THE INCORPORATION OF INTERNATIONAL INVESTMENT PROTECTION LAW IN RENEWABLE ENERGY DISPUTES: THE CASE OF SPAIN

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ABSTRACT

Spain is the most notoriously affected state in arbitration procedures based on the Energy Charter Treaty (ECT), having lost an estimated 825 million euros to date, with a total of 10,000 million euros sought. As of May 2020, twenty arbitral rulings had been delivered in what is now known as the "Spanish renewables saga," with more than forty-six lawsuits filed under that Treaty. In 2010, Spain began to change its renewable energy incentive programme, prompting arbitral accusations that it was violating the Fair and Equitable Treatment ('FET') provision in article 10(1) of the ECT. The purpose of this essay is to examine the interpretation of valid expectations offered by published decisions and to highlight, if any, anomalies.

In general, the idea of reasonable expectations is often regarded as the FET's "dominant element", covering all of these requirements. A State cannot develop reasonable expectations of a stable legal framework of investment incentives and then abruptly reverse such expectations under the 'legal stability' concept of legitimate expectations. As a result, legitimate expectations are dependent on the expected stability of a particular legal system as well as explicit or implicit statements made by the host State.

The main emphasis point for arbitral tribunals is thus to strike the appropriate balance between the State's commitment to establish a stable legal framework on the one hand, and the State's power to alter the regulatory framework on the other. As will be seen later, there is a contradiction between these affirmations in the examination of the awards made in the Spanish renewables case. First, an overview of Spain's relevant domestic law will be presented, followed by an examination of the interpretation and execution of legitimate expectations under Article 10(1) of the ECT. The research paper will also delve into different awards and will shed light on four specific issues highlighted in the process of these awards.

Key Words: Spain, Renewable energy, arbitration, treaty, lawsuits

INTRODUCTION

The regulatory framework of Spain, subsequent amendments to it, and the consequences for res investors will be introduced to give an impression of the practical relevance of rules on investment protection in the real estate sector. Following that, a brief examination of various arbitral awards involving Spain will take place. It will be concluded that there is currently a lack of legal certainty in the application of investment treaty norms. The Spanish government enacted a very generous res support scheme in 2007, which provided direct financial assistance in the form of a *FIT*[1]. Royal Decree 661/2007 (rd 661/2007) anticipated in *FITS* that were granted for the lifetime of a facility, but were reduced after a certain number of years. Additionally, res generators were given priority dispatch. Generators were required to register in order to be eligible for assistance under rd 661/2007[2].

One author noted in 2007 that rd 661/2007 "guarantees very attractive profitability levels for [renewable electricity] investors." Furthermore, it will be provided even after [res] plants are fully paid-off, imposing an unnecessary burden on consumers[3]. Indeed, under rd 661/2007, some photovoltaic (pv) solar energy investors could receive up to eur 0.44 per kWh[4]. By late 2007, Spanish authorities were aware that investments in solar energy, in particular, were rapidly increasing. On the one hand, one could argue that the policy was successful; in 2008, "Spain alone accounted for over 50% of the installed pv solar in the world."[5] On the other hand, one could argue that if one support scheme attracts 50% of all PV investments globally, it may be too generous and not necessarily successful, but rather a huge financial liability.

A further complication was that because the electricity tariff in Spain was regulated by the government, the costs of these fits could not be passed on to final electricity consumers. The difference between the regulated electricity tariff and the fit resulted in a 'tariff deficit,' or the amount paid to producers that could not be recovered from consumers. However, it should be noted that generous subsidies were not the sole cause of the tariff deficit. The tariff deficit

