

# COVID-19: Public Health Emergency Measures And State Defenses In International Investment Law

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As States declare national emergencies to address the COVID-19 pandemic and enact legislation aimed at combatting the crisis, States may take measures that may adversely affect the investments of foreign investors. This situation could in turn give rise to claims by foreign investors against States pursuant to international investment agreements (“IIAs”), asserting that substantive treaty protections have thereby been breached.

Investment treaty tribunals regularly consider State measures enacted in the context of major crises. While the COVID-19 pandemic is unprecedented in scope and effect, investment arbitrations addressing measures taken by States in prior crises have raised issues that are likely to be relevant in investment disputes that may arise out of the current health emergency.

This alert memorandum addresses selected legal issues that may arise in investment treaty arbitrations relating to the COVID-19 pandemic, including issues arising out of current measures to cope with the public health emergency as well as measures taken in the coming months to address any subsequent economic crisis. This memorandum further analyses the possible defenses that States are likely to raise.

International investment law affords broad discretion to States to regulate in the public interest, including to protect public health. In the first instance, States may contend that measures taken to respond to the current health emergency are within the *bona fide* exercise of a State’s regulatory discretion, or “police powers”. In addition, States may attempt to raise defenses under the express terms of IIAs, such as under “national and essential security” clauses which explicitly carve out certain measures from the scope of treaty protections. In addition to any defenses under the applicable IIA, States may also seek to rely on defenses under customary international law.

If you have any questions concerning this memorandum, please reach out to your regular firm contact or the authors listed below, or our COVID-19 task force by clicking [here](#).

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## Challenges to State Measures under International Investment Law

### *Substantive Protection of Foreign Investments*

The substantive protections under an IIA invoked by a foreign investor will determine the types of claims that foreign investors may raise in challenging measures taken to respond to the COVID-19 pandemic, or to any subsequent economic crisis.

In the current public health emergency, foreign investors may be particularly concerned about the nationalization of assets, since certain States have enacted legislation permitting the requisitioning of goods and services by the State where necessary to counter the pandemic.<sup>1</sup> Foreign investors may also raise concerns that State measures aimed at responding to the pandemic discriminate against foreign investors, and thereby may breach the national treatment, fair and equitable treatment (“FET”), or most-favored-nation treatment (“MFN”) standards typically included in IIAs, including in the Energy Charter Treaty, the most frequently invoked IIA in investment arbitration according to recent data.<sup>2</sup>

The expropriation of foreign investments by States is generally permitted in IIAs provided that expropriation is carried out for a public purpose, is made against adequate compensation, and is done in accordance with due process and in a non-discriminatory manner. The notion of expropriation is defined or interpreted broadly and includes indirect expropriations that occur where a State substantially deprives an investor of its investment, without a formal transfer of title or outright seizure of property. The line between an unlawful indirect expropriation and a lawful, non-compensable exercise of governmental regulatory power requires a case-by-case assessment. In determining whether States are required to compensate foreign investors, arbitral tribunals constituted under IIAs may consider whether the State measures were discriminatory or disproportionate, frustrated the investor’s legitimate expectations, or violated specific commitments made by the State to the investor.

### *State Discretion to Regulate for Public Health Reasons*

As a general matter in international investment law, States are afforded broad “police powers” to regulate in the public interest. The investment chapter of the recent EU-Singapore Investment Protection Agreement, for instance, expressly affirms the Parties’ “*right to regulate...to achieve legitimate policy objectives, such as the protection of public health, [and] safety*” and provides that “*the mere fact that a Party regulates...in a manner which negatively affects an investment or interferes with an investor’s expectations...does not amount to a breach of an obligation*” under the investment chapter.<sup>3</sup>

The broad discretion of States to regulate for reasons of public health is well established. For example, the arbitral tribunal in *Philip Morris v. Uruguay* held that measures taken by Uruguay to regulate tobacco products were justified as the *bona fide* non-discriminatory exercise of the State’s “police powers” to regulate for reasons of public health that did not amount to an indirect expropriation or a breach of the FET standard.<sup>4</sup> The *Philip Morris* tribunal reaffirmed a State’s broad “margin of appreciation”, emphasizing that “*investment tribunals should pay great deference to governmental judgments of national needs in matters such as the protection of public health*”.<sup>5</sup> In this case, the World Health Organization intervened as *amicus curiae* in support of the public health measures enacted by Uruguay.<sup>6</sup> Other investment tribunals, notably *Chemtura v. Canada* and *Apotex v. United States*,<sup>7</sup> have confirmed the broad discretion of States to regulate in the interests of public health.

