State Responsibility for COVID-19 Regulatory Measures under International Economic Law

By:

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The COVID-19 pandemic has made the regulatory measure known as lockdowns a routine response in some states that have seen the COVID-19 virus invade their territories. Lockdowns are meant to lower the spread of the COVID-19 virus within a territory by slowing down the movement and interactions of people so that they do not infect each other with the virus. One of the features of a lockdown is the temporary closure of businesses that are deemed non-essential by a state. Some of these businesses may be owned by foreign investors. The fact that a lockdown is not applied in every state that has CIVD-19 cases means that it is a discretionary measure that must be justified and applied with caution, bearing in mind possible investor claims. The possibility of legal action that challenges lockdowns is not remote. In South Africa, there have been threats of legal action against the government relating to the lockdown regulations (as amended from time to time) from alcohol retailers, hot food retailers and tobacco manufacturers. Aside from enacting lockdown regulations, states also took an array of investment policy measures triggered by the COVID-19 pandemic. These will impact investments differently across the globe, as the content and context of the measures varies.

An issue that arises is, to what extent, if at all, can a host state be held liable for losses suffered by foreign investors as a result of a lockdown and the subsequent mandatory suspension of trading imposed by the host state. Due to space constraints, this post cannot exhaustively answer this question, but it will and seeks to briefly analyse the fundamental legal aspects from an international economic law perspective.

Under customary international law, states as sovereigns have the right to regulate all activities within their territories. States exercise their regulatory authority by means of sovereign actions including legislation, which may be in the form of acts of parliament, regulations, decrees, orders, proclamations etc. Regulations passed under emergency circumstances potentially put host states at risk of investor claims as they are drafted in a hurry and with limited time for public consultations compared to acts of parliament. Therefore they must be designed not to expose host states to investor claims. For example, when South Africa banned the sale of hot food, Werkmans, a big five South African law firm was also quick to advise Woolworths, a major food and clothing retailer that the ban is unlawful. This incident illustrates how a state can, when acting in haste, easily overlook the parameters of the actions it seeks to regulate. In the process, a state can leave gaps in the regulation, or it may for example exceed its authority and expose itself to lawsuits. Developing states that do not have access to specialist legal resources in this regard are most at risk of having poorly crafted regulations. They may also lack the resources to properly enforce such regulations, thereby further exposing a state to damages claims occasioned by poor or negligent enforcement of lockdown measures.

A while ago I had an opportunity to reflect on the basis on which a host state may be responsible to compensate an investor for a wrongful act committed by it. In my thesis, I adopted the point of departure that a host state incurs international responsibility towards an investor under circumstances where it breaches one or more of the following:

(a) A rule of customary international; (b) A a treaty obligation, in this case one arising from a bilateral or multilateral investment treaty; (c) An investment contract between a host state and a foreign investor; and/or (d) By the enactment of legislation.

The Draft Articles on Responsibility of States for Internationally Wrongful Acts (ARSIWA) provide some of the underlying principles regarding the responsibility of states towards aliens such as foreign investors. The articles are a codification of the principles of customary international law. The articles define what an internationally wrongful is; how a wrongful act is attributable to a state; and what the consequences of such an act are. Briefly, key provisions of the articles that are relevant to the responsibility of states towards forreign investors are as follows. I discuss these in my thesis. However, some of the provisions of ARSIWA are controversial and do not fully represent the legal position as they purport to do. Therefore one must not lose sight of the fact that the laws relating to the protection of aliens and investors in particular has a historical bias in favour of investors who predominantly are nationals of capital exporting states. This is more so when regard is had to investor rights such as full compensation for expropriation. Leading scholars such as professors Dugard and Sornarajah have argued, as I do in my thesisthat despite the provisions of ARSIWA regarding reparation to internationally wrongful acts as stated below, it is not a universal rule of international economic law that expropriation must always be accompanied by full compensation. A look at the investment laws of states and investment treaties will reveal this untruth. A look at the history of investment treaties also attests to the fact that these treaties came into being as a form of protection of investors without regard to the rights of host states, who were predominantly developing states. Professor Gathii and Vandevelde's articles in this regard are some of the best I have come across in this regard. I also address this issue in my recent article.

Article 2 of ARSIWA states that there is an internationally wrongful act of a State when conduct consisting of an action or omission: (a) is attributable to the State under international law; and (b) constitutes a breach of an international obligation of the State.

