Executive M.B.L.-HSG

University of St.Gallen

# Master Thesis

# Investment Protection in Renewable Energy Projects

Standards of protection to investors under the Energy Charter Treaty against adversary changes to Renewable Energy support policies


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| **Course:** | Executive M.B.L.-HSG XXIII 2018/19 |
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## LIST OF ABBREVIATIONS

| | |
|---|---|
| 2001 Renewables Directive | Directive 2001/77/EC on the Promotion of Electricity Produced from Renewable Energy Sources in the Internal Electricity Market |
| ADR | Alternative Dispute Resolution |
| AG | Advocate General |
| BGH | German Bundesgerichtshof (German Federal Supreme Court) |
| BIT | Bilateral Investment Treaty |
| bn | Billion |
| Charter | The European Energy Charter |
| CJEU | Court of Justice of the European Union |
| Contracting Party | Contracting Party as defined in Article 1(2) ECT |
| CSP | Concentrated Solar Power |
| DD | Due Diligence |
| EC | European Commission |
| ECT | Energy Charter Treaty dated of 17 December 1944 |
| EEC | European Economic Community |
| *e.g.* | exempli gratia |
| ERO | Energy Regulatory Office (Czech Republic) |
| EU | European Union |
| European Treaties | TEU and TFEU |
| FET | Fair and Equitable Treatment |
| FIT | Feed-in tariff |
| GP | General partner |
| GSE | Gestore dei Servizi Energetici (Italy) |
| HoldCo | Holding Company |
| ICSID | International Centre for Settlement of Investment Disputes |
| ICSID Convention | Convention on the Settlement of Investment Disputes between States and Nationals of Other States |
| *Id* | Idem |
| ILC Articles | ILC Articles on the Responsibility of States for Internationally Wrongful Acts |
| Intra-EU Dispute | Dispute under a BIT or MIT between an investor from the EU and a Member State of the EU |
| Intra-EU Investment | Investment made by an investor from the EU in the territory of the EU |
| ISDS | Investor-state dispute settlement mechanism |

| | |
|---|---|
| kWh | Kilowatt hour |
| kWp | Kilowatt peak |
| LP | Limited partner |
| MIGA | Multilateral Investment Guarantee Agency |
| mn | Million |
| MIT | Multilateral Investment Treaty |
| MS | Member States of the European Union |
| OPIC | Overseas Private Investment Corporation |
| PE | Private equity |
| PF | Project finance |
| PV | Photovoltaic |
| RD | Royal Decree (Spain) |
| RE | Renewable energy |
| REIO | Regional Economic Integration Organisation |
| SCC | Stockholm Chamber of Commerce |
| Spain | The Kingdom of Spain |
| Special Regime | Spain's RE-support policies based on RD 661/2007 and 1578/2008 |
| PPA | Power purchase agreement |
| PPP | Public-private partnership |
| PV | Photovoltaic |
| RAIPRE | Registro Administrativo de Instalaciones de Producción en Régimen Especial, the Spanish Public Authority Register for production facilities to be registered under the Special Regime |
| RECIEL | Review of European, Comparative and International Environmental Law |
| sec. | Section |
| TEU | Treaty on European Union |
| TFEU | Treaty on the Functioning of the European Union |
| USD | US Dollar |
| VCLT | Vienna Convention on the Law of Treaties of 23 May 1969 |

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## ABSTRACT

Starting with the 2008 financial crisis and over-subsidisation in the renewable energy ("*RE*") sector, various favourable state subsidies and RE- support schemes have been re-evaluated by various European states hosting foreign investments, thereby negatively affecting investors' returns. International tribunals came to different conclusions regarding standards of protection that investors have invoked under the Energy Charter Treaty ("*ECT*") as a reaction to changes to RE-support schemes in Spain. However, an analysis of selected awards reveals that general views can be taken regarding investment protection in RE-projects, standards of protection to investors under the ECT against adversary changes to RE- support policies respectively. In order to benefit from standards of protection under the ECT, an investor must be organized under the laws of a host state which is a contracting party to the ECT. The notion of investment under the ECT has been broadly interpreted as referring to the shares held by an investor in the project company operating the RE-project. Absent a stabilization clause, which offers highest protection to an investor against adversary changes to RE-support schemes, an investor may rely on the host states' obligation to provide fair and equitable treatment to a RE-investment as well as to protect an investor from direct and indirect expropriation. International tribunals have confirmed the conformity of the dispute resolution mechanism under the ECT with EU law regarding disputes resulting from investments made within the territory of the EU by EU investors.

## 1. INTRODUCTION AND OUTLINE

In 2015, investments in renewable energy ("*RE*") projects amounted to a record USD 286 bn, compared to USD 273 bn in 2014, and more than six times the figure set in 2004.[1] Driven by environmental policies, continued advances in technologies, and an increasing demand for electricity at the lowest cost, it can be expected that RE-sources will become an even more important source of electricity in years to come. Numerous states have attracted foreign investments through subsidies and Re-support schemes.

However, starting with the 2008 financial crisis and over-subsidisation in the RE-sector, various favourable state subsidies and RE-support schemes have been re-evaluated by states hosting foreign investments, negatively affecting investors' returns. Political risk to the affected RE-projects has crystallized. While traditionally political risk has been considered predominantly in investments in developing economies, more recent developments in Europe, most notably in Spain, Italy and the Czech Republic, have shown that regulatory risk is also relevant for RE-projects situated in Europe. Especially Spain has faced a mass of investor claims, where various standards of protection have been involved by investors under the Energy Charter Treaty ("*ECT*").

Legal remedies against adversary regulatory changes can be found under private as well as under public international law. With regard to the latter, the ECT as multilateral investment treaty for the protection of investments in the energy sector provides for effective instruments for protection of RE-investments.[2] A review of various published awards resulting from changes to RE-support schemes in Spain reveals that international tribunals came to different conclusions with regard to various standards of protection investors have invoked. As the facts upon which infringements of such standards of protection have been largely comparable, it seems that the outcome of the published awards leaved doubts to investors as to the means and methods of the structuring of their RE-investment in order to enjoy protection under the ECT.

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1 *See Manner/Niedermaier* in *Scherer (ed.)*, Energy Arbitration 86 (FN 7), with further references. *See e.g. Boute*, 27(3) JERL 333 et seq, *Sullivan/Kirsey*, 18 JWIT 100 et seq, or *Tsifopoulou*, 6 Climate Law 264 et seq for impact of RE-support policies on climate change and environmental policies; *Meier/Vagliasindi/ et al.*, Design and Incentives 1 et seq.

2 *See e.g. Wälde (ed)*, Energy Charter Treaty 35 et seq; for history and background of investor state arbitration *see e.g. Sornarajah*, Settlement of Foreign Investment Disputes 151 et seq; *Newcombe/Paradell*, Standards of Treatment 1 et seq; *Reed/Paulsson/et al.*, Guide to ICSID Arbitration 1 et seq; *Reisman/Crawford/et al.*, Foreign Investment Disputes 1 et seq.

The research question underlying this thesis is therefore if, considering the deviating results of international tribunals taken in the Spanish RE-cases, general views can be taken regarding investment protection in RE-projects, standards of protection to investors under the ETC against adversary changes to RE- support policies respectively. The research shall, starting with brief assessment of views prevailing in case law and legal doctrine, be limited to the assessment of six recent arbitral awards (*Charanne*, *Eiser*, *Novoenergia II*, *Masdar Solar*, *Antin*, and *RREEF Infrastructure*), which resulted from claims of investors resulting from changes to RE-support schemes in Spain and which arrived at different results.

Although the tribunals arrived in some of these cases at different result, it seems that the six Spanish cases provide an interesting basis to draw general conclusions, *i.e.* "*lessons learned*" for investors, which shall be proven as result of the following discussion. The assumption therefore is that, absent different results, the reasoning of the tribunals is comparable to such extent as it allows to draft general conclusions with regard to standards of protection to investors under the ETC against adversary changes to RE-support policies. Most notably and aim of this thesis shall be to present the reader based on such general conclusions with specific recommendations to investors for the structuring of a RE-investment in order to ensure that an investor benefits from the standards of protection the ECT offers against adversary change to RE-support policies by a host state.

For the purposes of the discussion, the thesis will be structured as follows:

Section 2 introduces the reader to the legal structuring of a typical RE-investment and the basic specifics of a project finance ("*PF*") structure. In order to effectively raise a claim under the ECT, an investor needs to show that it is "*investor*" and that it has made an "*investment*", each to be assessed under the ECT. Based on selected arbitral awards, the notions of "*investor*" and "*investment*" in RE-projects will be discussed. This is a crucial preliminary issue which needs to be discussed prior to going into the details of the substantive standards of investment protection.

Section 3 discusses adverse regulatory changes as element of political risk more generally. Various examples of more recent adversary regulatory changes in Europe will be presented, most notably the changes to Spain's Special Regime. The changes to the Special Regime constituted the factual basis for the six arbitral awards which are the heart of the discussion of substantive standards of protection in the following sections. The reader will be also introduced to methods of risk mitigation under private and public

international law against the risk of adversary regulatory changes, the latter which will be discussed more thoroughly in the chapters to follow.

Section 4 and Section 5 form the core part of this thesis and discuss the host state's obligations to provide fair and equitable treatment ("*FET*") to an investor regarding a RE-investment as well as protection against direct and indirect expropriation. Both of these substantive standards of protection will be discussed under six selected arbitral awards which resulted from claims of investors resulting from changes to RE-support schemes in Spain. The reasoning of the tribunals will be discussed, and it will be assessed whether general conclusions can be drawn from such reasoning for the structuring of RE-investments for an investor to effectively enjoy protection under the FET standard and against direct and indirect expropriation.

Section 6 will discuss the compatibility of the ECT with EU law. Although this topic would require far more elaborate discussion than will be possible in one chapter, the recent developments in light of the prominent *Achmea* Decision rendered by the Grand Chamber of the CJEU should not remain untouched for purposes of discussing means and methods of investment protection under the ECT. Indeed, fierce resistance by EU Member States (*MS*) based on the "*intra-EU objection*" as well as resistance by various MS to enforce awards which have been rendered by international tribunals which have not followed such objection provide currently inherent risk to effective investment protection under the ECT in Europe. Investors should be aware of the risks resulting from these recent developments and adequately consider them in the investment structuring.

Section 7 will, based on the findings of prior sections, finally present the reader with specific recommendations to investors for the structuring of a RE-investment in order to ensure an investor benefits adequately from the standards of protection the ECT offers against adversary change to RE-support policies by a host state.

# 2. DEFINING INVESTOR AND INVESTMENT IN RE-PROJECTS

## I. Overview

The following section will first introduce the typical legal structure of RE-projects (sec. 2.II). On such basis, the notions of "*investor*" (sec. 2.III) and "*investment*" (sec. 2.IV) in RE-projects as two pre-conditions for an investor to have standing and to make use of protection under the applicable investment law regime under the ECT will be discussed. Starting from potential outcomes, the discussion will be based on general views in legal doctrine and more particular, recent ECT-jurisprudence in the RE-sector.

## II. Setting the Scene: Typical Legal Structure of RE-Projects

A key feature in the design of a foreign investment is laying out in advance the risks inherent in the typically long-term relationship of the investment, both from a business perspective and from a legal point of view.[3] This involves identifying a business concept and a legal structure which is suitable for the implementation of the project and which minimizes the risks which may arise during the period of the investment.[4]

RE comprises of a broad, and heterogeneous, range of energy sources and technologies, including onshore and offshore wind and solar photovoltaics (solar PV), as well as bioenergy, hydropower, ocean power, and geothermal power.[5] In case of RE-investments, investors regularly opt for a project-finance ("*PF*") structure on a "*non-recourse*" basis where a special purpose vehicle ("*SPV*") is set up exclusively for the specific project, excluding liability of the investor for the SPV's debts.[6] Three criteria are generally distinctive for such structure: (i) cash-flow related lending, (ii) the principle of risk sharing, and (iii) off-balance financing.[7]

The first two elements, namely cash-flow related lending and risk sharing, are of predominant interest when addressing methods of mitigating legal risks inherent to the

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3 *Mistelis* in *Scherer (ed.)*, Energy Arbitration 153; *Dolzer/Schreuer*, Principles 21.

4 *Dolzer/Schreuer*, Principles 21.

5 *Manner/Niedermaier* in *Scherer (ed.)*, Energy Arbitration 86.

6 *See e.g. Böttcher/Lange* in *Böttcher (ed.)*, Handbuch Windenergie 14; *Manner/Niedermaier* in *Scherer (ed.)*, Energy Arbitration 90.

7 *See e.g. Böttcher/Lange* in *Böttcher (ed.)*, Handbuch Windenergie 15 et seq.

RE-project.[8] Accordingly, as the project company relies on constant, adequate and sustainable cash-flows in order to pay costs and serve debt, legal risks which may detrimentally affect such cash-flows (*e.g.* by cutting FITs typically set above market prices[9]) need to be adequately mitigated. This is particularly important as the credit-risk of the project is, due to its non-recourse nature, generally limited to the cash-flows which are being generated by the project itself.[10]

More generally, a typical PF structure involves a variety of contractual relationships, which all involve a certain element of risk, such as to the right to occupy land, build, and operate the project, construction risk, insolvency risk of contractors, foreign exchange, interest rate risks, force majeure events, and political risk. The prudent investor will be keen to allocate any project risks to third parties, such as (sub-)contractors, (sub-) suppliers, operators, project developers and insurers (*i.e.* to the parties highlighted in blue other than the sponsor in the below figure) in order to ensure that a project is considered as being "*bankable*" by the financing banks.[11]

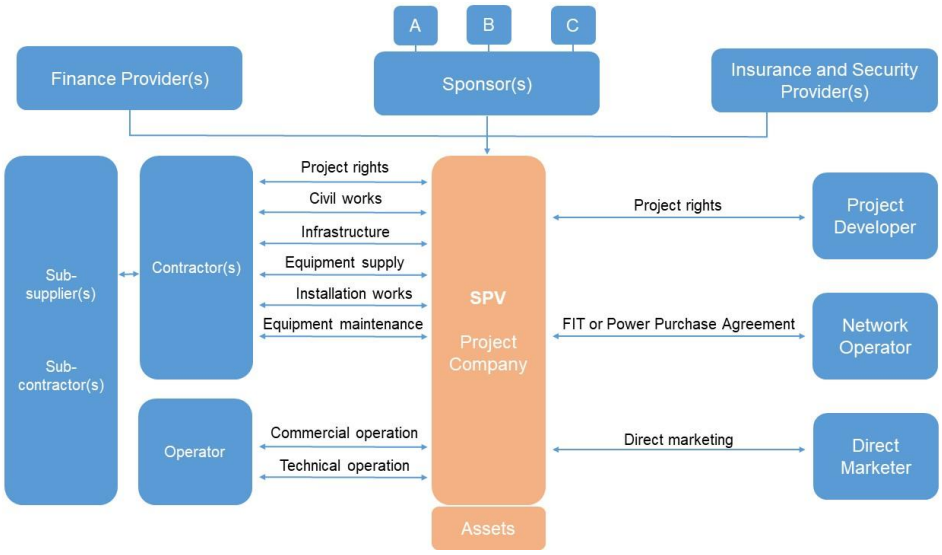


*Figure 1: Allocation of risks in typical PF-structure*

Based on the finance structure outlined above, the notions of "*investor*" and "*investment*" shall be discussed in the following chapters.

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8 For risk allocation in PF transactions *see e.g. Shen-fa/Xiao-ping*, 40 Energy Policy 1 et seq.

9 *See e.g. Couture/Gagnon*, 38 Energy Policy 955 et seq; *Däuper/Lachmann*, EnWZ 2018, 3; *Haufe/Ehrhart*, 121 Energy Policy 217; *Rensmann/Frey*, EnWZ 2014, 243.

10 *See e.g. Böttcher/Lange* in *Böttcher (ed.)*, Handbuch Windenergie 14.

11 For issues of "*bankability*" *see e.g. Manner/Niedermaier* in *Scherer (ed.)*, Energy Arbitration 92 et seq.

## III. Defining the Notion of Investor

### A. Potential Outcomes

Following the typical PF financing structure outlined in sec. 2, either (i) the final beneficiary or ultimate shareholder of a corporate group (Figure 2 below: A, B, C), (ii) the first HoldCo as direct shareholder of the SPV (figure 2 below: the sponsor), or (iii) the SPV itself as project company could be arguably regarded as "*investor*" for purposes of protection under international investment law.

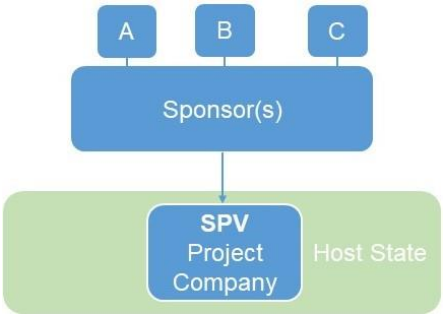


*Figure 2: Possible outcomes for investor identity*

The notion of "*investor*" in RE-projects shall be assessed in the following based on the views prevailing in academic writing (sec. 2.III.A.), as well as under recent ECT-jurisprudence regarding RE-investments (sec. 2.III.B.).

### B. The General View under the ECT

International investment law is designed to promote and protect the activities of private foreign investors.[12] The foreignness of an investor, be it individual or company, is determined by the investor's nationality.[13] As only a foreign investor is protected under the investment law regime existing between the foreign investor's home state and the state where the investment is being made (also referred to as the "*host state*"), one of the first jurisdictional questions in investor-state arbitrations is typically whether the claimant is to be regarded as "*investor*" under the applicable investment law regime and thus, whether the tribunal has jurisdiction *ratione perseonae* to hear the case.

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12 *Dolzer/Schreuer*, Principles 44; for a recent overview over investors' identities in cases brought under the ECT, *see e.g. Hobér* in *Scherer (ed.)*, Energy Arbitration 177 et seq.

13 *Dolzer/Schreuer*, Principles 44, with further references.

If an investor wishes to rely on protection under international investment law, it must show that it has the nationality of one of the two state parties; in case of reliance on a multilateral or regional investment treaty (such as the ECT[14]), it must show that it has the nationality of one of the state parties to such treaty.[15] Accordingly, under the ECT, the element of foreignness is reflected in Article 26(1), which refers to the settlement of "*disputes between a Contracting Party and an Investor of another Contracting Party relating to an Investment of the latter in the Area of the former.*"[16]

Further, "*investor*" means pursuant to Article 1(7) ECT "*with respect to a Contracting Party: (i) a natural person having the citizenship or nationality of or who is permanently residing in that Contracting Party in accordance with its applicable law; (ii) a company or other organisation organised in accordance with the law applicable in that Contracting Party ….*"[17] With regard to corporate entities, the requirement for investor identity pursuant to the wording of the ECT ("*organised in accordance with the law applicable in that Contracting Party*") is in line with the most commonly used criteria for the nationality of corporate entities in international investment law, being "*incorporation*" or "*main seat of the business*".[18] With regard to Figure 2 above, the final beneficiary or ultimate shareholder of a corporate group, the first HoldCo as direct shareholder of the SPV, as well as the SPV itself as project company could therefore in principle be each and all regarded as "*investor*" for purposes of protection under the ECT.

Notably, the wording of the ECT does not provide for any requirements beyond the formal requirement of "*organisation*", such as bond of economic substance between the corporate investor and the state whose nationality it claims or effective control over the corporation by nationals of the state or genuine economic activity of the company in the host state.[19] However, the ECT does provide for a "*denial of benefits*" provision in Article 17(1) ECT which provides that each Contracting Party "*reserves the right to deny the advantages of this Part to legal entity if citizens or nationals of a third state own or control*

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14 *See e.g. Hobér* in *Scherer (ed.)*, Energy Arbitration 175 and sec. 3.V.B.

15 *Dolzer/Schreuer*, Principles 44 f; *Baltag*, Notion of Investor 69 et seq.

16 Emphasis added; the term "*Contracting Party*" is defined pursuant to Article 1(2) ECT as "*a state or Regional Economic Integration Organisation which has consented to be bound by this Treaty and for which the Treaty is in force*".

17 Emphasis added.

18 *Dolzer/Schreuer*, Principles 47; for the assessment of the nationality of private individuals *see e.g. Id.* 45.

19 *See Dolzer/Schreuer*, Principles 48, providing various examples of bilateral and multilateral investment treaties that go beyond such formal requirements.

*such entity and if that entity has no substantial business activities in the Area of the Contracting Party in which it is organized*". The background of a provision of this kind is that a host state typically reserved the right to deny the benefits arising from a treaty to a company incorporated in a state but with no economic connection to that state.[20]

In some cases, states attempt to avoid arbitrating disputes with certain investors by invoking Article 17 ECT. However, this clause has been widely seen not as a limitation of the scope of the notion of "*investor*", but rather as a condition according to which a state may refuse the benefits of Part III of the ECT (the investment protection regime).[21] International tribunals have found that such a right must be affirmatively exercised by the contracting party (*e.g.* by notice)[22] after which it has only prospective effect.[23]

### C. Recent ECT Jurisprudence in the RE-Sector

#### 1. Charanne

The claimants in *Charanne* were the Dutch entity Charanne B.V. and the Luxembourg entity Construction Investment S.à.r.l., which brought a claim to the Arbitration Institute of the SCC under the ECT against Spain due to changes to Spain's Special Regime.[24] The claimants were 18.6583% and 2.8876% shareholders of Grupo T-Solar Global S.A., a Spanish entity (*Grupo T-Solar*), which owned at the time of the dispute, via certain companies, 34 production facilities generating electricity by means of solar photovoltaic technology under the Special Regime.[25]

As the Spanish entity Grupo T-Solar would, due to the absence of the element of "*foreignness*", generally not enjoy protection under international investment law in the

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20 *See Dolzer/Schreuer*, Principles 55.

21 *Vorburger/Petti* in *Arroyo (ed.)*, Arbitration in Switzerland 1305.

22 *See e.g. Plama v. Bulgaria* (Decision on Jurisdiction) paras 155-65 (observing that "*by itself, Article 17(1) ECT is at best only half a notice; without further reasonable notice of its exercise by the host state, its terms tell the investor little; and for all practical purposes, something more is needed"; see also Yukos v. Russia* (Interim Award on Jurisdiction and Admissibility) para 456.

23 *Plama v. Bulgaria* (Decision on Jurisdiction) paras 159-65; *see also Yukos v. Russia* (Interim Award on Jurisdiction and Admissibility) para 458.

24 For background information on Spain's Special Regime *see* sec. 3.III.C. below.

25 *See Charanne v. Spain* (Final Award) paras 1 – 9, also for further background as to certain corporate restructurings of Grupo T-Solar Global S.A; for background information on Spain's Special Regime *see* sec. 3.III.C. below.

territory of Spain – and in particular, not under the ECT[26] –, the claim against Spain was likely brought for this reason by the foreign claimants seated in the Netherlands and in Luxembourg. Further, the claimants were potentially also chosen against the background that Grupo T-Solar has, prior to the initiation of the claim under the ECT, exhausted local remedies against Spain under local law to challenge the Special Regime, which would arguably bear high risk that a claim brought by Grupo T-Solar would fail on jurisdictional grounds based on the "*fork in the road*" objection pursuant to the ECT.[27]

Spain nevertheless objected to the jurisdiction of tribunal, arguing that the claimants were two "*empty shells*" through which two individuals of Spanish nationality "*realised their investments*", and that to allow the claimants to benefit from the protections that the ECT offers to foreign investors would amount to overlooking the aim sought by the instrument, that is no other than to protect foreign investors, and not domestic investors that structure their investment in an artificially complex manner.[28] Thus, by arguing that "*the 'foreign' nature of the legal entity is not a formal requirement, but an objective condition that allows the arbitral tribunals to lift the corporate veil to determine the real controller of the company,*"[29] Spain requested the tribunal to look behind the "*formal requirements*" of 1(7)(a) ECT, to disregard therefore the elements of "*incorporation*" and instead assess the nationality of the claimants based on the nationality of their shareholders.

The *Charanne* tribunal did not, for good reasons, share the arguments submitted by Spain. It was undisputed that the claimants were Dutch and Luxembourg entities which met the requirement of Article 1(7)(a)(ii) ECT,[30] as such states were "*Contracting Parties*" in the sense of the ECT. The tribunal held that the Article 1(7)(a)(ii) ECT did not contain any other requirement but that the investor is constituted in accordance with the applicable law of the Contracting Party, in this case, the Netherlands and Luxembourg.[31]

Notably, in addressing Spain's request to "*lift the corporate veil*", the *Charanne* tribunal held that there is generally no basis for importing to the ECT a general rule according to

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26 *See* Article 26(1) ECT and sec. 2.III.B. above.

