (UNCTAD)'s Investment Policy Monitor in a special issue² anticipated that there would be a large number of investment arbitrations brought against states in respect of those various measures. The websites of various law firms offer their services in respect of the anticipated claims.

If such claims are brought, their success would be tenuous under the current and emerging law. It is now established that measures to protect the health of the public are regulatory in nature. They will not amount to compensable expropriation if property is affected.³ They will not be a violation of the fair and equitable standard if they were regulatory measures taken in the public interest. Besides, there is a plethora of defences that becomes available. National security precludes not only measures taken to avoid military threats amounting to a breach, but also to avoid the dangers posed by pandemics and other crises. Since the preservation of life is involved, human rights consideration could also provide adequate validity to the measures taken. The defence of necessity could be available, except in the possible instance where an effective alternative producing less harm was available.⁴

These are new developments which have been made. They are to be found in the new, "balanced treaties" which make sustainable development their goal. The older treaties which contain only provisions on investment protection do not preserve regulatory space nor do they refer to defences to liability. Most arbitral awards are still based on the old treaties. Even in the case of the ones based on newer treaties, the ingrained tendency of the arbitrators would be to interpret the restrictions on liability in a narrow manner. There are also arbitrator-constructed doctrines which have no basis in the treaties like proportionality which give discretion to the tribunals to limit the scope of the regulatory powers of states or the scope of the defences by allowing them to review public policy decisions rather than according governments sufficient discretion. If disputes are brought before them, there will be a category of arbitrators who will make a finding of state responsibility even if the treaty under which it is brought is a balanced treaty, and unless the treaty has confined claims to denial of justice or discrimination. But even in the latter case, discrimination remains a possible basis of claim. Due to the need to act fast, or in particular geographical areas, a state may have given facilities to local business it did not give foreign investors. The state may have taken over foreign owned hospitals without taking locally owned hospitals. Claims are still possible under treaties which define the possible claims narrowly. The possibility of liability remains open. Consequently, the steps that states can take to avoid responsibility for such liability or the bringing of claims must be considered.

² UNCTAD, "Investment Policy Responses to the Covid-19 Pandemic", *Investment Policy Monitor Special Issue No. 4* (May 2020).

³ *Philip Morris v Uruguay* (ICSID Case No. ARB/10/7), *Philip Morris v Australia*, PCA Case 20/12 (17 December 2015); *Methanex v U.S.*

⁴ This formulation of necessity is taken from the International Law Commission (ILC) Draft on State Responsibility. There is little authority for the view that necessity is not available if there is an alternative producing lesser harm. It is not a calculation that can be easily made given the exigencies of the circumstances. There is little authority for the requirement that there should be no alternative available.

One must have heed also to the fact that threats of arbitration could be made through the simple filing of a memorandum of arbitration to exert pressure on the state to not impose restrictive measures on the claimant. They could also be brought to bring about a “regulatory chill” to ensure that states avoid taking further measures even where necessary to control the epidemic in fear of arbitrations.

There are two other types of claims that could come about. The economies of all states will be enfeebled as a result of virtual stoppage of production. Recovery will be slow. Developing states would be most affected. During this period, developing states as well as other states will face difficulties in servicing their loans and bonds. As is known, in certain circumstances, such sovereign defaults could give rise to claims based on treaty violations.⁵ There will be a need to reform the financial system to cope with the new realities that emerge again resulting in violation of treatment standards of foreign banks.⁶ The other situation is that the effects of the economic decline will be felt by the most disadvantaged communities in the society. They could resort to violence if there is a shortage of food, denial of essential commodities and services or widespread unemployment. The discontent could be diverted to foreign investors. This would involve the state in giving protection to the foreign investors. Failure to do so could trigger claims based on the violation of giving full protection and security to foreign investment.⁷

After the pandemic is over, the exact time being unpredictable, there will be a long recovery phase during which measures will have to be taken to restart the economies of states devastated by the pandemic. These measures, such as the restructuring of industries, devaluation of currencies and exchange controls will affect foreign investment adversely. The period of recovery could last for several years. The potential for investment disputes during this period remains great. The most affected states would be the developing states of the world. They can hardly sustain the impact of claims for violation of investment treaties, at a time when they have to rebuild their economies from scratch. Means of forestalling such investment arbitration have to be explored. Six such means are considered below:

(i) Termination of Investment Treaties

Given the legitimacy crisis in investment arbitration, the termination of treaties is becoming a common occurrence. Treaties are suspended along with their sunset clauses, which keep obligations under it alive for a period of time after termination. The European Union ensured that intra-European investment treaties are terminated by consent so as to accord with the Achmea decision. India and Indonesia unilaterally terminated their investment treaties with the intention of replacing them with new model treaties which are of the reformed “balanced” variety. Ecuador terminated treaties on the advice of a Presidential Commission on the subject of investment treaties. South Africa terminated its treaties unilaterally and replaced them with domestic legislation making foreign investment a matter exclusively for domestic law- a true return to the Calvo doctrine.

⁵ *Abaclat and Others v. Argentine Republic*, ICSID Case No. ARB/07/5 (4 Aug. 2011); *Ambiente Ufficio S.p.A. and others v. Argentine Republic*, ICSID Case No. ARB/08/9 (8 Feb. 2013), 470-471; *Theodoros Adamakopoulos and others v. Republic of Cyprus*, ICSID Case No. ARB/15/49 (7 Feb. 2020).

