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Legitimate Expectations in Renewable Energy Treaty Arbitrations: The Lessons So Far

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The initially alluring and subsequently vehemently amended incentives for investments in renewable energy projects across Europe have given rise to a significant number of arbitration claims brought on basis of the Energy Charter Treaty (ECT) and various BITs. Currently there are tens of pending investment treaty arbitrations with respect to renewable energy projects in Spain, Italy, Czech Republic, etc. A number of awards have already been rendered.

The analysis below considers the awards under four recent cases regarding alleged breaches of the standard of treatment (FET), including issues of stability and legitimate expectations: *Charanne B.V., Construction Investments S.A.R.L. v Spain*, SCC Arbitration No.: 062/2012 ("**Charanne**"); *Eiser Infrastructure Limited and Energia Solar Luxembourg S.a.r.l. v Spain*, ICSID Case No. ARB/13/36 ("**Eiser**"); *Blusun S.A., Jean-Pierre Lecorcier and Michael Stein v. Italy*, ICSID Case No. ARB/14/3 ("**Blusun**"); and *Jürgen Wirtgen, Stefan Wirtgen, Gisela Wirtgen, JSW Solar (zwei) GmbH & Co. KG v. The Czech Republic* ("**Wirtgen**") PCA Case No. 2014-03; *Novenergia II-Energy & Environment (SCA) (Luxembourg), SICAR v. Spain*, SCC Arbitration 2015/063 ("**Novenergia**").

No Breach Found

Charanne, which was the first decided investment treaty claim arising from the situation with renewable energy producers, considered various breaches of the ECT, including FET and legitimate expectations. The tribunal adopted the view, which is consistently expounded in previous arbitral case law, that it cannot be expected that regulatory framework would remain unaltered (para. 503 of the award). A state is entitled to sovereign policy as to its legislative incentives. However, this could be overridden if the investor holds legitimate expectations. These can be generated by a specific commitment towards the investor (para. 490 of the award). The tribunal did not find that there is such a commitment that incentives to renewable investments would not be altered. Moreover, the amendments in focus did not affect the essential characteristics of the renewable energy framework (para 539 Of the award) – feed-in tariff, etc.

In *Blusun*, the tribunal did not find a breach either. It held that the state is entitled to

make regulatory changes (para. 319 of the award). However, it distinguished its position from the analysis in *Charanne* and considered that there is no necessity to establish unreasonableness as to legislative amendments. The ECT, it was held, clearly demanded stability and predictability not only at the initial time of investment but also throughout its operation. Any amendments, although within a state's margin of appreciation, should be proportionate to a legislative aim. It is not only what is the substance of the regulatory changes but also what is their manner. The only carve-out is when there is a specific commitment and the investor has placed reliance on it (para. 373 of the award)..

The reasoning of *Wirtgen* seems a bit different, though. The tribunal indeed followed the argument that a state is entitled to make regulatory amendments and there can be a violation only if legitimate expectations generated by specific commitments are affected (para. 436-437 of the award). The tribunal, however, held that the guarantees of return to investors as the groundwork of the renewable energy promotion regime had been left intact. If an investor would continue to receive a level of revenue through the FIT system that ensures a 15 year payback of capital expenses and a return on investment of at least 7% per year over a period of 15 (later 20) years, there should not be a breach.

A Dissenter

A very strong dissenting opinion was put forward by Gary Born in *Wirtgen*. Born accepted that the Czech Republic breached the FET by amending its regulatory regime by the so called "solar levy". Although a state is allowed to make regulatory amendments and an investor is not entitled to expect that no changes are made, if a state makes specific commitment regarding guarantees to investments, these should not be affected by regulatory changes. A specific commitment may be in the form of a legislation in favour of a class of investors providing a set of elements for ensuring the operation of promoted investments. As the Czech Republic had committed itself and guaranteed a minimum of profit in the form of feed-in tariffs to the investors for a fixed period of time, an investor who relied on this regulatory regime is entitled to expect that the regime would not change. So the dissenting opinion goes beyond what was said in the award by the majority - that a level of profitability was guaranteed and hence if the level of profits is ensured, there can be no breach. Instead, the entire regime is, in the view of Born, a commitment guaranteed by the state and should not be amended.

Breach Found

Eiser was the first award where a host state providing beneficial incentives to investors in renewable energy production has been found to breach its international investment treaty obligations by altering its regulatory regime. The tribunal in *Eiser* reiterated that a state has full regulatory powers but on the other hand, this should not abrogate its fair and equitable treatment obligations towards investors (para. 362 of the award). If any changes are made, however, these should not be of a manner that does not take account of the circumstances of existing investments made in reliance on the prior regime. The ECT was found to protect investors against total and unreasonable changes (para. 363 of the award). Although changes are allowed,

fundamental stability of the essential characteristics of the legal regime relied upon by investors in making long-term investments should be ensured by the host state and radical amendments on key characteristics of the investment that were relied upon by the investors would constitute a breach. In *Eiser*, the tribunal accepted that the regulatory change was so radical and fundamental that it affected the financial fundament of the investments made in Spain and “washed away” the benefits envisioned at the time of investment. This qualified as a breach.

In February 2018, the tribunal in *Novenergia* noted the reasoning in *Eiser* and analysed whether Spain generated legitimate expectation and whether subsequently Spain radically altered the essential characteristics of its legislation in a manner that violates the FET standard (para. 656 of the award). The tribunal found that the objective of Spanish legislation was to ensure achieving emissions and renewable targets under EU law. Spain created, according to the tribunal, a very favourable investment climate for renewable energy investors. The domestic legislation in force at the time of investment incorporated commitments and assurances to guaranteed revenues on which investor placed reliance. Hence, the investor had a legitimate expectation that there would not be any radical or fundamental changes to the local laws. However, the investor could not have reasonably expected that there would be no changes to lower the value of its investment (para. 688 of the award). Spain had regulatory powers, but not unrestricted ones. A state’s regulatory interests are weighed against the investors’ legitimate expectations and reliance. It is not simply sufficient to look at the economic effect; but it can show a change in the essential characteristics of the legal regime relied upon by investors when making long-term investments (para 694 of the award). Ultimately, the tribunal found the challenged Spanish measures to be radical and unexpected which transformed the legal and business environment under which the investment was decided and made.

Inferences

The cited awards, although not entirely in line with each other and having a dissenting view, can serve as basis for a set of inferences.

It is not a matter of dispute that a state is entitled to make changes to its legislative framework and policy, including as to incentive and regulation of renewable energy production.

Any amendments have a “substantive” aspect, i.e. that changes should be targeted at a proportionate aim; and a “procedural aspect”, i.e. that should be enforced in a reasonable manner.

If a host state makes specific commitments, including guarantees that certain (financial) end results would be available to a renewable energy producer, an investor who relies on the commitments and guarantees can have legitimate expectations that these would not be altered. A commitment may be made not only by a direct stipulation towards a particular investor but also by enacting legislation in favour of a class of investors.

Complete subversion of the financial status of a project would be tantamount to a

breach of legitimate expectations. Alteration to key elements and essential characteristics of a regulatory framework such as feed in tariffs can also be a potential breach. If the legislative framework caters for specific levels of returns, this can also qualify as possible breach of legitimate expectations. An adverse economic effect may not be the only factor, but may indicate the implementation of drastic changes when considering the breach of FET.

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