Investment Treaty News
(https://www.iisd.org/itn/en/) (https://www.iisd.org/)

ANALYSIS (HTTPS://WWW.IISD.ORG/ITN/EN/ANALYSIS/) | JUNE 27, 2019 | YULIA LEVASHOVA

Investor Due Diligence and the Energy Charter Treaty

At the end of 2018, the Subgroup on Modernization of the Energy Charter Conference agreed on a list of topics to be considered in the process of ECT modernization.[1] Next, the subgroup will identify the policy options for each topic; negotiations based on these will start sometime in 2019. Among the topics identified for modernization are the definition of FET and the right to regulate.

This article discusses the implications of the current ECT formulation of FET for the interpretations of this standard adopted by recent tribunals in renewable energy cases. It focuses on the assessment of the stability requirement provided for in ECT Article 10(1), on the one hand, and the state's regulatory flexibility on the other. In particular, it looks into whether a requirement of investor due diligence, as one of the options in reforming the FET standard under the ECT, could help rebalance investors' right to "stability" and states' right to change their laws.

SUBSCRIBE (/itn/subscribe)

Keep updated with the ITN newsletter or subscribe to our RSS feed (https://localhost/iisd-itn/wordpress/feed/)

Follow ITN on Twitter (https://twitter.com/IISD_ELP)

SECTOR | COUNTRY / ORG | TOPIC | INSTRUMENT

Quarterly Journal Archives

Select Month

[:en]Investment Treaty News is an online journal published by the International Institute for Sustainable Development (https://www.iisd.org/)

ISSN 2519-8467 (English ed.)
ISSN 2519-8823 (French ed.)
ISSN 2519-8831 (Spanish ed.)[:fr]Investment Treaty News est un journal publié par l'Institut international du développement durable (https://www.iisd.org/)

ISSN 2519-8467 (Éd. en anglais)
ISSN 2519-8823 (Éd. en français)
ISSN 2519-8831 (Éd. en espagnol)[:es]Investment Treaty News es un boletín trimestral publicado por el Instituto Internacional para el Desarrollo Sostenible (https://www.iisd.org/)

ISSN 2519-8467 (ed. en inglés)
ISSN 2519-8823 (ed. en francés)
ISSN 2519-8831 (ed. en español)[:]

1. The requirement of stability under the ECT: Cases against Spain

The FET standard under the ECT is one of the most commonly invoked provisions, and the ECT itself is the most frequently invoked IIA in investment arbitration.[2] Currently, ECT Article 10(1) is formulated in an unqualified and open manner, committing host states to provide FET "at all times to Investments and Investors." This formulation is typical of older-generation IIAs. ECT Article 10(1) also includes the obligation of stability, providing that states shall "encourage and create stable, equitable, favourable and transparent conditions for Investors."

The wave of investment arbitrations in the renewable energy sector exemplifies foreign investors' reliance on the FET and stability provisions under the ECT.[3] Spain is the most frequent respondent state in renewable energy disputes and is currently facing 36 arbitrations.[4] In the cases against Spain, investors have argued that drastic alterations of the Spanish regulatory framework for renewable energy frustrated their legitimate expectations derived from the ECT obligation of stability.

The changes to the regulatory regime were motivated by an increasing electricity tariff deficit. The deficit resulted from the difference between the subsidies (feed-in tariffs) granted by Spain to renewable energy producers and the tariffs paid by consumers. The situation worsened because of the global economic crisis between 2008 and 2014.[5] In response to the tariff deficit and the crisis, Spain implemented several regulatory measures between 2010 and 2014, transforming the regime of subsidies for renewable energy producers. Several affected investors initiated ECT claims.[6]