27 *See Charanne v. Spain* (Final Award) paras 194 et seq, where Spain has nevertheless raised such "*fork in the road*" objection, notwithstanding that the claimant were distinct legal entities from Grupo T-Solar Global S.A. This objection has been correctly denied by the tribunal, see *Charanne v. Spain* (Final Award) paras 398 et seq for the tribunal's reasoning.

28 *Charanne v. Spain* (Final Award) para 412 et seq.

29 *Id.* para 413.

30 For Article 1(7)(a)(ii) ECT *see* sec. 2.III.B. above.

31 *Charanne v. Spain* (Final Award) para 414.

which the nationality of the investor should be analysed according to an economic criterion, when the ECT itself refers to the legal criterion of incorporation of the company under the law of a Contracting Party.[32] While the tribunal also stated that it would be only conceivable to lift the corporate veil and ignore the legal personality of an investor in case of fraud directed at jurisdiction or as an instrumental transfer of the assets of the investment after the emergence of the dispute, in *Charanne*, Spain did not make any allegation nor proved any fraudulent elements in the structure of the claimants' investments that could justify the lifting of the corporate veil.[33]

In order to adopt the argument of Spain would, in the views of the *Charanne* tribunal, amount to denial of benefits whenever an investor, legal entity incorporated under the applicable law of a Contracting Party in accordance with Article 1(7)(a)(ii) ECT, was controlled by citizens or nationals of the state receiving the investment.[34] In the view of the *Charanne* tribunal, the drafters of the ECT did not intend to include this hypothesis in the denial of benefits clause of Article 17 ECT, which would relate to the situation of a legal entity controlled by shareholders of a third country (a third country being a country not party to the ECT).[35] Further, the *Charanne* tribunal held that the ECT did not want to exclude from the scope of its application the investors as legal entities controlled by nationals of the Contracting State receiving the investment.[36]

On a more general level, the *Charanne* tribunal shared the position taken under the ECT by the tribunal in the *Yukos* case, according to which "*the Tribunal knows of no general principles of international law that would require investigating the structure of a company or another organization when the applicable treaty simply requires it to be organized in accordance with the laws of a Contracting Party.*"[37] Based on such reasoning, the *Charanne* tribunal rejected Spain's objections to jurisdiction based on Article 1(7) ECT.[38]

The conclusions of the *Charanne* tribunal are in line with the literal interpretation of the ECT as well as case-law rendered within the ambit of the ECT. It follows already from the methods of treaty interpretation under the rules of the VCLT that the wording of a

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32 *Charanne v. Spain* (Final Award) para 415.
33 *Id.* para 415.
34 *Id.* para 416.
35 *Id.* para 416.
36 *Id.* para 416.
37 *See Yukos v. Russia* (Interim Award on Jurisdiction and Admissibility) para 415.
38 *Charanne v. Spain* (Final Award) para 417.

treaty is the starting point when interpreting such treaty.[39] Here, as a matter of fact Article 1(7) ECT does stipulate only the formalistic element of "*organization*" in accordance with the law applicable in that Contracting Party. In order to deviate from the wording in a specific case, such deviation would need to have sufficient legal basis based on the methods of treaty interpretation under the VCLT (arguably, such as course of dealings after ratifying the ECT whereby the intent of two member states would show that they deviated from the wording of Article 1(7) ECT and intended to include further elements for the assessment of the investor's identity). Absent such specifics, the wording of a treaty generally prevails.

Notably, the ICSID cases *Tokio Tekelés v. Ukraine* and *Thales Spectrum de Argentina v. Republic of Argentina* submitted by Spain in support of its argument to deviate from the formalistic element of "*organization*" and to "*lift the corporate veil*" in order to arrive at a conclusion that the Spanish natural persons as shareholders behind the claimants, did not provide for sufficient grounds, analogy respectively, to deviate from the criteria stated in Article 1(7) ECT. This is because – and as has been correctly identified by the claimants in *Charanne* – the requirements of Article 25(2)(b) ICSID Convention relating to the notion of "*investor*" involve radically different criteria to those set forth in Article 1(7) ECT.[40] Notably, as Article 25(2)(b) ICSID Convention does foresee an element of foreign control – which the ECT does however not foresee –, case law based on Article 25(2)(b) ICSID Convention does not provide sufficient grounds to deviate from the formalistic element of "*organization*" pursuant to Article 1(7) ECT.

### 2. Eiser

The claimants in *Eiser* were Eiser Infrastructure Limited, a private limited company incorporated under the laws of the United Kingdom, and Energia Solar Luxembourg S.à r.I., a private limited liability company incorporated under the laws of Luxembourg,[41] which brought a claim to ICSID under the ECT against Spain due to changes to the Special Regime.[42] Eiser Infrastructure Limited was 100% shareholder in Energia Solar Luxembourg S.à r.I., which in turn held shareholding and debt interests in two Spanish

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39 *See e.g. McLachen/Shore/Weiniger*, International Investment Arbitration 79; *Clasmeier*, Arbitral Awards as Investments 5 et seq.

40 Note also the claimants' submission which however seems not having been addressed by the *Charanne* tribunal in its reasoning, *Charanne v. Spain* (Final Award) para 265.

41 *See Eiser v. Spain* (Award) paras 1 – 2.

42 For background information on Spain's Special Regime *see* sec. 3.III.C. below.

companies that owned and operated three CSP plants in Spain, *inter alia*, the ASTE project.[43] The situation was therefore comparable with *Charanne* in the sense that the claimants were not the SPVs operating the RE-projects, but indirect and direct shareholders in such SPVs.

Spain raised an objection to the tribunal's jurisdiction, arguing that claimants failed to show that they are qualifying investors under the ECT with requisite clarity and precision.[44] However, the *Eiser* tribunal held with reference to Article 1(7)(a)(ii) ECT that the claimants did satisfy the formal requirement of organisation and therefore no doubts were left with regard to their identity as "*investors*" pursuant to the ECT.[45] Thus, similarly to the *Charanne* tribunal, the *Eiser* tribunal assessed the investor's identity on the formal requirements under Article 1(7)(a)(ii) ECT, without requiring any additional elements.

### 3. Novenergia II

The claimant in *Novoenergia II* was the Luxembourg entity Novenergia, a *Société d'investissement en capital à risque* (SICAR), which brought a claim to the Arbitration Institute of the SCC under the ECT against Spain, *inter alia*, due to changes to the Special Regime.[46] The claimant held through the Spanish entity Novenergia II Energy & Environment España, S.L. the investment in in eight PV plants, which were held and implemented by various Spanish project companies.[47]

Spain objected to the jurisdiction of the tribunal, however, not – as in earlier cases – by alleging that Article 1(7)(a)(ii) ECT would foresee additional requirements to the formal element of "*organization"*, but based on the notorious "*Intra-EU objection*". Spain argued that due to the fact that Luxembourg and Spain were MS, the requisite envisaged in Article 26(1) ECT, which states that to be able to resort to arbitration, the dispute must be between a Contracting Party and investors from a different Contracting Party, were not met.[48] In other words, Spain argued that the claimant was not from an "*Area*" of "*another Contracting Party*", as set out in Article 26(1) ECT, since both Luxembourg and

43 *See Eiser v. Spain* (Award) paras 114, 224 et seq.
44 *See Id.* para 221 f.
45 *Eiser v. Spain* (Award) para 226.
46 For background information on Spain's Special Regime *see* sec. 3.III.C. below.
47 *See Novenergia II v. Spain* (Final Award) paras 1 – 5.
48 *Novenergia II v. Spain* (Final Award) paras 404 – 426.

Spain were MS. However, this arugment has been refuted by the *Novoenergia II* tribunal entirely.

Most notably, the tribunal correctly pointed out that in making this argument, Spain failed to recognise the fact that, even though the EU itself is a Contracting Party to the ECT, this did not eliminate the EU Member States' individual standing as respondents under the ECT.[49] The *Novoenergia II* tribunal was convinced that with a correct application of Article 26(1) ECT, interpreted in light of the VCLT, there would be no basis for any requirements other than that the investor shall be a national of a Contracting State other than the host State, each as defined under the ECT.[50]

Consequently the *Novoenergia II* tribunal came to the correct result – which fully considers the territorial sovereignty of the respective MS – that a limitation to the effect that an investor is not a national of an ECT Contracting Party to the extent that such a Contracting Party is also a member of the same REIO (*i.e.* the EU) as the host state cannot be deducted on the basis of Article 26(1) ECT.

### 4. Masdar Solar

The claimant in *Masdar Solar* was Masdar Solar & Wind Cooperatief U.A., a private limited company incorporated under the laws of the Netherlands, which brought a claim to ICSID under the ECT against Spain due to changes to the Special Regime.[51] The claimant held the investment in in three CSP plants, which were held and implemented by three distinct Spanish project companies.[52] The shares of the claimant were indirectly held and controlled by the Government of Abu Dhabi.[53] Spain alleged that as a matter of international law, the conduct of claimant was attributable to Abu Dhabi, which is not a party to the ECT.[54] Further, by referring to the ILC Articles, Spain alleged that the *Masdar Solar* dispute was in fact a dispute between two states.[55]

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49 *Id.* para 453.
50 *Id.* para 454.
51 For background information on Spain's Special Regime *see* sec. 3.III.C. below.
52 *See Masdar Solar v. Spain* (Award) paras 1 – 5.
53 *Id.* para 83.
54 *Masdar Solar v. Spain* (Award) para 145 et seq.
55 *Id.* paras 145 et seq.

However, the *Masdar Solar* tribunal held that in order for an act to be attributed to a state, it must have a close link to such state.[56] Such a link could result from the fact that the person performing the act was part of the state's organic structure (Article 4 ILC Articles), exercised governmental powers specific to the State in relation to that act, even if it is a separate entity (Article 5 ILC Articles), or if it acts under the direct control (on the instructions of, or under the direction or control) of the state, even if it is a private party (Article 8 ILC Articles).[57] However, none of those pre-conditions were met so that the claimant could have been equated to the state of Abu Dhabi.[58] Consequently, the tribunal came, based on the plain language and interpretation of the ECT, in line with the findings of the *Charanne* and *Eiser* tribunals, to the conclusion that the claimant was an "*investor*" for the purposes of Article 1(7)(a)(ii) ECT. Accordingly, Spain's "*ratione personae*" jurisdictional objection failed.

Spain also alleged that the claimant as "*mere mailbox or shell corporation*" in the Netherlands should be denied protection under the ECT based on the "*denial of benefits*" provision of Article 17(1) ECT.[59] However, the majority of the *Masdar Solar* tribunal held that giving affirmative notice before an exercise of the right to deny benefits pursuant to Article 17(1) would be consistent with the object and purpose of the ECT and that it would contradict the text and the purposes of the ECT to say that a Contracting State may deny benefits retrospectively, after an investment has been made and a dispute has arisen.[60] Further, the *Masdar Solar* tribunal unanimously held that there was no basis for a denial of benefits under Article 17(1) of the ECT as claimant was a holding company with substantial international assets under its control and with material business conducted in the Netherlands.[61] For that purpose, the tribunal referred to *AMTO v. Ukraine*, in which it was held that "*… "substantial" in this context means "of substance and not merely of form". It does not mean "large", and the materiality, not the magnitude of the business activity is the decisive question.*"[62] Accordingly, Spain's denial of benefits objection failed.

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56 *Id.* para 168 et seq.

57 *Id.* para 168.

58 *Id.* para 173.

59 *Id.* paras 204 et seq; see also sec. 2.III.B. above regarding denial of benefits under Article 17(1) ECT.

60 *Id.* paras 232 et seq.

61 *Id.* para 254.

62 *AMTO v. Ukraine* (Award), para 69.

Finally, Spain also alleged incompatibility of the underlying Intra-EU Dispute with EU law, an argument which will be analysed under sec. 6 below.

### 5. Antin

The claimants in *Antin* were Antin Infrastructure Services Luxembourg S.à.r.l., a company incorporated under the laws of Luxembourg and Antin Energia Termosolar B.V., a company incorporated under the laws of the Netherlands,[63] which brought a claim to ICSID under the ECT against Spain, *inter alia*, due to changes to the Special Regime. Antin Energia Termosolar B.V. was directly and wholly owned by the first claimant, and both claimants were two entities used by Antin Infrastructure Partners (AIP) FPCI, a French professional PE fund carrying out investments in the Spanish RE-sector.[64] As objection *ratione personae*, Spain alleged only incompatibility of the Intra-EU Dispute under the ECT with EU law, an argument which will be analysed under sec. 6 below.

### 6. RREEF Infrastructure

The claimants in *RREEF Infrastructure* were RREEF Infrastructure (G.P.) Limited, a company incorporated under the laws of Jersey and RREEF Pan-European Infrastructure Two Lux S.à.r.l., a company incorporated under the laws of Luxembourg,[65] which brought a claim to ICSID under the ECT against Spain, *inter alia*, due to changes to the Special Regime. The first claimant was general partner ("*GP*") of RREEF Pan-European Infrastructure Fund L.P., which held 100% of the share capital in RREEF Pan-European Infrastructure Lux S.à.r.l., which in turn held 100% in the second claimant.[66]

Amongst Spain's objection *ratione personae*, the most notable referred to the argument that investor identity would not be given in case of the investor being an "*empty shell*" and that the PE-fund in question would not control the alleged investment, which was controlled by the fund manager (not being claimant in this case) and that only one single "*investor*" per single "*investment*" would be admissible under the ECT [67]

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63 *Antin v. Spain* (Final Award) para 2.

64 *Id.* para 2.

65 *RREEF v. Spain* (Decision on Jurisdiction) paras 2 – 5.

66 *See Id.* paras 1 – 5.

67 *See RREEF v. Spain* (Decision on Jurisdiction) paras 129 et seq.

Regarding the "*shell company*" objection, the *RREEF* tribunal held that, unless there are reason under the relevant municipal law or investment treaty to conclude otherwise, there is no basis under international law to accord to a "*commercial entity that has little or no activity apart from owning or controlling directly or indirectly assets*" any less entitlement to the protections afforded under investment law than any other commercial entity. While there are examples of investment treaties that include within the definition of investor only commercial entities that can demonstrate certain characteristics or activities, there is, so the *RREEF* tribunal correctly, generally no such limitation in the ECT or the ICSID Convention.[68]

The *RREEF* tribunal explained that there are many different forms of commercial entities that are created by and exist within municipal legal systems around the world, such as a company, partnership, or limited partnership.[69] Equally, nothing in the ECT says there can only be one single investor for each investment.[70] International law looks to municipal law to determine as a question of fact the legitimate constitution of these commercial entities, their ownership, management, control, conduct and so on.[71]

Regarding the PE-fund structure, the tribunal concluded that its constitution, ownership, management, control and conduct and so on were legitimate: the GP appointed the manager to run the affairs of the limited partnership, while the GP had ultimate responsibility for managing the fund. Thus, the GP (*i.e.* the first claimant) had control over the investment as required by Article 1(6) ECT.[72] Accordingly, the RREEF tribunal concluded that it had jurisdiction *ratione personae*: the claimants met the definition of investors under the ECT. The first claimant indirectly controlled, and the second claimant indirectly owned and controlled, the assets in dispute.[73]

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68 *Id.* para 145.
69 *Id.* para 143.
70 *Id.* para 142.
71 *Id.* para 143.
72 *Id.* para 144.
73 *Id.* para 147.

## IV. Defining the Notion of Investment

### A. Potential Outcomes

Following the typical PF financing structure of a RE-investment outlined in sec. 2, either (i) the shares held in the first HoldCo as direct shareholder of the SPV (figure 3 below: the sponsor) or in the SPV directly, or (ii) the assets held by the SPV could be regarded as "*investment*" for purposes of the assessments of infringements of international law:

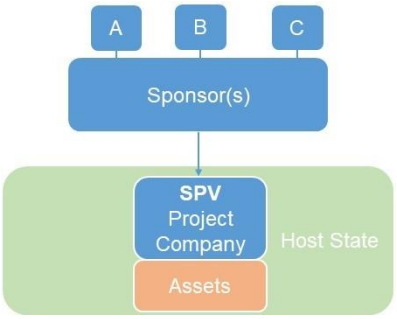


*Figure 3: Possible outcomes for notion of investment*

This notion of "*investment*" shall be assessed in the following based on the views prevailing in academic writing (sec. 2.IV.B.), as well as under recent ECT-jurisprudence regarding RE-investments (sec. 2.IV.C.).

### B. The General View under the ECT

While the complexity on the debate amongst scholars on the notion of "*investment*" largely stems out of the non-defined use in the jurisdictional clause of Article 25 ICSID Convention, no special problems typically arise if the investment in question is covered by one of the illustrative categories of BITs or MITs.[74] Thus, the starting point for the assessment of the notion of "*investment*" is the wording of the respective treaty.

The ECT is limited in scope to the energy sector, with a predominant part of the investments being brought to arbitration under the ECT having referred to the category of generation and sale of electricity (and in particular, in the RE-sector).[75] Pursuant to Article 1(6) ECT, "*investment*" means "*every kind of asset, owned or controlled directly*

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74 *See Dolzer/Schreuer*, Principles 61, 63; *Horn/Kröll*, Arbitrating Foreign Investment Disputes 283 et seq.

75 *Hobér* in *Scherer (ed.)*, Energy Arbitration 181, 183.

*or indirectly by an Investor and includes: (a) tangible and intangible, and movable and immovable, property, and any property rights such as leases, mortgages, liens, and pledges; (b) a company or business enterprise, or shares, stock, or other forms of equity participation in a company or business enterprise, and bonds and other debt of a company or business enterprise; (c) claims to money and claims to performance pursuant to contract having an economic value and associated with an Investment; (d) Intellectual Property; (e) Returns; (f) any right conferred by law or contract or by virtue of any licences and permits granted pursuant to law to undertake any Economic Activity in the Energy Sector.*"

The definition of investment contained in the ECT is broad, entailing a non-exhaustive list of qualifying assets.[76] With regard to Figure 3 above, the shares held in the first HoldCo as direct shareholder of the SPV or in the SPV directly, as well as the assets held by the SPV could be regarded as "*investment*" could in principle be regarded as "*investment*" for purposes of protection under the ECT. The following section will assess the findings in recent ECT-jurisprudence on such notion regarding investments in the RE-sector.

## C. Recent ECT Jurisprudence in the RE-Sector

### 1. Charanne

The claimants in *Charanne* seem to have argued that the notion of "*investment*" was based on Article 1(6)(b) and – at least for purposed of arguing expropriation by Spain – also on Article 1(6)(e) ECT. However, the *Charanne* tribunal held that the investments made by the claimants was their indirect shareholding in Grupo T-Solar and therefore investment in shares respectively pursuant to Article 1(6)(b) ECT. Regarding the argument based on Article 1(6)(e) ECT, the *Charanne* tribunal held that an investment protected under Article 1(6) ECT must be "*owned or controlled by the investor*", and that the claimants neither owned nor controlled the future returns of the plants, which did not constitute rights attached to their investment.[77]

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[76] *See Plama v. Bulgaria* (Decision on Jurisdiction) para 125; and *RREEF v. Spain* (Decision on Jurisdiction) para 156; *Stati et al. v. Kazakhstan* (Decision) para 806; *Masdar Solar v. Spain* (Award) para 195; for the notion of "*investment*" under the ICSID Convention *see e.g. Baltag*, ICSID Convention after 50 Years 75 et seq.

[77] *See Charanne v. Spain* (Final Award) paras 457 – 459.

Notably, a reference to Article 1(6)(a) ECT would, based on the reasoning of the *Charanne* tribunal referring to the requirement that an asset needs to be "*owned or controlled by the investor*", arguably need to fail in a typical PF-financing structure, as the assets are held and controlled by the respective SPV, and not by the management or any shareholders of the SPV.

### 2. Eiser

The *Eiser* tribunal had to assess, based on allegations made by Spain, whether the claimants had to satisfy the additional) requirements of "*contribution, duration and risk*" not included in the ECT's and ICSID Convention's definition of "*investment*".[78] The *Eiser* tribunal left this question deliberately open and came to the conclusion that "*assuming, while without deciding*", that the ECT and the ICSID Convention require that an investment possess these (additional) characteristics urged by Spain, the characteristics of "*contribution, duration and risk*" were indeed met in the case at hand. As will be shown further below, this question has been, at least to a certain extent, answered by the *Masdar Solar* tribunal.[79]

In *Eiser*, the claimants argued, based on the case *Azurix v. Argentina*, for a very broad notion of investment regarding the three CSP plants in Spain, covering rights to ownership of their shares, and their indirect rights in the assets of the Spanish operating companies.[80] However, the tribunal held, similarly to the *Charanne* tribunal, that claimants had standing to claim the reduction of the value of the companies in which the claimants held interests.[81] Thus, and although without explicitly specifying, it seems that the *Eiser* tribunal referred to Article 1(6)(b) ECT when defining the notion of investment, whose infringements gave the claimants standing *ratione materiae* when claiming damages under the ECT. Like the *Charanne* tribunal, also the *Eiser* tribunal correctly denied claimant's standing *ratione materiae* based on Article 1(6)(a) ECT with reference to a diminution of the assets held by the project company (*i.e.* the SPV) – as the assets where held by the SPV and not by its shareholder or parent company.

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78 For case law regarding criteria which are considered relevant for the notion of "*investment*", in particular the "*Salini criteria*" *see e.g. Dolzer/Schreuer*, Principles 66 et seq.

79 *See* sec. 2.IV.C.4. below.

80 *See Eiser v. Spain* (Award) paras 242 et seq, with reference to *Azurix v. Argentina* (Decision on Jurisdiction).

81 *See Eiser v. Spain* (Award) paras 245 et seq.

### 3. Novoenergia II

The *Novoenergia II* tribunal confirmed the understandings of the *Charanne* and *Eiser* tribunals regarding the notion of "*investment*" by referring to Article 1(6)(b) ECT with regard to acquisition of shareholding in the Spanish HoldCo.[82] However, what was questionable was the time as to when the investment was actually made. The date of the investment was relevant in terms of timing for the assessment of the claimants' legitimate expectations under the FET standard. While claimants took the views that the relevant time for this assessment was the acquisition of the interest in the first PV plant (*i.e.* 13 September 2007), while Spain alleged that the relevant date was in 2010, after the entering of certain project finance agreements, and in any case in 2008, at the end of the construction period.[83]

The *Novoenergia II* tribunal held that the timing of the investor's decision to invest sets a backstop date for the evaluation of legitimate expectations.[84] In the present case this was the time of acquiring 100% interest in the first of the eight PV plants, which were at dispute in *Novoenergia II*. As from that date (*i.e.* 13 September 2007) the claimant had irreversibly committed to investing in the Spanish PV sector, which commitments were subsequently fulfilled.[85] The PF-agreements Spain referred to were re-financing agreements of an earlier concluded bridge agreement that related to all the PV Plants.[86]

Thus, what can be derived from the reasoning of the *Novoenergia II* tribunal with regard to the notion of "*investment*" is the fact that the time for assessing whether an investment had been made seems to be the time of decision making to invest in a PF-structure and in case of various project components, in the respective first component. Notably, it seems, according to the reasoning of the *Novoenergia II* tribunal, not to be a requirement that the structuring of the investment is finalized, closing of the PF-financing closed respectively. Equally, it could be argued based on the findings of the *Novoenergia II* tribunal that an investment is being made for purposed of a PF-structure, where the investor enters into a binding commitment with the banks financing providing the PF.

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82 *See Novenergia II v. Spain* (Final Award) para 745.
83 *See Id.* paras 163 et seq and 536.
84 *Id.* para 539.
85 *Id.* para 539.
86 *Id.* para 541.

