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# The legitimate expectation of regulatory stability under the Energy Charter Treaty

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**Abstract**

One of the main catalysts for the shift towards renewable energies has been the practice of support schemes in a key number of EU member states. Some of these states have since withdrawn or revoked much of their original support, which has resulted in investment treaty arbitrations being filed against them under the Energy Charter Treaty. Arguably, a balance should be found between investors' legitimate expectations concerning the stability of the legal framework and the host states' right to adapt regulations to new needs. This can be achieved by clarifying and delimiting the principle of fair and equitable treatment, and by encapsulating it in a more precise set of rules. Due to its open character, this principle could otherwise become too intrusive a standard of judicial review for the exercise of sovereign power by host states. It could be diluted into a rhetorical framework inviting uncertainty and subjective judgment. While the focus of this article is on energy, the concern for legal stability equally applies to all those sectors where large upfront investments are required, which can only be recouped in the long run.

**Keywords:** energy; Energy Charter Treaty; incentive; legitimate expectation; regulatory change

## 1. Introduction

Soon after the ratification of the Kyoto Protocol,[1] the European Union issued a directive recommending that member states set 'national indicative targets' for the consumption of electricity produced from renewable sources.[2] These previously indicative targets have since been made binding by the legislative process for a recast of the renewable energy directive – which is still ongoing.[3] Therefore, many EU countries have introduced incentives, which were deemed indispensable in order to kick-start investments in renewable energies.[4]

[1]Kyoto Protocol to the United Nations Framework Convention on Climate Change, Kyoto, 11 December 1997, United Nations, Treaty Series, vol. 2303, 162.

[2]Directive 2001/77/EC of the European Parliament and of the Council of 27 September 2001 on the promotion of electricity produced from renewable energy sources in the internal electricity market, OJ L 283, 27.10.2001, 33–40 (no longer in force).

[3]Directive 2009/28/EC of the European Parliament and of the Council of 23 April 2009 on the promotion of the use of energy from renewable sources and amending and subsequently repealing Directives 2001/77/EC and 2003/30/EC, OJ L 140, 5.6.2009, 16–62.

[4]For many EU member states, the primary mode of support renewable energy under the current Directive has come through feed-in tariff, feed-in premium, and green certificate programs. A feed-in tariff program aims at offsetting the higher cost of renewable technologies in relation to fossil fuels. The electricity generated from renewable installations is paid at a fixed minimum price, generally set higher than the market price. On the contrary, a feed-in premium is paid in addition to the market price. It is considered to be more market-friendly than the feed-in tariff because the producer is to a certain extent exposed to market price risk. Other forms of incentives are tax and export subsidies, as well as power purchase agreements, i.e., long-term contracts between governments and renewable energy producers. On the different forms of incentives to promote renewable energies see G. De Maio, 'Politiche di incentivazione fiscale ed energie rinnovabili', in L. Chieffi and F. Pinto (eds.), *Il governo dell'energia dopo Fukushima* (2013), 315–34.

With favourable support schemes resulting in significant investment in renewables – meaning significant expenses in terms of incentives payable by host states – and hit by a global financial crisis, many European countries scaled back their original investment incentives to smaller amounts and shorter durations. Regulatory changes were often needed to comply with those countries' obligations under European Union law.

This has resulted in the surfacing of numerous arbitral proceedings where investors claimed that such regulatory changes breached the fair and equitable treatment (FET) standard[5] afforded by the Energy Charter Treaty (ECT).[6] In general, legal certainty and the investor's capability to foresee the consequences of their actions are prerequisites for rational enterprise in a capitalist economy. This is even more true for the renewable energy sector, because it depends on large, upfront investments, which can only be recouped over time, and are highly vulnerable to externalities. National legislations usually provide in advance for eligibility requirements and incentive rates applicable for three or four years, with the specific purpose of enabling operators in the renewable energy sector to properly foresee and evaluate costs and revenues. Investors make decisions on the financial viability of their investments based on the rate-setting decisions made and implemented by the host states. Thus, they have a strong interest in the stability of the regulatory regime – in particular the continuity of any incentive schemes over the expected amortization period – and protection from unwarranted government policy changes. Unsurprisingly, in the above-mentioned arbitration cases, investors complained that regulatory changes affecting incentives in renewables diminished or exhausted the commercial viability of their investments.

The core issue 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. In other words: to what extent can investors expect that the level of incentives initially granted will be protected by the ECT over time and, vice versa, what are the boundaries of host states' regulatory freedom? Unqualified protection of legitimate expectations may have the effect of fettering a state's right to regulate. On the other hand, an unlimited right to regulate would imply that investors should be ready to accept whatever the host state decides, resulting in a poor investment climate which would ultimately be detrimental to the host state itself.

[5]As far as the legal nature of the FET is concerned, P. Juillard argues that it is a principle of general international law, albeit of minimum substance (*noyau minimum*). P. Juillard, 'L'évolution des sources du droit des investissements', (1994) 250 *Recueil des Cours* 131–3. According to Gazzini, the FET standard is arguably the most important standard in investment disputes. State practice and *opinio juris* militate in favour of the development of a corresponding customary rule. See T. Gazzini, 'General Principles of Law in the Field of Foreign Investment', (2009) *Journal of World Investment & Trade* 116, in the footnote. *Contra* the arbitral tribunal in *ADF*: 'It may be that, in their current state, neither concordant State practice nor judicial or arbitral case-law provides convincing substantiation (or, for that matter, refutation) of the Investor's position [the claimant had held that a general requirement exists in customary international law to accord FET to foreign investments].' *ADF Group Inc. v. United States of America*, ICSID Case No. ARB (AF)/00/1, Award of 9 January 2003, para. 183. But the more recent arbitral award in *Blusun* recognizes that FET is a customary norm. See *Blusun S.A., Jean-Pierre Lecorcier and Michael Stein v. Italian Republic*, ICSID Case No. ARB/14/3, Award of 27 December 2016, para. 319 (3).

Whether or not FET forms part of customary law is nonetheless of limited relevance since it is part of most BITs and multilateral agreements (such as, as we will see, Art. 10 Energy Charter Treaty, Art. 1105 North America Free Trade Agreement, Art. 8(10) Comprehensive Economic and Trade Agreement between Canada and the European Union, CETA).

[6]Energy Charter Treaty, 17 December 1994, 2080 U.N.T.S. 100 (entered into force on 16 April 1998) (hereinafter ECT). The ECT was concluded the same year of the collapse of the Soviet Union (1991), with the aim to integrate the former Soviet Union's resource-rich energy sectors into the European market. At the time of the ECT negotiations, in the early 1990s, climate concerns were still relatively low and the renewable energy market was not as developed as today. Therefore, the ECT does not provide for a specific protection of renewable energy investments as opposed to investments in other forms of energy. The ECT nonetheless recalls in its Preamble to the United Nations Framework Convention on Climate Change, and its Art. 19 para. 1(d) foresees that its contracting parties shall have particular regard to developing and using renewable energy sources. Environmental concerns are also expressed in the annexed Protocol on Energy Efficiency and Related Environmental Aspects.

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To strike a balance, in line with an increasing tendency in international practice, the principle of FET shall be clarified, delimited, and encapsulated in a more precise set of rules.[7] Indeed, there is a risk, and a wrong premise, in the viewpoint shared by several arbitral tribunals and authors, according to which, with the FET principle not being precisely defined, its content depends on the interpretation of specific facts.[8] The risk is that the FET principle gets diluted into a rhetorical framework that gives the tribunal a free pass to judge the legitimacy of investors' expectations at its whim. The wrong premise is that it is one thing to say that facts need to be interpreted in order to verify whether the requirements for the application of a rule are met and another thing to infer the legal content of a rule from the facts of a specific case. The legal content is provided by the rule itself and should be identified. It will be ascertained that, despite its flexibility, the FET standard is not devoid of an independent legal content and is susceptible to specification through arbitral practice.

This work follows a step-by-step approach, starting with a clarification of the relationship between the FET standard and the protection of legitimate expectations. The analysis continues with an assessment of whether a legislative act or contract, entailing a specific commitment to regulatory stability, may be a source of legitimate expectations, and whether – and under what circumstances – legitimate expectations may arise in the absence of a specific commitment on the part of the host state. Based on the conclusion reached, safeguards are identified, which states should observe in order to avoid liability under the ECT when they are about to change a regulatory framework in a manner that is likely to impact foreign investors.