2. State's right to change its laws versus the obligation to provide stability

The central issue in concluded cases against Spain—*Charanne v. Spain*, *Eiser v. Spain (https://www.iisd.org/itn/2017/09/26/investors-triumph-over-spain-claim-concerning-spains-regulatory-overhaul-for-clean-energy-gladwin-issac),*[7] *Isolux v. Spain (https://www.iisd.org/itn/2017/09/26/all-claims-by-isolux-infrastructure-netherlands-against-spain-are-dismissed-isolux-infrastructure-netherlands-v-spain-scc-case-v2013-153-claudia-maria-arietti-lopez/)*[8] and *Antin v. Spain (https://www.iisd.org/itn/2018/10/17/spain-found-to-have-breached-the-energy-charter-treaty-in-award-by-icsid-tribunal-trishna-menon)*[9]—was the extent to which the host state can exercise its right to regulate by changing its laws without violating FET.[10] The tribunals assessed this issue by balancing the stability obligation under ECT Article 10(1) against the state's right to change its laws.

In all four cases, the tribunals affirmed the legitimate right of the state to regulate to remedy the tariff deficit problem, emphasizing that Spain had the right to change its laws to overcome financial difficulties.[11] One of the central criteria in the tribunals' assessments of regulatory stability was whether the change was disproportionate in view of its impact on the investments. The tribunals indicated that the changes must be consistent with the "public interest, economic reasonableness and the principle of proportionality."[12] They specified that a state's regulatory measure is considered disproportional when it amounts to a "sudden and unpredictable

elimination of the essential characteristics of the existing framework."[13] However, the tribunals had different views on what constitutes such an elimination.

In *Eiser* and *Antin,* the tribunals adopted a broad interpretation of the stability requirement, stressing that the "obligation to accord [FET] necessarily embraces the obligation to provide fundamental stability in the essential characteristics of the legal regime relied upon by investors in making long-term investments."[14] Through this prism, these tribunals primarily focused on the impact of the regulatory change on the investors.[15]

For the *Charanne* and *Isolux* tribunals, however, the issues addressed were whether the presence of the specific representations had led to legitimate expectations on the part of investors regarding regulatory stability.[16] In a more restrictive interpretation of the state's duty to ensure the stability of the regulatory framework, the tribunals emphasized that investors must comply with their due diligence obligations in order to be able to claim the protection of their (legitimate) expectations.

3. Implications of the divergent interpretations of the stability requirement under FET

The discrepancy among the cases against Spain concerning the interpretation of the FET standard and specifically the notion of stability is problematic on different counts.

First, there is a lack of predictability and consistency as to how the state's right to regulate is weighed against the notion of stability. There is no clear understanding of how tribunals value the relevant considerations in assessing the FET standard. For example, as illustrated by the cases discussed above, in weighing the economic circumstances concerning the tariff deficit challenge against investors' rights under the FET standard, tribunals have adopted different views on the role of these circumstances in assessing the question of whether they could justify the disputed state measures.

The *Charanne* tribunal, in evaluating whether the 2010 reforms were in the public interest, concluded that the measures of the Spanish authorities constituted legitimate public policies and had been adopted to "limit the deficit and price increases."[17] The special circumstances in the host state were one of the main considerations to support the decision of the tribunal that the host state had not breached the FET standard.

The *Eiser* tribunal also acknowledged the tariff deficit as a legitimate public policy problem. However, the tribunal placed less significance on this factor, by expressing the view that Spain, in dealing with the tariff deficit challenge, should still be able to comply with FET under the ECT.[18] To balance the state's right to change its laws with its duty to provide certain degree of stability, a tribunal should compare the impact of a regulatory change on an investor with other factors, such as the economic and socio-political circumstances of the change and the investor's due diligence.

