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Practice Groups:

*International
Arbitration*

Energy

International Investment Treaties as a Possible Shield Against Government Cutbacks in Subsidies for the Green Energy Sector

By Wojciech Sadowski

A number of Governments around the world have recently curtailed their incentive schemes for green energy producers. These measures have often led to disruption of the basic economic assumptions of many ongoing or newly completed projects, and have severely impacted the volume of new investments, particularly in the solar energy sector. The deepening of the economic crisis in a few of these countries and their commitments to comply with their respective austerity plans is likely to lead to more governmental interference into the pre-existing aid schemes.

The type of the risk involved in these measures, i.e. political and legislative risk, is typically considered to be immune from standard legal actions available to aggrieved business, at least on a domestic level. International investment treaties may however provide an option for certain parties adversely affected.

International Investment Treaties

Investments treaties are multilateral or bilateral international agreements, entered into by states to foster the influx of investments. There are currently more than 2500 bilateral investment treaties worldwide, and a number of important multilateral investment treaties, including the North American Free Trade Agreement, the Energy Charter Treaty or the Central American Free Trade Agreement.

International investment treaties afford foreign private parties (investors) a significant level of protection, against political and/or regulatory risks, such as a radical change of the regulatory environment in the state where an investment is made (the “**host state**”). Most of those treaties also provide the investors with the right to sue host states before independent international arbitral tribunals, which decide the disputes on the basis of international, rather than domestic, law.

Eligibility for protection under these treaties requires certain conditions to be met, such as existence of an **investor** and an **investment**.

Investors

International investment treaties protect **foreign** investors, i.e. individuals or entities originating from states, which are parties to the same international investment treaty or treaties (bilateral or multilateral), which bind the host state, in which the investment (e.g. an energy project) is located.

International investment treaties do not recognize as investors the individuals or entities, which have the same nationality as the host state. Protection of such entities (if not individuals) against adverse measures taken by host states, however, may be possible under international investment

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treaties through their direct or indirect shareholders, provided that any of such shareholders does qualify as an investor under an international investment treaty.

Given that the notion of an investor is a legal concept which may change from treaty to treaty, or be made subject to further requirements (such as the requirement of genuine business activity in the home state of the investor), it should always be confirmed against a specific international investment treaty.

Investments

Most international investment treaties define **investments** very broadly, including “*every kind of asset*”, such as:

- property (tangible and intangible, movable and immovable) and any property rights
- shares, stock and other forms of equity participation
- bonds and other debt of a company
- claims to money and claims to performance pursuant to contracts
- intellectual property rights
- rights conferred by law or by virtue of any licenses or permits.

The case-law of arbitral tribunals also requires that investments involve a contribution of an economic value, which involves certain duration and an assumption of business risk. Therefore, typical sales transactions and other one-off transactions would normally be excluded from the concept.

Against these criteria, various legal and economic interests involved in long-term energy projects may qualify as investments under many international investment treaties.

Standards of Investment Protection

Most international investment treaties include certain typical substantive standards of investment protection. These include:

Protection against expropriation. Although states generally remain entitled to expropriate investments, the treaties impose important restrictions on this sovereign prerogative, and prohibit e.g. expropriation which is discriminatory or fails to conform to the due process requirements. They also provide for standards of compensation in cases of expropriation. Most importantly, international investment treaties protect investors against cases of *de facto* expropriation. In a *de facto* expropriation, the legal title to the investment remains with the investor. However, the investor is permanently deprived, through sovereign acts of the host states, such as e.g. decisions, decrees, laws, judgments, acts of the police or the military, of the use and benefit of the investment. In particular, a *de facto* expropriation may consist in the cancellation of a right or benefit, without which the investment can no longer operate.

Protection against unfair or inequitable treatment. Fair and equitable treatment is a broad legal standard, which includes protection of investors’ legitimate expectations. It also requires the states to act in a consistent and transparent manner, and to provide the investors with a predictable and stable legal environment. Although host states preserve their right to change their policies, as well as the corresponding legislative and regulatory framework, the fair and equitable treatment standard puts a limit on the states’ discretionary power to change the existing legal environment in

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an abrupt and non-transparent manner. This standard has proven to be the most effective defense to the investors against regulatory changes in many sectors.

Protection against discrimination. International investment treaties generally protect investors from discrimination, both against nationals of the host state, and against entities from any third country, including investors covered by the same or another international investment treaty.

Protection of undertakings assumed by the state towards investors. Certain international investment treaties include so-called “umbrella clauses”, which reaffirm the host states’ duties to stand up to their obligations towards the investors. Such obligations may result from a contract with an investor, a unilateral act, or a specific legislative or administrative act. The effect of the umbrella clauses is that they may transform a breach of such obligation into a self-standing breach of the treaty, and warrant a corresponding remedy.

Remedies

In case an investor believes that its treaty rights were violated by the conduct of the host state, it may assert these rights pursuant to a dispute resolution clause contained in the treaty. In particular, many international investment treaties provide the investors with the possibility to bring a claim against the state directly before an **independent, international arbitration tribunal**. This provides an effective remedy to enforce the investor’s rights and protect its investment.

Although the powers of such tribunals are wide-ranging, including non-monetary, remedies, in practical terms the principal available remedy is a damages award. The damages, if the host state is found liable under an international investment treaty, are calculated so as to wipe out the negative consequences of the breach. The loss incurred by the investor is often calculated in line with the market standards.

Use of international investment treaties in practice

Over the last 30 years there have been several hundred disputes under different international investment treaties. The treaties have been successfully relied upon by investors around the world in response to, e.g., a wave of regulatory changes introduced by Argentina in the energy sector in the aftermath of the 2000 economic crisis. They were also used in disputes concerning cancelled or frustrated energy projects, including against Turkey, Germany, Hungary, Romania and Canada.

With respect to the recent regulatory changes in the renewable energy sector, international investment treaties could be of assistance to the entities aggrieved by recent measures in one of the following two ways. They could be used either as a tool of pressure against further governmental action in the green energy sector, or, alternatively, they could be considered as an exit strategy, which allows an investor to recoup a part or the totality of its loss associated with the frustrated project. Effectively, the treaties have already been used in each of these ways by certain investors. Formal arbitration proceedings have been initiated against Spain and Canada, and warnings have also been issued against the Spanish Government against the new proposed regulatory measures.

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