[1] The main purpose of FIT policy is to provide investors certainty by ensuring guaranteed prices for a certain period of time for electricity produced from res, which can be done in multiple ways, see Toby Couture and Yves Gagnon, 'An Analysis of Feed-in Tariff Remuneration Models: Implications for Renewable Energy Investment', Energy Policy, 38/2: 955–965 (2010).
[2] Articles 14 and 17(c), Royal Decree 661/2007, Legislation Development of the Spanish Electric Power Act, Volume 11, 2009, pp. 92–93 and 95.
[3] Pablo del Río González, 'Ten Years of Renewable Electricity Policies in Spain: An Analysis of Successive Feed-in Tariff Reforms', Energy Policy, 36/8: 2917–2929 (2008), p. 2926.
[4] Charanne and Construction Investments v. Spain, scc Case No. v 062/2012, Award, 21 January 2016, para. 121.
[5] Daniel Behn and Ole Kristian Fauchald, 'Governments Under Cross-Fire? Renewable Energy and International Economic Tribunals', Manchester Journal of International Law, 12/2: 117–139 (2015), p. 121.

existed prior to the financial and economic crises, which had a significant impact on the Spanish economy[6]. As a result of decreased economic activity, demand for energy fell, exacerbating the deficit. According to the credit rating agency Moody's, the tariff deficit totalled euro 28.8 billion in 2013.

Following the 'boom' in real estate investments in Spain and the realisation that the regulatory framework might not be financially sustainable, several legislative measures aimed at reducing the tariff deficit were enacted between 2008 and 2014. Many of these policies have resulted in numerous legal proceedings, both domestically and internationally[7]. Various measures were implemented from 2008 to 2012 to adjust the favourable legal framework. These measures had the effect of, among other things, reducing financial support for new plants[8], eliminating the fit from the twenty-fifth year onwards[9], introducing new technical requirements aimed at overcoming voltage dips in the network, limiting the number of annual hours that pv plants were entitled to support while producing electricity and the introduction of a toll for access to the electricity network, and the introduction of a 7% tax on e-waste[10].

More drastic measures were implemented in 2013 and 2014, effectively repealing the legal framework on which the assistance was granted. Finally, in June 2014, a new regulatory regime for remuneration was established, entitling generators to a 'reasonable rate of return' calculated on the basis of a hypothetical "efficient plant"[11]. This regime's calculation parameters were established by a ministerial order issued around the same time. The 2013 and 2014 measures essentially replaced the old support scheme with a completely new one, with fundamentally different remuneration parameters that are largely based on hypothetical assumptions that do not account for the actual and individual characteristics of projects[12]. This new regime was also applied to existing facilities. The consequences for existing investments that deviate from the hypothetical assumptions on which the new remuneration scheme is based could be severe.

[6] Iñigo del Guayo, 'Energy Law in Spain' in Martha Roggenkamp et al. (eds.), Energy Law in Europe – National, eu and International Regulation (Oxford: Oxford University Press, 2016), p. 1041.
[7] Behn and Fauchald, 'Governments under Cross-Fire?', pp. 122–123.
[8] Royal Decree 1578/2008; Del Río González, 'Ten Years of Renewable Electricity Policies in Spain', p. 2919.
[9] In particular Article 3, Royal Decree 1565/2010, Boletin Oficial del Estado, nr. 283, 2010, p. 97428.
[10] Royal Decree Law 14/2010 and Article 2 First Transitory Provision, Royal Decree Law 14/2010, Boletin Oficial del Estado, nr. 312, 2010, p. 106386.
[11] Article 11, Royal Decree 413/2014, Boletin Oficial del Estado, nr. 140, 2014, p. 43876; Eiser v. Spain, para. 147.
[12] Verburg and Lavranos, 'Recent Awards in Spanish Renewable Energy Cases'.

RENEWABLE ENERGY ARBITRATIONS AGAINST SPAIN: BACKGROUND AND PUBLISHED AWARDS:

Spain implemented a number of regulatory measures in 2007 to encourage investment in renewable energy. However, due to the program's success, a tariff deficit, and the effects of the financial crisis, Spain implemented a number of measures beginning in 2010 that reversed some of the original regulations. As a result, approximately 40 arbitration proceedings have been filed against Spain[13]. The key issue in the first four publicly issued final awards in these arbitrations was the application of the FET standard and legitimate expectations[14].

