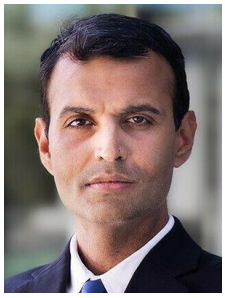
What Energy Claims Against Spain Mean For Investor Rights

By **Sohan Dasgupta** (January 10, 2023)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The Energy Charter Treaty, which enables investor-state arbitration against sovereign respondents by nationals of the signatory states, has recently been in the news.

Some say that the European Union might withdraw from the ECT; many signatories — Luxembourg, the Netherlands, Poland and others already have done so. The ECT, furthermore, is believed to present a threat to the EU's Green Deal.

The ECT has a vital mechanism to ensure the protection of foreign investors and to incentivize foreign investments. If both countries are signatories to the ECT, then the national of one country may request arbitration against another country under the rules specified in the ECT. Around 50 nations, including Spain and Japan, and supranational organizations have, at various times, been active signatories to the ECT.

Japanese investors proceeding against Spain have had significant success in a way that is a likely harbinger for developments to come in investor-state arbitration. This is particularly true for governments that try to reduce the benefits afforded foreign investors once they have already entered the country.

The successful ECT claim against Spain lodged by one Japanese investor in particular — JGC Holdings — is making waves. On Oct. 12 last year, Spain announced that it has given notice of its intention to leave the ECT.

The Japanese investor's award may have a profound pro-investor impact not only on the ECT but also on investor-state arbitration overall. It carries the seed of finessing a key doctrine — legitimate expectations, a component of fair and equitable treatment — in international arbitration.

But first, some background on the ECT is apt.

Background

The treaty's purposes are to promote the development of an open and competition energy market among all signatories, take due account of environmental concerns, create a climate favorable to the operation of enterprises and to the flow of investments and technologies by implementing market principles, and enhance safe energy transit.

Doubtless, the ECT imposes real brakes on how its signatories may achieve the purposes underlying the treaty as well as their own sovereign objectives. The ECT's liberalization policies are encapsulated by its commitment to "the principle of non-discrimination and ... market oriented price formation."

Just like most other foreign investment treaties that give rise to investor-state arbitrations, the ECT protects investor rights. It wants to ensure that foreign investors going into a host country will have their investments protected and security guaranteed. Otherwise, the incentives to do so might wane.

A sovereign government that has signed on to the ECT is obligated to honor, and conform its behavior to, a foreign investor's rights recognized by the treaty. Some of those rights include fair and equitable treatment, most favored nation treatment, and compensation.

Fair and equitable treament and its component, legitimate expectations, have been revolutionized by a slate of recent international investor-state tribunal decisions — arbitral awards carrying enduring and profound consequences. Investors aggrieved by the conduct of a signatory state may commence arbitral proceedings against that government before the International Centre for Settlement of Investment Disputes.

The palpable tension between investor protection and a nation's development goals is nothing new. While nations want to attract investment, they have sustainable development, economic success, national security and other goals they also want to honor. And they cherish their sovereignty.

Thus, there is often an inherent tension and indeed dissonance between what the signatory nation signs up for when it enters into an investment treaty and what it actually is willing to surrender when all is said and done — after all, governments tend to hold the view that it is their it is their "undeniable right and privilege to exercise [their] sovereign legislative power[s]," according to the tribunal in Parkerings-Compagniet AS v. Republic of Lithuania.[1]

Spain's Renewable Energy Efforts

Spain has been caught up in that quagmire. Around the start of this millennium, Spain — like Italy and the Czech Republic — invited foreign investors to invest in its renewable energy scheme. Spain guaranteed reasonable profitability rates to those investors.

But then the 2008 financial crisis occurred, the money for the renewable energy remuneration scheme dried up and Spanish regulators could no longer afford to pony up the incentivized payments to the foreign investors.

Starting around 2012, Spain changed its renewable energy scheme in fundamental ways.

At first, Spain slowly began to terminate its incentive scheme. Then around the middle of 2013, it simply ended the fixed feed-in remuneration system. Needless to say, foreign investors were displeased because they saw their investments and rates of return sinking fast. And many Japanese investors brought arbitral proceedings against the Spanish government before international investor-state tribunals.

And in those endeavors, fair and equitable treatment and the breach of legitimate expectations made for an obvious target. In particular, the aggrieved investors claimed that Spain, by reducing the benefits to be afforded the foreign investors, frustrated their legitimate expectations on the basis of which they had made these investments and incurred these costs in Spain to begin with.

The legitimate expectations test is a key and long-standing component of fair and equitable treatment. As scholars Marc Jacobs and Stephan Schill have observed, "the [FET] standard can be understood as an embodiment of the rule of law as it is familiar to numerous domestic and international legal regimes."[2]

Put differently, Schill explained that FET and legitimate expectations "restrict the exercise of

sovereign powers by host states, thus interpreting fair and equitable treatment as a public law concept."[3]

The legitimate expectations test essentially means that if a foreign investor had made investments in a host country on the basis of certain expectations that it reasonably had been made to have — by that host state or its agents, instrumentalities or representatives acting under its aegis, color or authority — then the host state may not deprive the investor of those legitimate expectations by inflicting mistreatment on them.

