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The Role of International Investment Law in Protecting Renewable Energy Investments from Sudden Legislative Changes

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In the present world, there is a noticeable surge in renewable energy investments to promote renewable energy production. This current scale of investment, promotion and increased regulation in renewable energy is unprecedented, motivated partly by climate policy objectives. Resultantly, in the past few years, a significant number of renewable energy disputes have been initiated under EU law and the Energy Charter Treaty (ECT) framework. Against this backdrop, this paper, primarily, highlights the tensions that have arisen between regulations seeking to promote renewable energy in achieving climate policy objectives and economic considerations regarding investor protection. Moreover, this paper looks at the international law disputes concerning renewable energy investments in the EU in the context of ECT. At a more abstract and academic level, this paper seeks to examine the interaction between private and public interests in an area where private investments are fully dependent on the details of the applicable regulatory framework.

Introduction

Renewable energy production is nothing new as such; windmills and dams have been used to produce energy for centuries. However, the current scale of investment in renewable energy and the increased promotion and regulation of this type of electricity generation is unprecedented, motivated partly by climate policy objectives. Given the surge in activities to promote renewable energy production, it is hardly surprising that legal disputes relating to renewable energy policies have also become more frequent. This paper highlights tensions that have arisen between regulations seeking to promote renewable energy and achieve

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climate policy objectives on one hand, and economic considerations related to investor protection on the other.

While renewable energy investments have raised disputes and litigation globally, the past few years in the European Union (EU) have witnessed a particular surge of judicial activity relating to renewable energy. Several renewable energy disputes have come before the Court of Justice of the European Union (CJEU) to be decided under EU law.[2] Issues that have led to disputes within the EU seem largely related to miscalculations made in the planning stages concerning the level of subsidy to be provided to promote renewable energy and excessive costs for the state in relation to such subsidies, especially when economic circumstances have changed.

A significant number of other renewable energy disputes have been initiated under the Energy Charter Treaty (ECT)[3] framework with respect to international investment protection rules and international law. While the applicable law in the cases discussed here are different, with the CJEU applying EU law and investment tribunals applying international law, the underlying problems are similar. They relate to various governmental policies and measures to promote renewable energy. In all cases, certain details of the applicable regulatory framework have had a negative impact on private investment.

This paper looks at the international law disputes concerning renewable energy investments in the EU in the context of ECT. At a more abstract and academic level, this paper seeks to examine the interaction between private and public interests in an area where private investments are fully dependent on the details of the applicable regulatory framework. The tension between economic and energy policy objectives and climate change polices at national, regional and international level means that disputes arise frequently. The difficult task of the adjudicators of these disputes is to balance these various policy objectives.

[2] For an overview, see S.-L. Penttinen, 'The role of the Court of Justice of the European Union in the energy market liberalization', Kim Talus (ed.), *Research Handbook on International Energy Law* (Edward Elgar 2014). See also Kim Talus, *EU Energy Law and Policy: A Critical Account* (Oxford University Press 2013).

[3] The Energy Charter Treaty (1994). See www.energycharter.org.

The paper starts with a brief introduction to the EU's regulatory framework on the promotion of renewable energy, following which it analyses disputes initiated within the ECT framework.

Regulatory framework for climate change and renewable energy in the European Union

There is a close link between EU climate law and measures to promote renewable energy. The EU and its Member States have recently started pushing for a greener energy mix involving a significantly increased share for renewable energy. EU measures to promote renewable energy have ranged from requiring Member States to provide electricity produced from renewable sources priority access to the electricity networks to setting mandatory targets for the share of renewable energy in the total energy mix for all Member States.[4] Without going so far as to create an EU-level scheme to support renewable energy production, the EU has allowed and encouraged Member States to set up support mechanisms for electricity generation from renewable sources. It has been left to individual Member States to decide on the contents of their support mechanisms.[5]

