The assessment of the FET standard between legitimate expectations and economic impact in the Italian solar energy investment case law

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1. *Introduction*

International investment law has always been concerned with the need of balancing the State's power to regulate in the public interest, on the one hand, and the need to grant certain standards of protection to the foreign investors impacted by the State's measures, on the other hand.[1] The search for a balance between these conflicting needs also underlies the conception, interpretation and application of international investment agreements provisions, from indirect expropriation to the fair and equitable treatment (FET) standard.[2]

A recent article discussing the legitimate expectations under the Energy Charter Treaty (ECT) has once more expressed this recurring dilemma

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[1] RY Jennings, 'General Course on Principles of International Law' (1967) 121 Recueil des Cours de l'Académie de Droit International 323, 489.

[2] For example, the Commission's guidelines on the EU common international investment policy establish that EU's international investment agreements shall balance investment promotion and protection with the EU public interest and social considerations. See the EU Commission's Investment Portal <https://ec.europa.eu/trade/policy/accessing-markets/investment/>; D Zannoni, 'The Legitimate Expectation of Regulatory Stability under the Energy Charter Treaty' (2020) 33 Leiden J Intl L 451, 456; B Kingsbury, SW Schill, 'Public Law Concepts to Balance Investors' Rights with State Regulatory Actions in the Public Interest – the Concept of Proportionality', in SW Schill (ed), *International Investment Law and Comparative Public Law* (OUP 2010) 75-104; C Henckels, 'Indirect Expropriation and the Right to Regulate: Revisiting Proportionality Analysis and the Standard of Review in Investor-State Arbitration' (2012) 15 J Intl Economic L 223, 223-255; AS Sweet, 'Investor-State Arbitration: Proportionality's New Frontier' (2010) 4 L & Ethics Human Rights 47, 47-76; *Saluka Investments B.V v Czech Republic*, UNCITRAL (Partial Award 17 March 2006) para 300.

> '[t]he core issue [underlying the application of the FET standard afforded by the ECT] is clearly to strike a balance between foreign investors' reliance on the regulations that underpin their long-term investments and the host states' right to adapt regulations to new needs'.[3]

Similar wording can be found in the scholarly debate and case law concerning indirect expropriation.[4]

How to draw the line between the State's exercise of legitimate regulatory powers and a breach of the investment treaty standards is a very difficult task, to which arbitration tribunals have given different answers.[5]

In relation to the FET standard, it has been argued that 'to comply with the standard, the State must respect the investor's reasonable and legitimate expectations', thus the State cannot legitimately implement a new regulatory regime or modify the previous one, if by doing so it frustrates the investor's expectations.[6]

[3] D Zannoni (n 2) 452; A Titi, *The Right to Regulate in International Investment Law* (Nomos 2014) 276-277.

[4] *El Paso Energy Int'l Co. v Argentina*, ICSID Case No ARB 03/15 (Award 31 October 2011) ('*El Paso v Argentina*') para 234.

[5] *Saluka v Czech Republic* (n 2) para 255; *Tecnicas Medioambientales Tecmed S.A. v United Mexican States,* ICSID Case No ARB(AF) 00/2 (Award 29 May 2003) para 121, the Tribunal quotes an excerpt from the award in the case of *Compañía del Desarrollo de Santa Elena, S.A. v Republic of Costa Rica*, ICSID Case No ARB 96/1 (Award 17 February 2000).

[6] The standard of fair and equitable treatment is usually tied to the notion of legitimate expectations which is the dominant element of that standard. See, *Rumeli Telekom A.S. and Telsim Mobil Telekomunikasyon Hizmetleri A.S. v Republic of Kazakhstan*, ICSID Case No ARB 05/16 (Award 29 July 2008) para 609; *Tecnicas Medioambientales Tecmed S.A. v United Mexican States*, ICSID Case No ARB(AF) 00/2 (Award 29 May 2003) para 154; *Electrabel S.A. v Hungary*, ICSID Case No ARB 07/19 (Decision on Jurisdiction, Applicable Law and Liability 30 November 2012) ('*Electrabel v Hungary*') para 7.75; *RREEF Infrastructure (G.P.) Limited and RREEF Pan-European Infrastructure Two Lux S.a.r.l. v Kingdom of Spain*, ICSID Case No ARB 13/30 (Decision on Responsibility 30 November 2018) para 260; *El Paso v Argentina* (n 4) 348; *Saluka v Czech Republic* (n 2) 302. *Contra*, see *Suez, Sociedad General de Aguas de Barcelona, S.A. and Vivendi Universal, S.A. v Argentine Republic*, ICSID Case No ARB 03/19 (Separate Opinion of Arbitrator Pedro Nikken) para 3; M Potestà, 'Legitimate Expectations in Investment Treaty Law: Understanding the Roots and the Limits of a Controversial Concept' (2013) 28 ICSID Rev/FILJ 88, 90. In general, concerning the FET standard and the legitimate expectations, R Kläger, *Fair and Equitable Treatment in International Investment Law* (CUP 2011), 164-186; FM Palombino, *Fair and Equitable Treatment and the Fabric of General Principles* (Springer 2012) 85-119.