### *State Measures in Crisis Situations*

States enacting measures to respond to a crisis have to consider both the need to respect their obligations as a matter of international law and the need to address the crisis. When assessing State measures in response to a crisis, arbitral tribunals may consider whether to take into account the particular circumstances of the crisis when applying the substantive protections accorded by the applicable IIA. In assessing State measures taken in the context of the Argentine economic crisis, for example, the *Total v. Argentina* tribunal emphasized the “*inherent*

*flexibility of the fair and equitable standard”, and concluded that “[u]nfairness must be evaluated in respect of the measures challenged, both in the light of their objective effects but also in the light of the reasons that led to their adoption.”*<sup>8</sup> The *National Grid v. Argentina* arbitral tribunal concluded that “[w]hat would be unfair and inequitable in normal circumstances may not be so in a situation of an economic and social crisis.”<sup>9</sup>

Foreign investors frequently rely on the FET standard to claim legitimate, investment-backed expectations with regard to the stability of the host State’s legal environment. However, arbitral tribunals have found that foreign investors cannot legitimately expect that a State’s legal framework will remain unchanged in times of crisis.<sup>10</sup>

In summary, although the degree of deference afforded by arbitral tribunals to State discretion differs, States are likely to attempt to resist claims relating to State measures taken during the COVID-19 pandemic or any subsequent economic or financial crisis by contending that the measures were taken in the exercise of the State’s ‘police powers’ to regulate in the public interest.

### **Possible State Defenses**

In addition to the generally broad discretion afforded to States in international investment law expressly affirmed in recent IIAs, States may also raise a number of defenses under traditional carve-outs in the applicable IIA, or under customary international law.

#### ***Carve-outs for Prudential Measures in International Investment Agreements***

Firstly, the contested measures may fall outside the scope of the applicable IIA altogether. In the wake of recent financial crises, States are increasingly including carve-outs for prudential measures in IIAs. Such carve-outs reaffirm their right to adopt prudential measures deemed necessary to restore financial stability and exclude such measures from the scope of treaty protection.<sup>11</sup>

Where a foreign investor contests measures taken to respond to financial crises that may arise in the wake of COVID-19, the implicated State may be able to rely on prudential carve-outs under certain IIAs.

#### ***National and Essential Security Clauses in International Investment Agreements***

If the contested measures fall within the scope of an applicable IIA, States may also seek to rely on clauses that expressly authorize the State to take measures that are otherwise not in conformity with their treaty obligations, in particular national and essential security clauses. Such clauses are included in various model bilateral investment treaties (“BITs”),<sup>12</sup> as well as in multilateral investment agreements, such as the Energy Charter Treaty, which is frequently invoked by foreign investors in the energy sector.<sup>13</sup> By way of example, the national and essential security clause of the U.S. Model BIT provides that “[n]othing 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>14</sup> The wording of national and essential security clauses varies, with certain clauses making reference to measures necessary for the “protection of...public health”<sup>15</sup> or the prevention of disease.<sup>16</sup> In responding to the present COVID-19 pandemic, a number of States have declared states of national emergency or epidemiological emergencies,<sup>17</sup> affording the State broad discretion to regulate to protect public health. In such cases, a State may seek to invoke such states of emergency when relying on a national and essential security clause in an investment treaty.

