

Kluwer Arbitration Blog

Japanese Renewable Investor Obtains Damages Award Over Spanish Regulatory Reforms

Michael McErlaine (Herbert Smith Freehills LLP) · Saturday, March 11th, 2023 · Herbert Smith Freehills

Renewable energy is front-and-centre in the Japanese energy agenda. Japan is still heavily reliant on fossil fuels for its electricity generation needs with [one-third of its carbon emissions](#) coming from its 78 thermal power stations. The [Japanese prime minister has pledged](#) that Japan will be carbon neutral by 2050 leading to the Japanese Ministry of Economy, Trade and Industry to publish its [Green Growth Strategy](#), which pushes for 50-60% of the country's energy to be supplied from renewables. At the same time, Japan has been resisting changes to the Energy Charter Treaty ("ECT") expressing its view on a number of occasions that amendments to the current ECT provisions are not necessary (as reported in the [Blog here](#)). This position likely reflects existing Japanese investments in fossil fuel energy projects (see further coverage on the potential divergence between protection of fossil fuel energy projects and renewable projects on the [Blog here](#)). However, this did not stop the contracting parties reaching an agreement in principle to modernising the ECT in June last year. Against this backdrop, this post considers the outcome of a recent ICSID claim against Spain filed by a Japanese investor in renewable energy, to consider how it fits within the broader context of the controversy surrounding the modernisation of the ECT.

Background: *Eurus Energy v. Spain*

Eurus Energy ("**Eurus**"), a joint venture between Toyota Tsusho Corporation and the Tokyo Electric Power Company, and one of the biggest Japanese renewable power developers, recently obtained a [favourable award](#) in its ECT claim against Spain. Eurus's claim arose out of reforms instituted by the Spanish government in the renewables sector. Eurus was part of a wave of investors who brought claims against Spain under the ECT after the Spanish authorities reduced subsidies in the renewables sector and introduced a tax on renewable power generators.

In 2007, the Spanish authorities implemented a number of regulatory measures to encourage investment in renewable energy including generous incentive programmes to attract foreign investment in the Spanish renewable energy sector. The huge take-up of these measures by investors, combined with the financial crisis, led Spain to change the regime, including to retract some features of the original regulatory measures and incentive regimes. Part of these reforms also included provisions under which Spain could claw back subsidies paid prior to 2013 that were

higher than those payable under the subsequent reforms.

This led to a number of arbitrations filed against Spain under the ECT by investors arguing a breach of the fair and equitable treatment standard as well as a breach of legitimate expectations. Eurus was one such investor who initially sought €258 million from the Spanish authorities. Eurus had two primary arguments: (i) that it had a legitimate expectation that the regulatory regime would continue, and (ii) that there was a breach of the fair and equitable treatment provision of the ECT.

Legitimate expectation

Eurus argued in the proceedings that it had a legitimate expectation that the regulatory regime would remain unchanged over the life of the projects. The counter-argument from the Kingdom of Spain was that the special regime was based on the principle of a “reasonable return”, meaning a producer was only guaranteed to receive sufficient funds to recover investment costs and operating costs, and make a return in line with market criteria. Spain argued that incentives for facilities were always subject to an undefined cap.

The Tribunal held that Eurus could not have held a legitimate expectation that the regulatory regime in Spain would remain unchanged and that subsidies would continue to be paid at the same rate indefinitely. The Tribunal was persuaded that the Spanish authorities had not made any specific commitments to maintain the subsidies. However, the Tribunal accepted that Eurus did have a legitimate expectation that subsidies would be continued “*in some substantial form*” even if they were to change over the lifetime of Eurus’ wind power projects.

Other claims related to fair and equitable treatment

Eurus had also argued that Spain’s changes to the regulatory regime breached the fair and equitable treatment protections of the ECT. In particular, Eurus argued that the retroactive changes to the rules breached Spain’s obligations to maintain stable and favourable conditions for its investment.

The Tribunal ruled that it was not its role to second guess reasonable measures Spain could have taken and propose alternative policies but, rather, to assess whether the measures were proportionate and had due regard to the reasonable reliance interest of recipients who may have committed substantial resources on the basis of the previous rules.

The Tribunal concluded that, with regard to most of the disputed measures, there had been no breach of the “fair and equitable” protection in the ECT in the absence of conclusive evidence that could substantiate a finding of unreasonableness or discrimination. However, one exception was the proposed claw-back of subsidies paid prior to 2013. The Tribunal held that when the subsidies had been paid, the investor remained entitled to the benefit of the stable regime promised by the ECT.

Damages

The Tribunal directed the parties to seek to reach agreement on the monetary impact of the ruling on the claw-back provisions. Eurus sought €106.2 million by way of damages and was awarded the full amount. This is one of the larger awards issued against Spain arising from changes to their renewables regime, although by no means the largest.

Analysis

Eurus' success came just before Japan's successful defence of a renewable energy claim brought under the Japan-Hong Kong bilateral investment treaty. That claim, brought by the Hong Kong-based investor, Shift Energy, reportedly concerned reforms to Japan's renewable energy subsidy regime introduced following the March 2011 Great East Japan Earthquake that led to the shutdown of Japan's nuclear reactors. The contrast with Spain's position demonstrates the implications of the *Eurus* decision and the proposed upcoming changes to the ECT.