Whether the FET standard protects the investor's expectations, when these expectations arise and when they are frustrated, however, is still subject to discussion and often depends on the wording of the relevant investment treaty.[7]
As far as the ECT is concerned, Article 10(1) states that:

> '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 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 obligation it has entered into with an Investor or an Investment of an Investor of any other Contracting Party'.[8]

This article has been subject of significant analysis in the last few years, in the context of the so-called 'renewable energy saga', involving a number of European States including Spain and Italy.[9] The crux of the

[7] ANNEX to the Proposal for a Council Decision on the conclusion of the Investment Protection Agreement between the European Union and its Member States, of the one part, and the Socialist Republic of Viet Nam of the other part (17 October 2018) art 2.5(4); Agreement between Australia and the Oriental Republic of Uruguay on the Promotion and Protection of Investments (signed 5 April 2019, not in force) art 4(4). See also, Investment Agreement between the Government of Australia and the Government of the Hong Kong Special Administrative Region of the People's Republic of China (signed 26 March 2019, entered into force 17 January 2020) art 8 (4) Annex II (3) and note 42; Agreement between the Government of Hungary and the Government of the Republic of Cabo Verde for the Promotion and Reciprocal Protection of Investments (signed 23 March 2019, not in force) art 3(2); and the NAFTA Free Trade Commission, Notes of Interpretation of Certain Chapter 11 Provisions (31 July 2001) <www.international.gc.ca/ trade-agreements-accords-commerciaux/disp-diff/NAFTA-Interpr.aspx?lang=en&view=d>.

[8] The Energy Charter Treaty (signed December 1994, entered into force April 1998).

[9] I Reynoso, 'Spain's Renewable Energy Saga: Lessons for international investment law and sustainable development' (27 June 2019) Investment Treaty News <https://www.iisd.org/itn/2019/06/27/spains-renewable-energy-saga-lessons-for-international-investment-law-and-sustainable-development-isabella-reynoso/>. As to the Spanish case law, among the others: *Antin Infrastructure Services Luxembourg S.a.r.l. and Antin Energia Termosolar B.V v Kingdom*

matter in all these cases has been the interpretation and application of the FET standard contained in Article 10(1) of the ECT to protect the investor's legitimate expectations against the State's decision to modify the legal framework applicable to renewable energy investments.[10]

The present paper aims to discuss how Article 10(1) of the ECT has been interpreted and applied in the context of the Italian 'renewable energy saga' and how arbitrators have drawn the line between the State's regulatory power and the breach of the FET standard.

In doing so, the paper will, firstly, verify when the investor's legitimate expectations are deemed to arise and what difference, if any, exists between legitimate expectations arising out of general regulation and legitimate expectations emerging from specific commitments of the State; and secondly, when such legitimate expectations are frustrated in violation of Article 10(1) of the ECT. The paper will emphasise that the criteria employed by investment tribunals to answer these questions in the Italian scenario and in the Spanish case law are very similar and that arbitrators significantly cross-referred to each-others to sustain their respective positions.

The paper will also stress that, in assessing whether the legitimate expectations of the foreign investor are frustrated in violation of the FET standard, arbitrators tend to pay special attention to the effects produced by the measure upon the foreign investment.

of Spain, ICSID Case No ARB 13/31 (Award 15 June 2018); *Eiser Infrastructure Limited and Energia Solar Luxembourg S.a.r.l. v Kingdom of Spain*, ICSID Case No ARB 13/36 (Award 4 May 2017); *Charanne B.V and Construction Investments S.a.r.l. v Kingdom of Spain*, SCC Arb No 062/2012 (Award 21 January 2016) ('*Charanne v Spain*').

[10] Tribunals have constantly argued that the protection of the legitimate expectations of the foreign investor comes within the scope of application of art 10(1) ECT. See among the many, *Antaris Solar GmbH and Dr. Michael Göde v Czech Republic*, PCA Case No 2014-01 (Award 2 May 2018) ('*Antaris v Czech Republic*') para 360; *AES Summit Generation Limited and AES-Tisza Erömükft v The Republic of Hungary*, ICSID Case No ARB 07/22 (Award 23 September 2010) ('*AES Summit v Hungary*') paras 9.3.6-9.3.26; *Electrabel v Hungary* (n 6) 7.74.

2. *The Italian incentives framework, the regulatory changes and related case law*

2.1. *The incentives framework*

Legislative Decree 387/2003 implemented in Italy the EU Directive 2001/77/EC on the promotion of electricity from renewable energy sources in the EU internal electricity market. Pursuant to Article 7 of Legislative Decree 387/2003, Italy adopted an incentives framework for solar plants based on fixed remuneration rates, called feed in tariffs ('FITs'). The incentive framework also featured an 'off-take regime' whereby the GSE engaged to directly purchase the electricity from small renewable energy producers at a price above the average market price.
The incentive system was first implemented in 2005, through the so-called First Energy Account, and subsequently amended through the Second, Third, Fourth and Fifth Energy Accounts. Each Energy Account was anchored to a specific target (in terms of power or financial expenditure) and was designed to incentivize the production of energy until the attainment of the target. Once the target was achieved the Government would have proceeded to introduce a new Account with new targets.