### 4. Masdar Solar

In *Masdar Solar*, the respondent Spain alleged that the claimant as mere "*channel for the investment of the Government of Abu Dhabi in the Kingdom of Spain*" had failed to make a qualifying "*investment*" in Spain for the purposes of either Article 25 of the ICSID Convention or Articles 26(1) and 1(6) ECT, because two "*mandatory*" criteria, namely contribution of economic resources and assumption of risk, had not met by the investment.[87] Further, Spain alleged that no investment has been made as the funds have been provided by the Government of Abu Dhabi, however, not by the claimant.[88] The claimant on the other hand argued that its investment shall be interpreted broadly, fulfilling the elements of Article 1(6)(b) – (f) ECT and that the ECT would not contain an origin of capital requirement, as was alleged by Spain.[89]

The *Masdar Solar* tribunal held that, unlike the ICSID Convention, which contains no definition of "*investment*", and therefore is susceptible to the interpretative efforts of ICSID tribunals, notably in *Salini*,[90] Article 1(6) ECT does contain a definition of investment. In the views of the *Masdar Solar* tribunal, this definition is incontrovertible, and it is extremely broad.[91] Although it seems that the *Masdar Solar* tribunal did not require additional requirements as the ones stated in Article 1(6) ECT as to the notion of "*investment*", it held, based on an interpretation of Article 1(6) ECT, that the existence of an "*investment*" requires a commitment or allocation of resources for a duration and involving risk and that, for example, a one-time sale resulting in receivables would not qualify as an "*investment*," even if the receivables may be listed as "*assets*."[92]

Further, the *Masdar Solar* tribunal held with reference to *Poštová banka*, "*the definition of what constitutes an investment*" implies "*a contribution to an economic venture of a certain duration implying an operational risk.*"[93] However, in the case at hand the resources committed by the claimant fully corresponded to the meaning of the term "*investment*" enshrined in Article 1(6) ECT and in Article 25 of the ICSID Convention and

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87 *Masdar Solar v. Spain* (Award) paras 179 et seq; *Baltag*, ICSID Convention 75 et seq.

88 *Id.* paras 190 et seq

89 *Id.* paras 190.

90 *See e.g. Dolzer/Schreuer*, Principles 66 et seq.

91 *Masdar Solar v. Spain* (Award) para 195, referring to *Energoalliance v. The Republic of Moldova* (Award) para 244.

92 *Masdar Solar v. Spain* (Award) para 199.

93 *Id.* para 200.

that the definition has been satisfied.[94] Accordingly, unlike the *Eiser* tribunal, which refrained from answering this question, the *Masdar Solar* tribunal took the views that the notion of "*investment*" would, similarly to the *Salini* criteria, require the characteristics of "*contribution, duration and risk*".

However, with regard to Spain's allegations that the ECT would contain an "*origin of capital requirement*", the *Masdar Solar* tribunal held with reference to the cases of *Yukos* and *Arif*,[95] that the definition of investment in Article 1(6) ECT did not include any additional requirement regarding the origin of capital or the necessity of an injection of foreign capital. Accordingly, neither in the ECT nor in the ICSID Convention a requirement of "*origin of capital*" from the investor in question can be found.[96] As will be shown below, the *RREEF Infrastructure* tribunal took similar views on the requirement of "*origin of capital*".

### 5. Antin

The claimants in *Antin* alleged that they directly and indirectly owned and controlled the "*interest*" as (a) direct and indirect shareholdings and debt interests in the SPV operating the PV plants (Article 1(6)(b) ECT); (b) interests in the PV plants (Article 1(6)(b) ECT); (c) claims to money (Article 1(6)(c) ECT); (d) returns (Article 1(6)(e ECT); and (e) rights conferred by the Special Regime (Article 1(6)(f) ECT). Spain objected to the extent that the ECT only conferred jurisdiction based on Article 1(6)(b) ECT as to the shareholdings and debt interests in the SPVs and that it would be furthermore required under the ECT that only the real and ultimate owner or beneficiary may submit claims to arbitration.[97]

The *Antin* tribunal held that it was by reason of such shareholding (direct and indirect) that claimants were claiming an interest in the SPVs, in other words, the claimants were claiming "*damages caused to the value of their shareholding interests*" in the SPVs.[98] Thus, the damage to the assets of the SPVs transmitted into de-valuation of the shareholding in the SPVs themselves, not directly into the assets – a views which has been shared by other tribunals, most notably in *Charanne* and *Eiser* referred to above. Further, by referring to the case *ST-AD v. Bulgaria and Poštová v. Hellenic Republic*, the

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94 *Masdar Solar v. Spain* (Award) para 201.
95 *See Yukos v. Russia* (Interim Award on Jurisdiction and Admissibility) para 432.
96 *Masdar Solar v. Spain* (Award) para 201.
97 *See Antin v. Spain* (Final Award) para 231 et seq.
98 *Id.* para 270.

*Antin* tribunal re-iterated that although the rights of a subsidiary are not the same as the rights of the parent company, the latter is entitled to bring claims under the treaty for actions directed at the subsidiary and affecting the assets of the subsidiary that cause loss to the value of the shares held by the claimant parent company.[99] Therefore, the tribunal denied Spain's allegations that claims for "*reflective losses*" by shareholders are not permitted under investment treaties.

Further, the *Antin* tribunal held that neither the interpretation of the ECT und der VCLT nor the drafting history of the ECT would lead to a conclusion that the ECT would support Spain's proposed concept of "*indirect ownership*". Notably, there is nothing in the ECT that would require an analysis of "*indirect possession*" up until the last "*possessory stage*," to find such "*real and ultimate owner*."[100] Accordingly, Spain's objection imposing such additional requirement under the ECT failed. As will be shown in the following, the *RREEF Infrastructure* tribunal came to very similar conclusions regarding the concept of "*indirect ownership*".

### 6. RREEF Infrastructure

In *RREEF Infrastructure*, Spain raised the argument that the definition of "*investment*" under Article 1(6) ECT as well as under Art 25 ICSID Convention would require criteria which go beyond the wording of said provisions, requiring provision of money, assumption risks and making the investment for a period of time, amongst other things.[101] In Spain's view, the claimants have neither provided the funds nor assumed any risks nor the duration.[102] Equally, Spain alleged that in the PE-typical structure at hand, those who made the contributions of funds were the ones who assumed the risks of the investment, *i.e.* the LPs, and not the claimants. The *RREEF* tribunal also re-iterated that a shareholder's right to claim compensation due to measures negatively affecting company's (here the SPV's) assets, which detrimentally affects the value of the share price in such SPV, would stem from Article 1(6) ECT, clearly including shares among the protected investments.[103]

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99 *Antin v. Spain* (Final Award) para 271, referring to *ST-AD v. Bulgaria* (Award on Jurisdiction) paras 282, 312.

100 *Antin v. Spain* (Final Award) paras 264 et seq.

101 *See RREEF v. Spain* (Decision on Jurisdiction) paras 148 et seq.

102 *Id.* para 149.

103 *RREEF v. Spain* (Decision on Jurisdiction) paras 123.

Further, the tribunal held in terms of ownership that shares do fall within the ECT's "*investment*" definition and "*indirect investments*" are also protected by the ECT. Given the wide definition contained in Article 1(6) ECT, if participants in an enterprise "*upstream*" own and control an ultimate asset, then necessarily so too do those participants "*downstream*" and to the same degree.[104] This would suffice in order to conclude that the claimants owned controlled investments, as that term is defined under the ECT. This reasoning is therefore in line with the conclusions made by the tribunals in *Charanne*, *Eiser*, and *Novoenergia II* (with reference to Article 1(6)(b) ECT).

The *RREEF Infrastructure* tribunal held that the definition of investment in the ECT is contained in Article 1(6) ("*referring to every kind of asset" associated with an "Economic Activity" in the "Energy Sector"*) is open, general and not restricted.[105] Neither the ECT nor the ICSID Convention would foresee a requirement for any assumption of risk or for bringing funds from a Contracting State to another.[106] Thus, on this issue the *RREEF Infrastructure* tribunal seems to have taken views deviating from the *Masdar Solar* tribunal, which, based on an interpretation of Article 1(6) ECT, at least implicitly required with regard to the existence of an "*investment*" a commitment or allocation of resources for a duration and involving risk.[107]

## V. Summary

A typical RE-investment is regularly structured by means of a non-recourse financing structure. Investor under the ECT for purposes of non-recourse RE-projects will be typically an entity organized under the laws of the host state of another Contracting Party to the ECT (*i.e.* meeting the requirement of foreignness through referring to the concept of "*incorporation*"), without requiring any additional elements or assessing the nationality of shareholders behind such organisation. International tribunals have predominantly assessed the notion of "*investment*" pursuant to the ECT regarding RE-investments as the right to the value of the shares held by the investor directly or indirectly in the project company (SPV).

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104 *Id.* para 159.
105 *Id.* para 156.
106 *Id.* para 158.
107 *See* sec. 2.IV.C.4. above.

# 3. ADVERSE REGULATORY CHANGES: RISKS AND MITIGANTS

## I. Overview

The following section will introduce the risk of adverse regulatory changes as preeminent political risk to RE-investments (sec. 3.II.), followed by examples of three EU jurisdictions where such adverse changes have occurred more recently (sec. 3.III.). Thereafter, several methods of mitigation of political risk under private law (sec. 3.IV) and private international law (sec. 3.V) will be presented, the latter examples being elaborated further in the following chapters of this thesis.

## II. Adverse Regulatory Changes as Element of Political Risk

Before investing in a RE-project, the prudent investor undertakes a thorough risk-assessment of a prospective project from a business, technical, and legal perspective, by regularly involving various external advisors. The type of project risk which lies at the heart of this thesis is political risk, defined by *Dolzer/Schreuer* as the risk inherent in future intervention of the host state in the legal design of a project.[108] Common examples of political risks which can detrimentally influence a RE-project are expropriation, breach of contracts by governments of sovereigns, terrorism, war, civil disturbance, nationwide strikes, permitting and licensing risk, currency and interest rate risk.[109]

According to the most recent Political Risk Survey published by MIGA,[110] the type of political risk which provides most concerns to investors in developing economies, is the risk of adversary regulatory or legislative changes.[111] However, as has been shown by more recent developments, equally various EU-jurisdictions have made considerable changes to RE-support policies, typically motivated by down-turning economies in times of financial crisis. Thus, the risk of adverse regulatory changes is also inherent to project realized within the EU.

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108 *Dolzer/Schreuer*, Principles 21 et seq; the term "*host state*" refers to the state in which territory a foreign investor invests; see also *Mistelis* in *Scherer (ed.)*, Energy Arbitration 154.

109 For an overview of risks in RE-projects *see e.g. Mistelis* in *Scherer (ed.)*, Energy Arbitration 154.

110 *See* types of political risk of most concern to investors in developing countries in *MIGA*, 2013 World Investment and Political Risk 21.

111 *See e.g. Ortino*, 21 JIEL 845.

## III. Examples of Adverse Regulatory Changes in Europe

Most notable changes to RE-support policies in Europe after the 2008 financial crisis have been made by the Czech Republic, Italy, and Spain,[112] whose most important elements will be described in the following. In particular, changes to RE-support policies in Spain have triggered a mass of investor-state claims, some key award resulting from such claims being the basis for the discussion in this thesis.

### A. Czech Republic

The Czech Act 180/2005 of 1 August 2005 intended to promote the use of RE-systems and to increase the share of electricity from RE-sources, providing investors with a maintained FIT for RE-sources for 15 years (later amended to 20 years by ERO), from the date of commissioning.[113] However, when the popularity of the program coupled with decreasing costs of PV production led Czech officials to fear an increase of electricity prices for households and industrial consumers, Act 402/2010 of 14 December 2010 was introduced, which effectively applied a solar levy of 26% on FITs and 28% on green bonuses. Further, on, Act 330/2010 of 1 January 2011 abolished all incentives related to PV plants with installed output exceeding 30 kWp commissioned after 1 March 2011.[114]

### B. Italy

In Italy, the Conto Energia Decree provided for a FIT for a period of 20 years starting from the date on which each PV plant entered into an agreement with the state-owned GSE for connection to the power grid, thereby incentivizing investments in PV plants.[115] However, beginning in 2012, Italy implemented a series of measures, including Law Decree No. 91/2014 of 24 June 2014, diminishing the incentives offered to the investors,[116] thereby resulting in various investor-state claims brought against Italy.[117]

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112 For an overview *see e.g. Coop/Seif* in *Scherer (ed.)*, Energy Arbitration 221 et seq (FN 2 - 9); *Bellantuono*, 10 JWELAB 274 et seq; more generally *IEA*, Energy Policies of IEA Countries: EU 1 et seq.

113 *Paguio*, 3 (9) Investment Treaty News 25.

114 *Id.* 25.

115 *Balakrishnan*, 1 (10) Investment Treaty News 25; *Bellantuono*, 10 JWELAB 274 et seq.

116 *Balakrishnan*, 1 (10) Investment Treaty News 25; *Bellantuono*, 10 JWELAB 274 et seq.

117 For an overview *see e.g. Coop/Seif* in *Scherer (ed.)*, Energy Arbitration 221 et seq (FN 2 - 9); *Bellantuono*, 10 JWELAB 274 et seq.

### C. Spain

In an attempt to adopt the 2001 Renewables Directive and in pursuit of its own national interests, Spain introduced in 2007 and 2008 two regulations (RD 661/2007 and 1578/2008, the *Special Regime*), which established a generous FIT-system above market prices, payable to solar energy producers that supplied electricity into the general grid,[118] thereby promoting CSP and other sources of RE.[119] The Special Regime specified the amounts of both the fixed tariff and the premium in euros per kilowatt hour that would be payable in respect of each hour of production, subject to a cap and a floor and provided for qualifying installations with priority of access and priority of dispatch to the transmission and distribution networks.[120]

In 2010, Spain introduced two regulations that negative affected the Special Regime. RD 1565/2010 first eliminated the electricity producer's right to guaranteed FIT after the 26th year of operation and required energy producers to install certain devises to protect the grid from drops in voltage.[121] Further, with RDL 14/2010, Spain limited the maximum number of hours during which the producers could feed electricity into the grid and imposed charges for using the transportation and distribution network[122] (the 2010 modifications together, the "*Phase I Modifications to Spain's Special Regime*").

Between 2012 and 2014 Spain introduced even more drastic changes to the Special Regime. In December 2012, the Spanish parliament adopted Law 15/2012 without prior notice to CSP producers, imposing, *inter alia*, a 7% tax on the total value of all energy fed into the national grid by electricity producers and eliminating premiums for electricity generated with gas.[123] Further, in 2013, Spain repealed the whole FIT-system with RD 2/2013 and left CSP producers the option of either the market price or the fixed rate tariff, also cancelling the mechanism for updating the FITs in accordance with the then applicable consumer price index (the 2012 – 2014 modifications together, the "*Phase II Modifications to Spain's Special Regime*").

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118 *Arp*, 110 ASIL 327; see also *Eiser v. Spain* (Award) paras 101 et seq, with regard to RD 661/2007, in particular *Id*, para 112; *Gallagher* in *Scherer (ed.)*, Energy Arbitration 250.

119 *Eiser v. Spain* (Award) para 102.

120 *See e.g. Antin v. Spain* (Final Award) para 559.

121 *Arp*, 110 ASIL 327; *Eiser v. Spain* (Award) para 367.

122 *Arp*, 110 ASIL 327; *Eiser v. Spain* (Award) para 367.

123 *See Eiser v. Spain* (Award) para 144.

Further legislative reforms in 2013 set the ground floor for a new system providing for "*specific remuneration*" based on the investment costs of "*model facilities*", which would be equated with "*an efficient and well- managed company*" (RDL 9/2013).[124] Through RDL 9/2013 and Law 24/2013, Spain replaced the FIT system by a remuneration system that allowed certain RE installations to obtain a special payment by reference to a standard installation and withdrew the right of priority of grid access and priority of dispatch for RE installations.[125]

In June 2014, Spain finally abandoned the Special Regime, substituting a new regime of reduced remuneration based on hypothetical "*standard*" investment and operating costs and characteristics of a hypothetically "*efficient*" plant with a duration of 25 years of operative life (RD 413/2014 and Ministerial Order IET/1045/2014 of 16 June 2014, also applying to existing plants constructed and financed under the principles of the prior regime). These "*typical*" costs however had arguably little in common with the real costs and efficiencies of specific existing plants.[126] RDL 9/2013, Law 24/2013, RD 413/2014, and Ministerial Order IET/1045/2014 dismantled all the features of the Special Regime (the 2014 modifications together, the "*Phase III Modifications to Spain's Special Regime*").

## IV. Protection under Private Law

An investor may seek protection against adverse regulatory changes by entering a contractual agreement with the host state (sec. 3.IV.A.) or by entering a political risk insurance with a (third party) insurance provider (sec. 3.IV.B.).

### A. Contractual Agreement

At the heart of an energy dispute is often a contract between a private company and a state or a state-affiliated entity, which can take the form of long-term oil or gas delivery agreements, electricity supply contracts, joint-venture agreements, production sharing

124 *See e.g. Eiser v. Spain* (Award) para 146.
125 *See e.g. Antin v. Spain* (Final Award) para 560.
126 *Selivanova*, 33(2) ICSID Review 422 (449).

agreements (PSAs/PSCs), build, operate and transfer contracts (BOT) or risk service agreements (RSA), license agreements, concessions or service contracts.[127]

Should a government or state entity breach a contractual agreement it has entered, the investor will be able to seek compensation under the laws applicable to the contract, eventually under the laws of the host state. In transaction structures where the private investor enters a contract with a government, or state entity, such as under PPP models, the investor may *e.g.* agree on contractual covenants which protect it against detrimental legislative changes by the host state. Such provisions typically seek to qualify the extent to which the investor can claim compensation from the Government in case of detrimental changes to the applicable law (*e.g.* in case of an increase of taxes).[128]

An investor may also enter a contract under private law not only directly with the state, a government respectively, but with an entity that has the capacity to enter such contracts based on the laws of the host state. Accordingly, under such model an investor may *e.g.* enter a contractual agreement regarding a specific FIT for a specified duration.[129] Upon entering such contract,[130] the FIT is secured for the duration set out in the respective national law and the FIT obtained by the investor is protected by means of private law against any future legislative changes.

While the parties could include an arbitration clause in the contract with the state or state-entity, whereby the investor could file its claims in private in (commercial) arbitration proceedings, *i.e.* before a neutral forum outside of the courts of the host state,[131] an investor may be confronted with various obstacles when enforcing its right against the host state in commercial arbitration. First, international commercial arbitration against a

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127 *Vorburger/Petti* in *Arroyo (ed.)*, Arbitration in Switzerland 1283.

128 For a more general discussion on contractual mechanisms regularly entered for purposes of stability in energy contracts (such as law stabilization clauses, economic equilibrium clauses, freezing clauses, force majeure clauses, hardship clauses, contractual adaptation and adjustment clauses), *see e.g. Mistelis* in *Scherer (ed.)*, Energy Arbitration 157 et seq.

129 *See e.g.* the RE-regime under the Austrian Green Electricity Act (Ökostromgesetz 2012, Austrian Federal Gazette, volume 1, no° 75/2011), which aims at supporting the production of green electricity via a FIT, providing for the right to apply for a FIT for the duration of 13/15 years under specific circumstances and procedures set out in the act.

130 *E.g.* under the Austrian Green Electricity Act, a private law contract is entered between the investor and the Green Energy Clearing and Settlement Agency (OeMAG), which has the capacity and mandate of granting the FIT.

131 *See e.g. Mistelis* in *Scherer (ed.)*, Energy Arbitration 155.

host state will generally require waiver of sovereign immunity by the host state.[132] However, even if such waiver had been validly obtained, the host state may allege potential violations of national constitutional laws or *ordre public*. Further, even if a claimant succeeded in obtaining a favourable arbitral award, it may still face a general reluctance of courts of the host state in enforcing such an award is against the host state or the host state's government.

As will be explained in sec. 3.III. below, public international law does generally validate stabilization clauses,[133] which can be equally enforceable under the host state's private and therefore domestic law. More generally, concurrent violation of a contractual obligation and an investment treaty obligation may provide a dual basis for a tribunal's jurisdiction, *i.e.* based on the contractual arbitration clause as well as on the dispute resolution mechanism included in the applicable investment treaty.[134] Most notably, while *Mistelis* has recently correctly advocated for the cumulative application of domestic and international law regarding the application of contractual stabilization clauses,[135] the more viable route for an investor to enforce such clauses may be the one of public international law before international arbitral tribunals.

### B. Political Risk Insurance

As has been correctly pointed out by *Gallagher*, investment treaties are not insurance policies against bad business judgment.[136] However, political risk insurance is a legal instrument which can be obtained for such purpose in order to obtain cover against risks like those addressed in BITs,[137] thereby constituting a further technique to address the risk of adverse regulatory changes on a private-law (*i.e.* contractual) basis.[138]

Political risk insurance has its origins in the public sector. Notably, in 1985 the member states of the World Bank decided to establish the international organization MIGA to

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132 *See e.g. Mistelis* in *Scherer (ed.)*, Energy Arbitration 171; *Blackaby/Partasides/et al.*, International Arbitration 653 et seq; *Born*, International Commercial Arbitration 91 et seq; *Gaillard/Savage*, Fouchard Gaillard Goldman 387 et seq; *Horn/Kröll*, Arbitrating Foreign Investment Disputes 387 et seq; *Lew/Mistelis/et al.*, Arbitration 733 et seq.

133 *See* sec. 3.V.A. below and *Mistelis* in *Scherer (ed.)*, Energy Arbitration 160.

134 *Vorburger/Petti* in *Arroyo (ed.)*, Arbitration in Switzerland 1284.

135 *Mistelis* in *Scherer (ed.)*, Energy Arbitration 160 et seq.

136 *Gallagher* in *Scherer (ed.)*, Energy Arbitration 267, with further references.

137 *Dolzer/Schreuer*, Principles 230.

138 *Ortino*, 21 JIEL 845.

insure investments in MIGA-member countries that prove economic soundness and have received host country approval.[139] Until today, MIGA is one of the most important political risk insurance providers, in particular with regard to projects in developing countries. However, there are also notable providers from the private sector, such as from London based Lloyd's or New York based American International Group.

Political risk insurance is typically obtained in addition to the standards of protection offered under BITs and MITs. The investor will therefore have the choice to either enforce its rights under applicable international law against the host state (*e.g.* in case of breaches of FET or in case of expropriation), or to make use of its private law claim against the insurer. In case of payment under the insurance contract, the insurer's rights are regularly assigned to the insurer, which can enforce them against the host state (so-called "*subrogation*").[140]

However, it has been correctly pointed out that invoking the insurance can lead to a dispute with the insurance provider, thereby actually triggering a dispute where questions as to breaches of international law would equally be triggered (*e.g.* if expropriation had actually occurred, against which the insurer had insured the investor as policyholder). While the downside for the investor would be definitely that such dispute would refrain from immediate payment under the private law insurance contract, the upside could be at least seen in the fact that such dispute should generally be decided swifter than actually invoking investor-state arbitration, although such dispute could be fought through various instances under municipal law, thereby making the compensation claim arguably a long undertaking.

## V. Protection under Public International Law

An investor may seek protection against adverse regulatory changes by invoking instruments offered by public international law. The most important means of protection to such extent can be achieved through entering a stabilization clause with a host state, which is typically included in an investment agreement entered between the investor and the host state (sec. 3.V.A.). An alternative protection under public international law, which

139 *Dolzer/Schreuer*, Principles 229 et seq.

140 *Id.* 230.

will be discussed in the following sections thoroughly, is the investor's reliance on various substantive standards of protection offered by public international law (sec. 3.V.B.).

### A. Stabilization Clause

It has been correctly pointed out by scholars that the stability of a host state's regulatory framework is a matter of high importance for foreign investors, particularly in the energy sector.[141] Stabilization clauses are tools used to minimize the risk of a state revisiting the original investment arrangement to the disadvantage of the investor and thus protect investors from a bargaining power shift after the realization of the energy project.[142] The purpose of such stabilization clause is to safeguard the stability of the investment contract, in particular regarding host states whose political and legal regime has in the past been subject to frequent changes or volatility.[143]

Stabilization clauses are regularly entered as part of an investment agreement. Investment agreements are negotiated between an investor and the host state to allow for special rules between the two parties, separate from the general legislation of the host state.[144] Arbitral tribunals have repeatedly confirmed the validity of stabilization clauses and awarded damages to contracting parties whose rights have been violated by changes in the law or tax regimes.[145] Such investment agreements provide very strong protection of an investor under public international law from the beginning to the end of their common project.[146] Indeed, it has been correctly pointed out by scholars that potentially the strongest technique to address the risk of adverse regulatory changes can be achieved by entering a stabilization clause.[147]

The stabilization of the contract can be accomplished through different techniques, whereby the objective remains the same: all types of stabilization clauses strive to provide a contractual guarantee that the legal and regulatory framework underlying the terms of the contract remains the same over the entire lifespan of the energy project.[148]

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141 *See Coop/Seif* in *Scherer (ed.)*, Energy Arbitration 221.
142 *Vorburger/Petti* in *Arroyo (ed.)*, Arbitration in Switzerland 1297.
143 *Dolzer/Schreuer*, Principles 82.
144 *Id.* 82.
145 *Mistelis* in *Scherer (ed.)*, Energy Arbitration 160 and 163 et seq.
146 *Dolzer/Schreuer*, Principles 82.
147 *Ortino*, 21 JIEL 845.
148 *Vorburger/Petti* in *Arroyo (ed.)*, Arbitration in Switzerland 1297.