The backbone for the current EU climate and renewable energy policy measures is provided by the 20-20-20 by 2020 climate and energy targets set in 2007.[6] For renewable energy, the objective is a 20% overall share of renewable energy production in the EU by 2020. The 20-20-20 by 2020 objectives also include 20% targets for increasing energy efficiency and reducing greenhouse gas emission which are, however, beyond the scope of the present paper.[7]

The overall objective of a 20% share for renewable energy in the EU by 2020 has been translated into a national renewable energy target for each of the 28 Member States. Unlike

[4] For details, see S.-L Penttinen and K. Talus, 'The development of Sustainability Aspects in EU Energy Law', *Research Handbook in Climate Change Mitigation Law* (Edward Elgar 2015).

[5] For an overview of the latest renewable energy support schemes in various EU Member States, see S-L. Penttinen, 'The First Examples of Designing the National Renewable Energy Support Schemes under the Revised EU State Aid Guidelines' 2 *European Competition Law Review* (2016).

[6] 'Renewable Energy Road Map. Renewable energies in the 21st century: building a more sustainable future' (COM(2006) 848 final), Brussels, 10.1.2007. For analysis, see K. Kulovesi, E. Morgera & M. Muñoz, "Environmental Integration and Multifaceted International Dimensions of EU Law: Unpacking the EU's 2009 Climate and Energy Package", 48 *Common Market Law Review* (2011), 829-891.

[7] These are discussed in S.-L. Penttinen and K. Talus, 'The development of Sustainability Aspects in EU Energy Law', *Research Handbook in Climate Change Mitigation Law* (Edward Elgar 2015). See also A. Johnston & G. Block, *EU Energy Law* (Oxford University Press 2012).

the previous EU legal regime for renewable energy,[8] Directive 2009/28/EC[9] (the 'Renewable Energy Directive') made the national targets binding. The binding nature of the national targets has resulted in a considerable increase in investment in renewable energy in the EU.[10] However, this trend is not limited to Europe, as investment in this area has increased globally.[11]

The EU's climate and energy objectives and targets were updated through a Council decision on 24 October 2014[12] and were included in the Energy Union framework[13] and the 'summer package' adopted in July 2015.[14] As part of efforts made in relation to 'transforming Europe's energy systems'[15] the updates include objectives for the period after 2020. The following goals have been set for 2030 in respect of sustainable development:

- Greenhouse gas emissions to be cut by 40% compared to 1990 levels.
- Renewable energy to constitute at least 27% of overall energy consumption.
- Energy savings of at least 27% compared with the business-as-usual scenario.[16]

Without going into the details of the new objectives, the fact that the new rules on renewable energy involve replacing individual targets for Member States with an EU-wide binding target to raise the share of renewables in the energy mix to at least 27% by 2030 is worth

[8] Directive 2001/77/EC of the European Parliament and of the Council of 27 September 2001 on the promotion of electricity produced from renewable energy sources in the internal electricity market (OJ L 283, 27.10.2001, p. 33).

[9] Directive 2009/28/EC of the European Parliament and of the Council of 23 April 2009 on the promotion of the use of energy from renewable sources and amending and subsequently repealing Directives 2001/77/EC and 2003/30/EC (OJ L 140, 5.6.2009, p. 16).

[10] http://ec.europa.eu/eurostat/statistics-explained/index.php/File:Electricity_generated_from_renewable_energy_sources,_EU-28,_2003%E2%80%9313_YB15.png.

[11] See for example, BP, 'Energy Outlook 2035', (2015), pp. 1-98, available at www.bp.com/content/dam/bp/pdf/Energy-economics/energy-outlook-2015/Energy_Outlook_2035_booklet.pdf and http://www.iea.org/publications/freepublications/publication/WEO_2014_ES_English_WEB.pdf.

[12] See also communication from the European Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: A policy framework for climate and energy in the period from 2020 to 2030, COM/2014/015 final.

[13] See http://ec.europa.eu/priorities/energy-union/index_en.htm.