Pursuant to their specific wording, national and essential security clauses apply either to generally exclude State liability for breaches of substantive treaty protections or as carve-outs only to certain treaty standards.<sup>18</sup> However, such clauses, including in the Energy Charter Treaty, may not necessarily exempt the State from the obligation to pay compensation to a foreign investor in cases where their investment is requisitioned during a national emergency, or from the obligation not to discriminate when paying compensation.<sup>19</sup> Other such clauses may not necessarily preclude claims for discrimination.<sup>20</sup>

While arbitral tribunals have construed national and essential security clauses broadly, applying them

beyond the confines of security issues, their application has often been inconsistent. For instance, the national and essential security clause in the U.S.-Argentina BIT, which applies to measures for the maintenance of public order or security, was considered by numerous tribunals to be potentially applicable in the circumstances of an economic crisis.<sup>21</sup> However, arbitral tribunals considering the Argentine economic crisis took differing views on whether to rely on this national and essential security clause to excuse non-compliance with treaty obligations.<sup>22</sup>

Certain national and essential security clauses may be worded in “self-judging” terms, permitting a State to take any measure that the State considers necessary in the interests of national security.<sup>23</sup> The tribunal in *CC Devas v. India* found that such clauses are not self-judging unless the treaty contains specific wording expressly granting the State full discretion to determine what it considers necessary for the protection of its security interest. Nevertheless, it found that a “wide measure of deference” should be afforded by tribunals regarding the measures adopted by States under such clauses.<sup>24</sup> However, even if such clauses are worded in “self-judging” terms, their invocation by States is subject to a good-faith review by arbitral tribunals.<sup>25</sup>

### ***State Defenses Under Customary International Law***

In the context of the COVID-19 pandemic, States may also seek to rely on the customary international law defenses of necessity, *force majeure* and, in limited circumstances, distress to justify measures that would otherwise violate their obligations under IIAs. Although numerous States have declared national crises or states of emergency as a result of the COVID-19 pandemic, arbitral tribunals will independently determine whether the requirements of necessity, *force majeure*, and distress are satisfied under international law.

#### ***State of Necessity***

States facing crises have frequently invoked necessity, alleging that contested measures were necessary to address a crisis or emergency faced by the State. Pursuant to the customary international law rule codified in Article 25 of the International

Law Commission’s Articles on Responsibility of States for Internationally Wrongful Acts (the “**ILC Articles**”), a State may raise the defense of necessity to preclude the wrongfulness of an internationally wrongful act where the act in question, “(a) *is the only way for the State to safeguard an essential interest against a grave and imminent peril; and (b) does not seriously impair an essential interest of the State or States towards which the obligation exists, or of the international community as a whole.*”<sup>26</sup>

To successfully invoke the defense of necessity, a State will have to demonstrate that: (i) the State faces a grave and imminent peril that threatens an essential interest; (ii) the State’s act was the only way to safeguard that essential interest; (iii) the State’s act did not seriously impair the essential interest; (iv) the international obligation in question did not exclude the possibility of invoking necessity; and (v) the State did not contribute to the situation of necessity.<sup>27</sup>

Necessity has been invoked frequently by States facing economic and financial crises. However, arbitral tribunals have applied the required elements of necessity inconsistently,<sup>28</sup> and some uncertainty persists. In particular, customary international law, as reflected in the ILC Articles and its commentaries, does not offer a definitive answer to the question of whether compensation is payable in cases where a State successfully invokes necessity.<sup>29</sup> Necessity has often been considered alongside national and essential security clauses, whose operation may result in denial of any award of compensation for the damages suffered during the recognized period of necessity.<sup>30</sup> However, after the end of the period of necessity, the State may no longer be exempted from the requirement to pay compensation.

The declaration by a State of a state of emergency may only serve as evidence for an international tribunal of a state of emergency that may give rise to a necessity defense under international law.<sup>31</sup> At the same time, States may still point to these declarations and the seriousness of the accompanying measures to demonstrate that a state of necessity existed.



