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Before the Other Shoe Drops (II): The First ICSID Final Award in the Spanish Renewable Energy Arbitration Saga Finds for the Investors – Crossing the Line?

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The following updates the author's entry September 2015 in this blog entitled *"**Before the Other Shoe Drops: The Current State of Renewable Energy Arbitration in Spain (https://efilablog.org/2015/09/22/before-the-other-shoe-drops-the-current-state-of-renewable-energy-arbitration-in-spain/)**."*

In recent years, some 30 cases have been filed — under SCC, UNCITRAL and (principally) ICSID rules — alleging that Spain breached the Energy Charter Treaty (ECT) when it altered the regulatory framework governing investments in the renewable energy sector.

During the course of 2016, final awards were issued in favor of Spain in two cases challenging certain regulatory changes in the photovoltaic sector heard under the auspices of the Stockholm Chamber of Commerce (SCC). Now, in a landmark award issued on 4 May 2017, an ICSID tribunal has found in favor of the claimant investors in a case challenging a series of more recent changes impacting the thermo-solar sector.

The Tribunal awarded damages of € 128 million plus interest to investors Eiser Infrastructure Ltd of the UK and its subsidiary Energia Solar Luxembourg sarl of Luxembourg for the loss in value of their investments in three concentrated solar power (CSP) thermosolar plants.

Issued in both English and Spanish versions, only the Spanish version is to date available on the Internet.

Below is a limited summary of the award, together with a few preliminary observations about its possible impact on the resolution of the future cases, many of which are fast-approaching decision.

Background

In the early years of this century, Spain's then-government designed a Renewable Energy Plan based on a very generous incentive system for investments in the production of electricity from renewable energies. As a result, sunny Spain quickly became a world leader in renewable energy. However, the opening of a gaping "tariff deficit" (excess of subsidies paid to producers and revenues from the sale of energy to consumers), exacerbated by the consequences of the financial crisis, led to a series of aggressive and ultimately effective measures aimed to cutback on the incentive system and erase the tariff deficit.

Starting in 2012 the regulatory changes became particularly stringent. Significantly, in December 2012, Spain imposed a 7% tax on electricity production and eliminated certain solar power subsidies. In the course of 2013, new regulations eliminated the tariff regulations set out in Decree 661/2007 which provided stability in electricity tariffs and a "reasonable return" on investment. Finally, in 2014, a new regime governing renewable energy was established, which calculated a reasonable rate of return for investors based on the hypothetical standard operating costs of hypothetical 'efficient' solar energy plants – standards to which Claimants' plants did not conform.

Claimants argued that, taken together, these regulatory changes amounted to 'complete value destruction' of their investment, as the plants' revenue fell below what was required to cover financing and operating costs or provide a return on investment, and their Spanish operating companies were forced into debt rescheduling negotiations with their lenders.

Certain Jurisdictional Matters

Unlike many of the series of cases, the Eiser case was not bifurcated into separate jurisdictional and merits phases. The award accordingly includes extensive discussion of the various jurisdictional objections that Spain had raised.

Of particular relevance is the Tribunal's rejection of the contention that the ECT's investor-state mechanism does not apply to intra-EU disputes. Citing similar conclusions reached by an ICSID panel in a 2016 jurisdictional ruling in the RREEF matter which had found its way to the public domain and in the SCC Charanne case mentioned below, the Tribunal found unavailing Spain's argument that there was an *implicit* exception in case of intra-EU disputes, suggesting that if it had been the intent of the treaty's drafters to exclude intra-EU disputes, this would have been made clear in the text, rather than being a "trap for the unwary". Interestingly, the Tribunal declined to admit to the file an *amicus curiae* brief presented by the EU Commission two months before the merits hearing, since the Commission refused to provide the costs undertaking which the Tribunal had deemed appropriate in light of the eleventh-hour presentation of the submission.

On the other hand, the Tribunal granted Spain's ECT's tax exception objection to jurisdiction, to the effect that the Tribunal had no jurisdiction to determine whether the 7% energy tax breached the treaty. Claimants, relying on the Yukos case, had argued that the tax was a bad faith alternative to reducing the subsidies, and thus was not entitled to the treaty's tax exception. However, the Tribunal was not prepared to find bad faith, and thus applied the exception, observing that the exercise of the sovereign's taxing power should not be questioned lightly, and that the facts did not at all suggest a patter of conduct designed to destroy Claimants or their investment (such as found by the Yukos panel in that case).

In an interesting obiter, the Tribunal observed (twice) that any damages that might accrue to a CSP investment due to the 7% tax would be substantially limited, if not entirely eliminated, since Spain had decided to include this charge as an indemnifiable cost.