[14] Commission press release, Transforming Europe's energy system - Commission's energy summer package leads the way (IP 15/5358) Brussels, 15 July 2015.

[15] Transforming Europe's energy system - Commission's energy summer package leads the way (IP/15/5358) Brussels, 15 July 2015.

[16] A policy framework for climate and energy in the period from 2020 to 2030 [COM(2014) 15].

highlighting. It is possible that this decision will have a negative effect on renewable energy deployment in many EU Member States.

It is in this regulatory and policy context that the renewably energy disputes examined in this paper have been initiated. As far as the ECT disputes are concerned, the efforts to meet binding national quotas for renewable energy, together with miscalculations concerning the costs of national renewable energy support schemes and the resulting changes have led to multiple cases being pursued against several EU Member States. The next section will now provide an overview of the ECT framework.

International law protection for renewable energy law investments: Energy Charter Treaty

The ECT entered into force in 1994. Its original purpose was to promote industrial cooperation between East and the West by providing legal security for investments, transit and trade. It aimed to establish a legal foundation for long-term cooperation in the energy sector on the basis of the objectives laid down in the Energy Charter Treaty.[17] Despite this original emphasis on EU-Russia cooperation, the geographical application of the Treaty has expanded over the years and, in particular, the substantive provisions regarding investment have been applied in relation to different kinds of international investment disputes involving various countries.

The ECT covers a large variety of functions in respect of energy and its most important provisions concern investment protection, non-discriminatory conditions for trade in energy materials, products and energy-related equipment, ensuring reliable cross-border energy transit and the resolution of disputes between participating states.[18] The Treaty is partly based on general international trade law and partly on EU energy regulation from the mid-1990s. Similarly to the Energy Community, the Treaty does not form part of EU energy law, but is an instrument of international law.

[17] T. Wälde (ed.), *The Energy Charter Treaty: An East-West Gateway for Investment and Trade* (Kluwer Law International 1996) and C. Bamberger and T. Wälde, 'The Energy Charter Treaty', in M. Roggenkamp et al. (eds.), *Energy Law in Europe* (Oxford University Press 2008), pp. 145-94.

[18] See www.encharter.org.

The Energy Charter Treaty and investment: scope

In order for an investment to be protected under the Treaty, it must be made by a natural person or a legal person established in accordance with the law of the contracting party in question. A natural person has to have the citizenship or nationality of a contracting party or has to be permanently resident in a contracting party in accordance with the applicable law of the country in question. Furthermore, in applying a multilateral agreement of this kind, it is important to note that it applies only in relation to cross-border situations and not in purely national circumstances. However, this requirement has been interpreted quite flexibly, and in some cases the mere fact that an undertaking's official registered office is situated in a different state has been held as sufficient basis to apply bilateral rules on investment protection despite the fact that the undertaking's owners, nearly all its business activities and the events leading up to the dispute occurred within the same state. In other words, the fact that the registered office of one party is in another state has been held to be sufficient in itself to establish an international dimension.[19]

Under the Treaty, an investment refers to every kind of asset owned or controlled, directly or indirectly, by an investor. This definition includes: tangible and intangible, movable and immovable property; any property rights; a company or business enterprise; shares, stock, or other forms of equity participation in a company or business enterprise; bonds and other debt of a company or business enterprise; and rights conferred by law or contract or by virtue of any licenses and permits granted to the undertaking. It follows from the above that ownership of company shares is included in the definition of an investment. In this situation, the company itself might not receive investment protection under the Treaty due to the fact that it does not constitute an investor residing in another contracting state. However, the owners of the company's shares may receive protection as separate claimants. This is possible, for example, when a foreign entity owns company shares.[20]

[19] See *Tokios Tokelés v Ukraine* (ARB/02/18) 29 April 2004. In the case of *Libananco Holdings Co. Limited (Cyprus) v Republic of Turkey (ARB/06/8)*, 2 September 2011. On the other hand, in cases *Loewen v United States*, (ARB(AF)/98/3), 26 June 2003, and *TSA Spectrum de Argentine S.A. v Argentine Republic* (ICSID Case No. ARB/05/5), 19 December 2008, the tribunals did not entirely accept the approach taken in the *Tokios Tokelés* case.

