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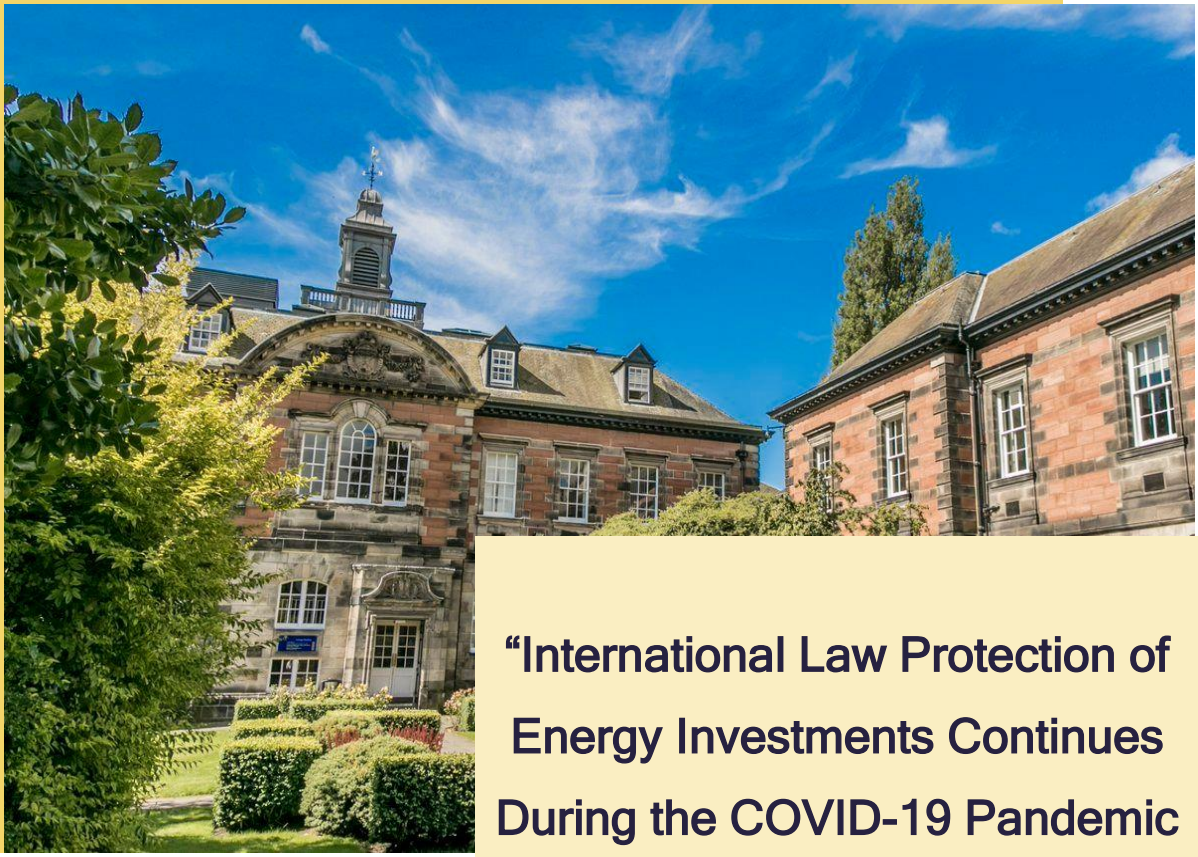

"International Law Protection of Energy Investments Continues During the COVID-19 Pandemic and its Economic Fallout"

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This paper is dedicated to the memory of the author's friend and former colleague Jeffrey C. Bates, who passed away on 7 May 2020 after contracting the COVID-19 virus.

