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BRIEFING: ITALY

IN-DEPTH ANALYSIS ICSID ARBITRATION AWARD: *EISER INFRASTRUCTURE LTD V. KINGDOM OF SPAIN*

MAY 2017

- IN-DEPTH ANALYSIS OF RECENT ICSID AWARD AGAINST SPAIN IN FAVOUR OF CONCENTRATED SOLAR POWER INVESTORS

This briefing provides an in-depth analysis of a recent ICSID award given against Spain in favour of concentrated solar power ("CSP") investors (see our previous briefing).

Introduction

Between 2007 and 2011, UK company Eiser Infrastructure Ltd and its Luxembourg-based affiliate Energía Solar Luxemburg S.à.r.l (the "Claimants") invested about €126m in three Spanish CSP plants. At the time, Royal Decree 661/2007 was in force. This decree had established a feed-in tariff ("FiT") for energy production through renewable energy installations, such as the CSP plants, as well as other incentives and benefits. However, this FiT regime was subsequently modified in two periods:

- 2012 to 2014: the FiT regime was changed to the detriment of the facilities. Measures included the introduction of a 7% tax on electricity production, the reduction of energy production using gas, the reduction of production hours with the right to receive the FiT, etc.

- Post-2014: under Royal Legislative Decree 9/2013, the FiT regime was completely overhauled (Royal Decree 661/2007 was revoked) and a new system was approved. This new system established a retribution regime complementing the energy sold in the market based on the retribution of the asset (taking into

consideration a CAPEX and OPEX "model"), not the production of energy. This retribution is based on obtaining a "reasonable profitability" margin referred to a 10-year bond plus 3%. This was a completely new regime, different to any other renewable energy retribution regime, and had not been tested before. It applies to existing facilities, including the CSP plants in which Eiser had invested.

The Claimants decided to sue Spain and submit arbitration proceedings before the International Centre for Settlement of Investment Disputes ("ICSID").

"THE CLAIMANTS ARGUED THAT THE CHANGES THAT THE SPANISH GOVERNMENT HAD INTRODUCED BREACHED THE ECT."

The position of the parties

The Claimants argued that the changes that the Spanish Government (the "Defendant") had introduced breached the Energy Charter Treaty (the "ECT"). They argued the changes: (i) breached article 13 of the ECT, as they resulted in their investment being expropriated; (ii) denied them fair and equitable treatment, in breach of article 10(1) of the ECT; (iii) applied exorbitant measures to their investments; and (iv) did not comply with the obligations on which the Claimants had relied.

The Defendant argued that it had not breached articles 10(1) and 13 of the ECT, as it had not denied the Claimants fair and equitable treatment. It also argued that no expropriation had taken place since the Claimants: (i) had kept their stock ownership in the Spanish companies that own the solar plants, (ii) had received revenue from the sale of energy and subsidies; and (iii) were entitled to receive a "reasonable profitability" margin from their investment, which was guaranteed by the new system.

The Defendant also argued that, as a sovereign state, it was entitled to change its legislation, including the FiT regime, in order to protect public interest from issues such as tariff deficits.

Breach of the fair and equitable treatment standard

Despite the other infringements alleged by the Claimants, the ICSID Arbitral Tribunal decided to limit its decision to the alleged denial of fair and equitable treatment, as it considered that this claim provided the most adequate legal context for analysing the case.

"THE MAIN QUESTION HERE WAS TO WHAT EXTENT THE PROTECTIONS AFFORDED BY THE ECT COULD BE INVOKED AND GIVE RISE TO COMPENSATION."

According to the Arbitral Tribunal, the main question here was to what extent the protections afforded by the ECT (more specifically, the obligation to provide investors with a fair and equitable treatment) could be invoked and give rise to compensation following a State exercising its right to regulate a specific sector (the renewable sector in this case).

The Arbitral Tribunal determined that, unless the State had entered into a strict commitment with the investors not to change the previous regulatory regime, the fair and equitable treatment standard does not grant investors an absolute and unbreakable right of regulatory stability. However, the fact that an existing legal framework can be modified should not lead to "unreasonable" changes being implemented, as the one the Spanish Government implemented in 2014.

The fair and equitable treatment standard therefore provides that when States modify their regulatory regime, they should not implement "fundamental" changes that do

not take into account the circumstances of the investments made on the basis of the previous regulatory regime.

