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Legitimate Expectations in the Absence of Specific Commitments According to the Findings in Blusun v. Italy: Is there Inconsistency Among the Tribunals in the Solar Energy Cases?

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Introduction

The investment solar energy saga triggered by the regulatory reforms in the renewable energy undertaken by Spain and Italy is likely to be the new Black Swan in the investment arbitration world, reaching the importance and controversy of the Argentinian crisis of 2001. In addition, the question whether the ISDS system has learnt the lessons from the latter and is now capable of producing consistent results amidst the ocean of criticism remains open.

In June 2017, the Final Award of the ICSID tribunal in the first investment arbitration proceedings instituted against Italy arising out of the Italian reform in the solar energy sector (*Blusun S.A., Jean-Pierre Lecorcier and Michael Stein v. Italian Republic (ICSID Case No. ARB/14/3)*) was made available to the public. Although the Tribunal dismissed the infamous intra-EU jurisdictional objection raised by the European Commission as amicus curie, all claims were subsequently rejected on the merits. Similarly to other European solar energy cases, the dispute revolved around the central question whether the regulatory changes were contrary to the foreign investors' legitimate expectations and, hence, in breach of Art. 10(1) Energy Charter Treaty (ECT). After a thorough examination, the Tribunal concluded that no violations of the said provision have occurred. The analysis which led to this conclusion included a critical assessment of the findings reached by the tribunal in the previously resolved Spanish solar energy dispute in *Charanne v. Spain*, a process recently called by another author "cross fertilization". This cross fertilization, however, produced results which are far from consistent as the following notes demonstrate.

A Brief Factual Description

The dispute arose from the same facts as the *Eskosol S.p.A. in liquidazione v. Italian Republic (ICSID Case No. ARB/15/50)*, which is currently pending and was recently commented by Gabriele Gagliani. The Claimants in *Blusun v. Italy* were Blusun S.A., a Belgian company, and Messrs. Lecorcier and Stein, who own 80 % and 20% respectively of the shares in Blusun. Blusun was established in 2009 as a holding company in order to carry out the development, through two Italian subsidiaries (Eskosol and SIB), of a 120-MW photovoltaic project in Puglia, Italy. The project consisted of 120 smaller (up to 1 MW) photovoltaic plants which were to be joined through

a medium-voltage grid (rings) and were to be connected to the national grid through two substations (Award, paras. 53, 56).

The Disputed Measures

The Claimants disputed several measures undertaken by the Italian central and local authorities, namely:

1. the Constitutional Court decision of 2010, which declared the provisions of the Puglia's Regional Law 31/2008 enabling the application of the lighter DIA (Declaration of Initiation of Activities) regime with respect to solar plants up to 1 MW unconstitutional;
2. the Romani Decree, which limited the application of the feed-in tariffs to plants entered into operation before 31 May 2011 instead of 31 December 2013 as previously established;
3. the Fourth Energy Account, which allegedly further limited the scope of application of the incentives regime;
4. the Brindisi Stop-Work Order, which prevented any further work on investors plants following a police report and a local prosecutor's allegations of criminal activities violating zoning regulations.

Main Claims and Tribunal's Analysis

The Tribunal in *Blusun v. Italy* agreed with the investors that the first and the second sentences of Article 10(1) of ECT contain two separate obligations. Consequently, the first sentence of the said paragraph, namely: "*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*.") embodies an obligatory commitment towards investments and, in this sense,

1. should not be considered as a part of the fair and equitable standard (FET) embodied in the second sentence of Art. 10(1) ECT;
2. is not merely preambular or hortatory, as argued by the Respondent (Award, para. 319).

In contrast, the tribunal in *Charanne v. Spain* opined that the FET standard forms part of Spain's obligation to encourage and create stable, equitable, favourable and transparent conditions to foreign investors under Art. 10(1) ECT (*Charanne v. Spain* Award, paras. 476-477) rejecting, therefore, the asserted existence of two separate obligations in the first two sentences of Art. 10(1) ECT. The violation of the obligation in the first sentence of Art. 10(1) ECT was the key assertion on which the Claimants in *Blusun v. Italy* based their legal instability claim.

The Tribunal, however, further specified that the core commitment under Art. 10(1) ECT is to be found in the *second* sentence, which contains the FET standard. Thus, although the Claimants' position was based on the separate existence of two obligations under Art. 10(1) ECT, the Award analyzed the case through the prism of the alleged existence of legitimate expectations of the investors and the boundaries of the regulatory freedom entertained by Italy.

