

# Legitimate expectations in the arbitral practice of green energy cases under the Energy Charter Treaty

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### ABSTRACT

This paper discusses the issue of legitimate expectations in the arbitral practice of green energy cases under the Energy Charter Treaty. Before the economic crisis of 2008, several European countries provided special incentives and subsidies to investors in the field of renewable energy. However, following the crisis, some of them (e.g. Spain and Italy) abridged these benefits, which resulted in a number of arbitration proceedings under the Energy Charter Treaty. Some of these are still pending. Most of these disputes are centered on legitimate expectations, a major component of the fair and equitable treatment standard. The introductory part of the article gives a general overview of the issue of legitimate expectations in international investment law, and identifies the three types of situations which can generate legitimate expectations: specific commitments, unilateral representation or promises, and regulatory frameworks. The main part of the work analyses the most relevant green-energy cases of the Energy-Charter-Treaty-related arbitrations, with special emphasis on the issue of legitimate expectations. In the final part of the paper, conclusions are drawn based on the case law here presented, as well as other researched cases.

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### KEYWORDS

legitimate expectations, investment protection, green energy, Energy Charter Treaty, ECT

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## 1. INTRODUCTION

The investment decisions of investors are affected by their legitimate expectations as they desire legal certainty and a predictable legal environment. Legitimate expectations, as a sub-standard of fair and equitable treatment, is not mentioned in treaties, but in arbitration practice and scholarly writings.<sup>1</sup> Notwithstanding this, during the last decade the former has become one of the major components of the fair and equitable treatment standard.<sup>2</sup> Some authors even claim that legitimate expectations may be regarded as a ‘general principle of international law that prescribes a direction to be followed and, alongside, vests the judge [arbitrator] with the power of inferring (from the principle) the rules applicable to a given case.’<sup>3</sup> Some authors, like Yannick Radi, consider legitimate expectations to be a balancing method used by dispute settlement bodies with which they justify and legitimize their rulings.<sup>4</sup> Regarding the latter’s relation to fair and equitable treatment, Radi goes so far as to state that legitimate expectations is not a sub-category, but a category that replaces fair and equitable treatment.<sup>5</sup>

One of the first awards which referred to the protection of legitimate expectations (or only ‘expectations’) as a sub-standard of fair and equitable treatment was the *Tecnicas Medioambientales Tecmed S.A. v The United Mexican States*<sup>6</sup> case. Tecmed, a Spanish company, requested arbitration against Mexico based on the bilateral investment treaty concluded between Spain and Mexico.<sup>7</sup> Tecmed, among others, claimed that the Mexican authorities had in fact expropriated its investment by denying the renewal of a license to operate Tecmed’s landfill, as well as had violated the fair and equitable treatment standard of the respective bilateral investment treaty.<sup>8</sup> The Tribunal

<sup>1</sup>However, there are also tribunals which did not find that a breach of legitimate expectation does not violate in itself the fair and equitable standard (see *Mesa Power Group, Llc v Government of Canada*, PCA Case No. 2012-17).

<sup>2</sup>Potestà (2013) 88, 103; Palombino (2018) 86; See also *Saluka Investments BV (The Netherlands) v The Czech Republic* case, PCA Case No. 2001-04 para 302.

<sup>3</sup>Palombino (2018) 89.

<sup>4</sup>Radi (2013) 8.

<sup>5</sup>Radi (2013) 10.

<sup>6</sup>Case No. Arb (Af)/00/2 Award. *Tecnicas Medioambientales Tecmed S.A.* paras 41, 88, 122.

<sup>7</sup>In an earlier NAFTA case there was already a reference to the expectations of the investor: in the *Metalclad Corporation v The United Mexican States* case, Case No. ARB(AF)/97/1, a U.S. waste disposal company, Metalclad Corporation, initiated arbitration proceedings against Mexico alleging, among other things, breach of NAFTA article 1110. Its notice of arbitration asserted that Mexico wrongfully refused to permit Metalclad’s subsidiary to open and operate a hazardous waste facility that the company had built in La Pedrera, despite the fact that the project was allegedly executed in response to the invitation of certain Mexican officials and allegedly met all Mexican legal requirements. Metalclad sought damages of USD 43,125,000 and damages for the value of the enterprise taken. In this case, the ICSID Arbitral Tribunal interpreted expropriation as including: ‘also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host state.’ The tribunal also found that Mexico breached the fair and equitable standard, because despite the federal government’s promises the company did not get the necessary licenses.

<sup>8</sup>The claimant also argued that not granting the permit had deprived the investment of its market value. The respondent argued that it had the discretionary power to not grant the permit, as it was a regulatory measure within the state’s police power. The Tribunal concluded that such denial was in fact expropriation of the investment and awarded damages of USD 5.5 million to the claimant. *Tecnicas Medioambientales Tecmed S.A.*; see also: Piernas (2006) 218-22.



defined very clearly the concept of legitimate expectations in the award: ‘The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations.’<sup>9</sup> Several awards later referred to this case regarding the legitimate expectations standard.<sup>10</sup> The award is criticized because the Tribunal bound the fair and equitable treatment standard to the good faith principle, even though the latter cannot be the source of obligation in itself.<sup>11</sup>

In *International Thunderbird Gaming Corporation Claimant v The United Mexican States*,<sup>12</sup> the Tribunal even defined the concept of legitimate expectations (although only under NAFTA): ‘[...] a situation where a Contracting Party’s conduct creates reasonable and justifiable expectations on the part of an investor (or investment) to act in reliance on said conduct, such that a failure by the NAFTA Party to honor those expectations could cause the investor (or investment) to suffer damages.’<sup>13</sup>