Article 3 provides that the determination of whether an act is wrongful or not is conducted in terms of international law, not the municipal law of a host state. This connects with articles 26-27 of the Vienna Convention on The Law of Treaties, which provides that treaties must be honoured in good faith, and further provides that a state may not rely on its municipal law to avoid compliance with a treaty obligation. Article 32 of ARSIWA affirms article 27 of the Vienna Convention on The Law of Treaties. Articles 4-11 provide for circumstances under which an act or omission may be attributable to a state. In terms of article 4 of ARSIWA, the conduct of the legislature, the executive and the judiciary are attributable to a host state. Hence a state incurs international responsibility by the enactment and enforcement of legislation such as COVID-19 regulations. Article 5 states that the acts of an entity that is not an organ of a state but which exercise governmental authority, are attributable to the state. This provision covers parastatals, state owned entities and public entities. Of importance is that a state incurs international responsibility for the acts of its organs or entities that are authorised to exercise governmental authority even if they acted ultra vires. Articles 12-15 deal with the breach of an international obligation. Article 23 exempts a state from international responsibility where force majeure prevents it from complying with an obligation. Article 15 states that a series of actions may be taken as one in order to consider their combined effect and wrongfulness. This incorporates for example measures that may amount to creeping expropriation. Articles 20-26 detail circumstances where the conduct of a state may be precluded from being wrongful, such as consent and necessity. Articles 28-37 provide the consequences of an wrongful act. Of relevance here are articles 31 and 34, which when read together codify the decision in the *Factory at Chorzow (Germany v Poland) (Jurisdiction)* and *Factory at Chorzow (Germany v Poland) (Merits)* to the effect that a state is responsible for breach of an international obligation, and that it must make such reparation for injury attributable to it which shall wipe out the consequences of its wrongful act. Articles 35-37 provide for restitution, compensation and satisfaction respectively.

Working from the premise that bona fide regulatory measures are not compensatory, under customary international law, a regulatory measure must first be assessed in terms of certain criteria in order to determine if it amounts to indirect expropriation (and is therefore compensatory) or not. I discussed these criteria in my thesis. The criteria are: lack of public purpose, discrimination, lack of due process, lack of proportionality, lack of fair and equitable treatment, abuse of rights and direct benefit to a state. In *Phillip Morris Brand SARL v Uruguay*, the tribunal held unanimously that regulatory measures must be bona fide, non-discriminatory and proportionate. Therefore this decision adds the requirement of bona fides to the criteria stated above, as recent tribunals in *A11Y v Czech Republic*, *Marfin v Cyprus* and *UP and C.D Holding Internationale v Hungary* did. *Marfin v Cyprus* followed *Phillip Morris Brand SARL v Uruguay* in this regard. *Phillip Morris Brand SARL v Uruguay* added that in order to amount to indirect expropriation, a regulatory measure must amount to a substantial deprivation of its value, use or enjoyment. Recently the tribunal in *A11Y v Czech Republic* affirmed that a claimant bears the onus of proving that the criteria for indirect expropriation are met.

It must however be borne in mind that the doctrine of judicial precedent does not apply to investor-state arbitration and thus no tribunal can set binding criteria in this regard. Therefore the criteria are a guide only.

I also indicated in my thesis that in addition to the above criteria, there are two approaches that are used to assist in the determination of whether a regulatory measure is indirectly expropriatory or not. These are the intent approach, and the effects approach. The intent approach postulates that a regulatory measure must be assessed from the point of view of the intention and purpose of a state's regulatory measure. The recent decisions of *Marfin v CyprusUP and C.D Holding Internationale v Hungary* applied this approach.

The challenge with this approach is that it is subjective, although a tribunal will also objectively consider the factual circumstances concerned. Furthermore, the test cannot stand on its own, as it does not exclude the enquiry into whether the requirements for indirect expropriation such as the complete or substantial destruction of the value of an investment are met. It also does not replace the criteria stated above with regard to whether a regulatory measure is compensatory or not. These requirements may override the stated intention of the state. Nonetheless, the intention of a state is relevant to, among others, provide the context within which the regulatory measure took place. The tribunals in *A11Y v Czech Republic,* *Marfin v Cyprus* and *UP and C.D Holding Internationale v Hungary* considered the intention of the state in the course of assessing whether the regulatory measures in those cases were bona fide. In *UP and C.D Holding Internationale v Hungary* the tribunal considered the intention of the respondent state, but it also applied the criteria of public purpose, proportionality, effect of the measure, discrimination, due process, and the duty to pay expropriation. In my view this supports the point I make above that the intent approach is not a self-standing test for whether a regulatory measure amounts to indirect expropriation or not.