[20] See, for example, *Hulley Enterprises Limited v The Russian Federation* (PCA case no. AA 226), 30 November 2009; *Yukos Universal Limited v The Russian Federation* (PCA case no. AA 227), 30 November 2009; *Veteran Petroleum Limited v The Russian Federation* (PCA case no. AA 228), 30 November 2009.

The Energy Charter Treaty: material provisions on investment

The provisions on investment are based on the idea that contracting parties encourage investors from other contracting states to invest and, in order to do so, create stable, equitable, favourable and transparent conditions.[21] These conditions include the obligation to extend fair and equitable treatment (FET) to investments made by investors from other contracting states. The relevant provision, Article 10 (1) of the ECT, provides for the FET standard:

> [e]ach Contracting Party shall, in accordance with the provisions of this Treaty, encourage and create stable, equitable, favourable and transparent conditions for Investors of other Contracting Parties to make Investments in its Area. Such conditions shall include a commitment to accord at all times to Investments of Investors of other Contracting Parties fair and equitable treatment.

ECT also requires that the investments of investors of a contracting party in the area of any other contracting party may not be nationalized, expropriated or subjected to a measure or measures that has an effect equivalent to nationalization or expropriation except where such expropriation is for a purpose which is in the public interest, not discriminatory, carried out under due process of law and accompanied by the payment of prompt, adequate and effective compensation.[22] Furthermore, no contracting party is allowed in any way to impair by unreasonable or discriminatory measures their management, maintenance, use, enjoyment or disposal ('protection against arbitrary and discriminatory treatment').

The Treaty also includes a so-called umbrella clause, which states that each contracting party must observe any obligations it has entered into with an investor or an investment of an investor of any other contracting party. The umbrella clause is based on the internationally accepted legal principle of *pacta sunt servanda*: agreements must be kept.

[21] These standards and principles are not new but have been developed in accordance with the general principles associated with the protection of foreigners. See, for example, G. Schwarzenberger, 'Province and Standards of International Economic Law', 402(2) Int'l L.Q. (1948).

[22] Article 13 of the Energy Charter Treaty.

While all investment standards contained in the ECT can be employed and useful in a particular factual circumstances, it is the FET standard that provide in many ways most opportunities for creative legal work and that have also been applied by investment tribunals in the investment cases against Spain. These cases will be examined next.

Renewable energy disputes under the Energy Charter Treaty

In the context of public international law, the ECT is the only energy-specific multilateral investment protection mechanism currently in existence. It has provided the applicable international legal framework for more than 84 disputes.[23] Earlier disputes were initiated in the context of energy market liberalization. Here, fundamental changes in the regulatory environment and approach to energy markets - from state to markets[24] - had a negative impact on private investment. Similarly to these earlier cases, some of the recent or ongoing cases have related to changes in energy policy, as in the *Vattenfall v. Germany* case concerning nuclear energy in Germany.[25] The latest, and by far the largest wave of investment disputes, however, concerns the renewable energy sector, and many of these disputes have been initiated under the ECT. Around 30 renewable energy cases have been initiated under the ECT against Spain, around 10 against Czech Republic and Italy and one against Bulgaria.[26]

Given the need for subsidies and other forms of state support for renewable energy which is not at this stage able to compete with traditional forms of energy, investment in this area is heavily dependent on the public sector and the investment host states' energy policies and regulatory frameworks. Regulatory frameworks change and investors cannot expect regulations or even policies to remain unchanged. States have the right to alter their energy policies. While investors must prepare and adapt to such changes, certain limits exist concerning the way in which changes may be made and what changes are acceptable.

[23] For the list of publicly known cases, see http://www.encharter.org.

