Squaring the Circle: Reconciling Conflicting Awards in the Eiser and Isolux Spanish Renewable Cases (Part II)

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The below continues and concludes a two-part post about the Spanish renewable energy cases which have been concluded to date, in particular, the apparently contradictory *Eiser* and *Isolux* awards, the former of which was decided in May 2017 and the latter, which (although decided in July 2016) only became public in June 2017. Part I of the post can be found here.

The Three Awards – Reprise and (Partial) Reconciliation?

The investors in *Charanne* acquired control of the owner of 34 photovoltaic (PV) plants in Spain in 2009. The regulatory changes enacted in 2010 eliminated regulated tariffs for such plants after 30 years of operation, introduced technical requirements for voltage dips, limited operating hours and hours entitled to retribution in the period 2011-2013and imposed charges for the use of the transportation and distribution network. The investors alleged that the changes reduced the profitability of their plants by some 10%.

The Tribunal concluded that although the economic and financial consequences of the reduction in profitability were significant, they did not justify a conclusion that the value of the investment had been destroyed (paragraph 466) so as to constitute an indirect expropriation. The Tribunal (by majority) further concluded that the commitments of regulatory stability contained in RD 661/2007 were not sufficiently targeted or specific so as to permit legitimate expectations on the part of claimants that its provisions would not be modified.

Isolux (in many respects, a companion case to *Charanne*, brought by related investors – parts of the group of companies controlled by the Spanish construction group of the same name, now the subject of insolvency proceedings – with the same counsel, and the same co-arbitrators named by each party) involved a challenge to the 2012-2014 changes by claimants who made their investment decision and indirect investment in 117 entities (thus stepping into the latters' shoes), each owning a PV plant in Spain. According to the award, in prior litigation, the investor's parent company had submitted an expert report to the Spanish Supreme Court indicating an expected rate of return of some 6% on its investment, less than the "reasonable" rate of some 7% provided by the new regulation.

The tribunal concluded that the claimant could not have had a legitimate expectation at the time of its investment (determined by the majority to be October 2012, as Spain had argued, instead of June 2012, as claimant had argued) that the regulatory framework would not materially – or even fundamentally –change, since (i) in the years prior to the investment, the regulatory framework had already been modified on various occasions (paragraph 788), (ii) the Spanish Supreme Court had established clearly that – insofar as national law was concerned – there were no obstacles to the modification of the regulatory regime, with a reasonable investor presumed to have knowledge of this situation (paragraphs 793-794); and (iii) the claimant was perfectly aware of the referenced

Spanish case law (paragraph 795). This last element was of particular importance because the claimant's ultimate parent company have unsuccessfully challenged one of the 2010 measures before the Spanish courts. The challenge resulted in a decision of the Supreme Court of September 2012 (before the investment itself was made in October 2012) which concluded that the regulatory changes were permitted so long as they respected a reasonable rate of return, noting (paragraph 818, translation by the author) that "*A party who decides to invest in a country which, according to it, lacks legal certainty, cannot later complain that it was not provided such certainty*". The majority also echoed the *Charanne* finding that the legislative commitments were insufficiently targeted and specific to permit them to be the basis for legitimate expectations of essential stability.

The *Isolux* tribunal concluded (paragraph 804, translation by the author) as follows:

"*In October 2012, any investor could have foreseen not only a fundamental modification of the Special Regime but also its suppression, so long as the principle of reasonable profitability of the investment was guaranteed… With its special knowledge of the Supreme Court decision of September 23, 2012, Claimant should have considered the abolition of the Special Regime as a realistic possibility when it made its investment*."

Significantly, *Isolux* (like *Charanne*) was issued by majority, over a short but forceful dissenting opinion on the FET/legitimate expectations issue of Prof. Dr. Guido S. Tawil. The dissent's principal discrepancy with the majority involved the "*manner in which the factual circumstances of 'foreseeability' of the measures adopted by the Kingdom of Spain should be evaluated*" (paragraph 6, translation by the author).

Noting that the claimant had effected its investment (obtaining the acquired rights of a prior investment) under a specific remunerative regime, the dissent observes that "*elements permitting the conclusion that* [, as of either June or October 2012,] *the Kingdom of Spain would completely eliminate the FIT… without recognizing a right to compensation for eventual holders of rights affected by such measure were not presented*" (paragraph 7, translation by the author). The dissent further observed that if the FIT established in 2007 could be eliminated without triggering a right to compensation, nothing would prevent Spain from eventually eliminating in the future the more recently-established guaranty of "*reasonable profitability*".

