Veblen Institute *for Economic Reforms*

# Protecting renewables with the Energy Charter Treaty: a false good idea

## Lessons learned from an analysis of renewable energy arbitrations under the ECT

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## EXECUTIVE SUMMARY

An increasing debate surrounds the Energy Charter Treaty (ECT) and its compatibility in a world that is trying to stay in line with the Paris Agreement's objectives. The ECT was ratified in 1994 in order to protect energy investments in countries where political stability could not be guaranteed. However, today two thirds of the complaints are intra-European.

More importantly, the **overall context has changed**: the climate emergency is leading international commitments and national and regional policies and it will increasingly orientate public policies in the future, as it should. As a consequence, there is a **growing number of complaints related to the adoption of climate policies**. One very recent example is the case of the German coal company RWE, attacking the Dutch government after the recent policy that plans to exit from coal for electricity production by 2030. RWE claims 1.4 billion euros - public money that would be diverted from needed spending on the ecological transition. In response, the Dutch government brought the case to German courts questioning the legal basis of the claim: '*Given long-term developments, owners of coal-fired power plants could assume that in*

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*time government measures will be taken to reduce CO2 emissions'* declared minister Bas Van't Wout[1]. Uniper also announced it would sue the Dutch State over the same coal phase-out a couple of months later[2].

Those cases justify the concerns expressed around the ECT and how it is impeaching the responses to climate change by protecting investments in fossil fuels. Voices were raised from civil society organizations[3], the scientific community[4], investors[5], renewable energy industries[6], Members of European and National Parliaments[7], and European Member States[8].

In the face of growing calls to end protection for fossil fuel investments, some proponents of the Energy Charter Treaty **argue that the treaty remains an essential tool for protecting investments in renewable energies**[9]. In fact, **it appears to be a wrong idea**: in a rapidly changing climate and variable economic context, **governments need to have the agility to quickly adapt how public money is spent in order to encourage the ecological transition**. The recent pandemic and financial crises showed how quickly contexts can evolve and the necessity for States to sometimes review their policies. In some cases, after a first moment of strong support for renewables through public expenditures, governments had to reduce the subsidies as the market appeared to be highly competitive or because the initial supporting schemes had become unsustainable due to the decline in electricity demand or the unexpectedly enthusiastic adoption of the incentives by producers.

This has been the case in particular in Spain, Italy and Czech Republic, three countries that have been targeted by dozens of arbitration claims based on the ECT.

Overall, in October 2020, some 80 cases had been brought in relation to renewable energy, under the ECT alone, averaging a total of $21 billion claimed by investors[10]. Similar claims may well target other States such as France in the future (see box 1).

While some cases are still pending, many awards have been rendered over the last years. In most of the cases, the States have failed to defeat the investors' claims. As an illustration, Spain, which faces the highest number of arbitrations, has been found to breach its obligation under the ECT in 18 cases (out of 23 in which an award has been rendered so far) and only managed

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[1] Nederlandse Staat naar Duitse rechter om kolenmaatregel | Nieuwsbericht
[2] European Council for an Energy Efficient Autonomy - Energy Charter Treaty strikes again as Uniper sues Netherlands over coal phase-out - April 2021
[3] Open letter on the Energy Charter Treaty (pdf)
[4] Front page | EndFossilProtection.org
[5] Institutional Investors Groups on Climate Change - Letter to EU leaders regarding the modernisation of the Energy Charter Treaty - December 2020
[6] EREF Press release The Energy Charter Treaty impedes the European Green Deal – EU and Member States should therefore withdraw from the Treaty- December 2020
[7] Statement of European Parliamentarians on the modernisation of the Energy Charter Treaty
[8] Letter of French Ministers to the European Commission - December 2020
[9] Interview: A new Energy Charter Treaty as a complement to the Paris Agreement
[10] According to the Energy Charter Secretariat website.

to defeat all the investors' claims in five cases[11]. As a result, Spain had to grant **more than one billion euros of damages**.

This paper conducts an in-depth review of the publicly accessible awards[12]. It looks in particular at the notion of **predictability** from a legal point of view and the **different arguments put forward** in the decisions. Several conclusions may be drawn from this analysis:

1. The reviewed decisions tend to confirm that the ECT **offers "investors"** (i.e. energy producers, investment funds, wealthy shareholders and holdings) **an overly broad protection against regulatory changes.** Indeed, in the decisions under review, whereas most arbitration tribunals have acknowledged the legitimacy, adequacy and – often – reasonableness of the reforms undertaken by governments, they found that **they breached the protection of investors' legitimate expectations guaranteed by the so-called "*fair and equitable treatment*" ("FET") standard under the ECT**.

   To reach such conclusions, arbitrators have adopted an interpretation of the notion of "*legitimate expectations*" overly favourable to the investors marked by different lines of **reasoning, leading to divergent and inconsistent assessments regarding the same facts and the same ECT provisions.**

   This demonstrates the existence of a **high degree of subjectivity** in the assessment which highly depends on who are the selected arbitrators in charge of judging the cases. In addition, as the ECT **does not provide for an appeal mechanism[13],** even the more legally questionable decisions are not subject to subsequent review and cannot be corrected. Overall, this leads to a **lack of legal consistency and legal uncertainty** which may be harmful to both States and investors including in the renewable energy sector.