The first published award was in 2016, ***Charanne v. Spain***[15], concerned investors who owned photovoltaic installations in Spain. They claimed that the evolution of the special regulatory framework created insecurity and ambiguity, which violated their legitimate expectations, in violation of ECT Article 10.(1). The tribunal dismissed both claims, siding with Spain.

The ***Eiser v. Spain*** tribunal ruled in favour of the investors in three concentrated solar plants in 2017[16]. Unlike in Charanne, they claimed that subsequent regulations from 2012 to 2014 violated their ECT rights, devaluing their investments and forcing their Spanish subsidiaries into debt restructuring negotiations. The tribunal ruled in the investors' favour. ***Isolux v. Spain***[17], which was decided first but only published after Charanne and Eiser became public, was a sort of companion case to Charanne in many ways, as it was brought by related investors, involved the same counsel, and each party named the same co-arbitrators. Isolux, like Eiser, challenged the 2012-2014 regulations. The investor claimed that Spain enticed it with the promise of maintaining a long-term feed-in tariff for photovoltaic energy production under a special regime, and that by later abolishing it, it violated ECT Article 10. The tribunal ruled in Spain's favour.

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[13] Cosbey, A., *Can investor–state dispute settlement be good for the environment?*, INTERNATIONAL INSTITUTE OF SUSTAINABLE DEVELOPMENT (April 2017), http://www.iisd.org/library/can-investor-state-dispute-settlement-be-good-environment

[14] Hendel, C., *Squaring the circle: Reconciling the conflicting awards in the Eiser and Isolux Spanish renewable cases (Part I)*, KLUWER ARBITRATION BLOG (July 27 2017), http://arbitrationblog.kluwerarbitration.com/2017/07/27/squaring-circle-reconciling-conflicting-awards-eiser-isolux-spanish-renewable-cases-part/

[15] Charanne and Construction Investments v. Spain, SCC Case No. V 062/2012, Award, January 21, 2016

[16] Eiser Infrastructure Ltd. and Energia Solar Luxembourg v. Spain, ICSID Case No. ARB/13/36, Award, May 4, 2017.

[17] Isolux Netherlands, BV v. Kingdom of Spain, SCC Case V2013/153, Final Award, July 17, 2016.

In February 2018, the ***Novenergia v. Spain*** tribunal ordered Spain to pay EUR 53 million to a Luxembourg fund that had invested in Spanish photovoltaic plants[18]. The claim in Novenergia was based on the same reforms implemented in 2012-2014 as in Eiser and Isolux. Although the above-mentioned disputes were sparked by the same reforms, a closer examination of the tribunals' interpretation and application of the FET standard in each award reveals the inconsistencies that the ISDS regime can cause.

The awards shed light on four specific issues, which are:

I. Lack of Clarity Regarding whether an Investor has Legitimate Expectations and, if so, What Those Expectations Are:

There is no agreed-upon definition of what gives rise to an investor's legitimate expectation that a regulatory framework will remain unchanged. True, none of the four awards can be interpreted as denying the state's right (or duty) to regulate (and re-regulate). They also do not imply that a state's right to regulate is limitless. Furthermore, all awards acknowledge that Spain had some sort of obligation to respect the investor's legitimate expectations. However, the tribunals' methods of proceeding differed at this point.

The investors in Charanne claimed that the regulatory framework established by Spain prior to the 2008 crisis induced them to invest in Spain and created the expectation that the terms would not be changed. However, the tribunal determined that this framework could not provide legitimate expectations because the documents were insufficiently specific. According to the Charanne award, anything less than a stabilisation clause or a specific commitment to investors specifying that the regulatory framework will remain unchanged will fall short of creating such a legitimate expectation[19].