In case law, we can distinguish among three types of situations which can generate legitimate expectation: specific commitments, unilateral representations or promises, and regulatory frameworks. In the first situation, the host state makes specific commitments in the individual investment agreement concluded with the investor, which the investor claims created legitimate expectations. For example, suppose a government concludes an investment agreement that promises ten years’ tax exemption. However, after a few years, a change in government leadership imposes a tax despite the investment agreement that established the foreign investor’s expectations. A good example of an award that supported such a view of an investor is the *EDF (Services) Limited v Romania*<sup>14</sup> case. The Tribunal found that: ‘Except where specific promises or representations are made by the State to the investor, the latter may not rely on a bilateral investment treaty as a kind of insurance policy against the risk of any changes in the host State’s legal and economic framework. Such expectation would be neither legitimate nor reasonable.’<sup>15</sup>

Further, several tribunals have differentiated between legitimate expectations protected under international law and purely contractual expectations.<sup>16</sup> To claim a host state’s breach of fair and equitable treatment standard, more than a simple breach of contractual obligations

<sup>9</sup>*Tecnicas Medioambientales Tecmed S.A.* para 154.

<sup>10</sup>For example, the already mentioned, and frequently cited *Saluka Investments BV* award in para 302.

<sup>11</sup>*Potestà (2013)* 5; See also *Tecnicas Medioambientales Tecmed S.A.* para 154.

<sup>12</sup>In this case the foreign investor, who wanted to invest into operating skill machines (‘for purposes of enjoyment and entertainment’) asked for an official opinion regarding the legality of operating these machines in Mexico. Following the positive written answer, they invested money and started operations. Shortly after this the Mexican Government shut down the business declaring it illegal. *International Thunderbird Gaming Corporation v The United Mexican States*, UNCITRAL, 2006.

<sup>13</sup>*International Thunderbird Gaming Corporation* para 147.

<sup>14</sup>ICSID Case No. ARB/05/13.

<sup>15</sup>*EDF (Services) Limited* para 217.

<sup>16</sup>E.g. *Parkerings-Compagniet AS v Republic Of Lithuania*, ICSID Arbitration Case No. ARB/05/8, or *Duke Energy Electroquil Partners SA v Ecuador*, ICSID Case No. ARB/04/19, *Gustav F W Hamester GmbH and Co KG v Ghana*, ICSID Case No. ARB/07/24; *Potestà (2013)* 17.



(i.e. more than not merely fulfilling a contract) is needed. An investor would have to prove bad faith, substantial breach, abuse of government authority, or similar.<sup>17</sup> Furthermore, it is questionable whether the investor can invoke the legitimate expectation argument successfully if it is known or should have known (i.e. such as through due diligence) that the government promises are contrary to legislation.

The second situation which can generate legitimate expectation is a unilateral representation or promise. That is, when the host state makes unilateral, informal promises to the investor (i.e. comfort letter, official opinion, promise made publicly by the representative of the government, etc.) on which the investor relies when making the investment. The *Metalclad Corporation* case – a NAFTA case that precedes the *Tecnicas Medioambientales Tecmed S.A.* case that we discussed earlier – is a good example of such a situation. The *International Thunderbird Gaming Corporation* case would also have been a good example were it not for the investor not disclosing all the facts when asking for the official opinion of the Mexican authority. To base the breach of fair and equitable treatment standard on the unilateral representation, the investor must first provide proper information to the host state's representatives. There is also the requirement that the government promises have to be addressed to a specific investor and be specific regarding its object in investment.<sup>18</sup> General political statements by representatives of the government are not considered specific commitments (except if made in bad faith).<sup>19</sup> However, there is still no clear-cut or uniform practice regarding this issue.

The third situation is when the investor relies on the general regulatory framework (i.e. legislation) of the host state at the time of making the investment, and the host state changes the regulation. In this case the legislation is general and not directed specifically at a particular investor and their investment.<sup>20</sup> Regarding this issue, tribunals are divided. There are several cases in which the Tribunal established that the stability of the legal environment is an essential element of the fair and equitable treatment standard.<sup>21</sup> However, there is constant evolution both in economy and law. And increasingly, more tribunal awards find that there should be a balance between the legitimate expectations of the investor and the host state's public interest (i.e. legitimate regulatory interest). Recently, tribunals have increasingly been of the opinion that it would be unreasonable to expect the host country not to change its legislation in the public interest (in a non-discriminatory manner).<sup>22</sup> This would be especially detrimental for

<sup>17</sup>Potestà (2013) 18; Schreuer (2005) 357, 380.

<sup>18</sup>Potestà (2013) 21.

<sup>19</sup>*El Paso Energy International Company v The Argentine Republic*, ICSID Case No. ARB/03/15 para 395 of the award states: '... declaration made by the President of the Republic clearly must be viewed by everyone as a political statement, and this Tribunal is aware, as is every individual, of the limited confidence that can be given to such political statements.'

<sup>20</sup>Potestà (2013) 2.

<sup>21</sup>E.g. *Occidental Exploration and Production Company v The Republic of Ecuador*, London Court of International Arbitration Administered Case No. UN 3467 para 183, or the *supra* mentioned *Tecnicas Medioambientales (Tecmed) v Mexico* case.

<sup>22</sup>*El Paso Energy International Company v The Argentine Republic*, ICSID Case No. ARB/03/15 para 352; there are also special situations, like economic crisis and similar. In the *El Paso Energy International Company* case the tribunal stated that: '... a balance should be established between the legitimate expectation of the foreign investor to make a fair return on its investment and the right of the host State to regulate its economy in the public interest.' *El Paso Energy International Company* para 358.



developing countries, which usually have lower labor and environmental protection standards (raising these standards has hit hard the foreign investors who are usually attracted to the low standards in developing countries) – although, theoretically, there is still the so-called stabilization clause as a legal instrument for avoiding such situations. Even if investors do not receive an automatic exemption from the application of new legislation, they may be granted an exemption through the stabilization clause. Therefore, the threshold for claiming a host state's breach of the fair and equitable treatment is high.

