Investor's Legitimate Expectations v State's Regulatory Power

In Spanish Renewable Energy Saga Context

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Abstract

International investment law affords treaty protection mechanisms to investors against host states' misconduct. One such tool available for investors is the fair and equitable treatment standard and its dominant element – legitimate expectations. Host states are under an obligation not to frustrate investors' legitimate and objective expectations. Such a duty impairs states from free and flexible exercise of their sovereign right to regulate and change legislative framework in public interests. Regulatory action from a host state is often alleged to be frustrating investor's legitimate expectations of regulatory stability. On the other hand, states have undertaken obligations towards people and are liable to fulfil their sovereign obligations. Exercise of the right to regulate overlaps investor's legitimate expectation of stability and this is when conflict between public and private interests arises. Addressing the conflict and balancing these two opposing interests are the main concern and task of tribunals. The latest development of case law illustrates that the balancing exercise is conducted through the proportionality principle which entails weighing both interests against one another and finding a balance between them.

Keywords: *international investment law, fair and equitable treatment, legitimate expectations, special representations, due diligence, state's right to regulate, regulatory objectives, Spanish Renewable Energy Saga, economic crisis, national security, absolute stability, relative stability, balancing exercise, proportionality principle*

Abbreviations

BIT	Bilateral Investment Treaty
CETA	EU-Canada Comprehensive Economic and Trade Agreement
EU	European Union
FET	Fair and Equitable Treatment
IIA	International Investment Agreement
ICSID	International Centre for Settlement of Investment Disputes
ICJ	International Court of Justice
ISDS	Investor-State Dispute Settlement
OECD	Organisation for Economic Cooperation and Development
RD	Royal Decree
RDL	Royal Decree Law
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
UNESCO	United Nations Educational, Scientific and Cultural Organization

1. Introduction

1.1 Background

The fair and equitable treatment (FET) standard is one of the most frequently used legal standards in international investment law. The FET clause can be found in almost every bilateral investment treaty (BIT) and other international investment agreements (IIA).[1] The standard is embodied in the Energy Charter Treaty (ECT), which is a multilateral instrument aiming to enhance cooperation in the energy sector.[2]

The FET clause is actively used by investors as a shield against host states.[3] The standard aims to protect investors from arbitrary, discriminatory, and abusive actions by the host state[4] and to fill gaps left by other treaty provisions.[5] Despite its generic nature,[6] the FET standard is considered to be a stand-alone rule with independent content[7] and certain constituent elements can be underlined through the case law:[8] (1) stability, predictability, and uniformity of the regulatory

[1] Stephan W. Schill, 'Fair and Equitable Treatment, the Rule of Law, and Comparative Public Law' in Stephan W. Schill (ed) *International Investment Law and Comparative Public Law* (OUP 2010) 151, 151 <https://academic-oup-com.ludwig.lub.lu.se/book/3504/chapter> accessed 13 April 2023; *Continental Casualty Company v The Argentine Republic*, ICSID Case No. ARB/03/9, Award (2008) (*Continental v Argentina*), para. 254 <https://www.italaw.com/sites/default/files/case-documents/ita0228.pdf> accessed 16 April 2023;

[2] Energy Charter Treaty (1998) <https://www.energycharter.org/process/energy-charter-treaty-1994/energy-charter-treaty/> accessed 3 May 2023, the treaty came into force in 1998 and there are fifty-three contracting parties

[3] Rudolf Dolzer, 'Fair and Equitable Treatment: A Key Standard in Investment Treaties' (2005) 39 Int'l Law 87, 87 <https://scholar.smu.edu/cgi/viewcontent.cgi?article=2319&context=til> accessed 12 April 2023); United Nations Conference on Trade and Development, 'Fair and Equitable Treatment' (2012) UNCTAD Series on Issues in International Investment Agreements II (UNCTAD), 1 <https://unctad.org/system/files/official-document/unctaddiaeia2011d5_en.pdf> accessed 12 April 2023

[4] UNCTAD (n 3), 1

[5] Dolzer (n 3), 90

[6] Schill (n 1), 155; *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 (2006) (*LG&E v Argentina*), para. 123 <https://www.italaw.com/sites/default/files/case-documents/ita0460.pdf> accessed 16 April 2023

[7] *Saluka Investments B.V. v The Czech Republic*, Partial Award (2006) (*Saluka v Czech Republic*), para. 284 <https://www.italaw.com/sites/default/files/case-documents/ita0740.pdf> accessed 13 April 2023; *El Paso Energy International Company v. The Argentine Republic*, ICSID Case No. ARB/03/15, Award (2011) (*El Paso v Argentina*), para. 357 <https://www.italaw.com/sites/default/files/case-documents/ita0270.pdf> accessed 22 April 2023; UNCTAD (n 3), 61; Ivar Alvik, *Contracting with Sovereignty, State Contracts and International Arbitration* (Hart Publishing 2011), 193

