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Tribunal finds Spain's changes to its regulatory regime to have violated investors' legitimate expectations under ECT's Art. 10(1)

Mathias Kruck and others v. Kingdom of Spain, ICSID Case No. ARB/15/23

The dispute

This case concerns a dispute between 73 investors (claimants) in the renewable energy sector and Spain (respondent). The dispute was submitted to the ICSID based on the ECT. The issue before the tribunal was whether Spain's changes to its regulatory regime amounted to a violation of the FET standard assumed under Article 10(1) of the ECT.

The claimants alleged that Spain had induced foreign investment in renewable energy sources (RES), and then subsequent changes to the regulatory scheme had fundamentally altered and abolished the framework. The respondent, on the other hand, argued that the changes did not amount to a violation as they had been made in accordance with the ECT and domestic laws in place before the claimants had made their investments.

Background

All the investments in Spain had been made by the claimants following the EU-wide attempt to increase reliance on RES encapsulated in EU Directive 2001/77/EC. Spain was given the goal of meeting 29.4% of its energy demand from RES by 2020.

In 2004, Spain introduced changes affecting the renewable energy sector. These changes had been introduced to attract investment in RES. In 2006, there were indications that the regime was being changed again. Mathias Kruck, one of the claimants, read about the proposed changes in different media sources and spoke to a Spanish attorney. On May 25, 2007, these proposed changes were adopted through Royal Decree (RD) 661/2007. The new law was highly successful in achieving Spain's target. The incentives

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provided were only available for facilities established before September 29, 2008. Claimants 1-35, 66, 67, 69, 70, 71, and 73 had made their investments before this deadline (para. 45).

From 2013 to 2014, Spain adopted a series of measures that the claimants alleged adversely affected their investments.

FET and legitimate expectations

The claimants argued that, by reversing the incentives available to them, Spain had violated its obligations under Art. 10(1) of the ECT. To the contrary, the respondent argued that the claimants' interpretation of the ECT would lead to a "petrification of general rules," which would prove detrimental to state parties and their nationals (para. 119).

To conclude whether Spain's actions had indeed amounted to a violation of the FET standard, the tribunal was faced with the difficulty of assessing the application of the doctrine with respect to legitimate expectations (para. 158). The respondent relied on *Saluka* and *Philip Morris,* arguing that a finding of a breach of the FET standard required a balancing exercise and that a state could not be deemed to violate the FET standard if the measure had been enacted in pursuit of legitimate public policy objectives. The claimant found the respondent's argument to be a gross overstatement.

The tribunal stated that "very specific commitments" are needed to give rise to legitimate expectations (paras. 159–160). Consequently, the tribunal was faced with the question of whether any representations had been made by the respondent. From the outset, the tribunal held that representations by parties not acting on behalf of the respondent could not give rise to legitimate expectations (para. 163). As a result, statements by the Spanish lawyer and other parties Kruck consulted and material in the media could not create any obligations. However, the text of laws could give rise to legitimate expectations, provided that one could "point to something that clearly indicates that the State is making a commitment not to exercise its legislative power in a particular way" (para. 167).

The tribunal reasoned that where the legislation is aimed at inviting investment based on a guarantee of stability, it could give rise to specific commitments (para. 189). It found that the stability of the laws enacted by Spain was an essential feature, as indicated by the wording found throughout the texts of these laws (para. 190). Consequently, the tribunal found RD 661/2007 and RD 1578/2008 to have given rise to the legitimate expectations of the claimants.

While the tribunal accepted the respondent's argument that legislation can always be amended, it expressed concern over whether such changes were fair and equitable or harmed certain investors that had relied on the assurances of stability (para. 193). Moreover, in the view of the tribunal, the question was if Spain had committed to refraining from exercising its sovereign powers (para. 199). The assurances of stability evidenced that commitment.

The tribunal held that the claimants' investments after May 25, 2007, were made in reliance on the specific assurances given by Spain (para. 205). It excluded investments made before this date, even if they were made based on

the knowledge of the upcoming law, because these investments had been based on speculations (para. 204).

The tribunal then assessed whether Spain had breached the specific commitments the investors had relied upon. The tribunal found the disputed measures adopted between 2013 and 2014 to be a reasonable response to the economic crisis faced by Spain. However, it found that the abolition of the incentives for investors who had already committed significant capital based on the earlier assurances was unreasonable (para. 224). It consequently found Spain to have breached its commitments under Article 10(1) of the ECT and found it liable to pay compensation.

