ICSID tribunal orders Spain to pay EUR128 million for changes to renewable energy sector regime

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In *Eiser Infrastructure Ltd and another v Spain (ICSID Case No. ARB/13/36)*, an ICSID tribunal considered whether Spain had breached the fair and equitable treatment standard (FET) provided for in Article 10(1) of the Energy Charter Treaty (ECT) by changing the regulatory regime applicable to the renewable energy sector.

Speedread

On 4 May 2017, an ICSID tribunal rendered an award ordering Spain to pay EUR128 million plus interest for fundamentally changing the regulations concerning its solar energy sector. (The claimants have already submitted an application for enforcement in the New York courts.)

The arbitrators unanimously held that Spain had breached the fair and equitable treatment standard provided for in Article 10(1) of the Energy Charter Treaty, when, in 2013, it modified the regulatory framework governing the thermosolar plants in which UK-registered Eiser Infrastructure Ltd and its Luxembourg subsidiary Energia Solar Luxembourg Sàrl had invested.

This award is the third decision in a series of pending cases against Spain for cuts applied to its renewable energies sector between 2010 and 2014. It is also the first case decided against the interests of the state. The first two cases were decided in favour of Spain by the Arbitration Institute of the Stockholm Chamber of Commerce (SCC) tribunals. If other ICSID tribunals resolve the remaining cases in the same way as this case, reports estimate that Spain could face damages awards against it of between EUR5-7 billion. (*Eiser Infrastructure Ltd and another v Spain (ICSID Case No. ARB/13/36)*.)

Background

Article 10(1) of the ***Energy Charter Treaty*** (ECT) contains the core protections for investors:

"Each 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. Such Investments shall also enjoy the most constant protection and security and no Contracting Party shall in any way

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impair by unreasonable or discriminatory measures their management, maintenance, use, enjoyment or disposal. In no case shall such Investments be accorded treatment less favourable than that required by international law, including treaty obligations. Each Contracting Party shall observe any obligations it has entered into with an Investor or an Investment of an Investor of any other Contracting Party."
Article 21 of the ECT refers to taxation measures under the ECT:

"(1) 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.
(...).
(5) (a) Article 13 shall apply to taxes.
(b) Whenever an issue arises under Article 13, to the extent it pertains to whether a tax constitutes an expropriation or whether a tax alleged to constitute an expropriation is discriminatory, the following provisions shall apply:
(i) The Investor or the Contracting Party alleging expropriation shall refer the issue of whether the tax is an expropriation or whether the tax is discriminatory to the relevant Competent Tax Authority. Failing such referral by the Investor or the Contracting Party, bodies called upon to settle disputes pursuant to Article 26(2)(c) or 27(2) shall make a referral to the relevant Competent Tax Authorities;
(...)."
For further information on arbitrating under the ECT and under ICSID, see *Practice notes, Investment Arbitration under the Energy Charter Treaty* and *ICSID arbitration: a step-by-step guide*.

Facts

Between 1997 and 2007, Spain established a regulatory framework aimed at promoting the production of energy from renewable sources, including concentrated solar thermal power (CSP).

Among the rules that shaped this regulatory framework, the most important was Royal Decree 661/2007 (RD 661/2007). This Decree granted renewable energy producers the right to choose, on an annual basis, feed-in remuneration through either a regulated tariff per unit of production, or a pool price plus premium, during the plant's life.

To be entitled to this feed-in model, renewable facilities had to comply with a series of conditions, chiefly, registration in the registry for installations within the special regime (RAIPRE).

Attracted by this regulatory framework, and in particular by the economic rights granted by RD 661/2007, UK-registered Eiser Infrastructure Ltd and its Luxembourg subsidiary Energia Solar Luxembourg Sàrl (claimants) invested in 2007 in three CSP plants, which were ultimately registered with RAIPRE.

In 2009, Spain became increasingly concerned about its tariff deficit (the gap between the cost of subsidies payable to renewable energy producers and the revenues derived from energy sales to consumers). Therefore, Spain began amending the regulatory framework. These adjustments did not affect CSP plants such as the claimants' which were already registered with RAIPRE or in the pre-allocation register pursuant to Royal Decree Law 6/2009.

From late 2012 until 2014, Spain dismantled the feed-in model put in place by Royal Decree 661/2007 and substantially changed the regulatory framework (Disputed Measures). The Disputed Measures affected existing plants including the claimants'.

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In 2013, the claimants commenced ICSID arbitration on the basis that the Disputed Measures adopted by Spain breached various provisions of the ECT.