A stabilization clause in the strongest sense would even require the host state not to alter its general legal regime for the area addressed in the clause.[149]

The different kinds of stabilization clauses as they are most regularly seen include: (i) freezing clauses (which prohibit a host state from changing its laws for the area covered by the clause and freeze the "*provisions of a national system of law chosen as the law of the contract as to the date of the contract in order to prevent the application to the contract of any future alterations of this system*"), (ii) intangibility or inviolability clauses (freezes the individual contract rather than the law and prevents a state's unilateral changes to its law to the extent it may have an effect on the terms of the contract ), (iii) rebalancing or economic equilibrium clauses (requires renegotiation of contract terms to restore the initial economic balance in the event of specified circumstances ) and (iv) allocation of burden clauses (instead of requiring a renegotiation of a contract they require the state or state entity to reimburse the other party for any damage or losses incurred due to the change of the law).[150]

As has been correctly pointed out by *Mistelis*, where a "*regulatory chill*" cannot be obtained, whereby a host state is obliged not to amend certain laws at all, a "*freezing effect*" may provide for non-interference of regulatory changes vis-à-vis the contractual relationship between an investor and a host state.[151] As states have progressively become more reluctant to agree to the inclusion of such provisions in energy-related contracts since they are seen as preventing states from developing and modernizing their legal system,[152] the investor's concerns will be limited to the stability of the individual agreement it has concluded with the host state[153] or qualified by any acts which are deemed reasonable to a legitimate public policy objective.[154]

Thus, in order to achieve protection against regulatory changes potentially detrimental to an investor, the prudent investor will be inclined to conclude a well-negotiated stabilization clause with the host state, potentially through the entering of an investment agreement. However, as has been shown by *Mistelis* recently, stabilization clauses which limit the regulatory sovereignty of a state are becoming less common in practice,

149 *Dolzer/Schreuer*, Principles 83.
150 *Vorburger/Petti* in *Arroyo (ed.)*, Arbitration in Switzerland 1298.
151 *See Mistelis* in *Scherer (ed.)*, Energy Arbitration 158.
152 *Vorburger/Petti* in *Arroyo (ed.)*, Arbitration in Switzerland 1299.
153 *Dolzer/Schreuer*, Principles 83.
154 *Ortino*, 21 JIEL 849.

and even where states agree to such restriction in regulatory sovereignty, they still seem to retain it in practice.[155]

### B. Substantive Standards of Protection

Regulatory changes may not only be mitigated through stabilization clauses but may also be reason to bring claims by investors against states based on an applicable investment protection regime.[156] It has only been in the last decades that private companies started to increasingly rely on international investment protection regimes and the dispute resolution mechanisms contained in investment treaties.[157]

Investment treaties can take the form of either a bilateral investment treaty ("*BIT*") or a multilateral investment treaty ("*MIT*"), both of which normally include a unilateral standing offer by host states to arbitrate disputes arising from the treaty with an investor of the other states who are signatories to the treaty.[158] The ECT as multilateral investment treaty of sectoral nature is the prime choice for investors in case of RE-disputes.[159] The ECT is unique since it is limited to investments "*associated with an Economic Activity in the Energy Sector*". The ECT entered into force in April 1998 and has fifty-one signatory countries, mostly from Western Europe (including Switzerland), Eastern Europe and the former Soviet Union.[160]

Part III of the ECT, titled "*Investment Promotion and Protection*" contains the substantive legal obligations owed by signatory states to investors, which include in particular: fair and equitable treatment ("*FET*"), most constant protection and security, protection from impairment by unreasonable and discriminatory measures, application of national and most favoured nation treatment, encouragement and creation of stable conditions, application of an umbrella clause and compensation for expropriation.[161]

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155 *See Mistelis* in *Scherer (ed.)*, Energy Arbitration 158, with examples of stabilization clauses entered with various African countries.

156 *Vorburger/Petti* in *Arroyo (ed.)*, Arbitration in Switzerland 1299.

157 *Id.* 1285.

158 *See Vorburger/Petti* in *Arroyo (ed.)*, Arbitration in Switzerland 1285.

159 *Dolzer/Schreuer*, Principles 15.

160 *Vorburger/Petti* in *Arroyo (ed.)*, Arbitration in Switzerland 1287.

161 *Id.* 1306.

Under the ECT, international investors have predominantly relied on two substantive standards of protection against adverse regulatory changes of RE-support policies, the protection based on FET as the most frequently invoked standard in investment disputes and also has the highest practical relevance for investor protection under BITs and MITs,[162] as well as protection against expropriation.[163] To such extent, sec. 4. and sec. 5. will examine recent ECT jurisprudence in the RE-sector in order to discuss both of these standards with regard to adverse regulatory changes to RE-support policies.

## VI. Summary

Examples of adversary changes to RE-support policies in Europe (*e.g.* in Spain, Italy, or the Czech Republic) have shown that investors' concerns against regulatory changes as main element of political risk in RE-projects are not limited to investments made in developing economies. Notably, investors in Spain experienced far-reaching changes to RE-support policies after the 2008 financial crisis.

There are various instruments how investors can obtain protection against adversary changes to RE-support policies made by a host state under private as well as under public international law. Protection under private law may be sought based on contractual agreement with the host state or by means of political risk insurance. Such rights may be enforced by the investor either in litigation before the courts of the host state or in international commercial arbitration. However, in both cases risks of facing sovereign immunity objections by host states as well as failed enforcement risk are omnipresent.

Entering of a stabilization clause, ideally in the form of an investment contract, with a host state provides most effective protection to an investor under private, and most notably also under public international law. Absent such stabilization clause, an investor may seek investment protection under the substantive standards of protection the ECT offers, most notably the host state's obligation to provide FET as well as protection against the direct and indirect expropriation of an investor's investment.

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[162] *Dolzer/Schreuer*, Principles 130; *see* also *Mistelis* in *Scherer (ed.)*, Energy Arbitration 166, regarding the relevance of stabilization clauses and *Coop/Seif* in *Scherer (ed.)*, Energy Arbitration 223.

[163] With regard to the standard of FET *see e.g. Dolzer/Schreuer*, Principles 18, in particular *Waste Management v. United Mexican States* (Award) and *Total v. Argentina* (Decision on Liability).

# 4. PROTECTION BASED ON FAIR AND EQUITABLE TREATMENT

## I. Overview

The following section deals with Fair and Equitable Treatment as the main substantive standard of protection international law offers to investors in case of adversary regulatory changes. After outlining the prevailing general view under the ECT, considering the State's and the investor's interests, which need to be aligned by means of a balancing exercise (sec. 4.II.A.), recent ECT-jurisprudence in the RE-sector will be discussed with regard to the standards of FET which have been applied recently by international tribunals (sec. 4.II.B.).

## II. The Standard of Fair and Equitable Treatment

### A. The General View

The concept of FET is the most frequently invoked standard in investment disputes.[164] It is also the standard with the highest practical relevance: the majority of successful claims pursued in international arbitration are based on a violation of the FET standard.[165] The ECT contains elaborate language around the requirement of FET in Article 10(1) ECT: „*Each Contracting Party shall, in accordance with the provisions of this Treaty, encourage and create stable, equitable, favourable and transparent conditions for Investors of other Contracting Parties to make Investments in its Area. Such conditions shall include a commitment to accord at all times to Investments of Investors of other Contracting Parties fair and equitable treatment.*"

However, as the ECT does not provide for a definition of the concept of "*fair and equitable treatment*", such concept must be assessed based on methodologies applied under general public internal law.[166] Indeed, as *Vorburger/Petti* have correctly stated, despite the rapidly growing number of cases under the ECT, the available case law does not yet include an all-inclusive interpretation of the ECT-specific FET standard.[167] International

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164 *Dolzer/Schreuer*, Principles 130; *Diehl*, Standard of International Investment Protection 311 et seq.

165 *Dolzer/Schreuer*, Principles 130.

166 *See e.g. Dolzer/Schreuer*, Principles 141 et seq.

167 *Vorburger/Petti* in *Arroyo (ed.)*, Arbitration in Switzerland 1306.

tribunals tried to define the concept of FET occasionally by creating broad definitions or descriptions.[168]

A different approach, notably endorsed by *Dolzer/Schreuer*, is to identify typical factual situations to which this principle has been applied.[169] An examination of the practice of tribunals demonstrates that several principles can be identified which are embraced by the standard of FET.[170] It has been correctly pointed out that the question, whether the ECT-specific FET standard operates as an independent basis for a claim, or as a broad general basis for an investment protection claim (which must otherwise be grounded in a number of other more concrete investment protection provisions also contained in Article 10(1) ECT (for instance the one providing for non-discrimination)), is still an open issue.[171] As will be shown, this is also reflected in the six selected arbitral awards resulting from recent RE-disputes with Spain, as will be discussed further below.

### 1. The State's View: Right to Regulate in Public Interest

States are key players in energy related matters due to their economic, political and social interests, regulatory function and as owners of the energy resources sought.[172] For the state, in case of investments in the energy sector, often important national interests are at stake.[173] States have traditionally taken the view that they have full discretion when amending their national legislation. However, and as has been correctly pointed out by scholars, the prevailing (more conservative) view is that every state has the right to regulate within its territory, to the extent such right is not limited by the obligations that such state has granted foreign investors though international investment agreements and treaties, including the ECT.[174]

The host state is generally interested in concentrating the discussion before arbitral tribunals on questions whether it had the right to act in public or security interest,

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168 *See e.g. Tecmed v. Mexico* (Award) para 154, where the tribunal interpreted the concept of FET autonomously, taking into account the ordinary meaning of its text, international law, the good faith principle, and in particular legitimate expectations of an investor that a host state will not take inconsistent, arbitrary, and ambiguous measures.

169 *Dolzer/Schreuer*, Principles 145.

170 *Id.* 145.

171 *Vorburger/Petti* in *Arroyo (ed.)*, Arbitration in Switzerland 1306.

172 *Id.* 1296 et seq.

173 *See e.g. Hobér* in *Scherer (ed.)*, Energy Arbitration 175.

174 *See Coop/Seif* in *Scherer (ed.)*, Energy Arbitration 221.

generally also pleading for a wide margin of appreciation, discretion respectively. If successful with such argument, the investor would lose its right to claim damages which may have resulted as a result of the host state's decision. However, as will be shown based on selected ECT-jurisprudence, the discussion considering a host state's obligation to grant FET to its investors is generally not limited to such narrow scope of assessment.

### 2. The Investor's View: Legitimacy of Expectations

The investor on the other hand regularly argues that based on the host state's legal framework and on any (explicit or implied) undertakings and representations made by the host state to offer a favourable investment environment,[175] the investor has been attracted by such favourable environment and made its investment on such basis. The applicable legal framework can constitute, *inter alia*, national legislation, treaties, and decrees. If a host state alters existing state-aid/support regimes, which detrimentally affect the investment, the investor regularly takes the view that the favourable investment environment must be preserved for the duration of the investment. Accordingly, such investor takes the view that the host state must compensate the investor as a result of the adversary changes for any deprivation in of its investment, which has been made in good faith and legitimate expectations that the favourable investment environment would be maintained.

### 3. The Balancing Test

The host state's as well as the investor's views are from a stand-alone view legitimate and it has been the task of international tribunals to adequately accommodate the contradicting interests based on a "*balancing test*", in order arrive at a "*fair and equitable*" result in the sense of the FET standard. The relevant point in time for balancing the respective parties' interests is the time when the investment was made.[176]

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175 *See Dolzer/Schreuer*, Principles 145.

176 *See e.g. Mondev v United States* (Award) para 156; *Feldman v. Mexico* (Award) para 128; *LG&E v. Argentina* (Decision on Liability) para 130; *Enron v. Argentina* (Award) para 262; *BG Group v. Argentina* (Award) paras 297-298; *Duke Energy v. Ecuador* (Award) paras 340, 365; *Bayindir v Pakistan* (Award) paras 190, 191; *EDF v. Romania* (Award) para 219; *AES v. Hungary* (Award) paras 9.3.8-9.3.18.

As a general rule, a host state has the right to determine its own legal and economic order subject to the international minimum standard.[177] In case of regulators changes, the requirement of stability is not absolute and does not affect the state's right to exercise its sovereign power to legislate and to adapt its legal system to changing circumstances.[178] However, a host state's legal and business framework must meet the requirements of stability and predictability under international law.[179] Thus, what matters is whether measures exceed normal regulatory powers and fundamentally modify the regulatory framework for the investment beyond an acceptable margin of change.[180]

As a reversal of assurances by the host state that have led to legitimate expectations will violate the principle of FET,[181] a substantial part of the balancing task is to asses if the investor in fact had those legitimate expectations based on laws and acts by and from the host state. Expectations are protected only if they are legitimate and reasonable in the circumstances.[182] Notably, according to *Dolzer/Schreuer*, undertakings and representations made explicitly or implicitly by the host state are the strongest basis for legitimate expectations.[183] Legitimate expectations are not subjective hopes and perceptions; rather, they must be based on objectively verifiable facts.[184] Particularly important in the creation of legitimate expectations are specific assurances and representations made by the host state in order to induce investors.[185]

However, the investor's legitimate expectations will be seriously reduced if there is general instability in the political conditions of the country concerned.[186] In deciding

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177 *Dolzer/Schreuer*, Principles 146.

178 *See e.g. Parkerings-Compagniet v. Lithuania* (Award) paras 327 – 338; *BG Group v. Argentina* (Award) paras 292-310; *Plama v. Bulgaria* (Award) para 219; *Continental Casualty v Argentina* (Award) paras 258 - 261, *AES v. Hungary* (Award) paras 9.3.27-9.3.35; *El Paso v. Argentina* (Award) paras 344-52 and 365-74.

179 *See e.g. Occidental v. Ecuador* (Final Award) para 191.

180 *Dolzer/Schreuer*, Principles 146, with reference to *EDF v. Romania* (Award).

181 *Id.* 145.

182 *Id.* 148; *see* also *AWG v. Argentina* (Decision on Liability) para 209 whereby one must not look single-mindedly at the claimants' subjective expectations. The Tribunal must rather examine them from an objective and reasonable point of view.

183 *Dolzer/Schreuer*, Principles 145.

184 *Dolzer/Schreuer*, Principles 148.

185 *See e.g. Kardassopoulos v. Georgia* (Decision on Jurisdiction) para 191; *Parkerings-Compagniet v. Lithuania* (Award) para 331; *Sempra v. Argentina* (Award) paras 298, 299; *Duke Energy v. Ecuador* (Award), paras 359-64; *Continental Casualty v Argentina* (Award) paras 258 - 261; *Total v. Argentina* (Decision on Liability) paras 119-20 and 309.

186 *Bayindir v Pakistan* (Award) paras 192 – 197.

between the investor's right to stability and the state's right to regulate, some tribunals have furthermore weighed the investor's legitimate expectations against the state's duty to act in the public interest.[187]

## B. Recent ECT Jurisprudence in the RE-sector

### 1. Charanne

In *Charanne*, the claimants alleged that Spain had breached the standard of FET by adopting the Phase I Modifications to Spain's Special Regime.[188] The *Charanne* tribunal accepted the general principle that tribunals have estimated, based on good faith principle of customary international law, that a state cannot induce an investor to make an investment, hereby generating legitimate expectations, to later ignore the commitments that had generated such expectations.[189] Thus, in assessing whether the Phase I Modifications to Spain's Special Regime constitutes a breach of Article 10(1) ECT, the existence of legitimate expectations of the investor was the relevant factor for the *Charanne* tribunal.[190]

According to the *Charanne* tribunal, a finding that there has been a violation of investor's expectations must be based on an objective standard or analysis, as the mere subjective belief that could have had the investor at the moment of making of the investment is not sufficient.[191] This seems to be a generally accepted standard, notably in *Mamidoil Jetoil Greek Petroleum Products Societe Anonyme S.A. v. Republic of Albania*, the tribunal held that "*it is generally accepted that there must be more on Claimant's side than the subjective hope that nothing will change for the worse*".[192] As will be discussed below, one of the issues to consider for investors and resulting indirectly from this objective

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187 *See e.g. Saluka v. Czech Republic* (Partial Award) para 306; *Total v. Argentina* (Decision on Liability) paras 123, 309.

188 *See Charanne v. Spain* (Final Award) para 478 et seq. Notably, the claimants excluded from the framework of this arbitration the legislative changes by Spain made in 2013; see also the analysis in *Simoes*, 26 (2) RECIEL 174 et seq.

189 *Charanne v. Spain* (Final Award) para 486, citing *El Paso v. Argentina* (Award), *International Thunderbird Gaming Corporation v. United Mexican States* (Award); *Waste Management v. United Mexican States* (Award).

190 *See Charanne v. Spain* (Final Award) para 486; *Coop/Seif* in *Scherer (ed.)*, Energy Arbitration 237.

191 *Charanne v. Spain* (Final Award) para 495.

192 *Mamidoil v. Albania* (Award) para 731.

standard, is the requirement for investors to perform a thorough DD of the environment in which an investment is made.

The *Charanne* tribunal first assessed whether Spain had given specific commitments not to change its regulatory framework to the claimants. This question referred to the more general question what can give rise to legitimate expectations. There is no doubt amongst scholars that specific assurances to the investor (including stabilization clauses) can give rise to legitimate expectations.[193] Accordingly, the *Charanne* tribunal held that legitimate expectations on an investor can be based on a stabilization clause[194] or any kind of statement that the state had directed to the investors and according to which the existing regulatory framework would not change.[195] In the absence of a stabilization clause (*e.g.* included in an investment agreement, energy contract respectively), the *Charanne* tribunal had to assess if assurances had been given that the Special Regime would not be changed (at all) in the future by general legislation applicable at the time of the investment.

For such purpose, the *Charanne* tribunal assessed whether the Special Regime contained specific commitments of stabilization, reasons for legitimate expectations respectively. The tribunal held that although the Special Regime was directed to a limited group of investors, it did not make them to be commitments specifically directed at each investor.[196] The rules at issue were of general nature to convert a regulatory standard into a specific commitment of the state and deriving specific commitments of stabilization from general legislation would constitute an excessive limitation on power of states to regulate the economy in accordance with the public interest.[197] It therefore seems that the *Charanne* tribunal rejected the view that provisions of general law could give rise to legitimate expectations at all,[198] not only in the specific circumstances underlying the Special Regime. As will be shown further below, other ECT-tribunals took different views on this issue. Notably, also one of the members of the *Charanne* tribunal also issued a dissenting opinion on this issue, deviating from the views of the majority vote.[199]

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193 *Coop/Seif* in *Scherer (ed.)*, Energy Arbitration 239.
194 *See* sec. 3.V.A. above.
195 *Charanne v. Spain* (Final Award) para 490.
196 *Id.* para 493.
197 *Id.* para 493.
198 *See* also *Coop/Seif* in *Scherer (ed.)*, Energy Arbitration 240.
199 *See* also *Id.* 240 et seq.

The Charanne tribunal also held that marketing materials which aimed at promoting and attracting investment in the sector of RE-generation (such as the prospectus "*The Sun Can Be All Yours*") could not be regarded as being specific enough to have generated an expectation that the Special Regime would not be modified.[200] Although these marketing materials did contain a reference to RD 661/2007, they did not, in the views of the *Charanne* tribunal, include any language from which it could be reasonably inferred that the regulated tariff would remain untouched for the rest of the regulatory lives of the plants.[201] As will be shown further below, other ECT tribunals took different views also on this issue.

According to the *Charanne* tribunal and in the absence of a specific commitment, an investor cannot have a legitimate expectation that existing rules will not be modified (at all).[202] Notably, the Charanne tribunal agreed with the position adopted by the tribunal in *Electrabel v. Hungary* under the ECT, according to which "*while the investor is promised protection against unfair changes, it is well established that the host State is entitled to maintain a reasonable degree of regulatory flexibility to respond to changing circumstances in the public interest. Consequently, the requirement of fairness must not be understood as the immutability of the legal framework, but as implying that subsequent changes should be made fairly, consistently and predictably, taking into account the circumstances of the investment.*"[203] These findings are in accordance with reasoning of tribunals such as *CMS v. Argentina* or *El Paso v. Argentina*, were, *inter alia*, the views had been taken that a legal framework can always evolve and be adapted to changing circumstances and that economic and legal life is by nature evolutionary.[204]

Accordingly, as the *Charanne* tribunal held that Spain was entitled to amend the Special Regime, the relevant next question was to what extent and based on which criteria Spain was entitled doing so in order not to infringe the FET standard. Here, the *Charanne* tribunal took the view that an investor generally has a legitimate expectation that, when modifying the existing regulation based on which the investment was made, a host state will not act disproportionately, unreasonably, or contrary to the public interest.[205]

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200 *Charanne v. Spain* (Final Award) para 497.

201 *Id.* para 497; see also the *Novoenergia II* award, where the tribunal came to a different conclusion, section 4.II.B.3. below.

202 *Charanne v. Spain* (Final Award) paras 499 et seq, 503.

203 *Electrabel v. Hungary* (Decision on Jurisdiction, Applicable Law and Liability) para 7.77.

204 *See CMS v. Argentina* (Award) para 277 and *El Paso v. Argentina* (Award) paras 350, 352

205 *Charanne v. Spain* (Final Award) para 514.

Accordingly, the Charanne tribunal assessed whether, by amending these regulations through the 2010 legislative changes, Spain acted in a disproportionate fashion, unreasonably, or against the public interest.[206] The burden of proving a breach of said principles was on the claimants.[207]

As for proportionality, the *Charanne* tribunal considered that this criterion is satisfied if the changes are not capricious or unnecessary and do not amount to suddenly and unpredictably eliminate the essential characteristics of the existing regulatory framework.[208] The Phase I Modifications to Spain's Special Regime were considered proportionate as the adaptations did not eliminate the fundamental characteristics of the existing regulatory framework, considering that the photovoltaic operators remained entitled to a FIT as well as the possibility to sell their electricity production to the system in priority.[209] Thus, they were proportionate in the views of the *Charanne* tribunal.

In terms of economic rationality, the *Charanne* tribunal held that both the temporal limitation as the limitation of eligible hours cannot be branded as irrational: the limitation of the tariff to thirty years reflects an objective criterion that is the expected lifetime of a PV power plant, while limiting eligible hours reflects an objective criterion based on the climate zone in which the plant is located and the technology used.[210] In the opinion of the *Charanne* tribunal, although these measures may have harmed economic interests of generators, they have been adopted on the basis of objective criteria and could not have been be considered irrational or arbitrary.[211] Notably, the regulatory changes were considered reasonable by the *Charanne* tribunal, as they were based on objective criteria.[212]

Finally, the Phase I Modifications to Spain's Special Regime were in line with the needs of general public interest. Indeed, considering the Special Regime, premiums paid to the PV-sector accounted for more than what had been paid to all other technologies in absolute terms and were increasing every year in important proportions.[213] Further, in

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206 *Charanne v. Spain* (Final Award) para 515.
207 *Id.* para 536.
208 *Id.* para 517.
209 *Id.* para 533.
210 *Id.* para 534.
211 *Id.* para 534.
212 *See Coop/Seif* in *Scherer (ed.)*, Energy Arbitration 237.
213 *Charanne v. Spain* (Final Award) para 535.

the views of the *Charanne* tribunal, the price paid by domestic consumers per kWh was increasing in Spain above the average proportion of the EU.[214] Thus, the Phase I Modifications to Spain's Special Regime were also proportionate in the views of the *Charanne* tribunal.

