COVID-19 and the construction sector: potential relief under international investment treaties

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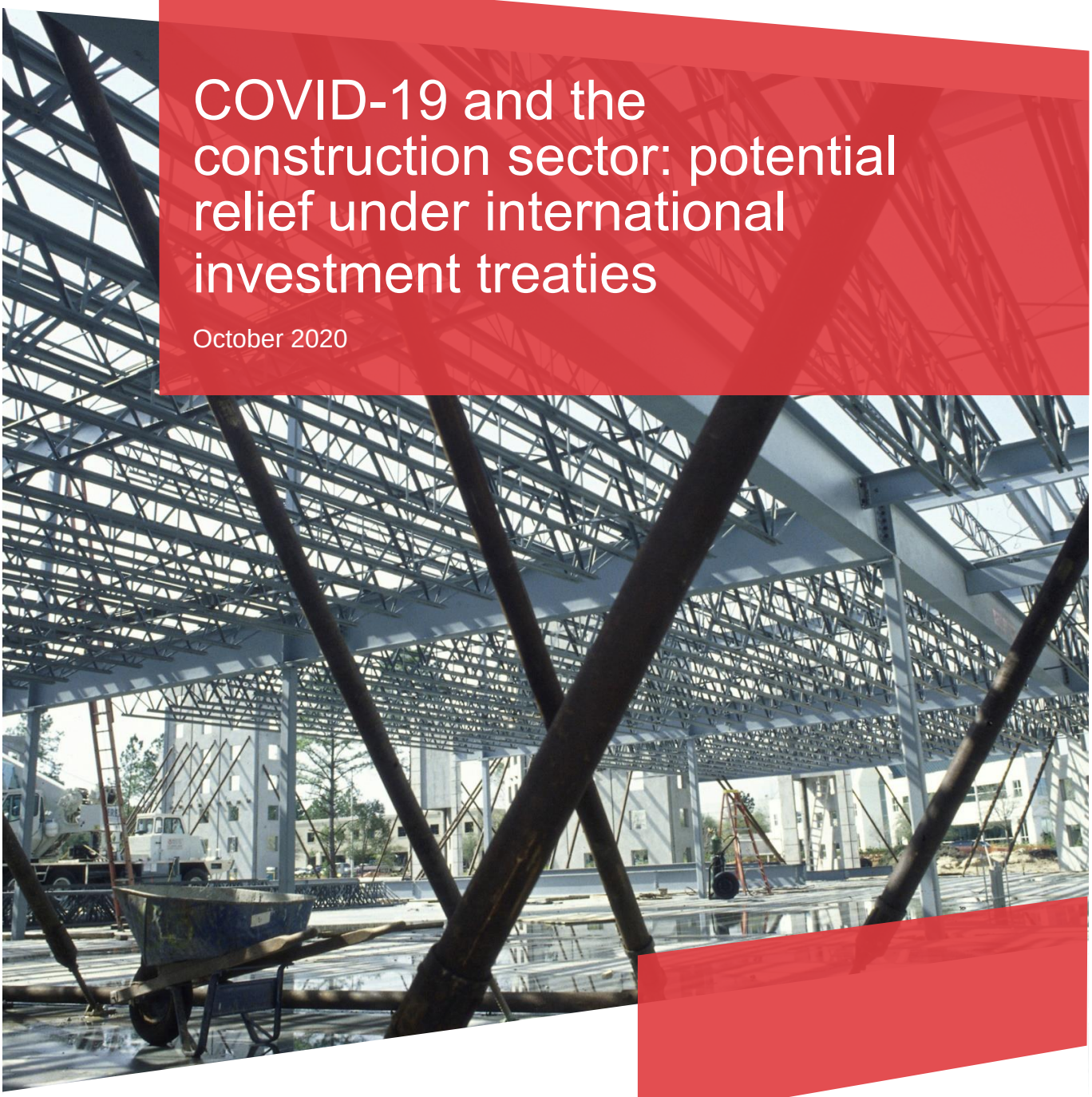

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Introduction

The COVID-19 pandemic has had a significant impact on the global construction industry. A large number of intended projects have been reduced in scope, deferred, or canceled in their entirety, as owners look to save costs and the financial viability of planned investments in energy and infrastructure projects comes under renewed and closer scrutiny. Projects that are already underway have experienced the impact of the pandemic to varying degrees. On certain projects, the works have been completely suspended. For others, while the works are progressing, owners and contractors are facing a myriad of evolving challenges, including fabrication facility shutdowns and supply chain disruptions or delays, lockdowns, travel restrictions, labor shortages, enhanced health and safety measures, reduced productivity and cashflow problems. Naturally, these issues are impacting the works and causing delays, disruptions and additional costs.