Investors' position

Among other things, the claimants contended that when they made their investment they had a legitimate expectation that the regulatory framework, and in particular the economic rights established by RD 661/2007, would remain stable during their plants' operating life (40 years). This expectation was the result of a series of commitments, promises and assurances made by Spain.

However, the Disputed Measures eliminated the regulatory regime under which the claimants had invested, particularly the economic rights established by RD 661/2007, replacing it with an arbitrary, non-transparent, and substantially different regime. As a result of the Disputed Measures, the CSP plants' revenues had dropped so dramatically that their investment was no longer profitable.

According to the claimants, by eliminating and replacing the regime established under RD 661/2007, Spain had violated the following ECT obligations by:

- Illegally expropriating their investment (*Article 13*).
- Denying fair and equitable treatment (FET) (*Article 10(1)*).
- Subjecting their investment to exorbitant measures (*Article 10(1)*).
- Failing to honor the obligations assumed towards the claimants' investments (*Article 10(1)*).

To determine damages for these breaches, the claimants followed a discounted cash-flow analysis (DCF) and sought compensation of EUR297 million:

- EUR196 million in losses from June 2014, when the new regulatory regime was established, until the end of the plants' operating life, which they set at 40 years post establishment.
- EUR13 million in losses until June 2014 ("historic" losses).
- EUR88 million as tax gross-up for the eventual payment of taxes in Luxembourg.

Spain's position

Spain raised six jurisdictional objections:

- **Intra-EU disputes**. Lack of jurisdiction *ratione personae* (by reason of the person), because Article 26 of the ECT implicitly precluded the application of the ECT to disputes relating to investments made within the EU by investors from other EU countries.
- **Objective requirements for investments**. Lack of jurisdiction *ratione personae*, because the claimants had not made an "objective" investment (one which includes a contribution of funds, a risk and a certain duration), as required by Article 1(6) of the ECT and Article 25 of the *ICSID Convention*.

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- **Shareholder complaints**. Lack of jurisdiction *ratione materiae* (by reason of the subject-matter), because, under international law, an investor cannot claim damages for "reflective losses" (losses suffered by a company in which the investor holds shares). A shareholder may only claim damages for the loss in value of the shares held.
- **Taxes**. Lack of jurisdiction to hear the claims that related to the 7% tax on the value of electricity production (TVPEE), because the ECT does not impose obligations on the contracting parties with respect to taxes.
- **Taxes and expropriation**. Lack of jurisdiction to hear the expropriation claim related to the TVPEE, because the claimants failed to refer the issue of whether the TVPEE is an expropriation or discriminatory, to the relevant competent tax authority, as required by Article 21(5) of the ECT.
- **Cooling off period**. Lack of jurisdiction to hear certain claims related to the Disputed Measures because the claimants had not attempted negotiations with Spain to settle the disputes regarding those measures before initiating arbitration proceedings, as required by Article 26 of the ECT.

On the merits, the respondent maintained that it had granted the claimants FET, and that there had been no expropriation or other breaches of the ECT.

Among other things, Spain maintained that, like any other state, it had the right to adopt structural reforms to redress macroeconomic imbalances such as the tariff deficit, with the ultimate objective of serving the public welfare. The claimants could not have a legitimate expectation that the regulatory framework under which they invested would be frozen, including the economic rights granted by RD 661/2007. They could only expect to obtain a **reasonable return** on their investment.

Decision

The ICSID tribunal accepted jurisdiction over all but the tax claims and ordered Spain to pay EUR128 million plus interest for breach of the FET standard.

Jurisdiction

The arbitrators rejected Spain's jurisdictional objections based on intra-EU disputes, objective requirements for investments, shareholder complaints and the cooling off period deciding as follows:

- **Intra-EU disputes**. Article 26 of the ECT, interpreted in accordance with the *Vienna Convention on the Law of Treaties*, does not exclude intra-EU disputes.
- **Objective requirements for investments**. The tribunal did not determine whether the ECT and ICSID Convention require that an investment display the characteristics of contribution, risk and duration. In any event, even if they did, the claimants' investment clearly met these requirements.
- **Shareholders' complaints**. Contrary to Spain's assertions, the claimants based their claims on the loss in value of their shareholding.

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- **Cooling off Period**. Some Disputed Measures arose after the commencement of the arbitration proceedings, so the claimants did not attempt prior negotiations in relation to them. Nevertheless, these measures are part of an evolving dispute which arose earlier, and which the claimants properly notified to the respondent. The claimants did not have to send a new notice of arbitration after each new measure. In any event, it appears that negotiations would have been futile because Spain had not replied to any of the earlier notices sent by the claimants.