Each investor receiving incentives under the Energy Accounts framework received confirmation of its right to a specific FIT with a letter from the National Energy Agency (GSE) and, afterward, entered into an agreement with the GSE. The letter usually expressly stated that the FIT would remain constant for a twenty-year period (the average esteemed life of the plant) starting from each plant's connection to the grid. The contract set forth the specific tariff incentive rate that the investor would have received and the specific dates comprising the twenty-year period during which the incentive would have been paid. The relevant contractual wording is substantively the same in all GSE contracts under the Energy Accounts.

2.2. *Regulatory changes*

Starting from 2011, some regulatory changes were implemented by the Italian Government that impacted on the incentive framework described above. These regulatory changes were mostly justified by legitimate public reasons, such as the need to reduce the costs related to green

energy incentives and the energy bill of final customers; but they also generated regulatory uncertainty and impacted on the rentability of a number of plants.

Legislative Decree No 28/2011 of 3 March 2011 (the '*Romani* Decree') modified the timeframe to apply the incentives provided under the Third Energy Account. After the entry into force of the Romani Decree, the FITs established by the Third Energy Account applied only to plants that entered into operation before 31 May 2011 and not, as originally established, to plants that entered into operation by 31 December 2013.[11]

Law Decree No 145/2013 of 23 December 2013 ('*Destinazione Italia* Law Decree') changed the 'off-take regime' limiting the possibility of certain photovoltaic facilities to benefit from the minimum guaranteed price. While, the so-called *Spalma-incentivi* Decree (Law Decree No 91/2014) modified the incentives framework, providing that producers would have a choice from among three options for the method of calculating new FITs that would apply to their photovoltaic facilities.[12] All the options led to a reduction of the amount of tariff originally granted to the investor.[13]

2.3. *The foreign investors' claims against Italy under the ECT*

Following the above regulatory changes, a number of claims were brought against Italy before international investment tribunals under the

[11] Law Decree No 1/2012 of 24 January 2012 also established that solar plants built on agricultural land and entering into operation after 20 March 2012 would be eligible for FITs only if they had a capacity of less than 1 MW and occupied less than 10% of the agricultural parcel on which they were erected. The original regulation set a 50% ratio.

[12] Art 26 of the Decree No 91 of 2014 (as modified by Law of Conversion 11 August 2014 No 116).

[13] Art 26 of the Decree No 91 of 2014 (as modified by Law of Conversion 11 August 2014 No 116) provided for three alternatives: a) the first alternative spreads the incentive over a longer period (24 years) and reduces its amount for the whole remaining period; b) the second alternative maintains the same period of incentive (20 years), but it reduces the amount of the incentive in the first period, to then increase it (of the same amount) in the remaining period; c) the third alternative maintains the same period of incentive (20 years), but it reduces its amount for the remaining years. In addition, to changing the FITs, the *Spalma-incentivi* Decree altered the way in which they were disbursed: from payment on the basis of the actual electricity produced monthly, made at the end of the second month; to payment based on the plant's estimated yearly average production of electricity, made in part (the estimate) monthly and in part (the balance) the following year.

ECT.[14] Decisions were rendered in five cases: *Blusun (*27 December 2016),[15] *Greentech* (23 December 2018),[16] *CEF Energia* (16 January 2019),[17] *Belenergia* (6 August 2019)[18] and *Sunreserve* (25 March 2020).[19] Three of these cases (*Blusun*, *Belenergia* and *Sunreserve*) were decided in favour of the State, the other two (*Greentech* and *CEF Energia*) in favour of the investor.

The decision in the case *Blusun* represents the first award rendered in cases involving the Italian Republic as respondent State and, together with the decision in the case *Charanne v Spain (*21 January 2016), one of the first awards rendered in cases concerning reforms in the photovoltaic sector in Europe.

The *Blusun* case does not involve the repealing of incentives by the Italian State; but, rather, the adoption by Italian local authorities of a series of measures, that – according to the investors – negatively impacted on their capacity to obtain the expected incentives for the development of their solar energy investment project in the first place, in breach of Article 10(1) of the ECT (fair and equitable treatment) and Article 13(1) of the ECT (protection against expropriation).[20] The case has been

[14] E Kemble, 'Institutional Investors Lodge Complaint over Italy's Retroactive Solar Laws' (2014) IJ Global – Infrastructure J Project Finance Magazine 1; S Faccio, 'The Italian Energy Reform as a Source of International Investment Disputes' (2016) 52 Rivista di diritto internazionale privato e processuale 460-482.

[15] *Blusun S.A., Jean-Pierre Lecorcier and M. Stein v Italian Republic*, ICSID Case No ARB 14/3 (Award 27 December 2016) ('*Blusun v Italy'*).

[16] *Greentech Energy Systems A/S, NovEnergia II Energy & Environment (SCA) SICAR*, and *NovEnergia II Italian Portfolio SA v The Italian Republic,* SCC Arb No 2015/095 (Award 23 December 2018) ('*Greentech v Italy'*).

[17] *CEF Energia B.V v The Italian Republic*, SCC Arb No 2015/158 (Award 16 January 2019) ('*CEF Energia v Italy'*).

[18] *Belenergia S.A. v Italian Republic*, ICSID Case No ARB 15/40 (Award 6 August 2019) ('*Belenergia v Italy'*).

[19] *Sunreserve Luxco Holdings S.a.r.l., Sunreserve Luxco Holdings II S.a.r.l., Sunreserve Luxco Holdings III S.a.r.l*, SCC Arb No 2016/32 (Award 25 March 2020) ('*Sunreserve v Italy'*).

