

# The Fair and Equitable Treatment Standard and the Revocation of Feed in Tariffs—Foreign Renewable Energy Investments in Crisis-Struck Spain

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**Abstract** This contribution explores a highly topical issue in international investment law—the protection of foreign investors’ legitimate expectations through the Fair and Equitable Treatment standard (FET) in case of a repeal of renewable energy support schemes. On the grounds of the Spanish case of disruptive cuts, particularly regarding Feed in Tariff regulation supporting photovoltaic energy since 2008, a possible violation of legitimate expectations is being assessed. The investors may rely on the stability of the Spanish *régimen especial*, despite their own conduct and the State’s right to regulate. Even in times of crisis the State may not justify changes in the regulation to the point of stripping away the very *raison d’être* of the initial investment. Such measures could constitute a breach of legitimate expectations. Regarding the current global trend of revoking renewable energy support schemes, the present case may initialize a cascade effect for a number of claims.

**Keywords** International investment law · Fair and equitable treatment · Legitimate expectations · Feed-in tariffs · Spanish FiT regime

## 1 Introduction

It is a seminal issue for the promotion of Sustainable Development—the search for convergence between investment law and Sustainable Development policies, or more specifically renewable energy policies. If renewable energy investment

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incentives are to be taken seriously, States have to assure a stable investment climate, as well as they have to consider the public interest. Renewable energy has become the buzzword behind the global climate change initiative (e.g. United Nations 1997, Art. 2[1]a [iv]) and new national energy, industrial and environmental policies (e.g. Spanish national plan for the promotion of renewable energy 2000–2010 (Spain 1999), Spanish national renewable energy plan 2005–2010 (Spain 2005) and German Renewable Energy Act 2014). Furthermore, and as confirmed by the energy and climate package (hereinafter 2020 package) of the European Commission (2009),<sup>1</sup> renewable energy promotion is at the very heart of the European Union's environmental policy. Notwithstanding this global trend, during the current global financial crisis many Governments have revoked their commitments to renewable energy support and have undertaken major changes in their regulation. This has triggered a whole wave of claims in investor-state dispute settlement in a number of countries, particularly with international renewable energy investors in Spain, the Czech Republic and Italy having already made a start in filing for arbitration (Jha 2012; Peterson 2013). The largest claims are the ones in the Spanish case, which are probably the most drastic proceedings, especially as far as photovoltaic (hereinafter PV) energy is concerned. Since the Spanish Government started reducing incentives for renewable energy and as of July 26, 2015, 20 arbitration claims have been brought against Spain under the Energy Charter Treaty (hereinafter ECT), all of which involve solar energy (Energy Charter Secretariat 2015).<sup>2</sup> PV investors are likely to rely on the Fair and Equitable Treatment Standard (hereinafter FET) contained in Article 10 of the ECT (Energy Charter Secretariat 1984). The main question will be whether PV investors can successfully claim a breach of their legitimate expectations, due to cuts, including retroactive changes, in incentive programmes for PV plants the Spanish regulator has introduced since 2008. Particularly important for assessing a potential breach of

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<sup>1</sup>Enacted in 2009, the 2020 package consists of a set of binding legislation establishing three objectives to be reached by all Member States by 2020: to reduce greenhouse gas emissions by 20 %, to raise the energy consumption produced from renewable resources to 20 % and to improve the energy efficiency by 20 %.

<sup>2</sup>These claims are (in chronological order): *The PV Investors v Spain*, *Charanne (the Netherlands) and Construction Investments (Luxembourg) v Spain*, *Isolux Infrastructure Netherlands B.V. v Spain*, *CSP Equity*.

*Investment S.à.r.l. v Spain*, *RREEF Infrastructure (G.P.) Limited and RREEF Pan-European Infrastructure Two Lux S.à.r.l. v Spain*, *Antin Infrastructure Services Luxembourg S.à.r.l. and Antin Energia Termosolar B.V. v Spain*, *Eiser Infrastructure Limited and Energia Solar Luxembourg S.à.r.l. v Spain*, *Masdar Solar & Wind Cooperatief UA v Spain*, *NextEra Energy Global Holdings B.V. and NextEra Energy Spain Holdings B.V. v Spain*, *InfraRed Environmental Infrastructure GP Ltd. et al. v Spain*, *RENERGY S.à.r.l. v Spain*, *RWE Innogy GmbH and RWE Innogy Aersa S.A.U. v Spain*, *Stadtwerke München GmbH, RWE Innogy GmbH et al. v Spain*, *STEAG GmbH v Spain*, *9REN Holding S.a.r.l v. Spain*, *BayWa r.e. Renewable Energy GmbH and BayWa r.e. Asset Holding GmbH v. Spain*, *Cube Infrastructure Fund SICAV and others v. Spain*, *Matthias Kruck and others v. Spain*, *KS Invest GmbH and TLS Invest GmbH v. Spain*, *JGC Corporation. v. Spain*. Cases No. 31, 34, 38, 39, 40, 41, 43, 50, 52, 53, 58, 61, 62, 63, 67, 68, 69, 70, 71 and 72, respectively.

legitimate expectations of PV investors in this case is the legal nature of the normative framework which the Spanish legislator revoked, being feed-in tariffs (hereinafter FiTs), which are incentives guaranteeing the payment of a fixed amount of money per unit of electricity supplied to the grid for a certain period of time (United Nations Environment Programme 2011, p. 226, European Commission 2005, points 4–5). Furthermore, the PV investors' own conduct involving the duty to reasonably assess the investment risks of the host country, as well as the Host State's right to regulate are limitations to the legitimate expectations of high relevance for a possible breach in the Spanish case. Interestingly, the central argument of the Spanish Government to justify the cuts has not so much been the financial crisis that the country faces today or the austerity measures imposed by Brussels, but the necessity to correct the country's energy tariff deficit (*déficit tarifario*) in order to ensure the financial stability of the Spanish energy system (Soria 2014).

The claims brought against Spain will serve as case study, by which this article will explore an increasingly important but until now uncommon issue of international investment law—the protection of foreign investors' legitimate expectations in a case of FiT revocation. To this end, the article will be after this introduction (Part 1) organized as follows. Part 2 will consider the background in which the Spanish FiT regime was set up and examine the regulations that have led to the rise and fall of support schemes for PV energy in the country. Part 3 will briefly introduce the two most important standards of investment protection for cases of renewable energy incentive revocation and will specifically assess the content and scope of FET, with special regard to the legitimate expectations of PV investors in Spain. In Part 4 the findings determining the chances of a successful claim based on a violation of FET in the Spanish case will be weighed and summed up.

## **2 Context and Evolution of the Photovoltaic Energy's Economic Regime in Spain**

### ***2.1 Introduction to the Spanish Energy Sector—Putting All Its Eggs in the Renewable Energy Basket***

During the past decades, the Spanish energy sector has revealed three main and repeated features: a high level of dependency on energy imports, a heavy reliance on fossil fuels and a poor record on energy efficiency (National renewable energy plan 2011–2020 (Spain 2011, p. 10). Different than in other EU Member States, the energy consumption structure in Spain is dominated by imported oil products. This, added to the meagre contribution of indigenous resources to the national energy mix, is the main reason for the country's high rate of energy import dependence (close to 80 %) when compared to the average rate in the EU (54 %) (Eurostat 2013). Moreover, as in many other EU economies, the economic growth experienced by Spain before 2008 led to an increase in the country's energy consumption.

These features and incidents have made the Spanish energy regulator pursue three prime goals during the past twenty years, namely, (1) to secure energy supply (2) in a way that is affordable and (3) respectful of the environment (Spain 1997). The EU regulation has also played a major role in reshaping the energy sector in Spain, especially in competition and environmental issues. With regard to the latter, the 2020 package's objectives of reducing greenhouse gas emissions, raising the energy consumption produced from renewables and improving the energy efficiency (European Commission 2009) have been high on the agenda of the Spanish regulator.

In order to pursue these national and European objectives, renewable energy had to be taken forward. In fact, the progress of green energy sources in Spain in the last twenty years has been remarkable. While in the eighties energy production in Spain was mainly based on coal, in the mid-nineties nuclear energy became the most important domestic source and today renewable energies represent the prime energetic asset of the country (Sevilla et al. 2013, p. 37; Spanish Power Transmission Company 2014, pp. 5 and 10). In particular, two sources advanced considerably over the past decades in Spain in terms of installed capacity, namely wind and solar energy (Agosti and Padilla 2010, p. 518). Wind power started expanding first, however, since 2005 PV energy has been the fastest-growing energy source in the country, mainly because of the high level of public support for installations using this technology (Agosti and Padilla 2010, p. 521). Along with the national and European goals explained above, such incentives were motivated by the aim of the Spanish Administration to position Spain among the world leaders in PV energy, both in installed capacity and technology production [National renewable energy plan 2005–2010 (Spain 2005, p. 157)].

