COVID-19, Preventative Measures and the Investment Treaty Regime

By:

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A pandemic with serious economic impacts

The World Health Organization has declared COVID-19 a pandemic, marking the latest in a list of public health crises, which includes SARS, the H1N1 influenza virus, MERS, Ebola, and the Zika virus. The mounting human cost associated with the rapid spread of the coronavirus, causing COVID-19, has provoked stringent preventative measures that restrict the movement of people, and encourage or mandate self-isolation. Some States have made the quarantine mandatory for people with a high risk of exposure to the coronavirus. In contrast, some countries have gone into complete lockdown, while some cities around the world are under near complete lockdown. Meanwhile, several States have declared a state of emergency allowing the executive to impose mandatory measures to contain the outbreak and some States have called for military assistance to tighten their grip in the battle against the pandemic. Indeed, these measures are vital to prevent the coronavirus from spreading further. Yet, their inevitable economic impacts are already being felt,

and have given rise to numerous issues such as labour shortages, reduction in manufacturing capacity and prevention of the cross border movement of products and services. As a consequence, supply chains have been disrupted, increasing the risk of a growing number of businesses halting their production and halting the provision of services. It has thus been predicted that the economic impacts of the COVID-19 pandemic for some States would be potentially greater than the global financial crisis, as it seriously impacts most sectors of the economy, particularly manufacturing, trading, retail and tourism and travel-related industries.

The Tension between the Human Cost and Economic Cost of COVID-19

The full effect of preventative measures concerning COVID-19 on the global economy is yet to be seen, but the tension between the human cost of health crises and the economic cost of managing them is already manifested. It has been reported that the economic impact of the stringent preventative measures taken by China, such as locking down cities entirely and closing of workshops, prompted some business executives to insist on the urgency of streamlining rules to reopen factories and get workforces and production running again, while encouraging the Chinese government to relax the quarantine regulations, notwithstanding its necessity in controlling the spread of the virus. Similar tensions are now apparent in other parts of the world as growing number of States are taking extraordinary preventative measures to deal with the COVID-19 pandemic since the spread of the coronavirus continues to grow. One of the best examples so far is the Spanish government's decision to nationalize all private hospitals and healthcare providers to contain the spread of the coronavirus in Spain, one of the worst-affected countries in Europe.

It is thus apparent that preventative measures relating to COVID-19 are becoming increasingly stringent. Some of them, such as the prolonged and compulsory closure of businesses and nationalization of private properties interfere with private interests, particularly those of foreign investors. This scenario could possibly trigger allegations on the violation of investment treaty obligations undertaken by States through entering into international investment agreements (IIAs), such as the obligation to afford fair and equitable treatment

to foreign investors and not to nationalize their properties without compensation. If so, could States rely on any of the provisions in investment treaties to shield their measures aimed at containing the COVID-19 pandemic from possible allegations on violating investment treaty protection afforded to foreign investors?

Shielding preventative measures relating to COVID-19 from possible allegations on investment treaty violations

To begin with, provisions in IIAs that expressly or implicitly refer to public health and safety or the State's right to regulate are the relevant starting point, as preventative measures relating to COVID-19 are ultimately aimed at safeguarding public health, a responsibility which rests with the State. However, not all such provisions are equally germane in justifying and excusing preventative measures, as their functionality depends on the manner in which they have been included. For context, an express reference made to public health in the preamble to the treaty provides an interpretative guidance for arbitrators, advocating a more balanced treaty interpretation that looks beyond mere investment-related matters and purely economic considerations. Moreover, right-to-regulate clauses which require State regulations of investment "to be consistent" with the agreement (e.g., NAFTA Article 1114[1]), make an implied reference to a pre-existing State right that remains restrained by other clauses in the agreement. Such restrictive language does not establish the primacy of the State's right to regulate over the treaty-based rights of investors, but indicates otherwise. On the contrary, right-to-regulate clauses which reaffirm State right to regulate to achieve legitimate policy objectives, such as the protection of public health, give an explicit recognition to the inherent right to regulate in the public interest (e.g., CETA Article 8.9).

Presumption against compensation for non-discriminatory regulatory measures and the doctrine of the State's police power

Accordingly, the presumption against compensation for non-discriminatory regulatory measures to protect legitimate public welfare objectives, which necessarily includes the protection and preservation of public health, is likely to be invoked by the States, where possible. This presumption is routinely included in modern IIAs, mainly in the context of indirect expropriation, one of

the frequently invoked treatment standards. It allows States to take measures for the protection of public health without paying compensation, unless the claimant foreign investor disproves the presumption and, therefore, establishes an indirect expropriation which is compensable. Hence, this presumption does not provide States with an absolute right to regulate, and thus its successful invocation to shield preventative measures relating to COVID-19 depends not only on their non-discriminatory nature but also their proportionality. Measures that are more damaging to foreign investors than is required to achieve their objective will be prevented from benefitting from the presumption. Modern IIAs further facilitate a holistic analysis in the context of indirect expropriation by providing a list of criteria to be considered when determining the existence of an indirect expropriation, which include both the economic impact of any disputed measure and its character, the latter of which is significant to validate measures taken in response to health-related matters.

Similarly, States could invoke the doctrine of the State's police power, the relevance of which has been accepted in relation to claims arising under the expropriation clause in IIAs by virtue of Article 31(3) (c) of the Vienna Convention on the Law of Treaties (e.g. Philip Morris v. Uruguay). The doctrine underscores that State regulations within the accepted police power or normal regulatory power of States are not considered as a compensable expropriation provided that such measures are taken bona fide for the purpose of protecting public welfare, in a non-discriminatory and proportionate manner. Accordingly, the valid exercise by a State of its police power in responding to the COVID-19 pandemic would not constitute a compensable expropriation as the protection of public health is routinely contemplated as an essential manifestation of the State's police power. This is the reason why the Germany-Venezuela Mixed Claims Commission in the case of Bischoff relied on the police power doctrine to reject claims challenging measures designed to protect health, by stating that "there can be no liability for the reasonable exercise of police powers during an epidemic of an infectious disease"- smallpox in this particular case.

