The German Constitutional Court Judgment in the Vattenfall case: Lessons for the ECT Vattenfall Arbitral Tribunal

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On 6 December 2016 the German Constitutional Court (GCC) delivered its judgment in the case of Vattenfall and other nuclear power energy companies against Germany.

This dispute and final judgment – which have attracted far less attention and criticism from anti-ISDS groups than the *Vattenfall* dispute currently under the Energy Charter Treaty (ECT) – provide some valuable lessons for the arbitral tribunal in the ECT *Vattenfall* dispute.

As is well known, the ECT *Vattenfall* dispute (as well as the dispute before the GCC) relate to the rather sudden decision of the German Government following the Fukushima disaster to close down all nuclear power stations without any compensation. This decision was taken only months after the same Government had decided to significantly extend the periods of the existing permits for the nuclear power plants.

The main issue of the dispute before the GCC concerns the question whether or not Vattenfall and the other energy companies must be compensated. This in turn requires that the property of the companies has been expropriated in a manner that must be compensated according to German constitutional law by the German State.

Interestingly, the main question at issue in the ECT proceedings is very similar: must Germany compensate Vattenfall according to the ECT because the investments (property) of Vattenfall were unjustifiably expropriated?

It therefore does not come as a surprise that the main elements of the legal analysis and conclusions of the GCC can to a large extent be applied in analogy to the ECT proceedings. In other words, the *Vattenfall* judgment of the GCC offers useful lessons for the ECT arbitral tribunal – in fact, for any arbitral tribunal that has to balance the protection of investments against the protection of public goods and regulatory policy space.

1st lesson: States enjoy broad regulatory powers

The GCC was very clear that the State enjoys broad regulatory powers when it comes to the protection of public goods such as health and environment. Although the events in Fukushima did not

alter the security of the nuclear power stations in Germany and despite the fact that such an earthquake followed by a tsunami can be practically excluded for Germany, the German State is free to decide to shut the nuclear power stations down. In other words, the German Government and ultimately the German Parliament are free to make the ultimate determination as to whether or not the remaining risks of nuclear power stations are still acceptable or not. Thus, the GCC unambiguously confirmed the broad regulatory powers of the State. Indeed, it did so in a very similar manner as the arbitral tribunal in the *Philip Morris v. Uruguay* tobacco plain packaging case.

Accordingly, the GCC *Vattenfall* judgment defies yet again the unfounded critique of anti-ISDS groups that judicial proceedings – be they national or international – would somehow limit the regulatory powers of the State

2nd lesson: legitimate expectations must be protected

Despite the broad regulatory freedom of the State, the State must act within certain boundaries. One important element in this regard is the protection of legitimate expectations.

More specifically, after the German State had extended the permissions for the nuclear power plants, Vattenfall and the other power plant operators were entitled to feel encouraged to undertake investments in their plants and did not have to expect that within the same legislative period, the German legislature would again distance itself from its fundamental decision in energy policy matters. The GCC stated in this context that:

“even the paramount public interest grounds for an accelerated nuclear phase-out cannot absolve the legislature of the consequences of those investments undertaken in the short period of validity of the 11th AtG Amendment [which extended the permissions] and in the legitimate expectation that the legislature itself had brought about with view of the prolongation of the operational lifetimes”.

Again, the similarities with the legitimate expectation principle in investment arbitration law is striking. Many arbitral tribunals have essentially approached this matter in the same way: when States create legitimate expectations, which in turn have resulted into investments, the investor can expect that the State acts in a reasonable and foreseeable manner. Conversely, if the State suddenly and unexpectedly completely reverses in a very short time frame its policy, the legitimate expectations of the investors must be protected.

3rd lesson: unjustifiable expropriation of property must be compensated

Finally, the GCC turned to the issue of the protection of property, expropriation and compensation. Based on its extensive jurisprudence, the GCC first of all made it clear that the protection of property can be limited for public purposes. Accordingly, the power plant owners had to accept a certain level of interferences with their property rights.

However, based on the principle of proportionality the GCC found that the lack of any compensation for the complete reversal of its policy on nuclear power constitutes violation of the property rights of Vattenfall et al.

Accordingly, the main take away from this judgment is that while the State retains broad regulatory powers to protect public goods, which may even lead to the expropriation of the property, disproportionate expropriation must be compensated.

In other words, expropriation for public purposes is acceptable as long as it is accompanied by adequate compensation. Again, this is strikingly similar to the system provided for in practically all bilateral investment treaties (BITs). This shows that the provisions contained in BITs and the

jurisprudence developed by arbitral tribunals is very much in tune with generally accepted constitutional law principles. Hence, BITs are nothing extraordinary or give investors special rights, but rather fit nicely into the Rule of Law system of the most advance democratic legal systems.

Foreshadowing the outcome in the *Vattenfall* ECT dispute

While it is obviously impossible to try to forecast the outcome of the *Vattenfall* ECT dispute, the similarities described above would seem to indicate that the arbitral tribunal would come to comparable conclusions as the GCC.

More specifically, it seems rather undisputed that the arbitral tribunal would also conclude that Germany has broad regulatory powers to determine whether or not, and if so, to what extent it considers the use of nuclear power as acceptable.

Moreover, following the general approach of other arbitral tribunals concerning the protection of legitimate expectations, it would seem likely that the *Vattenfall* arbitral tribunal would also conclude that Germany created legitimate expectations vis-à-vis Vattenfall that deserve to be protected.

As a consequence thereof, it would not be surprising if the *Vattenfall* arbitral tribunal would come to the same conclusion as to the GCC, namely, that the absence of any compensatory measures is a disproportionate interference with the property of Vattenfall, which has led to the destruction of investments made by Vattenfall, that must be compensated.

Whether or not the *Vattenfall* arbitral tribunal will decide as predicted remains to be seen.

However, at the very least it can be expected that the arbitral tribunal will perform a very comprehensive balancing between the regulatory powers of the State and the protection of the legitimate expectations and property rights of the investor. Just like the GCC, the arbitral tribunal will most likely analyse all arguments in-depth and come to a well-reasoned decision. In other words, we can expect to see a detailed award, which meets the highest legal standards – very much comparable to the GCC or any other international court or tribunal.

Accordingly, the *Vattenfall* arbitral tribunal will – hopefully – defy the anti-ISDS groups who have created such an unfounded hysteria against ISDS in the public debate by claiming that the *Vattenfall* case is an example of so-called “regulatory chill” or even worse undermining democracy.