At the same time, the majority of authors and arbitral jurisprudence agree that the expectations of the investor have to be reasonable and objective.<sup>23</sup> This means that the investor has to exercise due diligence when making the investment, and take into consideration all the circumstances which might affect the investment in the host country.<sup>24</sup> Some awards even suggest that diligent investors ask for a stabilization clause from the host state when investing.<sup>25</sup> The problem with such findings is that it is usually the host state that is the stronger party in the investment contract. In the case of smaller investors, there is even greater uncertainty concerning attaining a stabilization clause.

## 2. LEGITIMATE EXPECTATION IN THE ARBITRAL PRACTICE: GREEN ENERGY CASES UNDER THE ENERGY CHARTER TREATY

The research embraced all the accessible green energy cases under the Energy Charter Treaty; however, due to limited space, only the most important cases are presented and analyzed from the perspective of legitimate expectations. However, concluding remarks are based on all of the available cases.

To better understand this set of cases, it should be mentioned here that before the economic crisis of 2008, several European countries provided special incentives and subsidies to investors in the field of renewable energy. However, following the crisis, some of them (e.g. Spain and Italy) abridged these benefits, which resulted in a number of arbitration proceedings under the Energy Charter Treaty. Some of these are still pending. Most of these disputes are centered on legitimate expectations.

In the majority of green energy cases under the Energy Charter Treaty the investor relies on the general regulatory framework. However, in some of them, the claimants invoked also the reliance on the unilateral representation of the state or its agencies. For the latter, a good example is the *Antaris GmbH and Dr Michael Göde v the Czech Republic* case, in which German investors invested in solar power plants in the Czech Republic. The Czech Republic changed the system of incentives, as there were too many investments into this subsidized energy sector. The

<sup>23</sup>The Tribunal found in the *Saluka Investments BV* case that '[...] the scope of the [Agreement on encouragement and reciprocal protection of investments between the Kingdom of the Netherlands and the Czech and Slovak Federal Republic] Treaty's protection of foreign investment against unfair and inequitable treatment cannot exclusively be determined by foreign investors' subjective motivations and considerations. Their expectations, in order for them to be protected, must rise to the level of legitimacy and reasonableness in light of the circumstances.' *Saluka Investments BV* para 304.

<sup>24</sup>Radi (2013) 11.

<sup>25</sup>*Parkerings-Compagniet AS* paras 332, 336.



claimants initiated international arbitration based on the Energy Charter Treaty and a BIT, claiming, among other things, unfair and inequitable treatment, unreasonable and arbitrary measures, and indirect or creeping expropriation.<sup>26</sup> The Tribunal referred to several precedents; however, we would like to highlight the test applied by the Tribunal for legitimate expectation. According to this, the claimant should prove that the clear and explicit (or implicit) representation was attributable to the host state, and that it was reasonably relied upon by the claimant but subsequently repudiated by the host state.<sup>27</sup> So, this Tribunal accepted that there is no need for an 'express stabilization clause' and that an implied promise might be enough for a legitimate expectation of stability.<sup>28</sup> However, it rejected all the claims of the claimants as 'there was neither an impairment of the investment, nor the use of unreasonable or irrational or arbitrary measures'. Moreover, it also took into consideration that the investor did not exercise due diligence when investing and rejected all the claims of the claimants.<sup>29</sup>

In one of the first important green energy cases, *Charanne B.V. (Netherlands) Construction Investments S.A.R.L. (Luxembourg) v The Kingdom of Spain*,<sup>30</sup> the claimant invoked all three above mentioned 'situations': it claimed that the Royal Decrees were specific commitments because they were 'directed at a specific limited group of investors who meet the requirements within the established time periods',<sup>31</sup> that the promotional presentations by the Spanish Ministry of Industry, Energy and Tourism of Spain ('Minetur') entitled 'The Sun can be yours' constituted unilateral representations by a state agency,<sup>32</sup> and that the legislation was the regulatory framework which generated legitimate expectations. Regarding these issues, the Tribunal made some conclusions which were referred to later by other tribunals related to green energy cases.<sup>33</sup> First of all, the Tribunal derived from the good faith principle of customary international law a rule according to which host states cannot induce foreign investors to make investments, with said inducements generating legitimate expectations, then later ignore its commitments that served as the basis for these legitimate expectations. It also established that legitimate

<sup>26</sup>*Antaris Gmbh and Dr Michael Göde v the Czech Republic case*, PCA Case No 2014-01 para 74.

<sup>27</sup>*Antaris Gmbh and Dr Michael Göde* paras 360, 367.

<sup>28</sup>*Antaris Gmbh and Dr Michael Göde* para 399.

<sup>29</sup>*Antaris Gmbh and Dr Michael Göde* paras 440, 446.

<sup>30</sup>SCC Arbitration No. 062/2012. In this case, the claimants, Charanne and Construction, acquired shares of a Spanish company Grupo T-Solar Global S.A. in 2009. This company owned more than three dozen renewable energy facilities in Spain that produce electricity with photovoltaic technology. At the time, there was a special regulation providing incentives and subsidies to such renewable energy producers, and the aforementioned photovoltaic solar power plants were also covered by this special legal regime. To be more specific, the aforementioned T-Solar company was established in 2007, and the great majority of its photovoltaic solar power plants (according to the claimants) were all registered with the so-called RAIPRE registry (which covered renewable energy plants benefiting from Spain's special regime) before the autumn of 2008, thus even before the investment was made by the claimants. In 2012, the claimants initiated international arbitration based on the Energy Charter Treaty, claiming that the new renewable energy regulation Spain introduced in 2010 retroactively caused losses to its investments by eliminating regulated tariffs after a while, and by introducing further requirements. *Charanne B.V. Construction Investments S.A.R.L.* paras 4,5, 78-80, 149, 268.