The common distinction between 'principles' and 'rules' captures one set of typical relationships, namely those between norms of a higher and lower degree of abstraction, where rules have greater clarity and definiteness.[9] Thus, the 'translation' of the FET principle into more specific rules would increase legal certainty and reduce *ex ante* the number of disputes between investors and host states. Reference by arbitral tribunals to the host state's performance of these safeguards, rather than to the sole FET standard, would also have the merit of making arbitral decisions more foreseeable and coherent with each other, which regrettably is not always the case today.

[7] As an example of treaty provision which specifies the FET into more specific rules, see Art. 8.10(2) of the EU-Canada CETA and, among arbitral awards, *Rumeli Telekom A.S. v. Kazakhstan*, ICSID ARB/05/16, Award, 29 July 2008, para. 609.

[8] *Ex multis, Mondev International Ltd. v. United States of America*, ICSID Case No. ARB(AF)/99/2, 11 October 2002, para. 118; *Waste Management, Inc. v. United Mexican States* ("Number 2"), ICSID Case No. ARB(AF)/00/3, 30 April 2004, para. 99. See C. Schreuer, 'Fair and Equitable Treatment in Arbitral Practice', (2005) 3 *Journal of World Investment and Trade*, 364; J. Kalicki and S. Medeiros, 'Fair, Equitable and Ambiguous: What is Fair and Equitable Treatment In International Investment Law?', (2007) *ICSID Review* 26.

[9] In the international literature, and even in arbitral practice, the terms of 'rule' and 'principle' are often used interchangeably. See *Compañia del Desarrollo de Santa Elena S.A. v. Republic of Costa Rica*, ICSID Case No. ARB/96/1, Award of 17 February 2000, para. 64; M. Ragazzi, *The Concept of International Obligations Erga Omnes* (1997), 136. However, one may still distinguish between the two terms. In the words of Fitzmaurice a principle 'underlies a rule, and explains or provides the reason for it'. G. G. Fitzmaurice, 'The General Principles of International Law Considered from the Standpoint of the Rule of Law', (1957) 92 *Recueil des Cours* II, 7. Mosler suggests an additional difference between the two terms: 'principles' have a 'wider meaning' and give rise to a 'wider variety of means of application and execution', while 'rules' define rights and obligations 'in a clearer way'. H. Mosler, *The International Society as a Legal Community* (1980), 73; M. Koskenniemi, 'General Principles: Reflections on Constructivist Thinking in International Law', in M. Koskenniemi (ed.), *Sources of International Law* (2000), 359–99. In the *Gentini* case the umpire recalls the definitions of 'rule' and 'principle' offered by Bourguignon and Bergerol's *Dictionnaire des Synonymes*: a 'règle est essentiellement pratique et, de plus, obligatoire; il est des règles de l'art comme des règles de gouvernement' [a rule is essentially practical and, moreover, mandatory; There are rules of the art as rules of government], while principle (principe) 'exprime une vérité générale, d'après laquelle on dirige ses actions, qui sert de base théorique aux divers actes de la vie, et dont l'application à la réalité amène telle ou telle consequence' [expresses a general truth, from which one directs its actions, which serves as a theoretical basis for the various acts of life, and whose application to reality brings about a certain consequence or another one]. *Gentini* case, 1903, in *RIAA* X, at 556.

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## 2. When does a change in a host state's legal framework constitute a breach of the fair and equitable treatment standard?

In arbitral practice, the fact that a state cannot generate legitimate expectations of a stable legal environment to incentivize an investor to make an investment and later ignore such expectations, is grounded in the FET standard,[10] often combined with the principle of good faith, which is customary in international law.[11] The tribunal in *CMS* v. *Argentina*, for instance, observed that the stability of the legal and business framework is an essential element of FET.[12] In this regard, the principle of estoppel, encapsulated in the maxim *nemo venire potest contra factum proprium*, as a corollary of the principle of good faith, is also often recalled.[13]

This does not mean that a breach of the FET principle requires the deliberate intention or bad faith of the host state, although, and admittedly, such intention or bad faith may be taken into account and aggravate the position of the host state.[14] If a state acts fraudulently or in bad faith, then there is at least a *prima facie* case for arguing that the FET principle has been violated.[15] Think of a state which promises incentives to investors up to a certain date and then suddenly removes them prior to that date as soon as the pursued objective of the state's energy policy has been achieved.[16]

[10]"The standard of "fair and equitable treatment" is therefore closely tied to the notion of legitimate expectations which is the dominant element of that standard.' *Saluka Investments B.V. v. The Czech Republic*, UNCITRAL, Partial Award, 17 March 2006, para. 302; 'The case law also confirms that to comply with the standard [of FET], the State must respect the investor's reasonable and legitimate expectations.' See *Rumeli*, *supra* note 7, para. 609; see also *Tecnicas Medioambientales Tecmed S.A. v. United Mexican States*, ARB (AF)/00/2, Award, 29 May 2003, para. 154; *El Paso Energy Int'l Co. v. Argentina*, ICSID Case No. ARB 03/15, Award, 31 October 2011, para. 348; *Electrabel S.A. v. Hungary*, ICSID Case No. ARB/07/19, Decision on Jurisdiction, Applicable Law and Liability, 30 November 2012, para. 7.75; *RREEF Infrastructure (G.P.) Limited and RREEF Pan-European Infrastructure Two Lux S.à r.l. v. Kingdom of Spain*, ICSID Case No. ARB/13/30, Decision on responsibility, 30 November 2018, para. 260. According to some isolated dissenting arbitrators, the inclusion in the FET of an obligation to satisfy, or at least not to frustrate, the legitimate expectations of investors does not correspond, in any language, to the ordinary meaning to be given to the terms 'fair and equitable'. Therefore, *prima facie*, such a conception of FET is at odds with the rule of interpretation expressed in Art. 31, para. 1 of the Vienna Convention on the Law of Treaties: see *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, separate opinion of arbitrator P. Nikken, para. 3.

[11]*Tecmed*, *supra* note 10, para. 154; *Charanne and Construction Investments v. Spain*, SCC Case No. V 062/2012, Award, 21 January 2016, para. 486. R. Kolb argues that the principle of good faith operates in protecting the legitimate expectations which a legal-factual relationship among two or more subjects has generated. See R. Kolb, 'Principles as Sources of International Law (With Special Reference to Good Faith)', (2006) *Netherlands International Law Review* 20. See also R. Dolzer, 'Fair and Equitable Treatment: A Key Standard in Investment Treaties', (2005) *The International Lawyer* 91.

[12]*CMS Gas Transmission Company v. Argentina*, ICSID Case No. ARB/01/8, Award, 12 May 2005, para. 274; *Occidental Exploration & Production Co. v. Ecuador*, LCIA Case No. UN3467, Final Award, 1 July 2004, para. 183; *Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic*, ICSID Case No. ARB/01/3, Award, 22 May 2007, para. 260.

[13]The *Gold Reserve* award refers to the principle of *Vertrauensschutz* as the basic rationale of the protection of legitimate expectations. *Gold Reserve Inc. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB(AF)/09/1, Award, 22 September 2014, para. 576. See A. Tanzi, 'The Relevance of the Foreign Investor's Good Faith', in A. Gattini et al. (eds.), *General Principles of Law and International Investment Arbitration* (2018), 209.

Other arbitral tribunals and authors use the legitimate expectations principle as a further general principle that is used in order to interpret and apply the FET standard. But, to try to give some substance to a general principle by resorting to another general principle of law seems largely superfluous. This only shifts the terms of the question. *Contra*, the Tribunal in the *Total* case decided to interpret the FET standard looking also at other general principles of international law, and based the principle of legitimate expectations on a comparative analysis of legitimate expectations in domestic jurisdictions. See *Total S.A. v. The Argentine Republic*, ICSID Case No. ARB/04/01, Decision on Liability, 27 December 2010, paras. 126–8. For an overview on this issue see J. Ostransky, 'An Exercise in Equivocation: A Critique of Legitimate Expectations as a General Principle of Law under the Fair and Equitable Treatment Standard', in Gattini et al., ibid., at 344–77.