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1. INTRODUCTION

As the COVID-19 pandemic continues to unravel without regard to national frontiers, countries around the world are faced with both public health and economic issues on a scale not previously witnessed. The economic fallout from the pandemic is forecast to be unprecedented. In this context, international law, particularly international investment law, continues to apply to the treatment of foreign energy investors and their investments. It does not present a binary choice between "State protection" and "investor protection" but involves a balancing of rights and interests. The measures adopted by sovereign States using their regulatory "police powers" to respond to the pandemic and its economic aftermath may have a significant impact on foreign investments situated within their territory. This applies especially to investments in the energy sector, which depend on long-term guarantees and stable legal regimes applied in a transparent manner.

Therefore, it is imperative that countries hosting foreign energy investments take into account applicable international law safeguards and limits when adopting reactive measures, such as acting in a non-discriminatory and non-arbitrary manner, in order to prevent a potential fallout from disputes with foreign energy investors. Conversely, foreign energy investors must also be watchful of these intrusive measures, and they should consider whether action taken by a host State is compliant with that State's obligations under international treaty and customary law and whether the State's conduct might give rise to an international law remedy in addition to remedies available under the laws of the host State.

2. GOVERNMENT MEASURES AND INVESTMENT PROTECTION

2.1. Responding to the pandemic and its economic fallout

International law recognises that sovereign States have a right and a duty to protect the health and safety of their citizens, as well as their economy, when faced with a health crisis such as that presented by COVID-19. It is generally accepted that States enjoy a margin of appreciation in taking regulatory action in fulfilment of this duty. Whilst few would doubt that this margin expands considerably during a global pandemic of the kind we are witnessing, which has already claimed the lives of more than 300,000 human beings globally at the time of writing, States must always exercise their police powers in a manner which is not arbitrary, discriminatory or for illegitimate reasons, or they risk facing claims from foreign investors under applicable bilateral or multilateral investment treaties or customary international law before international tribunals. Nevertheless, it is imperative to remember that, as stated by the arbitral tribunal in *Philip Morris v. Uruguay*,[1] "the responsibility for public health measures rests with the government and investment tribunals should pay great deference to governmental judgments of national needs in matters such as the protection of public health." As this statement indicates, arbitral tribunals appear to give considerable deference to State regulators and scientific bodies, and appear to assign greater relevance to public health as a policy objective, in sensitive areas such as public health protection.

In response to the pandemic's effects on public health, countries such as the United Kingdom have swiftly adopted measures which, amongst other things, enforce a mandatory "lockdown" on the public, with only essential travel and work being permitted. Many countries have closed their borders or have imposed severe restrictions on border crossings. This may affect the principle of freedom of transit of energy enshrined in Article 7 of the1994 Energy Charter Treaty (ECT), a multilateral framework for energy cooperation among 52 countries, including the United Kingdom. For example, a State which is a party to the ECT (State B) might violate the ECT if it interrupts, through long-term delays or restrictions, the carriage of ECT-covered energy materials and products, including equipment necessary for the development of initiated energy projects, through State B originating in the territory of State A and destined for State C (with either State A or State C being a party to the ECT).ECT parties might invoke the COVID-19 crisis as a justification to slow down the construction of new or initiated energy transit routes and infrastructure such

[1] ICSID Case No.ARB/10/7.

as Russia's controversial Nord Stream 2pipeline project, which is already the subject of the first ECT claim filed against the European Union, an ECT party, in 2019.

The restriction on movement of people (labour) and capital has consequential effects on a State's economy, as businesses are unable to operate as normal, leading to economic measures being taken[2]. A number of countries are offering substantial aid packages, including special state loans and guarantees, to struggling domestic companies, including key companies (some state-owned) in the energy sector, in an effort to rescue them from bankruptcy, whilst excluding foreign investors from such measures[3]. Some countries are introducing or tightening foreign investment screening mechanisms that affect the admission of, and entry criteria for, foreign investments.[4]