<sup>31</sup>*Charanne B.V. Construction Investments S.A.R.L.* para 491.

<sup>32</sup>*Charanne B.V. Construction Investments S.A.R.L.* 95, 102 and *Novenergia II - Energy & Environment (SCA) (Grand Duchy of Luxembourg), SICAR v The Kingdom of Spain case*, SCC Arbitration (2015/063) para 133.

<sup>33</sup>*Charanne B.V. Construction Investments S.A.R.L.* para 490.



expectations should be based on an objective standard, and that investors should exercise due diligence when investing. Furthermore, it found that the expectations should be reasonable and proportional. As to the former, it concluded that no investor can expect from the host state that it will not change its regulatory framework in the public interest, and referred to the *El Paso Energy International Company* case, in which it was held that ‘economic and legal life is by nature evolutionary.’<sup>34</sup> At the same time, the investor has a legitimate expectation that, when modifying the existing regulation based on which the investment was made, the state will not act ‘unreasonably, disproportionately or contrary to the public interest.’<sup>35</sup> Regarding the issue of proportionality, the Tribunal found that it is satisfied as long as the changes are not capricious or unnecessary and do not amount to suddenly and unpredictably eliminat[ing] the essential characteristics of the existing regulatory framework.<sup>36</sup> In the specific case, it concluded that no specific commitments were made by the host state. The Tribunal stated, for example, that there was no stabilization clause or other specific agreement, assurance or statement by which the host state promised to the claimants not to change the regulatory framework that existed at the time of the investment.<sup>37</sup> It also found that the campaign to attract investment in the renewable energy sector could not generate legitimate expectations, at least with regard to the belief that the beneficial tariff regime would not be modified. In particular, the Tribunal found issue with the documents’ lack of specificity, and that the language used in them did not indicate, from any reasonable reading, that the tariff regime would remain untouched for the rest of the operating life of the photovoltaic solar plants.<sup>38</sup> And finally, the Tribunal again turned to the question of whether the regulatory framework itself could cause a legitimate expectation to come into being. The Tribunal’s general position here, consistent with its earlier remarks, was that if the framework does not contain a specific commitment, then the investor could not have had a legitimate expectation that the existing legal regime would remain unmodified. To reinforce this position, the Tribunal looked to *Electrabel S.A. v Republic of Hungary*<sup>39</sup> (which stressed that host states are entitled to regulatory changes, and that the requirement of fairness cannot be interpreted as immutability, but rather that changes to the framework should be fair, consistent and predictable), *CMS Gas Transmission Company v The Republic of Argentina*<sup>40</sup> (which also reinforced the notion that the host state’s regulatory framework is allowed to evolve under the principles of foreign investment protection law), and *El Paso Energy International Company*

<sup>34</sup>*El Paso Energy International Company* paras 350, 352.

<sup>35</sup>*Charanne B.V. Construction Investments S.A.R.L.* para 514.

<sup>36</sup>*Charanne B.V. Construction Investments S.A.R.L.* para 517.

<sup>37</sup>According to the Tribunal, the fact that the regulations were directed to a limited group of investors, and were thus not universal in scope, did not necessarily turn them into commitments specifically addressed to each investor meeting the regulatory requirements. The Tribunal posited that such limitation in scope does not mean that a law or regulation loses its general nature shared by other laws and regulations. In fact, the Tribunal was of the opinion that if it did find that such laws and regulations were to constitute specific commitments by the host state, merely because the persons affected by the regulation are limited in character and number, then that would result in an excessive limitation on the regulatory power of host states with regard to regulating the economy in a manner that is suitable in relation to the given public interest in the given situation. *Charanne B.V. Construction Investments S.A.R.L.* paras. 490-94.

<sup>38</sup>*Charanne B.V. Construction Investments S.A.R.L.* paras 495-97.

<sup>39</sup>ICSID Case No. ARB/07/19.

<sup>40</sup>ICSID Case No. ARB/01/8.





(which posited that ‘economic and legal life is by nature evolutionary,’<sup>41</sup> and that fair and equitable treatment should not be equated with stability of the legal and business framework).<sup>42</sup> The Tribunal ruled that approving the existence of such a legitimate expectation would essentially mean the freezing of Spain’s regulatory framework with regard to the eligible photovoltaic solar power plants, as the regulatory framework would be subject to the same international legal effects in practice as if Spain were to provide a stabilization clause or other specific commitment.<sup>43</sup>

In the *Sunreserve Luxco Holdings S.À.R.L., Sunreserve Luxco Holdings II S.À.R.L., Sunreserve Luxco Holdings III S.À.R.L. v the Italian Republic*<sup>44</sup> case, the Tribunal was of the opinion that legitimate expectations can be created by general legislation, and that specific commitments by the host state are not necessary for this.<sup>45</sup> At the same time, the Tribunal cited the *Saluka Investments BV* case in that the investor’s expectations should be legitimate and reasonable, and such expectations cannot be based only on the investors’ subjective motivations (should be ‘crystallized’). It also established that the investor has the duty of ‘due diligence’ of a ‘prudent investor’ when investing.<sup>46</sup> Second, regarding the reliance of the investor on legitimate expectations, the Tribunal stated that it is a factual question.<sup>47</sup> And third, as to the issue of the frustration of the legitimate expectations, it concluded that not every breach of legitimate expectation of the investor is automatically a breach of the fair and equitable standard; in other words, of international obligations under the Energy Charter Treaty. There is a high standard to

<sup>41</sup> *El Paso Energy International Company* paras 350, 352.