While a contractor's immediate focus will naturally be to look for relief under its construction contract, there is, in certain scenarios, the alternative option of seeking relief under an international investment treaty, which is worthy of consideration.

Relief under construction contracts

In the current environment, contractors and owners are looking, in the first instance, to assess their position under the construction contract.

Relevant questions include the following:

- What obligations do contractors have under the contract to put in place measures (including health and safety measures) to enable the works to proceed and/or to address and mitigate the delays and disruptions to the works?
- What is the likely impact on the project once such measures have been taken?
- What rights to relief (if any) do contractors have in respect of the impact on the works and the resulting delays and additional costs?
- What are the notice requirements and dispute resolution procedures for dealing with these claims?
- Can the parties effectively deal with the claims within the contractual framework, in circumstances where the impact is continuing to be felt and the progress of the pandemic (and measures being put in place to address it) is constantly evolving?

Each contract will be different and it is important to consider carefully the exact contract terms as against each set of facts, to determine whether the contractor may have an entitlement to relief in respect of the impacts of the pandemic. The two provisions which will typically be most scrutinized in this respect are the **change in law** and **force majeure provisions.**

Change in law – where legislation, regulations, directives or other instruments with legal force have been introduced by states or state entities to deal with the impacts of COVID-19, and have had an impact on the works, contractors will look to test whether the relevant instrument falls within the definition of laws, and whether it can be said that there has been a change in law under the contract, thereby establishing – in principle and subject to satisfying notice requirements and demonstrating the consequent time and costs impact – a right to relief.

Force majeure – assuming there is a force majeure provision in the contract, contractors will look to identify whether it applies, either because the relevant provision specifically refers to an epidemic or pandemic, or because the definition of a force majeure event is broad enough to capture the impacts of COVID-19.

The above analysis may not be straightforward and there may be a number of challenges for contractors to overcome. Examples of such challenges include:

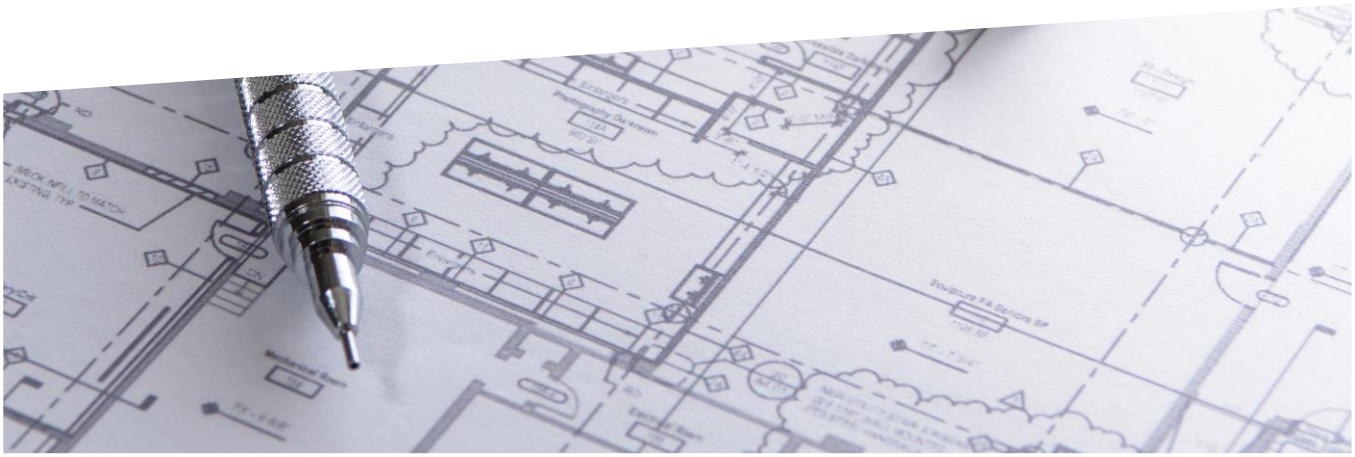
- If there has been no change in the law, but rather the introduction of measures by a state or state entity pursuant to existing powers, does the contractor still have a right to relief ? (This will depend on a thorough understanding of what constitutes “law” in the relevant context and what arguments can be made on the wording of the change in law provision.)
- Establishing clearly what the relevant “event” is for the purposes of the force majeure provision: is it the pandemic, measures taken in response to the pandemic, other specific, practical manifestations of the pandemic, etc.? (This will depend on the facts and the wording of the clause, but in any event the contractor will also need to look carefully at the other tests to be satisfied, including the need to establish a causal link between that event and the relief claimed.)
- What (if any) is the relationship between the contractor’s rights to relief under these two provisions? Are those rights standalone, such that the contractor can elect under which clause it wishes to pursue relief, assuming that it can demonstrate the relevant requirements? Alternatively, can the provisions be read in such a way as to operate together and limit the contractor to one course or the other in certain circumstances? (Again, this will come down to a careful reading of the provisions.)