The effects doctrine states that the determining factor when assessing whether a regulatory measure is indirectly expropriatory or not is the effect that a regulatory measure has on an investment. Its proponents argue that a regulatory measure will be compensatory if its effect is the same as if indirect expropriation had taken place. *Phillip Morris Brand SARL v Uruguay* supported this doctrine when the tribunal held that “Be that as it may, in order to be considered an indirect expropriation, the government’s measures interference with the investor’s rights must have a major adverse impact on the Claimants’ investments. As mentioned by other investment treaty decisions, the State’s measures should amount to a “substantial deprivation” of its value, use or enjoyment, “determinative factors” to that effect being “the intensity and duration of the economic deprivation suffered by the investor as a result of such measures.”

According to Professor Schreuer, the effects doctrine has the most support. Schreur argues that the severity of the economic impact of a regulatory measure is the decisive criterion in determining whether it is indirectly expropriatory or not. The impact must be substantial, and must affect all or part of an investment. In terms of duration, Schreuer argues that the effects of the regulatory measure must be permanent or be for a substantial period of time. In my view this explains the wisdom of measures that are being taken by states around the world to mitigate the impact of COVID-19 measures on the business community. In the event of investor claims of indirect expropriation, those states that went out of their way to minimise losses to the business community will be able to show that they took measures to mitigate the losses that may be suffered by businesses. I agree with the effects doctrine, because it ties-up with the decision in *Phillip Morris Brand SARL v Uruguay* as well as the requirement for indirect expropriation that the expropriatory measure must have resulted in a total or near total destruction of the investment’s economic value.

Aside from being expropriatory, regulatory measures may potentially breach investment treaty obligations by interfering with investors’ rights such as the right to fair and equitable treatment, full protection and security, arbitrary, unreasonable or discriminatory measures, national treatment and the like. Fair and equitable treatment is by far the investor’s favourite cause of action. At the time of writing, fair and equitable treatment coupled with the minimum standard of treatment were used in almost half of all known investor-state arbitrations, being 499 out of 1023 cases. This is followed by Indirect expropriation (412 cases), full protection and security (249 cases), arbitrary, unreasonable or discriminatory measures (247 cases). The notoriety of fair and equitable treatment is the reason it was excluded from the 2016 Annex 1 of the SADC Protocol on Finance and Investment, India’s Bilateral Investment Treaty Template, the South African Protection of Investment Act and the Pan African Investment Code among others.

This means that in addition to bearing in mind the criteria for a bona fide regulatory as discussed above, states must also ensure that their regulatory measures do not breach the provisions of investment treaties and contracts to which they are parties.

In conclusion therefore, in order to be non-compensatory, regulatory measures must be: (a) bona fide; (b) for a public purpose; (c) non-discriminatory; (d) adhere to due process; (e) proportionate to the public purpose intended; (f) comply with fair and equitable treatment where applicable; (g) not amount to an abuse of rights; (h) not give a direct benefit to the state.

In the consideration of the above criteria, regard must be had to the intention of the regulatory measure in question so as to view the matter in a proper context. Ultimately though, the effect of the measure on an investment must be such that the measure has substantially or completely destroyed the investment in question. Such destruction must be permanent or near-permanent. However one must bear in mind that a state can raise the defenses excluding wrongfulness referred to above. Investment treaties and the municipal laws of a host states may provide for grounds such as national security or health regulation where a state may take measures that violate investor rights without exposing it to liability. If these exceptions are not provided for, a state may still rely on the principles of customary international law to raise the defenses excluding wrongfulness, including force majeure as provided for in ARSIWA as stated above.

Investors have shown time and time again that they will not hesitate to challenge regulatory measures not matter what a states’ underlying intent is. Only when the COVID-19 dust has settled will it be known which states had robust, well-crafted COVID-19 regulatory measures that can survive investor claims.

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