[20] In particular, Blusun complained the instability of the legal framework applicable to its investment, deriving from the adoption by the Italian State of a series of acts, including: (a) the Constitutional Court decision of 2010 that caused delay over the investment project and its financing; (b) the Romani Decree and the Fourth Energy Account that sharply limited the applicability of the incentives provided for the Third Energy Account, imposing to the Claimants to acquire additional land to meet the new ratio allowance for photovoltaic plans in agricultural land eligible for FIT; (c) the publication of multiple lists of eligible plants by GSE and (d) the adoption of a temporary

recently object of an annulment proceeding whose outcome has been published on April 2020.[21]

As opposed to the *Blusun* case, in the cases of *Greentech*, *CEF Energia*, *Belenergia* and *Sunreserve* the investors were entitled and benefited of the incentives, which were originally recognised throughout a twenty-year period, based on the content of the Energy Accounts, the GSE letters and GSE Agreements.[22] According to the investors, the reforms implemented by the Italian State, in particular the *Spalma-incentivi* Decree, modified the incentives framework they relied upon by making the investment and frustrated their legitimate expectations in breach of the FET standard contained in Article 10(1) of the ECT.[23]

3. *How does legitimate expectations arise? General regulation, specific commitments and the investor's due diligence*

In essence, there are two schools of thought on the question how does legitimate expectations arise: one school of thought considers that legitimate expectations can result from statements in general laws or regulations; the other considers that to give rise to legitimate expectations there shall be specific commitments by the State *vis à vis* the foreign investor.[24] The due diligence carried out by the investor in the undertaking of the

municipal stop-work order, which prevented the Claimants to finish up construction to meet the deadline set by the Romani Decree to benefit from incentives.

[21] *Blusun S.A., Jean-Pierre Lecorcier and Michael Stein v Italian Republic*, ICSID Case No ARB 14/3 (Decision on Annulment 13 April 2020). The *ad hoc* Committee denied the investor's request for annulment.

[22] *Greentech v Italy* (n 16) 446-447; *CEF Energia v Italy* (n 17) 190, the tribunal found that the legitimate expectations of the investor only arose with reference to its *Enersol* investment; *Belenergia v Italy* (n 18) 573-577; *Sunreserve v Italy* (n 19) 210.

[23] *Greentech v Italy* (n 16) 11-12, 406-416; *CEF Energia v Italy* (n 17) 163; *Belenergia v Italy* (n 18) 382, 394 ss.; *Sunreserve v Italy* (n 19) 278-282.

[24] *Masdar Solar & Wind Cooperatief U.A. v Kingdom of Spain*, ICSID Case No ARB 14/1 (Award 16 May 2018) para 490; *Suez, Sociedad General de Aguas de Barcelona, S.A. and Vivendi Universal, S.A. v Argentine Republic*, ICSID Case No ARB 03/19 (Decision on Liability 30 July 2010) paras 222-223. Specific: *El Paso v Argentina* (n 4) 375-377; *Charanne v Spain* (n 9) 491-493, 504, 508. See also, C Schreuer, 'Fair and Equitable Treatment in Arbitral Practice' (2005) 6 J World Investment and Trade 374, 374-380; R Dolzer, 'Fair and Equitable Treatment: Today's Contours' (2014) 12 Santa Clara J Intl L 7, pp. 22-24; UNCTAD, 'Fair and equitable treatment' (2012) UN Doc UNCTAD/DIAE/IA/2011/5, 64-71.

investment may also play a role in the assessment as to whether any legitimate expectation has crystallised[25].

3.1. *General regulation v specific commitments*

In the Italian cases, tribunals consistently argued that the FET standard contained in Article 10(1) protects the legitimate expectations of the foreign investor.[26] These legitimate expectations may arise both from the regulatory framework existing at the time of the investment and from specific commitments made by the host State to the foreign investor. In the former case, the protection granted to the legitimate expectation of the foreign investor shall be balanced with the regulatory freedom of the State; in the latter case, the balancing operation and, consequently, the State's regulatory freedom are limited by the specific commitments given to the investor.[27]

For example, the *Blusun* tribunal referred to the principles enounced in the case *Charanne v Spain* and argued that

> 'under international law … in the absence of a specific commitment toward stability an investor cannot have a legitimate expectation that a

[25] UNCTAD, Fair and Equitable Treatment (n 24) xvi, 91; *CEF Energia v Italy* (n17) 223-234; *Belenergia v Italy* (n 18) 583-584; *Sunreserve v Italy* (n 19) 711-714; *Antaris v Czech Republic* (n 10) 360(6); *Isolux Netherlands, BV v Kingdom of Spain*, SCC Arb No 2013/153 (Award 17 July 2016) ('*Isolux v Spain'*) para 781; *Stadtwerke München GmbH, RWE Innogy GmbH, and others v Kingdom of Spain*, ICSID Case No ARB 15/1 (Award 2 December 2019) ('*Stadtwerke v Spain'*) paras 264, 308.

[26] *Belenergia v Italy* (n 18) 570; *Blusun v Italy* (n 15) 365-374; *Greentech v Italy* (n 16) 455; *CEF Energia v Italy* (n 17) 183-191; *Sunreserve v Italy* (n 19) 684, 694 ss.