[8] Mara Valenti, 'The protection of general interests of host States in the application of the fair and equitable treatment standard' in Giorgio Sacerdoti and others (eds) *General Interests of Host States in International*

framework; (2) legality; (3) the protection of legitimate expectations; (4) due process and access to justice; (5) prohibition of discrimination and arbitrariness; (6) transparency; and (7) reasonableness and proportionality.[9]

Legitimate expectations is a 'dominant element' of the FET clause.[10] However, its exact content, similar to the FET standard itself, is not clarified and vastly depends on interpretations of arbitral tribunals.[11] The concept is particularly relevant in the investment law field due to the typically long-term nature of investments especially in energy sector.[12] With a longer investment project, there is a heightened expectation for a stable regulatory environment, and concurrently, the risk that regulatory instability could adversely impact the investment escalates.[13] Several risk factors might endanger the success of an investment. One group is ordinary business risks accompanying every business operation and falling under the

Investment Law (CUP 2014), 26, 39 <https://www-cambridge-org.ludwig.lub.lu.se/core/services/aop-cambridge-core/content/view> accessed 12 April 2023

[9] *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 and on the Principles of Quantum (2018) (*RREEF v Spain)*, para. 260 <https://www.italaw.com/sites/default/files/case-documents/italaw10455_0.pdf> accessed 3 May 2023; *Stadtwerke München GmbH, RWE Innogy GmbH, and others v. Kingdom of Spain*, ICSID Case No. ARB/15/1, Award (2019) (*Stadtwerke v Spain*), para. 256 <https://www.italaw.com/sites/default/files/case-documents/italaw11056.pdf> accessed 26 April 2023; *Watkins Holdings S.à r.l. and others v. Kingdom of Spain*, ICSID Case No. ARB/15/44, Award (2020) (*Watkins v Spain*), para. 482 <https://www.italaw.com/sites/default/files/case-documents/italaw11234_0.pdf> accessed 8 May 2023; *LG&E v Argentina* (n 6), para. 131; *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 (2016), para. 320 <https://www.italaw.com/sites/default/files/case-documents/italaw7417.pdf> accessed 13 April 2023; Schill (n 1), 160; The similar list of conducts is provided for in Article 8.10(2) of the EU-Canada Comprehensive Economic and Trade Agreement (2017) (CETA) <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:22017A0114(01)&from=EN> accessed 13 April 2023

[10] *Saluka v Czech Republic* (n 7), para. 302; Rudolf Dolzer, Ursula Kriebaum and Christoper Schreuer, *Principles of International Investment Law* (3rd edn, OUP 2022), 208 <https://opil-ouplaw-com.ludwig.lub.lu.se/display/10.1093/law/9780192857804.001.0001/law-9780192857804-chapter-8> accessed 20 April 2023; Campbell McLachlan, Laurence Shore and Matthew Weiniger, *International Investment Arbitration: Substantive Principles* (2nd ed, OUP 2017), para. 7.157; UNCTAD (n 3), 63; Schill (n 1), 163; Dolzer (n 3), 103

[11] Enrique Boone Barrera, 'Human Rights Obligations in Investor-State Contracts: Reconciling Investors' Legitimate Expectations with the Public Interest' in Clair Gammage and Tonia Novitz (eds) *Sustainable Trade, Investment and Finance: Toward Responsible and Coherent Regulatory Frameworks* (EEP 2019) 197, 205 <https://www-elgaronline-com.ludwig.lub.lu.se/display/edcoll> accessed 12 April 2023

[12] Dolzer (n 3), 104; Schill (n 1), 161; *Continental v Argentina* (n 1), para. 258

[13] Lone Wandahl Mouyal, *International Investment Law and the Right to Regulate: A Human Rights Perspective* (RRIEL 2016), 10

investor's own liability and control area,[14] and another group of risks derives from the measures of the state[15] and negatively affects the investment.[16]

Two principles must be considered while reviewing whether particular legislation treats an investor in an unfair and inequitable way: (a) the principle that the investor must accept the legislative framework of the host state as it is; and (b) expecting reasonable regulatory changes.[17] Tribunals consider these factors under a substantial part of the FET standard – legitimate expectations.[18]

The current implications of the FET standard and particularly its dominant element – legitimate expectations can be clearly and comprehensively seen in the so-called Spanish Renewable Energy Saga[19] which concerns investment arbitration proceedings commenced as a result of regulatory changes by Spain.[20] In all referred cases investors were alleging the frustration of legitimate expectations and thus, the violation of the FET standard based on the Article 10(1) of the ECT. Similar to other IIAs or BITs the ECT does not contain any definition of the FET standard and does not make any reference to investor's legitimate expectations.

