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State liability and COVID-19: key aspects

Legal flash

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The measures of suspension or restrictions imposed on certain business activities as a result of the state of emergency declared under Royal Decree 463/2020, of March 14, declaring the state of emergency to manage the public health crisis caused by COVID-19, provide grounds to analyze the scope of the potential liability of the state.

This legal flash gives an overview of the key aspects concerning the liability regime of the state resulting from these measures. Among others, it addresses the following issues:

- Can compensation be claimed for the suspension or restrictions imposed on business activities?
- What are the requirements to be entitled to compensation?
- What if a company has already received state aid to compensate for the effects of the state of emergency?
- What is the time limit to make the claim and who should it be filed with?
- Can the right to compensation be transferred to third parties?
- How would this claim be processed in a situation of insolvency?

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1. Can compensation be claimed for the suspension or restrictions imposed on business activities as a result of COVID-19?

Yes, the Spanish Constitution recognizes the principle of responsibility of the government and its agencies during the state of emergency. Under article 3.2 of the *Spanish Act on States of Alarm, Emergency and Siege* *"Those who, as a result of applying the actions and provisions adopted while those states are in force, suffer damages or losses, whether directly or personally, or to their rights or assets, due to situations that are not attributable to them, are entitled to compensation as established by law."*

2. What are the requirements to be entitled to compensation?

The requirements are those generally applicable to state liability:

- Unlawful damage (the person suffering the damage does not have the legal obligation to sustain it).
- The damage must be effective, financially quantifiable and individualized with respect to a person or group.
- There must be a causal link between the legislative act and the damage, which is excluded in cases of *force majeure*.

3. How is it possible to combine the obligation to comply with the measures adopted due to the state of emergency with the right to compensation?

Measures adopted due to the state of emergency are imposed on all citizens to safeguard and protect the community's right to life and health, which means there is a legal obligation to comply with them (unless the declaration of a state of emergency or its extensions were ruled unconstitutional). However, the law also recognizes the right to compensation for losses and damages resulting from these measures. To overcome this apparent contradiction, it is necessary to consider the uniqueness (as laid down by case law, the government is not a general insurer of all risks) and the proportionality of the sacrifice

imposed on each specific economic operator.

4. When is it considered that a unique sacrifice is sufficiently substantiated to warrant compensation?

Public burdens must be assumed based on the principle of equality. Therefore, compensation must be provided for damages that involve a unique sacrifice for a particular sector or company, imposed in the interest of the community, being greater than the general sacrifice imposed on all citizens and economic operators.

The issue courts need to clarify is where to set the threshold of the uniqueness and specificity of the sacrifice from which the right to compensation arises. One estimation is provided by sectors that have been subject not merely to the restrictions and constraints imposed on their activity, but to the complete suspension of it. It cannot be ignored that state liability is a highly case-specific matter, which means that the particular circumstances of each economic operator claiming compensation must be analyzed.

5. What circumstances would qualify for a measure to be considered disproportionate?

Another allocation of liability may arise from the disproportion of the measure imposed. This disproportion would not necessarily mean that the declaration of the state of emergency was unconstitutional, but that it would lead to a series of sacrifices greater than those required to achieve the intended public purpose.

The temporary nature of the sacrifice is fundamental, both from the standpoint of the measures first taken (given that earlier action would have resulted in smaller sacrifices, as long as there was the evidence necessary to adopt them), of its duration (an analysis must be conducted as to whether the length of the restriction was necessary), and of its proportionality (i.e., whether, instead of suspending the activity, the same end could have been achieved with less restrictive measures, such as laying down strict conditions of use).

6. Why would the exception of *force majeure* not apply?

Because there is a special law providing entitlement to compensation in states of alarm, emergency and siege that are clear cases involving the existence of *force majeure*. Also, because compensation does not derive from the effects of the pandemic itself or from its social and economic effects, but from the consequences arising from the measures implemented by the government. When faced with an epidemic, or with any other event, the government may react in several ways. Once it has chosen one at any particular time, it is obliged to respond to any damages the chosen measures may cause, as long as the above requirements are met.

7. Should the compensation cover all financial effects resulting from the pandemic?

In principle, damages must be fully compensated. However, it is worth making two observations.

The first is that it seems reasonable to distinguish between the direct effects of the pandemic (it is indisputable that consumption would have decreased, and many people would have stopped eating at restaurants and staying at hotels, for example) and the severe distress caused to some sectors owing to the measures approved by the government. In fact, it is logical to conclude that there is a concurrence of causes, the direct effects of the pandemic, and the effects of the measures adopted owing to the state of emergency. In these cases, judicial practice will proportionally limit the recognized compensation.

The second observation regarding the total compensation amount is that, as explained in the following section, it is worth taking into account whether any other state aid has been granted.

8. What if a company has already received state aid to compensate for the effects of the state of emergency?

Any aid amounts received through any means will be subtracted (this would include the

deduction of social security contributions in the case of a temporary redundancy plan). This occurs because, although damages must be fully compensated, this cannot lead to the enrichment of the claimant, as would be the case if these amounts were not deducted.

9. What is the time limit to make the claim and who should it be filed with?

The time limit is one year from the date the state of emergency is lifted or on which the measure causing the damage was adopted.

If the declaration of the state of emergency was ruled unconstitutional, the period would begin on the date the ruling is published stating that the declaration was unconstitutional. In this case, the issue arises as to whether, generally speaking, the law requires that the adoption of acts implementing unconstitutional law must have been challenged (note that the declaration of the state of emergency is a legislative act). However, as this provision must be self-applied (the suspended activity must be stopped immediately without waiting for an order or notice to do so), this requirement does not appear to be enforceable although, for the sake of caution, it is advisable to file the claim as soon at the state of emergency has been lifted.

10. Can the right to compensation be transferred to third parties?

Generally speaking, in the field of private law, all credits are susceptible to being granted unless another agreement has been reached or it is not permitted by law.

When it comes to state liability, the law remains silent, so it is reasonable to assume that granting a credit as a result of this liability is not prohibited. However, in its judgment dated January 22, 2020, the Supreme Court ruled to the contrary, stating that credit claims resulting from state liability can only be granted, much the same as in the case of administrative agreements, once it has been recognized in a final administrative decision or, if applicable, in a final judgment. In other words, according to the Supreme Court, what should be granted is a collection right, not a right yet to be recognized.

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11. How would this claim be processed in a situation of insolvency?

Claims are subject to the general restrictions resulting from the insolvency situation with regard to the need for a certificate of capacity issued by the receiver to take legal action or file a claim. From another perspective, it may be included as an asset in the company's balance sheet and transferred, subject to the limitations set out above.

CUATRECASAS TASK FORCE

At Cuatrecasas, we are working non-stop to provide our clients with legal advice on everything related to the COVID-19 crisis, and we are available to give immediate answers in all legal matters.

Our Knowledge and Innovation Team continues to manage our collective knowledge in the most efficient way during these uncertain times to provide top-quality, innovative legal advice to our clients in all matters related to this crisis.

For more details, contact Cuatrecasas or visit our *website*.

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