### Force Majeure

The defense of *force majeure* is codified in Article 23(1) of the ILC Articles. It provides that the wrongfulness of an act is precluded “*if the act is due to force majeure, that is the occurrence of an irresistible force or of an unforeseen event, beyond the control of the State, making it materially impossible in the circumstances to perform the obligation*”.<sup>32</sup>

For a State to successfully invoke the defense under Article 23(1) of the ILC Articles, it must have become “*materially impossible*” to perform the obligation in question. Here, investment tribunals have found that the defense of *force majeure* does not exempt a State from international responsibility where “*performance of an obligation has become more difficult, for example due to some political or economic crisis*.”<sup>33</sup>

In addition, to successfully rely on the *force majeure* defense, a State must demonstrate that: (i) an unforeseen event or irresistible force exists that is beyond the control of the State; (ii) the State did not contribute to the situation in question; and (iii) the State did not assume the risk of the situation occurring.<sup>34</sup>

Arbitral tribunals will assess on a case-by-case basis whether a State meets the high standard of material impossibility. This may become more difficult as time goes by and as State measures are taken to cope with economic or financial crisis, rather than with the COVID-19 pandemic itself.

### Distress

In limited circumstances, States may be able to raise the defense of distress. Article 24 of the ILC Articles provides that the defense of distress may be raised

where “[t]he wrongfulness of an act of a State not in conformity with an international obligation of that State is precluded if 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>35</sup>

International tribunals have further required “*the existence of very exceptional circumstances of extreme urgency involving medical or other considerations of an elementary nature*,” which must be clearly recognized on a case-by-case basis by the other interested party.<sup>36</sup> Measures taken by State agents to protect their own lives or the lives of those to whom they owe a duty of care may be excluded from the scope of treaty violations by operation of this defense.

\* \* \*

In sum, if investment claims arise in relation to measures taken by States in response to the current health emergency, it is likely that States may raise an array of defenses against such claims, either on the grounds that the measures were part of the legitimate exercise of their regulatory discretion or fell within a treaty exception. States may also seek to rely on customary international law defenses under the applicable IIA or under customary international law. Whether resort to such defenses will prove successful will depend on the particular circumstances at the time of the measures and the nature of the measures themselves.

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<sup>1</sup> For example, both France and Spain have enacted legislation permitting the State to requisition businesses in the context of the COVID-19 pandemic. See [Loi n° 2020-290 du 23 mars 2020 d’urgence pour faire face à l’épidémie de covid-19](#), JORF n° 0072 du 24 mars 2020, texte n° 2, Art. L. 3131-15(7); [Royal Decree 463/2020 \(Mar. 14, 2020\)](#), [Official State Gazette of the Kingdom of Spain](#), Art. 8(1).

<sup>2</sup> “[The Energy Charter Treaty \(ECT\) Remains the Most Frequently Invoked IIA](#)”, International Energy Charter, (Jan. 11, 2019). According to data from UNCTAD Investment Policy Hub, as at December 31, 2019, 128

investment arbitrations had been commenced under the Energy Charter Treaty. See United Nations Conference on Trade and Development (UNCTAD), Investment Policy Hub, [Investment Dispute Settlement Navigator](#) (data correct as at December 31, 2019).

<sup>3</sup> EU-Singapore Investment Protection Agreement (2018), Article 2.2.

<sup>4</sup> *Philip Morris Brands Sàrl, Philip Morris Products S.A. and Abal Hermanos S.A. v. Oriental Republic of Uruguay*, ICSID Case No. ARB/10/7, Award (July 8, 2016), ¶¶ 306, 420, 434.