[14]*CMS*, *supra* note 12, para. 280; *Mondev*, *supra* note 8, para. 116; *Loewen Group, Inc. and Raymond L. Loewen v. United States of America*, ICSID Case No. ARB(AF)/98/3, 26 June 2003, para. 132; *Enron*, *supra* note 12, para. 263.

[15]*Waste Management*, *supra* note 8, para. 138.

[16]I cite here the evocative words of M. Luciani: 'è particolarmente odioso che lo Stato, dismesso lo scettro e imboccata la strada del diritto premiale, si riappropri delle sue prerogative una volta ottenuto l'effetto sperato'. M. Luciani, *Il dissolvimento*

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On the other hand, investors' needs for stability and predictability shall be balanced with the host state's right to regulate, which may involve changing previous regulations to meet evolving circumstances and public needs. As the tribunal in *EDF (Services) Limited* v. *Romania* noted, the FET requirement cannot mean 'the virtual freezing of the legal regulation of economic activities, in contrast with the state's normal regulatory power and the evolutionary character of economic life'.[17]

What seems to be admitted at a preliminary stage is that the host state's right to regulate includes the right to adapt the level and duration of support in order to avoid overcompensation of investments. No doubts of compatibility with the FET standard seem to arise here. Fed-in tariffs, for instance, can lag behind the technology change they create, thus generating windfall profits and over-subsidizing the industry. As a result, the regulatory framework underpinning these incentives could become outdated. This bears specific relevance to renewables, because, thanks to technological development, renewable energy technologies have rapidly increased their efficiency, while simultaneously decreasing the energy price per kWh.

But neither is it a question of whether the framework can be dispensed with altogether when specific commitments to the contrary have been made. International investment law has been developed with the specific objective of limiting *ex ante* the chance of discretion in the actions of public authorities *vis-à-vis* foreign investors. When a state undertakes a specific commitment to stability, it renounces to its complete freedom of exercise of regulatory power.[18] The crucial issue is to establish when such commitment is undertaken as well as the degree of specificity required to hold the state to its commitment.

Of course, the specific content of the FET standard – and thus the limits of legitimate expectations – may vary depending on the wording of a particular treaty. The Investment Agreement for the Common Market for Eastern and Southern Africa Common Investment Area explicitly contemplates an element of flexibility in the interpretation of the FET standard based on the level of development of the host state.[19] A binding interpretation by the parties to a treaty, or by an authorized treaty body, may expressly state the equivalence between the FET standard and the minimum standard of treatment under customary law.[20] For instance, the NAFTA Free Trade Commission, a body composed of representatives of the three NAFTA state parties, with the

*della retroattività. Una questione fondamentale del diritto intertemporale nella prospettiva delle vicende delle leggi di incentivazione economica*, (2007) *Giurisprudenza italiana* 2091. In this regard, in his partial dissenting opinion in *RREEF*, Judge R. Volterra refers to what is colloquially known as 'bait-and-switch'. R. Volterra, partial dissenting opinion to *RREEF*, *supra* note 10, para. 26.

[17]See *EDF (Services) Ltd. v. Romania*, ICSID Case No. ARB05/13, Award, 8 October 2009, para. 217 (noting that otherwise investors could 'rely on a bilateral investment treaty as a kind of insurance policy against the risk of any changes in the host State's legal and economic framework'); *Enron*, *supra* note 12, para. 261; *Saluka*, *supra* note 10, para. 305; *Charanne*, *supra* note 11, para. 503; *El Paso*, *supra* note 10, para. 352; 'The fair and equitable treatment standard does not give a right to regulatory stability per se.' *Eiser Infrastructure Limited and Energía Solar Luxembourg S.à r.l. v. Kingdom of Spain*, ICSID Case No. ARB/13/36, Award, 4 May 2017, para. 362 recalling *Ioan Micula, Viorel Micula, S.C. European Food S.A, S.C. Starmill S.R.L. and S.C. Multipack S.R.L. v. Romania*, ICSID Case No. ARB/05/20, Award, 11 December 2013, para. 666; *Toto Costruzioni Generali S.p.A. v. The Republic of Lebanon*, ICSID Case No. ARB/07/12, Award, 7 June 2012, para. 165; *Total S.A.*, *supra* note 13, para. 115.

[18]In the *Charanne* case, for instance, the Tribunal found that 'in the absence of a specific commitment [with respect to the stability of the incentives regime], an investor cannot have a legitimate expectation that existing rules will not be modified'. *Charanne*, *supra* note 11, at para. 499. 'In the absence of a specific commitment, the State has no obligation to grant subsidies such as feed-in tariffs, or to maintain them unchanged once granted.' *Blusun*, *supra* note 5, para. 319. 'Absent explicit undertakings directly extended to investors and guaranteeing that States will not change their laws or regulations, investment treaties do not eliminate States' right to modify their regulatory regimes to meet evolving circumstances and public needs.' *Eiser*, *supra* note 17, para. 362; *RREEF*, *supra* note 10, para. 321.

[19]Art. 14, para. 3 (*Fair and Equitable Treatment*), Investment Agreement for the Common Market for Eastern and Southern Africa Common Investment Area.

[20]On the issue of the autonomy of the FET standard in respect to the minimum standard of treatment see Schreuer, *supra* note 8, at 357–86.

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power to adopt binding authentic interpretations, issued a Note of Interpretation stating that the FET standard contained in Article 1105 NAFTA does not require treatment in addition to or beyond what is required by the customary minimum standard of treatment of aliens in international law.[21] Arbitral tribunals applying Article 1105 of NAFTA at times, as in the *Glamis* case, have coherently applied strict requirements, demanding that investors' expectations be based on the definitive, unambiguous, and repeated commitments or assurances by the host state that have 'purposely and specifically induced the investment'.[22] This tendency was confirmed in the *Mesa Power Group* case, where the Tribunal held that 'the failure to respect an investor's legitimate expectations in and of itself does not constitute a breach of Article 1105, but is an element to take into account when assessing whether other components of the standard are breached'.[23] This case law suggests that, in the application of NAFTA, a narrow interpretation of the FET standard is adopted.

The ECT instead expressly refers to the host state's duty to create 'stable' and 'transparent' conditions for foreign investments, as well as to the 'commitment to accord *at all times* ... fair and equitable treatment'[24] to such investments, giving particular weight to long-term stability. One may argue that this provision could serve as a basis for affording the legitimate expectations of investors operating in the energy field comparatively greater protection against regulatory changes.[25]

## 3. A specific commitment to regulatory stability

The first issue to deal with is whether a legally binding act under domestic law, entailing a specific commitment to regulatory stability, may be a source of legitimate expectations under the FET standard.

In arbitral practice, the most certain case of legitimate expectation to regulatory stability is generally considered that of contractual commitments with individual investors, where the state undertakes to grant subsidies and, once granted, to leave them unchanged for a certain period of time. When the Tribunal in *Continental Casualty* v. *Argentina* categorized the different types of 'factors' on which the claimant based its expectations, it asserted that expectations arising from contracts deserved greater protection as they generate 'legal rights and therefore expectations of compliance'.[26]

This seems to be particularly true for the ECT. Article 10(1) ECT, contemplating the FET principle, contains an 'umbrella clause' which requires a host state to 'observe any obligations it has entered into with an Investor or an Investment of an Investor', arguably elevating contractual breaches to treaty breaches.'[27] The strictness of this obligation is echoed by Article 22(1) ECT, where states have 'to ensure' the compliance of state enterprises with such obligations.

[21]NAFTA Free Trade Commission, Notes of Interpretation of Certain Chapter 11 Provisions, 31 July 2001. Such decision is a 'subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions', under the terms of Art. 31 para. 3 (a) of the Vienna Convention on the Law of Treaties. See M. Herdegen, 'Interpretation in International Law', *Max Planck Encyclopedia of Public International Law* (2013), paras. 34–5.

[22]*Glamis Gold Ltd. v. United States of America*, UNCITRAL, Award, 8 June 2009, paras. 766, 799, 802. On this point see P. Dumberry, 'The Protection of Investors' Legitimate Expectations and the Fair and Equitable Treatment Standard under NAFTA Article 1105', (2014) *Journal of International Arbitration* 67; Schreuer, *supra* note 8, at 363–4.