In Novenergia, the tribunal held that, contrary to Charanne, such expectations "arise naturally from undertakings and assurances" given by the state. These do not have to be specific undertakings like contractual stabilisation clauses; simply stating that such expectations exist is sufficient. Novenergia was entitled to form legitimate expectations about the 2007 regime

[18] Novenergia II – Energy & Environment (SCA) (Grand Duchy of Luxembourg), SICAR v. The Kingdom of Spain, SCC Case No. 2015/063, Final Arbitral Award, February 15, 2018

[19] Charanne, supra note 15, para. 504.

based on statements by officials of Spain's Congress of Deputies, as well as marketing documents from Spain, which the tribunal deemed "bait"[20]

In contrast to Charanne, the Novenergia tribunal was referring to the legitimate expectation that the regulations that incentivized investors would not be drastically altered. It did not, however, distinguish between this test and the one articulated in Charanne. The Charanne decision implies that, despite any statements made by a state, the legitimate expectation that a state will not act unreasonably or disproportionately when regulating is embedded in the FET standard. The Novenergia award appears to apply the Charanne analysis to determine whether investors had a reasonable expectation that the legislation would not be drastically changed.

Because of the disparity in how both tribunals approached the analysis of an investor's legitimate expectations, it is difficult for a state to predict the boundaries of how statements and advertisements will be scrutinised in the event of a dispute.

II. Diverse Perspectives and a Lack of Reasoning on whether Spain's Regulatory Measures were Justified:

In general, the Eiser tribunal failed to give an examination of what the investor's legitimate expectations were or may have been based on the facts of the case. Instead, the panel focused on how Spain may have broken the FET norm regardless of any explicit obligations by behaving arbitrarily while regulating, a concern that the tribunals in Charanne, Isolux, and Novenergia also considered[21]. This approach emphasises the second common theme in all awards: a lack of uniformity in determining whether Spain's regulatory changes were fair.

Each tribunal had a different definition of "reasonableness." According to the Isolux tribunal, the reasonableness requirement requires a state's behaviour to exhibit a reasonable link to some logical policy[22]. The Charanne panel, on the other hand, addressed the problem in greater depth and established a thorough and rather high threshold. It originally declared that it would evaluate whether Spain's actions were unjustified, excessive, or against the public interest[23]. Concerning proportionality, the tribunal determined that this condition would be met if the

[20] *Novenergia v. Kingdom of Spain, the ECT and the ECJ: Where to now for intra-EU ECT claims?* KLUWER ARBITRATION BLOG, http://arbitrationblog.kluwerarbitration.com/2018/03/20/novenergia-v-kingdom-of-spain

[21] Eiser, supra note 16, paras. 513–516.

[22] Isolux, supra note 17, para. 822.

[23] Charanne, supra note 15, para. 515.

modifications were not arbitrary or unwarranted, and did not abruptly and unexpectedly remove the core features of the current regulatory system.

However, in Novenergia, the tribunal appeared to apply a tighter criteria, holding that the FET criterion protects investors from a "radical or fundamental" change in law rather than only a "unreasonable or excessive" alteration, as indicated in Charanne. The Novenergia tribunal failed to clarify the bounds of the planned test, exposing another another source of uncertainty for states. Furthermore, while the Eiser tribunal found that Spain behaved irrationally and violated the FET, it neglected to offer any information on how it determined the reasonableness of Spain's measures. This explains why Spain recently sought the decision's annulment, citing a failure to articulate grounds and an apparent abuse of power.

The tribunals also disagreed on how to interpret the challenged passages. The Eiser panel gave undue weight to the economic impact of the rules on investment. It began by differentiating Charanne on the grounds that the measures in Charanne had less severe impact for the claimants (losses of around 10%) than in Eiser (losses of more than 60 per cent). For many pages, the Eiser tribunal explained the detrimental impact of the challenged measures on the investment, emphasising that Spain's new measures robbed the claimants of nearly all of the value of their investment[24].

The economic consequences of a policy should not be overlooked. However, it is an aspect that is typically examined in expropriation claims and is rarely found in the test to demonstrate a violation of the FET standard. The Eiser tribunal's decision to disregard the expropriation claim in favour of focusing on FET may have resulted in an overemphasis on the negative impact of the measures and a lack of scrutiny as to whether the additional measures were reasonable.