2. **From an economic viewpoint it is neither justified nor efficient to protect a limited category of private actors – even in the renewable energy sector – from any regulatory change where such changes are legitimate and do not deprive investors of their profits**.

   - EU law already provides for adequate and harmonised protection to all actors[14].

   - Such overprotection may become counterproductive and inefficient for the development of renewable energy. Indeed, faced with high risks of arbitration claims, States may be reluctant to test new public policies and incentive schemes

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[11] *Charanne v Spain*, SCC Case No. V062/2012, Award (21 January 2016); *Isolux v Spain*, SCC Case No. V2013/153, Final Award (17 July 2016); *Stadtwerke München and RWE Innogy v Spain*, ICSID Case No. ARB/15/1, Award (2 December 2019); *FREIF Eurowind v Spain*, SCC Case No. V2017/060, Final Award (8 March 2021); *Eurus Energy Holdings Corporation v Spain*, ICSID Case No. ARB/16/4, Decision on Jurisdiction and Liability (17 March 2021).

[12] For the purposes of this paper, approx. 20 awards in the renewable energy sector have been analysed.

[13] Due to the inadequacy of the arbitration mechanism with the latest adjustments promoted by the EU in the framework of investment protection agreements or trade agreements including an investment protection chapter, the ECT could moreover be considered by the Court of Justice of the European Union as not being in conformity with Community law (see CJEU, Opinion 1/17 about CETA).

[14] European Commission, Communication on the protection of intra-EU investment, COM/2018/547 final (2018), <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52018DC0547&rid=8>.

and are thus likely to adopt less bold and innovative approaches in terms of climate policy.

- Locking States in unsustainable schemes guaranteeing State aids to certain private actors – even once the initial market failure has disappeared – is economically inefficient and hampers States' capacity to better allocate public resources to promote truly needed investments, in order to answer sudden crises for example. This may in turn impair States' capacity (or willingness) to adapt their strategy to fight climate change according to the scientific advances and economic changes.

Therefore, this analysis showing the arbitrary nature of many awards **questions the legitimacy and opportunity** of maintaining the derogatory regime granted by the ECT including should the scope of the ECT be limited to the renewable energy sector. The amount paid by governments in the end represents **millions or billions of euros of public money, directly into private actors' reserves**, most of which aren't renewable companies but speculative investment funds[15].

In order for the EU Member States to have the necessary means to implement comprehensive, fair[16] and cost-efficient climate change policies consistently with their obligations under EU law, it is **paramount and urgent to put an end to the investors' overprotection offered by the ECT, in all the sectors it covers**. Due to the impasse in the negotiations on the modernisation of the ECT, the EU, EU Member States and all States committed to the Paris Agreement need to leave the ECT by COP26. To make such an exit as safe and effective as possible, volunteer countries should also work on an inter se neutralization of the survival clause[17].

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[15] "In 87% (39 cases) of the 45 claims against Spain, the claimant investor is not a renewable energy company, but an equity fund or other speculative financial investor". see España : un caso paradigmático de los arbitrajes de inversión en el sector de las energías, Abril 2019 - Suplemento del Reporte "Un tratado para gobernarlos a todos", TNI y CEO.

[16] Including for the next generations. See. German Constitutional Court's decision of 24 March 2021: <https://www.bundesverfassungsgericht.de/SharedDocs/Pressemitteilungen/EN/2021/bvg21-031.html>.

[17] Nathalie Bernasconi-Osterwalder, Lukas Schaugg and Amandine Van den Berghe Energy Charter Treaty Reform: Why withdrawal is an option – Investment Treaty News

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**PROTECTING RENEWABLES WITH THE ENERGY CHARTER TREATY : A FALSE GOOD IDEA**

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The Veblen Institute for Economic Reforms is a non-profit think tank promoting policies and civil society initiatives for the ecological transition. We believe the current economic model is profoundly unsustainable and should be transformed in the spirit of social justice and respect of planetary boundaries.

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# INTRODUCTION

The Energy Charter Treaty ("ECT") is a plurilateral investment agreement, ratified by more than 50 countries and dedicated to protecting foreign investments in energy supply. It grants foreign investors in the energy sector extensive protection. This is the agreement that has triggered the largest number of lawsuits by foreign investors against signatory states in the world through the investor state dispute settlement (ISDS) mechanism. Today it urgently needs to be reformed in order to be made compatible with the Paris Agreement trajectory. This means that States should stop protecting investments in fossil fuels that lock-in those energy sources for decades and remove ISDS provisions from the treaty. A modernisation process of this treaty has been launched in 2019 but the current ongoing negotiations are not even dealing with these two main objectives.

In the face of growing calls to end protection for fossil fuel investments, some proponents of the ECT argue that the treaty remains an essential tool for protecting investments in renewable energies[18] and want to maintain the ECT for this category of energy sources. While it may look appealing, it deserves to be examined in detail. To begin with, the link between the existence of investment protection measures and investment flows has never been established. It is also acknowledged that the development of renewable energies happens independently from subsidies as it has become economically attractive[19]. But most importantly, the legal analysis provided in this note shows that maintaining the ECT and its ISDS provisions for the renewable energy sector could prove a costly option in terms of public money whereas it is not even a demand from the renewable industries. On the contrary, its European federation has even expressed itself in favour of the European states leaving the ECT if the exclusion of fossil investment could not be achieved[20].