<sup>42</sup> However, there was a dissenting opinion by one of the arbitrators, whose main argument was that the specific circumstances of the two regulations serving as the regulatory framework’s basis could have created an objective belief in investors (and thus legitimate expectations), owing partially to the limited number of targeted recipients and similar factors. The dissenting arbitrator considered it legally unacceptable that host states could modify frameworks without any judicial consequences in such a way as to eliminate benefits – on which foreign investors relied – after the host state used the framework to attract investments in the first place. The arbitrator also rejected the Tribunal’s conclusion that the concept of a legal framework generating legitimate expectations would lead to the freezing of said framework. Instead, the arbitrator merely noted that states always retain regulatory power, but they have to compensate the damage caused by their alterations to the framework. Dissenting Opinion of Prof. Guido Santiago Tawil (unofficial translation by Mena Chambers). *Charanne B.V. Construction Investments S.A.R.L.* paras 5–11.

<sup>43</sup> *Charanne B.V. Construction Investments S.A.R.L.* paras 498–503. The Tribunal also noted that legitimate expectations necessarily demand that the investor first makes a diligent analysis of the legal regime its planned investment would fall under. Thus, the only instances where there would be a violation of the investors’ legitimate expectations would be the situation in which the host state’s new regulatory measures were not foreseeable at the time of the investment.

<sup>44</sup> SCC arbitration V (2016/32). During the 1980s and the 1990s, Italy introduced plans and regulations providing incentives to produce energy from renewable resources, which were also supported by European Union directives. This tendency of providing incentives for renewable energy continued at the beginning of the new millennia. Based on these incentives, the claimants, three companies all subsidiaries of SunReserve International LP, started to invest and develop photovoltaic plants in Italy in 2010, and built up a total of nine such plants. Shortly after this, Italy partly revoked and partly changed the rules related to these incentives. The investors initiated arbitration with the Arbitration Institute of the Stockholm Chamber of Commerce claiming breach of article 10(1) of the Energy Charter Treaty by Italy, particularly by not providing fair and equitable treatment to its investment, impairing it through unreasonable and discriminatory measures, and breaching the ‘umbrella clause.’ *Sunreserve Luxco Holdings S.À.R.L., Sunreserve Luxco Holdings II S.À.R.L., Sunreserve Luxco Holdings III S.À.R.L.* paras 183–84, 585.

<sup>45</sup> *Sunreserve Luxco Holdings S.À.R.L., Sunreserve Luxco Holdings II S.À.R.L., Sunreserve Luxco Holdings III S.À.R.L.* para 699.

<sup>46</sup> *Sunreserve Luxco Holdings S.À.R.L., Sunreserve Luxco Holdings II S.À.R.L., Sunreserve Luxco Holdings III S.À.R.L.* paras 711,714. See also: [Faccio \(2020\)](#) 3, 14.

<sup>47</sup> *Sunreserve Luxco Holdings S.À.R.L., Sunreserve Luxco Holdings II S.À.R.L., Sunreserve Luxco Holdings III S.À.R.L.* para 715.





constituting a breach,<sup>48</sup> thus it should be proven that the conduct of the host state: '[...] was manifestly or grossly unfair or unreasonable, was arbitrary or discriminatory, or that the host State engaged in a willful neglect of duty or a willful disregard of due process of law or showed an extreme insufficiency of action falling far below international standards, such that the conduct would shock judicial propriety.'<sup>49</sup>

*Novenergia II - Energy & Environment (SCA) (Grand Duchy of Luxembourg), SICAR v The Kingdom of Spain*<sup>50</sup> the Tribunal held that the most important element of the fair and equitable treatment obligation is the legitimate and reasonable expectation of the investor.<sup>51</sup> The Tribunal also found that the legitimate expectation of the investor of a stable regulatory framework can arise not only from the host state's explicit guarantees and commitments but also from implicit conduct or statements of the state not specifically directed towards the individual investor.<sup>52</sup> The host state has the right to change the regulation; however, the fair and equitable standard should protect investors from radical or fundamental changes.<sup>53</sup> The Tribunal invoked the opinion of the *Electrabel* and the *Saluka* Tribunals, which stated that under the Energy Charter Treaty the host state does not have an unconditional obligation to respect the investor's interests. It is required from the state that it takes into consideration the investor's legitimate and reasonable expectations and balances them with the public (or legitimate regulatory) interest when regulating, taking into consideration all the circumstances. The effects of the intended measure should be proportionate with regards to the affected interests.<sup>54</sup>

*PV Investors v Spain*'s<sup>55</sup> factual background is very similar to the *Charanne B.V. Construction Investments S.A.R.L.* case.<sup>56</sup> Regarding legitimate expectations specifically, the Arbitral

<sup>48</sup>*Sunreserve Luxco Holdings S.À.R.L., Sunreserve Luxco Holdings II S.À.R.L., Sunreserve Luxco Holdings III S.À.R.L.* para 727.

<sup>49</sup>*Sunreserve Luxco Holdings S.À.R.L., Sunreserve Luxco Holdings II S.À.R.L., Sunreserve Luxco Holdings III S.À.R.L.* para 728.

<sup>50</sup>The claimant, a company registered in Luxembourg, acquired Novenergia Spain in 2007, which held seven photovoltaic power plants through seven other Spanish companies. Spain promised incentives for investing in the photovoltaic power plants, but subsequently changed its policy and legislation. The claimant initiated arbitration with the Arbitration Institute of the Stockholm Chamber of Commerce in 2015. *Novenergia II - Energy & Environment (SCA)* para 2, 3.

<sup>51</sup>*Novenergia II - Energy & Environment (SCA)* para 648.

<sup>52</sup>*Novenergia II - Energy & Environment (SCA)* paras 650, 651.

<sup>53</sup>*Novenergia II - Energy & Environment (SCA)* para 654.

<sup>54</sup>*Novenergia II - Energy & Environment (SCA)* paras 657, 658.

<sup>55</sup>PCA Case No. 2012-14; See also: [De Luca \(2015\)](#); [Nathanson \(2013\)](#); [Glinavos \(2016\)](#).