These wide-ranging measures taken by States using their police powers, while assumingly necessary to respond to a crisis of this magnitude, could have serious consequences for foreign investors, especially those in the energy sector where the stakes are high, and could negatively affect the economic value of their assets. The case of *CMS Gas Transmission Company v. The Argentine Republic*[5] demonstrates such consequences. In that case, Argentina suffered a severe economic crisis in the late 1990s, and enacted an emergency law in early 2002in response. The emergency law terminated the right of licensees of public utilities to calculate their tariffs in US dollars and instead converted them into Argentine pesos at a conversion rate of one Argentine peso to one US dollar. It also prevented the licensees from adjusting their tariffs according to the United States Producer Price Index. These measures caused a significant devaluation of the foreign investor's investment in a gas transportation company in Argentina, not least because the company's share price had allegedly decreased by over 90% as a result. In comparing the measures taken by Argentina in connection with the pesos crisis to measures that States could potentially take in relation to foreign energy investments during the current pandemic, it is noted that Pakistan's Ministry of Energy (Power Division) has proposed that the government should freeze the

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[2] For example, the UK Government has offered financial grants to small businesses and businesses in the retail, hospitality and leisure sectors, to assist them financially during the pandemic.

[3] For example, in the state of South Australia, the local government has suspended exploration and licence fees for the mining, oil and gas sectors until 31 December 2020.

[4] For example, Italy has passed Law-Decree No. 23 of 8 April 2020 in response to theCOVID-19crisis in order to strengthen its special powers in strategically important sectors. In accordance with this new law, the Italian Government has a broader scope in terms of foreign direct investment screening in relation to the financial, credit and insurance sectors, and this temporarily also applies to foreign acquisitions originating from within the European Union.

[5] ICSID Case No. ARB/01/8.

electricity energy tariff from April to September 2020 to alleviate the impact of COVID-19 on consumers. If this measure is enacted, it could negatively affect foreign investors' investment in the energy industry in Pakistan.

A recent report by UNCTAD warns that "policy responses taken by governments to address the pandemic and its economic fallout could create friction with existing investment treaty obligations, hence the risk of investor-State disputes."[6]

2.2. Protection under investment treaties

States have certain obligations to protect foreign investments admitted into their territory, which are set out in bilateral and multilateral investment treaties that they have concluded with other States. Such treaties only protect investors who are nationals of a contracting State other than the State hosting their investment. In terms of the investments eligible for treaty protection, this is usually defined quite broadly, generally covering any investment other than an ordinary sales transaction and including shares and rights in a company. For example, Article 1(6) of the ECT defines "investment" as "every kind of asset, owned or controlled directly or indirectly by an Investor," which includes both natural and legal persons.

Article 26 of the ECT makes the substantive guarantees enshrined in the ECT actionable by providing a direct right of address to foreign investors covered by the ECT. It does so in the form of investor-State arbitration by a neutral panel of arbitrators. This includes the possibility of referring claims to the International Centre for Settlement of Disputes (ICSID), the World Bank's arbitration institution that was set up to facilitate the settlement of investment disputes. According to the latest ICSID statistics, the majority of new cases filed in 2019 involved the oil, gas and mining sector, and electric power and other energy sources, with each accounting for 26% of registered cases. In 2019, bilateral investment treaties were the primary instrument invoked to support ICISD jurisdiction (62%), followed by the ECT (12%).[7]

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[6] United Nations Conference on Trade and Development (UNCTAD), Investment Policy Monitor, *Investment Policy Responses to the COVID-19 Pandemic*, 4 May 2020, *text available at* https://unctad.org/en/PublicationsLibrary/diaepcbinf2020d3_en.pdf?utm_source=World+Investment+Network+%28WIN%29&utm_campaign=a7844307c4-EMAIL_CAMPAIGN_2017_05_18_COPY_01&utm_medium=email&utm_term=0_646aa30cd0-a7844307c4-70229725

[7] ICSID News, *ICSID Releases 2019 Caseload Statistics*, 7 Feb. 2020, *available at* https://icsid.worldbank.org/en/Pages/News.aspx?CID=353

Amongst the host State's obligations to protect foreign investments is the duty to offer due process to foreign investors, as typically assumed under the treaty standard of "fair and equitable treatment"—a significant concern for foreign energy investors during the present pandemic. Article 10(1) of the ECT incorporates this standard.