Since 2011, several EU Member States, especially Spain, the Czech Republic and Italy have been targeted by dozens of arbitration claims based on the Energy Charter Treaty over their renewable energy policy. Those countries have set incentive schemes in the 2000s to stimulate investments in the renewable energy sector (solar, wind, hydraulic, and waste incineration). However, starting at the end of the decade, faced with a decline in electricity demand and the unexpected popularity of these incentive schemes among producers, they have implemented reforms to resolve the economic unsustainability of the schemes. In substance, those reforms consist in reducing these incentives according to their amount, length or eligibility criteria.

As an illustration, in Spain, an incentive scheme was adopted in 2004 and 2007, with the Royal Decree ("RD") 661/2007, providing for grants, tax incentives, loan guarantees and most notably, fixed feed-in tariffs which allowed owners of renewable energy plants to sell electricity at a higher rate for the first 25 years and at a reduced rate afterwards. Starting in 2010, and especially in 2013 and 2014, Spain adopted new decrees to address tariff deficit, consisting of limitations to the feed-in tariffs granted to investors and adjustments of eligibility criteria. Nevertheless, the new regime was conceived in a way to provide investors a reasonable rate of

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[18] The Energy Charter Treaty supports investment in renewables
[19] Key findings: Renewable power generation costs in 2019
[20] EREF Press release : The Energy Charter Treaty impedes the European Green Deal – EU and Member States should therefore withdraw from the Treaty

return, in line with the overarching principle established by the 1997 Law and confirmed by case law of the Spanish supreme court.

As a result of these regulatory changes, energy producers, investment funds and holdings have brought arbitration claims against those States claiming billions in compensation.

Those claims have been handled by arbitrators with very different lines of reasoning, leading to divergent and inconsistent assessments regarding the same facts.

While some tribunals took greater account of the State's right to regulate in their analysis and sought to balance the competing interests, ruling out any violation of the called "*fair and equitable treatment*" where a reasonable return was guaranteed to investors, many decisions have granted extensive protection to investors against regulatory changes (**1**). Such protection under the ECT goes well beyond the protection granted by EU rules and even by other investment treaties (**2**).

### Box 1. The announced revision of photovoltaic contracts and risks of arbitration against France

Similar to Italy and Spain, France could soon experience a wave of arbitrations related to the revision of photovoltaic contracts voted in December 2020[21] to control public spending and comply with the rules on state aid.

The renegotiation of the contracts will apply to contracts signed between 2006 and 2011 which guaranteed a high and excessive level of feed-in tariffs and would consist of a reduction in these tariffs averaging 50%.

The installations concerned would represent only 5% of the renewable production, but concentrate a significant share of public subsidies (more than 1 billion euros per year, or one third of the annual financing of renewable energy).

Some law firms are already pointing out potential breaches of the ECT and suggesting to foreign investors the possibility of arbitration proceedings on the basis of the treaty.

> *"Depending on the nationality of the affected producers, the implementation of Article 225 of the 2021 Finance Law could also give rise to claims under bilateral and multilateral investment treaties ratified by France, including the Energy Charter Treaty. Amongst other things, these treaties generally require France to observe the obligations it entered into with protected investors or investments, to accord such investors and investments fair and equitable treatment, and to protect them against arbitrary measures. Importantly, moreover, these treaties typically give investors a direct right of recourse before an arbitral tribunal for breach of those protections. European countries that have adopted similar measures have faced an avalanche of investment treaty claims from foreign investors affected by such measures, some of which have already resulted in sizeable awards in favor of the foreign investors. France's newly adopted provision may invite a similar fate".*[22]
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> White and Case Alert, 19 February 2021

## I. The extensive protection of investors against regulatory changes

Article 10(1) of the ECT provides a so-called 'Fair and equitable treatment' standard (FET) in the following terms:

> *Each Contracting Party shall, (…), 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. (…)*

[21] Article 225, Loi de finance pour 2021. A draft implementing decree and a draft enforcement decree were recently made accessible (June 2021).

[22] White & Case, "Solar tariffs in France: The 2021 finance law and the renegotiation of power purchase agreements" (February 2021); See also: Allen Overy, "France considers retroactive solar tariffs cuts, at the risk of facing investment-treaty claims" (November 2020); Dentons, "Retroactive cuts for solar feed-in tariffs" (November 2020); Graham Coop, "France: Does The Sun Still Shine On Solar Power In France? The Proposed Amendment To France's Solar Feed-In Tariffs And The Rights Of Solar Investors" (Mondaq, November 2020).

This standard has been deemed to include "*an obligation to act transparently and with due process; and to refrain from taking arbitrary or discriminatory measures or* ***from frustrating the investor's reasonable expectations with respect to the legal framework adversely affecting its investment***".[23]

It is usually accepted that investors are entitled to rely on their "*reasonable expectations*", referred to in ECT Article 10(1) only where such expectations are legitimate and not based purely upon investors' subjective motivations[24].

Thus, States are in principle free to regulate and modify the regulatory framework in a manner that is respectful of due process and/or does not exceed reasonableness, *at least* in the absence of a "*stabilisation clause*" or another specific assurance giving rise to a legitimate expectation that the regulatory framework will not change.

However, **in the case of the ECT, the balance between the States' right to regulate and the obligation to provide stable frameworks for investments has been found to weigh more in favour of investors** but with a high degree of inconsistency of the awards. This is well shown by the different awards in the cases against Spain, where the arbitrators often reached contradictory solutions for the same facts, both in the assessment of the content of the expectations (**1.1**) and of their legitimacy (**1.2**).

