



# The Arbitration Review of the Americas

2021

**Concession Contracts in Times of  
Crisis**

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# Concession Contracts in Times of Crisis

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## Summary

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## IN SUMMARY

Concession contracts are very rapidly and very profoundly affected by crisis situations, as confirmed by the covid-19 pandemic. This chapter analyses the way in which the applicable domestic and international rules guide that interaction, and, in the case of national laws, specifically the different ways in which civil and common law approach the issue.

Our review reveals that both domestic and international rules distinguish between the situation where the crisis results in an impossibility to abide by the terms of a legal obligation, as opposed to the situation where the crisis creates a heightened cost or complication, but not a full impossibility. In analysing those rules, this chapter also identifies a number of arguments and defences that can arise in commercial or investment disputes arising from crisis situations affecting concession contracts.

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## DISCUSSION POINTS

- State of necessity.
  - Non-precluded measures.
  - Force majeure in domestic and international law.
  - Hardship.
  - Concession contracts.
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## REFERENCED IN THIS ARTICLE

- Argentina-US BIT (1992).
  - US Model BIT (2012).
  - ILC Articles on State Responsibility for International Wrongful Acts.
  - Restatement (second) of contracts.
  - Chitty on contracts.
- 

As we write these pages, for some months, international travel has been interrupted in every continent, most countries have adopted one form of lockdown or other – usually as restrictions on the purposes for which individuals can leave their residences – and a curfew has been imposed in a significant number of large cities.

The situation stems from a global pandemic caused by a novel coronavirus that carries a disease called covid-19, and it was surprising enough, and developed recently enough, that it would be fair to say that the vast majority of the global stock of legal rights and obligations currently in existence was crafted, negotiated or otherwise enacted by individuals, companies and governments without any knowledge or suspicion that this situation would thus develop.

## CONCESSION CONTRACTS AND CRISIS DEFINED

While the effects of the coronavirus pandemic on human health have been very similar across borders, the way in which these effects have affected the regulatory needs and policies of different local, regional, national and supranational governments and agencies so far varies significantly from one to the other for a gamut of reasons too nuanced to be efficiently mapped in these lines. However, all of these nuanced needs and policies converge in a discrete set of legal consequences when it comes to analysing the way in which ‘concession contracts’ (which we define as the agreements under which certain activities are outsourced to non-governmental entities – including individual or corporate contractors, and state-private joint ventures) are impacted by the ‘crisis’ (which we define as the aggregation of adverse changes in circumstances making it necessary to adapt governmental policies to overcome a threat to the general wellbeing of the population).

Certainly, we will concede that the two critical definitions adopted are themselves arbitrary and technically too broad, but to any reader who was active – or trying to remain active – in the second quarter of the year 2020, the ubiquitous question marks currently surrounding most forms of human economic activity will provide a sufficiently clear backdrop that will assist those definitions to be widely accepted as practically relevant to the issues before us.

We will first address the types of potential disputes that may arise at the intersection of concession contracts and situations of crisis, and then move on to analysing the substantive and procedural rules governing crisis situations, which typically arise from formulations of domestic law, which, for certain disputes, may be supplemented, superseded or supplemented by certain specific rules of public international law (including investment law).

## CONCESSION DISPUTES

Disputes involving concession contracts may involve the state or state entities, or arise between or among purely private parties.

State parties may become involved in concession-related disputes either in their role as parties to the concession agreement itself, or in their capacity as the regulator of the economic activity constituting the subject matter of the concession. This will also be true of investment disputes, except in the limited, seldom case where a respondent state’s liability is premised on measures adopted (or omissions incurred) in the mere capacity of recipient of a protected investment, but not directly related to the regulation of the concession activity.<sup>[1]</sup>

Private-to-private disputes, meanwhile, can arise between concessionaires and customers, or between concessionaires and contractors or suppliers (including the particular case of the suppliers of financing). Because of the nature of the concession activities, however, all of these disputes will be triggered or impacted by provisions of public law, even if a state party is not directly involved in the dispute.