Notwithstanding the efforts put in promoting a more sustainable energy system, it is most likely that Spain will not meet its 2020 climate and energy targets in terms of greenhouse gas emissions reduction and increase of renewables' shares in total energy consumption (European Environment Agency 2014, p. 10). Furthermore renewable energies have had a significant impact on the sharp rise of energy prices in Spain in the last years (Sallé 2012, pp. 104–105). This is due to the large number of energy sources benefiting from subsidies and the above average support granted to renewable energies when compared to other EU countries (Sallé 2012, p. 105). What is more, the Spanish Government identifies the support for renewables as a main cause of the national energy tariff deficit (*déficit tarifario*) [e.g. Press conference following the Council of Ministers held on 27 January 2012 (Spain 2012a), first intervention of Minister of Industry Soria; EFE Economía 2013], that is the difference between the sum owed by the Administration to electrical companies and the amount the Administration receives from consumers.

These developments, which coincided in time with a severe financial crisis in the country and strict austerity measures imposed by the EU, prompted the Spanish Government to introduce major changes to the renewable energy regulation. These changes have ultimately led to serious damages for low-carbon investors. In order to provide enough detail to draw an informed opinion on whether Spain should be held accountable for the losses suffered by foreign PV energy investors, the focus of

the next section is on the evolution of the PV energy's economic regime in Spain. However, before reaching any conclusion, political and economic issues surrounding the decisions to cut incentive programmes also need to be taken into consideration. While the section on the Host State's right to regulate will address the questions of the crisis and the austerity measures imposed by Brussels as possible arguments to limit Spain's responsibilities, it is important here to provide further detail on the tariff deficit.

Initially, the tariff deficit was designed to address temporary and small imbalances between revenues and costs in the Spanish electricity system. These occurred because electricity prices in Spain are revised only once a year according to cost predictions (at the end of each year for the next year) and the latter are most often inaccurate. In order to solve this problem, and motivated by the desire to maintain low energy prices for consumers, the Spanish Administration introduced a system for financing the gap through the contribution of five energy companies (Hidrocantábrico, Endesa, EON, Iberdrola and Gas Natural Fenosa) (Sallé 2012, p. 107). The tariff deficit first arose in the year 2000, reached the sum of € 5.6 billion in 2012 (Spanish Energy Commission 2013, p. 3) and today seems to be under control, given that it was reduced to € 2.9 billion in October 2014 (Spanish National Stock Market Commission 2014, p. 3).

## 2.2 *The Rise and Fall of the Support Regime for Photovoltaic Energy in Spain*

### 2.2.1 **The Rise: The Development of Support Schemes for Photovoltaic Energy in Spain**

In Spain, the generation of electricity from renewable sources has been regulated through statutes, such as laws (*leyes*) and royal decree laws (*reales decretos ley*), as well as through regulations, for instance national plans (*planes nacionales*), royal decrees (*reales decretos*) and ministry orders (*órdenes ministeriales*).<sup>3</sup> The 1997 Electricity Sector Law, which provided the basis for the liberalization of the electricity market in the country, initiated the process of regulating the special regime (*régimen especial*) (Spain 1997, Title IV, Chap. II), i.e. the set of rules that apply exclusively to renewable energies and that define their economic regime. During the period 1998–2007 two National Renewable Energy Plans established the goals to be reached for each renewable energy, and several decrees developed the regime applicable for each technology. Royal Decrees (hereinafter R.D.)

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<sup>3</sup>In Spain, laws and royal decree laws have the same position in the hierarchy of legal sources (statutes) but differ in procedural terms. Laws are initiated and approved by the Congress. Royal decree laws are issued by the Government for extraordinary and urgent reasons, but have to be approved by the Congress. Regulations rank below statutes, serve to complete, specify and implement statutes and the Administration controls their whole development process.

**Table 1** Evolution of tariffs and premiums in the special regime (adapted from Agosti and Padilla 2010 p. 526)

Technology	R.D. 2818/1998	R.D. 436/2004		R.D. 661/2007	
	1998	2004		2007	
	Premium (€/MWh)	Tariff (€/MWh)	Premium (€/MWh)	Tariff (€/MWh)	Premium (€/MWh)
PV < 100 kWp	60.00	414.4	n/a	440.0	n/a
PV > 100 kWp	30.00	216.2	187.4	229–417	n/a
Solar thermal	20.00	216.2	187.4	269.0	254.0
Wind energy	31.6	64.9	36.0	73.0	29.0
Hydro power < 10 MW	32.8	64.9	36.0	78.0	25.0
Hydro power > 10 MW	0–35.8	57.7–64.9	28.8–36.0	66–78	13.0
Geothermal	32.8	64.9	36.0	69.0	38.0
Biomass	28.0	64.9	36.0	107–158	61–115

For the 2007 regime only average prices given

2818/1998, 436/2004 and 661/2007 were the key royal decrees for the sharp rise in PV energy subsidies in that period.

In line with the 1997 Electricity Sector Law, R.D. 2818/1998 classified renewable energy plants according to the technology used and the installed capacity [Electricity production through renewable sources, cogeneration and waste (Spain 1998), art. 2]. Article 26 provided that the remuneration mechanism for plants will consist of a fixed premium being placed on the electricity market price dependent upon the type of the plant, and articles 27–31 specified the premium applicable to each type of plant (see details in Table 1). According to the decree, the regulator had to reassess and adjust the premiums every four years (Electricity production through renewable sources, cogeneration and waste 1998 art. 32).

One year later, the Spanish Government approved the National Plan for the Promotion of Renewable Energy 2000–2010. As part of the strategy for attaining the three main national energy objectives (energy import independence, affordable prices and an environment-friendly system),<sup>4</sup> the Plan set investment objectives for increasing the share of renewable energy in primary energy consumption to 12 % by 2010 (Spain 1999, p. 1). Furthermore, the Plan established objectives of installed capacity for each renewable energy source and included information on the technological and environmental aspects, the investment and construction costs, the barriers and possible support measures associated with each source (Spain 1999, Chap. IV). When tackling the question of incentive measures for PV energy, the Plan stated:

<sup>4</sup>See Part 2.1.

On the premises of the high solar radiation in Spain, the favourable environmental effects of PV energy and the particular characteristics of this source, it is necessary to undertake measures and incentives to increase the presence of this energy in the territory of the State. The measures proposed are designed to [...] conduct an integrated plan that strengthens the Spanish photovoltaic sector [...] (Spain 1999, p. 116).<sup>5</sup>

R.D. 436/2004 included important modifications into the economic regime of renewables with a view to facilitating the achievement of the 2010 renewable energy objectives [Methodology for updating and structuring the special regime (Spain 2004)]. It allowed the majority of renewable energy producers (depending on the technology) to choose between two options for selling their energy: (1) to sell the energy directly on the national market, on the futures market, or through a bilateral contract, each time at the market price plus a premium; (2) to sell the energy to distribution companies at a fixed tariff (Spain 2004, art. 22). As far as the PV energy is concerned, this decree set a considerably higher remuneration for small plants, but only allowed their owners to sell the energy through FITs (Spain 2004, art. 33) (see Table 1).

Having realized that the target set for 2010 of raising the share of renewables in primary energy consumption to 12 % was not going to be achieved, in August 2005 the Spanish Government adopted the National Renewable Energy Plan 2005–2010. This new text did not only reaffirm the 2010 target, but it also recommended increasing renewable incentives and fixed one new objective: by 2010 electricity production from renewable sources in the country had to increase to 29.4 % (Spain 2005, pp. 7 and 9). In what constituted an even more exhaustive report than the 2000–2010 National Plan, this Plan presented for each type of renewable energy (1) a comparative analysis of installed capacity across EU countries, (2) a summary on its evolution and the state of the technology in Spain, (3) a new target in terms of installed capacity, (4) the measures needed to meet this target, and (5) possible lines for technological innovation (Spain 2005, Chap. III). Furthermore, an entire chapter was dedicated to the funding of the Plan, which included different technical and financial hypotheses based on the specific features of each renewable source, a detailed evaluation of the investment envisaged, the nature of this investment and the public aid needed to meet the targets (Spain 2005, Chap. IV). With reference to PV energy, while the Plan recognized the development of this energy source in the country, it nevertheless acknowledged that its progress was insufficient (Spain 2005, p. 157). In this context, the Plan proposed a series of measures with a view to raising the share of PV energy in the national energy mix and to furthering the national PV energy industry.

Following the recommendations of the 2005–2010 Plan, R.D. 661/2007 introduced two main changes to the special regime. First, it divided the technologies into new categories [Law regulating the activity of electricity production under the special regime (Spain 2007) art. 2] and set the premiums and/or tariffs according to each category, the installed capacity and the age of the installation (Spain 2007,

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<sup>5</sup>Translation by the authors.

