Solar Arbitrations: A Year in Review

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Over the last four years, Spain has been held liable to investors under bilateral and multilateral investment treaties for over €800 million following changes to its renewable electricity incentive scheme. From 2016 to 2018, four tribunals found that a series of measures taken by Spain between 2010 and 2014 to roll back or eliminate solar energy subsidies violated the country's obligations under the Energy Charter Treaty ("ECT"). In 2019, the tide shows no signs of slowing: in the last five months, six awards have been issued against Spain under the ECT in favor of investors, most recently in *OperaFund Eco-Invest SICAV plc and Schwab Holding AG v. Spain*.

National policy and regulatory framework in the renewable electricity sector is a major driver of investment opportunity and risk. Countries are actively progressing transition to a low-carbon future based on their 2015 Paris Agreement commitments, expressed in the form of Nationally Determined Contributions ("NDCs"). Different countries have different levels of ambition and different strategies to realise that ambition, but implementation of some form of policy to increase renewables investment is largely universal.

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Private investment is key to successful transition to a low-carbon future; it is necessary for countries to meet the goals of the Paris Agreement and implement their NDC plans. An estimated USD 1.7 trillion is needed by 2030 just to implement the renewable energy components in the NDCs.[1] Private investment seeks a stable investment environment, which allows investors to **maximize the opportunities** and **minimize the risks** as systems transition to a low-carbon future. International arbitral awards interpreting and implementing foreign investment protections under investment treaties play an important role in maintaining that stable investment environment, potentially enhancing successful transition.

This "In Depth" considers the six 2019 solar investment awards against Spain. The awards demonstrate the tension between investment protection and countries' rights to regulate in a fast-moving, uncertain future of systems transition in response to the Paris

[1] International Renewable Energy Agency, "Investment Needs," https://www.irena.org/financeinvestment/Investment-Needs (last accessed 19 September 2019).

Agreement. This "In Depth" considers the benefits of the international dispute resolution system with respect to this category of disputes and the value it could add to global energy transition if properly applied.

The Evolution of Spain's Regulatory Regime

Spain put in place a new renewable electricity incentive scheme in 2004 in order to attract investment in renewables. Under that scheme, electricity production through solar photovoltaic ("PV") energy was regulated by a "special regime" that provided for incentives and subsidies. From 2005 to 2007, the Spanish government published a series of promotional presentations—titled "The Sun Can Be Yours"—that provided reasons to invest in PV installations. In 2007, the Spanish National Energy Commission ("NEC") also issued a report describing "a proposed Royal Decree on regulation of the electric energy production activity under a special regime" and setting out the criteria that should apply to such a regime such as ensuring that "economic incentives are stable and predictable."[2] Royal Decree 661/2007 ("RD 661/2007") was subsequently enacted on 25 May 2007. RD 661/2007 contained a remuneration mechanism for electricity produced under the special regime, which provided for regulated tariffs and special premiums for electricity produced from PVs.

The special regime policy design was ill considered, and the feed-in tariffs were overly generous. This was exacerbated by the 2008 financial crisis and a growing deficit in the electricity system. The deficit was a consequence of power generation and distribution costs exceeding what utilities could recover from consumers. The total deficit at the end of 2012 was EUR 25.5 billion. By 2010, the government sought to contain the harm by beginning to roll back the special regime. The key legislative amendments impacting investors included:

- **Royal Decree 14/2010**: limited the number of production hours that were eligible to benefit from the feed-in tariff regime, which had been a part of Spanish renewable energy policy since the 1990s.

- **Royal Decree 1565/2010**: Government support for electricity produced from PV plants limited to 25 years rather than the lifetime of the facility.

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[2] National Energy Commission, Report 3/2007.

- **Royal Decree-Law 1/2012**: eliminated economic incentives for certain new production installations.
- **Law 15/2012**: imposed a seven-percent tax on electricity generation starting 1 January 2013 to be applied to all electricity generators.
- **Royal Decree-Law 2/2013**: eliminated the special premiums provided for in RD 661/2007.
- **Royal Decree Law 9/2013**: eliminated existing system of tariffs.
- **Law 24/2013**: eliminated the existing special regime for electricity producers and provided for limited subsidies for renewable energies. It abolished fixed tariffs for the lifetime of the installation and provided for tariff revision every six years.