<sup>56</sup>Concerning changes in Spain's regulatory framework related to solar energy. The claimants were numerous foreign investors of Luxembourg, Dutch and German origin, each of them possessing a renewable energy investment in Spain that originally fell under a special regime, similar to as already discussed in *Charanne B.V. (Netherlands) Construction Investments S.A.R.L. (Luxembourg)*. The foundation of this regime was a 1997 law on the energy industry and a regulation from 2007. The 2007 regulation, in particular, provided significant advantages and incentives to investors seeking to develop the renewable energy sector in Spain. However, this special regime gave way to a significantly less beneficial regime in 2010 as a consequence of the global financial crisis. This was ultimately followed by a law in 2013 that erased the distinction between normal and special regimes, citing the lack of purpose in separately regulating renewable energy. Thus, these investors initiated arbitration against Spain in 2011 based on the Energy Charter Treaty. In this case, their claims focused on alleged breaches of Article 10(1) of the Treaty, particularly legitimate expectations. Interestingly, the investors also put forward an alternative claim to the arbitral Tribunal (in response to certain statements by Spain), which reasoned that even if the Tribunal were to find that the investors' legitimate expectations were limited by Spain's own concept of reasonable return, then Spain still faces liability for breaching the Energy Charter Treaty due to lowering said reasonable return by its newer regulatory policies. *PV Investors* paras 181-216.



Tribunal first noted some general principles in this regard as well. Referring directly to *Charanne* in establishing that legitimate expectations have an objective standard of protection (as opposed to a subjective standard), they must be interpreted by tribunals concerning all relevant circumstances. It also reiterated the commonly accepted principle of investment tribunals that legitimate expectations must arise in an investor at the time the investment is made. Similarly, it established three general criteria that must be examined: (1) there must be a specific commitment given to the investor by the host state; (2) the change in regulatory frameworks must be unreasonable to breach fair and equitable treatment; and; (3) that legitimate expectations must be balanced with the host state's right to regulate (there is a margin of appreciation host states enjoy, especially with regard to economic regulation).<sup>57</sup> As we can see from the other cases presented in this work, this is also quite like the reasoning of several other tribunals (except for the specific commitment requirement).<sup>58</sup> With the content of both fair and equitable treatment in general and legitimate expectations specifically established by the Arbitral Tribunal, it now turned to applying these principles to the specific case at hand. First, it established that, looking outwardly, none of Spain's relevant regulations constituted a specific commitment to stability with respect to the foreign investors. Then the Arbitral Tribunal turned to a systematic examination of the wider regulatory context to discern whether there was a legitimate expectation about the immutability of the special regime (at least while the foreign investors' plants were operational). To do so, much like in *Charene*, it relied on examining the evolution of the renewable energy legal framework in Spain and noted that domestic court practice is highly relevant, the outcomes of this being treated as facts by arbitral tribunals when evaluating legal frameworks. In particular, it noted that when the investments were being made, the Spanish Supreme Court in at least two instances rejected the view that the renewable energy legal framework should not be subject to changes. Alongside similar factors that also indicated an ongoing evolution of the regulatory landscape in Spain, it thus established that no reasonable investor would have a legitimate expectation in respect of the immutability of the legal framework and the special regime within the timeframe that the investments were made.<sup>59</sup> With the lack of a proper legitimate expectation in this regard thus established, the Arbitral Tribunal turned to examining whether any other legitimate expectations could have been at play in the case. It highlighted the legitimate expectation to receive a reasonable return on the investment, which, as the Arbitral Tribunal stated, was also enshrined in several relevant pieces of Spanish legislation and regulation. Thus, a principle of reasonable profitability was certainly present. Considering the circumstances, the Arbitral Tribunal dismissed the applicability of this expectation with regard to the original claim and deferred the question to its examination of the already mentioned alternative claim. Interestingly, in the latter regard it engaged with the assistance of the parties in a thorough quantification process to show the alleged difference between the reasonable return guaranteed by earlier legislation and the return the investors would make under the newer regime. Based on this numerical analysis, it concluded that Spain

<sup>57</sup>In the *Antaris v Czech Republic* case (PCA Case No. 2014-01), for instance, the tribunal used a similar test, establishing that the claimant should prove that the clear and explicit (or implicit) representation was attributable to the host state, and that it was reasonably relied upon by the claimant, but subsequently repudiated by the host state.

<sup>58</sup>*PV Investors* paras 572-84.

<sup>59</sup>*PV Investors* paras 587-615.



did indeed reduce the reasonable return, and thus violated fair and equitable treatment in this regard.<sup>60</sup> Returning to the original claim, after legitimate expectations, the Arbitral Tribunal also dealt with other aspects of fair and equitable treatment: to be specific, the allegations that the regulatory changes were unreasonable, arbitrary, and disproportionate, amongst other facets. Thus, it followed the same line of thought as several other tribunals in treating the prohibition of discriminatory, unreasonable, and arbitrary measures as close to and implicitly part of (though the Tribunal's language is ambiguous) the concept of fair and equal treatment. Based on the same line of reasoning that it used with regard to legitimate expectations, it established that regulatory changes in themselves did not satisfy the meaning of unreasonableness, arbitrariness, and disproportionateness. The Arbitral Tribunal also noted that there was a clear correlation between Spain's policy and the measure, and that it sought a balanced and middle-of-the-road measure when it enacted the newer regime in response to the financial crisis. Thus, it cannot be considered disproportionate, arbitrary, or unreasonable. The Arbitral Tribunal also dismissed here allegations relating to Spain's alleged lack of transparency, noting that it had been in contact with investors and was sufficiently clear about its planned measures.<sup>61</sup>

*Voltaic Network GmbH v Czech Republic*<sup>62</sup> established an applicable test to be used for determining whether there had been a violation of legitimate expectations, divided into four

<sup>60</sup>*PV Investors* paras 616-20, 847.

<sup>61</sup>*PV Investors* paras 621-32.

