

# EU Treaty Proposal Constricts Rights Of Energy Investors



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The Energy Charter Treaty is one of the most frequently invoked international instruments in international investment treaty disputes. Under the ECT, qualifying investors can bring claims against host governments for harm those governments cause to their foreign investments in the energy sector.

The European Union recently has proposed modernizing the ECT's investment chapter, which, if adopted, will significantly reduce its scope, and make investor claims far more difficult.

Entities that have already been harmed through measures imposed by any of the 53 signatory and contracting parties to the ECT should take heed of these proposed amendments, and should consider bringing their claims before such reforms to the ECT are adopted. The investor rights available under the existing ECT are likely to be significantly broader than those which will likely exist under the renegotiated and modernized ECT.

## Rights Available Under the ECT

Negotiated in the early 1990s to promote open and competitive energy markets, the ECT has been one of the most frequently invoked international treaties in recent decades in investor-state disputes.

Over the years, the application of the ECT has expanded significantly. Currently, there are 53 signatories and contracting parties to the ECT, including all European Union member states (apart from Italy, which notified its intention to withdraw from the ECT on Dec. 31, 2014), the European Union itself, all current and former member and observer states of the Commonwealth of Independent States, and further countries including the United Kingdom, Japan, Turkey, Iceland and Switzerland.

Under the ECT, investors in the energy sector benefit from a number of protections — ranging from the right not to be discriminated against to the right to receive fair and equitable treatment by the host state government. To the extent that investors' rights under the ECT are breached, the ECT provides for the right to bring arbitration claims

against a host state, and for such arbitral tribunals to award full compensatory damages for losses suffered by those investor claimants.

There have been a number of claims against host states to date pursuant to the ECT. For example, investors have filed claims against foreign governments as a result of the repeal or reduction of lucrative feed-in tariffs that were promised to investors who invested in the renewable energy sector.

Those claims have been brought primarily against Spain, together with a smaller number of claims having been brought against Italy, the Czech Republic and Bulgaria. While each case is specific on its facts, and the outcomes have been varied, there has been a general trend of success and significant damages awards for claimants, as demonstrated by the table below.

## Table 1: Representative List of Publicly-Known ECT Arbitrations and Outcomes

CASE NAME	OUTCOME
<i>Eiser Infrastructure Ltd. and Anor v. Spain</i> , ICSID Case No. ARB/13/36	Claimants successful. Claimants awarded €128 million. Each party shall bear its legal costs and expenses.
<i>Novenergia v. Spain</i> , SCC Case No. 2015/063	Claimant successful. Claimant awarded €53.3 million damages and €2.6 million in legal and arbitration costs.
<i>Masdar Solar and Anor v. Spain</i> , ICSID Case No. ARB/14/1	Claimants successful. Claimants awarded €64.5 million. Each party shall bear its own legal costs and expenses.
<i>Antin Infrastructure Services Luxembourg SÁRL and Anor v. Spain</i> , ICSID Case No. ARB/13/31	Claimants successful. Claimants awarded €112 million damages and 60% of claimant's legal costs.
<i>Greentech Energy Systems and Anor v. Italy</i> , SCC Case No. 095/2015	Claimants successful. Claimants awarded €11.9 million damages, €478,000 of claimants' arbitration costs and €1,408,268 of claimants' legal costs.
<i>CEF Energia BV v. Italian Republic</i> , SCC Case No. 158/2015	Claimant successful. Claimant awarded €9.6 million, €589,276 of claimant's arbitration costs and €900,000 of claimant's legal costs.

CASE NAME	OUTCOME
<i>Cube Energy SCA and Ors v. Spain</i> , ICSID Case No. ARB/15/20	Claimants successful. Claimants awarded €2.89 million, 50% of claimants' legal costs and 50% of claimants' arbitration costs.
<i>9REN Holding SÁRL v. Spain</i> , ICSID Case No. ARB/15/15	Claimant successful. Claimant awarded €41.76 million damages and 80% of claimant's legal costs.
<i>NextEra Energy Global Holdings BV and Anor v. Spain</i> , ICSID Case No. ARB/14/11	Claimants successful. Claimants awarded €290.6 million damages, one-third of claimants' legal costs and two-thirds of claimants' arbitration costs.
<i>SolEs Badajoz GmbH v. Spain</i> , ICSID Case No. ARB/15/38	Claimant successful. Claimant awarded €40.98 million damages and \$357,006.075 in claimant's arbitration costs. Each party to bear their own legal costs and expenses.
<i>Foresight Luxembourg Solar 1 SÁRL and Ors v. Spain</i> , SCC Case No. 2015/150	Claims partially successful. Claimants awarded €39 million and €3.9 million of respondent's arbitration costs.
<i>Stadtwerke München GmbH, AS 3 Beteiligungs GmbH and Ors v. Spain</i> , ICSID Case No. ARB/15/1	Claimants partially successful. Respondent failed to provide claimants with stable, equitable, favorable and transparent investment conditions. Claimants' remaining claims rejected. Claimants ordered to pay 83.33% of respondent's legal costs and 83.33% of respondent's arbitration costs.
<i>RREEF Infrastructure GP Ltd. and Anor v. Spain</i> , ICSID Case No. ARB/13/30	Claimants partially successful. Respondent failed to insure a reasonable return on claimants' investments, and in breach of its ECT obligations for the retroactive application of the new regime. Claimants' remaining claims rejected. Claimants awarded €59.6 million damages. Each party shall bear their own legal costs and expenses.