Emerging Trends

Investors have claimed various violations of investment treaty protections based on rollback measures. However, the ECT's fair and equitable treatment ("FET") protection—specifically, the protection of an investor's legitimate expectations—has formed the basis for most findings of breach by tribunals.[3]

The scope of "legitimate expectations" will vary according to the investment treaty framework, the legal framework in place in the host country and the specific facts of the case. As indicated by the tribunal in the 2018 case *Antin Energia Termosolar v. Spain*, the ECT sets forth a specific framework for energy-focused investments that obliges host countries to "afford fundamental stability in the essential characteristics of the legal regime relied upon by the investors in making long-term investments."[4] This means countries cannot suddenly and radically alter the regulatory framework in place at the time of the investment. The content and scope of legitimate investor expectations created by such obligations may differ, however, in cases involving treaties "whose text

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[3] *See Charanne and Construction Investments v. Kingdom of Spain*, SCC Case No. V062/2012, Final Award (21 Jan. 2016); *Isolux Netherlands, BV v. Kingdom of Spain*, SCC Case No. V2013/153, Final Award (17 July 2016); *Eiser Infrastructure Limited and Energía Solar Luxembourg S.à.r.l. v. Spain*, ICSID Case No. ARB/13/36, Final Award (4 May 2017); *Novenergia II – Energy & Environment(SCA) (Grand Duchy of Luxembourg) SICAR v. Kingdom of Spain*, SCC Case No. 2015/063, Final Award (15 Feb. 2018); *Masdar Solar & Wind Cooperatief U.A. v. Kingdom of Spain*, ICSID Case No. ARB/14/1, Award (16 May 2018); *Antin Infrastructure Services S.à.r.l. and Antin Energia Termosolar v. Kingdom of Spain*, ICSID Case No. ARB/13/31, Award (15 June 2018).

[4] *Antin Energia* at para. 532.

is substantially different" from the ECT or "where no specific obligation of stability is contained."[5]

Pre-2019 awards provide guidance as to the scope of the ECT's FET provision as it applies to the protection of legitimate expectations. One of the key points of contention has been the interplay between a country's right to regulate and investors' expectation of stability. The *Eiser* tribunal found that, while the ECT did not bar Spain from making changes to the existing regulatory regime, it did oblige countries to "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."[6] As a result, investors had a legitimate expectation that the regulatory regime upon which their investments were based would not undergo a "total and unreasonable change."[7] Similarly, the *Masdar* tribunal explained that while a country is indisputably "at liberty to amend its legislation," that "right is not unfettered."[8]

Generally speaking, what an investor knew or should have known at the time of the investment is relevant to assessing the existence and extent of its legitimate expectations. Thorough due diligence into the existing legal regime and the likelihood that regime will change over time may impact whether an investor's expectations were reasonable. For example, a Supreme Court decision empowering the government to make changes to the regulatory regime was a factor in a tribunal finding that the investor could not have expected Spain's regulatory regime to remain unchanged.[9]

These cases demonstrate that a host country's conduct also plays a pivotal role in assessing reasonable expectations. Some tribunals found that the legal framework in itself cannot "generate" legitimate expectations, and, "in the absence of a specific commitment, an investor cannot have a legitimate expectation that existing rules will not be modified."[10] Other tribunals considered that legitimate investor expectations "arise naturally from undertakings and assurances" made by, or on behalf of, a host country—and that such undertakings or assurances "can be explicit or implicit."[11] The tribunal in *Novenergia II* looked not only to Spain's intended conduct toward the

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5 *Antin Energia* at para. 533.
While every fair and equitable treatment provision is sui generis, ECT jurisprudence draws on jurisprudence under other bilateral investment treaties including in the solar energy cases. For example, the tribunal in Charanne drew on the findings of the tribunals in *CMS v. Argentina* and *El Paso v. Argentina* regarding the "freezing" of the legislative framework on the basis that it "deem[ed] relevant the considerations delivered by other tribunals although taken under other treaties" (paras. 501 and 502).

6 *Eiser* at para. 363.

7 *Eiser* at para. 363.

8 *Masdar* at paras. 485–486.

9 *Isolux Netherlands, BV v. Kingdom of Spain*, SCC Case No. V2013/153, Final Award (17 July 2016).