Tables 1, 2 and 3). Second, it provided higher incentives for certain technologies, particularly for PV energy (Spain 2007, cf. Tables 1, 2 and 3).<sup>6</sup> Despite the fact that the regulator fixed higher tariffs and premiums for the first 15–25 years of each installation (depending on the technology), no lifetime caps on production were imposed (Spain 2007, Tables 1, 2 and 3). On the other hand, this R.D. stipulated that once the 85 % of the objectives set for a technology in the National Renewable Energy Plan 2005–2010 were reached, the regulator would fix a date for changing the tariffs and/or premiums applicable to that technology (Spain 2007, art. 22).

Due to the incentives introduced by R.D. 661/2007 for small PV installations (€ 440.0/MWh, i.e. 567 % above the reference average tariff for that year), in May 2008 the total installed capacity of PV energy in Spain reached 1000 MW and in October of the same year exceeded 2200 MW (Sevilla et al. 2013, p. 44). The 2005–2010 Plan had fixed the target of 400 MW for the year 2010. This boom of PV installations, seen as financial investment products by national and international investors, led to the adoption of R.D. 1578/2008.

### 2.2.2 The Fall: Cuts and Retroactive Changes in the Spanish Support Schemes for Photovoltaic Energy

R.D. 1578/2008 can be seen as the turning point in Spain's approach to renewable energy support schemes. For the first time since 1997, Spain reduced incentives for renewable energy sources. Having surpassed the target set in the 2005–2010 National Plan for installed capacity of PV energy, the regulator decided to lower PV energy tariffs with a view to not discouraging technological innovation [Remuneration for photovoltaic installations created after the deadline set in the R. D. 661/2007 (Spain 2008)]. This cut only affected PV energy plants installed after 29 September 2008, applying the R.D. 661/2007 regime to all plants built before that date (Spain 2008, art. 2).

Nevertheless, since the approval of R.D. 1578/2008, the regulator has adopted countless regulations that introduced drastic changes to the economic regime of renewable energy sources, also for plants that were operating before 29 September 2008. The Preambles of those regulations (e.g. Preambles of R.D.L. 14/2010, R.D. L. 2/2013, R.D.L. 9/2013 and R.D. 413/2014 in this section) and the statements made by the Government (e.g. Soria 2014) refer to two interrelated reasons for such changes: the necessity to reduce the tariff deficit and to guarantee the financial stability of the electricity system. Regulators must be in the position to control the effects and costs of their national support schemes (European Parliament and Council 2009, 25th recital in the Preamble); the pertinent question here is, how far regulatory changes with retroactive effects can go. While Part 3 of this contribution will examine in detail that question through the lense of international investment law, the focus of this section is on the retroactive changes in PV energy incentive

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<sup>6</sup>PV energy tariffs defined in Table 3, under energy type b.1.



programmes, which are central for the claims of international PV investors against Spain. It is noteworthy saying that retroactivity refers in this section to rules applying in the future to regimes introduced in the past.<sup>7</sup>

Three years after the adoption of R.D. 661/2007, R.D. 1565/2010 aimed at adjusting and correcting the special regime [Law regulating and modifying certain aspects relating to the production of energy production under the special regime (Spain 2010a)]. Among other changes, the decree removed administrative barriers for new installations and added clarifications on existing regulation (Spain 2010a, p. 97429). However, the most polemical aspect of this decree was the elimination of all the benefits for PV projects operating under the R.D. 661/2007 regime after the twenty-fifth year (Spain 2010a, art. 1.10). As explained in the previous section, R. D. 661/2007 did not establish lifetime caps for PV energy installations.

Despite the fact that the Government had approved in 2009 a new regulation for tackling the tariff deficit [Law approving extraordinary measures in the energy sector (Spain 2009)], in 2010 the regulator passed new urgent measures in order to correct it. The reason for this was that the forecasts which accompanied the 2009 regulation did not materialize and the tariff deficit continued rising. Royal Decree Law (hereinafter R.D.L.) 14/2010 included new measures so that all players in the energy industry contributed with an additional and shared effort to the deficit reduction [Law establishing urgent measures to correct the tariff deficit (Spain 2010b)]. Hence, the R.D.L. introduced a new toll for accessing the transport and distribution networks for all electricity generation companies, obliged the companies operating under the ordinary regime to finance the Energy Savings and Efficiency Plans 2004–2012 and set two limitations on the operating hours of PV installations operating under the R. D. 661/2007 regime (Spain 2010b, pp. 106387–106388). The First Additional Disposition fixed production-hour caps based on five climatic solar zones. Additionally, the Second Transitory Disposition introduced further hour production restrictions for the period 27 December 2010–31 December 2013.

In 2012 the Spanish Parliament approved Law 15/2012, which sought internalizing the environmental costs linked to energy production to energy producers [Fiscal reform in order to ensure the sustainability of the energy system (Spain 2012c)]. This bill imposed seven new taxes on the energy sector (Spain 2012c, p. 88081), including a tax on electricity production with a single tax rate of 7 % for all power plants (Spain 2012c, cf. art. 1, art. 6.1 and art. 8). It is striking that, even if this bill aimed at promoting Sustainable Development, the same tax was imposed on fossil-fuel and renewable energy plants.

Notwithstanding the efforts of the Government, the tariff deficit continued growing and reached the sum of € 5.6 billion at the end of 2012 (Spanish Energy Commission 2013, p. 3). In an attempt to alleviate the ever-increasing sum owed by the Administration to electric companies and to avoid raising energy prices, R.D.L.

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<sup>7</sup>The Spanish Supreme Court refers to this type of retroactivity as “improper retroactivity” and considers it permissible because it only affects expectations, e.g. Spanish Supreme Court (2012) fifth legal basis.

2/2013 introduced a new system for updating the prices of energy products [Urgent measures in the electricity system and in the financial industry (Spain 2013a)]. Since its entry into force, energy prices adjusted annually for inflation are not based on the Consumer Price Index, but use instead a special index that does not include non-elaborated food products and energy products (Spain 2013a, art. 1). This measure further harmed (renewable) energy producers, because these two types of products usually present the biggest changes occurring in the price level of consumer goods and services throughout a year.

The period July 2013–June 2014 might have witnessed the definitive step from the Spanish Government towards eliminating the tariff deficit and adjusting the remuneration for renewable energy sources. This last stage was initiated on 12 July 2013, with the approval by the Government of R.D.L. 9/2013, and ended on 16 June 2014, once the Government passed the new remuneration mechanism for renewables in R.D. 413/2014 and Ministerial Order IET/1045/2014.

R.D.L. 9/2013 had three major aims: (1) to reduce extra costs arising from the tariff deficit accumulated during the first semester of 2013; (2) to set the basis of a new regulatory framework that would ensure the financial stability of the electricity system; (3) to guarantee energy supply at the lowest cost possible [Urgent measures to guarantee the financial stability of the electricity system (Spain 2013b)]. For tackling the tariff deficit's extra costs of 2013, the regulator sought to implement "balanced, proportionate and wide-ranging measures" across the different stakeholders in the energy sector (Spain 2013b, p. 52110). In the end, energy producers operating under the special regime and energy distribution companies assumed the bulk of those costs (Noceda 2013). Drastic modifications to the economic regime of renewable energy production included: First, R.D. 661/2007 and R.D. 1578/2008 were repealed (Spain 2013b, sole Repeal Provision), what amounted to a de facto revocation of the special regime. Second, even if the specific remuneration for each technology was to be set in subsequent regulations, this R.D.L. revealed that instead of tariffs, the new remuneration of renewable energy plants will consist in the income from the sale of the energy produced paid at market price plus, if applicable, a complementary retribution aimed at ensuring a reasonable profitability (Spain 2013b, art. 1.2). This complementary retribution could include the remuneration for investment and operating costs which are not covered by the market price (Spain 2013b, art. 1.2). In connection with the remuneration for installations operating between 14 July 2013 (date of entry into effect of the decree) and the date of the approval of the definite regime, the reformed 661/2007 regime continued applying in an interim basis, but the sum received for the energy produced between those dates had to be credited against the remuneration to be received under the new regime (Spain 2013b, Third transitory disposition).

The new regime for renewable energy plants was finally unveiled in June 2014. R.D. 413/2014 set the methodology to be used for calculating the remuneration of plants [Law regulating the generation of electricity using renewables, cogeneration, and waste (Spain 2014a)]. According to article 13 of the decree:

1. A Ministerial Order will establish a classification of installation types according to the kind of technology, the installed capacity, the age, the electrical system, and any other criteria deemed necessary for implementing the remuneration system (...).
2. The remuneration of each installation type will be calculated taking into account a fixed set of criteria, (...). The most relevant criteria include:
  - a) Remuneration on the investment
  - b) Remuneration on the operation
  - c) Regulatory lifetime
  - d) The number of minimum and maximum operating hours
  - e) Operating threshold
  - f) The average market price (...).