## 1.1. Assessment of legitimate expectations

### Legitimate expectations induced by specific commitments from the State

It is not disputed among investment tribunals that some State conducts may induce specific commitments, giving rise to legitimate expectations of stability of the legal framework[25]. Accordingly, the host State must act consistently, without repudiating its former commitments that were relied upon by the investor.

Different approaches are shared by tribunals regarding specific commitments that could give rise to legitimate expectations. Some found that only *specific* representations presenting a "*high degree of specificity*" – thus excluding rules of general nature – could give rise to legitimate expectations of regulatory stability (i.e. immutability)[26].

[23] *Electrabel v Hungary*, ICSID Case No ARB 07/19, Decision on Jurisdiction, Applicable law and Liability (30 November 2012), para 7.74.
[24] *Saluka v Czech Republic*, Partial Award (17 March 2006), para. 304; *Toto Costruzioni v. Lebanon*, ICSID Case No. ARB/07/12, Award (7 June 2012), para. 242.
[25] *Antaris v Czech Republic*, PCA Case No. 2014-01, Award (2 May 2018), para. 360.
[26] *Charanne v Spain*, para. 493; *Blusun, Jean-Pierre Lecorcier and Michael Stein v Italy*, ICSID Case No ARB/14/3, Award (27 December 2016), para. 367; *Stadtwerke v Spain*, para. 264; *Isolux v Spain*, para. 775; *InfraRed Environmental Infrastructure v Spain*, ICSID Case No. ARB/14/12, Award (2 August 2019), para. 366. This is justified by the necessity to not significantly limit a state's sovereign legislative powers in the absence of a specific expression of consent.

But tribunals generally accepted that legitimate expectations could also be incurred by general legislative or administrative acts which are not specifically addressed to the investor, when they are targeted to a specific group with the deliberate aim of attracting investment with a promise to maintain an advantageous framework for a certain period of time[27].

Among these, variable assessment of similar facts, including domestic regulations, often resulted in contradictory findings. In several case, tribunals have found that such specific commitments of stability were made to investors[28]:

- In the *Masdar* case*,* where Dutch investors brought a claim against Spain concerning reforms undertaken between 2012 and 2014, the tribunal considered that the requirement of registration with the Special Registry was "*a very specific unilateral offer from the State*"[29], reaching a conclusion opposite to that in *Charanne v Spain* (see box 2);
- A number of arbitral tribunals also found that the provisions of the Spanish decrees on which investors relied to make the investment did establish specific commitments that the tariffs are guaranteed and would not be subject of future revision[30]. For example, the *Cube Infrastructure* case, the tribunal considered that legislation creating a special regime amounted to a stabilisation clause: it unanimously stated that "*whatever the rationale behind the structure of tariffs and premiums set out in RD 661/2007*", it was clear that the provisions contained a clear commitment to maintain the special regime in the terms it established[31]. In comparison, a number of decisions have found no such stability promise in the same national provisions[32].

[27] *Cube Infrastructure v Spain*, ICSID Case No. ARB/15/20, Final Award (26 June 2019), para. 388.
[28] *InfraRed v Spain*, paras 410 and 451-453; *Masdar Solar v Spain*, ICSID Case No. ARB/14/1, Award (16 May 2018), paras 518-520; *NextEra Energy v Spain*, ICSID Case No. ARB/14/11, Decision on Jurisdiction, Liability and Quantum Principles (12 March 2019)paras 591-599.
[29] *Masdar v Spain*, para 512. See also *Antin Infrastructure Services v Spain*, ICSID Case No. ARB/13/31, Award (15 June 2018), para. 552; *OperaFund v Spain*, ICSID Case No. ARB/15/36, Award (6 September 2019), para. 483.
[30] *ibid.*, para 503: "RD661/2007 […] include[s] a stabilisation clause [which] is sufficient to exclude any modification of the law, so far as investors, which had made investments in reliance upon its terms, were concerned"; *Antin v Spain*, para. 552; *OperaFund v Spain*, para. 485; *Watkins v Spain*, ICSID Case No. ARB/15/44, Award (21 January 2020), paras 526 and 563.
[31] *ibid.*, para. 296.
[32] *Stadtwerke v Spain*, para. 261. *FREIF Eurowind v Spain*, para. 557; *Eiser Infrastructure and Energía Solar v Spain*, ICSID Case No. ARB/13/36, Final Award (4 May 2017), paras 363 and 387; *Charanne v Spain*, para. 503; *Isolux v Spain*, paras 774 and 787; *Foresight and Greentech v Spain*, SCC Case No. 2015/150, Final Award (14 November 2018), para. 366; *InfraRed v Spain*, paras 406-407 (in this case, the tribunal did find specific commitments regarding stability of some key features of the legal regime, but based on specific representations made to the investors, see paras 433-436); *NextEra v Spain*, para. 591.