CASE NAME	OUTCOME
<i>AES Solar Ampere Equity Fund and Ors v. Spain</i> , UNCITRAL 2012-14	Claimants partially successful. Respondent breached Article 10(1). Claimants' remaining claims rejected. Each party to bear their own legal costs and expenses and parties to bear the arbitration costs in equal shares.
<i>Blusun SA and Ors v. Italy</i> , ICSID Case No. ARB/14/3	Claims dismissed. Claimants awarded \$29,410.69 of claimants' arbitration costs.
<i>Antaris Solar GmbH and Anor v. Czech Republic</i> , PCA Case No. 2014-01	Claims dismissed. Claimants ordered to pay \$1.75 million. Each party shall bear arbitration costs in equal shares.
<i>Voltaic Network GmbH v. Czech Republic</i> , PCA Case No. 2014-20  <i>ICW Europe Investments Limited v. Czech Republic</i> , PCA Case No. 2014-22  <i>Photovoltaik Knopf Betriebs-GmbH v. Czech Republic</i> , PCA Case No. 2014-21  <i>WA Investments-Europa Nova Limited v. Czech Republic</i> , PCA Case No. 2014-19	Claims dismissed. Respondent awarded €49,180.98. Each party to bear its own legal costs and expenses, and respondent to bear 25% and claimants to bear 75% of arbitration costs.
<i>Belenergia SA v. Italy</i> , ICSID Case No. ARB/15/40	Claims dismissed. Each party to bear their own legal costs and expenses. Each party to bear the arbitration costs in equal shares.
<i>EVN AG v. Bulgaria</i> , ICSID Case No. ARB/13/17	Claims reportedly dismissed and decision in favor of the state.

## Reforms to the ECT and the Draft EU Proposal of March 2020

In November 2017, in light of a number of geopolitical developments, together with a perception by some stakeholders that the existing system too heavily favors investors, the Energy Charter Conference, the governing and decision-making body for the ECT process, launched a discussion on modernizing the ECT.

That modernization process is to include updating, clarifying and modernizing Part III of the ECT, which part sets out investor protections and the rights of investors to bring claims against host states.[1]

The modernization and updating process has gone through several phases since then. One of the most recent developments has been the publishing by the European Union, on March 2, of the draft EU proposal for amending the ECT.[2]

The draft EU proposal is reported to be undergoing finalization before submission to the ECT secretariat, at which point it would be put forward to the ECT contracting parties for further negotiation among ECC members, and eventual ratification, acceptance or approval pursuant to Article 42 of the ECT.

The draft EU proposal is important because the EU represents a significant proportion of the ECT contracting states, and so can likely already count on support for the draft EU proposal from at least 26 of the 49 ECT contracting parties. Any amendment to the ECT pursuant to Article 42 requires the support of 75% of the ECT contracting parties — meaning that the EU will be well on its way to that level of support for its proposed amendments.

Set out below is a summary of the changes in the draft EU proposal.

## *Stricter Definitions of Qualifying Investments and Investors*

Only investors with qualifying investments can bring claims under the ECT. The draft EU proposal sets out additional language to the existing definition of qualifying investments, which clarifies that investments must have “the characteristics of an investment, including such characteristics as a certain duration, the commitment of capital or other resources, the assumption of risk, or the expectation of gain or profit.”[3]

While this generally reflects the trend in existing cases (including in particular the so-called Salini test, formulated by the tribunal in *Salini v. Morocco* to characterize what constitutes a foreign investment[4]), the net effect is that arbitral tribunals may feel emboldened to apply those criteria more stringently against investor claimants and their alleged investments. The result may be that a higher number of transient or short-term investments, or investments at very early stages, might not qualify for protection.