Ten days after the approval of R.D. 413/2014, the Government passed the Ministerial Order IET/1045/2014, which detailed in more than 1700 pages the specific remuneration parameters applicable to standard renewable facilities [Ministerial Order validating the remunerative parameters for installations using renewables, cogeneration, and waste (Spain 2014b)]. Annex I listed the installation types existing under the new regime, showed how they corresponded to the categories in the 661/2007 regime and established a code for each installation type. While the 661/2007 regime classified PV installations in six categories, the new regulation includes 91 categories (cf. art. 2 and Table 3 in R.D. 661/2007 with Annex I in Ministerial Order IET/1045/2014). Annex II established the concrete valuation of the remuneration parameters for installation types with a right to a feed-in tariff prior to 14 July 2013, differentiating between the parameters applicable in 2013 from those applicable in 2014–2016. Remuneration parameters will be revised every three years (Spain 2014b, p. 46431).

The radical overhaul of the energy system has certainly contributed towards the reduction of the tariff deficit and the financial stability of the system, as evidenced by the fact that the tariff deficit was reduced to € 2.9 billion in October 2014 (Spanish National Stock Market Commission 2014, p. 3). Moreover, this has been achieved amidst the most severe financial crisis experienced by Spain in the last century. However, such changes have had devastating effects on the country's renewable energy industry,<sup>8</sup> have put at stake the Spain's 2020 climate and energy targets (European Environment Agency 2014, p. 10) and have led to massive losses in revenue for PV system owners. Due to the numerous remuneration parameters introduced in the Ministerial Order IET/1045/2014, conclusions cannot be generalised to all renewable energy sources. But if we take the small PV energy installations built before September 2008 as reference, their remuneration has been cut in more than half in a period of only seven years (cf. art. 2 and Table 3 in R.D. 661/2007 with Annexes I and II in Ministerial Order IET/1045/2014). Previously, in the time frame 2010–2013, PV investors had already suffered important shortfalls in

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<sup>8</sup>Since 2013, major Spanish PV panels producers such as Isofotón, T-Solar, Siliken and 3S Soluciones have entered into state of bankruptcy, liquidation and cessation or suspension of activities.

**Table 2** Retroactive measures affecting PV installations introduced in the period 2010–2014 (author's elaboration)

Regulation	Objective	Retroactive measure(s)
R.D. 1565/2010	Introduction of new technical requirements and specifications for renewable energy installations	– Set up of lifetime caps (25 years) for PV installations
R.D.L. 14/2010	Reducing the tariff deficit	– Introduction of production-hour caps for PV installations based on five climatic solar zones throughout the country – Establishment of limitations on production hours for PV plants for the period 27 December 2010–31 December 2013
Law 15/2012	To ensure the stability of the electricity system	– Introduction of a 7 % tax on the value of the electricity produced by all plants, including renewable energy plants
R.D.L. 2/2013	Reducing the tariff deficit	– Introduction of a new actualisation method for energy prices which is not linked to the Consumer Price Index, but instead to an index that does not include unprocessed food and energy products
R.D.L. 9/2013	To ensure the stability of the electricity system	– Revocation of R.D. 661/2007 and R.D. 1578/2008 (de facto revocation of the special regime) – Despite the fact that the new remuneration mechanism for renewable energy plants had to be set in subsequent regulations, this regime had to apply from 14 July 2013 (date of entry into effect of R.D.L. 9/2013)
R.D. 413/2014 and IET/1045/2014	To ensure the stability of the electricity system	– Introduction of the new remuneration mechanism for renewable energy plants applying since 14 July 2013

the returns of their investments as a result of the retroactive norms passed by the Government (see Table 2). Major changes on the revenue of PV plants have forced many investors to renegotiate the loans for their installation (Cerrillo 2014). They accumulate now higher costs due to loan repayments and installations' maintenance costs than gains. Even worse, some investors have entered bankruptcy and their plants now belong to banks. What level of protection does international investment law offer in such cases? The next part analyses this question in detail.

### 3 Fair and Equitable Treatment as Protective Standard and the Spanish Revocation of Renewable Energy Incentives

The FET standard is the most frequently invoked protective standard in international investment law (Dolzer and Schreuer 2012, p. 130). FET is part and parcel of nearly every bilateral investment treaty (hereinafter BIT), but it is also included in other international investment agreements (hereinafter IIAs), such as the North American Free Trade Agreement (hereinafter NAFTA) and the ECT. In this line, in the proceedings of the PV investors against Spain and in other cases of revocation of renewable energy investments, Article 10(1) ECT, containing the Host State's obligation to ensure a stable investment environment and including the protective standard of "fair and equitable treatment", is likely to be in the claimants' focus (Alfonso 2011; Freshfields Bruckhaus Deringer 2013<sup>9</sup>).

#### 3.1 *The Fair and Equitable Treatment Standard—Attractive and Promising*

The main reasons for the FET's attractiveness among investors lie in its flexibility [*Waste Management, Inc. v United Mexican States* (2004)]<sup>10</sup> and absoluteness (Dralle 2011, p. 6).<sup>11</sup> This makes FET the most successfully invoked but also the most heavily criticized standard in investment arbitration. For greater legal certainty, it is at first necessary to identify the situations in which the FET standard may operate (*Total S.A. v The Argentine Republic*, Decision on Liability (2010) para. 107),<sup>12</sup> which in line with the interpretation by Dolzer and Schreuer, would be: the stability and the protection of the investor's legitimate expectations; compliance with contractual obligations; procedural propriety and due process; good faith; freedom from coercion and harassment (Dolzer and Schreuer 2012, p. 145). These categories also apply to FET as it is found in Article 10 ECT, which by itself does not provide any explicit specifications regarding the content of FET.<sup>13</sup> In the

<sup>9</sup>For the Romanian Government's Emergency Ordinances of 2013.

<sup>10</sup>Para. 99: "[...] the standard is to some extent a flexible one which must to some extent be adapted to the circumstances of each case".

<sup>11</sup>As opposed to the relative standards of "national treatment" and "most favored nation treatment".

<sup>12</sup>Para. 107: "[...] there cannot be a single definition of FET, but that although its exact content is not predefined, except in cases where a treaty provides additional specifications".

<sup>13</sup>Energy Charter Treaty, Article 10(1) on the Promotion, Protection and Treatment of Investments: 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*

following it is the element of the investor's legitimate expectations that will be shed light upon and that will prove FET to be the most promising standard of protection against the revocation of green energy incentives, respectively FiTs (Boute 2012, p. 613; Boute 2009, p. 333; Kasolowsky 2011). In line with some views, invoking the non-expropriation standard, contained in Article 13 ECT, also seems possible (Cf. *Nykomb Synergetics Tech. Holding AB v Latvia*, Arbitration (2003); Wälde and Hobér 2004, p. 15. For an overview of the views on expropriation, such as police powers doctrine, sole effects and economic effects test see Dolzer and Schreuer 2012, p. 112). Yet, absent of a deprivation of a foreign investor's acquired rights and the transfer of ownership rights to the state or a third person (Reinisch 2008, p. 408) through the revocation of FiTs, a direct expropriation or nationalization can be ruled out here. An indirect expropriation, which leaves the investor's title untouched and which is by far the more common form of an expropriation in international investment law (Dolzer and Schreuer 2012, p. 101) would only be thinkable in case of a "partial expropriation" (Kriebaum 2007, pp. 69, 83; opposing this view is Boute 2012, p. 635). In the end, according to none of the dominant views, the revocation of FiTs will amount to an indirect expropriation, since the investors usually still retain control of their power plants and will receive the profits of the electricity output (Boute 2009, pp. 333, 363).

### 3.2 *Legitimate Expectations of Renewable Energy Investors*

Acknowledging the dependence of the renewable energy sector on private foreign investments and the subsequent support of this branch of industry through specialized economic incentives,<sup>14</sup> it is not surprising that an investor expects and relies upon the predictability and stability of these mechanisms. However, the individual factual background has to be assessed when judging the legitimacy of the investor's expectations. Could, for example, a reliance on a tariff regime granting more than 500 % above the reference average tariff for that year<sup>15</sup> still be assumed to be a reasonable rate of return and thus constitute a legitimate expectation?

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(Footnote 13 continued)

*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 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 [...].*

<sup>14</sup>For an explanation of Feed-in Tariffs (FiTs) see Part I—Introduction.

<sup>15</sup>Such was the remuneration for small photovoltaic plants regulated through R.D. 661/2007.

### 3.2.1 Functional Importance of Legitimate Expectations to the FET Standard

Since the tribunal in *Tecmed v. Mexico* was the first to explicitly consider investment protection through the “basic expectations” of the investor, today, no real dispute remains as to the existence of this sub-element [*Técnicas Medioambientales Tecmed S.A. v United Mexican States* (2003, para. 154)]. The tribunal in *Saluka v Czech Republic* even considered the legitimate expectations to be “the dominant element” of FET (*Saluka Investments BV (The Netherlands) v Czech Republic* (2006) para. 302). Recently, the tribunal in *Electrabel S.A. v Hungary* stated that it was “widely accepted” that the legitimate expectations were the “most important function” of the FET standard (*Electrabel S.A. v Hungary* 2012, para. 7.75). It is also named “one of the major components” of FET (*Ulysseas Inc. v Ecuador* (2012) paras. 248–249). Such a qualification within FET is convincing, because the closely related principle of good faith even qualifies as a “general principle of law” in the sense of Article 38(1)(c) of the Statute of the International Court of Justice (*Total* para. 111, in reference to Forsyth 1988 p. 242).<sup>16</sup>

### 3.2.2 Definition and Scope of Legitimate Expectations in Cases of Renewable Energy Investments in Spain

Concerning the general definition of legitimate expectations the decision in *Tecmed v. Mexico* is predominantly considered as being a landmark award. It has served as a sample for almost identical FET provisions in most IIAs:

The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations [...] The investor also expects the State to use the legal instruments that govern the actions of the investor or the investment in conformity with the function usually assigned to such instruments. (*Tecmed* para. 154).