In Masdar Solar & Wind Cooperatief UA v. Kingdom of Spain, an investor-state tribunal appeared to state the standard principle that

> the FET constitutes a standard the purpose of which is to ensure that an investor may be confident that (i) the legal framework in which the investment has been made will not be subject to unreasonable or unjustified modification; and (ii) the legal framework will not be subject to modification in a manner contrary to specific commitments made to the investor." But that tribunal also concluded that "a State is at liberty to amend its legislation.

The prototypically pro-investor view, stated by an investor-state tribunal in Suez, Sociedad General de Aguas de Barcelona SA and Vivendi Universal SA v. Argentine Republic, is that When an investor undertakes an investment, a host government through its laws, regulations, declared policies and statements creates in the investor certain expectations about the nature of the treatment that it may anticipate from the host State.

The character of the commitment, including its specificity, matter greatly. In the words of the investor-state tribunal in the Masdar case,

> If the general legislation is to be regarded as a source of an investor's legitimate expectations, the investor must demonstrate that it has exercised appropriate due diligence and that it has [familiarized] itself with the existing laws.

But some other international tribunals and authorities have disagreed with this overall view. To them, domestic laws are by nature subject to repeal and thus do not necessarily give rise to a commitment, much less a specific one, to foreign investors.

General legislation, under this view, is not a permanent straitjacket stopping the sovereign host state from experimenting with its investment policies. Under this view, according to the tribunal in EDF (Services) Ltd. v. Romania,
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.

Energy Claims Against Spain

Many such claims have been filed, with varying results.

We come to the Japanese investor JGC Holdings' arbitration against the Spanish state. In 2010, JGC had invested in two solar power plants in southern Spain. In JGC Holdings Corp. v. Kingdom of Spain, an ICSID tribunal found that changes to Spain's renewable energy regime violated JGC's ECT-based right to not have its legitimate expectations frustrated.

This violated JGC's rights under the fair and equitable treatment standard. The tribunal commanded the Spanish government to pay €23.5 million, or around $25.2 million, in damages plus interest, although JGC had sought €161 million; 40% of JGC's legal costs; and 75% of the total cost of arbitration.

This investor-state tribunal, consisting of arbitrators Hi-Taek Shin, August Reinisch and Mónica Pinto, did not accept the host state's contention that JGC should have been aware that the feed-in remuneration once offered to incentivize the entry of JGC and other foreign investors into the Spanish renewable energy sector might terminate.

With respect to the pre-mid-2013 changes were concerned, a 2-1 majority of the tribunal, with Pinto dissenting, determined that Spain had breached JGC's legitimate expectations, and as for the mid-2013-onward changes, the tribunal was unanimous in finding a legitimate-expectations breach.

As far as the tribunal's majority was concerned, JGC had conducted reasonable due diligence. This is not a particularly high standard; and it seems to be in keeping with the legitimate-expectations concept that "withdrawal of undertakings and assurances given in good faith to investors as an inducement to their making an investment[] is by definition unreasonable."

Nor did the tribunal did not demand the showing of any specific Spain-to-JGC assurances since it is doctrinally the case that such assurances are "not always indispensable .... Specific assurances will simply make a difference in the assessment of the investor's knowledge and of the reasonability and legitimacy of its expectations."

And in fact, a prominent international law firm had prepared a report counseling JGC that Spain might adversely change its incentive scheme but had not had a basis for deducing that Spain's entire renewable-energy incentives template would be terminated by the government.

The Impact

This maximalist application of the legitimate expectations principle is a potent arrow in the quiver of the pro-investor wing. If future international tribunals elect to follow the JGC award — this decision certainly could be given persuasive authority effect — it would mean that reasonable due diligence of the kind JGC had conducted here would bullet-proof an investor's legitimate expectations claim.

It is not that the JGC award is an avulsive rupture from the fair and equitable treatment decisions of earlier tribunals. But the JGC award recognizes a successful fair and equitable treatment legitimate expectations claim based on commonly arising set of facts, one that numerous future tribunals will face. And that makes it easily applicable, administrable and handy for investors — and tribunals.

The JGC tribunal announced its decision on Nov. 9, 2021. The Spanish government has moved to have this award annulled under the aegis of an ICSID annulment committee.

But of course, the standard for annulment is very high, for annulment is possible only if a member of the tribunal had been corrupted; if the tribunal manifestly had exceeded its power; if the tribunal was not properly constituted; if the tribunal seriously had departed from fundamental procedural rules; or if the award did not state the reasons on which it was based.

Last autumn, Spain announced that it would depart from the ECT. A prevalent feature among investment treaties is that after they set the arbitral forum, the treaty organizations have little direct control over those arbitral proceedings or outcomes. In this case, what ICSID arbitrators do in this space is not perfectly controllable by the ECT officials either personally or institutionally.

Yet the departure of signatories — often a result of unfavorable arbitral outcomes — is a consequence the salient treaty organization must face. We will soon witness how the ECT's future plays out.

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[1] Parkerings-Compagniet AS v. Republic of Lithuania, ICSID Case No. ARB/05/8, Award, 11 September 2007, ¶ 332.

[2] Marc Jacob & Stephan W. Schill, "Fair and Equitable Treatment: Content, Practice, Method," in International Investment Law: A Handbook 761 (Marc Bungenberg et al. eds. 2015).

[3] Stephan W. Schill, "Fair and Equitable Treatment, the Rule of Law, and Comparative Public Law," in International Investment Law and Comparative Public Law 151, 159 (Stephan W. Schill ed. 2010).