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**Research Report**

## The world economic crisis as a changed circumstance

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## Columbia FDI Perspectives

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### The world economic crisis as a changed circumstance

by

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In September 2008, the bankruptcy of Lehman Brothers sent financial markets in the United States into a spin. Credit markets froze as banks began to mistrust counterparties, not knowing the extent of toxic assets in loan portfolios that could lead to another major bank collapse. The crisis quickly spread around the world. Governments were urged to take drastic measures. Experts discussed the possible nationalization of portions of the U.S. banking industry and other sectors. Other countries also considered measures to save key industries.

In the world of investor-state arbitration, many predicted that national measures to combat the economic crisis would result in treaty claims.<sup>1</sup> Commentators also warned states to heed the lessons of Argentina, which was unable to escape its treaty obligations by invoking a state of necessity. Predicted investor claims included violations of non-discrimination, fair and equitable treatment (FET) and expropriation provisions.

There is little evidence that the investment treaty regime anticipated the possibility of a worldwide economic crisis like that of 2008-2010. While claims against states responding to the crisis have yet to materialize, most investment treaties are silent with respect to a limitations period. Such claims may appear long after the crisis. States have, however, another defense: changed circumstances.<sup>2</sup>

The defense typically has arisen in the context of treaty termination, but an unexplored aspect is a temporary suspension of treaty obligations. Different from necessity and force majeure, the defense of changed circumstances, classically known as *rebus sic stantibus*,<sup>3</sup> is tailor-

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<sup>1</sup> See Anne van Aaken and Jürgen Kurtz, "The global financial crisis: Will state emergency measures trigger international investment disputes?" *Columbia FDI Perspectives*, No. 3 (March 23, 2009); Joshua Fellenbaum and Christopher Klein, "Investment arbitration and financial crisis: The global financial crisis and BITs," 3(6) *Global Arbitration Review* (2008).

<sup>2</sup> International law has recognized this defense; see, e.g., Vienna Convention on the Law of Treaties (VCLT), Article 62.

<sup>3</sup> The portion of the doctrine raised here focuses on the legitimate expectations of the parties, rather than excuses for non-performance. Provisions regarding necessity and *force majeure* are generally addressed in BITs,

made for this crisis. Its literal meaning – “things standing thus” – refers to the expectations of the parties and the circumstances existing at the time a treaty was negotiated. In the context of investor claims arising from governmental responses to the crisis, the crisis itself is a fundamental change, not anticipated under the economic model on which the current treaty system is based, i.e., the “circumstances” existing in the 1990s. Some states can argue credibly that they did not cause the crisis, yet their economies were greatly affected. Under these changed circumstances, a state should be able to enact emergency economic measures to sustain critical national industries.

If the investment treaty regime is to remain sustainable, should a state not be permitted to suspend its treaty obligations during exceptional circumstances? Article 62 of the Vienna Convention on the Law of Treaties (VCLT) permits temporary suspension but provides no guidance. The circumstances that have changed must have constituted an “essential basis” of the parties’ consent, and the change must “radically transform” the extent of obligations. The VCLT permits the state to terminate the treaty entirely or temporarily suspend its obligations. A temporary suspension – a more limited response – logically should require a lower standard. The VCLT uses the same standard for both actions. This is perhaps the reason why Article 62 has been invoked rarely by states seeking to defend against claims relating to measures taken to address unanticipated crises. A mere suspension of treaty obligations would strengthen the treaty system by making it resilient. The standard for suspension, while remaining high, should take into account exceptional circumstances. A workable approach might include: (i) an unforeseen global crisis; (ii) causing considerable hardship to significant populations; (iii) not a consequence of the state’s own actions; (iv) suspension is made in good faith with the expectation of resuming obligations; and (v) suspension is reasonable under the facts and circumstances.

As the economic crisis has required many countries to undertake protective measures, the suspension of rights and obligations might be the most desirable option. The risk of not permitting suspension might cause states to consider less desirable alternatives when claims are asserted.<sup>4</sup> Questions regarding the length of suspension, and which rights and obligations are suspended, are subjective. Arbitrators could make such determinations in light of facts and circumstances. Recognition that suspension of treaty obligations might be appropriate under certain circumstances will not weaken the treaty system but strengthen it.

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establishing the parties’ risk allocation. BITs rarely address global issues that might impact states at a macro level.

<sup>4</sup> States already have shown scepticism toward this treaty regime. See Osgoode Hall Law School, York University, *Public Statement on International Investment Regime*, (2010); George Kahale, III, “A problem in investor/State arbitration”, 6 (1) *Transnational Dispute Management* (2009).

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