## Box 2. *Charanne v Spain* (SCC Case No. V062/2012, 21 January 2016):

**Charanne and Construction Investment are respectively Dutch and Luxembourg companies that were shareholders of an energy company operating in Spain. They attacked Spain on the basis of alleged legitimate expectations based on RD 661/2007 and which were supposedly frustrated by the 2010 reforms.**

"*Although RD 661/2007 and RD 1578/2008 were directed to a limited group of investors, it does not make them to be commitments specifically directed at each investor. The rules at issue do not lose the general nature that characterizes any law or regulation by their specific scope. To convert a regulatory standard into a specific commitment of the state, by the limited character of the persons who may be affected, would constitute an excessive limitation on power of states to regulate the economy in accordance with the public interest*." (para. 493)

In contrast, in ***Novenergia v Spain*, where the arbitrators dealt with and examined the meaning of the same decree, they found that** "*RD 661/2007 was not a general erga omnes commitment, but a specific commitment towards a defined group of investors – a discrete and identifiable group of PV plants*" (para. 707).

## The enhanced obligation of stability of the regulatory regime

In the absence of a specific commitment, host States are generally expected not to act "*unreasonably, contrary to the public interest, or in a disproportionate matter*", when modifying the regulation taken into account by the investor at the time of the investment[33]. The State's right to regulate is therefore balanced with its obligations under this background.

However, it has been argued that Article 10(1) of the ECT, which expressly refers to the host State's duty to create "*stable*" and "*transparent*" conditions for foreign investments and to the "*commitment to accord at all times […] fair and equitable treatment*", could serve as a basis for affording the legitimate expectations of investors operating in the energy field comparatively **greater protection against regulatory changes[34].**

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[33] *Charanne v Spain*, para. 514. This can also be said to infer "legitimate expectations", which in this case relate to the behaviour that is generally expected from host States in the absence of specific commitments. They could be referred to as "basic expectations", for the sake of clarity and distinction with expectations based on specific commitments.

[34] Alexander Reuter, "Retroactive reduction of support for renewable energy and investment treaty protection from the perspective of shareholders and lenders" (2015) 12 *Transnational Dispute Management*, 24, 30.

This is **reflected by a large majority of awards under review**[35]**.** Most tribunals have interpreted Article 10(1) references to stability as conferring on the State a "*specific obligation*" of long-term stability – which can rather be understood as one of consistency – and thus a greater protection against regulatory changes[36].

Box 3. *Eiser Infrastructure v Spain* (ICSID Case No. ARB/13/36, 4 May 2018)

"*Article 10(1)'s obligation to accord fair and equitable treatment 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*" (para. 382)

For example, in the *RREEF* case, in which a claim targeting the Spanish 2012-2014 reforms was brought by an investment fund from the United Kingdom and Luxembourg in 2013, the arbitrators shared a view established in the *Eiser* case, as they found that this "*obligation to create a stable environment certainly excludes any unpredictable radical transformation in the conditions of the investments*"[37]. Following this approach, any regulatory change must be consistent with ECT specific stability obligation contained in the FET standard, which means that investors are protected from radical and unexpected alteration of regulatory regimes.

However, the interpretation of the notion of "radical alteration" of regulatory regimes varies among the decisions. The *Eiser* award subjected the breach of the FET standard to the fact that the investors were deprived of their investment's value[38], while in *Antin*, they considered that a change of the essential features of the regime in place "*in ways that affect investors*" amounted to a breach of the FET standard[39]. Other arbitral tribunals have set higher thresholds. For example, the *RREEF* decision required a "*total alteration of the entire legal setup*"[40] and

[35] See *Cube Infrastructure v Spain*, paras 354 and 476; *Antin v Spain*, paras 530-533; *Plama v Bulgaria*, ICSID Case No. ARB/03/24, Award (27 August 2008), para. 173; *Electrabel v Hungary*, para. 7.73; *SolEs Badajoz v Spain*, ICSID Case No. ARB/15/38, Award (31 July 2019), para. 315; *Novenergia v Spain*, SCC Case No 2015/063, Award (15 February 2018), para. 497; *InfraRed v Spain*, para. 368; *Greentech v Spain*, para. 377.

[36] *Antin v Spain*, paras 530-533.

[37] *RREEF Infrastructure v Spain*, ICSID Case No. ARB/13/30, Decision on Responsibility and on the Principles of Quantum (30 November 2018), paras 315 and 379: unreasonable and disproportionate changes are understood as "drastic and radical change" affecting "unexpectedly" the conditions of the investments.

[38] *Eiser v Spain*, para 382. The tribunal thereby placed emphasis on the effects of the measures on the investment, and not only on the degree of change of the regime. See also, *RREEF v Spain*, para. 475; *Greentech v Spain*, para. 377: the tribunal considers the the regulatory framework needs to be "fundamentally and abruptly changed, depriving [investors] of a significant part of their projected revenues, as opposed to merely modified".

[39] *Antin v Spain*, para. 531

[40] *RREEF v Spain*, para. 317; *Blusun v Italy*, para. 363: "the emphasis is on the subversion of the legal regime".

considered, due to States being in charge of general interest, that "*only measures taken in clear violation of the FET will be declared unlawful*"[41].

Tribunals have also reached different conclusions as to what were the "*essential features*" of the legal regime which could have been expected to remain stable (e.g. stability of tariffs[42] or the guarantee of a reasonable rate of return[43]). Several awards concluded that investors could only legitimately expect a reasonable return, in accordance with a general principle laid down in the 1997 Electricity Law[44] and reflected in the implementing decrees, including RD 661/2007[45], or simply relying on the FET as such.