However, the *Tecmed* approach has been criticized as “not being a standard at all [but] rather a description of perfect public regulation in a perfect world, to which all states should aspire, but few [if any] will ever attain” (Douglas 2006, pp. 27–28). Opposing the broad and subjective definition by the *Tecmed* tribunal, yet, not shaping the term of legitimate expectations equally precise, was the tribunal in *Saluka* which found that “[...] in order for [investor expectations] to be protected, [they] must rise to the level of legitimacy and reasonableness in light of the circumstances.” (*Saluka* para. 304). In the view of some authors, therefore, FET has already been devaluated to be merely subject to the distinctive views of single arbitral tribunals (Hobér 2010, pp. 153, 158).

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<sup>16</sup>Considering the concept of legitimate expectations to have emanated from German law where it is extensively applied in the function of “Vertrauensschutz”.

The most precise definition of legitimate expectations has, so far, been provided in the case of *Thunderbird Gaming v. Mexico*: “[...] The concept of ‘legitimate expectations’ relates [...] to a situation where a Contracting Party’s *conduct creates reasonable and justifiable expectations on the part of an investor* (or investment) to act in reliance on said conduct, such that a failure by the [Host State] Party to honour those expectations could cause the investor (or investment) to suffer damages.” (*International Thunderbird Gaming Corporation v The United Mexican States* (2006) para. 147 *emphasis added*).

With regard to the Spanish case, the ECT has been assumed to include the concept of legitimate expectations (Hobér 2010, p. 158). Yet, although explicitly embodying FET in its Article 10, the ECT is lacking a reference to legitimate expectations. Such lacuna can be found in basically every existing IIA.<sup>17</sup> This makes the exact content of legitimate expectations difficult to assess through the ordinary meaning of FET in accordance with Article 31(1) of the Vienna Convention on the Law of Treaties. However, the terms in Article 10(1) ECT to “encourage and create stable, equitable, favourable and transparent conditions for investors”, requiring a positive commitment of the contracting parties, suggest a stronger obligation than in other IIAs (See e.g. Article 2(2) of the German Model BIT (2008): “Each Contracting State shall in its territory in every case accord investments by investors of the other Contracting State fair and equitable treatment [...]”; Wälde 2006, paras. 31, 113). The imperative language in sentence 2 of Article 10(1) ECT, such as “shall”, “commitment”, “at all times”, supports this finding (Wälde 2006, para. 114). The tribunal in *Electrabel v. Hungary* also made a reference to a particular feature of Article 10 ECT, adding the obligation of the Host State to establish “favourable and transparent conditions” to the general understanding of FET. The tribunal deducted from this the obligation to be “forthcoming with information about intended [investment-relevant] changes in policy and regulations” and, thus, provide the possibility for the investor to “engage the host state in dialogue about protecting its legitimate expectations” (*Electrabel* para. 7.79).

After all, the main purpose of the ECT is to promote conditions for profitable investments in energy projects and to ensure a high level of legal security and to provide a stable and transparent framework.<sup>18</sup> This purpose already comprises the main aim of the general concept of legitimate expectations, “to enable the foreign

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<sup>17</sup>Few IIAs, and mainly concerning the question of indirect expropriation, merely include the term of ‘investment-backed expectations’ such as the US Model BIT (2012), Annex B(4)(a)(ii). But also see the consolidated text of CETA (2014), stating in Article X.9, para. 4: “When applying the above fair and equitable treatment obligation, a tribunal may take into account whether a Party made a specific representation to an investor to induce a covered investment, that created a legitimate expectation, and upon which the investor relied in deciding to make or maintain the covered investment, but that the Party subsequently frustrated [...]”.

<sup>18</sup>Furthermore, within a contextual interpretation, the ECT preamble’s wording, with its aim to “liberalize investment” and by its explicit labelling the of the ECT’s commitments as legally binding, suggests that the State is under an obligation to provide a high level of investment protection.



investor to make rational business decisions relying on the representations made by the host State” (Schreuer and Kriebaum 2009, p. 265).

The ECT, thus, offers a higher level of protection of the investor’s legitimate expectations than other IIAs would. In the following, these findings, relevant for renewable energy investors in Spain, will be assessed against the background of the general understanding of legitimate expectations by investment law tribunals outside the ECT context.

### 3.2.3 Legitimate Expectations Based on Contractual Arrangements, Specific Representations or Even Less?

The main critique regarding the legitimate expectations concept is that it is of such breadth that it may cover an infinite number of situations (Sornarajah 2010, p. 355).

Hence, many tribunals have begun narrowing down its scope by introducing new criteria. In this way, the situations in which legitimate expectations may arise can be systematized into three groups (see Schill 2006, p. 16; Hirsch 2011, p. 8):

- (1) Contractual arrangements (*Parkerings Compagniet AS v The Republic of Lithuania* (2007) para. 334; *Total* para. 117; *CME Czech Republic B.V. v Czech Republic* (2001) para. 611);
- (2) Representations, specific commitments (*Ulysseas Inc. v The Republic of Ecuador* (2012) para. 249, *CMS Gas Transmission Company v The Republic of Argentina* (2005) para. 277) or assurances which were reasonably relied upon by the investor (*Waste Management* para. 98; *CME* para. 611);
- (3) Legitimate expectations deriving from the general regulatory framework the Host State has put in place, as long as the confidence that the framework generates is sufficiently specific (*Total* para. 122, describing this as being “the most difficult case”; *CMS* paras. 266-284; *Electrabel* para. 7.78; *Occidental v Ecuador* (2004) para. 196; *Suez and Vivendi Universal S.A. v Argentine Republic* (2010)<sup>19</sup>). Yet, in the last group the Host State must have acted in order to induce the investment (*Glamis Gold v United States* (2009) para. 766; *Total* para. 121; *Suez* para. 208<sup>20</sup>).

Of further importance in each group is the interplay of the specificity of the representations and the legitimacy of expectations in the stability of the legal

<sup>19</sup>Para. 226: “In examining the various cases that have justifiably considered the legitimate expectations of investors and the extent to which the host government has frustrated them, this Tribunal finds that an important element of such cases has not been sufficiently emphasized: that investors, deriving their expectations from the laws and regulations adopted by the host country, acted in reliance upon those laws and regulations and changed their economic position as a result”.

<sup>20</sup>Para. 208: “Argentina through its laws, the treaties it signed, its government statements, and especially the elaborate legal framework which it designed and enacted, deliberately and actively sought to create those expectations in the Claimants and other potential investors in order to obtain the capital and technology that it needed to revitalize and expand the Buenos Aires water and sewage system.”.

framework. The more formal and specific and clear a representation is, the more legitimate the investor's expectation will be and the less regulatory space will remain for the Government. Or as Wälde (2006, para. 31) has put it: "[...] [T]he less formal "personal communications", the less likely is the emergence of a legitimate expectation; this means that the greater the formality of an assurance, the greater its ability to trigger a legitimate expectation." (Cf. *Total* para. 121).

Addressing the group of "contractual arrangements", as well as the one of "specific representations" is the tribunal in *Parkerings*. Here the ICSID tribunal found that an expectation can only be legitimate if there is as a basis a "received [...] explicit promise or guaranty from the host state" and that in absence of an agreement "in the form of a stabilisation clause or otherwise [...]" the amendment of the original regulatory framework was lawful (*Parkerings* paras. 331, 332; Cf. *CME* para. 611; Tudor 2008, p. 165).

More recently, and relating to Article 10 and 13 ECT, the award of *AES v. Hungary* demanded a specific stabilization agreement or stabilization clause as a condition for the investor's legitimate expectations (*AES Summit Generation Limited and AES—Tisza Erőmű Kft. v Hungary* (2010) para. 9.3.18, where the tribunal ultimately found no breach of FET had occurred).

However, the majority of awards did not require specific contractual stabilization clauses,<sup>21</sup> yet, they are unclear and inconsistent in their terminology of what should form the basis of legitimate expectations. Some tribunals named "specific representations" (*Ulysseas* para. 249; *Glamis Gold* para. 627) others required "commitments" as a basis for a claim (*Duke Energy Electroquil Partners and Electroquil SA v Ecuador* (2008) para. 340; *Continental Casualty v The Argentine Republic* (2008) para. 252).