The draft EU proposal also adds that investments must be “made in accordance with the applicable law.”[5] Clauses requiring compliance with the host state’s laws concern the legality of the investment, i.e., whether an investment made or conducted illegally is entitled to investment protections.

Once again, this revision reflects the general trend in the approach by arbitral tribunals which have read such a requirement to be implicit.[6] However, as the requirement is now explicit, this may cause arbitral tribunals to more thoroughly explore this requirement — and perhaps reject more claims, on the basis that investments were not made in accordance with the applicable law.

The draft EU proposal also seeks to limit the ability of holding companies within a given jurisdiction to qualify as investors. The proposal by the EU is that a corporate investor must also be “engaged in substantive business activities” in the state whose nationality it claims.[7]

The EU defines substantial business activities according to Article 54 of the Treaty on the Functioning of the European Union,[8] which provides that companies must be “formed in accordance with the law of a Member State and having their registered office, central administration, or principal place of business within the Union.”

As amended, this more restrictive definition of investor would require corporate foreign investors to establish that their business activity in the state of incorporation is of substance and not merely of form,[9] by showing, for example, that they maintain offices in the country, have employees and executives of that nationality, and hold business meetings in the state.[10]

## *Substantial Fortification of Host States’ Right to Regulate*

The EU proposes adding a new article on regulatory measures to the ECT's investment chapter, to reaffirm states' right to regulate in order to achieve legitimate policy objectives, including public health, social services, public education, safety, the environment (including climate change), public morals, social or consumer protection, privacy and data protection, or the promotion and protection of cultural diversity.

To this end, the proposed addition clarifies "[f]or greater certainty" that states are permitted to "change the legal and regulatory framework, including in a manner that may negatively affect the operation of investments or the investor's expectations of profits."<sup>[11]</sup> Additionally, states' decisions against issuing, renewing or maintaining a subsidy, absent specific legal or contractual commitment to the contrary, shall not constitute a breach of the ECT.<sup>[12]</sup>

It is likely that these proposed amendments are a direct response to the numerous ECT-based investment arbitrations against EU member states arising from changes to those states' regulations, including Spain, Italy, Bulgaria and the Czech Republic, related to the reduction of government subsidies for renewable sector projects; claims based on anti-nuclear policies (e.g., *Vattenfall v. Germany* and *Aura Energy v. Sweden*<sup>[13]</sup>); and even a threatened claim based on climate change policies (e.g., *Uniper v. Netherlands*).

The draft EU proposal furthermore seeks to strengthen the EU's power to regulate and govern its member states. The EU proposes adding that the ECT shall not be construed to prevent states from discontinuing or seeking reimbursements of subsidies (defined to include state aid) where necessary for the state to comply with directives of a regional economic integration organization or competent authority (defined to include the European Commission).<sup>[14]</sup>

Again, this proposal likely is in direct response to claims against EU member states for revoking foreign investment incentives because they constituted illegal state aid under EU law.<sup>[15]</sup>

## *More Clearly and Narrowly Defined Substantive Protections*

The EU's proposed amendments to the following three substantive standards of investment protections are notable. First, the draft EU proposal rewrites the ECT's provision on fair and equitable treatment, or FET.

The proposal removes the more general wording regarding the creation of "stable, equitable, favorable and transparent conditions" for investors, in favor of a narrower and enumerated definition, which recognizes denial of justice, denial of due process, manifest arbitrariness, targeted discrimination and abusive treatment (harassment, duress, coercion) as constituting a violation of the FET standard.<sup>[16]</sup>

Notably, this enumerated list excludes legitimate expectation as an independent basis for assessing whether a state is in breach of its FET obligation. Instead, the EU seeks to limit legitimate expectations to only those situations where a specific representation was made by the host state to the investor.<sup>[17]</sup>

Second, the proposal limits the application of the most favored nation, or MFN, clause, and excludes its application to procedural concerns. In the two decades since the landmark *Maffezini v. Spain* decision on MFN,<sup>[18]</sup> investors have sought to invoke MFN provisions of one treaty to use more favorable dispute settlement procedures of another investment instrument.

The EU forecloses this possibility by amending the ECT's MFN provision, and clarifying that it "does not include dispute settlement procedures provided for in other international agreements."<sup>[19]</sup>

Third, the draft EU proposal clarifies that expropriation under the ECT may be either direct or indirect — which reflects how ECT tribunals have already interpreted the current expropriation standard.<sup>[20]</sup> The proposal also provides the criteria for an indirect expropriation, though notably this codifies the existing legal standard.<sup>[21]</sup>

Furthermore, the EU proposes setting a high bar to establish creeping expropriation in violation of the ECT, i.e., only in a "rare circumstance when the impact of a measure or series of measures is so severe in light of its purpose that it appears manifestly excessive."<sup>[22]</sup>

These proposed amendments to the ECT's substantive protections reflect the growing trend among states to incorporate bright-line standards to interpret substantive protections in investment treaties. Generally, such amendments have the effect of fundamentally shifting the standards of investment protection, so as to allow host states more flexibility in developing and implementing the state's policies and regulations.