Second, the notion of stability in ECT Article 10(1) does not reflect the current evolution of the investment policy landscape. Many states have undertaken efforts to reform the FET standard in their IIAs. The approaches towards FET adopted in recent IIAs vary significantly. The different approaches include: (1) an omission of the FET standard from the treaty

altogether;[19] (2) clarification of the content of the FET standard, with a list of the state's obligations and an exclusion of the obligation of stability from the scope of the treaty;[20] and (3) an elimination of protection of legitimate expectations.[21]

Accordingly, different avenues could be considered to rebalance stability and regulatory flexibility of the FET standard in a modernized ECT. This piece focuses on the approaches recently adopted by the EU, given that the EU and all of its member states (with the exception of Italy) form the majority of the state parties to the ECT. Therefore, ECT modernization is more likely to follow the approach taken in EU treaties.

Recent EU IIAs continue to include the FET standard, but attempt to narrow it down by excluding the requirement of stability from the scope of the treaty. The CETA, the EU–Singapore FTA and the EU–Vietnam FTA, for example, provide for the state's right to regulate and specify that the "mere fact" of a change to the regulatory framework in a "manner which negatively affects an investment or interferes with an investor's expectations" does not amount to a breach of investment obligations under the agreement.[22] However, this formulation does not exclude the possibility that, in combination with other facts—for example, manifest arbitrariness, one of the possible grounds for the violation of FET under CETA Art. 8.10(2)(c))—a change to a regulatory framework could play a role in a tribunal's assessment of whether the legitimate expectations of an investor were frustrated.

Therefore, treaty language in recent EU IIAs reduces to some extent the host state's risk of incurring liability under the FET standard, when it changes its regulatory framework. However, it does not provide clear criteria for determining the extent of regulatory change that may lead to liability. One such criterion could be the inclusion of a due diligence obligation in the treaty.

4. Investor's due diligence as a yardstick in assessing the stability requirement

Should the FET and stability language be maintained in a modernized ECT, adding an obligation of due diligence of the investor as a condition for the protection of its legitimate expectations could help balance the rights and obligations of states and investors under the FET standard. Numerous tribunals have underlined that an investor bears the responsibility of appraising the reality and the context of the state where the investment is being made by performing due diligence and risk assessments.[23] The investor must be aware of and take into account the relevant policies and regulations concerning its investment in order to anticipate possible risks. [24]

This is especially relevant for cases in which the legitimate expectations claim is based on the changes to a general regulatory framework. The extent of an investor's due diligence investigation can operate as a yardstick in judging whether the contested changes could have been predicted by an investor. Only if the changes were not foreseeable by a prudent investor,[25] despite visible efforts to collect the information about the future of the regulatory framework, would the legitimate expectations of the investor be protected under the treaty.

While the inclusion of an FET standard that leaves open the door to legitimate expectations remains inherently unpredictable due to the subjectivity of the concept, the inclusion of a requirement for investors to undertake due diligence in order to benefit from FET would at least provide some additional clarification: only a diligent investor, performing a proper assessment of the laws and regulations in a host state and potential changes, would be able to rely on the specific representations under the FET standard. From the perspective of balancing the rights of the investor and the state's right to regulate, such a reference could also strengthen the importance of investors' responsibilities in international investment law.

Author

Dr. Yulia Levashova is an Assistant Professor at Nyenrode Business University and an Associate Research Fellow at Utrecht University. She is an investment law consultant to UNCTAD in Geneva. The opinions expressed in this article are solely those of the author and do not reflect views of affiliated organizations.

Notes

[1] International Energy Charter. (2018). *Approved topics for the modernisation of the Energy Charter Treaty*. Retrieved from https://energycharter.org/media/news/article/approved-topics-for-the-modernisation-of-the-energy-charter-treaty (https://energycharter.org/media/news/article/approved-topics-for-the-modernisation-of-the-energy-charter-treaty/); see also the Bucharest Energy Charter Declaration, signed on November 28, 2018. Retrieved from https://energycharter.org/media/news/article/energy-charter-conference-adopts-the-bucharest-declaration (https://energycharter.org/media/news/article/energy-charter-conference-adopts-the-bucharest-declaration/)