Eiser involved a challenge, by UK and Luxembourg-based claimants who made their investment decision and investment in a series of concentrated solar power plants (CSP) in Spain in 2007. The claimants alleged that the regulatory changes from 2012-2014 constituted "*a complete value destruction*" of their investment because some Euro 125 million was reduced in value to a mere Euro 4 million, thereby (as indeed found by the Tribunal, paragraph 365) "*stripping claimants of virtually all of the value of their investment.*"

The *Eiser* Tribunal noted (e.g., in paragraphs 365-369) that the changes to the PV regulatory regime at issue were far more "*dramatic,*" "*sweeping*" and "*drastic*" in terms of their impact on the economic value of the claimants' assets and interests than those at issue in *Charanne*.

Eiser did not address *Isolux*. Indeed, it could not: while *Isolux* was decided many months before *Eiser*, the award remained confidential at the time (it was only leaked to the public after the *Eiser* award was issued, as noted above) and for this reason, the *Eiser* Tribunal rejected Spain's attempt to introduce it into evidence.

None of the *Charanne, Isolux* or *Eiser* awards can be understood to deny the state's right (and duty) to regulate (and re-regulate). Nor does any suggest that the right to regulate is limitless, i.e., that there can be no circumstances in which the state, in the exercise of its sovereign right and duty, defeats legitimate expectations of an investor and thus violates the obligation to accord FET, becoming obligated to provide compensation.

The question is where to draw the line. In some cases (as in *Isolux)*, where the violation is not clear to all members of the panel, the claim may founder. In others, as in *Eiser* (where the front-loaded nature of capital investment in CSP projects and their financing made the impact of the new regulatory regime particularly "*devastating*" (paragraph 409) on the claimants' investments), a claim has clear prospects for success. The following observation (paragraph 365) of the unanimous *Eiser* Tribunal is telling:

"*…[T]he evidence shows that Respondent eliminated a favorable regulatory regime previously extended to Claimants and other investors to encourage their investment in CSP. It was then replaced with an unprecedented and wholly different regulatory approach, based on wholly different premises. This new system was profoundly unfair and inequitable as applied to Claimant's existing investment, stripping Claimants of virtually all of the value of their investment.*"

A Caution

The reconciliation attempted above is only partial, and not entirely novel: A June 29, 2017 IA Reporter post also indicates that "*one partial explanation for the differing outcomes* [*in Isolux and Eiser*] *may be that the respective investors invested at different junctures, perhaps creating different expectations.*"

Just as it is undeniable that the *Isolux* majority can be said to have found a (perhaps, peculiar) way to let Spanish jurisprudence enter its considerations "by the back door"; it is undeniable as well that the *Eiser* award reflects, in substance and tone, a particularly (and perhaps, peculiarly) harsh evaluation of the new Spanish regulatory regime, referring to it as imposing a "*one size fits all*" standard on existing facilities (paragraph 400) and expressing "*serious reservations about basing the new regulatory regime on the hypothetical costs of a hypothetical "efficient" plant… cast[ing] into question the fairness and equity of the change to the new regime*" (paragraph 393).

To the extent that this harsh general view of the new regulatory regime is shared by future arbitral panels, they may establish relatively low hurdles as a predicate for legitimate expectations and/or relatively low thresholds for finding relevant economic or financial consequences to an investor or investment.

Surely, the approach taken by counsel and experts, the preparation and credibility of witnesses and experts, the identity and background of, and chemistry among, tribunal members, will (as always) matter. That being said, the factual specificities of the three cases have clearly played a fundamental role in their resolution.

To the extent that investors in the pending cases can establish that they had reasonable grounds at the time of making their investment to expect regulatory stability and/or that the changes that were enacted impacted them or their investments in a truly material (or even "*devastating*") way, more awards like *Eiser* can be expected. On the other hand, as long as investors fail to so establish and Spain can show that the investors' reasonable expectations must have been otherwise and/or the impact of the regulatory changes on the investor or investment was modest, then more awards like *Isolux* can be expected.