<sup>62</sup>PCA Case No. 2014-20. The foundation of the issue lies in the energy sector regulations that developed in the Czech Republic following the latter's accession to the European Union in 2004. Over the course of several years a series of legislations and other regulations have led to the appearance of an incentivizing regime that greatly favored renewable energy investments through general preferential treatment, a combination of tariff and non-tariff mechanisms, such as obliging grid operators to purchase all electricity produced from renewable energy on a priority basis, etc. These measures were combined with a decrease in the price of photovoltaic components in 2008, which in turn led to solar energy becoming particularly attractive for foreign investors in the Czech Republic. It was among these circumstances that the claimant's investment was set up in 2010, in the form of a solar plant. However, while the claimant's investment was in the process of being realized, changes were occurring in the Czech political landscape. In early 2009, the then-incumbent prime minister was forced to resign, leading to an interim government that was in power for more than a year, during which time it decided not to interfere in any polarizing or politically contentious subjects. During the tenure of this government, an impromptu solar energy boom developed in the Czech Republic, which was also popularized by media, with allegations that due to the incentivizing regime, as well as the falling prices of solar panel components, distributors were being forced to enhance power lines, which in turn made electricity more expensive to consumers. However, due to the interim government's nature, no significant steps were taken to address the situation. Over the course of 2009 and early 2010 numerous voices in the Czech government highlighted that the current regulatory system in solar energy was unsustainable and prioritized excessive profits for investors over long-term societal benefits. Beyond governmental actors, these views were also echoed by Czech distributor companies, which faced unfavorable outcomes as the result of the solar energy boom. A new EU directive also set a new renewable energy percentage goal for the Czech Republic by 2020. As a result of the latter, an action plan was developed and released in 2010 that seemed to suggest that a beneficial regime would be retained to some extent. However, by the second half of 2010, the government was sending signs that the solar boom would be addressed by amending the existing incentive regime. This culminated in a proposal that aimed to withdraw the various beneficial subsidies from most solar plants (except for the smallest ones). Power plants already connected would have been exempt from this, however. This later changed, and over the next few years the regulatory regime turned against the previously beneficial system and included the introduction of a 'solar power levy,' removing the income exemption, changing the shortened depreciation period. In 2012, a requirement was also introduced by the Czech government that renewable energy producers wishing to maintain their access to certain subsidies would have to enter into mandatory supply contracts with specific distributors chosen by the Czech government. This course of events led to the filing of the arbitration claim by the claimant and nine other investors in 2013. *Voltaic Network GmbH* paras 130-96.



parts or questions: (1) whether the host state committed to regulatory stability or otherwise assured the investor of it; (2) whether the investor relied on this assurance or commitment in an effective manner; (3) whether this reliance can be considered reasonable, based on the given circumstances (social and economic); and finally, (4) whether there was a violation of the investor's legitimate expectations by the host state (excluding minor and insignificant violations). For the first question, it ruled that the host state in the present case did not give any kind of assurance about regulatory stability to the claimant; that all of its measures were within the scope of its regulatory power; and that in the absence of a stabilization provision (the existence of which the claimant failed to prove), the beneficial regime could be amended whenever the host state had sufficient economic justification to do so. Second, it established based on the available facts that the claimant investor was not relying on any such assurance. In fact, certain easement agreements entered into by the claimant instead seemed to show that the claimant was aware of the possibility of the termination of its incentives. Thus, two elements of the applicable test failed to prove the existence of legitimate expectations. For the third aspect of the test, the Tribunal noted that even if the claimant was relying on an assurance, it would not have been reasonable in the context due to the changes in circumstances the claimant was aware of. For the fourth aspect, the Tribunal interestingly noted that EU law precluded any legitimate expectation that the benefits system would stay in place in unchanged form. In its reasoning, the Tribunal essentially interpreted EU law (a point of contention with the EU Commission and the Court of Justice of the European Union, as seen from cases like *Achmea BV v The Slovak Republic*). Finally, the Tribunal reached the conclusion that there was no legitimate expectation in play, and thus the Czech Republic could not be found to be violating fair and equitable treatment in this context.<sup>63</sup>

*RREEF Infrastructure (G.P.) Limited and RREEF Pan-European Infrastructure Two Lux S.à.r.l. v Spain*<sup>64</sup> established a two-step process for identifying a legitimate expectation: namely, determining what the investor's expectations were, and whether these expectations were legitimate. If they were, then their frustration means that the host state had undertaken a wrongful act. Interestingly, the Tribunal took time here to explicitly spell out that several factors must be kept in mind for assessing the legitimacy of expectations: that the host states enjoy a wide margin of appreciation in the field of economic regulations, and, as such, the threshold of legitimate expectations will necessarily be high and only measures that are in clear violation of

<sup>63</sup>*Voltaic Network GmbH* paras 495-537.

<sup>64</sup>ICSID Case No. ARB/13/30. The claimants first invested in Spain in early 2011 as part of a project by indirectly purchasing an equity interest in three companies that dealt with wind power. This was followed by another indirect investment over the course of the summer of 2011, this time into three solar power plants. These solar power plants were already operational when the foreign investor made its investment. Interestingly, the claimants first expressed interest in investing into Spain's renewable energy sector in 2007, but these plans were shelved due to the beginning of the global financial crisis, and only resumed in 2010. During this latter year, the claimants made a thorough assessment of the aforementioned specific investment opportunities, including consultations with financial advisors, bankers and developers. This assessment period also resulted in several reports for the claimants that informed them of the investment situation in Spain regarding the planned investments. Notably, though both the wind and solar investments were assessed separately, the information was pooled by the claimants. The said solar power investments were sold in 2017. The investment arbitration case against Spain, as a result of its regulatory framework changes, was registered in 2013. The claimants sued under the Energy Charter Treaty. *RREEF Infrastructure (G.P.) Limited and RREEF Pan-European Infrastructure Two Lux S.à.r.l.*, Decision on Responsibility and on the Principles of Quantum paras 43-177.