[23]*Mesa Power Group LLC v. Government of Canada*, PCA Case No. 2012-17, Award of 24 March 2016, para. 502.

[24]Art. 10(1) ECT [emphasis added].

[25]This is suggested by a number of arbitral awards. See *ex multis Eiser*, *supra* note 17, paras. 378–9; *Antin Infrastructure Services Luxembourg S.à.r.l. and Antin Energia Termosolar B.V. v. Kingdom of Spain*, ICSID Case No. ARB/13/31, Award, 15 June 2018, para. 533. See, then, the following passage of the *RREEF* award, applying the ECT: 'The FET principle includes, but goes beyond, the traditional "minimum standard" as conceived in the *Neer Case*.' *RREEF*, *supra* note 10, para. 263.

[26]*Continental Casualty Company v. The Argentine Republic*, ICSID Case No. ARB/03/9, 5 September 2008, para. 261.

[27]In virtue of Art. 26(3), states may opt out of the 'umbrella clause' contained in Art. 10(1) of the ECT (to date only four states have refused the application of the umbrella clause). A 'reverse umbrella clause' is also conceivable, transforming breaches of domestic law by the investor into treaty breaches. See, as an example, Art. 11 of the Model Text for the

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As shown by conflicting arbitral decisions, the scope of application of the so-called umbrella clause is not unequivocally conceived. According to a first interpretation which is grounded on and emphasizes the plain text of the provision, it is 'any' obligation which requires observation. The clause serves to bring any contractual agreements between the investor and the state under the 'umbrella' of the ECT, thus making contractual rights enforceable under the ECT.[28]

According to a second, narrower and nuanced interpretation, the rationale of the provision is to prevent that a state abuses its governmental powers to escape from its contractual obligations when it acts in its dual role as contracting party on the one hand and regulator on the other. Thus, a claimant can trigger the umbrella clause on the sole condition that the core or centre of gravity of a dispute is the exercise of governmental powers (*la puissance publique*) or reliance on governmental prerogatives and advantages, with the exclusion of normal contractual non-performance.[29] The scope of the umbrella clause is thus reduced and the risk of 'opening of the floodgates' avoided.

Whatever the point of view adopted, the unilateral change of tariffs by the host state affecting a contract or licence and, in general, a reduction or withdrawal of incentives, seems to intrinsically constitute the exercise of governmental power. Therefore, if a contract contains a commitment to tariffs/incentives stability, a breach thereof certainly triggers the umbrella clause and is elevated to an ECT breach.

That expectations arising from contracts deserve greater protection can be supported by the fact that contracts are a kind of *lex specialis* concluded by the host state so as to attract and accommodate foreign investors. They reflect the carefully negotiated balance achieved by the opposing parties and could be said to crystallize the parties' expectations.[30] As such, they could seem to justify special protection of the affected investor, more so than the expectation of the investor who has decided to operate under the host state's general legislation. According to the Tribunal in *Continental Casualty* v. *Argentina*, general legislative statements which are not specifically addressed to the relevant investor only 'engender reduced expectations, especially with competent major international investors in a context where the political risk is high'.[31]

Indian Bilateral Investment Treaty requiring investors' compliance with 'all laws, regulations, administrative guidelines and policies of a Party concerning the establishment, acquisition, management, operation and disposition of investments'.

[28]The feared side-effect of such interpretation is the opening of floodgates, which, however, is mitigated when the substantive rule of the umbrella clause is read in combination with the jurisdictional rule contemplated under Art. 26(3)(b)(i) of the ECT. Under such provision, state parties may opt to rule out subsequent access to arbitration where the investor has previously submitted the dispute to the host state's courts or administrative tribunals, or to any previously agreed dispute settlement procedure. This exception is known as the 'fork in the road'. For a list of state parties which have conditioned their consent to arbitration in such a way see ECT, Annex ID. Arbitral tribunals, however, usually take a narrow view of this provision, requiring continuity in the identity of the parties, cause of action, and object of the dispute (the so-called 'triple identity test'). See, e.g., *Hulley Enterprises Ltd. (Cyprus) v. Russian Federation* – PCA Case No. AA 226, Award, 18 July 2014, 402–6; *Charanne*, *supra* note 11, paras. 405–8.

It is nonetheless submitted that the choice to take the dispute to the national courts does not preclude the investor from bringing an international claim for breach of FET, if the national procedure fails to meet the minimum due process standard demanded by that principle. In such a case, it is not the underlying investment dispute that founds the international case, but the very fact that the national procedures charged with its resolution have failed to meet international treaty standards. In this sense see also P. T. Muchlinski, *Multinational Enterprises & The Law* (2007), 646. Muchlinski further maintains that investors should have a duty to use local remedies as an aspect of good corporate citizenship and good management practice, in return for the host country providing proper and effective means of redress, with international dispute settlement remaining available as an option of last resort. See P. T. Muchlinski, 'Caveat Investor - The Relevance of the Conduct of the Investor under the Fair and Equitable Treatment Standard', (2006) *International & Comparative Law Quarterly* 555–6.

[29]T. W. Wälde, 'The Umbrella Clause In Investment Arbitration: A Comment on Original Intentions and Recent Cases', (2005) *Journal of World Investment & Trade* 235.

[30]M. Potestà, 'Legitimate Expectations in Investment Treaty Law: Understanding the Roots and the Limits of a Controversial Concept', (2013) 28 *ICSID Review* 1, at 103.

[31]Continental Casualty Company, *supra* note 26, para. 261. According to the Tribunal in *Blusun*, tribunals have so far declined to sanctify laws as promises. *Blusun*, *supra* note 5, para. 367. See also *Total S.A.*, *supra* note 13, para. 122. The Tribunal, however, further admits that a claim to stability can be based on the inherently prospective nature of a regulation aimed at providing a defined framework for future operations.

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Indeed, a stabilization commitment made in a law is just as much subject to change as all the other dispositions of the law in question – within the limits of 'respect of fundamental human rights and *ius cogens*', which were not elaborated on further by the Tribunal.[32]

These arguments are not persuasive, mainly because it is debatable that a piece of legislation engenders reduced expectations compared to the ones engendered by a contract. Quite the contrary: it may be argued that contractual arrangements deserve less protection, precisely because they deviate from general legislation, which may be considered to reflect the public good more comprehensively than an individual contract.[33]

As a practical matter, in today's market economies, modern states cannot negotiate contracts with large numbers of private actors, and therefore rely on the ability to make binding commitments and provide guarantees to private parties, including investors, by way of legislative or regulatory instruments.[34] To deny states this power would gravely obstruct a state's governance and regulation, and undermine the rule of law.

The reasons are not just practical, but also legal. If it is true that contracts create 'legal rights', the same holds true for legislative acts.[35] According to a principle which can be derived from comparative law, the legal effect of a contract is that of a law for the parties to the contract.[36] It therefore seems contradictory to grant contractual entitlements greater protection than that accorded to a law. The EU-Canada CETA contemplates the equivalence of a specific commitment to stability undertaken through a contract or legislation, which is also worthy of note as an element of state practice.[37] Finally, if one adopts the point of view that general legislative instruments grant reduced protection, the investor should be ready to accept whatever the host state decides to do, on the sole condition that this is done through a legislative act amending a previous legislative act.[38]

In the light of the above, it seems that where a state is found to have provided undertakings or commitments to a class of investors regarding a specified treatment for a prescribed period of time in its general legislation, a legal right to stability arises from these undertakings or commitments no less than where the state has made a specific stabilization commitment to an individual investor.[39]

As a general rule, as long as an appearance of legitimacy is met (*apparentia juris*), it is insignificant whether relevant acts are then declared null and void, or susceptible to invalidation, under national law.[40] On the other hand, the mere existence of a legal norm, or of a contract, is obviously

[32]*Continental Casualty Company*, *supra* note 26, para. 261.

[33]In this sense, see also R. Dolzer, *supra* note 11, at 104.

[34]As far as incentive law is concerned, 'la legge deve rispettare un impegno (che ben può definirsi) sostanzialmente contrattuale, assunto dal legislatore', M. Luciani, *supra* note 16, at 2090–1.