The Tribunal also granted Spain's objection based on the ECT's requirement that claims alleging expropriation by reason of taxes be submitted first to the tax authorities.

The remaining jurisdictional objections were rejected, in rather short shrift, i.e, those based on (i) the supposed lack of standing of Claimants due to their being funds who only channeled capital of participants/limited partners, (ii) the supposed inability of shareholders to bring claims for damages actually incurred by participated entities even where the claim is for the reduction in value of the shareholding and (iii) the supposed failure to observe the ECT's cooling-off period in respect of certain of the regulatory changes challenged (the Tribunal characterizing as unreasonable and inefficient Spain's suggestion that each new regulatory measure in the challenged series be the subject of a new cooling-off period requiring a new trigger letter, when in reality the case involved a single dispute arising from the claim that by a series of measures, Spain modified in a fundamental way the economic regime for Claimants' CSP projects in violation of the ECT).

Merits: Focus on FET as a guaranty of stability and protection against fundamental regulatory changes which fail to take into account circumstances of existing investments; "Crossing the line"

Citing judicial and financial economy (values noted by the Tribunal in a variety of contexts throughout the award), he Tribunal focused its analysis on Claimants' arguments based on fair and equitable treatment (FET) under Article 10(1) of the ECT, considering this the most adequate benchmark under which to evaluate the measures, and thus not specifically and directly addressing the other claims of expropriation, unreasonable measures or breach of the ECT's umbrella clause.

Recognizing the inherent right of states to regulate, and thus rejecting any suggestion of an absolute right to regulatory stability, the Tribunal concluded that the FET clause of the ECT protected against "*fundamental*" changes in a manner that failed to take account of the circumstances of existing investments made in reliance on the prior regime and that led to "*unprecedented*", "*totally different*" regulatory regimes.

Significantly, the Tribunal distinguished the case from the February 2016 Charanne award which rejected an investor's claims in an SCC matter challenging regulations promulgated in 2010, affirming in forceful language that the factual and legal situations in the two cases were "*fundamentally different*," the measures challenged in Charanne having only marginally decreased solar investments' profitability, being "*much less dramatic*" and "*much less extensive*" than those challenged in Eiser, which created "*a totally new regulatory focus,*" and were applied in a manner which "*eliminated the financial bases*" of existing investments.

The consequences to the Claimants of the "*total and unreasonable*" change in the regulatory regime was the virtual destruction of their investment. The Tribunal accordingly concluded that the changes violated the FET clause.

The core of the Tribunal's analysis is set out in paragraphs 362 and 363 of the award. Interestingly, the award circles back and restates the analysis once and again thereafter. The following excerpts (in the author's "reverse-engineered" translation from the Spanish version of the award which is circulating on the internet to the English in which it was surely drafted) give a good flavor:

362. "…The question presented is to what extent treaty protections, in particular the obligation under the ECT to provide investors fair and equitable treatment, can be invoked and give rise to a right of compensation as a result of the exercise of the recognized right of a State to regulate."

363. "….[T]he Tribunal finds that Respondent's obligation under the ECT to provide fair and equitable treatment to investors protects them from a fundamental change in the regulatory regime in a manner which does not take into account the circumstances of the existing investment made on the basis of the prior regime. The ECT does not prohibit Spain from making appropriate changes in the regulatory regime of RD 661/2007….But the ECT does protect investors against the total and unreasonable changes experienced here."

352."Taking into account the context, object and aim of the ECT, the Tribunal concludes that the obligation to provide fair and equitable treatment established by Article 10(1) necessarily implies an obligation to provide fundamental stability in the essential characteristics of the legal regime on which investors relied in making long-term investments. This does not mean that regulatory regimes cannot evolve. Clearly they can….[but] they may not be so radically changed that they deny investors who made investments on the basis of such regimes of the value of their investment."

387. "Claimants could not reasonably expect that there would be no change in the regime of RD 661/2007 over the course of three or four decades. As with any other regulated investment, they must have anticipated that there would be changes over time. Nonetheless, Article 10(1) of the ECT gave them the right to expect that Spain would not modify, in a drastic and abrupt manner, the regime on which their investment depended, in a manner which destoyed its value. But this was the result …..As expressed in Parkerings: 'any businessman or investor knows that laws will evolve over time. What is prohibited, however, is for the State to act unfairly, unreasonably or inequitably in the exercise of its legislative power.'"

418. "….The derogation of RD 661/2007 by Respondent, and its decision to apply a completely new method to reduce the remuneration of Claimants' existing plants, denied them of essentially the entire value of their investment. Doing so violated Respondent's obligation to provide fair and equitable treatment."