Where the contract provisions do not assist, or assist to only a limited degree, contractors will have to assess whether there is any relief available under the law governing the construction contract. This will typically be a more fertile area of enquiry in respect of contracts governed by **civil law**, where the legal framework regarding force majeure and hardship may come into play in the absence of such relief available under the contract. Under **common law** jurisdictions, there is

typically less scope for such remedies (for example, the English law remedy of frustration – which brings the contract to an end and relieves the parties of further performance, where an event occurs which renders performance impossible or transforms the relevant obligation into a radically different obligation – is in practice of limited application).

Whatever the position – in terms of the strengths and weaknesses of the contractor's claims – to secure that relief, a contractor will have to comply with a series of mandatory steps and processes, starting with notice of its claim, provision of particulars and, where the claim is not accepted by the owner or its representative, pursuit of relief by way of, perhaps, referral to adjudication, but ultimately (and typically) international arbitration.

But before that stage, it is likely contractors and owners will start a constructive dialogue. Indeed, in most instances, that is likely to be a sensible course, so as to prioritize the project – and, so far as possible, recovery of the same – and seek to find an agreed way forward to avoid disputes, which can only detract from that focus.



Potential relief under international investment treaties

Why are international investment treaties relevant to contractors suffering from the impacts of COVID-19?

In addition to the above, a contractor may, in certain circumstances, have redress under one or more bilateral or multilateral investment treaties (BITs/MITs). These treaties represent an agreement between two (or more) states to encourage and promote investments between those states by, among other things, providing certain legal protections to the foreign investor and its investment.

While there is no standard treaty and the exact terms will vary, most BITs and MITs enable an aggrieved foreign investor to bring a claim directly against the state in which the investment has been made (the "host state"). Any such action by the contractor of an impacted project will be an action against the state under the applicable BIT/MIT, rather than against the owner under the construction contract.

The protection provided by BITs/MITs is **extra-contractual**. It applies in addition to anything expressed in the construction contract, even where that contract provides for a different dispute resolution mechanism (such as commercial arbitration or local litigation). In other words, by ratifying a BIT/MIT, a state is bound under public international law to give effect to such international treaties.

An investor's ability to turn to international arbitration to enforce its rights under a BIT/MIT can be a powerful negotiating tool for a number of reasons, including: (i) any such dispute will be heard by an international arbitration tribunal constituted under the International Centre for Settlement of Investment Disputes (ICSID) Convention or under UNCITRAL or other arbitration rules (an ICSID action is a matter of public record and ICSID awards are "automatically" enforceable as domestic judgments in 163 states around the world, whereas non-ICSID awards are enforceable in any country that is a signatory to the New York Convention, which also has 163 state signatories to date); (ii) an unpaid ICSID award involving one of the World Bank's borrowing countries can jeopardize the economic interests of a borrower which the bank is meant to serve; and (iii) refusal by the state involved to comply with an investment award would deprive it of credibility in the international business community, which may undermine the state's ability to attract other potential investors.

This is a point worth noting for contractors. Further, while an action under the BIT/MIT will be against the state, the practical reality is that there are many projects where the owner is a state-linked entity, where there is otherwise a relationship between the owner and the state, and/or where the state has a vested interest in ensuring the progress, completion, and success of the project, such that a contractor may be able to leverage an action, or potential action, against the state to its broader advantage.

While, in the construction context, claims under investment treaties more typically arise where the owner is a state or an emanation of the state, a claim can also arise in circumstances where the state, independent of the construction contract, has taken actions which negatively impact the project (which is protected by the BIT or MIT as the contractor's investment). It is this latter scenario which comes into sharper focus in respect of the current pandemic because states are taking and implementing decisions – via legislative and executive actions – to combat the pandemic. Examples of such state measures include: (i) cancelling, deferring or re-scoping projects; (ii) closing of businesses deemed "non-essential"; (iii) construction site shutdowns; (iv) restriction or banning of movement and travel, both within a state and international travel to and from a state; (iv) import/export and visa restrictions and changes; and (v) the imposition of strict health protocols as a condition for business/works to resume, all of which may have an impact on construction.