[27] *Blusun v Italy* (n 15) 317; *CEF Energia v Italy* (n 17) 240; *Greentech v Italy* (n 16) 450-452. In the case *Belenergia*, the position of the Italian Government, then upheld by the tribunal, was that '…the FET standard under art 10(1) ECT does not have a chilling effect on States' regulatory activity; … But rather, stability implies *reasonable and proportionate* legislative changes (emphasis added)'. With the result that 'the FET obligation does not prevent host States' regulatory autonomy… [and] legitimate regulatory activity in the public interest does not amount to an FET breach even if it adversely affects investments', *Belenergia v Italy* (n 18) 572. In *Sunreserve*, the tribunal stated: '[i]n other words, the presence of specific commitments, contractual or otherwise, cannot automatically eliminate or diminish the significance of the host State's regulatory powers for the purposes of its FET obligation under Article 10(1) ECT', *Sunreserve v Italy* (n 19) 703, 699. See also *Joseph C. Lemire v Ukraine*, ICSID Case No ARB 06/18 (Decision on Jurisdiction and Liability 21 January 2010) paras 284-285.

> regulatory framework … is not be modified at any time to adapt to the needs of the market and to the public interest'.[28]

According to the tribunal, when a specific commitment does not exist, the protection granted to the investor is limited, as the investor only has 'a legitimate expectation' that 'the State will not act *unreasonably, disproportionately or contrary public interest* (emphasis added)', when modifying the regulation based on which the investment was made.[29] Similarly, in the case *Sunreserve*, the tribunal stated that

> 'in the absence of [such] specific undertakings, when the question of breach only implicates a host State's regulatory changes... in order for the regulatory change to amount to a breach of the FET obligation, such a change should rise to the level of a "radical or fundamental" change, in light of the high standard to satisfy a breach of the FET obligation'.[30]

The 'high' standard, referred to by the *Sunreserve* tribunal, implies that the host State's conduct

> '[is] manifestly or grossly unfair or *unreasonable*, [is] *arbitrary* or discriminatory, or that the host State engage[s] in a wilful neglect of duty or a wilful disregard of due process of law, or showed an extreme insufficiency of action falling far below international standards, such that the conduct would shock judicial propriety (emphasis added)'.[31]

[28] *Blusun v Italy* (n 15) 317, quoting *Charanne v Spain* (n 9) 510; *Sunreserve v Italy* (n 19) 702; M Potestà (n 6) 110-113.

[29] *Blusun v Italy* (n 15) 317, quoting *Charanne v Spain* (n 9) 510, 513, 517; *AES Summit v Hungary* (n 10) 10.3.7-10.3.8. It is worth observing that these *criteria* are very similar to those usually employed to draw the line between legitimate regulation and 'indirect expropriation'. For example, the Tribunal in the case *Philip Morris v Uruguay* has stated: '[a]s indicated by earlier investment treaty decisions, in order for a State's action in exercise of regulatory powers not to constitute indirect expropriation, the action has to comply with certain conditions. Among those most commonly mentioned are that the action must be taken bona fide for the purpose of protecting the public welfare, must be non-discriminatory and proportionate'. See *Philip Morris Brands Sàrl, Philip Morris Products S.A. and Abal Hermanos S.A. v Oriental Republic of Uruguay*, ICSID Case No ARB 10/7 (Award 8 July 2016) para 305. See also *WNC Factoring Limited v The Czech Republic*, PCA Case No 2014-34 (Award 22 February 2017) para 395; *Valeri Belokon v Kyrgyz Republic*, UNCITRAL (Award 24 October 2014) para 193.

[30] *Sunreserve v Italy* (n 19) 735.

[31] ibid 688, 691, 692, 728.

In the case *CEF Energia*, the tribunal observed that

> 'the dignity which attaches to sovereigns must be given deference, though that is not infinite when balanced against a combination of international obligations freely assumed and, further, fact-specific circumstances of the extent of commitments given to investors'.[32]

In this case, the tribunal emphasised that the *Spalma-incentivi* Decree enacted by the Italian State was not in itself 'an unreasonable measure' and that it pursued 'objective of general interests', but it nonetheless contradicted 'a clear promise [made by the Italian State to the investor] of twenty years of constant currency incentives pursuant to a private law contract'.[33] This specific commitment had the effect of limiting the State's scope of manoeuvre in enacting regulatory changes. Indeed,

> 'It is readily apparent to the Tribunal that the greater the level of engagement as between a sovereign and an investor, such as here through Respondent's undertaking to maintain a specific incentivized tariff for 20 years, ultimately resulting in legitimate expectations which are clear in both scope and origin, the more rigorous the scrutiny must be of acts which, even if reasonable, cut across those legitimate expectations'.[34]

According to the above decisions, both general regulation and specific commitments could be relevant for an investor's legitimate expectation to arise, however, in the latter case the State's measure will be assessed more rigorously with reference to the content of the commitment made by the State and the legitimate expectation engendered on the foreign investor; while in the former case a greater degree of flexibility is admitted to balance the competing interests at stake, as the investor only has a legitimate expectation that the State will not act unreasonably, disproportionately or arbitrary[35].