## *Changes to the Investor-State Dispute Process*

The draft EU proposal notably leaves the ECT's investor-state dispute settlement provision in Article 26 intact, with no proposed amendments for now. The EU has previously criticized the ECT's dispute settlement mechanism, and continues to argue that it does not apply to intra-EU disputes, i.e., between an EU investor in relation to its foreign investment in another EU country.

This absence might be explained by the fact that the EU previously announced that it will seek to apply its proposed Multilateral Investment Court — a permanent body to adjudicate investment law disputes — to any investor-state arbitration mechanism under the ECT.[23]

The proposal does address four concerns that fundamentally alter the ISDS mechanism.

First, the EU proposes adding a new frivolous claims procedure, pursuant to which a respondent state may “file an objection that a claim is manifestly without legal merit” in an expedited procedure.[24]

This procedure would be subject to a mandatory bifurcation. Costs of the proceedings would be borne by the unsuccessful party to the dispute, while other costs, like legal costs, would be apportioned according to the parties' respective success.

This proposed provision is similar to ICSID Arbitration Rule 41(5). Interpreting this ICSID rule, the tribunal in *Eskosol v. Italy* found that the “manifest” standard requires a very high degree of clarity ... that the claims as presented cannot succeed as a matter of law,” and that this rule should not be used to address complicated, difficult or unsettled issues of law.[25]

Assuming arbitral tribunals adopt this approach in the interpretation of this proposed provision, then this provision would lead to a streamlined procedure in meritless or frivolous claims, but should not be automatically equated to a summary determination procedure by which core legal issues are determined at an early stage of the proceedings.

Second, the EU proposes enhancing the transparency of ECT arbitrations, and therefore, proposes incorporating the UNCITRAL transparency rules to any ECT investment arbitration.

This means that parties will have to make public, among other things: pleadings; witness statements with exhibits; expert reports with exhibits; requests for amicable settlement; challenges to arbitrators; written submissions of nondisputing third parties; hearing transcripts; and orders, decisions and awards of the tribunals. Any such disclosure would be subject to limited confidentiality rules.

Third, with respect to third-party intervention, the draft EU proposal adds that the tribunal “shall permit any natural or legal person which can establish a direct and present interest in the result of the dispute” to intervene.[26] Interveners — which do not include creditors of an investor — would have access to the record and the right to attend hearings, and may make written submissions.

This provision seemingly gives nonrespondent states (including parties and signatories to the ECT) broad authority to intervene in ECT-based arbitrations, so long as they can establish a direct and present interest in the outcome of the dispute. This may also lead to heightened intervention by interested nongovernmental organizations, charities and interest groups.

Finally, the EU's proposal requires disclosure of third-party funding. The proposal states that the disputing party benefiting from third-party funding must notify the other party and the tribunal the name and address of the funder, as well as its beneficial owner.

This rule would generally apply to the investor, as they usually benefit from third-party funding. However, states previously have benefited from third-party funding as well, so this rule may well apply to them too.

## Conclusion

In short, investors in the energy sector or those contemplating energy sector investments in any of the contracting states to the ECT should take note of these EU proposals, and the very real possibility of reform to the investor protections under the ECT.

This may inform, for example, how investments are structured through corporate holdings, and what specific assurances are obtained from the relevant host state authorities at the outset of the investment or project.

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[1] Approved Topics for Modernization of the ECT dated Nov. 29, 2018, <https://www.energycharter.org/media/news/article/approved-topics-for-the-modernisation-of-the-energy-charter-treaty/>.

[2] Working Document from European Commission to Trade Policy Committee (Services and Investment) re Energy Charter Treaty Modernisation: Draft EU proposal, dated March 2, 2020 (hereinafter “Draft EU Proposal”), [https://www.politico.eu/wp-content/uploads/2020/03/Proposal\\_Treaty.pdf?utm\\_source=POLITICO.EU&utm\\_campaign=75bec6754f-EMAIL\\_CAMPAIGN\\_2020\\_03\\_25\\_06\\_46&utm\\_medium=email&utm\\_term=0\\_10959edeb5-75bec6754f-189693589](https://www.politico.eu/wp-content/uploads/2020/03/Proposal_Treaty.pdf?utm_source=POLITICO.EU&utm_campaign=75bec6754f-EMAIL_CAMPAIGN_2020_03_25_06_46&utm_medium=email&utm_term=0_10959edeb5-75bec6754f-189693589).