## 1.2. Is the expectation *reasonable*?

The legitimacy of the expectations has been much debated by arbitrators in the renewable cases. ECT tribunals have recalled that "*not all expectations of a foreign investor are 'legitimate' and only legitimate expectations are protected under the FET principle*"[46]. In order to overcome the inherent subjectivity of expectations, the usual standard followed by tribunals is that of an objective assessment of the legitimacy: it is not a question of whether the investor subjectively expected a certain behaviour from the State, but whether it was reasonable to rely on it[47].

One key criterion which is generally used to objectively assess the reasonableness of the investor's expectations is the due diligence it carried out in its decision to invest. This means that a certain level of care is required from the investors, who must take into account all relevant circumstances (e.g., the legal, economic and social context prevailing in the host state at the time of the investment) and inquire about foreseeable changes, as would be expected

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[41] *RREEF v Spain*, para. 262.

[42] *Cube Infrastructure v Spain*, para. 476 ; *SolEs v Spain*, para. 444.

[43] *RREEF*, para. 517 and 523: the tribunal found that the only key feature that gave rise to legitimate expectations was the guarantee of a reasonable return that included the right to have any modifications reasonable and equitable, even if it entails a lesser return. See also, *FREIF Eurowind*, para. 557.

[44] These tribunals relied on the hierarchy of norms and considered the Supreme Court judgement and the 1997 Law to assert that regulatory changes were possible and that the only commitment binding the Spanish government action was the requirement of a reasonable rate of return, stated as a general principle. See *Charanne v Spain*, para. 506; *Eurus v Spain*, para. 331 and 334; *Stadtwerke v Spain*, para 272; *BayWa Renewable Energy v Spain*, ICSID Case No. ARB/15/16, Decision on Jurisdiction, Liability and Directions on Quantum (2 December 2019), paras 470-472; *Isolux v Spain*, paras 788-794; *PV Investors v Spain*, PCA Case No. 2012-14, Final Award (28 February 2020), paras 595-596 (in this case, even legitimate expectations of a reasonable return were discarded)..

[45] Some tribunals relied directly on the provisions of the RD 661/2007 and RD 1614/2010 to find that there no stability clause guaranteeing the immutability of the conditions of the investment, or that although there was such a clause, the regulations also foresaw that adjustments were possible (see e.g. *RREEF v Spain*, para. 318). The preamble of the RD 661/2007 (para. 7) stated: "The economic framework established in this Royal Decree develops the principles contained in Law 54/1997 […] guaranteeing the owners of special regime facilities a reasonable return on their investments".

[46] *ibid.*, para. 261.

[47] *Cube Infrastructure v Spain*, para. 388; *Antaris*, para. 360(6); *SolEs v Spain*, para. 331.

from any prudent investor, especially in the renewable energy sector which is highly subject to regulatory changes.

However, while some tribunals have indeed led an objective analysis, others in fact introduced purely subjective considerations in their reasoning (**i**). Tribunals have also adopted varying levels of due diligence requirements (**ii**) and given similar circumstances and EU law on State aid different importance (**iii**).

## The introduction of subjective considerations into some tribunals' analysis

As recalled by the *Eurowind* tribunal, mere "impressions" from the investor are not sufficient to find reasonable expectations[48]. Only measures that could not have been objectively foreseeable may breach an investor's legitimate expectations[49].

Yet, **some tribunals have introduced subjective considerations** in assessing the legitimacy of expectations. For example, the *Masdar* award took into account the fact that the investor "*believed that it had a legitimate expectation that the laws would not be modified, as they included stabilisation clauses*"[50]. In the *Cube Infrastructure* case, the majority of the tribunal, as pointed out in a dissenting opinion, seemed to embrace too readily the argument of the plaintiff who maintained without further demonstration that the risk of radical change was purely residual, disregarding what seemed to be clear negligence by the investor in his risk analysis.

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48 *FREIF Eurowind v Spain*, para. 549.
49 *Isolux v Spain*, para. 781.
50 *Masdar v Spain*, para 499. See e.g., Danae Azaria, "The Renewable Energy Arbitrations Under the Energy Charter Treaty" in Hélène Ruiz Fabri and Edoardo Stoppioni, *International Investment Law: An Analysis of Major Decisions* (Hart Publishing, forthcoming 2021).

## Box 4. *Cube Infrastructure v Spain,* Final Award and Separate and Partial Dissenting Opinion of Professor Christian Tomuschat (ICSID Case No. ARB/15/20, 26 June 2019)

**Cube Infrastructure is a management company based in France and Luxembourg and focusing on investments in the European infrastructure space. Cube presented a claim against Spain in 2015 because of the change of taxes and subsidies around renewable energies.**

The majority of the tribunal justified its findings on the basis that investors are "professional investors, used to evaluating risk", and considered that "*the Respondent has not shown that any more exhaustive legal analysis would have produced any different understanding of the Spanish measures*" (Award, para. 401).

The dissenting opinion asserts that this circumstance "*tells the observer nothing about the diligence they applied in the instant case*" and that the investors "*handled the matter lightly*" and "*were clearly negligent in assessing the regulatory risks inherent in their planned investment decisions*". It considered that "*the contention that more exhaustive legal analysis would probably not have led to another result amounts to pure speculation and grants too easily a blessing to a major management failure*" (paras 19-20).

## A due diligence requirement sometimes ignored by tribunals

A number of ECT tribunals have clearly considered investors' due diligence to be a prerequisite for them to be able to rely on state commitments[51], unless it is shown that even an adequate due diligence verification would not have rendered the regulatory changes foreseeable[52].

