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Where Does the First Investor-State Arbitration Award in the Spanish Renewables Cases Leave Us?

Monica Feria-Tinta (20 Essex Street) · Tuesday, April 19th, 2016

A tribunal in an investor-state arbitration under the SCC rules issued an award on 21 January 2016, in *Charanne B.V, & Construction Investments S.A.R.L vs The Kingdom of Spain*, the first of a series of cases arising from reforms Spain made in the renewable energy sector. The tribunal found that regulatory measures modifying the feed-in tariff regime for the photovoltaic sector in Spain did not amount to an indirect expropriation and did not violate the investors' legitimate expectations.

The claim, brought by investors from Netherlands and Luxembourg (Charanne B.V. and Construction Investments S.A.R.L respectively) under the Energy Charter Treaty ("ECT"), alleged that regulatory reforms implemented by Spain to the tariff regime applied to electricity generation systems based on photovoltaic solar energy in 2010 (i) had amounted to an expropriation (in violation of Article 13 of the ECT) (ii) violated fair and equitable treatment to the detriment of the claimants, contrary to article 10 (1) of the ECT, and (iii) that by failing to provide effective means under Spanish domestic law for the assertion of their claims and the enforcement of their rights with regard to their investments, Spain had incurred further, in violation of Article 10 (12) of the ECT. The original regime included incentives and grants to investors in the area of renewable energy which were subsequently modified. The claimants argued that "after having attracted their investment in the photovoltaic sector" Spain had "illegally modif[ied] the special regime that regulates that industry" causing them damages.

"The Sun Can Be Yours" and subsequent changes

Promoted under the slogan "*The sun can be yours*" by the government, the original system in Spain, in line with European Communities' objectives to promote electricity from renewable energy sources (Directive 2001/77/EC), provided for a feed-in tariff regime for the photovoltaic sector to enable investors recovering from costs incurred in installing solar power infrastructure. Yet in the wake of its economic crisis Spain introduced changes cutting down on its subsidies and others, via legislation. The claim of *Charanne* and *Construction* focused on the effect that secondary legislation, a decree, (RD 1565) and primary legislation, Royal Decree-Law (RDL 14/2010), had on their investments. By means of a decree (RD 1565) a 30-year limit on the tariffs had been imposed. By means of primary legislation (RDL 14/2010) an annual cap on the number of hours the claimants could sell their electricity production benefiting from the regulated tariff had been introduced. The changes also introduced new technical requirements that implied significant new costs for the investors, and new access tolls to the transmission networks of electrical energy.

The claimants alleged that all these changes had amounted to an indirect expropriation because together they gave rise to a significantly negative effect upon the enjoyment and economic profitability of their investment. They argued that the destruction of the totality of the investment is not required to amount to an expropriation but that it sufficed, *a significant or substantial interference* with the investment as the *Vivendi v Argentina* award reflected. They also argued that fair and equitable treatment under the ECT demands the maintenance of a stable and predictable legal framework for the investments. In this case they argued, their legitimate expectations had been frustrated.

Jurisdiction

Spain challenged the jurisdiction of the arbitral tribunal on three essential grounds. Firstly, it alleged that the investors had activated the "fork-in-the-road" provision contained in Article 26(3)(b)(i) which potentially bars an investor from submitting a claim that was previously submitted to the local courts or administrative tribunals or to "any applicable, previously agreed dispute settlement procedure", to arbitration. *Charanne* and *Construction* had not filed themselves such claims but it was argued that they had done so via *Grupo T-Solar ("T-Solar")*, the corporation through which they had done their investments in Spain and in which they were shareholders. Together with subsidiary companies T-Solar had challenged the secondary legislation in question in administrative proceedings in Spain, and taken action against the primary legislation filing a claim before the European Court of Human Rights alleging violation of the right to property by Spain. Secondly, Spain alleged that the claimants were not "investors" within the meaning of article 1.7 of the ECT because both corporations were in fact "*corporate empty shells*" controlled by Spanish nationals and that the character of "foreign" under the ECT was not a formal requirement but an objective condition which would allow arbitral tribunals to lift the corporate veil. Thirdly, Spain argued that the arbitral tribunal had no jurisdiction because the claim was an intra-EU one (EU investors against an EU member State), "of exclusive jurisdiction of the jurisdictional mechanisms of the European Union." It argued that "*the aim and intention of the ECT can only be that of setting up a special regime for the protection of investments relating to energy issues outside the frontiers of the EU*."

The Tribunal rejected Spain's jurisdictional position on all grounds. It noted that the European Court of Human Rights is not a tribunal of Spain nor a "previously agreed dispute settlement procedure" by the parties in the sense of article 26(2)(b). Moreover, it held that although the claimants formed part of the Grupo T-Solar, this was not enough in itself to consider that there was "*a substantial identity of parties*" between *Charanne* and *Construction* on the one hand and *Grupo T-Solar* on the other. In respect of the arguments that such investors would be in fact not foreign because they would be controlled by Spanish nationals the tribunal held that the claimants were incorporated in accordance with the legislation of Netherlands and Luxemburg respectively and therefore foreign investors for the purposes of ECT, reiterating the *Yuko* principle, mainly that "*The tribunal knows of no general principle of international law that would require investigating how a company or another organization operates when the applicable treaty simple requires it to be organized in accordance with the laws of a contracting party*." More interestingly, the tribunal rejected the arguments of Spain which submitted that there existed in the ECT an "implied disconnecting clause" for intra-EU relations which disconnected EU State members from the ECT, in their relations among them. This was in the view of the arbitral tribunal, ultimately a matter of interpretation of the ECT in accordance with article 31 of the Vienna Convention on the Law of Treaties. The Tribunal held that the terms of the ECT were clear and did not justify to read within this treaty an implied disconnecting clause. It held: "*There is no rule of EU law that prevents*