- <sup>5</sup> *Philip Morris Brands Sàrl, Philip Morris Products S.A. and Abal Hermanos S.A. v. Oriental Republic of Uruguay*, ICSID Case No. ARB/10/7, Award (July 8, 2016), ¶ 399.
- <sup>6</sup> *Philip Morris Brands Sàrl, Philip Morris Products S.A. and Abal Hermanos S.A. v. Oriental Republic of Uruguay*, ICSID Case No. ARB/10/7, Written Submission (*Amicus Curiae* Brief) by the World Health Organization and the WHO Framework Convention on Tobacco Control Secretariat (Jan. 28, 2015).
- <sup>7</sup> *See, e.g., Crompton (Chemtura) Corp. v. Government of Canada*, UNCITRAL, Award (Aug. 2, 2010), ¶ 266; *Apotex Holdings Inc. and Apotex Inc. v. United States of America*, ICSID Case No. ARB(AF)/12/1, Award (Aug. 25, 2014), ¶ 8.75.
- <sup>8</sup> *Total S.A. v. Argentine Republic*, ICSID Case No. ARB/04/1, Decision on Liability (Dec. 27, 2010), ¶ 164.
- <sup>9</sup> *National Grid plc v. Argentine Republic*, UNCITRAL, Award (Nov. 3, 2008), ¶ 180.
- <sup>10</sup> *Impregilo S.p.A. v. Argentine Republic*, ICSID Case No. ARB/07/1, Award (June 21, 2011), ¶ 291; *El Paso Energy International Company v. Argentina*, ICSID Case No. ARB/03/15, Award (Oct. 31, 2011), ¶ 374; *Continental Casualty Company v. Argentina*, ICSID Case No. ARB/03/9, Award (Sept. 5, 2008), ¶ 258.
- <sup>11</sup> *See, e.g., Morocco-Japan BIT* (2020), Art. 13 (not yet in force). *See also* L. Achouk-Spivak, “Banking and financial investment arbitrations: past, present and future post *Achmea* and Opinion 1/17”, [European Central Bank, Legal Working Paper Series - The new challenges raised by investment arbitration for the EU legal order](#), No. 19 (October 2019), pp. 39-40.
- <sup>12</sup> *See, e.g., Canada Model BIT* (2004), Art. 10; *India Model BIT* (2015), Art. 33.
- <sup>13</sup> Energy Charter Treaty, Art. 24.
- <sup>14</sup> U.S. Model BIT (2012), Art. 18.
- <sup>15</sup> *See, e.g., Hungary-Russia BIT*, Art. 2.
- <sup>16</sup> *See, e.g., Peru-Singapore BIT*, Art. 11.
- <sup>17</sup> *See, e.g., for France, Loi n° 2020-290 du 23 mars 2020 d’urgence pour faire face à l’épidémie de covid-19*, JORF n° 0072 du 24 mars 2020, texte n° 2; for Italy, [Legal Decree \(Feb. 23, 2020\), No. 6](#), *Misure urgenti in materia di contenimento e gestione dell’emergenza epidemiologica da COVID-19*, Official Gazette of the Italian Republic.
- <sup>18</sup> For example, the Belgium-Luxembourg Economic Union-China BIT includes at Art. 4(2) a national and essential security clause that relates only to the provisions on expropriation, and the Japan-China BIT contains in its Protocol a national and essential security clause that relates only to the provisions on non-discrimination.
- <sup>19</sup> Energy Charter Treaty, Art. 24(1) (“This Article shall not apply to Articles 12, 13 and 29”). *See also* Energy Charter Treaty, Art. 12.
- <sup>20</sup> For example, Article 8 of the Framework Agreement for Comprehensive Economic Partnership between Japan and the ASEAN requires that measures within the scope of the security exception are not applied in a manner “which would constitute a means of arbitrary or unjustifiable discrimination.”
- <sup>21</sup> *See, e.g., CMS Gas Transmission Company v. Argentine Republic*, ICSID Case No. ARB/01/8, Award (May 12, 2005), ¶¶ 359-360; *LG&E Energy Corp., LG&E Capital Corp., LG&E International, Inc. v. Argentine Republic*, ICSID Case No. ARB/02/1, Decision on Liability (Oct. 3, 2006), ¶ 238.
- <sup>22</sup> For instance, in the *CMS* case, the tribunal concluded that the economic crisis in Argentina was not sufficiently severe to justify reliance on the national and essential security clause and the necessity defense. *See CMS Gas Transmission Company v. Argentine Republic*, ICSID Case No. ARB/01/8, Award (May 12, 2005), ¶¶ 353-356. In the *LG&E* case, the tribunal excused Argentina from liability for treaty breaches during a certain period, in reliance on the national and essential security clause and the defense of necessity under customary international law. *See LG&E Energy Corp., LG&E Capital Corp., LG&E International, Inc. v. Argentine Republic*, ICSID Case No. ARB/02/1, Decision on Liability (Oct. 3, 2006), ¶ 229.
- <sup>23</sup> *See, e.g., U.S. Model BIT* (2012), Art. 18 (“Nothing in this Treaty shall be construed: 1. to require a Party to furnish or allow access to any information the disclosure of which it determines to be contrary to its essential security interests; or 2. to preclude a Party from applying measures that it considers necessary for the fulfillment 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>24</sup> *CC/Devas (Mauritius) Ltd., Devas Employees Mauritius Private Limited., and Telcom Devas Mauritius Limited v. The Republic of India*, PCA Case No. 2013-09, Award on Jurisdiction and Merits (Jul. 25, 2016), ¶¶ 219, 244-245.
- <sup>25</sup> *LG&E Energy Corp., LG&E Capital Corp., LG&E International, Inc. v. Argentine Republic*, ICSID Case No. ARB/02/1, Decision on Liability (Oct. 3, 2006), ¶ 214 (“Were the Tribunal to conclude that the provision is self-judging, Argentina’s determination would be subject to a good faith review anyway, which does not significantly differ from the substantive analysis presented here”).
- <sup>26</sup> [Articles on Responsibility of States for Internationally Wrongful Acts](#), Yearbook of the International Law Commission (2001), Vol. II, Part Two (“ILC Articles”), Article 25(1).
- <sup>27</sup> [ILC Articles](#), Article 25.
- <sup>28</sup> A number of arbitral tribunals considering the necessity defense in the context of measures taken by Argentina