The *Charanne* award set a very high threshold for assessing due diligence, justified by reference to the highly regulated nature of the particular energy market[53]. In the *Masdar* case, the arbitrators stated that "*the investor must demonstrate that it has exercised appropriate due diligence and that it has familiarised itself with the existing laws*"[54], with such due diligence being "*thorough and sufficient*"[55]. Likewise, in *Eurowind*, the tribunal assessed whether the

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[51] See *Charanne v Spain*, para. 505; *Antaris v Czech Republic*, para. 432; *Stadtwerke Munchen v Spain*, para. 264 ("rigorous due diligence process"); *Infrared v Spain*, para. 370; *Hydro Energy v Spain*, ICSID Case No. ARB/15/42, Decision on Jurisdiction, Liability and Directions on Quantum (9 March 2020), para. 600.

[52] *Novenergia v Spain*, para. 678; *Infrared v Spain*, para. 441.

[53] *Charanne v Spain*, para. 507: "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."

[54] *Masdar v Spain*, para 494.

[55] *ibid.*, para 498.

investor's expectations were legitimate based on the information he knew and should have reasonably and objectively known according to the expected level of due diligence[56].

Despite an important number of awards suggesting there is such a requirement, **others have held that the right of investors to rely on state commitments was not conditional on a formal or thorough prior review of the regulatory framework[57].** In *Cube*, the tribunal admitted that it had not found any specific analysis of the stability of the regime in the reports provided by the plaintiff[58], but considered that it was up to the defendant – Spain – to show how a more exhaustive analysis of the risks would have led to a different conclusion[59].

### Divergent assessments for similar circumstances.

**Divergent assessments for similar circumstances.** Similar situations have been interpreted differently by arbitrators, sometimes **resulting in rather questionable findings**. The *Cube Infrastructure* case exemplifies the effects of the stricter stability obligation under ECT coupled with disputable reasonings. The majority of the tribunal found that investors could legitimately expect that the tariffs would not be altered, despite the notorious instability and unsustainability of the legal regime at the time of this investment, as largely evidence before the tribunal[60]. According to the dissenting opinion, the uncertainties were such that a *prudent* investor could not legitimately expect it to be maintained as it was[61], especially where new reforms were already expected to remedy it[62]. In other words, the tribunal considered there was no reason to expect a "radical" change towards a system based on a reasonable return[63]. This shows how difficult it may be to call into question an expectation of stability found by a tribunal with respect to the "fundamental characteristics" of the special regime.

This **contrasts with the position taken by the tribunals in other cases** such as *Isolux*, *Antaris* and *Belenergia*, in which the arbitrators found that the investors could, in such circumstances, only expect a reasonable return on the investment. The *Eurowind* award even states it was the state's duty in those circumstances to "*adapt the scheme through a variable reasonable rate of return to protect its economic health*"[64].

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[56] *FREIF Eurowind*, para. 544. It held that the investor was aware of the likelihood of changes in the remuneration scheme and that the only limitation to government action was the requirement of a reasonable level of profitability, as suggested in his due diligence report.
[57] *Cube Infrastructure v Spain*, para. 396. *SolEs v Spain*, para. 331.
[58] *ibid.*, para. 439.
[59] *ibid.*, para. 401.
[60] *ibid.*, para. 345.
[61] *Cube Infrastructure v Spain*, Separate and Partial Dissenting Opinion, para. 14.
[62] *Cube Infrastructure v Spain*, para. 349.
[63] *ibid.*, para. 333. The radical change here corresponded to the shift from a regime based on fixed feed-in tariffs and premiums to one based on the principle of reasonable return. Conversely, in *PV Investors v Spain*, the tribunal held that an expectation of an unchanged FIT could not have been reasonable given technological and economic circumstances (para. 596).
[64] *FREIF Eurowind v Spain*, para. 525.

### Influence of EU State aid law.

Another issue that has been dealt with by tribunals was whether EU State aid law could influence the assessment of legitimate expectations. The Commission has intervened as *amicus* in a number of arbitrations to submit, among others, that the incentives regimes put into place were contrary to EU law. Some tribunals did consider that the issue of State aid was a relevant fact in analysing the investor's expectation[65], stating that the investor "*could not have had expectations that ran contrary to EU limitations*"[66].

Conversely, others have rejected the idea that provisions of EU law on State aid weakened investors' entitlement to rely on the State's commitments[67]. In other instances where EU law could have been relevant, tribunals found that without a decision from the Commission, there was no basis at the time of the investment to conclude that the investor should have anticipated an inconsistency with EU requirements[68].

## II. THE ENHANCED STABILITY OBLIGATION UNDER THE ECT IN COMPARISON WITH EU RULES AND OTHER INVESTMENT PROTECTION INVESTMENTS

As anticipated by authors, Article 10(1) of the ECT provides the legitimate expectations of investors operating in the energy field **greater protection against regulatory changes**, in comparison to other treaties[69].