## CRISIS RULES IN DOMESTIC LAW

### Obstacles Resulting In Impossibility

In most legal systems, a party whose obligations have become legally or factually impossible is of course exempted – at least temporarily – from complying with it, under a legal theory usually involving some notion of frustration of performance or some translation of ‘force majeure’. The precise way in which this exemption operates varies from place to place and from industry to industry, but there is general consensus that any expectation that a party perform acts that have become physically impossible through some force of nature

(sometimes referred to as 'acts of god') as well as those that have become legally banned, are naturally not enforceable – in the latter case, at least in the jurisdiction whose laws have prohibited those acts. Thus, where contractual obligations have become impossible to discharge because of a crisis situation, as would be the case where the place where they should be performed is flooded, the obligation is usually suspended – or, in some cases, terminated – until such time as it becomes again possible to perform those acts. The situation is usually the same where it has become illegal to discharge them, as would be the case where the place of performance is located in an area which a flood has made unsafe, and the state orders it to be vacated.

### **Obstacles Short Of Impossibility**

Whether by contract, precedent or statute, domestic laws also typically also address other, lesser changes in circumstances not foreseen at the time of entering into contractual obligations, although the way in which those laws react to those changes varies from legal system to legal system, but the differences can be traced or mapped by references to the primary legal tradition to which those systems pertain, which – for contracts in the Americas – means either the common law or civil law legal traditions. Of course, this will only serve our goal to provide commonly shared themes, as opposed to a complete, comparative analysis of every jurisdiction.

### **In The Common Law Tradition**

For the most part, the common law tradition does not treat state contracts the same as the civil law tradition. While the regulator may have its own role, the rights and obligations of parties to a concession contract are normally governed by the same law as any other commercial agreement. There is thus no reason to draw a distinction between concession contracts and other types of commercial agreements – analysing the latter will resolve almost all questions of contract interpretation regarding the former.

It is difficult, if not impossible, to speak of one, consistent approach within the common law tradition. In the United States, contract law is almost always a question of individual state law, decided by that state's highest court. This is especially true in times of crisis. Almost all of the applicable legal theories derive from state – not federal – law. After all, there is no federal common law for contracts, and federal law only appears where a federal statute has properly preempted a field of state law, such as the Federal Arbitration Act.

Instead of selecting the law of a single state or handful of states, we have turned to general principles contract law, reflected in the Restatement (Second) of Contract Law and other similar authorities that provide a broader picture. There can be nuances on a state-by-state basis, but such a comprehensive overview is outside the scope of this chapter. Although valuable, other sources of common law in the region, such as the jurisprudence laid by the Caribbean Court of Justice, are best dealt with in a work specific to the relevant jurisdictions.

For the most part, the vast majority of commercial contracts in the Americas apply the law of a particular state in the United States, such as New York, Florida, California or Texas. But there are some agreements that look to English law. In addition, the Judicial Committee of the UK's Privy Council is the court of last resort in certain jurisdictions in the Americas, giving English law a continued relevance in the region. In recognition of this role, the chapter concludes with a reference to English law.

### **The United States**

Questions of hardship are normally irrelevant to the interpretation of contracts. 'Contract liability is strict liability',<sup>[2]</sup> and failure to perform is typically nothing more than a ground for contractual remedies, whether they be damages or something else. The exception to this rule comes from the doctrines of impracticability and frustration. In the past, these theories were an implied term of the contract, although there has been a move to reject this approach favour of that of Uniform Commercial Code section 2-615. There, 'the central inquiry is whether the non-occurrence of the circumstance was a "basic assumption on which the contract was made"'.<sup>[3]</sup>

This 'basic assumption' does not require the parties to know of the alternatives. This would be an unworkable model. Instead, the court must look to the internal functioning of the contract and how the parties intended it to work. Some cases are easy. Where a guest speaker dies, he or she is excused from performing any agreed upon presentation (although the situation would probably be one of impossibility, of course). But these kinds of personal service contracts are rarely the ones that cause the interpretive headaches.