[2] International Energy Charter. (2019, January 11). *The Energy Charter Treaty (ECT) remains the most frequently invoked IIA*. Retrieved from https://energycharter.org/media/news/article/the-energy-charter-treaty-ect-remains-the-most-frequently-invoked-iia (https://energycharter.org/media/news/article/the-energy-charter-treaty-ect-remains-the-most-frequently-invoked-iia)

[3] Spain, Italy, Czech Republic that reformed their renewable energy policies are currently facing the multiple claims under the ECT and in some cases under BITs. Draguiev, D. (2018). Investment treaty arbitration in the renewable energy sector: Overview of arbitral case law on legitimate expectations in the light of policy. *Oil, Gas & Energy Law Journal (OGEL)*, *16*(5).

[4] At the time of writing, 36 arbitrations refer to pending renewable energy cases against Spain. See https://investmentpolicy.unctad.org (https://investmentpolicy.unctad.org)

[5] Bank of Spain. (2017). *Report on the financial and banking crisis in Spain, 2008-2014*. Madrid: Bank of Spain. Retrieved from https://www.bde.es/f/webbde/Secciones/Publicaciones/OtrasPublicaciones/Fich/InformeCrisis_Completo_web_en.pdf

(https://www.bde.es/f/webbde/Secciones/Publicaciones/OtrasPublicaciones/Fich/InformeCrisis_Completo_web_en.pdf)

[6] In de Braekt, M., & Geldhof, W. (2017, July 19). Mixed results in recent arbitral awards concerning Spain's renewable energy policy. *Stibbe Blog, Lexology*. Retrieved from https://www.lexology.com/library/detail.aspx?g=d384a0ee-31cf-4411-8898-adc714c414b6 (https://www.lexology.com/library/detail.aspx?g=d384a0ee-31cf-4411-8898-adc714c414b6); Power, R., & Baker, P. (2018, April 10). The European arbitration review 2018 – Energy arbitrations. *Clyde&Co*. Retrieved from https://www.clydeco.com/insight/article/the-european-arbitration-review-2018-energy-arbitrations (https://www.clydeco.com/insight/article/the-european-arbitration-review-2018-energy-arbitrations)

[7] Schacherer, S. (2018, October 18). Eiser v. Spain. In N. Bernasconi-Osterwalder & M. D. Brauch. (Eds.) *International investment law and sustainable development: Key cases from the 2010s*. Retrieved from https://www.iisd.org/itn/2018/10/18/eiser-v-spain (https://www.iisd.org/itn/2018/10/18/eiser-v-spain/); Issac, G. (2017, September 26). Investors triumph over Spain in a claim concerning Spain's regulatory overhaul for clean energy. *Investment Treaty News*, *8*(3), 17–18. Retrieved from https://www.iisd.org/itn/2017/09/26/investors-triumph-over-spain-claim-concerning-spains-regulatory-overhaul-for-clean-energy-gladwin-issac (https://www.iisd.org/itn/2017/09/26/investors-triumph-over-spain-claim-concerning-spains-regulatory-overhaul-for-clean-energy-gladwin-issac/)

[8] Arietti López, C. M. (2017, September 26). All claims by Isolux Infrastructure Netherlands against Spain are dismissed. *Investment Treaty News*, *8*(3), 13–14. Retrieved from https://www.iisd.org/itn/2017/09/26/all-claims-by-isolux-infrastructure-netherlands-against-spain-are-dismissed-isolux-infrastructure-netherlands-v-spain-scc-case-v2013-153-claudia-maria-arietti-lopez (https://www.iisd.org/itn/2017/09/26/all-claims-by-isolux-infrastructure-netherlands-against-spain-are-dismissed-isolux-infrastructure-netherlands-v-spain-scc-case-v2013-153-claudia-maria-arietti-lopez/)