Another protective standard, that of "full protection and security," guaranteed in the same provision in the ECT, may assume greater relevance during the COVID-19 crisis, as inaction or reduced vigilance by States, or even contribution to the crisis, may result in significant harm being caused to foreign energy investments, contrary to the State's obligation under this standard. For example, in *Azurix Corp. v. The Argentine Republic (I),*[8] the host State's failure to carry out works to improve the water quality of a dam contributed to a water quality crisis, negatively impacting the foreign investor's investment in providing drinking water and sewerage treatment services to local customers. In the present situation, if a State makes policy decisions that contribute to the pandemic, e.g., by introducing certain social distancing measures for its citizens which ultimately prolong and worsen the crisis, this could further deteriorate the State's economy and consequently the financial position of its citizens, thereby negatively affecting foreign energy investments which primarily generate income from supplying paying consumers with energy. The COVID-19 crisis also increases the risk of vandalism and looting, especially in areas of reduced patrolling by the police or military, which affects vulnerable energy facilities and infrastructure in particular.

In exercising their police powers during the COVID-19 crisis, countries hosting foreign energy investments should also be wary of being deemed to have indirectly expropriated foreign investments. For example, a State may enact a law in reaction to the crisis allowing it to order an energy investor's equipment to be provided for the State's use during the current pandemic, whilst promising to provide the affected investor with an appropriate indemnity from the State as a result of such requisitions being made. Whilst this may seem to be a necessary measure that is justified by the extraordinary circumstances of the present pandemic, it could amount to indirect expropriation, given that affected foreign investors may be deprived, for the foreseeable future, of the economic value or benefit of their assets, or at least their reasonable expectations as to the use of their assets.

To deal with potential investment disputes arising from the pandemic, host States may seek to invoke defences generally available under international law, including under investment

[8] ICSID Case No. ARB/01/12.

treaties. The case of *Continental Casualty Company v. The Argentine Republic*[9] concerned the economic crisis in Argentina which began in 1989, and Argentina's economic measures taken in response to the crisis led to a devaluation of the investment securities owned by a foreign-owned insurance company. Argentina invoked a defence under the relevant bilateral investment treaty, which allowed for measures to be applied which were necessary for the maintenance of public order. Such a treaty-based defence concerns the scope of application of a treaty. The international tribunal in this case noted that "[a]n interpretation of a bilateral reciprocal treaty that accommodates the different interests and concerns of the parties in conformity with its terms accords with an effective interpretation of the treaty. Moreover, in the tribunal's view, this objective assessment must contain a *significant* margin of appreciation for the State applying the particular measure: a time of grave crisis is not the time for nice judgments, particularly when examined by others with the *disadvantage of hindsight."* (emphasis added).

The tribunal's statements in this case are a stark reminder that in the event of a grave crisis, particularly a health crisis on the scale we are witnessing, the margin of appreciation for a State in enacting reactive measures affecting critical sectors of the economy may in fact be wider than usual. Still, the interpretation of an applicable treaty will be subject to the international law of treaties as codified in the 1969 Vienna Convention on the Law of Treaties and arbitral tribunals will generally verify whether a State's action was reasonable and proportionate to the aims sought to be achieved.

It is also worth noting that certain investment treaties go beyond the general defences found within them. The China-Australia Free Trade Agreement specifically prevents a claim being made by a foreign investor in response to measures which are non-discriminatory and made in relation to legitimate public welfare objectives of public health. This is arguably a comprehensive defence to any investment disputes arising from the COVID-19 crisis.