On the other hand, the tribunal upheld the remaining two jurisdictional objections, both of which related to the TVPEE. The tribunal concluded that it did not have jurisdiction to hear claims regarding the TVPEE for the following reasons:

- Irrespective of whether or not there is an exception to Article 21(1) of the ECT's tax carve-out for tax measures adopted in bad faith (as suggested by the claimants), the claimants failed to show that Spain adopted the TVPEE in bad faith.
- Under Article 21(5) of the ECT's claw-back provision, the tribunal has jurisdiction over expropriation claims regarding taxation measures like the TVPEE. Nevertheless, these claims remain inadmissible until claimants refer the tax claims to domestic tax authorities for six months before questioning them in an arbitration. Here, although the claimants sent letters to the Spanish Finance Minister to the Spanish President, these did not suffice to meet the requirements stipulated in Article 21(5)(b) of the ECT. The former because it did not refer to the ECT and the latter because the Spanish Prime Minister was not the correct authority specified in the ECT.

Merits

In the interests of judicial economy, the tribunal only analysed the FET claim, without addressing the other claims of expropriation, unreasonable measures or breach of the ECT's ***umbrella clause***.

The tribunal noted that FET does not give investors a right to regulatory stability per se. States have the right to regulate, and investors should expect legislation to change, unless there is a stabilisation clause or other specific guarantee that generates a legitimate expectation of stability. Notwithstanding the above, FET does protect investors against fundamental changes in the regulatory regime that do not take into account the circumstances of existing investments made on the basis of previous regimes.

Here, the ECT did not prohibit Spain from making appropriate changes to the regulatory regime of RD 661/2007. Therefore, the claimants could not expect that RD 661/2007 granted them immutable economic rights. However, the ECT did protect the claimants from the total and unreasonable change of the regulatory framework they experienced in 2013.

The tribunal held that Spain had removed the favorable regulatory regime previously granted to the claimants and other investors to encourage their investment in CSP, and replaced it with an unprecedented and completely different normative system based on completely different premises. This new system was deeply unfair and inequitable in the way it was applied to the claimant's' existing investments, stripping them of virtually their entire value.

The tribunal differentiated this case from *Charanne and another v Spain (Arbitration No: 062/2012)*, discussed in *Legal update, Majority SCC tribunal rejects ECT renewable energy claims against Spain*

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in which the tribunal rejected the investors' claims. Among other things, in Charanne the claims were not based on the measures adopted after 2013, which had a far more dramatic effect on the investors in the EISER case.

Damages

In calculating damages, the tribunal accepted the claimant's suggestion that a DCF analysis be applied. The arbitrators considered the DCF method of calculation was widely accepted and particularly suitable for these types of cases.

The tribunal deemed that the plants' operating life should be limited to 25 years, instead of 40 as requested by the claimants, thereby reducing the lost profits requested under the new regime from June 2014 from EUR196 million to EUR128 million.

Finally, it rejected both the claim for losses prior to June 2014 (because it found the breach only occurred in June 2014, when the new regulatory regime was established) and the claim for tax gross-up for the eventual payment of taxes in Luxembourg because this fell outside the tribunal's jurisdiction.

As a result, the tribunal awarded compensation of EUR128 million.

Comment

This award is the third decision in a series of pending cases against Spain for cuts applied to its renewable energy sector between the years 2010 and 2014. It is also the first case decided against the interests of the state. The first two cases were decided in favour of Spain by the Arbitration Institute of the Stockholm Chamber of Commerce (SCC) tribunals.

However, as in this case, most international investors have filed their claims before ICSID. Specifically, Spain has had 27 claims filed against it at ICSID, so this decision may be only the first of a long list of awards contrary to its interests. Spain is the second country by number of claims worldwide, behind only Venezuela.

This decision does not constitute a binding precedent for the other ICSID tribunals that have to decide on similar cases. However, the question remains as to the extent to which these tribunals will take into account, in whole or in part, the reasoning included in the award in support of their own analysis.

If the other ICSID tribunals decide the remaining claims in the same way as this one, reports estimate that Spain could face damages awards against it of between EUR5-7 billion.

Case

Eiser Infrastructure Ltd and another v Spain (ICSID Case No. ARB/13/36) (ITALAW).

Disclaimer: *The authors would like to make clear that this Legal update was written for information purposes only and nothing in it represents their opinion on any of the issues raised in this case.*

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