Notably, the *Charanne* tribunal highlighted the importance of an investor's DD of the applicable RE-support regime: in order to be in violation of the legitimate expectations of the investor, regulatory measures must not have been reasonably foreseeable at the time of the investment.[215] The Arbitral Tribunal considered that the claimants could have easily foreseen possible adjustments to the regulatory framework as those introduced by the rules of 2010.[216] At least that is the level of care that would be expected of a foreign investor in a highly regulated as the energy sector, where a preliminary and comprehensive legal framework applicable to the sector analysis is essential to proceed with the investment.[217] Thus, in order to exercise the right of legitimate expectations, the claimants should have made a diligent analysis of the legal framework for the investment.[218] The *Charanne* tribunal even took the views that a proper DD would have revealed that the Spanish law clearly left open the possibility that the system of compensation applicable to photovoltaics could be modified.[219]

International tribunals have indeed considered if claimants either knew of ought to have known about the context of the states in which they were investing.[220] As has been shown above, also the *Charanne* tribunal held that a violation of an investor's expectations must be based on an objective standard. Thus, as the mere subjective belief that an investor could have had at the moment of making of the investment is not sufficient,[221] an investor is well advised to perform, *inter alia*, a through DD in order to avoid allegations from the respondent host state that it had not been aware of the legal situation in place when making the investment.[222] While the *Charanne* tribunal left open, which kind of DD should be performed, it can be assumed that with regard to the possibility of adverse regulatory

214 *Charanne v. Spain* (Final Award) para 535.
215 *Id.* para 505.
216 *Id.*) para 505.
217 *Id.* para 507.
218 *Id.* para 505.
219 *Id.* para 505.
220 *See Coop/Seif* in *Scherer (ed.)*, Energy Arbitration 241, with further references.
221 *Charanne v. Spain* (Final Award) para 495.
222 *See* also section 7 below.

changes, a proper legal and regulatory DD would be required, as well as a thorough assessment of the political landscape, including potential changes to the legal and political environment throughout the lifetime of the RE-investment.

The *Charanne* tribunal concluded from the above that the Phase I Modifications to Spain's Special Regime could not be considered to violate the ECT. The modifications introduced limited amendments to the regulatory framework existing at the time of the investment without eliminating its essential characteristics, in particular the existence of a guaranteed tariff throughout the life of the facility.[223] No legitimate expectations under the ECT had been violated by being unreasonable, arbitrary, contrary to public interest, or disproportionate. Controversy, no commitment had been given to the claimants in the first place not to change the applicable regulations in place and the regulations were not changed arbitrarily or irrationally.[224]

Accordingly, the *Charanne* tribunal held that no breach of the FET standard by Spain had occurred due to the Phase I Modifications to Spain's Special Regime. As a matter of fact, the *Charanne* tribunal made clear that an assessment regarding the Phase II Modifications to Spain's Special Regime and the Phase III Modifications to Spain's Special Regime would need to be made by other tribunals, as these changes were not subject of the *Charanne* award pursuant to the choice of the Parties.[225] Indeed, the *Eiser* tribunal came to different conclusions as to the breach of FET with regard to the Phase III Modifications to Spain's Special Regime, as will be shown in the following.

### 2. Eiser

While *Charanne* concerned the Phase I Modifications to Spain's Special Regime, *Eiser* concerned essentially the Phase III Modifications to Spain's Special Regime.[226] The factual and legal situation presented to the *Eiser* tribunal was therefore fundamentally different from that addressed in *Charanne*. However, the crucial question in *Eiser* was, similarly to *Charanne*, to what extent treaty protections, and in particular, the obligation

223 *Charanne v. Spain* (Final Award) para 539.
224 *See Hobér* in *Scherer (ed.)*, Energy Arbitration 197.
225 *Charanne v. Spain* (Final Award) para 542.
226 *See* sec. 3.III. above.

to accord investors FET under the ECT, may be engaged and give rise to a right to compensation as a result of the exercise of a state's acknowledged right to regulate.[227]

Similarly to the findings of the *Charanne* tribunal as well as in line with views expressed by international tribunals,[228] the *Eiser* tribunal held that absent explicit undertakings directly extended to investors and guaranteeing that states will not change their laws or regulations, investment treaties do not eliminate a state's right to modify their regulatory regimes to meet evolving circumstances and public needs.[229] The FET standard does not give a right to regulatory stability *per se*.[230] The *Eiser* tribunal confirmed and as other tribunals have already observed that in order to adapt to changing economic, political and legal circumstances the state's regulatory powers still remain in place.[231] Accordingly, a state has a right to regulate, and investors must expect that the legislation will change, absent a stabilization clause or other specific assurance giving rise to a legitimate expectation of stability.[232]

However, while not requiring absolute stability in the sense of "*freezing*" the national RE-support regime, the *Eiser* tribunal highlighted with reference to existing ECT-jurisprudence that the stability of a legal and business framework is an essential element in the standard of what FET is.[233] Taking account of the context and of the ECT's object and purpose, the *Eiser* tribunal held that the obligation under Article 10(1) ECT to accord FET necessarily embraces an obligation to provide fundamental stability in the essential characteristics of the legal regime relied upon by investors in making long-term investments.[234] While regulatory regimes can evolve and legitimate expectations of any investor have to include the real possibility of reasonable changes and amendments in the legal framework, the Article 10(1) obligation means that regulatory regimes cannot be radically altered as applied to existing investments in ways that deprive investors who invested in reliance on those regimes of their investment's value.[235]

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227 *See Eiser v. Spain* (Award) para 362.

228 *See e.g. Parkerings-Compagniet v. Lithuania* (Award) para 332; *EDF v. Romania* (Award) paras 217-218.

229 *Eiser v. Spain* (Award) para 362.

230 *Id.* para 362.

231 *Id.* para 362, with reference to *BG Group v. Argentina* (Award) para 298.

232 *Id.* para 362, with reference to *Micula v. Romania* (Award) para 666.

233 *Id.* paras 386 et seq.

234 *Id.* para 382.

235 *Eiser v. Spain* (Award) para 382.

While the *Eiser* tribunal accepted that experienced investors must recognize that regulatory regimes for utilities are sometimes adjusted, but within foreseeable limits,[236] in the case at hand the Special Regime was replaced with an unprecedented and wholly different regulatory approach, based on wholly different premises.[237] It seems that one of the most relevant elements for the assessment of the *Eiser* tribunal of a potential breach of the standard of FET by Spain was, similarly to the views taken by the *Charanne* tribunal, the assessment of the proportionality of the measure.

Accordingly, the *Eiser* tribunal held that a host state's obligation under the ECT to afford investors FET does protect investors from a fundamental change to the regulatory regime in a manner that does not take account of the circumstances of existing investments made in reliance on the prior regime.[238] While the ECT did not bar Spain from making appropriate changes to the Special Regime, the ECT did protect investors against "*total and unreasonable changes*".[239] On such basis, the Eiser tribunal found that the Phase III Modifications to Spain's Special Regime were profoundly unfair and inequitable and that they stripped the claimants of "*virtually all of the value of their investment*".[240]

In particular, the *Eiser* tribunal had serious reservations about basing the new regulatory regime on the costs of a hypothetical "*efficient*" plant as a consequence of the Phase III Modifications to Spain's Special Regime.[241] Spain's decision to alter the target rate of return potentially available to existing investors touched upon the fairness and equity of the change to the new regime,[242] as Spain retroactively applied these "*one size fits all*" standards to existing facilities (like claimants'), that were previously designed, financed and constructed based on the very different regulatory regime of RD 661/2007.[243] No account had been taken of existing plants' specific financial and operating characteristics in establishing their remuneration.[244]

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236 *Id.* para 364.
237 *Id.* para 365.
238 *Id.* para 363.
239 *Id.* para 363.
240 *Id.* para 365.
241 *Id.* para 393.
242 *Id.* para 393.
243 *Id.* para 400.
244 *Id.* para 400.

The level of the FIT subsidy after the Phase III Modifications to Spain's Special Regime required to attain the prescribed return relied upon government officials' estimates of the capital and operating costs, per unit of generating capacity, of a hypothetical "*efficiently run standard installation*" of the type and age concerned – and not the actual costs and other characteristics of particular existing installations.[245] The new hypothetical "*standard plant*" utilized to determine the remuneration of claimants' existing plants did not take account of their actual characteristics, such as that the plants' historical capital costs were about 40% higher than the level deemed "*efficient*" under the new regime or that the PV-plant's O&M costs were from 13% to 18% higher than those of the hypothetical "*standard*" plant.[246] Notably, claimants' operating companies' financial reports for 2014 showed revenues under the new regime to be far below the level required to cover the plants' actual financing and operating costs, let alone to provide any return on or of investment.[247]

As explained by the *Eiser* tribunal, such abstract approach which did not consider the actual production capabilities of the PV plants in question, contradicted with positions of other international tribunals, most notably *AES v. Hungary*, in which the state developed a new regulatory approach for electrical generators that assessed the characteristics of individual plants, which was held not to be a breach of treaty.[248] Thus, the "*abstract*" not "*concrete*" calculation attributable to the Phase III Modifications to Spain's Special Regime was held unreasonable and breach of FET. The Phase III Modifications to Spain's Special Regime could be therefore regarded as "*disproportionate*" measure as per the reasoning of the *Charanne* tribunal. Notably, the *Charanne* and *Eiser* tribunals both concluded that that "*proportionality*" is one of the key elements of the FET standard, which particularly requires fair, equitable and reasonable adaptations to existing RE-support policies, not eliminating fundamental characteristics of an existing regulatory framework.

However, compared with the *Charanne* tribunal, which based its assessment predominantly on the rationale of the measure and its proportionality, the *Eiser* tribunal equally considered the detrimental effects on the state's measures on the investor's

245 *Id.* 403.
246 *Id.* para 413.
247 *Id.* para 416.
248 *Id.* para 401.

investment.[249] According to witness statements, the investment was valued at EUR 4 mn after the Phase III Modifications to Spain's Special Regime. Compared to the initial value of the plants of about 125 mn, this constituted a diminution of appx 97% of the initial investment value. Such diminution seems to have been another – if not the – key consideration for the *Eiser* tribunal to conclude that the standard of FET had been breached by Spain. Notably, the *Eiser* tribunal referred in various instances of its award to the fact that the FET deprived the claimants of "*substantially the total value of their investment*".[250]

While it seems that the *Eiser* tribunal, similarly to the *Charanne* tribunal, considered public policy considerations of the respondent state in question and even though the *Eiser* tribunal accepted that Spain faced a legitimate public policy problem with its tariff deficit, the tribunal stated with reference to *ADC v. Hungary* that in adopting the Phase III Modifications to Spain's Special Regime, Spain had an obligation to act in a way that respected the obligations it assumed under the ECT, including the obligation to accord FET to investors[251] – irrespective of any obligations under its nationals laws.[252] This reasoning seems to be in compliance with the generally accepted principle that a host state may take measures, adopt national legislation respectively irrespective of remedies under its national laws to the extent such adaptations are in compliance with the host states' obligations under public international law.[253]

### 3. Novoenergia II

The *Novoenergia II* tribunal had to assess the Phase I Modifications to Spain's Special Regime, the Phase II Modifications to Spain's Special Regime, and the Phase III Modifications to Spain's Special Regime, based on the investor's legitimate expectations of the Special Regime and the adaptations thereof by Spain.[254] The tribunal held that an investor's legitimate expectations are generally based on the host state's legal framework and on any (explicit or implicit[255]) representations or undertakings by the host state made

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249 *See Coop/Seif* in *Scherer (ed.)*, Energy Arbitration 237.

250 *See e.g. Eiser v. Spain* (Award) para 413.

251 *Id.* 371.

252 *Id.* para 373.

253 *See* sec. 4.II.A.3. above.

254 *See* sec. 3.III. above.

255 *Novenergia II v. Spain* (Final Award) para 650, with reference to *Total v. Argentina* (Decision on Liability) para 119-120; *Micula v. Romania* (Award) para 669.

at the time the investor makes the investment.[256] An expectation that the regulatory framework will be stable can arise from, or be strengthened by, state conduct or statements,[257] in particular if a state's assurances had been made to attract investors.[258] Intent is not needed, the relevant question is rather whether the statement or conduct objectively suffices to create legitimate expectations in the recipient.[259]

In determining whether claimants were legitimately entitled to rely on the stability of the Special Regime,[260] the *Novoenergia II* tribunal first held that Spain enacted the Special Regime with the objective of achieving its emissions and RE targets[261] and for such purpose created a very favourable investment climate for RE investors.[262] Further, in the tribunal's view, a number of relevant statements or assurances were made by Spain with respect to the Special Regime (*inter alia*, "*all the energy produced by them into the system" and would "obtain reasonable rates of return" as set by the government*" or "*providing those who have decided or will decide in the near future to opt for the special regime with a durable, objective, and transparent framework*"),[263] which aimed at incentivising companies to invest.

Notably, the *Novoenergia II* tribunal held – unlike the *Charanne* tribunal – that already based on objective assessment of the wording of the Special Regime, investors were entitled to have legitimate and reasonable expectations that the Special Regime would be stable and not subject to radical changes.[264] Most notably, the reasoning of the *Novoenergia II* tribunal seems to deviate from the view's expressed by the *Charanne* tribunal to the extent that the former held that general legislation can in fact provide grounds for creating reasonable expectations of an investor. Further, the *Novoenergia II* tribunal, in deviation from the *Charanne* tribunal's reasoning took the view that the assurances by law were supported through further statements and marketing materials (such as the prospectus "*The Sun Can Be All Yours*") aimed at incentivising companies

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256 *See Novenergia II v. Spain* (Final Award) para 662.

257 *Id.* para 651.

258 *See Novenergia II v. Spain* (Final Award) para 649, quoting *Micula v. Romania* (Award) para 667.

259 *Novenergia II v. Spain* (Final Award) para 652.

260 The relevant time for such assessment was the moment when the investment had been made, *i.e.* 13 September 2007, *see* sec. 2.IV.C.3. above.

261 *Novenergia II v. Spain* (Final Award) para 665.

262 *Id.* para 665.

263 *See Id.* para 666 for further examples.

264 *Id.* para 681.

to invest heavily in the Spanish electricity sector and formed part of the basis for the claimant's investment, upon which its reasonable expectations had been additionally based.[265]

By referring to *Electrabel S.A. v. Hungary*,[266] the *Novoenergia II* tribunal held that that the primary element for its assessment if a breach of FET had occurred on such basis are the legitimate and reasonable expectations of the claimant that the applicable legal framework remains stable.[267] The tribunal held with reference to *Micula v. Romania* that the FET treatment standard does not give a right to regulatory stability *per se*, rather, a state has a right to regulate and investors must expect that legislation may and will change.[268] However, the FET standard does, similarly to the view's expressed by the *Eiser* tribunal, protect investors from a "*radical or fundamental change*" to legislation or other relevant assurances by a state that do not adequately consider the interests of existing investments already made on the basis of such legislation.[269] While regulatory regimes may evolve, a state's measures cannot fall outside of the acceptable range of legislative and regulatory behaviour without breaching the FET standard.[270]

Based on the outcome that the Special Regime would be stable and not subject to radical changes, the *Novoenergia II* tribunal had to assess whether Spain's modifications to the Special Regime "*radically altered the essential characteristics of the legislation in a manner that violates the FET standard*".[271] The *Novoenergia II* tribunal held that a host state must in case of legislative changes ensure that the effects of the intended measure remain proportionate in regard to the affected rights and interests.[272] Thus, the *Novoenergia II* tribunal applied – similarly to the *Eiser* tribunal – predominantly a test of "*proportionality*", however, referring to an assessment of a "*balancing exercise*", where the interests of the investor and the host state had to be taken into consideration. Reference to such balancing of interests of the parties' involved in determining the

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265 *See Novenergia II v. Spain* (Final Award) para 668 et seq.

266 *Electrabel v. Hungary* (Award) para 7.75.

267 *Novenergia II v. Spain* (Final Award) para 648.

268 *See Micula v. Romania* (Award) para 666.

269 *Novenergia II v. Spain* (Final Award) para 654, with reference to *Eiser v. Spain* (Award) para 363.

270 *Novenergia II v. Spain* (Final Award) para 655, with reference to *AES v. Hungary* (Award) para 9.3.73.

271 *Novenergia II v. Spain* (Final Award) para 656.

272 *See* also sec. 4.II.A. above.

boundaries of FET was in fact in line with well-established ECT-jurisprudence, in particular *Saluka Investments BV (the Netherlands) v. the Czech Republic*, where it was held that "*the determination of a breach of the FET standard …requires a weighing of the Claimant's legitimate and reasonable expectations on the one hand and the Respondent's legitimate regulatory interests on the other.*"[273]

Regarding the Phase I Modifications to Spain's Special Regime, the tribunal did not consider the measures adopted to constitute a breach of the FET standard,[274] by arguing that the claimant could not have reasonably expected that there would be no changes at all to the regulatory regime that would lower the value of its investment and the changes to the Special Regime were motivated by Spain's need to address the so-called tariff deficit.[275] The tribunal did understand Spain's motivations in this respect and accepted that there was not only a need to address the tariff deficit, but also that Spain had a regulatory right to do so, albeit not an unfettered right.[276]

Thus, the Phase I Modifications to Spain's Special Regime did not, in the *Novoenergia II* tribunal's view, "*fall outside the acceptable range of legislative and regulatory behaviour*"[277] or could be considered as having "*entirely transformed and altered the legal and business environment under which the investment was decided and made*"[278].[279] Equally, such measures had only limited impact on the claimant.[280] The reasoning regarding FET with regard to the Phase I Modifications to Spain's Special Regime was also applied to the Phase II Modifications to Spain's Special Regime, *i.e.* they did not constitute a breach of the standard of FET either.[281]

However, regarding the Phase III Modifications to Spain's Special Regime, the tribunal came to a different conclusion. Taking into account Spain's statements and assurances prior to and in connection with the implementation of RD 661/2007, the legitimate expectations of the Claimant, and the changes introduced through RDL 9/2013, the

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273 *See Novenergia II v. Spain* (Final Award) para 658.
274 *Id.* para 688.
275 *Id.* para 688.
276 *Id.* para 688.
277 *See AES v. Hungary* (Award) para 9.3.73.
278 *See CMS v. Argentina* (Award) para 275.
279 *Novenergia II v. Spain* (Final Award) para 688.
280 *Id.* para 688.
281 *Id.* para 688.

Tribunal considers these challenged measures as "*radical and unexpected*".[282] The manner in which Spain adopted the measures including and subsequent to RDL 9/2013 fell "*outside the acceptable range of legislative and regulatory behaviour*" and "*entirely transformed and altered the legal and business environment under which the investment was decided and made*".[283]

The drastic and unexpected nature of the Phase III Modifications to Spain's Special Regime was supported by the significant damaging economic effect on the Claimant's investments, in particular evidenced by lower revenues on all of the PV Plants, the majority of which showed a decrease between 24 and 32% between 2013 and 2016.[284] Notably, a decrease in extreme amounts as in *Eiser*, where a diminution of the investment of appx 97% occurred, are required to find a breach of FET.[285] Consequently, the tribunal found that the Phase III Modifications to Spain's Special Regime which have effectively abolished the fixed long-term FIT and have done so retroactively, amounted to a breach by Spain of its obligation to accord to the investor FET as set out in Article 10(1) ECT. Notably, as the *Novoenergia II* tribunal has correctly pointed out – and has been mentioned in section 4.II.B.2. above – considerable destruction of the value of the investment is only one of several factors to consider when determining whether a state has breached Article 10(1) ECT, however, the actions of the host state need not have obliterated the investor's investment entirely to consider that a breach of the FET had occurred.[286]

In the tribunal's view, the assessment of whether the FET standard has been breached is a balancing exercise, where the state's regulatory interests are weighed against the investors' legitimate expectations and reliance.[287]It is not simply sufficient to look at the economic effect that the challenged measures have had.[288] Nevertheless, the economic effect on an investor's investment is an important factor in the balancing exercise pursuant to Article 10(1) ECT as well, as it can go towards showing a change in the essential characteristics of the legal regime relied upon by investors in making long-term

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282 *Novenergia II v. Spain* (Final Award) para 695.

283 *See Novenergia II v. Spain* (Final Award) para 695, with reference to *AES v. Hungary* (Award) para 9.3.73 and *CMS v. Argentina* (Award) para 275.

284 *Novenergia II v. Spain* (Final Award) para 695.

285 *See* sec. 4.II.B.2. above.

286 *Novenergia II v. Spain* (Final Award) para 694.

287 *Id.* para 694.

288 *Novenergia II v. Spain* (Final Award) para 694.

investments.[289] On this point, the views of the *Novoenergia II* tribunal seem to be largely in line with the views of the *Eiser* tribunal described above.

From the reasoning of the *Novoenergia II* tribunal it follows that the approaches of the *Charanne* and the *Eiser* tribunals in assessing whether a breach of FET occurred have been continued and developed: The first question to assess is the basis for legitimate expectations of an investor. In addition to a stabilization clause, such legitimate expectations can be generally based on general legislation as well as on other statement from or attributable to a host state, such as marketing materials and announcements to investors. While 100% stability can be only assumed in case of an explicit agreement between the host state and the investor, *e.g.* through entering a stabilization clause in an investment agreement, in the absence of such agreement, the host state may amend its national RE-support schemes within the boundaries of acceptable range of legislative and regulatory behaviour. This needs to be assessed based on a balancing test, taking in particular the proportionality, reasonableness as well as any diminution of the investment into consideration.

The *Novoenergia II* tribunal rejected Spain's allegations that the claimant should have considered warning signs that should have alerted the claimant to the fact that the Special Regime would not remain intact over the course of the lifetime of the PV Plants ("*foreseeability of legislative changes*").[290] This would have required warning sign that Spain was likely to implement "*radical and fundamental changes to legislation*" to the Special Regime.[291] Notably, this situation was different to the facts underlying *Isolux*, where the tribunal held that claimant made its Spanish PV-investment in October 2012, *i.e.* at a stage when it must have been clear to the investor that changes were being made to the Special Regime.[292] Even if such changes may not have reached the level of a breach of the FET standard, they certainly must have been an indication to the investor in *Isolux* that significant changes were being made to the Special Regime as set out in RD 661/2007.[293] This situation was different in *Novoenergia II*, where no indication as to

289 *Id.* para 694.

290 *See Id.* paras 671 et seq, in particular para 674 where the tribunal held that neither one of the documents could have given the Claimant the expectation that a "*reasonable rate of return*" would be limited to 7%, that stability and predictability could not be expected, or that the Special Regime could be abolished.

291 *Novenergia II v. Spain* (Final Award) para 677.

292 *Novenergia II v. Spain* (Final Award) para 686.

293 *Id.* para 686.

"*radical and fundamental changes to legislation*" at the time of the investment was found by the tribunal.

Further, the tribunal rejected Spain's argument that the claimant should have performed a proper legal DD on the Special Regime. The tribunal held that the claimant did carry out a reasonable analysis of the Spanish regulatory framework prior to its investment, also because RD 661/2007 was so adamantly clear that it's understanding by common readers did not require a particularly sophisticated analysis.[294] However, from this reasoning the conclusion can be drawn that the prudent investor is required to assess the applicable legislative framework of RE-support policies prior to actually making the investment in order to refute the argument of an host state that the investor should have known that the applicable legal regime could be subject to future changes or that such investor would have even foreseen future legislative changes. This is also in line with the reasoning of the tribunals in *Charanne* and *Eiser* explained above.

#### 4. Masdar Solar

The *Masdar Solar* tribunal had to assess whether the Phase II Modifications to Spain's Special Regime and the Phase III Modifications to Spain's Special Regime constituted a breach of Spain's FET obligations. With regard to the FET assessment, the tribunal held in compliance with the reasoning of *Charanne*, *Eiser*, and *Novoenergia II* in a concise manner that there is no doubt that the FET constitutes a standard the purpose of which is to ensure that an investor may be confident that the legal framework in which the investment has been made will not be subject to unreasonable or unjustified modification and that the legal framework will not be subject to modification in a manner contrary to specific commitments made to the investor.[295]

With reference to the question which kind of specific commitments can give rise to protected legitimate expectations, the *Masdar Solar* tribunal explained that there are two schools of thought on this question: the first school of thought considers that such commitments can result from general statements in general laws or regulations, the second school considers that any such commitments have to be specific.[296]

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294 *Id.* para 679.

295 *Masdar Solar v. Spain* (Award) para 484.

296 *Masdar Solar v. Spain* (Award) para 490.