The more difficult labour is resolved by determining 'which party assumed the risk'<sup>[4]</sup> of the occurrence of the basic assumption at issue. For example, in the context of a contract for the international sale of goods, the seller may have assumed a fixed delivery date, which includes the various risks that can arise, such as delays in customs, scheduling of cargo space or the occurrence seasonal disruptions to the supply chain. But this risk would not include closing the borders such that no goods can leave. Another example could be a lease contract with the obligation to pay rent. The tenant assumes the risk of operating a going concern that can meet its rent payments, and this rather broad risk continues, regardless of an economic crisis or lack of liquidity. But the tenant does not assume the risk of a terrorist attack on the building. In the latter case, it is unlikely the tenant would have to pay rent. At the same time, whether the owner who has failed to receive payment or rents because of this is exempted from making mortgage payments as a result, or whether the mortgage lender is itself then exempted from its financial commitments to bondholders, are also critical and more complicated issues, even if the starting factual point is one and the same.

In each case, the decision will likely turn on the risk identified. Pointing to the effect of an intervening government regulation can often form a powerful argument to excuse performance. But any review of this argument would require significant focus. If one government closes a border for a key component of the supply chain, but another government provides a subsidy that helps ramp up a replacement, the government measure may not be enough. Indeed, the duty to mitigate would still exist, and it would be unwise for a contractual party to merely assume it was excused from compliance without first exhausting all reasonable measures to partially or fully perform.

On a more practical level, these legal theories tend to play out when a party asserts frustration of purpose or impracticability of performance. The obligor can also assert both theories from a more proactive stance, arguing that it 'will not receive the agreed exchange for [its] own performance because some circumstance has discharged the obligee's duty to render that agreed exchange, on the ground of either impracticability or frustration'.<sup>[5]</sup> The doctrine of impossibility of performance has largely faded from view, due to the difficulty in applying it according to its terms (ie, too often the exceptions swallowed the rule).

Even if a party successfully raises one of the above excuses to suspend performance, this does not end in the inquiry. In some cases, the impediment may only be temporary, leaving the court to consider whether performance can be completed in the future. By way

of example, as governments discuss the 'new normal' after the lifting of the restrictions imposed in response to covid-19, this last point will become key. In both cases, the court would then decide whether the contract should be terminated or performance merely suspended.

There are other details a court would likely consider. There is often a duty for the obligor to notify the obligee of the supervening event, and the failure to notify can be fatal to an attempt to suspend or avoid performance, as is also typically the case in events of force majeure.

A separate issue is damages, which can still flow from excused performance. If a party has suffered damages in relying on the other party's ability to perform, outside the damages from the excused compliance, restitution may be available, either under the Uniform Commercial Code or a theory of unjust enrichment or quantum meruit. Courts can also exercise their equitable powers to supply an omitted, essential term of the parties' contract, although this would only be seen in rare circumstances.

### **The Law Of England And Wales**

English law recognises a more limited scope of arguments and focuses much more on the doctrine of frustration of performance. While also concerned with the allocation of risk of unforeseen events, the doctrine of frustration applies in limited circumstances and requires that (i) the underlying event is not the fault of any party to the contract, (ii) the event was not foreseen by the parties and occurred after the formation of the contract and (iii) the contractual obligation becomes physically or commercially impossible to fulfil, or the event has transformed the obligation to perform into a radically different obligation. As contractual clauses have emerged to deal with the risk of unforeseen events, the doctrine of frustration has shrunk even more.<sup>[6]</sup>

The doctrine of frustration should not be read as a licence for courts to end contracts based on the unjust result caused by changed circumstances. Indeed, the test should focus on the contract and if performance would involve a fundamental or radical change.<sup>[7]</sup> This is a more stringent test than in the United States, although it may not apply as strictly in the event of a supervening illegality, whether the event has created a 'radically different' obligation. Unlike under the law in many states in the United States, the application of the doctrine of frustration terminates the contract. Understandably, this makes the doctrine a strong remedy and one sparingly used.