[32] *CEF Energia v Italy* (n 17) 240.
[33] ibid 217-219, 222, 234, 237.
[34] ibid 243.
[35] In similar terms UNCTAD, 'Fair and Equitable Treatment' (n 24) 77 'Conclusions'.

3.2. *The Investor's due diligence obligations*

Investment tribunals have considered the investor's due diligence obligations both at the liability stage in order to establish whether the State breached the relevant investment standard and in the *quantum* phase to calculate the indemnity due to the foreign investor[36].

At the liability stage the investor's due diligence obligations play a major role in the assessment of the FET standard, as they are often employed by arbitrators to determine whether any legitimate expectation, worth of protection under the FET standard, has crystallized.

In the cases under analysis, the tribunals considered the investor's due diligence in order to establish whether the representations made by the State 'were reasonably relied upon by the Claimants'.[37]

The standard of due diligence that investors are required to meet is that of the 'prudent investor'.[38] According to the *Belenergia* tribunal, the investor is not required to carried out 'a full and extensive due diligence', rather it shall behave in accordance with the prudent investor standard, as 'an investor cannot legitimately expect that the legal and regulatory framework will not change when any *prudent* investor could have anticipated this change before making its investment (emphasis added)'.[39]

The standard of the prudent investor has also been endorsed by a number of tribunals in the so-called Spanish scenario[40]. What a prudent investor is expected to verify through the due diligence process is the background of information existing at the time of the investment and the prospects of a change in the regulatory framework. In particular, according to *Hydro Energy v Spain* the investor shall investigate the host State's

[36] UNCTAD, Fair and Equitable Treatment (n 24) 70-72. As to the impact of the investor's due diligence obligations in the *quantum* phase, see *MTD Equity Sdn. Bhd. and other v Republic of Chile*, ICSID Case No ARB 01/7 (Decision on Annulment 21 March 2007) paras 39, 101.

[37] *CEF Energia v Italy* (n 17) 223-234, 225; *Sunreserve v Italy* (n 19) 711-714; *Belenergia v Italy* (n 18) 584, 600. As to the reasonableness of the expectations and the investor's conduct, see also M Potestà (n 6) 119-121.

[38] *Sunreserve v Italy* (n 19) 714.

[39] *Belenergia v Italy* (n 18) 584, 600.

[40] A Noilhac, 'Renewable Energy Investment Cases against Spain and the Quest for Regulatory Consistency' (2020) 71 QIL-Questions Intl L 21-39; *Isolux v Spain* (n 25) 781; *Stadtwerke v Spain* (n 25) 264, 308.

applicable law and whether any official statements on which it relied could reasonably be attributed to the State[41].

4. *When are the legitimate expectations frustrated? The assessment of the effects of the measure*

In the cases under analysis, tribunals recognised the frustration of the legitimate expectations of the investor to have occurred, whenever the State measure was unexpected, in light of the commitments or representations made to and *reasonably* relied upon by the investor at the time of its investment and of the *effects* produced by the measure upon the investment.[42]

The concept is clearly stated by the tribunal in the case *CEF Energia*:

> 'The existence of a breach is not the automatic consequence of a finding that subsequent measures taken by the host state are in contrast with the legal regime and "assurances" of stability on which the foreign investor relied when it made its investment. To follow again Antaris, the reasons and justification of the state's action must also be evaluated, "*in the light of the then prevailing or reasonably to be expected changes in the economic and social conditions of the host State*" (Antaris, para 360(6)). This entails evaluating whether the subsequent action by the State "*... do not exceed the exercise of host State's normal regulatory power in pursuance of a public interest and do not modify the regulatory framework relied upon by the investor at the time of its investment outside the acceptable margin of change.*" (Antaris para 360(7)) This means that the quantitative negative impact on the investment's value and profitability must be taken into account'.[43]

The importance attributed to the assessment of 'the quantitative negative impact' is confirmed by the subsequent sections: '… Even the least damaging option (Option C) [of the *Spalma-incentivi* Decree], …, resulted in the amount of the tariff obtained by Enersol being less than the

[41] *Hydro Energy 1 S.a.r.l. and Hydroxana Sweden AB v Kingdom of Spain*, ICSID Case No ARB 15/42601 (Decision on Jurisdiction, Liability and Directions on Quantum, 9 March 2020) para 601.

[42] *Greentech v Italy* (n 16) 447-449, 453.

[43] *CEF Energia v Italy* (n 17) 236.

one originally granted on which Claimant had relied in making its investment'.[44] However, according to the tribunal

> '… the fact that the cut was not of such a magnitude as to render the investment unprofitable, but allowed it (arguendo) to still generate a fair return can[not] prevail over the legitimate expectations of Claimant that it is entitled to benefit of the originally granted and agreed incentivized tariff'.[45]

The separate opinion of professor Sacerdoti in the case *CEF Energia* is also of notice, as it confirms the importance of the role played by the effects of the measure in the overall assessment of the FET standard:

> 'Claimant should have been aware that under Italian law … the possibility that the State could unilaterally modify the tariff in special circumstances, for pressing reasons of public interest, *provided that the negative impact would be modest*, could not be ruled out (emphasis added)'.[46]

and further

> '[a]s to the tariff cut put in place by the Spalmaincentivi, the evidence shows in my opinion that it was a reasonable measure, taken in a transparent way, aimed at pursuing a legitimate public interest – both looking at its aims and at the economic context – and that, finally, due care was taken to protect the interests of the investors … *the negative impact was limited … The cut has not affected the profitability of the investment* (emphasis added)'.[47]