Interestingly, if the general legislation is to be regarded as a source of an investor's legitimate expectations, the *Masdar Solar* tribunal held, in particular with reference to the case of *Mamidoil Jetoil Greek Petroleum Products Societe Anonyme S.A. v. Republic of Albania*,[297] that an investor must demonstrate that it has exercised appropriate due diligence and that it has familiarised itself with the existing laws.[298] The *Masdar Solar* tribunal held that the investor had undertaken substantial DD, *inter alia*, by consulting external experts having detailed knowledge of the regulatory framework, local banks and law firms issuing regulatory legal advice.[299] No concerns were aroused, much less any indication at the time when the claimant was making its investment that there was the slightest possibility that the Special Regime would be swept away by the Phase II Modifications to Spain's Special Regime and the Phase III Modifications to Spain's Special Regime, or that any reasonable investor might foresee that they might be.[300]

Further, on the basis of the DD exercised, the claimant believed that it had a legitimate expectation that the laws would not be modified, as they included stabilisation clauses, in particular in the general regulations, and in particular in Article 44(3) of RD 661/2007,[301] whose views the *Masdar Solar* tribunal followed. Further, the tribunal also held that Article 4 of RD 1614/2010 also included a "*stabilisation commitment*" in terms similar to those of Article 44(3) of RD 661/2007.[302] Based on the views of the first school, the *Masdar Solar* tribunal therefore held that the fact that RD 661/2007 as part of the Special Regime and other texts included a stabilisation clause was sufficient to exclude any modification of the law, so far as investors, which had made investments in reliance upon its terms, were concerned.[303]

The *Masdar Solar* tribunal moved on with the assessment based on the second school, which considers that a specific commitment giving rise to legitimate expectations cannot result from general regulations and that something more is needed.[304] It espoused the

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297 *See Mamidoil v. Albania* (Award) para 625.

298 *Masdar Solar v. Spain* (Award) para 494, with reference to *Electrabel*, where the investor's expectations were to be assessed considering the "*information that the investor knew and should reasonably have known at the time of the investment …*", see *Electrabel v. Hungary* (Award) para 7.78.

299 *Masdar Solar v. Spain* (Award) para 497.

300 *Id.* para 497.

301 *Id.* paras 499 et seq.

302 *Id.* para 502.

303 *Masdar Solar v. Spain* (Award) para 503.

304 *Id.* para 504.

principle that a stabilisation commitment made in a law is just as much subject to change as all the other dispositions of the law in question.[305] A limitation of the state's legislative power can only be derived from constitutional principles in the internal legal order and possibly rules of *jus cogens* in the international legal order.[306] In other words, for adherents of the second school of thought, stabilisation provisions offered in general legislation, or political announcements, like press releases and others, cannot create legitimate expectations.[307] The *Masdar Solar* explained that the majority of the *Charanne* tribunal did follow the second school and therefore concluded that neither the Special Regime nor general documents, press releases, presentations and reports distributed to potential investors (such as the prospectus "*The Sun Can Be All Yours*") could not create legitimate expectations.[308]

However, the *Masdar Solar* tribunal also held that be that as it may, and to whichever of the two schools of thought one might adhere, this tribunal did not need to be detained by the decision of the majority of the *Charanne* tribunal, in that it has to considered in this case not only the totality of the Spanish legislative regime applicable to CSP installations, but it must also take account of the existence of specific commitments, outside the general legislation or general documentation.[309] Accordingly, the *Masdar Solar* tribunal held that by granting to investors a "*unilateral offer from the State*", which an investor would be deemed to have accepted, once it had fulfilled the substantial condition of construction of the plant and the formal condition of registration within the prescribed "*window*".[310] It was exactly this registration process, which the *Charanne* tribunal had regarded as "*mere administrative requirement with no specific consequences*",[311] and to which the *Masdar Solar* tribunal attached legal consequences which were determining for holding that Spain did breach its FET obligations based on a "*specific commitment*" made vis-à-vis the claimants.

Accordingly, as has been determined by the *Masdar Solar* tribunal, in the process of registration the CSP installations at dispute, letters have been exchanges which referred

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305 *Masdar Solar v. Spain* (Award) para 504.
306 *Id.* para 504.
307 *Id.* para 507.
308 *Id.* paras 504 et seq, 507 et seq.
309 *Id.* paras 511 et seq.
310 *Id.* para 512.
311 *Charanne v. Spain* (Final Award) paras 509 – 510.

to the "*compensation conditions for the facility throughout its operating life*", from which the tribunal followed that each of the PV-plants qualified under the RD661/2007 economic regime for their "*operational lifetime.*"[312] Because of these specific commitments, and irrespective of whether the general provisions of RD661/2007 would be sufficient (as the first school of thought would contend was the case), the *Masdar Solar* tribunal concluded that, in any event, the claimant had legitimate expectations that the benefits granted by RD661/2007 would remain unaltered.[313] On such basis, the *Masdar Solar* tribunal concluded that the Phase II Modifications to Spain's Special Regime and the Phase III Modifications to Spain's Special Regime constituted a breach of Spain's FET obligations pursuant to Article 10(1) ECT.[314]

### 5. RREEF Infrastructure

The *RREEF* tribunal had to assess the Phase II Modifications to Spain's Special Regime and the Phase III Modifications to Spain's Special Regime based on the investor's legitimate expectations regarding the stability of the Special Regime and the legitimacy of the adaptations thereof performed by Spain.[315]

In consideration of preeminent ECT case-law, the *RREEF* tribunal first performed a theoretical assessment of legitimate expectations under der ECT: not all expectations of a foreign investor are "*legitimate*" and only "*legitimate expectations*" are protected under the FET principle.[316] Therefore, all the investors' expectations do not imply an immutability of the conditions of the investment.[317] Whilst an "*expectation*" is subjective, whether or not it is "*legitimate*" must be objectively assessed.[318] To evaluate a claim to a legitimate expectation, it is therefore necessary to assess: *first*, whether the host state's conduct and representations gave rise to expectations of an investor; *second*, whether the expectations are legitimate and reasonable;[319] *third*, the investor must show that it relied on the state's conduct or representations; and, *fourth*, that the investor's

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312 *Masdar Solar v. Spain* (Award) para 520.

313 *Id.* para 521.

314 *Id.* para 522.

315 *See* sec. 3.III. above.

316 *RREEF v. Spain (Award)* para 261.

317 *Id.* para 261.

318 *RREEF v. Spain (Award)* para 261.

319 Only the frustration of a legitimate expectation establishes a wrongful act by the state whereas in turn the frustration of a nonlegitimate expectation does not establish a wrongful act by the state, *see RREEF v. Spain (Award)* para 261.

expectations were frustrated by the measures (*i.e.* here: the Phase II Modifications to Spain's Special Regime and the Phase III Modifications to Spain's Special Regime).[320]

Regarding the firs point, similarly to the *Charanne* and the *Eiser* tribunals, also the *RREEF* tribunal assessed whether Spain had entered a stabilization clause, commitment respectively, with the investor. Stability is not an absolute concept and absent a clear stabilization clause, it does not equate with immutability.[321] Notably, and in contrast to the *Masdar Solar* tribunal, the *RREEF* tribunal held that the Special Regime (with reference to Article 44(3) of RD 661/2007 and Articles 4 and 5 of RD 1614/2010) as well as indications given in the name of Spain could not be regarded as assurance of stability, but that they indeed showed that adjustments to the Special Regime were envisaged.[322] The *RREEF* tribunal agreed thus with the majority of the *Charanne* tribunal that, "*in the absence of a specific commitment an investor cannot have the legitimate expectation that the regulation in place is going to remain unchanged*".[323]

However, while the Special Regime could not give, in the views of the *RREEF* tribunal, reasons to believe in absolute stabilization of Spain's RE-support policies, the obligation to create a stable environment certainly excluded any "*unpredictable radical transformation in the conditions of the investments*".[324] While such expectation did not include a guarantee to have the legal regime in place unchanged until the end of the operation of the plants, it did include the obligation to conduct any modifications reasonably and equitably.[325] Whether such a legitimate expectations were violated can only be assessed by way of a global view of the situation that resulted from the modifications introduced by the respondent state (here: Spain) after the date of the investment.[326]

Indeed, the main criterion the *RREEF* tribunal applied for the interpretation of the FET standard was, similarly to *Charanne*, reasonableness and proportionality.[327] Although intellectually different, both concepts would be closely linked, because the breach of one

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320 *See RREEF v. Spain (Award)* para 261 and 388.
321 *RREEF v. Spain (Award)* para 315.
322 *Id.* paras 319 et seq.
323 *Id.* para 321.
324 *Id.* para 315.
325 *Id.* para 399
326 *RREEF v. Spain (Award)* para 399.
327 *Id.* para 263.

of them normally entails the breach of the other one; it can even be admitted that proportionality is the main test for reasonableness.[328] In the views of the *RREEF* tribunal, reasonableness in the exercise of regulatory power included three elements:[329] *First, legitimacy of purpose*: inasmuch as it represents interests of the society as a whole and does not alter the substance of the rights affected by the regulation. *Second, necessity*: which implies the existence of a pressing social need, the threshold being more demanding than the one for "*useful*" or "*desirable*". *Third, suitability*: in that it must make it possible to achieve the legitimate objective pursued. Proportionality for its part is a weighing mechanism that seeks a fair balance between competing interests and/or principles affected by the regulation, considering all relevant circumstances. The regulation must be closely adjusted to the attainment of its legitimate objective, interfering as little as possible with the effective exercise of the affected rights.[330]

The *RREEF* tribunal made the following three complementary remarks regarding the reasonableness and proportionality of the challenged measures, which can generally, at least to a certain extent, be used in defence of the host state's position:[331] *First*, a state enjoys a margin of appreciation in conducting its economic policy. *Second*, a state's margin of appreciation cannot be unlimited, otherwise decisions would be unchallengeable; "*discretionary*" cannot be equated with "*arbitrary*". Margin of appreciation is different from unfettered discretion; the FET (and its components) constitute generally the clearest limits of the host state's discretion. *Third*, it cannot be sustained that the measures taken by a host state could only result in the maintenance of the initial situation of the investors; to support such an argument would amount to asserting the immutability of the conditions applying to the investors, which however is not a tenable position.[332]

Based on the submissions of the parties, the *RREEF* tribunal established that the only established legitimate expectation of the claimants was the "*guarantee of a reasonable return of their investments*".[333] On such basis, the tribunal assessed the reasonableness of the disputed measures, *i.e.* whether such an expectation has been frustrated in

328 *Id.* para 463.
329 *Id.* para 464.
330 *Id.* para 465.
331 *Id.* para 468.
332 *Id.* para 468.
333 *Id.* para 470.

violation of the FET standard and its components as detailed in Article 10(1) ECT.[334] As such assessment would touch clearly upon an unavoidable part of subjectivity in such an assessment (neither the word "*legitimacy*" nor the word "*reasonable*" would lend themselves to a purely objective assessment), in order to perform an assessment objectively, the *RREEF* tribunal considered various calculations, based on different methods, made by the experts selected by the parties, notably (i) valuation date, (ii) risk of unsustainability; (iii) rentability of the investment, (iv) predictable lifetime of the plants; and (v) cost of money on the capital market.[335]

Most notably, the *RREEF* tribunal came to a result which seems particularly "*investor-friendly*", by holding that the claimants, when they made their investments, had legitimate expectations to receive a "*reasonable return on their investments*". Based on the amount of losses the claimants actually incurred, the *RREEF* tribunal held that the reasonable return of the claimants "*must not be below 6.86% post-tax*".[336] As claimants' rate of return was below such findings and the actual return earned by the claimants for their CSP plants therefore did not fulfil their legitimate expectation in the circumstances of the case, the *RREEF* tribunal concluded that Spain did not comply with its FET obligations under Article 10(1) ECT.

Although the minimum return rate of 6.86% post-tax cannot be generally applied analogously to other cases, it gives investors a strong precedent to argue in RE-cases that they are entitled to a certain minimum return rate, and not only to damages under Article 10(1) ECT in case of a substantial diminution of the value of their investment (as has been held *e.g.* in *Charanne* and *Eiser*, and as explained above).

### 6. Antin

The *Antin* tribunal had to assess Phase III Modifications to Spain's Special Regime as most severe adaptations to Spain's RE-support policies granted by means of the Special Regime.[337]

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334 *Id.* para 470.

335 *Id.* para 471.

336 *RREEF v. Spain (Award)* para 589.

337 *See Antin v. Spain* (Final Award) para 558, referring to "*disputed measures in the present case include RDL 9/2013, Law 24/2013 and Ministerial Order IET/1045/2014*", *see* also sec. 3.III.C. above.

Similarly to the *Eiser* tribunal, the *Antin* tribunal initiated its assessment of FET with an interpretation of Article 10(1) ECT in accordance with Article 31 VCLT, in particular considering the ECT's purpose in providing a legal framework that promotes long-term cooperation in the energy field,[338] thereby suggesting that the ECT is conceived as enhancing the stability required for such cooperation.[339] Notably, the stability of the legal regime would be also reinforced through a literal interpretation of the first sentence of Article 10(1) ECT, providing that each Contracting Party "*shall, in accordance with the provisions of this Treaty, encourage and create stable, equitable, favourable and transparent conditions for Investors of other Contracting Parties to make Investments in its Area"*.[340]

As to the stability of the Special Regime, the *Antin* tribunal held, quoting *inter alia* the *Charanne* and *Eiser* tribunals, that considering the context, object and purpose of the ECT, the obligation under Article 10(1) ECT to provide FET in order to protected investments comprises an obligation to afford fundamental stability of the legal regime relied upon by the investors in making long-term investments.[341] Similarly to most of the cases outlined above, also the *Antin* tribunal held that this does not mean that the legal framework cannot evolve or that a state party to the ECT would be precluded from exercising its regulatory powers to adapt the regime to the changing circumstances in the public interest.[342] It rather means, as has been outlined in particular by the *RREEF* tribunal, that a regulatory regime specifically created to induce investments in the energy sector cannot be radically altered – *i.e.*, stripped of its key features – as applied to existing investments in ways that affect investors who invested in reliance on those regimes.[343] Based on such understanding, the *Antin* tribunal set out the following principles for its assessment:

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338 *See* also *Hobér* in *Scherer (ed.)*, Energy Arbitration 175 et seq.

339 *See Antin v. Spain* (Final Award) paras 519 et seq, with reference to *Eiser v. Spain* (Award) para 378.

340 *See Antin v. Spain* (Final Award) paras 524 et seq, notably the modal verb "*shall*" expresses an instruction, command or obligation and therefore, compliance with the ECT requires that each Contracting State shall not only encourage but also create stable, equitable, favorable and transparent conditions for Investors of other Contracting Parties to make Investments in its Area.

341 *Antin v. Spain* (Final Award) para 532.

342 *Id.* para 532.

343 *Antin v. Spain* (Final Award) para 532.

*First*, the expectations of the investor cannot be analysed in the abstract nor can they be based on the investor's subjective beliefs; on the contrary, the finding that there has been a violation of the investor's legitimate expectations must be based on an objective standard, which must be assessed on a case-by-case basis.[344] This is a principle which has been followed by all tribunals outlined above, beginning with *Charanne*.

*Second*, the investor's expectations must be assessed at the time of the investment's making, *i.e.* the time of the investment, the circumstances at that time and the information that the investor had or should reasonably have had, had it acted with the requisite degree of diligence (considering its expertise).[345] This principle has been already explained in detail in particular by the *Novoenergia II* tribunal.[346]

*Third*, the expectations of the investor need to originate from some affirmative action of the state, either in the form of specific commitments made by the host State to the investor – as several international investment tribunals have recognized – or in the form of representations made by the host State, for example, with respect to certain features of a regulation aimed at encouraging investments in a specific sector.[347] In other words, legitimate expectations cannot arise from subjective considerations of the investor absent an affirmative action of the state which, objectively determined, evidences that the state intended to describe a particular treatment or regime on which the investor could rely when making its investment.[348] Regarding this issue, it seems that the *Masdar Solar* provided the most concise explanations as to the two schools, providing explanations as to the basis of legitimate expectations of an investor.[349]

The *Antin* tribunal held that that at the time of the claimants' investment in the CSP plants at dispute, Spain (i) recognised that RE projects required high upfront capital investments; (ii) understood that to foster investments in that sector, in line with its policy goals, it needed to create more appropriate incentives; (iii) issued RD 661/2007 providing incentives to encourage investments in certain RE technologies, including CSP projects,

344 *Id.* para 536.
345 *Id.* para 537.
346 *See* sec. 2.IV.C.3. above.
347 *Antin v. Spain* (Final Award) para 538.
348 *Id.* para 538.
349 *See* sec. 4.II.B.4. above.

and (iv) represented, through its acts and regulations, that the economic regime applicable to RE projects would remain stable and predictable.[350]

In accordance with the findings of the *Charanne* or the *RREEF* tribunals, the *Antin* tribunal held that the requirement of stability under the ECT does generally not equate to the immutability of the legal framework, and that the state would be certainly entitled to exercise its sovereign power to amend its regulations in order to respond to changing circumstances in the public interest.[351] However, any such changes would need to be consistent with the assurances of stability regarding the regulatory framework provided by the state and required by the ECT; notably the *Antin* tribunal found that such expectations may be defeated if the host state eliminates the "*essential features of the regulatory framework relied upon by the investor in making a long-term investment*".[352]

Key issues with regard to the assessment of the legitimacy of expectations, means of amendment of Spain's RE-support policies respectively were, as already expressed by the *Eiser* tribunal, serious reservations about basing the new regulatory regime on the costs of a hypothetical "*efficient*" plant as a consequence of the Phase III Modifications to Spain's Special Regime.[353] Thus, the *Antin* tribunal closely scrutinized "*how*" under the Phase III Modifications to Spain's Special Regime "*reasonable return*" was determined. In light of the obligation to comply with the stability and predictability requirements under the ECT, the *Antin* tribunal took the view that the methodology for determining the payment due to CSP installations needed to be based on identifiable and transparent criteria.[354]

However, the *Antin* tribunal held that the methodology for determining the "*reasonable return*" did not comply with the requirements of the ECT and that it was not sufficiently

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350 *Antin v. Spain* (Final Award) para 552.

351 *Id.* para 555.

352 *Antin v. Spain* (Final Award) paras 555 et seq, quoting *Charanne v. Spain* (Final Award) para 517: "*The Arbitration Tribunal considers that the proportionality requirement is fulfilled as long as the modifications are not random or unnecessary, and that they do not suddenly and unexpectedly eliminate the essential features of the regulatory framework in place.*" [Emphasis added]

353 *Eiser v. Spain* (Award) para 393.

354 *See Antin v. Spain* (Final Award) para 561, also explaining that the issue was not whether the Phase III Modifications to Spain's Special Regime did provide a "*reasonable return*" (but how it was to be calculated). Notably, this approach seems to be different from the *RREEF* tribunal, where the latter tribunal made its assessment based on the result of the "reasonable return", not on the mode of calculation.

aligned to the representations previously made by Spain regarding the stability of the legal and economic regime applicable to RE projects in order to induce investments in the CSP sector.[355] This was mainly attributable to the fact that the "*applicable rate for reasonable return*" did not provide for an identifiable basis for determining its adjustment through the lifetime of the CSP plants, its calculation was based on a standard installation for which no concise parameters had been set, and that the new rate could in fact even apply to periods preceding its establishment.[356] The reasoning reminds of the views taken already by the *Eiser* tribunal.

Finally, the *Antin* tribunal held that the Phase III Modifications to Spain's Special Regime could not justify the changes made to the Special Regime, allegedly enacted by Spain due to public policy considerations to address the tariff deficit in Spain and preserve the sustainability of the electricity system.[357] Accordingly, the *Antin* tribunal found that Spain was in breach with its FET obligations under Article 10(1) ECT.

### III. Summary

A review of six recent arbitral awards rendered under the ECT, which arrived at different conclusion, reveals that general conclusions can be drawn regarding a host state's obligation to provide FET. International tribunals have been generally reluctant to attribute a 100% stabilization commitment of a host state based on general legislation or statements made to the public, even if such legislation or statements were made with the intent to attract foreign investments. Absent a stabilization clause or any other specific commitment of a host state not to amend its legislation, an investor will generally not enjoy regulatory stability *per se*. Arguably, a host state may perform changes to RE-support policies if their "*essential characteristics*" are preserved. Such changes must comply with the criteria of proportionality, reasonableness and equitableness and they must preserve reasonable value of an investments, reasonable returns thereof respectively. Accordingly, an investor may claim breach of FET in case of substantial diminution of value of the investment (*i.e.* at least 25 - 30% of the original investment value) or where a host state has infringed the investor's right to a reasonable return on the investment.

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355 *Antin v. Spain* (Final Award) para 563.

356 *Id.* paras 563 et seq.

357 *See Antin v. Spain* (Final Award) para 569 et seq.

# 5. PROTECTION AGAINST EXPROPRIATION

## I. Overview

The following chapter will deal with measures of direct expropriation (sec. 5.II.) and indirect expropriation (sec. 5.III.) in RE-projects. As will be shown, the issue of indirect expropriation is of primary importance, which will be analysed based on the general view under the ECT (sec. 5.III.A.) as well as on recent ECT-jurisprudence in the RE-sector (sec. 5.III.B.).

## I. Direct Expropriation

Direct expropriation refers to measures by a host state where legal title of an owner is directly affected.[358] As has been shown by leading scholars in the field of international investment law, direct expropriation has become rare as states are reluctant to jeopardize their investment climate by taking the drastic and conspicuous step of an open taking of foreign property.[359] As far as can be seen, no case of direct expropriation has occurred in the RE-sector in Europe so far.[360] However, what has been successfully argued by RE-investors in Europe in the past, were cases of indirect expropriation.

## II. Indirect Expropriation

It is generally accepted that certain types of measures affecting foreign property will be considered an expropriation, even though the owner retains the formal title.[361] What was and remains contentious is drawing the line between non-compensable regulatory and other governmental activity and measures amounting to indirect, compensable expropriation.[362] The issue is of equal importance to the host state, which may wish to broaden the range of non-compensable activities, and to the foreign investor, who will argue in favour of a broad understanding of the concept of "*indirect takings*".[363]

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358 *Dolzer/Schreuer*, Principles 101.
359 *Id.* 101.
360 *See e.g. Coop/Seif* in *Scherer (ed.)*, Energy Arbitration 224.
361 *Dolzer/Schreuer*, Principles 102.
362 *Id.* 102.
363 *Id.* 102.

### A. The General View under the ECT

Direct as well as indirect expropriation is addressed in Article 13(1) ECT: "*Investments of Investors of a Contracting Party in the Area of any other Contracting Party shall not be nationalised, expropriated or subjected to a measure or measures having effect equivalent to nationalisation or expropriation (hereinafter referred to as "Expropriation") except where such Expropriation is: (a) for a purpose which is in the public interest; (b) not discriminatory; (c) carried out under due process of law; and (d) accompanied by the payment of prompt, adequate and effective compensation.*" Measures amounting to an indirect, *de facto* or "*creeping*" expropriation trigger indemnification where the acts in question have the equivalent effect of a direct nationalization or expropriation.[364]

Notably, *Dolzer/Schreuer* have pointed out that formulae used under the ECT ("*measure or measures having effect equivalent to nationalisation or expropriation*") need to be elucidated and concretized based on, most importantly, (1) the effect and purpose of a measure, (2) consideration of legitimacy of the investor's expectations, and (3) the relevance of control and diminution of economic value of the investment, and (4) the duration of the measure.[365] In other words, remuneration will be justified in cases where the acts lead to a "*substantial, radical, severe, devastating or a fundamental deprivation of its rights in order to rise to the level of an expropriation*."[366]

#### 1. Effect and Purpose of Expropriation

The effect of the measure upon the economic benefit and value as well as upon the control over the investment is the key question when it comes to deciding whether an indirect expropriation has taken place.[367] While there seems to have been disagreement amongst tribunals whether the "*effects of a measure*" or the "*intention to expropriate*", *Dolzer/Schreuer* have suggested that a proper analysis of an expropriation claim must go beyond technical considerations of formalities and "*look at the real interests involved and the purpose and effect of the government measure.*"[368]

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364 *Vorburger/Petti* in *Arroyo (ed.)*, Arbitration in Switzerland 1310.

365 *See Dolzer/Schreuer*, Principles 111 et seq.

366 *Vorburger/Petti* in *Arroyo (ed.)*, Arbitration in Switzerland 1310, with further references to ECT case-law; *Sicard-Mirabal/Derains*, Investor-State Arbitration 116 et seq.

367 *Dolzer/Schreuer*, Principles 112.

368 *See Dolzer/Schreuer*, Principles 115.