Answering research questions in light of Spanish Saga cases having more or less the same factual backgrounds is very useful for illustrating fragmented nature of international investment law and various possible implications of certain issues (for example whether general regulatory provision is capable of serving as special representation from a state).

For a better understanding of the Spanish Saga context, a short historical review of regulatory changes is necessary to be provided. However, factual background of

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[14] *Hydro Energy 1 S.à r.l. and Hydroxana Sweden AB v. Kingdom of Spain*, ICSID Case No. ARB/15/42, Decision on Jurisdiction, Liability and Directions on Quantum (2020) (*Hydro Energy v Spain*), para. 580 <https://www.italaw.com/sites/default/files/case-documents/italaw11282.pdf> accessed 8 May 2023

[15] Mouyal (n 13), 7

[16] UNCTAD (n 3), 64

[17] McLachlan and others (n 10), para. 7.157

[18] ibid

[19] The same events took place in Italy and Czech Republic, which gave rise to the commencement of number of investment arbitration proceedings, see at Maximilian Schmidl, 'The Renewable Energy Saga from Charanne v. Spain to The PV Investors v. Spain: Trying to See the Wood for the Trees' (2021) <https://arbitrationblog.kluwerarbitration.com/2021/02/01/the-renewable-energy-saga-from-charanne-v-spain-to-the-pv-investors-v-spain-trying-to-see-the-wood-for-the-trees/> accessed 23 April 2023

[20] Please see the list of pending or resolved cases against Spain to this end, the absolute majority of which is arising from this energy sector 'saga' <https://investmentpolicy.unctad.org/investment-dispute-settlement/country/197/spain/respondent> accessed 23 April 2023

particular cases is not significant for the present thesis purposes, only the understanding of general regulatory development is sufficient. In 1997 Spain enacted Law 54/1997[21] creating a 'Special Regime' aiming to create favourable conditions for the production of renewable energy reflecting the European Union (EU) target regarding the promotion of the production of electricity from renewable sources.[22] In 2004 additional incentives for renewable energy producers were introduced[23] which was later abolished in 2007 by Royal Decree (RD) 661/2007.[24] Importantly, this Decree contained Article 44(3) which is a milestone of the disputes since investors were mostly referring to this provision which states that future reviews of the regulated tariff shall not affect already operating facilities.[25]

Spain faced a financial crisis from 2008 which resulted in reduced incentives to renewable energy producers.[26] The concern was articulated in the Royal Decree Law (RDL) 6/2009 preamble of which stated that 'the growing tariff deficit [...] is provoking serious problems that, in the context of the current international financial crisis, is seriously affecting the system...'.[27]

In 2013 Spain totally abolished the Special Regime, depriving renewable energy producers (investors) of benefits previously enjoyed by virtue of such a regime.[28] RD 413/2014 in 2014 was the last nail in the coffin by which renewable energy

[21] Law 54/1997 (C-0060/R-0003) in *RENERGY S.à r.l. v Kingdom of Spain*, ICSID Case No. ARB/14/18, Award (2022) (*RENERGY v Spain)*, paras. 142-143 <https://www.italaw.com/sites/default/files/case-documents/italaw170256.pdf> accessed 20 April 2023; The author of the thesis wishes to note that all Saga cases are more or less based on the same facts. Therefore, any case among this group of cases will be relevant for describing the factual background. The reference here to *RENERGY v Spain* does not carry any meaning, rather it is an example chosen for illustration. Therefore, the author reserves the right not to refer to every Saga case, instead, use one case to describe the factual circumstances.

[22] Directive 2001/77/EC, On the promotion of electricity produced from renewable energy sources in the internal electricity market, art 3(4) in *RENERGY v Spain* (n 21), para. 143; Orhan Bayrak, 'Economic Crises and the Fundamental Change of Circumstances in Investment Arbitration' (2020) 35 ICSID Rev. 130, 131 <https://eds-s-ebscohost-com.ludwig.lub.lu.se/eds> accessed 3 May 2023

[23] *RENERGY v Spain* (n 21), paras. 155-156

[24] ibid, para. 175; RD 436/2004 was considered to be ineffective to attract investments in renewable energy sector to the degree desired by Spain, *Cube Infrastructure Fund SICAV and others v. Kingdom of Spain*, ICSID Case No. ARB/15/20, Decision on Jurisdiction, Liability and Partial Decision on Quantum (2019) (*Cube v Spain)*, para. 251 <https://www.italaw.com/sites/default/files/case-documents/italaw10692.pdf> accessed 20 April 2023