Effect of due diligence on investor's legitimate expectations

Spain argued that the claimants did not conduct due diligence at a level that is expected from a foreign investor, nor had they provided any due diligence report in support of their legitimate expectations (para. 132). The claimants, on the other hand, argued they had indeed conducted adequate due diligence by consulting multiple legal advisors (para. 101). It was found that not only Kruck but also the bank that financed the PV projects had relied on representations by the Spanish lawyer. Kruck had also read about Spain's regulatory regime in media and specialized magazines.

The tribunal agreed, in principle, that investors must undertake due diligence before relying on commitments by states (para. 191). It continued that while representations by third parties could not give rise to legitimate expectations, these representations were relevant for due diligence (para. 164). These representations are important as they are crucial in understanding how specific commitments by states have been interpreted by those to whom they have been addressed, and, as such, serve to "corroborate and support the Claimants' assertions as to what they understood the Respondent to be promising" (para. 209).

Damages

Having found that Spain had violated the FET standard by undermining the legitimate expectations of the investors, the tribunal turned its attention toward the issue of damages.

The tribunal stated that compensation based on the value of the claimants' investments was not adequate (para. 349). It recognized the difficulty of applying the "but for" test to calculate the damages due for a breach of the FET standard. However, it went on to say that the "but for" test was not entirely speculative (para. 352). The claimants had relied on the stability guaranteed under Spain's laws, and they were entitled to assume that they would not fundamentally change.

The tribunal held June 21, 2014, to be the date of the breach because that is the day when the predetermined payment system was repudiated by the new regulatory regime introduced in 2014 (para. 356). For the tribunal, the compensation due was a straightforward issue; it was the difference between what the claimants were owed under the specific commitments originally made and the amount they were actually paid (para. 357).

Since the modifications to the law introduced in 2010 had not amounted to a breach, the monies owed to the claimants would be calculated under RD 661/2007, as modified by the 2010 reforms. The tribunal, therefore, held that the claimants should be paid the fixed tariff payable for 30 years, with the annual hours capped in accordance with the 2010 reforms (para. 360). The tribunal also awarded compound interest, to be calculated from the date of the breach (para. 361).

The tribunal left the calculations of the exact monies owed to the parties, which they are to submit jointly based on the findings of the tribunal (para. 363).

Dissent

The dissent homed in on the assumption of the claimants and the majority that Article 44(3) of RD 661/2007 contained language to suggest that the Spanish government had effectively deprived itself of the power to repeal the regulation, despite any future changes that may occur, against the requirements of public interest. In his dissenting opinion, Zachary Douglas argued that there was nothing in the text to suggest that (Diss. Op., para. 63).

Analyzing the evolution of Spain's regulatory regime and related judicial decisions, the dissent argued that the investors, at the time of investments, would have been aware that: the umbrella legislation allowed adjustments to the calculations of the premium; there had been several changes made to the regulations preceding RD 661/2007; a previous regulation had contained a similar "stabilization clause" yet had been repealed and replaced; the Spanish Supreme Court had denied a similar argument as the claimants' in a case that concerned the stability of a regulation preceding RD 661/2007; and that the changes introduced in RD 661/2007 had been introduced to respond to changing circumstances (para. 79). Therefore, these circumstances could not have given rise to legitimate expectations.

Douglas criticized the strict liability approach adopted by the majority, which he argued, had been imported from contract law (para. 10). In his view, it was erroneous to equate a public regulatory relationship with a private contractual relationship (para. 29). He argued that liability stemming from a breach of legitimate expectations necessitated an element of "fault." Therefore, Spain would have been held liable if the disputed measures imposed an undue burden or offended some other criterion of fault. On the contrary, the majority had not found the disputed measures to be discriminatory or unreasonable.

The dissent also diverged on the requirements of due diligence. It was argued that no Spanish lawyer would have opined that RD 661/2007 contained a valid assurance of immutability (para. 101) simply because such an assurance would have been contrary to the Spanish legal order (para. 98–99). The dissent disregarded the claims by the claimants that they had performed satisfactory due diligence, as the legal opinion on the immutability of RD 661/2007 had been rendered orally by a Spanish lawyer. Consequently, the dissent did not attach any weight to it (para. 101).

The dissent proposed a test of proportionality as found in German law (para. 103). It was argued that such a test would ensure that tribunals factor in contextual information that caused the regulatory change (para. 106).

Note

The tribunal was composed of Michael Pryles, appointed by the claimants, Zachary Douglas, appointed by the respondent, and Vaughan Lowe, KC, as the President. Paul-Jean Le Cannu served as the secretary of the tribunal.

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