In the case of *Blusun*, the tribunal considered the 'effects' of the measures challenged by the investors in order to ascertain whether they amounted to a violation of the FET standard. It is worth recalling that in this case the tribunal did not find the investor to have any legitimate expectation arising out of a specific commitment by the State, but only 'a legitimate expectation' that 'the State will not act unreasonably, disproportionately or contrary public interest', in modifying existing

[44] ibid 238.
[45] ibid 241, 245.
[46] ibid 247.
[47] ibid 247.

regulation.[48] Nonetheless, in the assessment of the reasonableness, proportionality and public interest of the measures, the tribunal took in due account the effects they produced upon the investment.

Hence, with reference to the Constitutional Court decision the tribunal observed that it 'did not result into a loss of rights to Blusun or its affiliates'.[49] As to the tariff reduction determined by the Romani Decree and the Fourth Energy Account, the tribunal stated that it 'was not in itself crippling or disabling';[50] and the stop-work order 'was temporary in effect'[51]. With the consequence that none of the measures challenged by the investors amounted to a breach of the FET standard.

In the case *Sunreserve*, the tribunal investigated whether the investors' legitimate expectation to receive a fair remuneration for their investment was frustrated by the Italian regulatory measures. In this regard, the tribunal observed that the 'reduction of 7% in the enterprise value of Claimants' subsidiary companies and a resultant reduction of 19% in the value of Claimants' investment' did not have the effect of 'rid[ding] Claimants' photovoltaic plants of any fair remuneration'.[52] This is also confirmed by the circumstance that the investors were able to sell their plants at the price of approximately EUR 104 million, which

> 'indicate[s] that the enterprise value of Claimants' subsidiary companies, and in turn, the value of Claimants' investments were not impacted in such a manner that their photovoltaic plants were rid of any fair remuneration (emphasis added)'.[53]

The assessment of the effects of the challenged measure upon the investment in order to ascertain whether the measure has breached the FET standard is not a novelty in the realm of the solar energy case law, nor in the context of investment arbitration, more generally.[54] For

[48] *Blusun v Italy* (n 15) 317.
[49] ibid 329.
[50] ibid 342.
[51] ibid 360.
[52] *Sunreserve v Italy* (n 19) 840. In this case, the Tribunal established that the investors only had a legitimate expectation of a fair remuneration with respect to one power plant (the Fiumicino power plant).
[53] *Sunreserve v Italy* (n 19) 865, 870.
[54] *Marion Unglaube and Reinhard Unglaube v Republic of Costa Rica*, ICSID Case No ARB 08/1; ICSID Case No ARB 09/20 (Award 16 May 2012) ('*Unglaube v Costa Rica*')

example, in the case *Novenergia II v Spain*, the Tribunal held that the '[d]estruction of the value of the investment' is not only 'determinative in the assessment of whether a state has breached Article 13 of the ECT [i.e. indirect expropriation]', but it is also 'one of several factors to consider when determining whether a state has breached Article 10(1) of the ECT [i.e. the FET Standard]'.[55]

This tendency brings the assessment of the FET standard close to the analysis carried out in cases of indirect expropriation, which usually focuses on the effects produced by the measure upon the investment.[56] The 'magnitude' of the impact needed for a finding of indirect expropriation, however, remains higher compared to that needed under the FET standard;[57] and it shall not be necessarily related to 'unexpected' changes of

para 257; *Sempra Energy International v The Argentine Republic*, ICSID Case No ARB 02/16 (Award 28 September 2007) ('*Sempra v Argentina'*) paras 285, 286; *Railroad Development Corporation (RDC) v Republic of Guatemala*, ICSID Case No ARB 07/23 (Award 29 June 2012) paras 235, 260.

[55] *Novenergia II - Energy & Environment (SCA) (Grand Duchy of Luxembourg), SICAR v The Kingdom of Spain*, SCC Arb No 2015/063 (Award 15 February 2018) paras 694-695; *Eiser v Spain* (n 9) 365, 382. The tribunal found that the Spanish Regime 'was profoundly unfair as applied to the Claimant's existing investment, stripping [them] of virtually all of the value of their investment'.

[56] R Dolzer, 'Indirect Expropriations: New Developments?' (2002) 11 NYU Environmental L J 64, 79-80; U Kriebaum, 'Regulatory Takings: Balancing the Interests of the Investor and the State' (2007) 8 J World Investment and Trade 717, 724; WS Dodge, 'Case Report Metalclad Corporation v Mexico and Mexico v Metalclad Corporation' (2001) 95 AJIL 910, 910-919; EM Leonhardsen, 'Looking for Legitimacy: Exploring Proportionality Analysis in Investment Treaty Arbitration' (2011) 3 J Intl Dispute Settlement' 95, 95-136; JR Marlles, 'Public Purpose, Private Losses: Regulatory Expropriation and Environmental Regulation in International Investment Law' (2007) 16 Intl Investment L 275; R Dolzer, F Bloch, 'Indirect Expropriation: Conceptual Realignments?' (2003) 5 Intl L Forum du Droit International 155. Case law, see among the many: *Metalclad Corporation v The United Mexican States*, ICSID Case No ARB(AB) 97/1 (Award 30 August 2000) para 107; *Bear Creek Mining Corporation v Republic of Peru*, ICSID Case No ARB 14/21 (Award 30 November 2017) para 415.