[25] An unofficial translation in *RENERGY v Spain* (n 21), para.176

[26] Gian Maria Farnelli, 'Recent Trends in Investment Arbitration Concerning Legitimate Expectations: An Analysis of Recent Renewable Energies Investment Case Law' (2021) 23 ICLR 27, 39 <https://brill-com.ludwig.lub.lu.se/view/journals/iclr/23/1/article-p27_3.xml> accessed 2 May 2023; Álvaro López de Argumedo and others, 'Spain' (2022) EAR 136, 138 <https://www.uria.com/documentos/colaboraciones/3162/documento/GAR_EAR> accessed 2 May 2023; Schmidl (n 19)

[27] An unofficial translation in *RENERGY v Spain* (n 21), para.181

[28] ibid, para. 219

producers were entitled to receive remuneration only in case they exceed the 'reasonable return' threshold.[29] Moreover, the tariff payments received before the new regime were counted in the total remuneration that an installation might receive over its operational life (25 years).[30] As of 2013, the tariff deficit[31] of Spain was EUR 30 billion.[32]

Due to these fluctuations and changes in the regulatory framework a number of investors initiated arbitration proceedings against Spain.[33] Even though the factual background is more or less the same for all cases, their findings vary.

Wide treaty protection afforded to investors raises concerns about the limitation of the host state's sovereignty, particularly its right and power to enact or modify regulations. According to criticism, sovereign regulatory power is transferred from state to tribunals deciding whether and to what degree states can enact new laws.[34] On the other hand, ensuring a stable regulatory framework is crucial for foreign investors to properly plan their investments and analyse accompanying risks.

State's regulatory measure is often alleged to be frustrating investor's legitimate expectations by changing the regulatory framework based on which an investor decided to invest. State's right to regulate might overlap with investor's expectation to regulatory stability and this is when the conflict between these two sides arises. While the principle of the protection of investor is deeply rooted in international investment law, such protection is subject to limitation and equal regard must be given to state's regulatory flexibility.[35] Due to such a conflict, it is crucial for

[29] *RREEF v Spain* (n 9), para. 138

[30] ibid

[31] 'The tariff deficit is the result of an imbalance between costs to the system (such as subsidies to energy producers) and revenue (consumer payments)' at *SolEs Badajoz GmbH v. Kingdom of Spain*, ICSID Case No. ARB/15/38, Award (2019) (*SolEs v Spain*) para. 434 <https://www.italaw.com/sites/default/files/case-documents/italaw10836.pdf> accessed 4 May 2023

[32] European Commission, 'Electricity Tariff Deficit: Temporary or Permanent Problem in the EU' (2014) Economic Paper 534, 27, ch 3.4.1 <https://ec.europa.eu/economy_finance/publications/economic_paper/2014/pdf/ecp534_en.pdf> accessed 3 May 2023

[33] Approximately 55 cases have been initiated against Spain during this 'Renewable Energy Saga' <https://investmentpolicy.unctad.org/investment-dispute-settlement/country/197/spain/respondent> accessed 2 May 2023

[34] David Gaukrodger, 'The balance between investor protection and the right to regulate in investment treaties: A scoping paper' (2017) OECD Working Papers on International Investment 2017/02, 6 <https://read.oecd-ilibrary.org/finance-and-investment/the-balance-between-investor-protection> accessed 28 April 2023

[35] Yulia Levashova, *The Right of States to Regulate in International Investment Law: The Search for Balance Between Public Interest and Fair and Equitable Treatment* (Vol. 50 KLI 2019), 114 <https://www-kluwerarbitration-com.ludwig.lub.lu.se/book> accessed 28 April 2023

tribunals to achieve a balance between the state's and investor's interests and adopt resolutions settling this conflict and aiming to protect both parties from unreasonable limitations.

Compared to earlier case law where investor's legitimate expectations were interpreted in a broad way,[36] the Spanish Renewable Energy Saga cases adhere to a to certain criteria and test for the establishment of legitimate expectations. Such a unified approach enables to draw conclusions as to how the legitimacy of investor's expectations is established. Moreover, the Saga cases reviewed state's regulatory authority and the conflict between public and private interests resulting in the necessity to adopt a balancing approach aiming to resolve the conflict between these two opposing interests. Therefore, reviewing research issues in light of the Spanish Renewable Energy Saga cases will be helpful not only for answering the research questions, but it will also ensure that the research topics are analysed and described in light of the latest trends in international investment law.

1.2 Purpose and research question

The present thesis aims to study the relationship and overlapping between two conflicting interests: investor's legitimate expectations towards regulatory stability on the one hand and the state's sovereign power to regulate, on the other hand. The study of these issues will be conducted in light of the Spanish Renewable Energy Saga cases. Thus, the research questions and purpose of the thesis will be focused on this group of cases. The ultimate aim of this analysis is to find an approach(es) adopted by tribunals to identify conflict and balance investors' interests against the state's regulatory authority. Therefore, the thesis, by the analysis of the various sources will provide an overview of how these interests are balanced against each other in practice.