Of the 157 cases brought under the ECT, the vast majority of them – over 90 – relate to renewable energy projects. This reflects regulatory changes brought in by a number of countries as to how they incentivise investment in renewable energy. Global demand for renewable energy has led to an acceleration of investment in the sector. That is unlikely to change as governments and corporates seek to address climate change, and disputes in the renewable sector are only likely to grow. The developments in the Eurus proceedings come in the wake of the recent controversy surrounding the modernisation of the ECT. In particular, although it was announced in late June 2022 that the Contracting Parties to the ECT had reached an agreement in principle on its modernisation, many European countries including Spain have announced their intention to withdraw from the treaty. Although the contracting parties were supposed to finalise the draft modernised treaty late last year, that vote has now been postponed to April 2023.

Previous ICSID awards in other ECT-related claims involving Spain have reached different conclusions on whether an investor can have legitimate expectations in the circumstances and, if so, what those legitimate expectations are. For example, in *Charanne and Construction Investments v Spain* SCC Case No. V 062/2012 (“*Charanne*“) the investor claimed that the original regulatory regime induced them to invest in the Spanish renewables sector and gave rise to an expectation that the terms of that regime would not be altered. The Tribunal rejected that argument holding that – similar to the reasoning of the Tribunal in the Eurus arbitration – the regulatory framework was not sufficiently specific. In contrast, in *Novenergia II – Energy & Environment (SCA), SICAR v Spain* SCC Case No. 2015/063 (“*Novenergia*“), the Tribunal held that legitimate expectations could arise from “*undertakings and assurances*” provided by the Spanish authorities including, in that instance, statements by officials of the Spanish Congress of Deputies.

One of the key focus areas for the Contracting Parties in the negotiations was strengthening the right to regulate. Accordingly, the proposed changes to the ECT include additional references in the preamble to the States' right to regulate as well as a stand-alone article reaffirming such right in the interest of legitimate public policy objectives. In addition to strengthening the State's right to regulate the proposed changes to the ECT will narrow the definition of protected investors and investments. Overall, the planned reforms are likely to lead to a watering down of investment protections for investors.

The fair and equitable treatment standard will also be amended. In its current form, Article 10(1) of the ECT simply requires States “*to accord at all times to Investments of Investors of other Contracting Parties fair and equitable treatment*“. No definition or further information is provided. The Contracting Parties intend to list certain measures that would amount to the violation of the standard and to clarify the circumstances where legitimate expectations may be considered although investors are likely to see such arguments become more challenging rather than less. The exact approach that will be taken remains to be seen but may go to aligning some of the prior inconsistent cases.

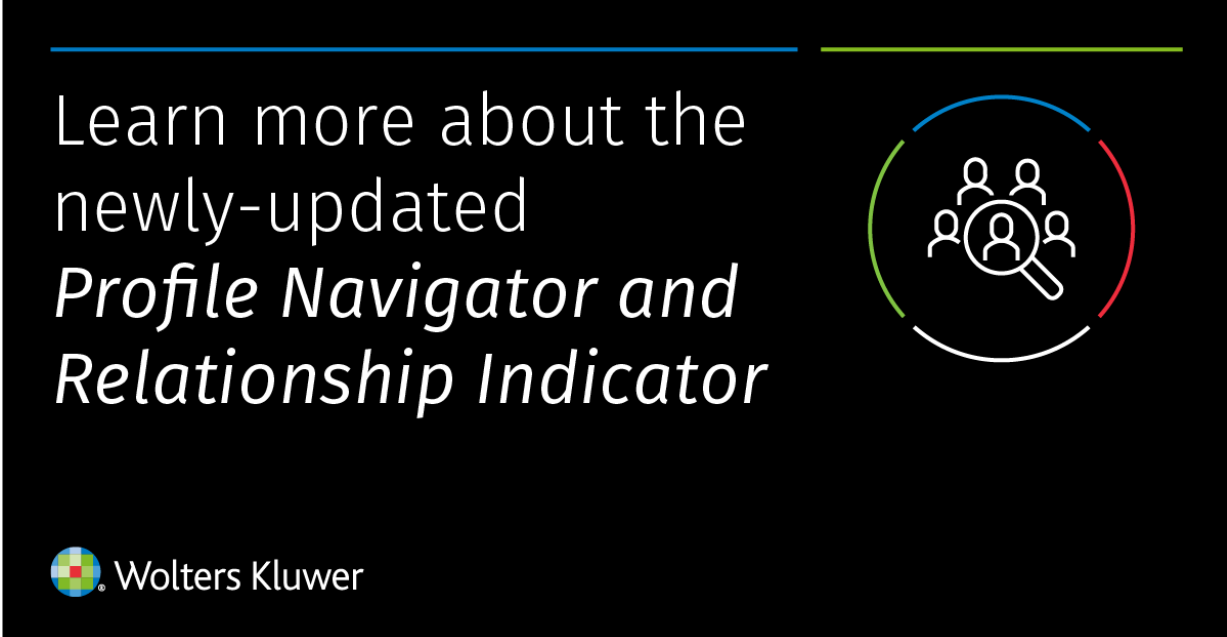
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The graphic features a black background with white text and a circular icon. The icon depicts a group of stylized human figures, with one figure in the center being magnified by a magnifying glass. The background is accented with horizontal lines in blue and green.

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