[35]In his Dissenting Opinion, G. Born points to both Czech legislation and Czech official statements to demonstrate that the breach of the undertaking to maintain fixed minimum FiTs for 15 (later 20) years was a violation of the Treaties' guarantees of FET. Dissenting Opinion of G. Born in *Antaris Solar GmbH and Dr. Michael Göde v. Czech Republic*, PCA Case No. 2014-01, 2 May 2018, para. 29. Legitimate expectations of compliance are often inferred from a presumably existent right under domestic law: 'That legislative guarantee, which was, as also discussed above, repeatedly reaffirmed in governmental statements, provided investors with an enforceable right to, and legitimate expectation of, stabilised FiTs for 15 (later 20) years.' Dissenting Opinion of G. Born, ibid., para. 57; 'they [contractual undertakings by governments] generate as a rule legal rights and therefore expectations of compliance', *Continental Casualty Company*, *supra* note 26, para. 261.

[36]See Art. 1103 of the French Civil Code and Art. 1372 of the Italian Civil Code.

[37]According to CETA, in the absence of any specific commitment *under law or contract* to issue, renew, or maintain a subsidy, a Party's decision not to issue, renew, or maintain that subsidy does not constitute a breach of the CETA. Art. 8.9, para. 3.

[38]*ADC Affiliate Limited and ADC & ADMC Management Limited v. The Republic of Hungary*, ICSID Case No. ARB/03/16, Award of 2 October 2006, para. 424.

[39]According to G. Born, the fact that a state makes an undertaking to investors in general legislation does not 'limit' the legitimate expectations of investors nor grant the state a margin of appreciation to refuse to honour the commitments it has made. Dissenting opinion of G. Born in *Antaris*, *supra* note 35, paras. 42, 44.

[40]'It is possible that under Egyptian law certain acts of Egyptian officials, including even Presidential Decree No. 475, may be considered legally non-existent or null and void or susceptible to invalidation. However, these acts were cloaked with the mantle of Governmental authority and communicated as such to foreign investors who relied on them in making their

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not sufficient to create a right to stability.[41] For a legal right to arise, they must contain a stabilization clause freezing a specific host state's legal framework, or the contractual regulation, on a certain date and for a certain period of time.[42] The setting of the final term for the enjoyment of an incentive can be read as a sign that the legislator has undertaken a commitment as it reinforces certainty (*Selbstbindung*).[43]

In summary, a breach of a previously adopted specific undertaking to stability is automatically a breach of FET. One may say that, while the FET is not a stabilization clause as such, it nonetheless guarantees the stabilization commitment already made by the host state by way of a legislative act or contract.[44] In both cases, the state no longer retains a margin of discretion to balance the investor's expectations against public policy objectives, no matter whether the regulatory change is properly or improperly retroactive.[45] In particular, a reason of mere budget opportunity, or a political choice to no longer consider renewable energies worthy of promotion, cannot justify such regulatory changes. Otherwise, compliance with the FET standard would become dependent on the mere discretion of the host state. Thus, if the problem was budget opportunity, the economic burden should be borne by the host state and should not be to the disadvantage of the investors.[46] The possible application of the circumstances precluding wrongfulness – for instance, the state of necessity – is of course justified if the corresponding prerequisites are satisfied.[47]

## 4. The acceptable margin of regulatory change in the absence of a specific commitment

In the absence of a specific commitment by the host state, an investor faces a steeper burden but protection is not *a priori* excluded. In this realm, even mere political declarations may assume a specific value, at least as supporting arguments to the investors' claims.[48]

investments ... These acts, which are now alleged to have been in violation of the Egyptian municipal legal system, created expectations protected by established principles of international law.' *Southern Pacific Properties (Middle East) Limited v. Arab Republic of Egypt*, ICSID Case No. ARB/84/3, Award of 20 May 1992, paras. 82–3.

[41]The Tribunal in the *Isolux* case excluded that Spain had undertaken a commitment towards the investors precisely because of the general character of the applicable rules. *Isolux Netherlands, BV v. Kingdom of Spain*, SCC Case V2013/153, Award of 17 July 2016, para. 775.

[42]*Charanne*, *supra* note 11, para. 490.

[43]D. Heckmann, *Geltungskraft und Geltungsverlust von Rechtsnormen*, Tübingen, 1997, 243; M. Luciani, *supra* note 16, at 2090. *Contra* the Tribunal in *Blusun* excluded that the frustration of the investor's expectation that the tariffs set by the Third Energy Account would remain in place for its duration according to its terms, thus until 31 December 2013, was in breach of Art. 10 ECT. This is because 'there is still a clear distinction between a law, i.e. a norm of greater or lesser generality creating rights and obligations while it remains in force, and a promise or contractual commitment'. *Blusun*, *supra* note 5, paras. 367, 371, 374.

[44]In this sense see also F. Ortino, 'The Obligation of Regulatory Stability in the Fair and Equitable Treatment Standard: How Far Have We Come?', (2018) 21 *Journal of International Economic Law*, 853.

[45]On the notion of proper and improper retroactivity see *infra*, Section 5, para. 5.

[46]D. Heckmann, *supra* note 43, at 249.

[47]In particular, a host state can successfully invoke the defence of necessity if the wellknown requirements listed by Art. 25 of the Draft articles on Responsibility of States for Internationally Wrongful Acts are met. Among them, the rule that the state cannot invoke necessity if it has contributed to that state of necessity is emphasized by the Tribunal in the *Sempra Energy International* case as the expression of a general principle of law devised to prevent a party from taking legal advantage of its own fault. *Sempra Energy International v. The Argentine Republic*, ICSID Case No. ARB/02/16, Award of 28 September 2007, paras. 353–4. In *Lg&E*, Argentina succeeded in invoking the necessity defence between December 2001 and April 2003. See *LG&E Energy Corp., LG&E Capital Corp., and LG&E International, Inc. v. Argentine Republic*, ICSID Case No. ARB/02/1, Decision on liability of 3 October 2006.

[48]'The Tribunal accepts that promises or representations to investors may be inferred from domestic legislation in the context of its background, including official statements. It is not essential that the official statements have legal force.' *Antaris*, *supra* note 35, para. 366. The Tribunal in *Total v. Argentina* noted that the legal regime in force at the time of making the investment does not *per se* constitute a guarantee of stability unless the state has explicitly assumed a specific legal obligation for the future, such as by contracts, concessions- or stabilization clauses, but it added that 'the situation is similar when

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As arbitral awards demonstrate, there is no single answer to the question as to when a change in regulatory framework, in the absence of a specific commitment, would entail a violation of the FET standard. The tests proposed by tribunals vary, ranging from consideration of the total or drastic or radical extent of the regulatory change[49] to its unreasonable[50] or disproportionate character in respect to the objective to achieve,[51] or to a combination of such criteria.[52] The Tribunal in the *Charanne* case specified that the proportionality requirement is fulfilled as long as the modifications are not random or unnecessary, provided that the essential features of the regulatory framework in place are not suddenly and unexpectedly removed.[53] In similar terms, in the *Novenenergia* case, the Tribunal emphasized that 'drastic and unexpected' regulatory changes entail a violation of FET.[54] And yet, in spite of the differences in the wording used, the emphasis always is on the subversion of the legal regime.

The public interest is also often outlined in arbitral awards, although in different ways. The *Electrabel* v. *Hungary* decision emphasized that the host state is entitled to maintain a reasonable degree of regulatory flexibility to respond to changing circumstances *in the public interest*.[55] Tariff

public authorities of the host country have made the private investor believe that such an obligation existed *through conduct or by a declaration*' (emphasis added). *Total S.A.*, *supra* note 13, paras. 117–18. *Contra*, in *El Paso v. Argentine Republic*, the claimant relied on a joint general message to Congress by Argentina's President and the Minister of Economics about the 'legal certainty' the enactment of the Electricity Law would achieve. The Tribunal observed that a 'declaration made by the President of the Republic clearly must be viewed by everyone as a political statement, and this Tribunal is aware, as is every individual, of the limited confidence that can be given to such political statements in all countries of the world'. *El Paso*, *supra* note 10, para. 395. The Tribunal admitted that such statements may have induced investors to decide to invest in the country. But it is one thing to be induced to make an economic decision by political proposals, and another to be able to rely on these proposals in order to claim legal guarantees. Such political declaration did not equate to specific commitments to foreign investors 'not to modify the existing framework, which was designed to attract them'. Ibid., para. 396.