To attain the purposes described above the present thesis will answer the following research questions:

[36] Eg investor's expectations were interpreted broadly by tribunal in *Técnicas Medioambientales Tecmed, S.A. v The United Mexican States*, ICSID Case No. ARB (AF)/00/2, Award (2003) (*Tecmed v Mexico*), para. 154 <https://www.italaw.com/sites/default/files/case-documents/ita0854.pdf> accessed 13 April 2023

1. What are the implications of the Spanish Renewable Energy Saga on the evolving balance between investor's legitimate expectations towards regulatory stability in a host state and that state's right to freely regulate?'

1.1. What is the current scope of protection of investor's legitimate expectations in light of the Spanish Renewable Energy Saga case law?

1.2. To what extent can a state freely exercise its regulatory powers while upholding its obligations towards foreign investors, and what legal argumentation has been employed by the tribunals in the Spanish Renewable Energy Saga to this end?

1.3. What are the key principles outlined by the tribunals for balancing investor's expectations with the state's power to regulate in the Spanish Renewable Energy Saga cases?

1.3 Delimitations

The present thesis will be strictly limited to the case law of the International Centre for Settlement of Investment Disputes (ICSID) where the Spanish Renewable Energy Saga cases were adjudicated. The reason behind this is the novelty of the awards and comprehensive analysis of research topics provided by tribunals.

The thesis focuses on international investment law, in particular, disputes arising from inconsistencies or interpretation of the ECT. Thus, other treaties or bilateral investment agreements will be excluded and merely remain as sporadic examples.

It is well known to the author of the thesis that the United Nations Commission on International Trade Law (UNCITRAL) Working Group III is working on the reformation of the Investor-State Dispute Settlement (ISDS) system.[37] Similarly, the ECT is being modernised.[38] However, the present thesis will not review the proposed reforms either in the ISDS system or in the ECT.

The main focus of the thesis is the review of current development and understanding of the issues to be discussed here. For this reason, the research questions will be

[37] UNCITRAL Working Group III: Investor-State Dispute Settlement Reform <https://uncitral.un.org/en/working_groups/3/investor-state> accessed 3 May 2023

[38] Modernisation of the ECT <https://www.energychartertreaty.org/modernisation-of-the-treaty/> accessed 3 May 2023

answered in light of already concluded[39] and available cases within the Spanish Renewable Energy Saga and future possible developments will not be examined.

Moreover, eighteen cases from the Spanish Renewable Energy Saga will be reviewed and analysed in the present thesis. A more detailed factual background, other than that provided in chapter 1.1, and outcome of each case will not be examined, rather only relevant parts of the cases will be reviewed which regard the issues at hand. The purpose of the thesis is not to review Spanish Renewable Energy Saga case law, but to analyse investor's legitimate expectations, state's right to regulate and conflict between these two interests with the assistance of Spanish Saga cases.

The present thesis is limited to investor's legitimate expectations through regulatory actions. The violation of the FET standard typically does not stem from the judiciary aspect because investors are not obliged to exhaust local remedies before initiating international investment litigation proceedings against a host state.[40] Therefore, cases where the violation was alleged or established as a result of administrative or judicial misconduct by a state are excluded from the study. Similarly, the thesis does not review the state's regulatory power in the context of public international law but rather focuses on the issue within the scope of international investment law.

By setting these limitations, the thesis maintains a specific focus on the appraisal of legitimate expectations and regulatory actions, ensuring a comprehensive analysis within the boundaries of international investment law.

The main focus of the thesis is the review of state's responsibility in creating investor's legitimate expectations. However, while state is liable for its actions, investor has its share of responsibility as well in the form of conducting proper due diligence and acting prudently. Since the scope of liability is greater on the state's

[39] It needs to be noted that the *Eiser Infrastructure Limited and Energía Solar Luxembourg S.à r.l. v. Kingdom of Spain*, ICSID Case No. ARB/13/36, Award (2017) (*Eiser v Spain*) <https://www.italaw.com/sites/default/files/case-documents/italaw9050.pdf> accessed 3 May 2023 was annulled by virtue of the Decision on Annulment (2020) <https://www.italaw.com/sites/default/files/case-documents/italaw11591.pdf> accessed 3 May 2023, based on the lack of disclosure by an arbitrator, thus, the ground of annulment was not legal error. For this reason, this award will similarly be reviewed in the thesis.

[40] McLachlan and others (n 10), para. 7.104; Gaukrodger (n 34), 14

part, the main emphasis will be made on it, only shortly reviewing investor's responsibility to fulfil due diligence obligation.