10 *Charanne* at para. 494–499.

11 *Novenergia II* at paras. 650–651.

claimant but to general statements in government reports and to government-issued marketing materials and was particularly interested in the statements and materials regarding the stability of the legal framework.[12] In this case, the tribunal did consider "prospective laws as well as laws which aim at attracting foreign investors" as a basis for legitimate expectations.[13]

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These trends continued in the 2019 awards. Tribunals underscored the importance of the particular factual context and specific commitments made to and relied on by investors. The *Cube Infrastructure* tribunal explained that the commitments on which legitimate expectations were based represented the exercise of sovereign power: while "States have the sovereign right to amend their legislation," they "also have the right, and the legal power, to make representations as to the future treatment of investments in such a manner as to create expectations that cannot be defeated without violating a duty of [FET]."[14]

For example, the legal framework surrounding an investment may provide that the investment will remain subject to a specific regulatory regime for a certain fixed or extendable period of time or that the benefits of the regime will extend to new owners of the investment in the case of a sale. Perhaps unsurprisingly, as noted by the *Cube Infrastructure* tribunal, regimes designed "with the overt aim of attracting investments" often involve such representations, which in turn give rise to legitimate investor expectations.[15] In Spain's case, representations that the "special regime" would remain in place were also made to investors through the "grandfather clause" in RD 661/2007. The *9Ren* tribunal held that this clause created legitimate expectations on which the investor had relied by providing that the benefits of the special regime would be irrevocable for facilities registered by a certain deadline.[16]

It does not follow that investors can "assume that the regulatory regime in place at the time that its investment is made will continue to remain in force"[17] simply because that regime was specially designed to attract investment. As the *Cube Infrastructure* tribunal

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[12] *Novenergia II* at paras. 666–668.

[13] *Novenergia II* at para. 548.

[14] *Cube Infrastructure Fund SICAV and Others v. Kingdom of Spain*, ICSID Case No. ARB/15/20, Decision on Jurisdiction, Liability and Partial Decision on Quantum (19 February 2019), para 397.

[15] *Cube Infrastructure Fund SICAV and Others v. Kingdom of Spain*, ICSID Case No. ARB/15/20, Decision on Jurisdiction, Liability and Partial Decision on Quantum (19 February 2019), para. 388.

[16] *9REN Holding S.à r.l. v. Kingdom of Spain, ICSID* Case No. Arb/15/15, Award (31 May 2019).

[17] *Cube Infrastructure Fund SICAV and Others v. Kingdom of Spain*, ICSID Case No. ARB/15/20, Decision on Jurisdiction, Liability and Partial Decision on Quantum (19 February 2019), para. 397.

explained, investor expectations must be "justified, rational and reasonable" and in cases involving special regimes similar to Spain's, may be "justified" by "legal due diligence reports."[18] An investor that has conducted a "thorough legal analysis of the provisions"[19] in place and identified limited regulatory risks is well placed to argue that its expectation of a stable regulatory regime is legitimate.

The 2019 awards against Spain have confirmed that "stable" does not equate to "unchanging." According to the *NextEra* tribunal, investors cannot expect that the regime in place at the time of the investment would be "frozen";[20] instead, the relevant question is whether the regime was "changed in a way that would undermine the security and viability of their investment."[21] In that context, the tribunal considered the legislative amendments implemented by Spain from 2013 – 2014, which "completely change[d] the remuneration mechanism applicable to date."[22] In the words of the tribunal, these amendments had "*fundamentally and radically*"[23] altered the regulatory framework in place at the time of the investment. In short, they went beyond anything the investors could have reasonably expected.

The following chart details investment arbitration awards issued against Spain in 2019—all under the ECT:[24]

Case Name	Treaty Protection Violated	Measures at Issue	Award	Damages Awarded
NextEra Energy Global Holdings BV and NextEra Energy Spain Holdings BV v. Kingdom of Spain	FET	2013–2014	31 May 2019	€291 million
9REN Holding S.à r.l. v. Kingdom of Spain	FET	2010–2014	31 May 2019	€42 million
Cube Infrastructure Fund SICAV and others v. Kingdom of Spain	FET	2013–2014	15 July 2019	€34 million

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18 *Cube Infrastructure Fund SICAV and Others v. Kingdom of Spain*, ICSID Case No. ARB/15/20, Decision on Jurisdiction, Liability and Partial Decision on Quantum (19 February 2019), para. 393.