Here, the evidence showed that the Defendant had revoked the regulatory regime established by Royal Decree 661/2007 and replaced it with a different and unprecedented new system, based on different assumptions, with the purpose of reducing the incentive regime.

Legal grounds of the decision

According to *Charanne BV. v. España*, an investor can rely on the legitimate expectation that regulatory changes to an existing regulation cannot be "unreasonable" or "disproportionate". A regulatory change shall be considered proportionate as long as: (i) it is not capricious or unnecessary; and (ii) it does not eliminate, in an unforeseeable and sudden way, the main elements of the existing regulatory framework.

The ECT's function is to provide a legal framework that promotes long-term co-operation between a State and investors and should therefore be interpreted accordingly. Consequently, the Arbitral Tribunal said that the obligation to provide a fair and equitable treatment entails the obligation to provide stability in the key aspects of the legal and economic regime on which the investors had relied when undertaking their investments.

The Arbitral Tribunal concluded that, by virtue of article 10(1) of the ECT, the investors had been entitled to expect that the Defendant would not change the legal regime on which they relied in a drastic and abrupt manner, disproportionately affecting the value of their investment.

Application to *Eiser*

The Arbitral Tribunal concluded that the changes introduced after 2014 resulted in the complete substitution of the FiT regime established by Royal Decree 661/2007. The new system created by Royal Legislative Decree 9/2013 was based on assumptions that were very different from the ones used in the FiT regime and used a new regulatory approach whose main purpose was to significantly reduce the benefits and incentives granted to existing facilities. Consequently, the Arbitral Tribunal concluded that the regulatory changes that the Defendant made after 2014 reformed the regulatory regime drastically.

The Arbitral Tribunal concluded that the post-2014 regulatory changes had infringed the fair and equitable treatment standard established in article 10(1) of the ECT as they were drastic changes and had led to a loss of value of the Claimants' investment.

The Defendant had relied on the Spanish Supreme Court decision confirming the legality of the 2014 reform. However, the Arbitral Tribunal concluded that the decision on the constitutionality of the regulation under the Spanish Constitution and the decision on the compliance with the ECT were different and that one did not prejudge the other.

Finally, the Arbitral Tribunal also concluded (in line with *Charanne*) that the regulatory changes carried out between 2012 and 2014 did not infringe article 10(1) of the ECT.

"THE COURT RULED THAT THE CLAIMANTS WERE ENTITLED TO COMPENSATION FOR THE ECONOMIC LOSS THEY HAVE SUFFERED AS A RESULT OF THE INFRINGEMENT OF DEFENDANT'S OBLIGATION TO PROVIDE THEM WITH FAIR AND EQUITABLE TREATMENT."

Damages

The Arbitral Tribunal ruled that the Claimants were entitled to compensation for the economic loss they have suffered as a result of the infringement of Defendant's obligation to provide them with fair and equitable treatment. This compensation must fully repair the damage caused by the said infringement.

As per the Claimants' request, the Arbitral Tribunal established that the restitution of the regulatory regime established by Royal Decree 661/2007 did not constitute adequate compensation, as the Arbitral Tribunal had not questioned Spain's right to take the regulatory measures in question for the benefit of the public interest.

The Arbitral Tribunal determined that damages should be awarded based on the reduction of the fair market value of the investment, which must be determined by calculating the current value of the past and present cash flows that had allegedly been lost.

In accordance with the expert evidence provided, the Defendant has been ordered to pay an amount equal to €128m in final damages.

Further, the Arbitral Tribunal awarded the Defendant 2.07% as a monthly interest rate for the period between 20 June 2014 to the date of the ICSID award (as that was the Spanish monthly rate used for loans during the relevant period) and 2.50% as a monthly interest rate for the period between the date of the ICSID award to the date of payment. Finally, the Arbitral Tribunal decided that each party should bear its own costs.

Other cases

This ICSID award could be relevant to other similar Spanish arbitrations as well as Italian arbitrations challenging the so-called *Spalma-Incentivi* decree. In 2014, this decree of the Italian State imposed a unilateral reduction to the FiT for the Italian photovoltaic sector and resulted in several similar arbitrations being brought for violation of the fair and equitable treatment standard under the ECT.

FOR MORE INFORMATION

Should you like to discuss any of the matters raised in this Briefing, please speak with one of the authors below or your regular contact at Watson Farley & Williams.

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