### 2. Violation of Legitimacy of Expectations

Legitimacy of expectations, traditionally an element important for the assessment of a potential breach of the FET standard,[369] has also entered the law governing indirect expropriations,[370] be it through entering a contract, explicit or implicit assurances, or representations made by the state which the investor took into account in making the investment.[371] However, according to *Dolzer/Schreuer*, no violation of legitimate expectations will generally occur in case of regulatory changes which remain within the boundaries of normal adjustments customary in the host state and accepted in other states[372] as such changes are generally predictable for a prudent investor.[373]

### 3. Loss of Control and Diminution of Value

Occasionally tribunals have held that, even though a host state has breached the legitimacy of an investor's expectations, no expropriation had occurred because the investor continued to exercise control over the investment.[374] *Dolzer/Schreuer* have argued against an assessment based on the continued exercise of control exclusively, the unsuitability of such approach becoming particularly obvious in cases where a host state substantially deprives the investor of the value of the investment, leaving the investor with control of an entity that amounts to not much more than a shell of the former investment.[375]

The better approach seems therefore to be an assessment based on the diminution of value or the overall profitability of the investment. The measure for diminution of value for purposes of expropriation seems to be rather strict. Most notably, in *Tokio Tekelés v. Ukraine*, the tribunal held that a diminution of 5% of the investment's value will not be enough for a finding of expropriation, while a diminution of 95% would likely be

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369 *See* in particular sec. 4.II.A. and 4.II.B. above.

370 *Dolzer/Schreuer*, Principles 115 et seq.

371 *See e.g. Azurix v. Argentina* (Award) para 318.

372 *Dolzer/Schreuer*, Principles 115.

373 *Dolzer/Schreuer*, Principles 115, with reference to *Methanex v. United States* (Award) and *International Thunderbird Gaming Corporation v. United Mexican States* (Award).

374 *See e.g. Azurix v. Argentina* (Award) para 322 or *LG&E v. Argentina* (Decision on Liability) paras 188, 191 where the tribunal, although finding that other standards had been violated, denied the existence of an expropriation in view of the investor's continued control: "*Interference with the investment's ability to carry on its business is not satisfied where the investment continues to operate, even if its profits are diminished.*"

375 *Dolzer/Schreuer*, Principles 118.

sufficient.[376] However, as has been noted by *Dolzer/Schreuer*, an assessment based on control or diminution alone will not lead to a satisfactory result in all cases,[377] leading to the result that an assessment on one or both of said criteria on a case-by-case basis.

#### 4. Duration of a Measure

The duration of a governmental measure affecting the interests of foreign investor is important for the assessment of whether an expropriation has occurred.[378] Accordingly, the tribunal in *LG&E v Argentina* ruled that the duration of the measure had to be taken into account, holding that, as a rule, only an interference that is "*permanent*" will lead to an expropriation.[379]

### B. Recent ECT Jurisprudence in the RE-sector

#### 1. Charanne

The *Charanne* tribunal held that in order to affirm indirect expropriation, pursuant to Article 13(1) ECT, a "*substantial effect on the property rights of the investor*" (*e.g.* in the case of an effective deprivation of all or part of the assets constituting the investment, or a loss of value that could be equal by its magnitude to a deprivation of the investment) would need to be shown.[380] Further, the *Charanne* tribunal held that an indirect expropriation could arise both from loss of value of an investment and loss of control over it, however in order for a loss of value to be tantamount to expropriation, it has to be of such a magnitude as to amount to a deprivation of property.[381]

While it may seem from the reasoning of the *Charanne* tribunal that the test for indirect expropriation be a cumulative one, requiring loss of value of an investment and loss of control over it, the better view – also supported by recent views in literature and based on ECT jurisprudence – is that this test is an alternative one. Thus, in order for indirect expropriation to occur either (i) an investor must be deprived substantially of the control

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376 *See Tokio Tokelés* (Decision on Jurisdiction), para 120.

377 *Dolzer/Schreuer*, Principles 118.

378 *Id.* 124.

379 *See LG&E v. Argentina* (Decision on Liability) para 193; however, in *S D Meyers v Canada* (First Partial Award), the tribunal concluded that a measure of 18 months did not amount to expropriation.

380 *Charanne v. Spain* (Final Award) para 461.

381 *Id.* para 464.

over its investment or (ii) the investment must be deprived substantially of its value.[382]

In any case, the *Charanne* tribunal concluded in its reasoning that neither test was met. As the claimants remained holders of their shares in T-Solar, the company has not been deprived of all or part of its property or assets and continued operating and making profits,[383] the *Charanne* tribunal held that no indirect expropriation had occurred. Equally, "*a simple decrease in the value*" of the shares constituting the investment did not constitute a situation of such a significance that it could be considered that the investor has been deprived, in whole or in part, of its investment, property respectively.[384] Accordingly, the *Charanne* tribunal concluded that neither (i) an investor was deprived substantially of the control over its investment, nor that (ii) the investment was deprived substantially of its value of such a magnitude as to amount to a deprivation of property.

As in none of the RE-arbitrations under the ECT the sponsors have been deprived of their ownership in the project companies, indeed the relevant question is the decrease of the value of shares held directly or indirectly in the cash-flow generating project company (SPV). In fact, it is the indirect effect through the shareholding on the investor by negatively affecting the cash-flow into the project which is key for such assessment. Based on the submission of the claimant the disputed measures "*reduced the profitability of the plants under RD 1578 by 10% (from 9,41% to 8,48%) and plants under RD 661/2007 by 8,5% (from 7,36% to 6,72%) ...*",[385] such infringements were not regarded as having deprived the investment substantially or "*of such a magnitude as to amount to a deprivation of property.*"

Notably, considering the case of *Tokios Tokeles v Ukraine*,[386] a diminution of at least 90 - 95% seems to be required in order to conclude with high certainty under the available ECT-case law that sufficient diminution in value had occurred in order to conclude that

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382 *See Dolzer/Schreuer*, Principles 118 or more recently *Coop/Seif* in *Scherer (ed.)*, Energy Arbitration 225, with further references; *AES v. Hungary* (Award) para 14.3.1; an even stricter approach was taken in *Electrabel v. Hungary* (Decision on Jurisdiction, Applicable Law and Liability) para 6.62 ("*… substantial, radical, severe, devastating or fundamental deprivation of its rights or the virtual annihilation, effective neutralisation or factual destruction of its investment, its value or enjoyment*").

383 *Charanne v. Spain* (Final Award) para 462.

384 *Id.* para 465.

385 *See Charanne v. Spain* (Final Award) para 284.

386 *See Tokio Tokelés* (Decision on Jurisdiction), para 120.

the second part of above test has been met in order to amount to expropriation pursuant to Article 13(1) ECT.[387]

### 2. Eiser

In *Eiser*, the tribunal assessed the claimants' four distinct claims, *inter alia*, alleged breaches of FET under Article 10 ECT and indirect expropriation under Article 13(1) ECT. However, based on considerations of economy – both jurisprudential and financial – the *Eiser* tribunal concluded that the FET claim would fully resolve claimants' claim as "*most appropriate legal context for assessing the complex factual situation presented here*", thus not requiring the tribunal to deal thoroughly with claimants' expropriation claim.[388] The expropriation claim has not been assessed by the *Eiser* tribunal as it resolved the FET claim in the affirmative for the investors.

Interestingly, the *Eiser* tribunal did pay a large amount of attention, in considering whether the FET standard had been breached, to the fact that the measures "*deprived Claimant of substantially the total value of their investment*."[389] It has been correctly mentioned by *Coop/Seif* that if the *Eiser* tribunal had examined the claim for indirect expropriation on such basis, it might have found in favour of the claimants, given its findings in relation to the FET claim that the claimants had been deprived of "*virtually all of the value of their investment.*"[390] Unfortunately, the *Eiser* tribunal left however the issue open, even though it seems that, based on the test above, indirect expropriation in the sense of Article 13(1) ECT had in fact occurred in the *Eiser* case due to a diminution of appx 97% of the initial investment value.

### 3. Novoenergia II

For the *Novenergia II* tribunal, the elements of expropriatory effect ("*taking*") and intent of Spain's 2013 and 2014 regulatory acts were decisive for the assessment if indirect expropriation had occurred regarding the investment.[391] Claimant's assets, proprietary rights respectively that could be possibly expropriated were its industrial properties

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387 *See* also *Hobér* in *Scherer (ed.)*, Energy Arbitration 197.

388 *Eiser v. Spain* (Award) para 352 et seq, referring, inter alia, to *SGS v. Paraguay* (Award) para 161; *Micula v. Romania* (Award) para 874.

389 *See Eiser v. Spain* (Award) para 413; *Coop/Seif* in *Scherer (ed.)*, Energy Arbitration 229.

390 *Coop/Seif* in *Scherer (ed.)*, Energy Arbitration 232.

391 *Novenergia II v. Spain* (Final Award) para 761.

(plants and related facilities) and the shares of the companies involved in the investment that the claimant directly or indirectly owns and controls.[392]

While the value of these assets diminished as an effect of the state measures which proved to be incompatible with the FET obligation, the assets as such were neither expropriated, nor affected by measures having an effect equivalent to an expropriation.[393] As the claimant was still the "*untouched*" owner of its plants and the holder direct or indirect of the companies' shares and relevant capital,[394] the *Novenergia II* tribunal concluded that it did not see in the challenged measures any "*taking*" by Spain, even less an illicit taking, making claimants expropriation thereby fail.

It seems that the *Novenergia II* tribunal limited its assessment of a potential indirect expropriation to a potential loss of control of the claimant over its investment; however, not elaborating further on the second part of the test established by various ECT-tribunals and, as explained above, confirmed by the *Charanne* and *Eiser* tribunals, namely substantial deprivation of the value of the investment. However, and as has been shown above, the decrease in value of claimant's assets of around 24% and 32% between 2013 and 2016[395] would not meet the high threshold required for accepting indirect expropriation in the sense of Article 13(1) ECT.[396]

#### 4. Masdar Solar

In *Masdar Solar*, the claimant no longer maintained the claim for expropriation under Article 13 ECT, which had been initially part of claimant's request for arbitration.[397] The reasons for such withdrawal have not been disclosed in the award. However, it may be assumed that the ECT-jurisdiction available, most notably after rendering the awards referred to above in this section, led the claimant to conclude that such argument would, likely due to lack of substantial deprivation of the value of the investment of such a

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392 *Novenergia II v. Spain* (Final Award) para 762.

393 *Id.* para 762.

394 *Id.* para 762.

395 *Id.* para 695.

396 Generally, a loss of value as a result of adverse regulatory changes may amount to a breach of Article 13(1) and/or 10(1) ECT, *see Coop/Seif* in *Scherer (ed.)*, Energy Arbitration 232. Notably, the diminution determined by the *Novenergia II* was indeed sufficient enough in order to find a breach of Article 10(1) ECT.

397 *See Masdar Solar v. Spain* (Award) para 138.

magnitude as to amount to a deprivation of property, not be given.

#### 5. Antin

In *Antin*, no claim based on Article 13 ECT has been raised at all. The *Antin* award does not give any indication why the claimants have not raised a claim based on indirect expropriation. It can be only assumed that, similarly to *Masdar Solar*, no substantial deprivation of the value of the investment of such a magnitude as to amount to a deprivation of property had occurred. Instead, the claimants have extensively argued an alleged infringement of Article 10(1) ECT, as has been shown above.[398]

#### 6. RREEF Infrastructure

Equally in *RREEF Infrastructure*, no claim based on Article 13 ECT has been raised at all – presumably for same reasons as in the case of *Antin* outlined above.

### III. Summary

A review of six recent arbitral awards rendered under the ECT, which arrived at different conclusion, reveals that general conclusions can be drawn with regard to the host state's obligation to provide protection against indirect expropriation. While Article 13(1) ECT addresses direct as well as indirect expropriation, only the latter form of expropriation has been successfully pleaded by investors in RE-disputes under the ECT.

Indirect expropriation can take the form of loss of control over the investment and/or of substantial diminution of value of the investment, *e.g.* the value of the (indirect) shareholding in the project company (SPV) holding the assets of the RE-project. In order to successfully argue a claim based on indirect expropriation, generally a diminution in value of at least 90 - 95% of the initial investment value at the time of the investment has been required by international tribunals. In case indirect expropriation has been found by a tribunal under the ECT due to regulatory changes of a host state, chances are high that a breach of the obligation to grant FET equally occurred, as the threshold for a breach of FET under Article 10(1) ECT is substantially lower than for as indirect expropriation under Article 13(1) ECT.

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398 *See* sec. 4.II.B.4. above.

# 6. COMPATIBILITY OF THE ECT WITH EU LAW

## I. Overview

The following chapter will deal with the most important objection under EU law which has been raised by respondents in RE-arbitrations under the ECT, the alleged incompatibility of the dispute resolution mechanism of the ECT with EU Law.[399] After briefly describing the EC's role as *amicus curiae* in recent RE-arbitration under the ECT (sec. 6.II), selected ECT-jurisprudence will be analysed which had been rendered prior to the ECJ's ruling the prominent *Achmea* case (sec. 6.III). After a brief discussion of the *Achmea* judgment (sec. 6.IV), selected ECT-jurisprudence rendered after the *Achmea* judgment will be discussed. (sec. 6.V).

## II. The European Commission's Role as Amicus Curiae

Parties to the ECT are not only the EU Members States ("*MS*"), but also the EU itself. Thus, also the EU may be claimant and respondent to disputes under the ECT. Being party to the ECT enables the EU to take charge of defending EU law measures directly as a party to the proceedings. However, so far no cases have been reported publicly where the EU has been party to ECT-arbitrations itself.[400]

Rather, the EU has acted actively through the EC as *amicus curiae* in proceedings brought against MS.[401] As far as can be seen, the case of *Eastern Sugar B.V. v. The Czech Republic*[402] constituted the EU's first intervention where the EC submitted to the arbitral tribunal its concerns regarding compatibility of the applicable BIT with EU law. Since then, the EU joined challenges raised by respondent MS, *inter alia*, based on the argument that BITs, MITs respectively, would be unenforceable in case of Intra-EU

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399 Various other EU-related objections have been raised by Spain in connection with ECT-cases referring to changes of the Special Regime, *inter alia*, that a claimant from a MS could not be regarded as being from an "*Area*" of "*another Contracting Party*" for purposes of Article 26(1) ECT, since both the respective MS and Spain are Member States of the EU or that the ECT would contain a an "*implicit disconnection clause*", barring MS from applying the ECT *inter se*. For a concise summary of such arguments *see e.g. Novenergia II v. Spain* (Final Award) paras 449 et seq, where all such arguments have been dismissed.

400 With letter dated 12 April 2019, Nord Stream 2 AG put the EU on notice of a potential dispute under the ECT in relation to envisaged amendments of Directive 2009/73/EC; however, so far no initiation of formal proceedings has been reported, *see Dahlquist*, IAReporter 1 et seq.

401 *See Bermann* in *Scherer (ed.)*, Energy Arbitration 205.

402 *See Eastern Sugar v. The Czech Republic* (Partial Award).

Disputes,[403] in virtually every intra-EU investment arbitration where the EU has been allowed to do so.

As has been noted by *Gallagher*, it is difficult to determine what impact those submissions have on the awards issued in these cases.[404] However, even though the EU, represented by the EC, has strongly advocated more recently for incompatibility of the ECT with Intra-EU Disputes, as far as can be seen, none of the addressed tribunals have ruled in favour of the EC's standpoint.

## III. Pre-Achmea ECT Jurisprudence

### A. Charanne

*Spain* argued in *Charanne* that Article 344 TFEU does not allow MS to resolve disputes relating to EU law through international arbitration.[405] In order to decide upon such argument, the *Charanne* tribunal had to examine (i) whether Article 344 TFEU applied to an investor-state arbitration and if so, (ii) whether the dispute related to the interpretation or application of the European treaties within the meaning of Article 344, and (iii) whether there were any EU rule of public policy prohibiting the resolution of the underling dispute through arbitration.[406]

As to the first issue, the *Charanne* tribunal held that the scope of Article 344 TFEU does not prohibit MS to submit any dispute that could involve an interpretation of European treaties to a dispute settlement proceedings other than those provided by EU framework.[407] With reference to *Electrabel v. Hungary*, the tribunal correctly pointed out that the scope of Article 344 TFEU is exclusively limited to agreements of dispute resolution between MS in order to ensure harmonious application of EU law.[408] MS are respondents in many proceedings before national courts in which the interpretation or

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403 *See Bermann* in *Scherer (ed.)*, Energy Arbitration 206 (FN 15); *Fecak*, International Investment Agreements and EU Law 371 et seq.

404 *Gallagher* in *Scherer (ed.)*, Energy Arbitration 261.

405 Article 344 TFEU: "*Member States undertake not to submit a dispute concerning the interpretation or application of the Treaties to any method of settlement other than those provided for therein.*" See also *Bermann* in *Scherer (ed.)*, Energy Arbitration 208.

406 For interaction between EU law and the ECT *see e.g. Bonafe/Mete*, 9 JWELAB 174 et seq.

407 *Charanne v. Spain* (Final Award) para 444.

408 *Charanne v. Spain* (Final Award) para 444; see also *Bermann* in *Scherer (ed.)*, Energy Arbitration 208, citing *Eastern Sugar v. The Czech Republic* (Partial Award) para 146.

the application of the European treaties may come into play and a MS can equally agree to submit a dispute that may involve issues of EU law to an arbitration.[409] Further, the *Charanne* tribunal correctly referred to *Eco Swiss*, explaining that it is also universally accepted that an arbitral tribunal not only has the power, but also the duty to apply EU law under certain circumstances.[410]

As the *Charanne* tribunal concluded on the first issue at question hat that Article 344 TFEU did not apply to investor-state arbitration, it did not have to decide (and did not do so) upon the second issue.[411] With regard to the third issue, the *Charanne* tribunal held that Spain did not identify in its submissions any rule of European public order prohibiting the submission of a dispute between an investor and a MS to arbitration.[412] With regard to the then pending process of preliminary review of state aid, which has extended to the compensation regime under Spain's Special Regime, the *Charanne* tribunal held that such proceedings did not pose a bar *per se* to its jurisdiction. However, a potential breach of EU state aid rules would need to be considered by the tribunal when deciding on the merits and could indeed be considered by a state court if the validity of the resultant award should later be challenged.[413]

Accordingly, the *Charanne* tribunal did not find the ECT dispute resolution mechanism under Article 26(4) ECT being incompatible with EU law, including Art 344 TFEU.[414]

### B. RREEF Infrastructure

The main EU-related objection raised by Spain against the jurisdiction of the *RREEF* tribunal referred to the argument that due to supremacy of EU law over norms of international law,[415] the jurisdiction of the ECJ should prevail over the jurisdiction under the ECT. While the tribunal has accepted the supremacy of EU law in relation between MS, it pointed out that the tribunal's jurisdiction had been established based on the ECT,

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409 *Charanne v. Spain* (Final Award) para 443, with reference to Case C-126/97 *Eco Swiss* [1999] ECR I-3055; see also *Electrabel v. Hungary* (Decision on Jurisdiction, Applicable Law and Liability) para 4.158, where it was held that the EU signed the ECT, thus, accepting the possibility of arbitration between investors and MS under Article 26 ECT.

410 *Id*.

411 *Charanne v. Spain* (Final Award) para 447.

412 *Id.* para 448.

413 *Id.* para 449; see also *Ortolani*, 6 JIDS 118 et seq.

414 *Id.* para 444.

415 *See RREEF v. Spain* (Award) para 71 et seq.

which binds both MS as well as non-MS, and as for the latter, EU law is *res inter alios acta* and it cannot be upheld that, by ratifying the ECT, those non-MS have accepted the EU law as prevailing over the ECT.[416] Thus, the ECT has been regarded as the "*constitution*" of the *RREEF* tribunal.[417]

With reference to *Electrabel v. Hungary*, the *RREEF* tribunal held that if there must be a "*hierarchy*" between the norms to be applied, it must be determined from the perspective of public international law, not from the views of EU law.[418] Accordingly, the ECT would in principle prevail over any other norm.[419] Notably, this conclusion of the *RREEF* tribunal by means of an *orbiter dictum* seems to deviate from the conclusions rendered by the tribunal in *Electrabel v. Hungary*, holding that in case of inconsistency between the ECT and EU-law, the latter would prevail pursuant to Article 351 TFEU.[420]

Although the *RREEF* tribunal held that the ECT would in principle prevail over any other norm, the tribunal held that there would be in the case at hand no such conflict between the dispute resolution provisions of Article 26 ECT, Article 344 TFEU respectively. While Article 26 ECT is concerned with the "*settlement of Disputes between an Investor and a Contracting Party*", Article 344 TFEU would deal with the submission of disputes concerning the interpretation of the EU founding treaties.[421] Further, the *RREEF* tribunal referred to case-law of various international tribunals[422] as well as to the CJEU Opinion 1/09,[423] holding that other jurisdictional or arbitral bodies can and are called upon to interpret and apply EU law.[424]

Consequently, the *RREEF* tribunal rejected Spain's objection to its jurisdiction based on the intra-EU character of the dispute. Further, and while noting that the *RREEF* tribunal

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416 *RREEF v. Spain* (Award) para 72.

417 *Id.* para 74.

418 *Id.* para 75.

419 *Id.* para 75. With reference to the argument of Spain regarding the existence of an "*implicit disconnection clause*" in Article 26, such clause excluding Part 3 of the ECT for application among MS, the tribunal held that even assuming that there would be need for such clause based on the conclusion that an inconsistency between the ECT and EU law and absent any possibility to reconcile both rules through interpretation, the unqualified obligation in public international law of any arbitration tribunal constituted under the ECT would be to apply the ECT, *see RREEF v. Spain* (Award) para 87.

420 *See Electrabel v. Hungary* (Decision on Jurisdiction, Applicable Law and Liability) para 4.189.

421 *RREEF v. Spain* (Award) para 79.

422 *See RREEF v. Spain* (Award) para 80 (FN 75).

423 CJEU Opinion 1/09 [2011] para 63.

424 *RREEF v. Spain* (Award) para 80.

would in principle not be bound by previous awards or decisions rendered by other tribunals, the tribunal underlined that in all published or known investment treaty cases in which the "*intra-EU objection*" had been invoked by Spain, it failed.[425] Thus, the so rendered decision would squarely within the continuity of this consistent pattern of decision-making by international tribunals.[426]

### C. Eiser

The *Eiser* tribunal held, by citing the *Charanne* award, that its jurisdiction was derived from the express terms of the ECT, a binding treaty under international law and that it did not need to address the possible consequences that might arise in case of a conflict between its role under the ECT and the European legal order, because no such conflict had been shown to exist.[427] To the extent that provisions of European law may in some manner provide protections more favourable to investors or investments than those under the ECT, Article 16(2) would make clear that they did not detract from or supersede other ECT provisions, in particular the right to dispute settlement under ECT Part V.[428]

Further, the *Eiser* tribunal held that by its terms, Article 16 ECT would assure investors or their investments the greatest protection available under either the ECT or the other agreement.[429] Thus, an agreement covered by Article 16(2) ECT may improve upon particular protections available to investors or their investments, but it cannot lessen rights or protections under the ECT that are in other respects more favourable.[430] Accordingly, while not explicitly coming to such conclusion, it may be derived from the reasoning of the *Eiser* tribunal that primary EU law would not provide protection more favourable than under the terms of the ECT, which seems indeed plausible as the European Treaties do not provide for such explicit standards of protection as under the ECT, arguably with regard to expropriation or the guarantee of providing FET.

With reference to the argument of Spain based on Article 344 TFEU whereby questions relating to the internal electricity market should be refrained from submission to

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425 *RREEF v. Spain* (Award) para 89.

426 *Id.* para 89.

427 *Eiser v. Spain* (Award) para 199, with reference to *Charanne v. Spain* (Final Award) para 448.

428 *Eiser v. Spain* (Award) para 202.

429 *Id.* para 202.