Few tribunals even regarded a modification of the general regulatory framework at the time the investment was made, not specifically addressed to the investor, as sufficient for a breach of legitimate expectations (e.g. *Occidental* para. 196; *Suez* para. 226). In this way the tribunal in *Electrabel v. Hungary* concluded that specific assurances are "not always indispensable", hence, not always absolutely necessary for the investor's legitimate expectations and continued "specific assurances will simply make a difference in the assessment of the investor's knowledge and of the reasonability and legitimacy of its expectations [...]" (*Electrabel* para. 7.78).

Specifically relating to an economic crisis and absent a contract or specific representation, the tribunal in the case of *Total* qualified a specific stabilization clause to be "undoubtedly" sufficient. Interestingly, the same tribunal identified that, as a rule, the general regulatory framework would not suffice for legitimate expectations, however, as an exception, the change of regulation of "inherently prospective nature [which is] aimed at providing a defined framework for future operations [...]" may constitute a breach of FET (*Total* paras. 122, 129). To

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<sup>21</sup>The high standards for legitimate expectations set in the awards in line with *Parkerings* will have to be regarded as exceptions, especially because there was each time a contract between the investor and the Host State.

determine the threshold for a breach of such prospective regulation, the tribunal distinguished between a general promise of legislative stability (*Total* paras. 297, 308–314) and, absent such a promise, a commitment to provide for an “economic equilibrium” based on the principle of “regulatory fairness” (*Total* paras. 309, 122). The economic equilibrium had been violated by Argentina’s energy price regulation, which thus constituted a breach of FET (*Total* paras. 327, 330, 333). Importantly, the case indicates that the claimant can only reasonably rely on a diminished protection, when the regulatory framework was of unilateral and general character and not specifically addressed to him (*Total* paras. 119–124).

One can conclude that, in absence of an investor-state contract, but in presence of specific representations and assurances, there is a firm basis for the protection of the investors’ legitimate expectations. Yet, many investment law tribunals and scholars assume the above-mentioned unspecified “general regulatory framework” as being too low a threshold for a breach of legitimate expectations. Wälde and Kolo (2001, pp. 824–825) clarify that: “One cannot postulate that the environmental regime should be absolutely frozen [...]. The question is rather to identify the threshold of an unexpected regulatory change and its impact on the investor’s legitimate expectation [...]”.

However, as the case of *Total* and other awards have shown, the option to rely on the stability of the general regulatory framework is not completely barred, but diminished, in cases of regulation of a “prospective nature”, as long as the investor could “reasonably” rely on it and the government acted “to induce” the investment.

For the cases of foreign PV investors in Spain no investor state contracts have been publicized containing a stabilization clause in the sense of the first group. Concerning the second group, of specific representations reasonably relied on by the investor, at first sight, the special regime,<sup>22</sup> containing foremost general laws, would be lacking a specific addressee. As the tribunal in *Total* pointed out: “Representations made by the host State are enforceable and justify the investor’s reliance only when they are specifically addressed to a particular investor.” [*Total* para. 119; Cf. *Thunderbird Gaming* para. 147; *Merrill & Ring Forestry L.P. v Canada* (2010) para. 242; *El Paso Energy International Company v Argentine Republic* (2011) para. 375; Cf. on the necessarily individualized character of representations in order to form a basis for legitimate expectations, which is not present in abstract administrative decisions such as decrees: Diehl (2012, pp. 398–402)].

While the Electricity Sector Law was aiming at renewable energy investments, noticeably, it was neither only addressed to foreign investors nor was it restricted to PV energy production only (Electricity Sector Law 1997, Title IV, Chap. II). The same holds true for the National Renewable Energy Plan of 1999 which aimed at promoting renewable energies, among others the PV sector, yet, remained very general in its statements (National Plan for the Promotion of Renewable Energy 2000–2010 (1999) p. 116). Hence, the special regime by itself is not yet a specific representation in the above stated terms. However FiTs, as those affecting the PV

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<sup>22</sup>See above Part 2.2.1.

investors in Spain, set the exact amount of support for a specific group of investors with the particular aim to incentivize investments in an innovative industry with an environmental purpose for a minimum timeframe. The decree R.D. 2818/1998 was not yet directly favouring solar energy producers as a group among all renewable energy producers and only offered premiums as remuneration mechanism. However, R.D. 436/2004 divided the technologies into categories and now allowed energy producers to choose between premiums and/or tariffs, while for small PV plants only FiTs were foreseen (R.D. 436/2004, Table 3). Then R.D. 661/2007 stands apart as it further specified and privileged renewable energy as opposed to conventional energy suppliers, and, within this group of FiT recipients, strongly promoted solar installations. Table 3 of this decree contained specific FiT provisions not expressly naming one addressee, yet, evidently offering far higher sums to PV and solar thermal suppliers as opposed to any other renewable energy form. Thus, de facto, the addressees of the significantly elevated tariff were only solar investors. This may not make R.D. 436/2004 and R.D. 661/2007, as most FiT regimes, eligible to be “specific representations”. However, as seen, this regulatory framework was precise in its conditions, geared at a specific group, being domestic and foreign solar investors, contained an inducement to invest and, thus, formed the basis of the investors’ legitimate expectations. These R.D.s were, moreover, embedded into the broader regulatory framework of National Energy Plans, which through their continuous renewal and evolution produced an increasingly beneficial and specific framework for solar energy promotion. The two R.D.s taken together with the 1999 and 2004 National Plans constitute a firm basis for legitimate expectations to emerge on the side of any PV investor having invested within the timeframe between the enactment of R.D. 436/2004 and R.D. 661/2007 and the retroactive changes initiated by R.D. 1565/2010 (Real Decreto 1565/2010 Art. 1). Lastly, this also fulfils the prerequisite set up by the *Total* decision, of regulation of forward-looking, hence, prospective, nature.<sup>23</sup> Yet, as a caveat, one may add that due to the low threshold of the general regulatory framework, being neither a formal representation nor a contractual arrangement, the test for the reasonableness of the legitimate expectations will be a stricter one and may lead to a diminished protection. Whether the Spanish FiTs in fact render the expectations legitimate depends on other factors such as the investor’s own conduct or possible defences on the Government’s side. These will be examined next.

### 3.2.4 Legitimate Expectations Limited by the Renewable Energy Investors’ Own Conduct

There is a tendency among tribunals that the business risk inherent in an investment is to be borne by the investor, as shown by *Consortium RFCC v. Morocco*: “C’est le lieu de rappeler qu’un Traité de protection des investissements ne peut servir à

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<sup>23</sup>Until R.D. 1565/2010, the regulatory framework included no lifetime caps, see above.

compenser un investisseur déçu du résultat financier de l'opération réalisée,[...]” (*Consortium RFCC v Royaume du Maroc* (2002, para. 108); See also *Parkerings* para. 333, where the tribunal required the investor to “anticipate that the circumstances could change, and thus structure its investment in order to adapt it to the potential changes of legal environment”; Yannaca-Small 2008, p. 127). This will be true, in particular, in case of the investor’s own “bad business judgments” (*Maffezini v Spain* [2000] para. 64). Thus, for determining the scope of legitimate expectations, the investor’s *own conduct* has to be taken into account in order to conclude what is “fair and equitable” (Alvarez 2011, pp. 185, 383, 385; Potestà 2013, pp. 88, 119).

*Muchlinski* categorizes that the investor has the *duty* (1) to avoid unconscionable conduct, (2) to assess the investment risks of the host country reasonably and (3) to operate the investment reasonably (Muchlinski 2006, p. 527). Particularly relevant for the present case seems to be the second duty of due diligence to reasonably assess the risk, meaning “*all* circumstances, including not only the facts surrounding the investment, but also the political, socioeconomic, cultural and historical conditions prevailing in the host State.” (*Duke Energy* para. 340; *Bayindir Insaat Turizm Ticaret Ve Sanayi AS v Pakistan* (2009) para. 195; *Maffezini* paras. 64–71; *Methanex Corporation v USA* (2005) Part IV, Chap. D, para. 10). This seems necessary before deciding to invest in the first place (Tudor 2008, p. 217; *Tecmed* para. 154), especially when committing oneself to a long-term investment covering years of energy supply. Thus, the investor’s own conduct constitutes a general limitation to his legitimate expectations.

Regarding PV energy investors in Spain, it is thus a critical question as to how intensely they had to assess the socio-economic and regulatory circumstances in the pre-investment phase in order to maintain the legitimacy of their expectations in a stable and predictable business environment. Concerning the ranking of different risk factors, to the detriment of the solar investors, *Boute* has fittingly remarked that public support schemes are, almost always, a “*conditio sine qua non*” for the initial decision to invest in the renewable energy sector (Boute 2009, p. 637). The UNCTAD (2010, p. 30) states similarly express: “Foreign investment into new low-carbon industries may not be competitive in the start-up phase and may therefore need government support, such as feed-in tariffs for renewable energy or public procurement”. The Spanish regime reveals the common characteristic of such supportive legislation to be already in place before the investment, because it should incentivize the renewable energy investments. As in any renewable energy investor’s pre-assessment of the investment climate, the financial stability of the Spanish support system, thus, had to be considered as the most important risk factor (Cf. European Commission 2005, pp. 16–17).

