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The Renewable Energy Saga from Charanne v. Spain to The PV Investors v. Spain: Trying to See the Wood for the Trees

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In the early 2000s, several European states introduced generous incentive programs to attract investors to renewable energy, triggering an investment boom. In the wake of the global financial crisis of 2008, however, the incentive payments put a strain on regulators. The subsequent changes to the regulations of the renewable energy sector implemented by Spain, Italy, and the Czech Republic have sparked a considerable number of arbitrations against these states.

This contribution seeks to bring clarity to the 28 arbitral awards brought against Spain, Italy, and the Czech Republic (as of February 2020). Specifically, it will argue that these awards fit a typology made up of three different lines of reasoning, depending on their conclusions regarding the alleged frustration of legitimate expectations.

Background

Each of the renewable energy regulations adopted by the three states had a two-tier structure:

1. the framework laws guaranteed investors “reasonable profitability rates” (Spain), a “fair return” (Italy) or a certain payback period (Czech Republic); and
2. implementing legislation specified the exact feed-in tariffs which were at the heart of the incentive programs.

Spain, Italy, and the Czech Republic each rolled back their incentive schemes. Italy and the Czech Republic reduced the feed-in tariffs. Spain, by contrast, chose a two-stage process: the measures preceding the first half of 2013 constituted relatively cautious modifications whereas the changes from July 2013 onwards abolished the fixed feed-in tariffs.

As a result, the three states faced a wave of arbitral proceedings, mainly on the basis of Article 10(1) of the Energy Charter Treaty (to which reforms are currently being discussed), with the investors arguing a violation of the fair and equitable treatment standard due to a frustration of their legitimate expectations. The key legal question in this context was: what legitimate expectations can general legislation give rise to?

The 28 arbitral awards from *Charanne v. Spain* to *The PV Investors v. Spain* did not give a uniform answer to this question. Rather, these awards can be divided into three different lines of reasoning,

which are examined in the paragraphs that follow.

First Line of Reasoning – All State Measures Frustrated Legitimate Expectations

The first line of reasoning was followed by 5 tribunals and 4 dissenting opinions. The tribunals (and dissenting opinions) offered three different lines of analysis concerning this first line of reasoning.

The tribunal in *Masdar v. Spain* contrasted two investment scenarios: one with and one without a specific commitment as to the stability of the legal framework. If the host state had given a specific commitment, an investor could legitimately expect that the legal framework would not be modified contrary to such commitment. By contrast, without a specific commitment, an investor could only expect that the host state would refrain from unreasonable or unjustified changes. However, the tribunal then avoided the central legal question of whether general legislation could constitute a specific commitment as it found that Spain had provided other specific commitments.

A number of tribunals and dissenting opinions following *Masdar* equated generally applicable legislation with a specific commitment, invoking the wording and object and purpose of the respective laws to find they had been deliberately implemented to attract investors (*9REN v. Spain; OperaFund v. Spain; Greentech v. Italy; Antaris v. Czech Republic, Dissenting Opinion of Mr Gary Born; Wirtgen v. Czech Republic, Dissenting Opinion of Mr Gary Born*). Accordingly, the regulatory changes in Spain, Italy, and the Czech Republic were found to have frustrated the investors' legitimate expectations.

Prima facie, *CEF v. Italy* does not fall within this line of reasoning. For instance, the tribunal emphasized that without a specific commitment, investors' expectations had to be balanced against host states' right to regulate. Yet, it argued that Italy had undoubtedly committed to paying constant feed-in tariffs. Therefore, the cut-back frustrated legitimate expectations. Implicitly, then, the tribunal treated Italy's legislation as a specific commitment.

Lastly, the dissenting opinions in *Charanne* and *Isolux* maintained that while laws were not equivalent to a specific commitment, they could nonetheless give rise to a legitimate expectation that they would not be changed to the detriment of foreign investors.

Second Line of Reasoning – Only the Later Spanish Measures Frustrated Legitimate Expectations

The second line of reasoning was followed by 10 tribunals. These tribunals viewed only the later Spanish measures – i.e. the abolition of the fixed feed-in tariffs and their replacement by a significantly less generous remuneration regime – as a frustration of legitimate expectations, offering two different lines of argument.

One group argued that a regulatory framework *per se* did not contain a specific commitment. Therefore, investors could not legitimately expect that the legal framework be frozen. Nonetheless, investors could expect that when changing regulations, a state would not act "unreasonably, disproportionately or contrary to the public interest" (*Charanne v. Spain;* similarly *Blusun v. Italy;*

SolEs v. Spain; Antin v. Spain) or that changes would not be "total and unreasonable" (*Eiser v. Spain*; similarly *Foresight v.* Spain*; Novenergia II v. Spain; NextEra v. Spain*). Thus, while the tribunals in *Charanne* (dealing only with parts of the earlier Spanish measures) and *Blusun* denied a frustration of legitimate expectations, those in *SolEs, Antin, Eiser, Foresight, Novenergia II,* and *NextEra* found that Spain had contravened legitimate expectations by abolishing the fixed feed-in tariffs.