430 *Id.* para 202.

arbitration, the *Eiser* tribunal held that the case did not involve any dispute between MS, or address the allocation of competence between the EU and its members.[431] The *Eiser* tribunal construed from the ordinary meaning of the relevant provisions of the ECT in accordance with the rules of the VCLT that it was clear and supported claimants' ability to assert their claims in arbitration under the ECT.[432]

Thus, the *Eiser* tribunal supported the earlier views of the *Charanne* tribunal, whereby Article 344 TFEU would not apply to the investor-state arbitration under the ECT at hand. Accordingly, by referring to the *Charanne* award, also the *Eiser* tribunal concluded that there would be no room for conflict between the ECT and the TFEU: "*There is no rule of EU law preventing EU Member States to submit to arbitration their disputes with investors of other Member States. Neither there is any rule of EU law preventing an arbitral tribunal from applying EU law to resolve such a dispute.*"[433]

### D. Novoenergia II

In *Novoenergia II*, Spain also objected to the jurisdiction of the tribunal, by arguing based on Articles 25 and 26(6) ECT that EU law (and not the ECT) should apply to the intra-EU relation at hand and that such EU law provisions prevail over and displace any other law, including international law provisions, *inter alia*, the ECT. [434] In other words, Spain argued that EU law should be given preference over any other law that regulates internal EU relations.[435]

The *Novoenergia II* tribunal held that its jurisdiction is based exclusively on the explicit terms of the ECT. As was evident to the *Novoenergia II* tribunal, it was neither constituted based on the European legal order, nor subject to any requirements of such legal order.[436] An assessment based on the ECT would in principle not require taking EU law into consideration, as such understanding would not be reflected by the ECT and was

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431 *Eiser v. Spain* (Award) para 204.

432 *Id.* para 207.

433 *Id.* para 204, with reference to *Charanne v. Spain* (Final Award) para 438.

434 Spain argued that the dispute affected EU-law since, *inter alia*, since the tribunal had been requested to rule upon state aid to RE in Spain, something that has the effect of distorting the competition in the common electricity market, *see Novenergia II v. Spain* (Final Award) para 457.

435 *See Novenergia II v. Spain* (Final Award) paras 456 et seq.

436 *Id.* para 461.

not intended to be included by the drafters of the ECT.[437] The *Novoenergia II* tribunal noted that none of the claims were submitted with reference to EU law and that regarding an alleged clash between the two legal regimes of the ECT and EU law, in fact no such incompatibility between the ECT and EU law would exist – views which have been earlier especially by the *Eiser* tribunal.

The *Novoenergia II* tribunal held with reference to the *Charanne* award, that "*this case does not entail any assessment with regards to the validity of community acts or decisions adopted by European Union organs. Additionally, it does not concern in any way allegations by the European Union that EU law has been violated, nor claims against such organization. In this arbitration there is not an argument according to which the content of the disputed provisions … is contrary to EU law.*"[438] Accordingly, the *Novoenergia II* tribunal held that as its jurisdiction was exclusively derived from the ECT and that no conflict between EU law and the ECT has proven to exist, the question determining the hierarchy between the ECT and EU law became redundant.[439]

The *Novoenergia II* tribunal finally noted that ECT tribunals in other previous similar cases against Spain, namely *Charanne*, *Isolux*, *RREEF*, and *Eiser*, all followed the same approach and dismissed the jurisdictional objection of Spain on the same above grounds.[440] The *Novoenergia II* tribunal found no reason to depart from such a stable case law in resolving the present dispute, which involves similar, if not identical, legal issues. Consequently, also the *Novoenergia II* tribunal dismissed the "*intra-EU objection*" raised by Spain.

## IV. The Achmea Decision

The *Achmea Decision*[441] resulted from the BGH's request to the CJEU for preliminary ruling on certain questions on the compatibility with EU law of an arbitration clause contained in the 1991 Netherlands-Slovakia BIT ("*Netherlands-Slovakia BIT*"). The request had been made in the course of setting-aside proceedings initiated by Slovakia against an arbitral award rendered under the Netherlands-Slovakia BIT, where an *ad-*

437 *Novenergia II v. Spain* (Final Award) paras 459 et seq.
438 *Id.* para 462.
439 *Id.* para 463.
440 *Id.* para 464.
441 *See* Case C-284/16 *Achmea* [2018] ECLI:EU:C:2018:158.

*hoc* arbitral tribunal constituted under the UNCITRAL Rules and seated in Frankfurt found that Slovakia had violated the Netherlands-Slovakia BIT, ordering it to pay approximately EUR 22.1 million of damages to the Dutch insurance company Achmea B.V. (formerly known as Eureko B.V.).

Slovakia challenged the arbitral award on jurisdiction, arguing that the arbitral tribunal lacked jurisdiction to hear the claims, because the arbitration clause embedded in Article 8 of the Netherlands-Slovakia BIT was incompatible with EU law, more specifically Articles 18, 267 and 344 TFEU[442] and the principle of autonomy.[443] In this much-anticipated judgment, the Grand Chamber of the CJEU ruled that the arbitration clause contained in the Netherlands-Slovakia BIT had an adverse effect on the autonomy of EU law, therefore being incompatible with EU law.[444] Notably, the CJEU thereby rejected the arbitration-friendly Opinion of AG Wathelet, in which it was, *inter alia*, held that intra-EU BITs would be compatible with EU law, in particular Articles 267 and 344 TFEU.[445]

Essentially, the CJEU reminded of the primacy of the European Treaties over the laws of the MS and that arbitral tribunals may be called on to interpret or apply EU law, *inter alia*, provisions concerning freedom of establishment and free movement of capital. Based on the understanding that an arbitral tribunal is not a court or tribunal of a MS, and therefore not entitled to make a reference to the CJEU for a preliminary ruling, the CJEU held that an arbitral award is not subject to review by a court of a MS, thereby ensuring compatibility with EU law. Consequently, the CJEU concluded that the arbitration clause contained in the Netherlands-Slovakia BIT was incompatible with certain key principles of EU law, in particular Article 344 TFEU, and that it has an adverse effect on the autonomy of EU law. The *Achmea* Decision, which ultimately requires the MS to terminate all existing intra-EU BITs by mutual consent, was certainly a political judgment and must be read from the perspective of EU law, not public international law.

The key question, which seemed unanswered in the *Achmea* Decision, was whether the conclusions of the CJEU equally applied to the ECT (which is an agreement concluded by the EU itself as a party, with all of its MS and with a number of non-MS), or more

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442 *See Fouchard/Marc*, Kluwer Arbitration Blog 1 et seq; *Arp*, 112(3) ASIL 466 et seq.

443 *See Arp*, 112(3) ASIL 466 et seq.

444 For a summary of the CJEU's arguments see *Fouchard/Marc*, Kluwer Arbitration Blog 1 et seq; *Arp*, 112(3) ASIL 466 et seq.

445 *See* Opinion of AG Wathelet in *Achmea* 1 et seq.

broadly, to MITs in general applying (also) to the internal market of the EU.[446] The reactions of two tribunals which have rendered their decisions after the *Achmea* Decision shall be analysed in the following section.

## V. Post-Achmea ECT Jurisprudence

### A. Masdar Solar

At first the *Masdar Solar* tribunal dealt with the parties' submissions regarding the "*Primacy of EU Law*" objection, which had been made prior to the rendering of the *Achmea* Decision. The tribunal held, with reference to *Electrabel*, *Charanne* and, *Isolux*, that EU law is not incompatible with the provision for investor-state arbitration contained in Part V of the ECT, including international arbitration under the ICSID Convention.[447] The *Masdar Solar* tribunal held that two legal orders can be applied together as regards the parties' arbitration agreement and the arbitration at issue, because only the ECT dealt with investor-state arbitration; and nothing in EU law can be interpreted as precluding investor-state arbitration under the ECT and the ICSID Convention.[448]

After issuance of the *Achmea* Decision, the *Masdar Solar* tribunal invited the parties to submit their observations to the judgment, which were also considered in the final award. Spain maintained that the *Achmea* Decision confirmed its intra-EU objection, in particular that the tribunal should interpret the ECT in line with EU law and, thus, must reach the conclusion that an EU investor is not entitled to bring an investment arbitration proceeding against an MS.[449] Most notably, Spain argued that the *Achmea* Decision refers generally to "*international agreements*" (and not to bilateral investment treaties) and that it applied not only to international agreements concluded between two MS, but also to international agreements concluded by MS.[450] Thus, Spain alleged that the *Achmea* Decision should not only apply to intra-EU BITs only, but also to Intra-EU Disputes under MITs.

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446 *See also Vattenfall AB and others v. Federal Republic of Germany* (Decision on the Achmea Issue) para 43 et seq.

447 *Masdar Solar v. Spain* (Award) para 340.

448 *Id.* para 340.

449 *See Masdar Solar v. Spain* (Award) paras 674 et seq.

450 *Id.* para 675 (emphasis added).

In its relatively brief and concise reasoning, the *Masdar Solar* tribunal concluded that the *Achmea* Decision had no bearing upon the present case: the *Achmea* Decision is of limited application, applying to the Netherlands-Slovakia BIT. The *Masdar Solar* tribunal held that the *Achmea* Decision did not take into consideration, and thus it cannot be applied to, MITs, such as the ECT, to which the EU itself is a party.[451] Notably, the *Masdar Solar* tribunal referred to the Opinion of AG Wathelet in *Achmea*,[452] stating that this had been the "*the first opportunity for the CJEU to express its views on the thorny question of the compatibility of BITs concluded between member States and in particular of the investor- State dispute settlement ('ISDS') mechanisms established by those BITs.*"[453] For the *Masdar Solar* tribunal it was therefore clear that the *Achmea* Decision pertained exclusively to BITs concluded between MS as the wording of question no° 1 referred by the BGH to the CJEU would likewise confirm: "*Does Article 344 TFEU preclude the application of a provision in a bilateral investment protection agreement between Member States of the European Union (a so called intra-EU BIT) ….*"[454]

Notably, the *Masdar Solar* tribunal also quoted to the following statement from AG Wathelet: "*That multilateral treaty on investment in the field of energy the ECT operates even between Member States, since it was concluded not as an agreement between the Union and its Member States, of the one part, and third countries, of the other part, but as an ordinary multilateral treaty in which all the Contracting Parties participate on an equal footing. In that sense, the material provisions for the protection of investments provided for in that Treaty and the ISDS mechanism also operate between Member States. I note that if no EU institution and no Member State sought an opinion from the Court on the compatibility of that treaty with the EU and FEU Treaties, that is because none of them had the slightest suspicion that it might be incompatible.*"[455]

Had the CJEU seen it necessary to address the distinction drawn by the AG between the ISDS provisions of the ECT and the investment protection mechanisms to be found in BITs made between MS within the ambit of its ruling, it had, in the views of the *Masdar*

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451 *Masdar Solar v. Spain* (Award) para 679.

452 *Id.* para 680, with reference to Opinion of AG Wathelet in *Achmea*.

453 *Masdar Solar v. Spain* (Award) para 680, with reference to Opinion of AG Wathelet in *Achmea* para 2.

454 *Masdar Solar v. Spain* (Award) para 680, with reference to Case C-284/16 *Achmea* [2018] ECLI:EU:C:2018:158 para 23 (emphasis added).

455 *Masdar Solar v. Spain* (Award) para 680, with reference to Opinion of AG Wathelet in *Achmea* para 43.

*Solar* tribunal, the opportunity to do so.[456] In fact, the tribunal noted that the CJEU did not address this part of the AG's Opinion, much less departed from, or rejected it.[457] In the views of the *Masdar Solar* tribunal, the *Achmea* Decision was simply silent on the subject of the ECT. The tribunal adopted the AG's reasoning on this matter, relying in particular upon the observation in the final sentence cited above from AG Wathelet's Opinion.[458]

Accordingly, the *Masdar Solar* tribunal concluded that the *Achmea* Decision had no bearing upon its determination of the matters in issue in this arbitration and it denied Spain's objection. As opposed to the *Achmea* Decision, the *Masdar Solar* tribunal interpreted the questions on the compatibility of the ECT arguably from the perspective of public international law and not, as did the CJEU, from an EU law perspective. Further, the *Masdar Solar* tribunal argued obviously in favour of the arbitration-friendly views expressed in the Opinion of AG Wathelet. Notably, the correlation between the ECT and EU law remains not entirely, as they ultimately refer to different perceptions taken from the view of EU or public international law respectively.

It remains to be seen how and to what extent these views will be reconciled in the future. However, for investors this conflicting situation poses imminent treats to investments within the ambit of the ECT, as respondent MS may oppose the enforcement of awards rendered by ECT-tribunals on intra-EU investment, alleging violation of EU law by relying on the *Achmea* Decision. Absent clarifying case-law rendered by the CJEU, it seems that this risk can currently be only mitigated through structuring investments under the EC from outside of the EU, most notably from Switzerland or the (post-Brexit) United Kingdom.

### B. Antin

The *Antin* tribunal denied Spain's request (under ICSID Arbitration Rule 38(2)) that the proceeding be reopened to submit the *Achmea* Decision as well as the EC's decision of 10 November 2017 regarding the Spanish State Aid Framework for Renewable Sources.[459] While the *Antin* tribunal, unlike the *Masdar Solar* tribunal, did not deal with

456 *Masdar Solar v. Spain* (Award) para 682.
457 *Id.* para 682.
458 *Id.* para 682.
459 *See Antin v. Spain* (Final Award) paras 56 et seq.

the consequences of the *Achmea* Decision on its jurisdiction in the final award, it came, as tribunals before it, to the conclusion that it had jurisdiction "*ratione personae*" and that, in particular, Art 344 TFEU did not oppose such jurisdiction.

The *Antin* tribunal has largely supported views which have been taken earlier by the tribunals in *Charanne*, *Isolux* and *Eiser*. In the views of the *Antin* tribunal, the jurisdiction of an arbitral tribunal constituted under the ECT would be derived from the express terms of a treaty – the ECT – that would be binding under international law on the state parties thereof, such as the MS, as well as on the EU itself.[460] Notably, nothing in the text, context, purpose and object of the ECT would suggest that the inclusion of the reference to "*rules and principles of international law*" in Article 26(6) ECT would be intended to mean that the treaties creating the EEC and the EU and allocating competences among EU institutions and their MS, the EU's internal legislation, as subsequently interpreted by the CJEU, could be interpreted in a manner such that a development in the EU's *acquis* could be employed to undermine the prior consents to submit to arbitration under the ECT given by each of the MS and the EU itself.[461]

Accordingly, also the *Antin* tribunal did not find the ECT dispute resolution mechanism under Article 26(4) ECT being incompatible with EU law, especially Art 344 TFEU.

### VI. Summary

The EU has actively engaged in various recent ECT-arbitrations as *amicus curiae* advocating for the incompatibility of the ECT with EU law in case of Intra-EU Disputes. As far as can be seen, until now no single international tribunal has followed such views. With the landmark *Achmea* Decision, the CJEU held that intra-EU BITs violate EU law. Following the *Achmea* Decision, the EU as well as various respondent host states which have been engaged in RE-arbitrations under the ECT have relied on the *Achmea* Decision in support of their argument of an alleged incompatibility of the ECT with EU law. So far, no clarifying views have been expressed by the ECJ regarding the compatibility of the ECT with EU law. It can be therefore assumed that investors will continue facing obstacles in arbitrating Intra-EU Disputes under the ECT as well as when enforcing Intra-EU Disputes under the ECT within the area of the EU.

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460 *Antin v. Spain* (Final Award) para 224.

461 *Id.* para 224.

## 7. RECOMMENDATIONS TO INVESTORS

An analysis of six recent arbitral awards (*Charanne*, *Eiser*, *Novoenergia II*, *Masdar Solar*, *Antin*, and *RREEF Infrastructure*) which arrived at different results regarding claims of investors resulting from changes to RE-support schemes in Spain, reveals that general conclusions with regard to standards of protection to investors under the ETC against adversary changes to RE- support policies can indeed be drawn.

Following the above, specific recommendations to investors are made for the structuring of a RE-investment in order to ensure that the investor benefits from the standards of protection the Energy Charter Treaty (*ECT*) as multilateral investment treaty for the protection of energy projects offers against adversary change to RE-support policies:

1. The first step in effective RE-investment structuring under the ECT is to make sure that the investor will be regarded as "*investor*" for purposes of the ECT. In a typical PF structure, the project company (SPV) will not be regarded as „*investor*" for purposes of the ECT if it is organized under the laws of the host state, therefore does not meeting the required element of "*foreignness*" under the ECT. In order to benefit from protection under the ECT, the investor must be national of a Contracting State to the ECT and the investment must be made in another Contacting State. Typically the first HoldCo in the project company (SPV), the shareholder of such HoldCo or any other entity above such HoldCo will be regarded as "*investor*" under the ECT, as long as such entity is organized pursuant to the laws of another Contracting Party and the RE-investment is made in the Area of a Contracting Party to the ECT.

2. If the RE-investment is made through a typical (PE) fund structure, also a "*mere*" holding company may qualify as investor pursuant to the ECT, even if such company has little or no activity apart from owning or controlling directly or indirectly assets (*i.e.* the shares in the project company (SPV)). Equally, it is generally not required that the investor is the beneficial owner of monies which have been invested into or used for the financing of the RE-project, *i.e.* a GP may be accepted as claimant under the ECT, even though the monies for the project have been provided by the LP and such LP (as well as *e.g.* the fund manager) are not acting as claimant(s) in the dispute with the Contracting Party to the ECT in which the investment has been made by the investor.

3. The EU has been actively arguing for the incompatibility of the dispute resolution mechanism under the ECT with EU law. Following the *Achmea* Decision, which held that Bilateral Investment Treaties (BITs) entered between EU Member States are invalid due to violations of EU law, investors acting as claimants in RE-disputes under the ECT have been facing fierce objections by respondent EU Member States, relying on the *Achmea* Decision and alleging that disputes under the ECT between an investor from the EU and a Member State of the EU (*Intra-EU Disputes*) would equally violate EU law. Although international tribunals have rejected to accept such views, various respondent Member States of the EU have also relied on the *Achmea* Decision at the enforcement stage, declining to comply with awards where claimants have successfully pursued their claims before ECT-international tribunals with regard to Intra-EU Disputes. Under these circumstances, the most viable mitigant against jurisdictional objections (*ratione personae*) as well as reluctance of enforcement in the respective EU Member State seems to be that investments which may result in Intra-EU Disputes should be structured in such way that the investor is organized (*i.e.* seated) outside of the EU, *e.g.* in Switzerland or in the (post-Brexit) U.K.

4. International tribunals have repeatedly relied on the formal requirement of "*incorporation*" for the assessment of the nationality ("*foreignness*") of an investor established in the form of a company, without looking at the nationality of the shareholder behind such entity. Several respondent host states have tried to argue that tribunals should look at the shareholder behind the corporate entity ("*piercing the corporate veil*") in their assessment of "*foreignness*" (as one pre-condition for "*investor*" identity and standing under the ECT). In order to pre-empt such argument, substantial business activities should be conducted in the state of incorporation of the investor. This could be especially important in case an investor is seated in Switzerland or in the (post-Brexit) U.K for purposes of protection against alleged violations of EU law (*see* Point 3 above). Further, such substantial business activities would pre-empt that a host state relies on the "*denial of benefits*" provision enshrined in Article 17(1) ECT. However, reliance on such provision would typically require giving notice prior or at the time of the establishment of the investment, absent such *ex ante* notice the investor would be further protected.

5. While the ECT contains a broad definition of "*investment*", tribunals have repeatedly held with regard to structuring of RE-investments in the form of non-

recourse PF-structures that the investment for purposes of the ECT constitutes the right to the (direct and indirect) shareholding in the project company (SPV). When claiming damages in arbitration under the ECT as a result of adversary changes to RE-support policies, investors should therefore focus on the diminution of the value of the shares in the project company (SPV), and not on the diminution of the assets, which are held by the SPV as legal entity separate from the investor. Depending on the amount of diminution of the share value in the project company (SPV), investors may allege (indirect) expropriation of their investment and/or a breach of the host state's obligation to provide FET in protection of the RE-investment.

6. A successful claim of an investor based on (indirect) expropriation pursuant to Article 13(1) ECT will require showing that (i) an investor was deprived substantially of the control over its investment (*i.e.* the shares in the project company (SPV)) or that (ii) the investment has been deprived substantially of its value. As long as the investor (directly or indirectly) continues to hold shares in the project company (SPV) after the regulator changes to RE-support policies performed by the host state, the first argument will generally fail. Investors should then generally argue for substantial deprivation of the value of shares held (directly or indirectly) in the cash-flow generating project company (SPV). However, the threshold for such deprivation is very high and requires a diminution of at least 90 - 95% of the value of the investor's (direct or indirect) shareholding in the project company (SPV) in order to successfully plead (indirect) expropriation.

7. A successful claim of an investor based on a breach of the host states obligation to provide FET pursuant to Article 10(1) ECT as well as under private law will be most successful if an investor has entered a stabilization clause with the host state. Such clause should oblige the host state either not to amend its RE-support schemes at all or at least to exempt the investor's RE-investment through its lifetime from the scope of application of any regulatory or legislative changes performed by the host state which could detrimentally affect the cash-flows resulting from the RE-investment. Investors are therefore advised to enter such stabilization clause by means of *e.g.* an investment agreement with the host state, which may be enforced under private and/or private international law (*e.g.* under the ETC). However, as opposed to enforcing stabilization clause before international tribunals, an enforcement exclusively under private law bears the

risk of facing sovereign immunity objections from the host state, uncooperative acts of the courts of the host state, as well as enforcement risk within the territory of the host state.

8. Where an investor is not in a position to enter a stabilization clause (*e.g.* by means of an investment agreement) with the host state, the investor should obtain any other binding and specific commitment from the host state not to amend RE-support policies from which the RE-investment benefits for the lifetime of the RE-project. Investors should note that reliance on commitments of a host state expressed by means of general legislation or any other statements made to the public will be generally not accepted by international tribunals where such commitments have been formulated rather vaguely or expressed as being subject to future amendments by the legislator. Absent a specific commitment of a host state expressed vis-à-vis an investor that the host state's legislation will not be amended, an investor will generally not benefit form a guarantee of regulatory stability *per se*.

9. In case the investor has not entered a stabilization clause with the host state or has not obtained any other binding commitment form the host state not amend RE-support policies from which the RE-investment benefits, an investor may rely on the host state's general obligation to provide FET pursuant to Article 10(1) ECT vis-à-vis the investor. As the prevailing position of international tribunals seems to be that a host state must preserve (at least) the "*essential characteristics*" of RE-support regimes, an investor would need to show, *inter alia*, that changes to RE-support policies have breached the principles of proportionality, reasonableness and equitableness. An argument that changes to RE-support policies have not complied with the criteria of proportionality, reasonableness and equitableness, may be especially successful where a host state has amended legislation which applies to a broad range of investments, without taking objectively specific financial and operating characteristics of the respective RE-investment(s) into consideration or where criteria for amendment of RE-support policies have not been applied in a transparent manner.

10. A breach of the host state's obligation to provide FET pursuant to Article 10(1) ECT vis-à-vis the investor generally requires certain diminution of the investment (*i.e.* the value of the shares in the project company (SPV)) and can be generally effectively argued in case of substantial diminution of the value of the investment. Based on the standard to provide FET, a diminution of at least 25 - 30% of the

original investment value should be generally shown by the investor acting as claimant. The argument based on a breach of the FET standard pursuant to Article 10(1) ECT can be made cumulatively with the argument based on Article 13(1) ECT. As the threshold for an effective claim based on Article 10(1) ECT is substantially lower than based on Article 13(1) ECT (*see* Point 6 above), a claim based on breach of FET may be still successful even if a tribunal dismisses a claim based on Article 13(1) ECT.

11. As various tribunals (*e.g. RREEF Infrastructure* and *Antin*) held recently that an investor should be granted a certain minimum rate of return from its RE-investment, investors should, in addition to alleging a substantial diminution of their investment based on a breach of Article 10(1) ECT, also allege that by amending RE-support policies, the host state refrained the investor from its reasonable minimum return on the investment. The calculation of such minimum rate must be assessed on a case-by-case basis and must be based on the legitimate expectations of the investor in question.

12. The standards of legitimate expectations of an investor is an objective one. International tribunals will assess not only what the investor acting as claimant knew with regard to the RE-support policies underlying the investment, including any potential changes to such investments, but also what a reasonable and prudent investor should have known or what was reasonably foreseeable to such investor. Thus, performing due diligence of the RE-support policies underlying the project is crucial before entering into the RE-investment. As the exact scope of the required due diligence remained vague in recent ECT-jurisprudence, the prudent investor should perform thorough technical, legal and regulatory due diligence (including potential political risk in the host state) with the support of external, potentially local, advisors. Further, the investor is well advised to document the findings of the due diligence, in particular with regard to the stability of RE-support policies underlying the RE-project as well as any potential future changes to such policies, as this may constitute viable documentary evidence in showing that the investor has complied with its obligations to thoroughly assess the underling regulatory and political environment before making its investment.

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## RESUME

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