458. "The Tribunal considers that Respondent 'crossed the line' and violated the obligation to provide fair and equitable treatment in June 2014 when the prior regulatory regime was definitively replaced by a completely new regime…."

The Tribunal rejected Spain's attempt to put on record the July 2016 award of another SCC tribunal in the Isolux case, a kind of sister-case to Charanne, since that decision (unlike Charanne, which Spain's Energy Ministry published on its website) is and remains confidential. It is understood that Spain prevailed on the merits in Isolux (as in Charanne, over a dissenting opinion) in relation to the measures at issue in Eiser. But the Tribunal refused to accept the decision on record due to its confidentiality, chastising Spain for having communicated the award to the Tribunal on an *ex parte* basis.

DCF, damages and costs

In calculating damages for this breach, the Tribunal accepted the investors' suggestion to use a discounted cash-flow (DCF) analysis. Applied from June 2014 when the new regulatory regime took full force, the Tribunal awarded €128 million in lost profits as per claimants' experts' calculations, together with pre-award interest at Spain's borrowing rate, 2.07%, compounded monthly from the June 2014 date of breach, and post-award interest at 2.5%, also compounded monthly.

The Tribunal rejected for insufficient evidence claims for (a) Euros 68 million in additional damages on the basis of an asserted useful life of 40 years (rather than 25 years) and (b) Euros 88 million to gross up the requested compensation so as to neutralize the eventual tax consequences of an award in favor of Claimants, and further rejected (c) a claim for Euros 13 million for losses incurred prior to the June 2014 changes which the Tribunal found is when Respondent had actually "crossed the line."

In a communication posted on its website shortly after the award was issued, the Spanish Ministry of Energy highlighted the fact that Claimants had recovered less than half of what they had sought. However, from the nature of the heads of damages that were rejected, and the limited time and energy apparently devoted to their prosecution, it would seem clear that Claimants prevailed on their key damage claim.

Finally, the Tribunal left each party to bear its own costs.

Some Preliminary Observations

The Eiser award has been circulating on the Internet only since 8 May and only in its Spanish language version. It is 175 pages long and full analysis will require a more careful reading, hopefully of the English "original" text.

Yet some preliminary reactions can be offered:

1. As in the SCC cases decided last year favorably to Spain on the merits (Charanne and Isolux), albeit only by majority decision and with forceful dissents, Spain's principal jurisdictional arguments – including the intra-EU objection noted above — were largely rejected. Inasmuch as it would appear that none of the cases to date has been dismissed for lack of jurisdiction, it can probably be expected that this trend will hold, and future cases may be more likely to be heard without bifurcation, and thus decided more expeditiously.
2. The Eiser Tribunal's common-sensical (and perhaps, common-lawyerly, since all of its members are common-law trained professionals) and elegant discussion of the limits of the right to regulate and its application in the specific context of the facts and circumstances of the case (distinguishing clearly and effectively the factual and legal matrices involving its application in the context of Charanne) could prove to be a useful roadmap to future panels reviewing the same regulatory changes in the context of similarly-situated (or not similarly-situated) investors and investments.
3. The Isolux award, if and when it becomes public, will be closely studied to assess its "fit" into the competing Charanne and Eiser conclusions and its relevance to the future cases.
4. The Eiser award contains a number of comments and characterizations which could be read as being rather critical of Spain, not only regarding the merits or demerits of the underlying regulatory actions as mentioned above (the award cites excerpts from reports of various Spanish public entities which were critical of the regulation the draft of which had been submitted for their review), but also its litigation posture (e.g., insisting on bifurcation but refusing to contemplate any precedential or "test case" value of a

decision on jurisdiction) and procedural conduct (e.g., the *ex parte* communication mentioned above).

5. Of course, while there is no hierarchy in international arbitration and thus no doctrine of precedent or binding jurisprudence, Tribunals deciding cases raising issues which have been addressed by other Tribunals will generally take interest in the prior findings and reasoning, especially to the extent they appear well-reasoned and well-structured. The Eiser award (which itself relied on Charanne and RREEF where it considered it appropriate to do so) appears on first read to be well-reasoned and well-structured and may thus have material weight in the upcoming awards. By the same token, it may stimulate international investors who have been sitting on the sidelines these past few years to file claims.
6. Whether or not Eiser will prove to be a game-changer in the Spanish renewable energy saga after the two SCC awards issued in 2016 (Charanne and Isolux) appeared to give the overall advantage to Spain) remains to be seen.

Stay tuned: the game is far from over…..

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