[57] K Yannaca-Small, Fair and Equitable Treatment Statndard, in K Yannaca-Small (ed), *Arbitration under International Investment Agreements* (OUP 2010) 399; MC Porterfield, 'State Practice and the (Purported) Obligation under Customary International Law to Provide Compensation for Regulatory Expropriations' (2011) 37 The North Carolina J Int L and Com Reg 159, 168; *Unglaube v Costa Rica* (n 54) 257; *Sempra v Argentina* (n 54) 285, 286; *Abaclat and Others (Case formerly known as Giovanna A Beccara and Others) v The Argentine Republic*, ICSID Case No ARB 07/05 (Decision on Jurisdiction 4 August 2011) para 314; *MTD Equity Sdn. Bhd. And MTD Chile S.A. v Republic of Chile*, ICSID Case No ARB 01/07 (Award 25 May 2004) para 214.

the regulatory framework, although in a number of case the frustration of the legitimate expectations of the investor have also been considered by investment agreements and arbitrators in their analysis on indirect expropriation.[58]

In the words of professor Jennings, 'the essence of the wrong [in the case of the FET standard] is what the State has done in respect of that very relationship [with the investor]'.[59] Thus, as opposed to indirect expropriation, the effects produced by the measure shall not necessarily reach such a magnitude to 'cripple or disable'[60] the capacity of the investors to use, enjoy and dispose of its investment; but even a 'modest' impact may be sufficient to entail a violation for the FET standard, as long as the 'reasonable expectation and will of [the investor] at the time of the making of the [investment] is being destroyed'.[61]

4. *Concluding remarks*

It has been observed that the right to regulate and the legitimate interests of the State

> 'are more likely to be taken into account when the tribunal reviews the fair and equitable treatment, … because, … the FET standard by its very nature requires a balancing of interests and an interpretation that completely ignores the legitimate interests of a host state will hardly appear to be fair and equitable'.[62]

[58] *Bear Creek Mining Corporation v Republic of Perú*, ICSID Case No ARB 14/21 (Award 30 November 2017) para 415; *Blusun v Italy* (n 15) 407; S Fietta, 'Expropriation and the "Fair and Equitable" Standard' (2006) 23 J Intl Arbitration 375, pp. 375-399; 2012 US Model BIT, Annex B (4) (a); 2009 ASEAN Comprehensive Investment Agreement (signed 26 February 2009, entered into force 29 March 2012) Annex 2(3).

[59] RY Jennings, 'State Contracts in International Law' (1961) 37 British YB Intl L 156, 156-157, 167; RY Jennings, 'General Course on Principles of International Law' (n 1) 486-494.

[60] *Blusun v Italy* (n 15) 342.

[61] RY Jennings, 'State Contracts in International Law' (n 59) 181-182. Professor Jennings referred specifically to State's undertakings through contracts, but his reasoning, in the opinion of the author, is relevant also to the present cases, involving specific commitment made by the State *vis à vis* the foreign investor.

[62] A Titi (n 3) 276-277.

Thus, the tribunal in *CEF Energia* was 'at pains' to observe that the measures adopted by the State '[we]re not, in of themselves, an unreasonable measure', nonetheless it admitted that 'the dignity which attaches to sovereigns must be given deference, though that is not infinite'.[63] The limit of such deference shall be found in 'a combination of international obligations freely assumed [ie the FET standard under the ECT] and, further, fact-specific circumstances of the extent of commitments given to investors'.[64]

The line between the State's exercise of legitimate regulatory powers and a breach of the FET standard, as embedded in Article 10(1) of the ECT, therefore, is crossed whenever the measure adopted by the State is unexpected (ie 'outside the acceptable margin of change'[65]), in light of the commitments made to and reasonably relied upon by the investor at the time of its investment and the negative effects produced on the investment.

In case of legitimate expectations arising out of a general regulation the threshold of the impact needed for a finding of a breach of the FET standard seems to be set in the fair remuneration.[66] Thus, any measure prejudging the right of the investor to receive the expected fair remuneration amounts to a violation of the FET standard. By contrast, where the legitimate expectations are based on specific commitments of the State, it seems sufficient that the measure has the effect of lowering what was 'originally granted on which Claimant had relied in making its investment'.[67]

[63] *CEF Energia v Italy* (n 17) 240.

[64] ibid.

[65] ibid 236; *Antaris v Czech Republic* (n 10) 360; *El Paso v Argentina* (n 4) 402.

[66] *Sunreserve v Italy* (n 19) 865, 870; *CEF Energia v Italy* (n 17) 247. See also, *RREEF Infrastructure (G.P.) Limited and RREEF Pan-European Infrastructure Two Lux S.a.r.l. v Kingdom of Spain*, ICSID Case No ARB 13/30 (Decision on Responsibility and on the Principles of Quantum 30 November 2018) para 472; D. Zannoni (n 2) 13-15, stating that 'the regulatory change should be shaped in a manner which at least enables the investor to recover its operations costs, amortize its investments and make a reasonable return over time'.

[67] *CEF Energia v Italy* (n 17) 241, 245.