[49]In the *El Paso* case, the Tribunal argued that 'no reasonable investor can have such an expectation unless very specific commitments have been made towards it or unless the alteration of the legal framework is *total*' (emphasis added). *El Paso*, *supra* note 10, para. 374; 'In the absence of a stabilisation clause or similar commitment, which were not granted in the present case, changes in the regulatory framework would be considered as breaches of the duty to grant full protection and fair and equitable treatment only in case of a *drastic* or discriminatory change in the essential features of the transaction' (emphasis added). *Toto*, *supra* note 17, para. 244. 'However, Article 10(1) of the ECT entitled them to expect that Spain would not *drastically* and *abruptly* revise the regime, on which their investment depended, in a way that destroyed its value (*emphasis added*).' *Eiser*, *supra* note 17, para. 387. The Tribunal further specified that the previous legal regime was 'replaced with an unprecedented and wholly different regulatory approach, based on wholly different premises' and had the effect of stripping investors of virtually all of the value of their investment, with the consequence that a breach of FET occurred. Ibid., para. 365. 'The Tribunal will, thus, have to assess ... if subsequent legislation by the Respondent *radically* altered the essential characteristics of the legislation in a manner that violates the FET standard' (emphasis added). *Novenergia–II - Energy & Environment (SCA) (Grand Duchy of Luxembourg), SICAR v. The Kingdom of Spain*, SCC Case No. 2015/063, 15 February 2018, para. 656.

[50]In *Impregilo v. Argentina*, the Tribunal issued the following statement: 'The legitimate expectations of foreign investors cannot be that the State will never modify the legal framework, especially in times of crisis, but certainly investors must be protected from *unreasonable* modifications of that legal framework' (emphasis added). *Impregilo S.p.A. v. Argentine Republic*, ICSID Case No. ARB/07/17, Award of 21 June 2011, para. 291. In *Partkerings v. Lithuania*, the Tribunal affirmed that 'as a matter of fact, any businessman or investor knows that laws will evolve over time. What is prohibited however is for a State to act unfairly, unreasonably or inequitably in the exercise of its legislative power'. *Parkerings-Compagniet AS v. Republic of Lithuania*, ICSID Case No. ARB/05/8, Award of 11 September 2007, para. 332.

[51]The Tribunal in *Blusun v. Italian Republic* solely relied on the proportionality test. *Blusun*, *supra* note 5, paras. 318, 319, 372.

[52]'Nevertheless, the ECT did protect Claimants against the total and unreasonable change that they experienced here.' *Eiser*, *supra* note 17, para. 363. 'The answer depends ... on whether or not the changes can be held as being reasonable and proportionate.' *RREEF*, *supra* note 10, paras. 324, 462–3.

[53]*Charanne*, *supra* note 11, para. 517, recalled in *Eiser*, *supra* note 17, para. 370; *Antin*, *supra* note 25, paras. 531–2; *RREEF*, *supra* note 10, para. 460.

[54]*Novenergia*, *supra* note 49, para. 695.

[55]*Electrabel*, *supra* note 10, para. 7.77; see also *Saluka*, *supra* note 10, para. 305; *BG Group Plc v. The Republic of Argentina*, Final Award, 24 December 2007, para. 298; *El Paso*, *supra* note 10, para. 433; *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. 423; *Charanne*, *supra* note 11, para. 500; *Antaris*, *supra* note 35, para. 360. The 2012 UNCTAD Study on FET notes that, according to a significant number of

deficit, for instance, is a legitimate public policy problem which may be addressed by adopting regulatory changes on the condition that they are appropriate and reasonable.[56] Other awards are less demanding, as they require that regulatory changes are *not contrary to the public interest*. According to the Tribunal in the *Charanne* case, for instance, the FET standard is breached when regulatory changes are made in a manner that is unreasonable, disproportionate, or contrary to the public interest.[57] This was excluded by the Tribunal in this case, since the main function of the regulatory change was to limit the deficit and control electricity price increases for the consumer.[58]

Within the outlined limits, a 'margin of change' is acceptable and compatible with the FET standard.[59] Beyond this margin, a state cannot change its regulatory framework, or rather, it can change it, but under the obligation to redress the damage suffered by an investor whose expectations were frustrated.[60]

The substance does not change if the FET principle is viewed not as a statement of a state's obligation, but from the standpoint of the investor.[61] Prudent investors must know that economic activities may require changes in discipline. This is part of the business risk they have to bear when investing in a particular country.[62] The investor nonetheless has reasonable expectations that the legal framework of the host state will not change beyond the outlined acceptable 'margin'.

A cautionary note is necessary here on the circumstances surrounding the investment, which arbitral tribunals often emphasize to demonstrate that the regulatory change was foreseeable. An unqualified emphasis on the circumstances surrounding the investment entails a risk of subjectivism associated with legitimate expectations and gives the tribunal a free pass to judge the legitimacy of investors' expectations at its whim.[63] Thus, circumstances surrounding the investment can be used to demonstrate that the regulatory change was foreseeable on the sole condition that they are univocal, which is often not the case. The instable character of the legal framework regulating a specific area of investments, for instance, could be used to exclude the legitimate expectations of the investor only when continuous regulatory modifications are absolutely necessary to

awards, FET does not prevent host states from acting in the public interest, even if such acts adversely affect investments. United Nations Conference on Trade and Development, Fair and Equitable Treatment, Series on Issues in International Investment Agreements II, New York-Geneva, 2012, 72–3.

[56]*Eiser*, *supra* note 17, para. 371; the UNCTAD Study further specifies that 'investors can expect, however, that such changes will be implemented in good faith and in a non-abusive manner and that public-interest arguments will not be used as a disguise for arbitrary and discriminatory measures'. UNCTAD, *supra* note 55, at 77.

[57]*Charanne*, *supra* note 11, para. 514; which paragraph is recalled in *Eiser*, *supra* note 17, para. 370.

[58]*Charanne*, ibid., paras. 534, 536.

[59]The reference to an 'acceptable margin of change' is quite recurrent in arbitral practice. See *Antaris*, *supra* note 35, para. 360; *Philip Morris Brands S.à r.l.*, *supra* note 55, para. 423; *El Paso*, *supra* note 10, para. 402.

[60]Dissenting Opinion of G. Born in *Antaris*, *supra* note 35, para. 55; Partial Dissenting Opinion of Arbitrator Tawil in *Charanne*, *supra* note 11, para. 11.

[61]A distinction of perspective was drawn in the literature between person-oriented principles of justice (such as human rights) in contrast to state-centred principles of justice (such as FET). V. Kube and E. U. Petersmann, 'Human Rights Law in International Investment Arbitration', in Gattini et al., *supra* note 13, at 221.

[62]In *Parkerings v. Lithuania*, the Tribunal expressly noted that Lithuania was in transition from its Soviet past to being a candidate for European Union membership. Thus, legislative changes, far from being unpredictable, were to be regarded as likely. According to the Tribunal, investors could and, with hindsight, should have sought to protect legitimate expectations through a stabilization clause. *Parkerings-Compagniet*, *supra* note 50, paras. 335–6; 'a legitimate investor expectation cannot be induced by a regulatory framework when the investor's actual information allowed him to foresee and anticipate the unfavorable development of this regulatory framework before making the investment. In order to breach the legitimate expectations of the investor, the new regulatory measures should not have been foreseeable, either by a prudent investor or by an investor who, by reason of his personal situation, had specific elements to foresee those measures'. *Isolux*, *supra* note 41, para. 781.

[63]'C'est en réalité le droit objectif, qu'il résulte du droit international général ou des traités de protection des investissements, et non la subjectivité de l'investisseur, qui permet de départager le comportements licites ou illicites de l'Etat.' E. Gaillard, 'Centre international pour le règlement des différends relatifs aux investissements (CIRDI), chronique des sentences arbitrales', (2008) *Journal de droit international* 332–3. *Contra*, it was argued that such relativization appears to be an almost inevitable consequence of resorting to a concept – the expectation – that bears a certain level of subjectivity. See Potestà, *supra* note 30, at 122.