[24] This transformation has been discussed in detail in K. Talus, *EU Energy Law and Policy: A Critical Account* (Oxford University Press 2013).

[25] *Vattenfall v. Germany* (ICSID Case No. ARB/12/12).

[26] For a full list of cases under the ECT framework, see http://www.energycharter.org/what-we-do/dispute-settlement/all-investment-dispute-settlement-cases/. Interestingly, hundreds of domestic claims in this area have been initiated by those investors who have no recourse to the international investment dispute systems (which is only applicable to foreign investors from other ECT countries or countries with a bilateral investment treaty (BIT) with the relevant state): around 380 claims have been brought before various courts in Spain and over 900 before the Italian courts.

In terms of international law, the ECT's role is to lay down the conditions and limits for state intervention in the renewable energy sector. Enforced through international arbitral tribunals, the checks and balances in place offer a degree of investment certainty in this area. The fact that government subsidies provide the backbone for renewable energy investment makes such investment particularly vulnerable to changes in law and policy. The record number of claims relating to investment disputes brought against Spain serves to illustrate what kind of consequences changes in the regulatory framework for renewable energy and to rules relating to subsidies can cause under international investment law.

The Spanish cases – score board: 2-2

The background to the disputes is that Spain established a feed-in-tariff (FIT) for electricity produced from renewable source (and co-generation) in order to attract investment in this sector.[27] This was partly motivated by the need to comply with the EU's climate and renewable energy objectives. The original scheme applied to all electricity produced from renewable sources during the lifetime of a project and entitled the generator to a FIT. Due to dramatic changes in Spain's economic circumstances and the lack of public financial resources - combined with the fact that the Spanish FIT scheme was perhaps too generous in the first place - Spain made two modifications to the scheme. These changes were made with retrospective applicability to all renewable energy projects.

First, in 2010, Spain limited the period during which renewable projects could benefit from the FIT scheme.[28] The original scheme offered a generous FIT for 25-years and had no limits on operating hours of the generation. After the first 25-years, the scheme would have continued for the remaining operational life of the generation facility, albeit in a modified form. Since this first change involved significant economic consequences for investors, it led, unsurprisingly, to litigation before the Supreme Court of Spain. The Court noted that the changes made in 2010 should be considered as mere adjustments to the existing scheme and were reasonable in terms of the economic objective they were based on.[29]

[27] In particular, Royal Decree 661/2007.
[28] Royal Decree 1565/2010 and Royal Decree 1614/2010.
[29] JUR 2014/14099.

In July 2013, the Spanish government approved the Royal Decree-Law 9/2013,[30] which completely abolished the FIT regulation and replaced it with a new remuneration scheme. Unlike the FIT scheme, the new remunerations were not calculated based on energy produced but on the basis of installed capacity and the exploitation costs of a "standard facility" for each technology.[31] In other words, the new regime was based on government set standard compensation and on the idea of a "reasonable rate of return". In addition, the 2013 changes[32] included a 7% tax increase for power generation, which due to the different treatment of renewables and fossil-fuel-based power production, impacted on and targeted only renewable energy production (these producers had no ability to pass on the costs to the final consumer). The tax carve-out contained in Article 21 of the ECT[33] could be one of the reasons why the government took this approach.

The first award in the line of cases initiated against Spain was given on 21 January 2016.[34] The award was favorable to Spain and found that no violation of the ECT had taken place. It dismissed the claim based on protection of legitimate expectations and emphasized that there was no specific commitment that the FIT scheme would remain in place for the entire project duration. A commitment to provide a FIT for a large number of investors was not a specific commitment that could give rise to legitimate expectation, although one arbitrator dissented on this particular question. It also underlined that in order to claim protection of legitimate expectations, the investor must show that it has undertaken a diligent review of the legal framework. In the end, the balance between investor rights and states' rights to regulate in the public interest, tilted in favour of the state. However, it is important to note that this case was initiated in 2013 and relate only to the changes that had been introduced before the initiation of the proceedings in this particular case.