Moreover, since the aim pursued by Spain while taking regulatory measures was to handle economic crisis, Spanish Renewable Energy Saga cases do not review other regulatory objectives. However, for a comprehended analysis of the issue it is of utmost importance that other potential legitimate purposes forwarded by states to be shortly examined. Even though the present thesis is limited to the Spanish Renewable Energy Saga cases, other cases shall be used for examining various regulatory objectives. Thus, practice other than Spanish Renewable Saga cases shall be used solely for demonstration purposes, to create the whole picture and examine what other possible grounds can be invoked by states to justify their regulatory measures.

1.4 Materials and Method

Due to the very fragmented nature of international investment law, it is very difficult (and in some instances – impossible) to draw a single conclusion on how issues in a certain field of law is regulated and applied in practice.[41] To facilitate a scientific and systematic analysis for answering research questions a legal dogmatic method shall be applied. Dogmatics implies an analysis of legal materials in a scientific way and is explained as 'sentences that form a certain system, which enables to conceptually and systematically value the application of the law.'[42] Furthermore, Smits argues that the method implies 'a systematic exposition of the principles, rules, and concepts governing a particular legal field or institution and analyses the relationship between these principles, rules, and concepts to solve unclarities and gaps in the existing law.'[43] Thus, the legal dogmatic method could be applied to analyse the relevant legal sources for this thesis, such as positive law instruments, case law and working documents, publications and academic writings.

[41] Stephen Hall, 'Researching International Law' in Mike McConville and Wing Hong Chui (eds), *Research Methods for Law* (2nd edn EUP 2017) 253, 254

[42] Raul Narits, 'Principles of Law and Legal Dogmatics as Methods Used by Constitutions Courts' (2007) 12 Juridica Int'l 15, 19 <https://heinonline-org.ludwig.lub.lu.se/HOL/Page?handle=hein.journals/jurdint12> accessed 14 May 2023; Even though the title of the article makes reference to the costitutional court, only general parts of the article, describing general principles were used

[43] Jan M. Smits, 'What Is Legal Doctrine? On The Aims and Methods of Legal-Dogmatic Research' in Rob van Gestel and others (eds), *Rethinking Legal Scholarship - A Transatlantic Dialogue* (CUP 2017) 207, 210 <https://www-cambridge-org.ludwig.lub.lu.se/core/books/rethinking-legal-scholarship/what-is-legal-doctrine> accessed 14 May 2023

The review of arbitral decisions along with 'positive international law'[44] and academic writings are the main instruments to shed light on the concepts and study their application in practice.[45]

In order to properly understand the basis of inconsistency in international investment law, the main trigger of the confusion - treaties with non-homogenous wordings of the FET standard and the state's right to regulate shall be examined. Being 'workhorses of international law'[46] treaties are the starting point for assessment of a particular legal problem since it sets the playing field and determines the scope of rights and/or obligations. For this reason, only relevant parts (articles concerning the FET standard, legitimate expectations, state's right to regulate, and non-precluded measures) of the ECT, IIAs, or BITs shall be reviewed.

To have a clear understanding of the issues at hand, it is crucial to ascertain how certain concepts, principles, or rules operate and are applied in practice. In this vein, an analysis of the case law is provided aiming to expound the research topics. The aim of using case law is to shed light on vague issues since hard law instruments (treaties) do not usually contain any guidance on or definition of the content of particular concepts. Tribunals play a crucial role in this process through interpretations and gap-filling functions.[47] The importance of the case law is also reinforced by Article 38(1)(d) of the Statute of the International Court of Justice (ICJ) stating that to execute the decision-making function, the court shall apply judicial decisions.[48] Furthermore, as Dolzer noted, 'reliance on previous jurisprudence will serve as a useful guide for those authorities which give content to the clause'.[49] Case law does not have precedential nature in ISDS[50] which complicates the execution of analytical review of problems, since finding based on a certain decision (award) can always be undermined by another precedent. However, the 'de facto doctrine of precedent' is apparent since tribunals tend to

[44] According to Hall the 'positive international law' is a mix of customary law and treaties at Hall (n 41), 254

[45] ibid

[46] ibid, 255

[47] Anthea Roberts, 'POWER AND PERSUASION IN INVESTMENT TREATY INTERPRETATION: THE DUAL ROLE OF STATES' (2010) 104 Am. J. Int'l L. 179, 188 <https://www-jstor-org.ludwig.lub.lu.se/stable/10.5305/amerjintelaw.104.2.0179> accessed 15 May 2023

[48] Even though the article concerns the ICJ and the judicial decisions the same principle shall be applied to investment arbitration and arbitration awards

[49] Dolzer (n 3), 88

[50] Hall (n 41), 269

follow the findings of previous awards.[51] Therefore, tribunal awards shall be used here to provide a comprehensive understanding of the issues at hand and illustrate their practical implications.