When ECT tribunals, such as in the *Charanne* case, referred to awards on disputes concerning other investment treaties, there was more room for regulatory changes, as "*in the absence of a specific commitment, an investor cannot have a legitimate expectation that existing rules will not be modified*"[70]. In that case, "*subsequent changes should be made fairly, consistently and predictably, taking into account the circumstances of the investment*"[71]. The specificity of the ECT is further shown by the fact that tribunals have considered that "*reference to decisions on the stability of a regime based on treaties whose text is substantially different and where no specific obligation of stability is contained may be of no assistance in the interpretation of this*

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[65] *ibid.*, para. 532. See also *BayWa v Spain*, para. 569(a); *Eurus v Spain*, para. 428: under EU and Spanish law the investor could not legitimately have expected that the subsidies "were, for certain, lawful" and "should have known that these measures had not been notified to, let alone approved by, the EC"; *Antin v Spain*, para. 658 (requiring however a high threshold of demonstration from the State).
[66] *FREIF Eurowind*, para. 550.
[67] *Cube Infrastructure v Spain*, para. 307.
[68] *SolEs*, para. 442.
[69] Alexander Reuter, "Retroactive reduction of support for renewable energy and investment treaty protection from the perspective of shareholders and lenders" (2015) 12 *Transnational Dispute Management*, 24, 30.
[70] *Charanne v Spain*, paras 499-503.
[71] *ibid.*, para. 500. *Electrabel v Hungary*, para. 7.77.

*specific feature of the ECT*"[72], in opposition to what is common practice in investment arbitration.

In contrast with the decisions analysed above, **EU law already provides adequate and sufficient protection to investors**, through the application of the fundamental freedoms enshrined in the Treaty and principles of proportionality, legal certainty, and legitimate expectations[73]. Private investors can exercise their rights before reliable and efficient domestic courts and, if necessary, before the European Court of Human Rights – EU law does not grant them direct access to CJEU against EU Member States.

Under EU law, legitimate expectations are protected as part of the general principle of legal certainty under EU law[74]. However, their scope is not as broad as in international investment law. In particular, under EU law economic operators cannot, in general, claim a legitimate expectation that an existing legal regime will be maintained[75]. Only where national authorities have, through "*precise, unconditional and consistent acts*", created reasonable expectations that the current situation will not change (e.g. through a favourable decision, an individual representation or an assurance regarding the stability of a specific situation), an economic operator may rely on the principle of the protection of legitimate expectations[76].

In addition, to invoke this protection is conditioned on the investors' good faith and due diligence[77]. This means that investors cannot rely on their "*legitimate expectations*" in case of regulatory changes affecting their interests when such changes could have been foreseen[78].

Finally, **EU law** excludes the existence of legitimate expectations in the presence of illegal or unnotified State aids. According to the Commission decision on state aid in Spain, Support for electricity generation from renewable energy sources, cogeneration and waste, referring to the case law of the CJEU[79], "*a recipient of State aid cannot, in principle, have legitimate expectations in the lawfulness of aid that has not been notified to the Commission*" and "*no investor could have, as a matter of fact, a legitimate expectation stemming from illegal State aid*"[80].

[72] *Antin v Spain.*, para. 533.
[73] See generally, European Commission Brussels, 19.7.2018 COM(2018) 547 final Communication from the Commission to the European Parliament and the 14-16
[74] C-17/03 *VEMW*, paras 72-73.
[75] C-17/03 *VEMW*, ECLI:EU:C:2005:362, para. 81; C-201/08 *Plantanol*, ECLI:EU:C:2009:539, para. 53.
[76] European Commission, Consultation document - Public consultation on an intra-EU investment protection and facilitation initiative
[77] C-310/04 *Spain v Council*, ECLI:EU:C:2006:521, para. 81.
[78] C-201/08 *Plantanol*, para. 53.
[79] Case C-24/95 *Land Rheinland-Pfalz v Alcan Deutschland*, EU:C:1997:163, para. 25: "In view of the mandatory nature of the supervision of State aid by the Commission under Article [108] of the Treaty, undertakings to which aid has been granted may not, in principles, entertain a legitimate expectation that the aid is lawful unless it has been granted in compliance with the procedure laid down in that article. A diligent businessman should normally be able to determine whether that procedure has been followed."
[80] European Commission Decision on State aid SA.40348 (2015/NN) - Spain, Support for electricity generation from renewable energy sources, cogeneration and waste, 10 November 2017 ("State Aid Decision"), paras. 158 and 164.

## Policy Recommendations

Staying in the Energy Charter Treaty comes with legal and financial consequences for States across the world, and especially in the EU. The Treaty provides investors' tools for challenging public policies that evolve to adapt to new contexts and realities. Public policies are being questioned on the basis of so-called legitimate expectations of stability, with the introduction of subjective elements in the assessments of the obligations.

Governments are expected to take decisions to answer the climate crisis, but also any other social or economic situation that might involve a change in public policies. At a time when public money is crucially needed to feed the transition of different sectors, it cannot be straightjacked for investment groups or private companies.

As the EU's (even insufficient) proposals to align the treaty with the Energy Charter have not received any support from the other States Parties to the treaty in the ongoing modernisation process:

- **The EU, EU Member States and all States committed to the Paris Agreement need to leave the ECT by COP26.** Without waiting for an agreement from all these parties, several states could initiate such a withdrawal to encourage others to follow them.
- **An agreement neutralizing the survival clause** (the clause that keeps protecting investments covered by the ECT for 20 years after the withdrawal) **needs to be taken among Parties leaving the Treaty as well as voluntary Parties staying in the ECT[81].**

[81] About the withdrawal options, see IISD, ClientEarth, "Why withdrawal is an option", June 2021.