

PUBLIC POLICY CONFLICTS IN INVESTOR-STATE ENERGY ARBITRATIONS

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Changing energy policy and a growing demand for environmental protection create public policy conflicts for states. There is a fundamental tension between the host state's right to regulate and an investor's expectation of a stable regulatory environment. New domestic laws for environmental protection may conflict with treaty obligations to protect pre-existing investments of foreign investors. A host state's obligation to protect investments through existing international treaties may conflict with international obligations under new multilateral agreements. This article discusses the resulting constraints on the state's ability to manoeuvre in the realm of energy policy in light of states' international and domestic obligations.

Legitimate expectations and right to regulate

The conflict between a state's flexibility in respect of **energy policy** and legitimate expectations of the investors is illustrated by the line of cases concerning Spain's reform of its renewable **energy** incentives.

In 2007, the Spanish government offered a subsidised feed-in tariff (FIT) to stimulate solar PV investments. When Spain then faced a budget deficit, it reduced the subsidies. Aggrieved investors commenced over 50 **arbitrations** against Spain, basing their claim on the fair and equitable treatment (FET) obligation contained in the **Energy** Charter Treaty (ECT).

Under article 10(1) of the ECT, states are to refrain from taking "arbitrary or discriminatory measures" or from "frustrating the investor's reasonable expectations with respect to the legal framework adversely affecting its investment". Investors argued that they relied on representations by Spain when investing in renewable **energy** and legislative change deprived them of the benefits they expected to receive.

Tribunals consider the reasonableness of the investors' expectations based on the circumstances of each case, such as whether specific commitments were made and whether there was due diligence by the investors to ascertain the regulatory



conditions surrounding the investment. Where there are no "specific commitments" by the state, tribunals are less likely to find legislative change breaches the ECT.

In *Novenergia v Spain*, the tribunal agreed that the subsidies offered by Spain were "bait" which led the investor to believe that there would be no radical change in the regulatory regime. Various remuneration models in the subsidies (specifically Renewable **Energy** Plan 2005-2010 and RD 61/2007) had stated how returns of seven percent after taxes would be calculated. These remuneration models strengthened investor expectations of a stable subsidy scheme. Despite Spain's arguments that some changes were foreseeable, the tribunal found that Spain had violated the investors' legitimate expectations and violated its obligations under the ECT.

In contrast, in *Eurus Energy Holdings Corporation v Kingdom of Spain*, the tribunal noted that Spain had not made any specific commitments "as to the immutability of the FIT regime" and confirmed that oral statements on "promotional occasions" were insufficient to constitute a "specific commitment".

The majority of the tribunal also found that legitimate expectations related to "circumstances in existence at the time the investment [was] made". As most of Eurus' investments predated the FIT, Eurus's claim failed.

However, arbitrator Oscar Garibaldi disagreed, preferring a holistic view of the changing circumstances and the investor's conduct in response. If the investor had demonstrated acquiescence in the new regime even after his investment, it could create legitimate expectations. The dissent demonstrates that, even if the representations were made after the investment was made, the doctrine of legitimate expectations may nonetheless apply as the investor may rely on the new regime in keeping its business operations. This view would constitute another fetter on the states' ability to change course on **energy** policy.

Environmental regulations may clash with investors' rights

Environmental regulations adopted by states can conflict with investors' right to property or to a minimum standard of treatment. For instance, the United States has revoked permits in respect of a controversial pipeline project by a Canadian corporation due to its environmental impact. The investor has brought a legacy claim under chapter 11 of the North American Free Trade Agreement (NAFTA), as the investor was aggrieved by the "regulatory rollercoaster" regarding its cross-border permit.



Conflicts between differing treaty obligations

States may have introduced new regulations to comply with other treaty obligations. In February 2021, the German **energy** group RWE(1) brought a claim against the Netherlands under the ECT, alleging that the state's plan to phase out coal production by 2030 would render its investment in the coal industry worthless without adequate compensation. The plan to phase out coal production was part of the Netherlands' effort to comply with commitments under the Paris Agreement.

The fact that the state has exercised regulatory powers for a **public** purpose may not constitute a defence for a treaty breach. In *Westwater Resources v Turkey*, the state revoked the investor's uranium mining licence and the investor brought a claim against Turkey for unlawful expropriation in breach of the Turkey-USA bilateral investment treaty (BIT). The tribunal accepted the valid **public** purpose in the revocation of permits, which was either to regularise permits in accordance with the law (per the respondent) or to assert government control over uranium supply (per the claimant). However, this did not exonerate the Turkish government from liability for unlawful indirect expropriation under the BIT.

In *SD Myers v Canada*, the Canadian government introduced an export ban on the transportation of plastic waste in light of its Basel Convention obligations. The US investor, whose company handled such waste by exporting them to the US for processing, succeeded in its claim against Canada under the NAFTA. The tribunal found evidence that Canada's **policy** was influenced by the desire to protect and promote the market share of enterprises carrying out the waste processing in Canada which were owned by Canadian nationals. The tribunal, therefore, found that Canada had breached the national treatment obligation and the obligation of minimum standard of treatment.

States taking regulatory actions to comply with international obligations may, therefore, still find themselves in breach of other treaty obligations if the measure in question discriminates against foreign investors.

Comment

Arbitrations are likely to remain the preferred forum for foreign investors to resolve their disputes with states, as stated in the report on the future of international **energy** arbitration by Queen Mary University of London (January 2023). As states struggle to match their **energy** policies to the pace of climate change and technological development, conflicting international obligation may see an increase in energy-related **investor-state arbitrations** in the near future.