Member States of the EU from resolving their issues with investors from other Member States by means of arbitration. Nor is there any rule of EU law that prevents an arbitral tribunal from applying EU law to resolve such a dispute." The tribunal did not find reason to apply the *Electrabel vs Hungary* principle according to which "from whatever perspective the relationship between the ECT and EU Law is examined, the Tribunal concludes that EU Law would prevail over the ECT in case of any material inconsistency" as it did not see contradictions between the ECT and EU law in the case. Neither did it find that article 344 of the Treaty on the Functioning of the European Union (TFEU) prohibited the application of EU law by arbitral tribunals in cases concerning State members as alleged by Spain. It held: *"A Member State may draw up arbitral agreements in disputes that may involve issues of EU law. Nowadays it is universally accepted that an arbitral tribunal not only has the power but also the duty to apply EU law."* It further held that Article 344 of the TFEU did not apply to Investor-State arbitration.

Reasonable and foreseeable measures

The gist of the defence of Spain was that its measures were "reasonable and foreseeable". The limitation of the right to benefiting from a regulated tariff to 30 years, coincided with the average time of the working life of the installation. Based on the principle reflected on the *Methanex v EE.UU* arbitral award, Spain asserted that the legislative changes introduced in the sector were an expression of its Sovereign right to regulate. Moreover, it argued that the right to a tariff was not an *acquired right* and therefore its modification was legitimate. Meeting the fair and equitable treatment standard under the ECT in its view, does not mean to freeze a legal framework in place or the equivalent to a stabilization clause.

An important consideration of the arbitral tribunal revolved around the nature of the investment in order to examine whether such investments had been expropriated or not. It held that the investment of the claimants consisted of an indirect participation in *Grupo T-Solar*; that is, the claimants had invested in shares and not in returns. The tribunal appreciated that although the changes may have affected the value of the shares, this reduction in the profitability had not been of a degree sufficient to characterize it as an indirect expropriation. Referring to the 2012 UNCTAD study on fair and equitable treatment, which stated that, "an investor may derive legitimate expectations either from (a) specific commitments addressed to it personally, for example in the form of a stabilization clause, or (b) rules that are not specifically addressed to a particular investor but which are put in place with a specific aim to induce foreign investments and on which the foreign investor relied in making his investment", the tribunal held that in the present case no specific commitments had been adopted by Spain. This could have been adopted *via* a stabilization clause or by means of a declaration by Spain addressed to the investors but this had not taken place. Since such a specific commitment on the part of Spain did not exist, no violations of investors' legitimate expectations had taken place with the introduction of the legislative changes. The tribunal adopted the *Electrabel* principle as its own, according to which

"While the investor is promised protection against unfair changes, it is well established that the host State is entitled to maintain a reasonable degree of regulatory flexibility to respond to changing circumstances in the public interest. Consequently, the requirement of fairness must not be understood as the immutability of the legal framework […]".

The tribunal further found that the remedies available in the Spanish legal system to seek redress from, or challenge, the Royal Decree-Law (RDL 14/2010), such as the possibility to lodge a constitutional action were sufficient to satisfy Article 10 (12) of the ECT as this provision does not

impose on State parties a particular *modus* to follow within a judicial system.

The tribunal ordered the claimants to pay around 1.3 million euros to Spain towards its costs.

A partial dissenting opinion on the point of "legitimate expectations" was issued by one of the arbitrators in the case, Prof Guido Santiago Tawil.

Concluding remarks

The outcome of this case is of particular importance in the context of investment disputes.

A fundamental issue creating tension in investment arbitration already for some time, was at stake in the case: the right of the State to regulate in areas where foreign investment enjoys protection. An interesting point raised by the tribunal in that sense was the need to carry out a *due diligence* analysis of the legal framework of the host country on the part of the investors, in order to shape expectations. An interesting caveat, however, is the limited context the arbitral tribunal admittedly had in the case in order to assess regulatory stability under Article 10(1) of the ECT, as the parties had brought only the 2010 changes, given the fact that another arbitral tribunal is dealing with other legal changes. As the tribunal itself stated "*to appreciate whether the evolution of the regulatory framework characterises an instability contrary to article 10(1) would, in fact, suggest an examination of the combination of normative changes introduced to date*" and not just the effects of two norms.

The case is emblematic of existing tensions in investment arbitration at a number of levels: the tension between public (State regulation) *vs* private (investor rights); the tension between EU efforts to root out intra-EU investment arbitration and the jurisdiction asserted by arbitral tribunals under the ECT in such cases. A systemic integration approach that looks at international law as a unity (and not as a fragmented universe), nevertheless, can be seen from key observations made by the tribunal. Although the tribunal asserted jurisdiction contrary to the objections of Spain supported by an *amicus curiae* of the European Commission in the case, the tribunal acknowledged the relevance of EU Law for the International foreign investment protection regime.

This is the first of at least 26 cases Spain faces over its renewable energy reforms (including ICSID cases).

Indeed, as reported, Energy Charter Treaty claims made Western Europe the most sued region before ICSID during 2015 as a consequence of the cases brought against Spain. Electric Power & Other Energy arbitration accounted for 42 per cent of the total of ICSID cases in 2015.

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