Legitimate Expectations in The Absence of Specific Commitments

The framing of the investors' case in the above-described manner allowed the Tribunal to use the findings of the arbitrators in *Charanne v. Spain* with regard to investors' legitimate expectations and regulatory changes in the renewable energy sector as a starting point of its analysis. Having

determined that RD 661/2007 and RD 1578/2008 do not constitute specific commitments to foreign investors, the *Charanne v. Spain* Tribunal opined that the investors' legitimate expectations can nonetheless be frustrated by modifications of the existing regulatory framework provided that, in enacting such modifications, the State acted unreasonably, disproportionately or contrary to the public interest (*Charanne v. Spain* Award, paras. 513-516). As to the proportionality, the changes would not be proportionate if they are capricious or unnecessary and amount to sudden and unpredictable elimination of the essential characteristics of the existing regulation.

The arbitrators in *Blusun v. Italy* seemed to disagree with *Charanne v. Spain* tribunal regarding the criteria which need to be observed in order to determine whether the regulatory changes in the Italian energy law violate the legitimate expectations of foreign investors protected by the FET standard under ECT in the absence of specific commitments by the host State.

In particular, the arbitrators stated that:

> "Of the three criteria suggested in Charanne, 'public interest' is largely indeterminate and is, anyway, a judgement entrusted to the authorities of the host state. Except perhaps in very clear cases, it is not for an investment tribunal to decide, contrary to the considered view of those authorities, the content of the public interest of their state, nor to weigh against it the largely incommensurable public interest of the capital exporting state. The criterion of 'unreasonableness' can be criticized on similar grounds, as an open-ended mandate to second-guess the host state's policies. By contrast, disproportionality carries in-built limitations and is more determinate. It is a criterion which administrative law courts, and human rights courts, have become accustomed to apply to governmental action." (Award, para. 318)

On the basis of this disagreement, the tribunal in *Blusun v. Italy* defined the standard to be when assessing the legality of regulatory changes in light of the foreign investors' legitimate expectations in the absence of specific commitments as follows:

> "In the absence of a specific commitment, the state has no obligation to grant subsidies such as feed-in tariffs, or to maintain them unchanged once granted. But if they are lawfully granted, and if it becomes necessary to modify them, this should be done in a manner which is not disproportionate to the aim of the legislative amendment, and should have due regard to the reasonable reliance interests of recipients who may have committed substantial resources on the basis of the earlier regime." (Emphasis added) (Award, para. 319(5)).

Interestingly, the criteria of public interest has also been outlined in the past in the *Electrabel v. Hungary* award, where it was emphasized that notwithstanding the investor's promised protection against changes in the legislation, the host State is entitled to maintain a reasonable degree of regulatory flexibility to respond to changing circumstances in the public interest. (*Electrabel v. Hungary* Award, para. 7.77). Thus, the *Blusun v. Italy* tribunal deviated to a certain extent from this practice determining that the public interest and reasonableness are largely indeterminate criteria in deciding whether the regulatory changes are contrary to the investor's legitimate expectations and relying solely on the proportionality test. It seems that the other Spanish cases

recently resolved, namely *Eiser v. Spain* and *Isolux v. Spain* are more in line with the opinion of the Charanne tribunal to the extent that award in the first case determined that "*…[a]bsent explicit undertakings directly extended to investors and guaranteeing that States will not change their laws or regulations, investment treaties do not eliminate States' right to modify their regulatory regimes to meet evolving circumstances* ***and public needs****…*" (emphasis added) (*Eiser v. Spain* Award, para. 362), while the award in the second one relied on the "*standard of* ***reasonableness*** *and proportionality*" to assess whether the legislator changes infringe the investors legitimate expectations (*Isolux v. Spain* Award, para. 430).

According to the 2012 UNCTAD study on FET standard many previous tribunals have relied on the assessment of the reasonableness and the accordance with the public interest of regulatory measures when reconciling them with legitimate expectations purported by investors absent specific commitments by the host State. Whether the *Blusun v. Italy* criticism of those requirements will initiate a discussion as to their necessity remains to be seen. It is the present author's opinion that the balance between the regulatory flexibility of the States and the legitimate expectations of foreign investors should be defined on a case by case basis taking into consideration all relevant factors. In this sense, all abstract standards should have nothing than an instructive character. That being said, the opinion of the *Blusun v. Italy* Tribunal that the public interest consideration should generally be *domaine réservé* of the State itself and not to be decided by an arbitral tribunal, deserves support as it takes into account the sovereign character of public interest notion.

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