2.3 Protection under customary international law

States also owe duties to foreign energy investors in their capacity as "aliens" under customary international law, such as affording to them a minimum standard, which many believe includes fair and equitable treatment, and acting in good faith and in a non-discriminatory manner. Customary international law is derived from a general practice of States followed out of a sense of legal obligation.

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[9] ICSID Case No. ARB/03/9.

However, even under customary law, a State may shield itself against potential investment claims arising from the exercise of its police powers. For example, a State may invoke the defence of *force majeure*[10], or an unexpected change in circumstances, to justify its emergency actions taken in response to the COVID-19 pandemic, given that it constitutes an unforeseen event beyond the State's control.

Another defence that may be invoked by a State as a circumstance precluding wrongfulness is that of "state of necessity",[11] i.e., reactive measures taken to protect an essential interest from a grave and imminent peril. However, the case of *National Grid PLC v. The Argentine Republic*[12] demonstrates that this defence has a high threshold and generally will not be available where a State has substantially contributed to the crisis. In that case, Argentina amended its domestic laws in early 2002 to combat a severe economic crisis, which, amongst other things, resulted in the termination of the right to calculate public utility tariffs in US dollars and to adjust those tariffs using international price indices. Argentina also prevented electricity transmission and public utility companies from suspending or modifying their compliance with their concession agreements, ultimately resulting in the devaluation of a foreign investor's investment in an electrical power company in Argentina. Whilst the Argentine Republic attempted to plead the defence of necessity in this case due to its economic crisis, this was rejected by the tribunal as Argentina was held to have substantially contributed to the crisis by way of its policy decisions at the time. Indeed, the tribunal noted that "while the state of necessity has been accepted by tribunals as an admissible defense in theory, it has rarely been found to exist in practice because of its exceptional nature." Accordingly, States cannot expect to be able to rely on this defence following the pandemic where they have, for example, taken an extensive period of time, or acted in a questionable manner, in removing "lockdown" measures that ultimately worsened the health/economic crisis caused by COVID-19 (thereby contributing to it), when compared objectively to the time and action taken by similarly placed States in removing similar measures.

The defence of distress[13] may also be invoked by a State to protect itself against future investment claims relating to COVID-19. A threat to life is required for invoking this defence, and the devastating effects of the present pandemic affect its chances of success. Under

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[10] International Law Commission Report, UN Doc. A/56/10, August 2001, Article 23.

[11] Ibid., Article 25.

[12] UNCITRAL Award of 3 November 2008.

[13] International Law Commission Report, UN Doc. A/56/10, August 2001, Article 24.

this defence, a State must also show that it did not contribute to the situation created by the pandemic, which may in fact provide some scope for foreign energy investors to bring claims against host countries that either were not pro-active in protecting those within its territory against the pandemic or over-reached in their response to the pandemic.

It remains to be seen how investment tribunals will treat the UN International Law Commission's Articles on the Protection of Persons in the Event of Disasters, adopted in 2016, in this context.[14] It is unclear to what extent these Articles, which present a framework of rights and responsibilities during disasters, reflect customary international law binding on States and apply to the COVID-19 pandemic and the economic fallout from this crisis.

2.4 Attribution and its use as a defence by host States

In many countries, the official response to the COVID-19 pandemic is associated with de-centralised decision-making by lower bodies and officials. A claim before an international tribunal will fail unless there is convincing evidence of the violation of some rule of international law by the State party. The international law breach must also be attributable to the State party for the State to incur responsibility. A State party could use the element of attribution as a defence and argue that the acts of certain officials, bodies or authorities are not attributable to the State in the circumstances.

[14] International Law Commission Report, UN Doc. A/71/10, 2016, at 13.

3. PRACTICAL CONSIDERATIONS FOR ENERGY INVESTORS AND HOST STATES

Whilst international law will continue to offer protection to eligible energy investors and their investments, it is unclear whether, and to what extent, a competent tribunal will entertain and uphold an investor's claims and award compensation over the objection of host State respondents invoking their right and duty to protect the health and safety of people and companies during the COVID-19 crisis. This will depend on the particular circumstances of each case.