the fair and equitable treatment standard can be declared unlawful and in breach of the Energy Charter Treaty.<sup>65</sup> It also noted that the proportionality requirement is 'fulfilled inasmuch as the modifications are not random, unnecessary or arbitrary[;] that is, provided that they do not significantly modify the legal framework applicable to the investors.'<sup>66</sup> It noted that proportionality is a weighing mechanism that seeks a balance between differing interests and principles, taking all relevant facts and circumstances into account. For reasonableness, it identified three necessary elements that are required (within the context of exercising regulatory power): legitimacy of purpose (ergo, it represents the interests of society as a whole, and it does not change the substance of relevant rights); necessity (there is a pressing social need that needs to be met, and this is a higher standard than usefulness or desirability); and suitability (the regulatory exercise must be suitable for achieving the legitimate purpose).

### 3. CONCLUSIONS

Based on the examined case law, we can make some general conclusions. One of these is that the expectations of the investor should be objective, meaning that the focus is not on the subjective perspective of the investor, but rather what objective expectations could be established based on the consideration of all the circumstances of the given case. Furthermore, another important point that was established by most tribunals is that legitimate expectations can exist only at the time when the investment is made. Most tribunals agreed that this time was when the investor made the final decision to realize the investment, at which point there was no return without cost from making the investment. Furthermore, most tribunals agreed that any legitimate expectation must be reasonable and proportionate. And finally, most tribunals were in accord that a level of necessary legal due diligence was required on the part of the investor, though different standards of due diligence were established by different tribunals. However, most seemed to concur that perfect due diligence was not a requirement here.

It is also accepted that the origin of the legitimate expectation must be a commitment or representation. But the view of the tribunals concerning what constitutes a commitment seems to be different. In general, we can differentiate between two views (which can be further divided up): one of them claims that a so-called specific commitment from the host state is necessary, while the other, an alternative approach, holds that general commitments and representations, or even the regulatory framework itself, can also serve as a foundation for legitimate expectations. In the first case, tribunals that take this view generally tended to agree that a specific and explicit commitment from the host state to the foreign investor was sufficient to establish legitimate expectation. However, there were severe divergences regarding what can be considered a specific commitment: some tribunals rejected treating assurances given by government officials as specific commitments, for example. A similar divergence of views can be observed when it comes to interpreting government communications made to a group of investors,

<sup>65</sup>*RREEF Infrastructure (G.P.) Limited and RREEF Pan-European Infrastructure Two Lux S.à.r.l.*, Decision on Responsibility and on the Principles of Quantum paras 261-62.

<sup>66</sup>*RREEF Infrastructure (G.P.) Limited and RREEF Pan-European Infrastructure Two Lux S.à.r.l.*, Decision on Responsibility and on the Principles of Quantum para 460.



instead of one specific investor. However, tribunals adhering to this view seem to generally agree that the only case when laws or regulations can serve as a foundation for legitimate expectations is when they included explicit stabilization clauses, or otherwise when it was possible to pinpoint a single provision (or provisions) of the legislation that can be clearly interpreted as a commitment by the host state. The other approach also accepts the first view's conclusions regarding the origination of legitimate expectations, but adds the opinion that general and implied commitments can also potentially serve as sources of legitimate expectations on the part of investors. This approach chiefly focuses on establishing legitimate expectations based on the regulatory framework, even in the absence of a specific stabilization clause, or in general, provisions that could be clearly interpreted as commitments. However, there are some interesting issues here, such as the question of whether, for example, a preamble stating the host state's desire to encourage and protect foreign investment can be read as a general commitment, or whether it was possible to read an implied commitment from the whole of the regulatory framework and the general conduct of the host state when dealing with foreign investors. The arbitral tribunals gave differing answers to these conundrums.

Tribunals frequently emphasized that host states have a sovereign right to regulate, and this right cannot be superseded by international obligations, like the Energy Charter Treaty. The main reason for this is the evolutionary character of economic life (*EDF (Services) Limited v Romania*). Conversely, foreign investors are also entitled to protection by the Energy Charter Treaty. Therefore, tribunals often stressed that a balance must be exercised between the right to regulate in the interest of some public policy objective, and the interests of foreign investors. In connection with this exercise, the requirements of reasonableness and proportionality are often mentioned by the tribunals (reasonableness is also referred to with regard to the investors' reliance on expectations, as mentioned earlier). Perhaps the *RREEF v Spain* case summarizes these aspects best: proportionality means that the host state's measures are not random, arbitrary, or unnecessary, and they do not modify the framework in a way that is unnecessarily harmful to the investors, while reasonableness means in the tribunal's reading that the following requirements are fulfilled: legitimacy of purpose (ergo, it represents the interests of society as a whole, and it does not change the substance of relevant rights); necessity (there is a pressing social need that has to be met – this is a higher standard than usefulness or desirability); and suitability (the regulatory exercise must be suitable for achieving the legitimate purpose). Other tribunals followed a similar logic when analyzing reasonableness and proportionality (or their negative counterparts, arbitrariness, discriminatory character of measures, etc.). In the case of some tribunals, their reasoning focused on the question of whether the host state had modified the essential characteristics of the original regulatory framework on which the investor's legitimate expectations were based. Furthermore, it is important to note that while some tribunals focused on these issues from the perspective of legitimate expectations, others also examined the reasonableness and proportionality of the host state's conduct in the general context of fair and equitable treatment. Transparency is also sometimes added to this, although it is also sometimes separated from fair and equitable treatment (as already mentioned earlier).

In conclusion, we can say that arbitral practice, although having common patterns and positions in some respects, is still very colorful. At the same time, it can be seen that tribunals, besides referring to general investment arbitral practice, often take into consideration earlier Energy-Charter-Treaty-related cases.





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