⁶ *Marfin Investments v Cyprus*, ICSID ARB/13/27 (26 July 2018); *Postova Bank v Greece*, ICSID Case No. ARB/13/8 (9 Apr. 2015). Tribunals have recognized the right to regulate in these circumstances. Newer treaties provide for the situation.

⁷ For an instance of the Arab Spring giving rise to such claims, see *Ampal v Egypt*, ICSID Case ARB/12/11 (1 February 2016).

Unilateral termination of treaties is permitted under the Vienna Convention on the Law of Treaties under two circumstances. The first is where there is a fundamental change of circumstances.⁸ Clearly, the global pandemic is such a fundamental change. If it could have been foreseen at the time of the treaties, it would have been provided for. Another change is that states no longer make the old-style investment treaties without conserving regulatory space. There are sufficient changes in circumstances that justify the unilateral termination of treaties that restrict the taking of measures to combat the pandemic. The second situation of permitted termination is where there is a growth of an *ius cogens* norm which is inconsistent with the treaty which is terminated.⁹ The right to health is such an *ius cogens* norm. It is not the right to health as such that becomes an *ius cogens* principle but that in the context of the pandemic which has taken so many lives, the state's duty to provide medicines and treatment are factors that are included in the right to life. In that context, there is an *ius cogens* norm which renders any treaty principle that conflicts with it redundant. Its frequent assertion in recent tribunals elevates it to that status. In any event, in the case of the pandemic, since loss of life is heavy, it is associated with the right to life which is a principle of *ius cogens*. The argument is further bolstered up by the fact that the impact of human rights law on principles of investment liability is relatively new. In context, the right to health is a new *ius cogens* principle which invalidates investment treaties and justifies their termination.

(ii) Suspension of Treaties

States may be reluctant to terminate treaties unilaterally. In that situation, their suspension targeted at the measures taken to control the pandemic should be considered. Unilateral suspension of treaty obligations is permissible under the same instances of change of fundamental circumstances and the growth of an inconsistent *ius cogens* norm.

(iii) Withdrawal of Consent to Arbitration

Withdrawal of consent to arbitration is the most expeditious way of bringing a halt to the problem of large numbers of claims before arbitral tribunals. It also has been a frequently used technique in the face of anticipated claims that would involve the award of large sums of compensation. Faced with a history of such claims, several states in Latin America have had recourse to this technique. They include Venezuela, Ecuador and Uruguay. There is no law against such withdrawal of consent. No obligations would be broken as a result. The dispute settlement provisions giving the right to arbitration to foreign investors do not require that there should be consent maintained before the indicated tribunals. In the two arbitrations brought against Venezuela, the tribunals accepted the validity of the withdrawal of consent by Venezuela. The withdrawal of consent remains a quick way of ensuring that arbitrations are not brought. The withdrawal could be confined to claims arising from measures relating to the pandemic.

(iv) Statutory Prohibition of Recourse to Arbitration

⁸ Article 62(1) of the Vienna Convention on the Law of Treaties which reads: "A fundamental change of circumstances which has occurred with regard to those existing at the time of the conclusion of a treaty, and which was not foreseen by the parties, may not be invoked as a ground for terminating or withdrawing from the treaty unless:

(a) The existence of those circumstances constituted an essential basis of the consent of the parties to be bound by the treaty; and

(b) The effect of the change is radically to transform the extent of obligations still to be performed under the treaty".

⁹ Article 64 of the Vienna Convention on the Law of Treaties which reads: "If a new peremptory norm of general international law emerges, any existing treaty which is in conflict with that norm becomes void and terminates".

It is possible for a state to prevent claims being brought to litigation or arbitration by appropriate legislation. It could also prevent persons or corporations resorting to international arbitration regarding disputes arising from Covid-19 related measures. This will not prevent the foreign arbitration tribunal having jurisdiction if a claim is made before it. But, the claimant would be challenging the law of the jurisdiction in which business is conducted. Such a prohibition may deter pressure being brought against the state to negotiate for exemptions from measures or to bring about a regulatory chill.

(v) Corporate Responsibility

Moral pressure could be brought against the claimants not to bring claims in respect of violations of treaty standards on the basis of the pandemic measures. A foreign corporation must take the same business risks as the local businesses. It should not complain when the same measures that are being taken in its home state are being taken in the host state. The notion of corporate responsibility would require the foreign corporation operating in the host state to suffer along with the citizens of the host state the unforeseen circumstances that occur within the state. The existence of remedies outside the host state in respect of measures taken to control such circumstances in itself shows the inequity involved in the disparity. If the foreign corporation were to seek remedy overseas, it will attract considerable criticism within the state.¹⁰

The pandemic will lead to much rethinking about investment law. At a time when the United Nations Commission on International Trade Law (UNCITRAL) trifles with peripheral changes to the system,¹¹ more radical rethinking of the issues relating to investment arbitration will take place among states and others concerned with the abuse of the system.

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¹⁰ An analogous situation is where producers of AIDS drugs brought an action against the Government of South Africa against parallel imports. The litigation was withdrawn due to moral pressure brought about by public protests both within and outside South Africa against the litigation.

¹¹ The current proposals show little concern with the substantive law in which lie the causes of the illegitimacy claims directed at investment arbitration. Also, apart from considering the phenomenon of “double” and “triple” hatting and repeat appointments, the fact that a systemic community has arisen whose values dictate investment arbitration is not being considered.