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adapt the market to changing objective circumstances. On the contrary, when such instability simply mirrors poor legislation, instability may be used as an argument to demonstrate a breach of FET by the host state. Otherwise a state will be taking advantage of its own fault.[64]

## 5. Safeguards to prevent a breach of the fair and equitable treatment standard

In the absence of a specific commitment to stability, a definition of the exact threshold applicable in all types of situations may be an impossible endeavour. When is the regulatory change drastic, unreasonable, or disproportionate? Some may view this as regrettable for the ensuing lack of legal certainty, with investors unable to predict when a regulatory change will cross the line and become a breach of the FET standard. However, certain safeguards can be identified which states should observe in order to avoid liability under the ECT when they are about to change a regulatory framework in a manner that is likely to impact foreign investors. The 'translation' of the FET principle into more specific rules would increase legal certainty and reduce *ex ante* the number of disputes between investors and host states. Reference by arbitral tribunals to the host state's performance of these safeguards, rather than to the sole FET standard, would also have the merit to make arbitral decisions more foreseeable, and more coherent than they are today.[65]

Legal certainty is intrinsic to law. It can be argued that law is certain and foreseeable, otherwise it cannot be classified as law.[66] Thus, above all, under a precautionary perspective, each host state should assess the rationale and the appropriateness of each new incentive before its adoption, thus define in advance and in line with its objective the duration of and the amount to spend on the incentive. Without time and means being tailored to pre-established objectives, an incentive could create unlimited expectations among investors, which the host state could subsequently frustrate should the objective no longer be considered worthy of promotion.

A regulatory measure affecting the past should be assessed with caution beyond the traditional case of proper retroactive impact on acquired rights,[67] even with reference to pending contractual relationships (improper retroactivity, *quasi-retroattività*, *unechte Rückwirkung*). For instance, a new law withdraws or reduces an incentive for renewable energy plants already in operation, but only from its entry into force.[68] It is true that the new regulatory measure only applies to events occurring after its entry into force, thus for the future, but in doing so may affect a set of previously balanced interests. In more precise terms, it may interfere with settled expectations that arose, or even with vested rights accrued prior to the entry into force of the law. Rather than

[64]In the light of these remarks, see *Isolux, supra* note 41, para. 788.

[65]'L'attente n'est légitime que si elle suppose de la part de l'Etat un comportement conforme au droit international et aux engagements spécifiques qu'il est susceptible d'avoir pris à son égard. Plus juste, la notion apparaît alors passablement circulaire. Aussi gagnerait-on probablement à éviter le détour rhétorique par la notion d'attente légitime de l'investisseur pour s'attacher à définir ce que sont les obligations d'un Etat respecteux du droit international.' E. Gaillard, *supra* note 63, at 333.

[66]A. Pizzorusso, '*Certezza del diritto. Profili applicativi*', in *Enciclopedia giuridica* (1988), 2.

[67]If operators have already received an *una tantum* incentive, and a new regulatory measure withdraws or reduces the incentive, such measure clearly affects a 'consolidated' legal position, an acquired right, because it applies to cases which entirely belong to the past and are therefore exhausted. In virtue of the principle of legal certainty, the greatest possible protection should arguably be accorded to such acquired rights. The same applies with reference to past periods when a regulatory change affects contracts which are still pending. This is the so-called proper retroactivity (*retroattività propria*, *echte Rückwirkung*). Think of state aid, which, once granted, is qualified as incompatible with the single market by the EU Commission, and therefore recovered.

[68]The majority of renewable energy arbitrations precisely deal with laws which are improperly retroactive, although arbitrators wrongly qualify them as non-retroactive. The Czech regulatory modifications to the support scheme and tax measures at stake in *Antaris and Göde v. Czech Republic*, for instance, were deemed non-retroactive by the Tribunal. This position was supported by reference to an assumed consistent decision of the Czech Constitutional Court. *Antaris*, *supra* note 35, para. 430. Unlike suggested by the Tribunal, however, the Czech Constitutional Court had not concluded in its decision that the regulatory modifications at stake were non-retroactive, but that they were quasi-retroactive. See Czech Constitutional Court, Judgment Pl. ÚS 17/11, para. 48.

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wondering whether or not a new regulatory measure is retroactive, an assessment of the effects any new law may have on the operations in progress, and on the legitimate expectations of the investor, should be made by the host state, and eventually by the arbitral tribunal, with a specific caveat: a minimum impact on the past. Thus, the balance of the traditional principle of *lex posterior derogat priori* with the FET principle may result in the old law prevailing over the new one.[69]

In particular, since a sudden and unexpected regulatory change may be detrimental to legitimate expectations of investors, especially when the regulatory change introduces a new or heavier burden, or removes or reduces benefits, the host state should give those potentially affected by the change adequate warning and adopt transitional measures, unless when the regulatory change was *per se* foreseeable by a prudent investor.[70] The lack of transitional rules, rather than the regulatory change *per se*, which falls within the regulatory discretion of the host state,[71] may cause a prejudice to the legitimate expectations of the investors. However, such transitional measures must be harmonized with the objective situation. Their adoption must not undermine the effectiveness of the new legislation and jeopardize the objective it pursues. Thus, transitional measures can be avoided when their adoption is prevented by an overriding public interest requiring the immediate application of the new regime without warranting any claims for damages. Only in the absence of an overriding public interest and of transitional measures can the host state be held responsible for a violation of the FET standard because of the regulatory change. At least in part, arbitral practice already follows this *modus decidendi*. The Tribunal in the *Blusun* case, for example, not only considered that regulatory changes did not abolish incentives for which plant operators had already qualified, but also took into account the grace period of 12 months for grid connection, which was envisaged to preserve the pre-existing tariff level. Deemed reasonable by the Tribunal, the grace period was taken into consideration to exclude that the Italian regulatory changes were in breach of Article 10 ECT.[72]

The outlined rules apparently mirror the case law developed by the European Court of Justice on matters of legitimate expectations.[73] Thus, reference to these rules by arbitral tribunals arguably has the merit of facilitating the recognition of arbitral awards within the European Union.

Finally, 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

[69]In this sense, the Tribunal in the *RREEF* case, which accepts the retroactivity argument because the 'New Regime applies only for future remuneration, but it subtracts past remuneration (remuneration that was due under the previous regime) from the future remunerations'. See further *RREEF*, *supra* note 10, paras. 328–9. *Contra* the Tribunal in the *Charanne* case refused to see any retroactivity, assuming that there can be no retroactivity when a norm only applies to the future effects of past events. *Charanne*, *supra* note 11, para. 548.

[70]See *supra*, Section 4, para. 4; see *supra* note 62.

[71]Although redundant, 'for greater certainty', 'the mere fact that a Party regulates, including through a modification to its laws, in a manner which negatively affects an investment or interferes with an investor's expectations, including its expectations of profits, does not amount to a breach of an obligation under this Section' is explicitly contemplated by the EU-Canada CETA. Art. 8.9 (Investment and Regulatory Measures), para. 2.

[72]*Blusun*, *supra* note 5, paras. 342, 364.

[73]The European Court of Justice held that, *in the absence of an overriding public interest*, the Commission infringed on a superior rule of law by failing to couple the repeal of a set of rules with transitional measures for the protection of the expectations a trader might legitimately have derived from the Community rules. See Judgment of the Court (Second Chamber) of 22 June 2006. *Kingdom of Belgium (C-182/03) and Forum 187 ASBL (C-217/03) v. Commission of the European Communities*. Joined cases C-182/03 and C-217/03. Reports of Cases, 2006 I-05479, paras. 147–9. On the contrary, the system of adjustment of monetary compensatory amounts is intended to prevent speculation and abuse which might occur during the period between the discussions within the Council, and the date when the new representative rates take effect. It is therefore consistent with the objective pursued to choose the date on which the Council's intention to alter the representative rates was made public as the date to be taken into consideration for the adjustment of amounts fixed in advance. Judgment of the Court (Fifth Chamber) of 21 April 1988. *Fratelli Pardini SpA v. Ministero del Commercio con l'Estero and Banca Toscana*. Case 338/85, Reports of Cases 1988 02041, para. 24. For an analysis of the relevant European Court of Justice case law, see L. Lorello, *La tutela del legittimo affidamento tra diritto interno e diritto comunitario* (1998), 153–214; S. Bastianon, *La tutela del legittimo affidamento nel diritto dell'Unione Europea* (2012), 89–96.