A further argument for a stronger weight of the investors’ own conduct in the Spanish case may be the unreasonableness of an expectation in case of tariffs being offered at a rate of more than 500 % above the reference average tariff. However, specific rates cannot be expected from an investment, which has been undertaken in awareness of the common business risk of loss. A point in favour of photovoltaic energy investors would, again, be the fact that the Spanish Government applied

detailed market research and empirical analysis of respective renewable energy costs to establish FiT payment levels in the first place. This was supposed to ensure that the FiTs would allow competently operated projects to be profitable (Couture et al. 2010, pp. 7–8). Still, considering each investor’s professional “businessman” background (*Parkerings* para. 332), it seems reasonable to apply a stricter test to the investor’s own conduct. The large sum of investments totalling € 2–4 billion (Hepburn 2011), on the basis of a very generous FiT scheme, in the particular claims of PV Investors in Spain could, after all, indicate some naïveté. A possible point on the side of the solar investors would exist, if, at the time the investment was made, the tariff deficit was not foreseeable to serve as the Government’s main argument for cutting the support for renewables. Notably, the expectations must be assessed at the time of making the investment (*Duke Energy* para. 340; *LG&E v Argentine Republic* (2006) para. 130: “[expectations] are based on the conditions offered by the host State at the time of the investment.”). However, the investors had access to the tariff deficit and this very deficit was already eight years old when the Spanish Government started cutting support for renewables (Royal Decree 1578/2008). But until April 2009, the date when the first regulation adopting measures for tackling the tariff deficit was approved (Royal Decree Law 6/2009), the regulator did not seem concerned about this problem. Quite the opposite, in 2007, the regulator introduced higher incentives for plants operating under the special regime. Thus, the tariff deficit has not been a foreseeable argument for the cuts at the time the investments were made.

To sum up, the impact of the photovoltaic energy investors’ own conduct in Spain on their legitimate expectations is subject to a stricter test as they would have to assess whether there is at all a supportive regime in place that, as a “*conditio sine qua non*”, is eligible to let them, as renewable energy investors, compete with conventional energy producers. Yet, the scope of the investor obligation to due diligence does not cover miscalculations, hence, the question in what way the supportive regime may properly operate. This risk will remain within the sphere of the legislator setting up the regime, as in the Spanish case. Ultimately, as will be unfolded, the investors’ conduct by itself will not be the decisive factor for the tribunal’s decision, on whether there was a breach of legitimate expectations.

### **3.2.5 Legitimate Expectations Limited by the Right to Regulate of the Spanish State in Crisis**

Notably, the legitimate expectations and the implied requirement of stability of the legal framework do not per se affect the Host State’s right to exercise its sovereign regulatory powers—its right to regulate (Dolzer and Schreuer 2012, pp. 148–149; More recently the European Parliament (2011) called on the Commission to include in all future EU investment agreements specific areas for a right to regulate. In the ECT Article 18 also takes into consideration a right to regulate, specifically addressing energy resources).

The tribunal in the *Saluka* case made it clear that the investor cannot reasonably expect that “the circumstances at the time the investment is made *remain totally unchanged*” and that the Host State’s right “to regulate domestic matters in the public interest” must not be neglected (*Saluka* para. 305; Tudor 2008, p. 167). A regulatory measure would not have to be compensated, if States adopted laws within “the normal exercise of regulatory powers, [...] in a non-discriminatory manner [...] bona fide, that are aimed at the general welfare [...]” (*Saluka* para. 255; Cf. *Feldman v Mexico* [2002] para. 112). Similar formulations with respect to the indirect expropriation of investments are to be found in later IIAs and in Article 13 ECT. Moreover, the right to regulate requires a “weighing” of the investor’s legitimate expectations on the one hand and the host State’s legitimate regulatory interest on the other hand (*Saluka* para. 306). The tribunal in *EDF v Romania* established that in the case of the revocation of business licenses the aim to fight corruption within the Romanian state was found to be legitimate, as long as there was a “reasonable relationship of proportionality between the means employed and the aim sought to be realized” (*EDF v Romania* (2009) para. 293; Similarly *LG&E* para. 189). While tribunals have adopted the systematization that public policy objectives need to be “bona fide”, “non-discriminatory” and in the “public interest” in reference to indirect expropriation (*Methanex* Part IV, para. 7) they have not as clearly applied such categories to cases in which the right to regulate conflicts with FET and legitimate expectations (The tribunal in *El Paso* recently applied the *Saluka* test for the non-discriminatory, bona fide regulation of the Host State in the public interest to the FET claim of the investor and in this way pointed out that “legitimate expectations necessarily vary with the surrounding circumstances [...]” *El Paso Energy v Argentine Republic* (2011) paras. 358–359). If the State’s measure should not fulfil these conditions, rather than as a clear prerequisite for illegality in case of an expropriation, for the case of FET, this would serve as strong indicator for a violation. Except for a case of obvious discrimination or documented “mala fides” of the Host State the absence of a public purpose would not automatically entail a breach of FET, as the weight of the conflicting public and investors’ interests depends strongly on the surrounding circumstances. (Yet, for the criterion of “bona fide” *Schreuer* contends that: “[...] it may be regarded as established that action against the investor that is demonstrably in bad faith would be a violation of the fair and equitable treatment standard.” In his view, FET may also be violated in absence of “mala fides” on the side of the host State and the burden of proof in so far does not lie with the claimant, *Schreuer* (2005, pp. 383–385); Cf. *Glamis Gold* para. 22).

The first question to ask is whether Spain with its revoking and retroactive measures, in particular visible in the regulation following R.D. 1578/2008, has pursued a legitimate public interest aim. The public interest receives an increased importance in cases in which an abnormal socio-economic situation is present. Thus, the financial crisis of Spain since 2008 will be probably brought to the fore as an argument by the Spanish State and may give stronger weight to the right to

regulate in the public interest to reduce public debt or to avoid the tariff deficit.<sup>24</sup> Argentina faced similar problems resulting from its severe economic crisis from 1999 to 2002. Comparably, for example in the case of *CMS*, the Argentine Republic invoked the “right to regulate” as a defence against an alleged breach of the energy investors’ legitimate expectations (*CMS* para. 93; *CMS v Argentina*, Argentina’s Annulment Reply 2007, para. 43; Alvarez 2011, p. 247). Notably, in the award of *National Grid v. Argentina* FET was acknowledged to be defined differently “in case of an economic and social crisis” (*National Grid v Argentina* 2008, para. 180; Alvarez 2011, pp. 264–265). However, for the case of Spain, the weight of the crisis should not be overestimated because the economic conditions are far less severe than they were in Argentina,<sup>25</sup> and already the clear wording of most energy norms passed in Spain since 2008 such as R.D.L. 14/2010, R.D.L. 2/2013, R.D.L. 9/2013 and R.D. 413/2014 reveals that they pursue one major goal: the elimination of the tariff deficit.<sup>26</sup> However, the aim of reducing appears legitimate as Spain, being an EU Member State, is bound by the aims set forth in the EU Stability and Growth Pact which, inter alia, has fixed annual objectives per country in terms of deficit reduction since 1999 (European Commission 1999). Spain has not met these aims since the emergence of the crisis and would thus face sanctions if it not drastically changed its spending policies, which can be pursued, among other ways, by reducing subsidies in the electricity sector. This, taken together with the fact that the deficit is also a burden for the public, makes its reduction a legitimate aim, still, with a different weight than a severe socio-economic crisis such as the one experienced in Argentina.

The next question is whether the measures have been applied in a proportionate manner. The measures visible in the regulation following R.D. 1578/2008 were appropriate to reach the aim, as a large amount of public spending on PV energies would have been saved and the deficit presumably reduced. Yet, the measure was only necessary if there had not been any equally efficient means at hand for the Spanish State less violating for FET, to reduce the deficit. While higher taxes, in particular for other conventional energy sources, may have been thinkable, their outcome is just as uncertain. Moreover, it must not be overseen that, by 2012, Spain has implemented the most severe economic policies ever since the democracy has

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<sup>24</sup>As a legal basis for such an argument the exceptions of Article 24(3)(c) ECT may be invoked, as it is not explicitly inapplicable to Article 10 ECT. However, the Spanish measures cannot be construed as “for the maintenance of public order”, for in this case the latter did not seem at stake as a consequence of the economic crisis.

<sup>25</sup>At least three elements support this claim. First, while the Argentine Government passed the *Corralito* in 2001 for “fencing in” withdrawals and prohibiting international transfers, no limits on bank withdrawals have been imposed in Spain. See Argentine Decree No. 1570/01 of 1 December 2001 (Argentina 2001). Second, contrary to Argentina, Spain has not defaulted on its debts. Third, unlike what happened in Argentina, no international institution such as the International Monetary Fund has intervened in Spain. Furthermore, not even in the Argentine Gas Cases was financial crisis alone a sufficient argument for a permitted breach of international standards of investment protection with *National Grid* being the only exception.