The second group argued that general legislation could contain commitments to regulatory stability. However, the resulting legitimate expectations were limited in scope: a host state frustrated them only if it significantly altered the economic basis of investments made in reliance upon such legislation (*Cube v. Spain;* similar approach in *Watkins v. Spain*).

Importantly, while the tribunals following the second line of reasoning were divided over whether a regulatory framework could be equivalent to a specific commitment, they agreed that investors could not expect general legislation to remain unchanged. Rather, modifications had to reach the threshold of unreasonableness or disproportionality or call into question the economic basis of an investment to defeat legitimate expectations.

Third Line of Reasoning – Legitimate Expectations Were Confined to a Reasonable Return

The tribunals following the third line of reasoning argued that investors could not expect to be paid the fixed feed-in tariffs specified in the implementing legislation. Rather, their only legitimate expectation was a reasonable return (as the framework laws had promised). As long as they received such return, the host state had not contravened legitimate expectations.

The third line of reasoning was followed by 13 tribunals. Again, these tribunals presented three different lines of argument. However, unlike those following the first and second lines of reasoning, tribunals following the third line had to deal with quite heterogenous facts.

The tribunals in *Isolux v. Spain*, *Antaris v. Czech Republic*, and *Belenergia v. Italy* shared the premise of the first group in the second line (*Charanne* etc.) that general legislation could in principle give rise to legitimate expectations. Yet, as the investors had invested relatively late – when the unsustainability of the incentive schemes had become obvious – they could only expect a reasonable return. As the investors received such return, these tribunals dismissed the investors' frustration of legitimate expectations claim.

By contrast, according to the tribunals in *The PV Investors v. Spain*, *Stadtwerke v. Spain*, *BayWa v. Spain*, and *Wirtgen v. Czech Republic*, investors could only legitimately expect a reasonable return from the outset; and that legislative amendments would not be unreasonable, arbitrary or disproportionate. At this point, the tribunals in *The PV Investors, Stadtwerke,* and *BayWa* addressed the substance of the regulatory changes and sought to balance the competing interests of foreign investors and host states. Because the investors in *Wirtgen, Stadtwerke,* and *BayWa* still achieved a reasonable return, their legitimate expectations had not been contravened. Conversely, in *The PV Investors* some claimant entities were denied a reasonable return contrary to legitimate expectations.

Similarly, the tribunal in *RWE v. Spain* did not view general legislation as a specific commitment and therefore dismissed the frustration of legitimate expectations claim. However, it examined the

proportionality of the regulatory changes, likewise focusing on their substance. It concluded that they represented an excessive burden on some of the investors' power plants, were to that extent disproportionate, and therefore violated fair and equitable treatment.

Lastly, some tribunals combined the reasoning in *Isolux* etc. and *The PV Investors* etc., arguing that the legislation had promised only a reasonable return – all the more so as the claimants had invested late (*RREEF v. Spain; Photovoltaic Knopf v. Czech Republic; Voltaic v. Czech Republic; I.C.W. v. Czech Republic; WA v. Czech Republic*). Only in *RREEF* did the host state renege on that promise.

Conclusion

These awards fit a continuum, with the first line of reasoning fiercely defending investors' rights and the third line giving legitimate expectations the comparatively narrowest scope. Can the different approaches be reconciled?

Concerning the first and second lines of reasoning, the tribunals following the respective arguments seemingly shared the same premise as to whether general legislation could or could not constitute a commitment to stability. Yet, they reached different conclusions on the frustration of legitimate expectations by attaching different meanings to key terms.

For example, the tribunals in the first line of reasoning that equated general legislation to a specific commitment (*9REN* etc.) agreed with *Cube* in the second line that generally applicable legislation could contain a commitment to stability. Nonetheless, they broadened the scope of the legitimate expectations: in their view, investors could legitimately expect that the host state would not enact *any* adverse changes. Hence, the first line of reasoning implicitly gave a broader meaning to the term "commitment" than did the tribunal in *Cube*.

Similarly, the view in the first line of reasoning that laws, while not a specific commitment, could create legitimate expectations had a counterpart in the second line (*Charanne* etc.). Again, the first line of reasoning gave a different spin to a key term, namely to "legitimate expectations": according to the first line, investors could legitimately expect that there would be no disadvantageous changes to the regulations, whereas pursuant to the second line, they could only expect that changes would not be unreasonable or disproportionate.

With respect to the first two lines of reasoning and the third line, the main divergence relates to the two-tier structure of the regulations (especially the Spanish one): the third line considered the framework laws and not the implementing legislation to be decisive for legitimate expectations. Consequently, according to the third line, investors could not expect to receive fixed feed-in tariffs, but only to earn a reasonable return. Therefore, in particular the abolition of those tariffs through the later Spanish measures did not *as such* frustrate legitimate expectations, but only if investors were deprived of such return.

Overall, then, the three lines do not give the same scope to legitimate expectations created by general legislation. Nonetheless, the awards fit a typology made up of three different lines of reasoning; in other words, we can still see the wood for the trees.

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