There are many different kinds of supervening events, but one of particular interest to this chapter is the impact of decisions by foreign governments on contracts governed by English law. As the world sorts through a post-covid-19 world, there may be a web of decisions by foreign governments that may give rise to a claim of frustration, but not all acts will provide a basis to invoke frustration. If performance is outside the United Kingdom and declared illegal in the place of performance, this can give rise to a claim for frustration. The performance must be illegal for the entirety of the time calling for performance, not just a portion. But performance must be illegal, not just excused.<sup>[8]</sup>

When the parties have included a force majeure clause, the doctrine of frustration of performance is not available and vice versa. Any force majeure clause will be construed according to its terms and taking into account the intent of the parties. There is also the possibility of suspended performance, as opposed to termination of the contract, creating more flexibility for the obligor. Any interpretation of a force majeure clause (or other clause allocating risks of supervening events) would follow typical rules of contract interpretation.



### In Civil Law Jurisdictions

In civil law countries, it is generally accepted that the obligations arising from the principle of *pacta sunt servanda* – which commands parties to comply with and abide by the terms of their respective obligations – are subject to certain mitigating factors where long-term contracts are affected by subsequent developments that make it unreasonable for the parties to act as originally intended.

This is generally captured under the formula *rebus sic stantibus* (things being thus), which is shortform for *contractus qui habent tractum sucessivum vel dependentiam de futuro rebus sic stantibus intelliguntur*, a legal theory crafted in the Middle Ages that prescribed that contracts should be interpreted considering that parties had agreed their respective obligations only taking into account the circumstances known at that time, such that any later changes making those obligations unreasonably, unforeseeably onerous should result in a recalibration of the respective contractual expectations. While this theory was only mildly accepted at the time, it gained traction in most civil law jurisdictions throughout the 20th century, sometimes through court decisions, sometimes through changes in the legislation, often times through curial developments later followed by changes in legislation. The practical consequences of *rebus sic stantibus* are that judges are usually allowed to equitably reestablish the contractual equilibrium (eg, by amending the scope of the obligations of the parties, the contractual term or other provisions of the contract).

### Crisis Rules In International Public Law

International public law also contains rules and remedial devices aimed at dealing with unexpected developments impacting on the obligations of states. As the remit of our query is limited to a review of the scenarios relevant to the situation of concession agreements, we will focus on certain provisions in bilateral investment treaties, and certain devices existing in international customary law.

#### In Treaty Law

Starting with the Friendship, Commerce and Navigation Treaty between the US and China of 1946, a growing number of bilateral treaties include provisions like the one proposed in the US 2012 BIT model, which reads: ‘nothing in this treaty shall be construed . . . to preclude a party from applying measures that it considers necessary for the fulfilment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests’.<sup>[9]</sup>

Provisions of this type have been invoked in crisis situations, most notably in the context of the 2001 crisis in Argentina, which saw over 25 investment arbitration proceedings commenced against that South American country in the following years. Several of these cases involved claims under the Argentina-US BIT, which contained a provision analogous to the one transcribed above.<sup>[10]</sup>

The decisions issued interpreting this provision were not particularly uniform, with some tribunals having found that states had a margin of discretion to identify and react to situations involving their security interests without thereby breaching the BIT, while others rejected the notion that those provisions were self-judging. Still, that collection of disparate decisions provides a useful background for subsequent investment disputes, especially as more and more modern bilateral investment treaties specifically clarify that each contracting

state reserves for itself the prerogative to consider that a certain situation requires certain exceptional protective or responsive measures.<sup>[11]</sup>

#### In International Customary Law

In addition to the treaty provisions dealing with non-precluded measures – which have the effect that such measures, when adopted, do not breach the relevant treaty – international customary law also eliminates state liability when an international wrongful act has been committed under situations of force majeure, distress or necessity. The high threshold to prove those defences, and the limited scope of their application, are reflected in articles 23-25 of the International Law Commission's 2001 Articles on State Responsibility for International Wrongful Acts (the ILC Articles).