[30] Royal Decree-Law 9/2013.
[31] This regime has been described in many commercial online publications, such as http://www.cliffordchance.com/briefings/2013/07/royal_decree-law92013of12julyonth.html.
[32] Law 15/2012.
[33] "Except as otherwise provided in this Article, nothing in this Treaty shall create rights or impose obligations with respect to Taxation Measures of the Contracting Parties."
[34] *Charanne (the Netherlands) and Construction Investments (Luxembourg) v. Spain,* SCC Case No. V 062/2012 (award of 21.1.2016).

Similar events were also behind the second award, also favouring the state. The claims brought in Isolux Netherlands, BV v. Kingdom of Spain where dismissed in an award of 17. July 2016.[35]

The next publicly available award came in 2017.[36] In *Eiser*, the outcome was different from the two first cases, in many ways perhaps logically so. The case considers the changes taken by Spain as a whole, not only the changes made prior to 2013.

As with *Charenne* and many other awards, the tribunal emphasized that in the absence of explicit undertakings directly extended to investors and guaranteeing that States will not change their laws or regulations, investment treaties do not eliminate States' right to modify their regulatory regimes to meet evolving circumstances and public needs. States have the right to regulate.

But importantly for the outcome, the tribunal noted that states' obligation under the ECT to afford investors fair and equitable treatment does protect investors from a fundamental change to the regulatory regime in a manner that does not take account of the circumstances of existing investments made in reliance on the prior regime. ECT protects an investor against the total and unreasonable change, such as those taking place in Spain.

In this case, Spain had eliminated a favorable regulatory regime previously extended to investors to encourage their investment in renewable energy sector in Spain (which resulted in billions in investments into renewable energy sector). It was then replaced with an unprecedented and wholly different regulatory approach, based on wholly different premises. This new system was profoundly unfair and inequitable as applied to Eiser's (Claimant) existing investment, stripping Eiser of virtually all of the value of its investment. Because of this, the Tribunal concluded that Spain had breached its obligation to provide the investors with fair and equitable treatment. In the end, the Tribunal awarded Eiser 128 million Euros in damages.

[35] *Isolux Netherlands, BV v. Kingdom of Spain*, SCC Case V2013/153 (award of 17.7.2016)

[36] *Eiser Infrastructure Limited and Energía Solar Luxembourg* S.à r.l. v. *Kingdom of Spain*, ICSID Case No. ARB/13/36 (award of 4.5.2017).

A fourth publicly available award was rendered some weeks from writing this paper for the Tulane Environmental Law Summit 2018. In Novenergia v. Spain[37] the Tribunal came to a similar conclusion regarding the application of fair and equitable treatment standard and awarded the investor 53 million Euros in damages.

Conclusions

Measures to fight climate change and promote renewable energy in Europe have led to disputes under various legal frameworks: public international law, EU law, and Energy Community law. While it is difficult to map specific reasons or trends for these disputes, they do seem to have two factors in common. Most relate to government regulation (or changes in regulation) and/or the scale of activities in this area of energy. The underlying issue in these cases is not new: it is that of investor rights versus the right of states to regulate. The answer lies in fair treatment for investors: protection of legitimate expectations and the economic balance of the original deal.

Renewable energy investment relies heavily on public subsidies and the surrounding regulatory framework. Changes in these areas during the lifetime of the project will significantly affect the business case for the investment. Where changes take place, investors react. Investment arbitration involving Spain and other EU countries followed changes in the regulatory frameworks that had been relied on by the investors involved.

The *Eiser* and *Novenergia* awards confirm what should be obvious: even in the absence of a specific promise to an individual investor in the form of an investment agreement, investors can rely on investment treaties against fundamental and unpredictable changes to the regulatory regime in a manner that does not take account of the circumstances of existing investments made in reliance on the prior regime.

[37] Novenergia v. Spain, SCC Case No. 063/2015 (award of February 2018).