Working documents and publications of international organisations, as highly credible sources[52] shall be used in the thesis. Such publications are actively used and referred to by various tribunals for interpretation purposes.[53] Moreover, despite not being a source of law,[54] referring to academic writings is similarly important as it helps the analytical understanding of research questions and problems. For a thorough understanding of the research topics the review of findings or discussions in the academic circles is of utmost importance for the examination of different aspects and views around the issues. The present thesis is the continuation of the existing discussion regarding the research topics.

1.5 Structure

The present thesis starts with a review of the concept of investor's legitimate expectations in international investment law in light of the Spanish renewable Saga case law. The chapter examines constituent elements of legitimate expectations. The thesis details an ongoing debate regarding what type of undertakings can be considered specific enough to be eligible of creating investor's expectations. In that regard, the legal status and differences between explicit and implied representations are analysed. The main focus is on the question, of whether a general regulatory provision is capable of being a source of such special representations. This confusion is especially evident while comparing tribunals' findings in similar (or identical) factual backgrounds, which was the case in the Spanish Renewable Saga. Lastly, the chapter reviews due diligence as an important factor, having the potential to affect the legitimacy of investor's expectations.

The analysis of the state's right to regulate in a general international investment law context is provided in the second part of the thesis. Afterward, potential regulatory

[51] UNCTAD (n 3), 11

[52] Hall (n 41), 271

[53] Eg *9REN Holding S.a.r.l v. Kingdom of Spain*, ICSID Case No. ARB/15/15, Award (2019) (*9REN v Spain*), para. 294 <https://www.italaw.com/sites/default/files/case-documents/italaw10565.pdf> accessed 23 April 2023 referring to the UNCTAD report

[54] Hall (n 41), 271

objectives forwarded by states in investor-state arbitration proceedings to justify their regulatory measures are reviewed. In several possible regulatory goals, only several of them shall be examined here, particularly, the handling of the economic crisis in Spain during the Spanish Renewable Energy Saga and the national security objective in light of Argentina's economic crisis. Moreover, other possible aims, such as environmental protection, public health, and cultural heritage are shortly overviewed.

Lastly, the third part of the thesis combines the findings of the previous chapters and focuses on the interrelation between two conflicting interests, the investor's legitimate expectations (more precisely, on regulatory stability) and the state's regulatory authority. The chapter underlines the necessity to adopt a balancing approach to ensure fair distribution of burdens and benefits between the public and private sectors. The balancing exercise is analysed in two different contexts, one in case of Absolute stability, where tribunals' freedom to adopt broad interpretation is limited, and second, in Relative Stability where more flexibility in the interpretation process is ensured.

2. The Concept of Investor's Legitimate Expectations

2.1 Introduction

The concept of legitimate expectations of investors has become increasingly popular and tribunals usually base their decisions and establish violation based on it.[55] The concept requires a host state not to frustrate expectations that were created by the investor as long as these expectations are objective and reasonable and prompted an investor to make an investment.[56] In other words, investors allege the violation of their legitimate expectations when the state's conduct negatively affects their investment.[57]

It is an obligation of an investor to accept the host state's legislation as it is at the moment of making an investment.[58] This approach derives from the state's sovereign power to organize its internal affairs at its own discretion and foreign investor is not entitled to claim amendment of certain rule which is in effect before an investment is made.[59] As Dolzer noted, only those expectations are protected which are in accordance with the host state's legal order established by this state 'in accordance with the principles of territorial sovereignty and economic self-determination.'[60] It follows from this analysis that the basis of legitimate expectations shall be found at the time of making an investment.[61]

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[55] Elizabeth Snodgrass, 'Protecting Investors' Legitimate Expectations: Recognizing and Delimiting a General Principle' (2006) 21 ICSID Rev. 1, 10 <https://watermark-silverchair-com.ludwig.lub.lu.se> accessed 15 April 2023; Valenti (n 8), 48

[56] Marcin Kałduński, 'Some Remarks on the Protection of Legitimate Expectations in International Investment Law' (2019) 25 Comp. Law. Rev. 215, 218 <https://com-mendeley-prod-publicsharing-pdfstore.s3.eu-west-1.amazonaws.com> accessed 15 April 2023

[57] UNCTAD (n 3), 64

[58] McLachlan and others (n 10), para. 7.158

[59] Dolzer (n 3), 102

[60] Dolzer (n 3), 103

[61] *RENERGY v Spain* (n 21), para. 637; *Infrastructure Services Luxembourg S.à.r.l. and Energia Termosolar B.V. v Kingdom of Spain*, ICSID Case No. ARB/13/31, Award (2018) (*Antin Infrastructure v Spain*), para. 537 <https://www.italaw.com/sites/default/files/case-documents/italaw9875.pdf> accessed 20 April 2023; *Watkins v Spain* (n 9), para. 517; *SolEs v Spain* (n 31), para. 319; *Eurus Energy Holdings Corporation v. Kingdom of Spain* (ICSID Case No. ARB/16/4), Decision on Jurisdiction and Liability (2021) (*Eurus v Spain*), para. 324