<sup>26</sup>See Part 2.2.2.



been introduced to the country and that these now affect basically every sector, not only PV energy (see Spain 2012a, b). Thus, the measure was necessary.

Most importantly, the balancing of interests must have been proportionate. As shown, the own conduct of the renewable energy investors and their obligation to diligently pre-assess the investment climate appear stricter as the financial stability of the support system represents “the most important risk factor.” (European Commission 2005, pp. 16–17). Yet, the Spanish Government failed to act against the tariff deficit for nine years. It also cannot be expected of the investor to react to the revocation, becoming gradually visible, by autonomously removing the investment himself: an investment in renewable energies is not just a simple financial product which could be easily distributed or removed again but involves a complex and long-term construction, i.e. setting up a PV plant. Moreover, the bona fides of the Government remains doubtful because of three reasons. First, despite the difficulty to understand the precise cause of the tariff deficit, all the Parliament Members of the *Partido Popular* (party heading the current Government) rejected a parliamentary motion presented by a left-wing coalition in June 2013 for conducting an audit to reflect the true costs of energy production and distribution in Spain (Economía 2013). Second, the tariff deficit was initiated in the year 2000 and escalated to the amount of € 4 billion in the year 2005, yet tackled by Spain for the first time as late as the year 2009. Third, Spain was urged by the European Commission to proceed in its promotion of renewable energies and even surpassed the intermediate goal set out in the directive 2009/28/EC of raising the share of renewable energy in the final energy consumption to 10.9 % by 2.9 % (in the year 2010 this share amounted to 13.8 %) (European Commission 2013, p. 175, Annex 1). Thus, the legislator should have been more cautious in the implementation of support schemes for renewables from the beginning in order to avoid miscalculations.

The Spanish Supreme Court’s has found that the reforms in the special regime qualify as an “improper” legal retroactivity<sup>27</sup> and this indicated investors in the Spanish case could not expect the regulatory framework to remain unchanged, (an analysis of the question of relevance of national jurisprudence for international investment arbitration would surpass the scope of this article. Extensive research on such interplay of national and international legal orders has already been conducted by Kjos (2013). While it is clear that the standard of legitimate expectations is not identical with existing standards of legal certainty as laid down in many Constitutions<sup>28</sup> and that the principle of legal certainty cannot be understood as an “immutable right”, however, the principle of legitimate expectations must not be deprived of its main function: to provide protection by “enabl[ing] the foreign investor to make rational business decisions relying on the representations made by the host State” (see above Part 3; Schreuer and Kriebaum 2009, p. 265). In this way the “economic equilibrium” of the investment may have been distorted. According

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<sup>27</sup>See above Part 2.2.2.

<sup>28</sup>E.g. Article 9.3 of the Spanish Constitution; Article 20(3) of the German Constitution.

to the tribunal *Total* a breach of the “economic equilibrium”, hence of legitimate expectations, is reached when the investors are no longer able to cover their costs and make a reasonable return on their investment (*Total* paras. 313, 327.) The tribunal in *Total* already found that this could already be the case when not renegotiating the electricity tariff regime representing “regulation of general nature” (*Total* paras. 312, 327). In the Spanish case, the Government guaranteed high profit margins through R.D. 661/2007, as shown above. However, the changes introduced through R.D. 1565/2010, R.D.L. 14/2010, Law 15/2012, R.D.L. 2/2013, R.D.L. 9/2013, R.D. 413/2014 and Ministerial Order IET/1045/2014 have resulted in greater costs than revenues for many PV investors.<sup>29</sup> In this context, the very *raison d’être* of the initial PV investment becomes doubtful. With a special regard to the fact that the FiTs in place qualify as inducements to investment<sup>30</sup> their revocation can be seen as a heavy distortion of the economic equilibrium.

It can be concluded that the right to regulate may establish a limitation to the protective scope of FET. In relation to renewable energy investments, States have the right to adapt their support regimes in order to avoid overcompensation (Boute 2012, p. 648). Yet, the State cannot justify the withdrawal of a support scheme as regulating in the public interest when, in fact, it is primarily aiming to reduce an energy tariff deficit which is due, at least in part, to the Government’s mishandling.

In this way, it has to be said that the interest of the PV investors outweighs the regulatory interest of the Spanish State and the revocation measures constitute a breach of legitimate expectations and, hence, a violation of FET.

#### 4 Conclusions for Legitimate Expectations in Photovoltaic Energy Investments in Spain

Renewable energy investors in Spain, in particular PV investors, will be able to successfully claim a breach of FET due to the far-reaching revocation measures<sup>31</sup> put in place from 2008-2014. Regarding the scope of legitimate expectations in the case of Spain, as shown, PV investors can reasonably rely on the general regulatory framework the Host State has put in place. Particularly R.D. 661/2007,<sup>32</sup> can be qualified as being part of the general regulatory framework formed by the special regime, as part of which the FiTs have generated a confidence that was sufficiently specific (cf. *CMS*) and have served as an inducement to invest (cf. *Total* para. 110; *Glamis Gold* para. 766) in the Spanish solar industry.<sup>33</sup> This underscores the State’s

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<sup>29</sup>See above Part 2.2.2.

<sup>30</sup>See above Part 3.2.3.

<sup>31</sup>See Part 2.2.2.

<sup>32</sup>R.D. 661/2007.

<sup>33</sup>First, Article 2 in conjunction with Table 3 of R.D. 661/2007 promised a certain sum of payment for an unlimited period of time, offering significantly higher sums to PV energy suppliers, hence,

inducement ambitions once more (see e.g. National renewable energy plan 2005–2010, pp. 183–184). What is more, the protective scope of the legitimate expectations under the applicable ECT reaches further than it does under most IIAs.<sup>34</sup> Yet, in no regime, the FET protection is capable of reaching as far as a stabilization clause would (Cf. Hirsch 2011, p. 24). While international investment law is not supposed to force countries to keep in place subsidy programs that are inefficient and unintended in their consequences, renewable energy investors may legitimately expect the maintenance of an “economic equilibrium”, at least in terms of the viability of their business, as shown in *Total* at para. 313: “The respect for economic equilibrium principle entails that, in normal situations and from a long term perspective, the private generators are able to cover their costs and make a return on their investment, while providing their services to the market and consumers as required under the Electricity Law”, (also see Crockett 2012, pp. 516, 523). In the end, the interest of the PV investors outweighs the regulatory interest of the Spanish State and the revocation measures constitute a breach of legitimate expectations and, hence, a violation of FET. The provided evidence suggests that the conflict between the Spanish State and foreign investors could be best resolved through a compensation for the investors that takes into account the losses of the investors, the inappropriate regulation of the State and the financial limitations of the country due to the crisis.

In order to fulfil Sustainable Development goals States will have to promote renewable energies. Today there is a broad consensus that not only economic development, but all “three pillars”, the economic, the ecological and the social aspects of each regulatory or private measure have to be seen as one, in order to guarantee the sustainability of the regulatory measure (Principles 5, 7, 8 and 10 of the Rio Declaration [United Nations Conference on Environment and Development 1992]). However, as the concept of Sustainable Development cannot, yet, be considered as a binding norm in international law, also in investment law it, nonetheless, serves as an aid to interpretation. In the present disputes the claimants cannot and do not rely on Sustainable Development in a general manner. Yet, as Sustainable Development divides itself into several subprinciples an invocation of the latter, may be helpful. In this way, the Principle of Sustainable Use of Natural Resources demands of the actors to use all of their natural resources sustainably and efficiently, set out for a long-term maintenance for a general utility for society [Principle 1 of the New Delhi Declaration (International Law Association 2002); Principle 8 of the Rio Declaration (United Nations Conference on Environment and Development 1992)]. Clean energy investments, such as solar energy investments,

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(Footnote 33 continued)

de facto specifying the addressees of the tariff. Second, the progression of implementation over a long time generated a more reliable, more credible regime, of a prospective nature. Third, the purpose of the FiT regime in Spain comprised environmental goals, as well as the industrial policy objectives of fostering the development of domestic innovative technology. This underscores the State’s inducement ambitions once more.

<sup>34</sup>See Part 3.2.2.

fulfil the aims of this subprinciple as they constitute a surrogate for conventional energy sources, such as coal or gas, which will deplete over time and do far greater harm to the environment. However, only in sectors for which a specific international regime exists, the Principle of Sustainable Use has acquired some normative content (Birnie et al. 2009, p. 200). For international investment law, Sustainable Development has, so far, not attained a normative form, yet, its relevance is increasing rapidly, as can be seen e.g. in the broad-based Investment Policy Framework for Sustainable Development (UNCTAD 2012). Finally, it becomes visible in the proceedings of the international PV investors in Spain: For a credible pursuit of Sustainable Development goals States may be legally held to maintain a stable investment climate for the international renewable energy projects they have lured into the country.

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