In considering what protection may be available for their energy investments, foreign investors should check:

- whether there is an investment treaty in force between their home country and the country hosting their investment – this includes verifying that the treaty has been signed and ratified by both countries (for example, Italy withdrew from the ECT in 2016, which means that any post-2016 investments in the energy sector in Italy are not protected by the ECT whilst pre-2016 investments will remain protected during a 20-year period);
- that they satisfy the "investor" requirement under that investment treaty. Investors should consider how the treaty defines corporate nationality, e.g., whether by place of incorporation or headquarters and/or by a certain level of in-country business activity;
- whether their investment is one which is covered by the treaty (most treaties define "investment" broadly);
- whether the treaty contains the typical substantive protections such as fair and equitable treatment, full protection and security and national treatment;
- whether the treaty contains a so-called "umbrella" clause that brings breaches of contract under the protective umbrella of the treaty;
- whether non-discriminatory treatment is guaranteed in the event of losses owing to a national emergency or other significant event in the host State;
- whether the treaty contains an essential security interest or emergency measures clause which allows the host State to avoid its international law obligations;
- whether the treaty contains the host State's consent to international arbitration for a broad range of investment disputes, including energy sector disputes (States have the right to attach reservations excluding certain sectors from a treaty's scope of application);

- whether they are able to refer an investment dispute to investor-State arbitration; and
- whether there are any admissibility criteria for arbitration claims.

States hosting foreign energy investments should consider how the adoption of certain measures in response to the COVID-19 pandemic and its economic fallout affects foreign energy investors and their ability to complain about such measures before international tribunals under investment protection treaties or customary international law. Prior rulings by tribunals adjudicating investor-State disputes provide useful guidance regarding the content and scope of international investment law and the defences available to host States when confronted with claims of foreign investors, including those arising from economic crises.

States should keep in mind that the jurisdiction of an investor-State tribunal is decided by reference to international law, not their domestic law, and that an investment dispute could be decided exclusively based on international law, depending on the applicable arbitral mechanism and choice of law rules and principles. Specific energy sectors could also see the application of special sub-sets of norms, including *lex petrolea* for the international petroleum sector, by arbitral tribunals, especially those operating under arbitral rules mandating arbitrators to take into account any relevant trade usages.[15]

[15] See, e.g., Article 21(2) of the Rules of Arbitration of the International Chamber of Commerce (ICC). The status and content of *lex petrolea*, or the law merchant pertaining to the petroleum industry, remain uncertain and the concept itself is not uncontroversial.

4. CONCLUSION

The COVID-19 pandemic has caused severe loss of life and disruption across the globe, with States enforcing lockdowns and other drastic measures to restrict movement in a bid to contain the virus and secure the health and safety of their citizens. The measures taken by States in response to the pandemic have caused economic slowdown, with businesses facing increasing losses and economic uncertainty. Foreign energy investors operating within a State's jurisdiction will also be affected by the measures taken by their host State in response to the virus (some of which may favour domestic companies), and should consider whether such measures are consistent with the host State's international law obligations, especially under treaties providing procedural guarantees in the form of a direct right of redress against the host State through international arbitration.

Whilst sovereign States have a certain margin of appreciation in using their "police powers" to adopt and enforce measures in response to the global pandemic and the resulting economic fallout, a failure to comply with their international law obligations could result in future investment-related claims being brought against them before competent investor-State tribunals. However, it is clear that the margin of appreciation enjoyed by States in employing their police powers is considerable during a crisis such as the global spread of COVID-19. Nevertheless, States should respect certain safeguards and limits when imposing measures to combat the virus and economic fallout in order to reduce the risk of future investment treaty claims by eligible energy investors.

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