In a nutshell, customary international law force majeure exists where performance of the international obligation becomes impossible because of irresistible force or an unforeseen event, on condition that the situation was not caused by the state invoking it, and that the risk of its occurrence had not been assumed by it. As the commentary to the ILC Articles prepared by the ILC itself clarifies, this requires that the measures adopted do not involve a free choice by the breaching state, and amount in practice to an involuntary act. Of relevance to our survey here, that same commentary posits that '[f]orce majeure does not include circumstances in which performance of an obligation has become more difficult, for example due to some political or economic crisis',<sup>[12]</sup> although in an early case decided over a century ago, it was held that the obligation of a state to fulfil treaties may give way on the basis of force majeure 'if the very existence of the state should be in danger, if the observance of the international duty is . . . "self-destructive"'.<sup>[13]</sup> As customary law later developed, this formulation would qualify for a defence of necessity and not one of force majeure, as will be discussed below.

By contrast, distress in international law refers to a very specific situation, where 'the author of the act in question has no other reasonable way, in a situation of distress, of saving the author's life or the lives of other persons entrusted to the author's care',<sup>[14]</sup> subject to the situation not having resulted from acts of the state invoking it, and to the measures not resulting in comparable or greater peril than that avoided. While it would in principle seem that governmental measures aimed at saving the lives<sup>[15]</sup> of persons entrusted to its care would fit into this description – and it would be very hard to negate that this would be a primary concern of any state – the ILC commentary regarding distress suggests, however, that it:

may only be invoked as a circumstance precluding wrongfulness in cases where a state agent has acted to save his or her own life or where there exists a special relationship between the state organ or agent and the persons in danger. It does not extend to more general cases of emergencies, which are more a matter of necessity than distress.<sup>[16]</sup>

This may become a relevant discussion in connection with the measures adopted in response to the current covid-19 global outbreak, which has proven to trigger concerns about the health and lives of people in all geographies.

Finally, the customary law plea of necessity involves the allegation that a certain breach of an international obligation was the only way for a state to safeguard an essential interest against a grave and imminent peril,<sup>[17]</sup> but is only available if the state invoking necessity has not contributed to the creation of that situation, if the obligation in question does not

exclude the possibility of invoking necessity, and if the breach does not itself result in a serious impairment of an essential interest of the international community or the states, or states, towards which the obligation exists. Necessity has been invoked in a number of contexts in international disputes over the past two centuries, including in the context of the investment disputes resulting from the 2001 Argentine crisis discussed above.

As noted by the ILC:

[o]n balance, state practice and judicial decisions support the view that necessity may constitute a circumstance precluding wrongfulness under certain very limited conditions, and this view is embodied in [article 25 of the ILC Articles]. The cases show that necessity has been invoked to preclude the wrongfulness of acts contrary to a broad range of obligations, whether customary or conventional in origin. It has been invoked to protect a wide variety of interests, including safeguarding the environment, preserving the very existence of the state and its people in time of public emergency, or ensuring the safety of a civilian population. But stringent conditions are imposed before any such plea is allowed.<sup>[18]</sup>

Probably the condition that becomes the highest obstacle to overcome is that the breach for which necessity is pled must be the 'only way' available to safeguard the essential interest at stake, which may render the remedy unavailable if other alternatives exist, however expensive or inconvenient. The ILC goes as far as suggesting that any alternative way 'is not limited to unilateral action but may also comprise other forms of conduct available through cooperative action with other states or through international organisations',<sup>[19]</sup> meaning that, in its view, necessity would not be validly invoked if a pleading state could, through any alternative means to be reached, at any cost and in spite of all inconvenience (short of breaching other international obligations), have overcome the threat to the imperiled essential interest.

### IMPACT ON CLAIMS AND DEFENCES

In practical terms, crisis situations – and especially massive, global crises like the covid-19 pandemic currently under course – may conceivably give rise to numerous forms of claims based on protections regarding discrimination (including most favoured nation or national treatment obligations), expropriation or fair and equitable treatment, but claims made in this context need to factor in a number of key considerations, as follows:

- In cases of severe, widespread crisis, tribunals will probably feel disinclined to exempt a single investor from the consequences of general problems, especially if any comparable activity – in the investor's state of nationality or elsewhere – would be affected in similar terms to the actual investment in the actual host state.
- States will generally be granted a larger margin of appreciation the larger and the more unexpected the general crisis situation. In this context, any argument of 'legitimate expectations' – even if accepted conceptually by the sitting tribunal – will require an investor to prove that it really and validly expected that the host state's regulation not react to the impending crisis, which may be a rather difficult proposition.
- At the same time, states are not generally able to dispense with the application of investment treaties, meaning that the response to covid-19 or other crises, however grave, cannot involve discriminating against foreign investors, failing to grant fair and equitable treatment to them or expropriate their assets without compensation.