19 *Cube Infrastructure Fund SICAV and Others v. Kingdom of Spain*, ICSID Case No. ARB/15/20, Decision on Jurisdiction, Liability and Partial Decision on Quantum (19 February 2019), para. 393.

20 *NextEra Energy Global Holdings BV and NextEra Energy Spain Holdings BV v. Kingdom of Spain*, ICSID Case No. ARB/14/11, Decision on Jurisdiction, Liability and Quantum Principles (12 March 2019), para. 591.

21 *NextEra Energy Global Holdings BV and NextEra Energy Spain Holdings BV v. Kingdom of Spain*, ICSID Case No. ARB/14/11, Decision on Jurisdiction, Liability and Quantum Principles (12 March 2019), para. 596.

22 *NextEra Energy Global Holdings B.V. and NextEra Energy Spain Holdings B.V. v. Kingdom of Spain*, ICSID Case No. ARB/14/11, Decision on Jurisdiction, Liability and Quantum Principles (12 March 2019), para. 598.

23 *NextEra Energy Global Holdings B.V. and NextEra Energy Spain Holdings B.V. v. Kingdom of Spain*, ICSID Case No. ARB/14/11, Decision on Jurisdiction, Liability and Quantum Principles (12 March 2019), para. 599 (emphasis added).

24 Not all of these awards are publicly available, and therefore, in some cases, the information has been drawn from public reporting of the decisions.

Case Name	Treaty Protection Violated	Measures at Issue	Award	Damages Awarded
SolEs Badajoz GmbH v. Kingdom of Spain	FET	2013–2014	31 July 2019	€41 million
InfraRed Environmental Infrastructure GP Limited and others v. Kingdom of Spain	[Award not public]	[Award not public]	2 August 2019	Undisclosed (€92 million claimed)
OperaFund Eco-Invest SICAV PLC and Schwab Holding AG v. Kingdom of Spain	FET	2010–2014	6 Sept. 2019	€29 million

Key Takeaways

Especially in the aftermath of the Paris Agreement, countries must grapple with the policies and regulatory frameworks necessary to transition their electric energy systems. Many countries are seeking to stimulate investment in lower carbon electricity sources such as renewables, biomass and sources with carbon capture and sequestration. Many countries also are looking to create sound market mechanisms for carbon trading in order to stimulate investment in carbon removals where renewables are not an option. A number of countries recently announced net zero emissions targets by 2050 or even 2045, and electric energy transition is key to achieving those timelines. Inevitably, national policy and regulatory framework governing the renewables sector is still to face widespread, rapid and dramatic change. The uncertainty that accompanies this unprecedented transition in terms of scale converts all electric energy markets into "emerging markets," importing the risks and opportunities associated with these.

- The Paris Agreement allows countries to specify how they will—within the scope of their own regulatory histories, cultures and structures—contribute to the goal to limit global temperature increase through reduction of carbon emissions. As a result, national policies and regulatory frameworks will face unprecedented change in terms of scope and, potentially, variability between countries.

- Private investment will play a central role in making possible the transition required for countries to achieve their NDCs and to meet what is an internationally common concern—encapsulated in the objectives of the Paris Agreement. Private investment is concerned with the stability of the investment regime and associated returns.

- For investors, careful investment structuring around investment treaty, and legitimate expectations, protections offers an additional form of investment securitization. The existing Spanish solar cases offer a body of precedent that provides the necessary roadmap for an investor's securitization strategy.

- For countries, regime design in the renewables sector requires careful consideration in order successfully to achieve electric energy transition and also to avoid expensive damages awards. The Spanish solar cases offer a body of precedent outlining the pitfalls and nature of measures to avoid in national policies and regulatory frameworks governing electric energy transition.

- For transition to a low-carbon-energy future, success depends on systemic change. Each element in the system of electric energy or power must work towards that transition. Investment treaty protection, tribunals and awards are one element in the system. The awards in the Spanish solar cases (and their Italian and Czech Republic cousins) are giving a sense on the one hand, to countries as to how best to regulate, and on the other, to investors as to how best to invest.

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