during its financial crisis reached diverging findings. See *supra*, note 22.

<sup>29</sup> *LG&E Capital Corp., LG&E International, Inc. v. Argentine Republic*, ICSID Case No. ARB/02/1, Decision on Liability (Oct. 3, 2006), ¶ 264; *EDF and others v. Argentine Republic*, ICSID Case No. ARB/03/23, Award (Jun. 11, 2012), ¶ 1177.

<sup>30</sup> *CC/Devas (Mauritius) Ltd., Devas Employees Mauritius Private Limited, and Telcom Devas Mauritius Limited v. The Republic of India*, PCA Case No. 2013-09, Award on Jurisdiction and Merits (Jul. 25, 2016), ¶ 293 (holding that “if a State properly invokes a national security exception under an investment treaty, it cannot be liable for compensation of damages going forward.”); *LG&E Energy Corp., LG&E Capital Corp., LG&E International, Inc. v. Argentine Republic*, ICSID Case No. ARB/02/1, Decision on Liability (Oct. 3, 2006), ¶¶ 259-264.

<sup>31</sup> *Bernhard von Pezold and others v. Republic of Zimbabwe*, ICSID Case No. ARB/10/15, Award (July 28, 2015), ¶ 624.

<sup>32</sup> [ILC Articles](#), Article 23(1).

<sup>33</sup> [Draft Articles on Responsibility of States for Internationally Wrongful Acts, with commentaries](#),

Yearbook of the International Law Commission (2001), Vol. II, Part Two, p. 76, ¶ 3; *Sempra Energy International v. Argentine Republic*, ICSID Case No. ARB/02/16, Award (Sep. 28, 2007), ¶ 246; *Greentech Energy Systems A/S, et al v. Italian Republic*, SCC Case No. V 2015/095, Award (Dec. 5, 2018), ¶ 451 (considering that “a situation of economic difficulty” is insufficient to invoke the defense of force majeure).

<sup>34</sup> [ILC Articles](#), Article 23. See, e.g., *Autopista Concesionada de Venezuela, C.A. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/00/5, Award (Sep. 23, 2003), ¶ 119 (noting that: “[f]or lack of unforeseeability, Venezuela’s non-performance cannot be excused on the ground of force majeure.”).

<sup>35</sup> [ILC Articles](#), Article 24.

<sup>36</sup> *Case concerning the difference between New Zealand and France concerning the interpretation or application of two agreements concluded on 9 July 1986 between the two States and which related to the problems arising from the Rainbow Warrior affair*, Decision (Apr. 30, 1990), Reports of International Arbitral Awards, Vol. XX, p. 255, ¶ 79.