[9] Menon, T. (2018, October 17), Spain found to have breached the Energy Charter Treaty in award by ICSID tribunal. *Investment Treaty News*, *9*(3), 23–24. Retrieved from https://www.iisd.org/itn/2018/10/17/spain-found-to-have-breached-the-energy-charter-treaty-in-award-by-icsid-tribunal-trishna-menon (https://www.iisd.org/itn/2018/10/17/spain-found-to-have-breached-the-energy-charter-treaty-in-award-by-icsid-tribunal-trishna-menon/)

[10] Matteoti, S. & Payosova, T. (2017). The role of fair and equitable treatment standard: Regulatory coherence for trade and investment in renewable energy. In T. Cottier & I. Espa (Eds.). *International trade in sustainable electricity*. Cambridge: Cambridge University Press.

[11] *Antin Infrastructure Services Luxembourg S.à.r.l. and Antin Energia Termosolar B.V. v. Kingdom of Spain*, ICSID Case No. ARB/13/31, Award, June 15, 2018, para. 555. Retrieved from https://www.italaw.com/sites/default/files/case-documents/italaw9875.pdf (https://www.italaw.com/sites/default/files/case-documents/italaw9875.pdf); *Eiser Infrastructure Ltd. and Energia Solar Luxembourg v. Spain*, ICSID Case No. ARB/13/36, Award, May 4, 2017,

para. 371. Retrieved from https://www.italaw.com/sites/default/files/case-documents/italaw9050.pdf (https://www.italaw.com/sites/default/files/case-documents/italaw9050.pdf); *Isolux Netherlands, BV v. Kingdom of Spain*, SCC Case V2013/153, Final Award, July 17, 2016. Retrieved from https://www.italaw.com/sites/default/files/case-documents/italaw9219.pdf (https://www.italaw.com/sites/default/files/case-documents/italaw9219.pdf); *Charanne Construction v. Spain*, SCC Case No. 062/2012, Award, January 21, 2016, paras. 500 and 536. Retrieved from https://www.italaw.com/sites/default/files/case-documents/italaw7047.pdf (https://www.italaw.com/sites/default/files/case-documents/italaw7047.pdf)

[12] *Charanne Construction v. Spain*, *supra* note 11, para. 514; *Eiser v. Spain*, *supra* note 11, para. 370.

[13] *Charanne Construction v. Spain*, *supra* note 11, para. 517.

[14] *Eiser v. Spain*, *supra* note 11, para. 382. *Antin v. Spain*, *supra* note 11, para. 532.

[15] *Eiser v. Spain*, *supra* note 11, paras. 362 and 365; *Antin v. Spain*, *supra* note 11, para. 532.

[16] *Charanne Construction v. Spain*, *supra* note 11, paras. 499 and 504; *Isolux Netherlands, BV v. Kingdom of Spain*, *supra* note 11, paras. 764 and 775.

[17] *Charanne Construction v. Spain*, *supra* note 11, para. 514; *Eiser v. Spain*, *supra* note 11, para. 536.

[18] *Eiser v. Spain*, *supra* note 11, para. 371.

[19] Government of India. (2015). *Model text for the Indian bilateral investment treaty*. Retrieved from http://indiainbusiness.nic.in/newdesign/upload/Model_BIT.pdf (https://indiainbusiness.nic.in/newdesign/upload/Model_BIT.pdf); see Treaty Between the Republic of Belarus and the Republic of India on Investments, September 24, 2018. Retrieved from https://investmentpolicy.unctad.org (https://investmentpolicy.unctad.org); see also Brazil's Cooperation Facilitation Investment Agreements (CFIAs) concluded since 2015. Retrieved from https://investmentpolicy.unctad.org (https://investmentpolicy.unctad.org)