Similarly, a state's failure to adequately respond to covid-19 could lead to claims of violating basic treaty protections. As is often the case, a crisis can be a chance to advance unrelated initiatives, and resulting state action is not excused merely because a crisis has caused a regulatory response.

- Especially where there is no doubt that the crisis itself was not part of the measures challenged by the claimant-investor, the value of any affected investment will suffer – or possibly even vanish – for causes unrelated to or more pervading than any challenged state measures, which might result in meagre or negative damages even if the claimant prevails over any objections to jurisdiction or any defences on the merits of its case, which may make the prospects of litigating an international law dispute for years unattractive.

As a result of these considerations, it is not uncommon that many disputes relating to measures adopted in times in serious crisis are settled early on. By way of example, over 40 per cent of the wide array of investment cases brought against Argentina in connection with its 2001 crisis were eventually settled before an award was issued with no cash payment being involved.

In relation to private disputes, the precise impact of the crisis and of any state action adopted in response and affecting the contract at issue can have a definitive effect on the prospects or the outcome of a dispute. Some issues to consider include the following:

- Long-term contracts will be more difficult to terminate. Where the parties can adjust the price or the method for calculation of the amount they owe each other, there is no need to completely undo the contract. This is especially true of concession contracts since the parties are often looking at lengthy revenue streams.
- Short-term contracts could be at significant risk. If a specific part at a set time had to be delivered from a country with export controls or delayed travel, these contracts can be difficult to enforce.
- Private disputes are also subject to other pressures that can impact the dispute, whether it be bankruptcy or insolvency, pressure to do 'whatever it takes' that then leads to fraud or embezzlement, or the dramatic weakening of the economy as it relates to businesses exposed to certain sectors, reducing the appetite for a dispute.

Crises can present enormous opportunities and also risks for private industry, and the response to the spread of covid-19 will be no different. It is an evolving challenge with little precedent, and the disputes that may arise now could look quite different from those that appear after any second or third wave. Unlike the financial crisis of 2008, it is not readily clear who the winners and losers are. The dramatic measures to prop up the economy adopted by some states may be enough to keep some companies afloat but unwilling to take their claims into arbitration. In other cases, the reaction by the state may be something that all participants have to swallow, even if that means reduced revenue from the paying customer down to the parts supplier.

## CONCLUSION

So far, the covid-19 pandemic that spread globally in early 2020 has seen a dearth of proposed adaptations to otherwise applicable rules and principles in the many relevant domestic and international law contexts, in terms of both procedure and substance.

As regards procedural impacts of the pandemic, all known in-person events in international dispute resolution have been postponed<sup>[20]</sup> or replaced by telematic (telephonic or videographic) or written activity, and many jurisdictions have adopted similar modifications to their own internal court systems. On the side of substantive law, some jurisdictions have enacted legislation that suspends most forms of adverse action regarding breaches of contract caused by the covid-19 emergency – including the statute of limitations for such action.<sup>[21]</sup>

Without a doubt, this will create a new body of law and case law regarding the impact of crisis situations on concession contracts, which, in most instances, constitute the way in which the needs of the population are in practice actually catered to by states. While the domestic and international formulations have long contained ways in which to deal with the possibility of changes in circumstances, we may well be navigating through the exceptional situation where most or all of the legal relations and claims came to a practical hiatus across geographical and legal culture boundaries at the exact same time.

It would not be surprising that, out of imitation or similarity of regulatory instinct and needs, the responses to be enacted across those demarcations converge in a homogeneous set of measures, a *lex pandemiae* of sorts, which sets the foundation for predictable international economic activity in times of crisis.

## Endnotes



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