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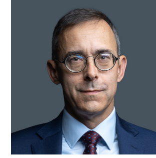
Insight

When worlds collide – how repealing renewables incentives could infringe investment protection treaties and lead to arbitration

Authors



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In the wake of E.ON's substantial damages award against Spain, we look at the pitfalls facing both States and investors when policies are changed.

On 18 January 2024, an arbitral tribunal (under the aegis of the International Centre for Settlement of Investment Disputes (ICSID)) issued an award against Spain to the German energy group E.ON in a case involving Spain's renewable energy subsidy reforms. E.ON's counsel referred to the award as "one of the largest awards against Spain," stating that its client secured "95 per cent of the damages requested".

E.ON considered that Spain had unlawfully withdrawn certain investment incentives – and the tribunal found Spain in breach of the fair and equitable treatment standard under the Energy Charter Treaty (ECT).[1]

This blog looks at how E.ON successfully claimed damages as a result of Spain's policy changes and what both investors and States should consider to avoid potential disputes.

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1. Investment incentives and protection in the major economies

Governments around the world have introduced investment incentives to encourage investment in renewable energy. While such incentives attract foreign investments, policies may (and invariably will) change over time, with incentives being lifted in the wake of such adjustments.

1.1 Incentives for renewable energy investments

- **United States (US):** The Inflation Reduction Act of 2022 aims to stimulate the transition to a clean energy economy by offering incentives that reduce the cost of renewable energy through tax credits.[2]
- **European Union (EU):** The European Green Deal is the EU's flagship initiative, steering the region towards climate neutrality by 2050. Unlike the Inflation Reduction Act, the European Green Deal relies more on non-tax incentives, providing grants and loans to companies committed to innovation, industrialisation and decarbonisation.[3]
- **China:** China has implemented measures such as feed-in tariffs, subsidies and tax incentives to encourage the development of renewable energy projects.[4]
- **Switzerland**: In June 2023, the Swiss voters approved climate change legislation favouring significant investment in renewable energies, energy efficiency and climate protection, and allocates a total of 3.2 billion Swiss

francs to incentivise such investments.[5]

However, States can (and must) adapt policies in the event of a change in circumstances, and governments have broad discretionary powers to do so. Since the alignment of such incentives is an expression of State prerogative, these are not per se illegitimate – but international investment protection treaties might place limits on adjustments. States should therefore take advice to ensure that any adjustments are in line with existing obligations to investors in order to avoid investor claims if such limits are ignored.

Renewable energy investments generally thrive on stable policy frameworks. Faced with unwelcome policy changes or the withdrawal of investment incentives, prudent investors will investigate the investment protection treaties available to them.

1.2 Investment treaty protection for investors

Investors can counter political changes and the resulting withdrawal of investment incentives by relying on solid international investment protection found in international law.

- **United States:** There are currently 89 US-bilateral investment treaties (BITs) or treaties with investment provisions (TIPs) in force. Not all of them grant access to Investor-State Dispute Settlement (ISDS), but those that do include the US BITs with Poland, Slovakia, Croatia, Bulgaria, Romania and the Czech Republic.[6]
- **European Union:** The EU currently has 61 BITs or TIPs in force, but is seeing a shift towards centralisation in investment protection, with a reduction in BITs concluded by EU Member States themselves. Investors in the EU should therefore get access to an investment protection agreement between the EU itself and their home country – such as the Comprehensive Economic and Trade Agreement (CETA) between Canada and the EU.[7]
- **China:** China has a comprehensive protective network, with 131 BITs or TIPs, some of which also include provisions safeguarding legitimate expectations and ISDS (see e.g., the Canada-China BIT).[8]

Investors should not be misled by the sheer number of treaties, but should ensure that effective protection is available for each investment. Not all treaties provide the same level of substantive protection or access to independent arbitration (ISDS).

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2. Potential consequences of investment incentive repeals: lessons from Spain and Italy

The experiences of Spain and Italy illustrate the significant financial and legal consequences of policy reversals after investment incentives have been promised – and show how an arbitral tribunal is likely to assess a dispute over the withdrawal of incentives and which provisions of investment treaties are essential.

2.1 Spain’s complex trajectory

In the early 2000s, Spain attracted global investments through incentive frameworks, culminating in a 2007 decree that guaranteed specific feed-in tariffs for renewable energy projects. However, from 2010[9] it modified and eventually repealed these frameworks – resulting in over 50 arbitration cases and claims around EUR 8bn. Tribunals found Spain liable for breaching its investment treaties (E.ON being the most recent example).

In deciding these cases, tribunals have (among other factors[10]) generally investigated:

- the specific terms of the framework and how public authorities promoted it;
- the level of due diligence investors carried out on the Spanish legal framework;
- whether the authorities made any specific promises to investors (e.g., through a communication addressed to that investor, or through other administrative documents such as registration certificates confirming the incentive that they would receive); and
- the scope of the changes and the process followed in making them (e.g., was it transparent or discussed with the industry sector in advance; were the changes "radical").

2.2 Italy's parallel journey

Italy's experience is similar. It introduced attractive incentives for renewable energy investments in the early 2000s (particularly for photovoltaics) but then adopted a decree in 2013 reducing the level and duration of incentives for existing plants. This triggered arbitration proceedings under the ECT, resulting in around 12 arbitration cases and damages to investors.[11]

2.3 Other States

Spain and Italy are not alone; Germany, Canada, the Czech Republic, Romania, Bulgaria and Latvia have all faced claims due to modifications in their incentives frameworks.[12]

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3. Restructuring investments to gain legal protection

What can investors do to anticipate possible adverse policy changes and what can States do to avoid claims brought by disgruntled investors?

3.1 States

States can ensure that policy changes are in line with the applicable bi- and multinational investment protection treaties. Such treaties generally provide for the right of investors to fair and equitable treatment (FET) and protection against expropriation.

3.2 Investors

- **Proactive restructuring:** in general, restructuring has to occur *before* disputes are foreseeable.[13] Ideally, when planning the investment, consideration should also be given to how the investment can be structured to obtain treaty protection.
- **Networks of investment protection treaties:** Investors with foreign investments can explore restructuring through any other state that has a treaty in place with the host state of the investment. Such restructuring grants access to the third state's treaty network, providing an additional layer of security for investments through investment treaty protection.[14]

Experience shows that securing investments through investment protection agreements can effectively ensure the profitability of foreign investments. Analysing the host State's treaty network and any possibilities for restructuring the investment to gain access to treaty protection will be time well spent.

The E.ON case highlights the importance of:

- investors' awareness of potential risks;

- proactive engagement with the host state's legal framework; and
- precautionary structuring of a company's investments to ensure effective legal protection.

The case also signals to States that policy changes must be in line with commitments undertaken in international investment protection agreements.

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[12] See e.g., *Strabag and others v. Germany* (ICSID Case No. ARB/19/29); *Mesa Power Group LLC v Government of Canada* (PCA Case No. 2012-17); *Antaris Solar GmbH and Dr. Michael Göde v. The Czech Republic* (PCA Case No. 2014-01); *LSG Building Solutions GmbH and others v. Romania* (ICSID Case No. ARB/18/19); *Astronergy Solar Netherlands v. Republic of Bulgaria* (ICSID Case No. ARB/22/32); *RSE Holdings AG v. Republic of Latvia (II)* (PCA Case No. 2022-41).

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