[20] Recent EU IIAs have adopted such approach to FET. See: Comprehensive Economic and Trade Agreement, Canada–European Union, October 30, 2016. Retrieved from https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:22017A0114(01) (https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:22017A0114(01)) [hereafter "CETA"]; Free Trade Agreement between the European Union and the Republic of Singapore, October 15, 2018. Retrieved from https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=COM%3A2018%3A0196%3AFIN (https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=COM%3A2018%3A0196%3AFIN) [hereafter "EU–Singapore FTA"]; Draft Free Trade Agreement between the European Union and the Socialist Republic of Viet Nam. Retrieved from https://eur-lex.europa.eu/legal-

content/EN/TXT/?qid=1551257348905&uri=CELEX:52018PC0691 (https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1551257348905&uri=CELEX:52018PC0691) [hereafter "EU–Viet Nam FTA"].

[21] In some recent treaties, states clarified that the "mere" violation of the legitimate expectations will not violate the said treaty. See: Agreement between the United States of America, the United Mexican States, and Canada, November 30, 2018, Article 14.6. Retrieved from https://ustr.gov/trade-agreements/free-trade-agreements/united-states-mexico-canada-agreement/agreement-between (https://ustr.gov/trade-agreements/free-trade-agreements/united-states-mexico-canada-agreement/agreement-between); and the Free Trade Agreement between the United States and the Republic of Korea, June 30, 2007, revised as of January 1, 2019, Article 11.5(4). Retrieved from https://ustr.gov/sites/default/files/uploads/agreements/fta/korus/Chapter_Eleven_Investment.pdf (https://ustr.gov/sites/default/files/uploads/agreements/fta/korus/Chapter_Eleven_Investment.pdf)

[22] CETA, *supra* note 20, Article 8.9 (2); EU–Singapore FTA, *supra* note 20, Article 2.2(2); see also, with slightly different formulation, EU–Viet Nam FTA, *supra* note 20, Article 13 bis (2).

[23] *Mamidoil Jetoil Greek Petroleum Products Société S.A. v. Republic of Albania*, ICSID Case No. ARB/11/24 Award, March 30, 2015. Retrieved from https://www.italaw.com/sites/default/files/case-documents/italaw4228.pdf (https://www.italaw.com/sites/default/files/case-documents/italaw4228.pdf); *Charanne Construction v. Spain*, *supra* note 11.

[24] *Charanne Construction v. Spain*, *supra* note 11, para. 505.

[25] *Isolux Netherlands, BV v. Kingdom of Spain*, *supra* note 11, para. 781.

TAGS ECT (HTTPS://WWW.IISD.ORG/ITN/EN/TAG/ENERGY-CHARTER-TREATY/)

FET (HTTPS://WWW.IISD.ORG/ITN/EN/TAG/FAIR-AND-EQUITABLE-TREATMENT-FET/)

LEGITIMATE EXPECTATIONS (HTTPS://WWW.IISD.ORG/ITN/EN/TAG/LEGITIMATE-EXPECTATIONS/)

SPAIN (HTTPS://WWW.IISD.ORG/ITN/EN/TAG/SPAIN/)

STABILIZATION (HTTPS://WWW.IISD.ORG/ITN/EN/TAG/STABILIZATION-CLAUSES/)

PREVIOUS ARTICLE

UNCITRAL Working Group III: July 15 deadline for submissions on proposed reform solutions (https://www.iisd.org/itn/en/2019/06/27/uncitral-working-group-iii-july-15-deadline-for-submissions-on-proposed-reform-solutions/)

NEXT ARTICLE

The Kenyan Parliament and Investment Treaty Making (https://www.iisd.org/itn/en/2019/06/27/the-kenyan-parliament-and-investment-treaty-making-bosire-nyamori/)

IISD

International Institute for Sustainable Development

(HTTPS://WWW.IISD.ORG/)

© 2023 INTERNATIONAL INSTITUTE FOR SUSTAINABLE DEVELOPMENT (HTTPS://IISD.ORG)
PRIVACY POLICY (HTTPS://WWW.IISD.ORG/ITN/PRIVACY-POLICY/)