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over time'.[74] This is even more true where unilateral declarations promising stability were made. In the *Total* case, for instance, the Tribunal found that the failure to readjust the tariffs according to principles of economic equilibrium and business viability violated FET.[75] Thus, a reduction of tariffs may be compatible with FET on the condition that business viability is safe.[76]

In the light of the above, an earlier termination of an incentive regulation deserves careful analysis, even if it is not properly retroactive, particularly in respect of those who have an expectation of future acquisition in respect to the incentive, as is the case with those who are yet to meet all requirements for putting a photovoltaic plant into operation at the time of the earlier withdrawal of an incentive. The enactment of Italian legislative decree n. 28 of 2011 and the subsequent approval of the Fourth Energy Account on 5 May 2011, for instance, limited the scope of application of the Third Energy Account through the provision that the Third Energy Account was applicable to the production of electricity from solar photovoltaic plants put into operation before 31 May 2011, and no longer, as originally envisaged, to those put into operation before 31 December 2013. The timeline for the application of the Third Energy Account was therefore reduced by more than two years and the incentive scheme was replaced by a less advantageous regime.[77]

This is neither a case of *echte Rückwirkung* nor one of *unechte Rückwirkung*. Photovoltaic plant operators who had already put their plant into operation and therefore acquired the right to the incentive (as contemplated by the Third Energy Account) before 31 May 2011, i.e., after the entry into force of the decree, kept their right for a period of 20 years. Nevertheless, the legal position of the investor should be considered, who, despite not being entitled to the relevant incentives yet, has started the preparation for installing a photovoltaic plant and ascertained its profitability based on the assumption that the incentives set out in the Third Energy Account would remain in place for its entire duration until 31 December 2013.[78] It is submitted that a balance for such cases is needed between the public interest on the basis of the regulatory change and the private interests likely to be affected. In particular, the absence of an acquired right to the perception of incentives does not seem sufficient for excluding *a priori* that the principles of FET and legal certainty may provide for a legal protection of investors' expectations, at least where, lacking an overriding public interest, no transitional measures are adopted.

In the absence of the above safeguards, a loss of confidence in the host state by foreign investors will be difficult to avoid, in addition to the risk of successful claims being made by the latter. The host state will ultimately bear negative consequences, in terms of reduced investments caused by its instable conduct.

## 6. Final remarks

Along this work, a breach of a specific commitment to stability, previously assumed through a legislative act or contract, was ascertained to automatically constitute a breach of the FET standard.

In the absence of a specific commitment to stability, protection is not *a priori* excluded. It was attempted to strike a balance between the thesis which derives legitimate expectations from the mere existence of legislation on the subject matter,[79] and the opposite thesis, according to which,

[74] *Total S.A.*, *supra* note 13, para. 122.

[75] Ibid., para. 333.

[76] In arbitral practice this criterion is followed, even if not univocally, in the calculation of damages: 'it is only to the extent that the modifications would have exceeded the limits of what is reasonable that compensation would be due and should be calculated'. *RREEF Infrastructure (G.P.) Limited* and *RREEF*, *supra* note 10, paras. 515, 517.

[77] For a detailed survey of that Italian regulatory change see V. Cirimbilla and L. Scappini, 'Quale futuro per gli investimenti nel settore fotovoltaico alla luce del D.Lgs. n. 28/2011?', (2011) *Il Fisco* 2340–4.

[78] The described regulatory change triggered the *Blusun* arbitration, *supra* note 5.

[79] In his dissenting opinion on the *Charanne* case, Arbitrator Tawil finds that legitimate expectations can also derive from a host state's legal regime in force at the time of the investment. Dissenting Opinion of Arbitrator Tawil in *Charanne*, *supra* note 11, paras. 5, 12.

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in the absence of a specific commitment, states are free to change a legal framework affecting investments with no limitations whatsoever. In their absoluteness, both theses are unacceptable. The former would be too intrusive against state sovereignty while the latter would leave investors at the mercy of the host states. Arbitral practice is nonetheless enlightening to strike a balance and shows that the FET principle does not prevent a regulatory change *per se*, but offers specific benchmarks to define the modalities through which such regulatory change should be attained.

A number of safeguards were coherently identified, which may be used as criteria to establish when a regulatory change exceeds the acceptable margin and becomes a breach of the FET standard. In particular, since a sudden and unexpected regulatory change may be detrimental to legitimate expectations of investors, especially when the regulatory change introduces a new or heavier burden, or removes or reduces benefits, the host state should give those potentially affected by the change adequate warning and adopt transitional measures, unless when the regulatory change was *per se* foreseeable by a prudent investor, or when an overriding public interest requires the immediate application of the new regime. Moreover, 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.

The translation of the FET principle in the outlined rules, which are obligations of conduct, makes it clear that the FET is an objective standard in the sense that its content is the same for all state parties to an international treaty, regardless of their level of development and of the financial resources at their disposal.[80]

In this regard, it was, on the contrary, maintained that what an investor can reasonably, and thus legitimately, expect, especially in terms of stability or transparency, cannot be the same in a highly developed country as it would be in a developing or emerging economy.[81] Nevertheless, assuming that developing states are by default bound by lower standards because they are presumably more instable and thus less reliable is dangerous, because it entails a risk of relativism and fragmentation of international law.[82] It is also detrimental to developing states themselves: if they are legally entitled to breach their commitment to stability simply because of their development status, they will not be able to attract investments. In addition, if it is true that poor development is often correlated with an absence of respect for contractual commitments, changing this by external disciplines is the very function of investment treaties – an instrument of good governance not only in terms of the protection of foreign investors but also in terms of creating a 'culture of commitment' as a key component of good governance.[83] Admittedly, a developing state

[80]'Fair and equitable treatment is an absolute standard that provides a fixed reference point.' Schreuer, *supra* note 8, at 367. This, of course, unless the contrary is established in the treaty concerned. See, as an example, the already recalled Investment Agreement for the Common Market for Eastern and Southern Africa Common Investment Area, which allows an element of flexibility in the interpretation of the FET standard based on the level of development of the host state.

[81]Potestà, *supra* note 30, at 118. In similar terms, T. W. Wälde maintains that a differentiated approach would draw support from the recognition in other international legal instruments (the WTO, environmental treaties) that developing countries require a differentiated set of legal obligations reflecting their particular level of development. T. W. Wälde, 'Energy Charter Treaty-Based Investment Arbitration: Controversial Issues', (2004) *Journal of World Investment & Trade* 386. This supporting argument is nonetheless quite peculiar because an international instrument cannot be used to interpret a treaty except in case the stringent requirements contemplated by Art. 31 of the Vienna Convention on the Law of Treaties are met, which is certainly excluded for the international instruments recalled by the author. It is true that Art. 31, para. 3(c) obliges to take into account for interpretative purposes, together with the context, 'any relevant rules of international law applicable in the relations between the Parties'. But even admitting that environmental treaties sometimes contain differentiated sets of obligations depending on the level of development of state parties, and assuming that such rules are applicable between the parties to an investment treaty, they are not relevant, and can thus not be used in order to interpret such investment treaty.

[82]One author has rightly questioned whether taking into account these variables (the investor's expectations or the level of the development of the host state) might undermine one of the most basic premises underlying FET, i.e., its absolute (non-relative) nature. See M. Kinnear, 'The Continuing Development of the Fair and Equitable Treatment Standard', in A. K. Bjorklund, I. A. Laird and S. Ripinsky (eds.), *Investment Treaty Law: Current Issues* (2009), 236.

[83]Wälde, *supra* note 29, at 220.

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might be more likely to invoke the defence of necessity to justify a breach of the FET standard, but this is merely a factual consideration and is not related to the primary obligation breached.

It goes without saying that reference by arbitral tribunals to the FET as an objective standard, and to the outlined rules and safeguards, would not completely remove discretion. A certain degree of discretion is unavoidable when legal principles apply to factual reality, which is substantially more complex than law. But there is a limit beyond which discretion becomes arbitrariness. The translation of the FET principle into more specific rules will help to avoid that such limit is overstepped, hopefully making arbitral decisions more foreseeable, and more coherent than they are today.

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