What must a contractor demonstrate to establish a right to treaty relief?

In order for a contractor to access appropriate relief under the applicable BIT/MIT, it must be able to satisfy the following threshold requirements:

First, the contractor must qualify as an **"investor."** Generally, a company incorporated in a state different from the host state, or a private individual who is a national of another state (such as a foreign shareholder), will meet this test.

Second, there must be a protected **"investment**" under the applicable treaty. This term is broadly defined in investment treaties, typically covering "every kind of asset" or "every form of investment," including shares or other forms of participation in local companies, tangible and intangible property, licenses, concessions and any rights given by law or contract. For construction projects, where the investor has contributed significant capital, know-how, and personnel over a significant period of time, the investment will likely meet the "standard" test. The qualifying investment might also consist of the rights acquired under the construction contract, together with all plant, equipment, and materials imported by the contractor in connection with the construction works, as well as any bank guarantees provided for the purpose of the works. Investment arbitration case law provides several examples of construction projects which have met the investment test, including projects for the development or construction of real estate, a golf club, housing, a toxic waste plant, a hydropower plant, a gas pipeline, a dam, an international airport, bridges, and roads and highways.

If a contractor is able to pass these threshold requirements, it will be entitled to the protections and relief set out in the relevant BIT or MIT. Investment treaties contain terms that are individually negotiated between the signatory states. However, they commonly include a suite of minimum rights and protections. As regards state measures related to the COVID-19 pandemic, the relevant protections which might – depending on the facts and circumstances – be relied upon by investors are:

- the prohibition of discriminatory measures vis-à-vis nationals of the host state (**national treatment**) or nationals of a third state (**most-favored nation treatment**);
- an obligation to afford investments **fair and equitable treatment** (requiring transparency, good faith, no arbitrary or discriminatory conduct or lack of due process, and protection against a denial of justice by the host state's courts) and provide **full protection and security** (a duty to abstain from state interference, and a duty to protect the investment from third party action);
- a requirement that direct or indirect **expropriation** be accompanied by compensation, conducted with due process of law, and carried out on a nondiscriminatory basis; and
- an obligation on the host state to observe contractual undertakings (also known as an **umbrella clause**).

Examples of COVID-19 measures implemented by states which may – on the face of it – breach these protections include measures that undermine the investors' legitimate expectations, are discriminatory (singling out foreign investors on their face or in practice), arbitrary, lack due process and transparency, and/or are motivated by other purposes than the pandemic.

Although not exclusive, the most common remedies in investment treaty arbitration are interim relief and damages, aimed at eliminating all the consequences of the illegal act(s). Quantifying damages in disputes involving the construction sector is often a complex exercise because such disputes are high value and may involve long-term contracts and sub-contracts, which may impact the profitability of the investment.

Will there be an obvious defense for states in respect of actions they have taken in response to COVID-19 which have adversely affected projects and investments?

To the extent claims are brought by investors in response to the pandemic, states will, of course, look for any defenses as may be available to absolve them of responsibility, whether (i) under the applicable treaty provisions or (ii) arising from any circumstances precluding wrongfulness under customary international law.

Many investment treaties contain exceptions to investment protection standards with respect to measures taken for reasons of "national security" or "public health," or to maintain "public order." Depending on the exact wording and parameters of these provisions, they may allow a state to legitimately derogate from its investment protection obligations. This has not yet been tested in any ICSID arbitration with respect to actions recently taken by states in response to the global pandemic. That said, the tribunal in AWG Group Ltd. v. The Argentine Republic held that a state is not permitted to derogate from the applicable protections, where "public health" is invoked as an unjustified pretext, where the state acts on a discriminatory basis, where the state's actions aggravate the crisis, or where states could have adopted other measures without violating treaty obligations.

Even in the absence of express treaty provisions, states may seek to justify COVID-19 measures that result, for example, in regulatory changes, by arguing that these represent a legitimate exercise of their "police powers," a doctrine which protects the state's bona fide right to regulate such matters as the maintenance of public order, health or morality, even when the regulation causes economic damage to an investor.

Another set of considerations concern a range of customary international law circumstances precluding wrongfulness codified in the ILC Draft Articles on State Responsibility for Internationally Wrongful Acts (November 2001). Of the various defenses contained therein, the most likely to be invoked in investment treaty arbitration relating to COVID-19 measures are: (i) **force majeure** (article 23); (ii) **distress** (article 24); and (iii) **necessity** (article 25).