Non-precluded measures (NPM) clauses

In addition, States could rely on the non-precluded measures (NPM) clause, which allows States to respond to extraordinary circumstances such as health

emergencies by taking measures that would otherwise be inconsistent with their IIA obligations. The successful invocation of a NPM clause, accordingly, removes some State measures from the substantive protections of a given IIA insofar as they were taken in pursuance of permissible policy objectives stipulated in the treaty. This transfers the burden of risk for the damage to foreign investment from the host State to the foreign investors and relieves potential State liability to pay compensation to aggrieved foreign investors. Therefore, NPM clauses in IIAs are vital to shield preventative measures relating to COVID-19 from possible allegations on violating investment treaty protection. Yet, their successful invocation depends on a number of conditions that vary across IIAs due to the typological variations in NPM clauses. To be precise, to successfully shield preventative measures under a NPM clause modelled on the basis of GATT Article XX or GATS Article XIV, which includes the protection of public health as one of the permissible objectives, in general, such measures should not have been applied in an arbitrary or unjustifiable manner, or they should not constitute a disguised restriction on international trade or investment. Such conditions are understandably aimed at preventing possible abuses by the States invoking the clause.

NPM clauses modelled on the basis of GATT Article XX or GATS Article XIV generally set a higher threshold for establishing the means-end relationship between the disputed preventative measures and the aim of containing the spread of the coronavirus - the necessity test. With respect to the COVID-19 preventative measures, this test would involve 'weighing and balancing' several factors pertaining both to the preventative measure to be justified as 'necessary' and possible alternative measures which would be reasonably available to the State to achieve its pursued objectives, as demonstrated by the WTO Appellate Body Report in *China-Publications and Audio-visual Products*. However, the use of WTO case law in interpreting NPM clauses in IIAs modelled on the basis of GATT Article XX or GATS Article XIV is doubtful. Both the tribunals in the recent cases of *Bear Creek Mining Corporation* v. *Peru* and *Copper Mesa Mining Corporation* v. *Ecuador* did not refer to the WTO case law when they applied and interpreted "WTO-styled" NPM clause in respective IIAs; Canada-Peru FTA of 2009 and Canada-Ecuador BIT of 1996.

Conversely, NPM clauses devised as “prohibitions and restrictions” clauses do not generally set a higher threshold for establishing the means-end relationship, allowing States to apply prohibitions or restrictions of any kind or take any other action, inter alia, which is directed to or taken for the protection of public health. Some of such clauses, mainly found in Indian BITs, articulate actions taken “in circumstances of extreme emergency” as another permissible objective which would encompass health emergencies like the COVID-19 pandemic. Such clauses, which mostly appear in early South-South IIAs such as the China-Sri Lanka BIT of 1986 and Sri Lanka-India BIT of 1997 (now terminated), apparently afford the State with considerable room to shield preventative measures relating to COVID-19 from possible allegations on violating investment treaty protection. However, this is conditional on States showing that such measures were designed to contain the rapid spread of the coronavirus causing COVID-19, and are applied on a non-discriminatory basis or in a reasonable manner where the respective treaty imposes such conditions.

Even if public health is not an expressly recognized permissible objective, security exception clauses are also significant in this respect, provided that they are not drafted to be limited to armed attacks. This is because any imminent threat to the health of a population of a given State could be reasonably argued as coming under the security exception clause, as health is essential to ensure the safety of a nation and its populace. Moreover, the concept of national security has become a multifaceted phenomenon that goes beyond interstate conflicts and encompasses a wide range of threats, inter alia, infectious disease. Meanwhile, the possibility of invoking general exceptions for security measures to defend non-military threats has been conceded in the investment treaty jurisprudence, particularly the arbitral awards relating to investment disputes stemming from the Argentine financial crisis. Compared to the non-self-judging security exception clauses, self-judging clauses apparently provide States with enhanced freedom to take measures they deem necessary to protect and preserve public health, especially during a health crisis, by limiting the scope of arbitral review only to the good faith invocation of the clause.

Concluding remarks

It is thus apparent that States could rely on a number of provisions in investment treaties to shield their measures aimed at containing the COVID-19 pandemic, which ranges from mere interpretation guides to limitations on the substantive treaty protection. Such provisions are vital to provide States with regulatory flexibility to deal with health-related matters including health emergencies, provided that such measures are taken bona fide for the purpose of protecting and preserving public health in a non-discriminatory, non-arbitrary and proportionate manner. In addition to these treaty provisions, States could rely on secondary rules on State responsibility to defend preventative measures relating to COVID-19, yet their successful invocation depends on satisfying several conditions set out in the ILC's Draft Articles on the Responsibility of States for Internationally Wrongful Acts, a discussion of which is beyond the scope of this post. Meanwhile, the applicability of the doctrine of margin of appreciation, developed by the European Court of Human Rights, to the claims arising under BITs has been accepted, justifying why investment tribunals should pay deference to governmental judgments of national requirements in the protection of public health when the "discretionary exercise of sovereign power, [is] not made irrationally and not exercised in bad faith" (Philip Morris v. Uruguay at [399]). Such a progressive interpretative approach considerably lessens the chilling effect of the investment treaty regime, particularly during health crises, which requires State measures to protect and preserve public health, as the responsibility thereof essentially rests with the State.

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