III. Different Tribunals' Findings on the Same Regulations are Inconsistent:

The third issue is that Eiser and Isolux disagree on whether the identical requirements were reasonable, and both tribunals fail to present convincing explanation for their judgments. In Isolux, the tribunal originally said that "Spain's action was a sensible policy that, whether someone liked it or not, had the purpose of safeguarding the consumer," without explaining why. In turn, the Eiser tribunal stated that the new system was based on quite different

[24] Eiser, supra note 16, para. 418.

assumptions and used a new and untested regulatory approach, all with the intention of significantly reducing subsidies to existing plants, but failed to explain how it was judging the "reasonability" of the regulatory changes, why it deemed the new regime unreasonable, and on what its reasoning was based. Its subsequent debate on whether Spain provided an indication for adjusting the reasonable return rate and whether the criterion utilised (which was based on a "efficient" plant) was common or not fails to give direction or clarity.

According to this research, Spain's policies were neither discriminatory or enforced in an arbitrary and unjustified manner. At one point, the Eiser tribunal acknowledges Spain's economic woes and admits that steps to repair its tariff imbalance must be implemented. However, it appears that despite the obvious moral hazard, allowing ineffective plants to get the same rate of return as efficient ones would have been a more sensible approach. Whether one agrees with the conclusion in Eiser or Isolux, the absence of in-depth reasoning in both rulings is disappointing, and the ensuing disparity is concerning.

IV. Lack of an Appellate Mechanism to Correct Inconsistencies:

Although Charanne and Isolux give some guidance on the issue of legitimate expectations, the dissenting judgement of arbiter Tawil in both the Isolux and Charanne decisions underscores the existing ISDS regime's enormous potential for inconsistency. Tawil agreed with the majority in Charanne on the issue of the tribunal's jurisdiction and agreed that Spain had not indirectly expropriated the Claimants' investment. He did, however, believe that genuine expectations may be developed in other instances when no express pledge was made. He believed that the initial plan was intended to motivate investors and was targeted at a certain set of investors, and that this was sufficient to demonstrate the claimants' legitimate expectations. On that premise, he believed it was not legitimate to acknowledge the host state's right to modify or withdraw the benefit without giving compensation. In Isolux, he disagreed on the same grounds.

Indeed, opposing views in court rulings are prevalent, and they usually deal with the most intricate and unclear areas of the law. However, Tawil's disagreement is concerning because, unlike most court conflicts, awards under the ISDS framework are neither bound by precedent or the responsibility imposed by the capacity to appeal a decision. Tawil's conclusion demonstrates that if the panel had been composed of another arbitrator with comparable views,

the verdicts in Charanne and Isolux would have been reversed. A state cannot anticipate such a situation while implementing regulatory reforms.

CONCLUSION

Despite the diverse decisions, it is possible to assume that several aspects were consistently taken into consideration by the tribunals to examine whether valid expectations had formed in the Spanish setting. To begin, tribunals typically investigated whether Spain had made explicit guarantees to investors in order to establish an obligation of legal framework stability, which was later disappointed by the enactment of the 2012/2014 measures: (i) the existence of a commitment stemming from State law and officials' assertions was affirmed in many awards; (ii) In others, the wording of Article 44(3) of RD 661/2007 was interpreted as a stabilisation provision, binding the State to a rigorous requirement of legal framework stability. Surprisingly, the tribunal in Stadtwerke mentioned the necessity for a contractual commitment for stability. Second, tribunals repeatedly ruled that claimants' inability to undertake due diligence had no bearing on the State's responsibility to uniformity in its legal framework, which would be violated by disproportional sanctions. Tribunals only ruled that failing to do due diligence means there is no requirement to maintain tight stability. Third, the timing of investments is key in determining reasonable expectations: it is necessary to identify the precise point in the regulatory framework where the investment was made. Fourth, the type of renewable investment is a crucial distinguishing factor across the scenarios.