[3] Draft EU Proposal, Art. 1(6).

[4] *Salini Costruttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco*, ICSID Case No. ARB/00/4, Decision on Jurisdiction dated July 23, 2001.

[5] Draft EU Proposal, Art. 1(6).

[6] See for example *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Award dated Aug. 27, 2008, ¶¶ 138-146 (interpreting the ECT). See also *Anderson v. Costa Rica*, ICSID Case No. ARB(AF)/07/3, Award, ¶ 53 (May 19, 2010) (concluding that the fact that the treaty contains such a clause “is a clear indication of the importance ... attached to the legality of investments made by investors of the other Party and their intention that their laws with respect to investments be strictly followed”).

[7] Draft EU Proposal, Art. 1(7)(a)(ii).

[8] Draft EU Proposal, Art. 1(7)(a)(ii), FN 2.

[9] See *Limited Liability Company Amto v. Ukraine*, SCC Arbitration No. 080/2005, Final Award dated March 26, 2008, at ¶ 69 (interpreting ECT, Article 17(1)).

[10] See *Masdar Solar & Wind Cooperatief U.A. v. Kingdom of Spain*, ICSID Case No. ARB/14/1, Award dated May 16, 2018 at ¶¶ 224-25, 253-54.

[11] Draft EU Proposal, Part III [New Article], Regulatory Measures, ¶ 2.

[12] Draft EU Proposal, Part III [New Article], Regulatory Measures, ¶ 3.

[13] *Vattenfall AB and others v. Federal Republic of Germany*, ICSID Case No. ARB/12/12. Aura Energy filed its notice of dispute in November 2019; it is not known whether it has commenced arbitration against Sweden.

[14] Draft EU Proposal, Part III [New Article], Regulatory Measures, ¶ 4 and Understanding.

[15] In particular, in the high-profile *Micula* case, *Ioan Micula, Viorel Micula and others v. Romania*, ICSID Case No. ARB/05/20.



[16] Draft EU Proposal, Art. 10(1)(i).

[17] Draft EU Proposal, Art. 10(1)(ii).

[18] Emilio Agustin Maffezini v. Kingdom of Spain, ICSID Case No. ARB 97/7 (Decision of the Tribunal on Objections to Jurisdiction dated Jan. 25, 2000).

[19] Draft EU Proposal, Art. 10(7)(i).

[20] Hulley Enterprises Limited (Cyprus) v. The Russian Federation, UNCITRAL, PCA Case No. AA 226, Final Award dated July 18, 2014, at ¶ 1580.

[21] Charanne and Construction Investments v. Spain, SCC Case No. V 062/2012, Award dated Jan. 21, 2016, at ¶ 461 (unofficial tr.); Electrabel S.A. v. Republic of Hungary, ICSID Case No. ARB/07/19, Decision on Jurisdiction, Applicable Law and Liability dated Nov. 30, 2012, at ¶ 6.53.

[22] Draft EU Proposal, Art. 13, Annex X (Expropriation).

[23] Energy Charter Secretariat, Decision of the Energy Charter Conference re “Adoption by Correspondence — Policy Options for Modernisation of the ECT,” dated Oct. 6, 2019, <https://www.energycharter.org/fileadmin/DocumentsMedia/CCDECS/2019/CCDEC201908.pdf>.

[24] Draft EU Proposal, Part V [New Article: Frivolous Claims].

## Related Capabilities

[25] Eskosol S.p.A. in liquidazione v. Italian Republic, ICSID Case No. ARB/15/50, Decision on Respondent’s Application Under Rule 41(5), dated March 20, 2017, at ¶¶ 34-41.

[26] Draft EU Proposal, Part V [New Article: Intervention by Third Parties].

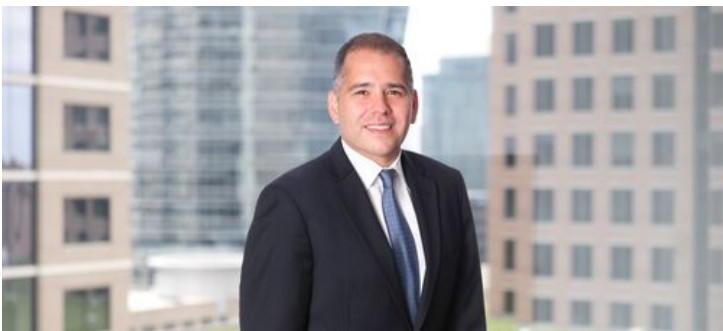
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