The plea of **force majeure** – i.e., the inability to perform an obligation due to unforeseen circumstances beyond the control of the state – has to date rarely been invoked in investment treaty arbitration. One tribunal which considered it, in Autopista v. Venezuela, held it could only be relied on if three conditions are met: (i) impossibility of performance; (ii) unforeseeability of the event; and (iii) the force majeure event not being attributable to the state.

Likewise, the defense of **distress** has typically been invoked in situations giving rise to threats to human life, and does not appear yet to have been invoked in investment treaty arbitration.

The defense of **necessity** presupposes that a state had no choice but to take certain actions against a "grave and imminent peril" to an "essential interest of the State." Several investment awards, the majority of which relate to Argentina's 2001-2002 economic crisis and to the 2008 financial crisis, have considered the defense of necessity. If a situation of necessity is found, it is relevant to assess the period during which it was applicable, because measures adopted outside that period may not be covered by such a defense.

In the current situation, it is anticipated that states will rely mostly on the defense of necessity. However, to do so successfully, a state would need to show: (i) that the COVID-19 measures it has imposed (impacting the construction and other sectors) were the only way to safeguard an "essential interest" against a grave and imminent peril; (ii) that it did not contribute to the situation of necessity; and (iii) that the measures imposed did not seriously impair an essential interest of the state or states towards which the obligation exists, or of the international community as a whole.

Why make investment treaty claims for COVID-19 losses?

The measures taken by states globally to combat COVID-19 have and will impact construction projects. In certain circumstances, consideration should be given as to whether there is any basis for a treaty claim.

Contractor investors should therefore be aware of relevant investment treaties that may extend protections to their investments in the jurisdictions in which they are operating, in addition to any contractual rights that they may have. Depending on how they have structured their investments, construction companies may be able to invoke applicable BITs and/or MITs to pursue binding international arbitration for any damages that they have suffered, or are likely to suffer, due to a state's conduct.

The ability to bring investment arbitration proceedings against a state that breaches the applicable treaty protections is an important tool for any investor. Such claims may give an investor (i) an additional claim in circumstances where a contractual claim would be frustrated or difficult to sustain and/or (ii) an additional tool which can be leveraged to its advantage, including to try to obtain an early settlement of its various claims, given that such claims are served at the very highest levels of a sovereign state.

The claim will be heard by a tribunal in a neutral forum outside the political/judicial arena of any state, is unlikely to be barred by any time limitation provisions, and awards are enforceable in most jurisdictions around the world. In addition, the transparency in investor-state arbitration can help a contractor's position because, as the state will be well aware, the existence of the contractor's action may undermine the state's ability to attract other potential investors, and/or may persuade other potential claimants to consider, threaten, or even start a similar action.

The best route to obtain appropriate relief, whether via contractual claims and/or treaty arbitration, will depend on several factors, such as:

- where the greatest extent of the loss really lies, what event can be said to have caused this loss, and whether state responsibility is engaged;
- obligations to mitigate (a failure to do so may prevent a party from obtaining relief);
- procedural or substantive challenges in securing relief by way of a contractual claim, including:

  (a) notification requirements;

  (b) the test and thresholds to be met to establish a right to relief; and

  (c) the parameters of available relief under the agreed contractual terms or governing law (time only, money only, time and money?);
- whether the claim is admissible under the applicable treaty;
- whether there is a need to exhaust local remedies or whether there is a "fork-in-the-road" provision under the applicable treaty (whereby the choice of an investor to submit disputes against the state either to a local court or international arbitration is deemed to be final to the exclusion of the other);
- the type of breaches and available forum; and
- whether there are strong strategic grounds for and advantages to pursuing a treaty claim.

An alternative route to consider

The COVID-19 crisis raises questions around the role of governments in managing the pandemic, where acts may trigger potential state liability vis-à-vis foreign investors who suffer economic losses.

Parties involved in large international construction projects should be proactive in considering whether any intrusive measure taken by a host state might give rise to an international law remedy, in addition to remedies available under the underlying construction contracts or governing law. This is because, as addressed above, there are certainly instances where acts taken by states in response to the COVID-19 pandemic may trespass legal protections in place within BITs/MITs, where a contractor may be entitled to treaty relief, and where there may be a number of advantages to considering and pursuing such alternative recourse.

Given the factual complexity of the ongoing COVID-19 pandemic, and the lack of definitive guidance in some aspects of the jurisprudence, it will be important to consult specialist counsel in international arbitration with a view to mitigating risks, and consider carefully how applicable treaty standards and potential defenses may apply to the particular facts of each construction project.

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