Being a non-independent treaty standard developed by arbitral tribunals the content of the legitimate expectations concept vastly depends on the interpretations made by tribunals.[62] Some tribunals adopt a broad application of the legitimate expectations, therefore, considering any change in legal or business framework a violation of the FET standard.[63] In recent case law several criteria are introduced to establish the legitimacy of expectations.[64] By analysing various investment case law the present thesis will review these conditions.

While the main actor in the establishment of the legitimate expectations is a state making special representations, relied on by an investor, diligence of the latter is equally important. The relevant question regarding the due diligence is not whether it is necessary or not, but rather, to what extent an investor is liable to conduct due diligence and to what scope investor's failure to do so affects the legitimacy of expectations.[65]

2.2 Elements of Legitimate Expectations

While the test applicable for the determination of the existence of legitimate expectations varies, common patterns can still be outlined. Tribunals usually base their consideration on the following factors:

(1) The existence of special representations on the part of the host state;
(2) Reliance of investor on host state's representations;
(3) The objectivity and reasonability of expectations.[66]

<https://www.italaw.com/sites/default/files/case-documents/italaw16123.pdf> accessed 17 May 2023; *Hydro Energy v Spain* (n 14), para. 596; Dolzer (n 3), 103; Schill (n 1), 174; UNCTAD (n 3), 71

[62] Kałduński (n 56), 216; Barrera (n 11), 205; McLachlan and others (n 10), para. 7.157

[63] Eg *Tecmed v Mexico* (n 36), para. 154; *CMS Gas Transmission Company v. The Republic of Argentina*, ICSID Case No. ARB/01/8, Award (2005) (*CMS v Argentina*), paras. 174-175 <https://www.italaw.com/sites/default/files/case-documents/ita0184.pdf> accessed 19 April 2023

[64] ibid

[65] Filip Balcerzak, *Renewable Energy Arbitration – Quo Vadis? Implications of the Spanish Saga for International Investment Law* (Vol. 23 Nij Int'l Inv. L. Ser. 2023) 325 <https://brill.com/display/title/61784?language=en> accessed 9 May 2023

[66] *RREEF v Spain* (n 9), para. 388; *Cube v Spain* (n 24), para. 388; *RENERGY v Spain* (n 21), para. 611; *OperaFund Eco-Invest SICAV PLC and Schwab Holding AG v Kingdom of Spain* (ICSID Case No. ARB/15/36), Award (2019) (*Operafund v Spain*), para. 481 <http://icsidfiles.worldbank.org/icsid/ICSIDBLOBS/OnlineAwards/C4806/DS12832_En.pdf> accessed 20 April 2023, in these cases tribunals also noted the fourth part of the test, particularly, whether the host state has frustrated investor's legitimate expectations, however, since this part concerns the appraisal of factual circumstances it will not be discussed in this thesis.

2.2.1 Special Representations from the Host State

The first element of legitimate expectations is the existence of special representation from the host state. Legitimate expectations can be created in case of the existence of commitment on the part of the host state,[67] otherwise, in the absence of such commitment, relevant factual circumstances shall be analysed to determine the existence of legitimate expectations.[68]

The case law and literature indicate that a representation giving rise to an investor's legitimate expectations can be either implicit, thus abstract, or explicit, specifically directed to certain investors.[69] While explicit representations usually prevail due to their precise nature, giving an opportunity to clearly establish the scope and content of such a commitment, a general undertaking is also capable of giving rise to an investor's legitimate expectations.[70] However, tribunals' approach regarding the nature of representations, particularly, how precise these undertakings should be, differ. While some tribunals might request the existence of specific promise, others consider this issue more broadly and deem implied representations (such as legislative provision) as those being capable of creating investor's legitimate expectations.[71] More recent case law indicates that not only specific but also generic undertakings or representations are equally capable of creating the basis for legitimate expectations, however, the difference is in the scope of protection afforded to an investor.[72]

2.2.1.1 Explicit Representations

Explicit and specific commitments create the strongest basis for investor's legitimate expectations.[73] However, there is no particular definition of what constitutes such specific commitments and it vastly depends on the particular

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[67] Valenti (n 8), 42

[68] *RREEF v Spain* (n 9), para. 320; *Stadtwerke v Spain* (n 9), para. 264

[69] *Cavalum SGPS, S.A. v. Kingdom of Spain*, ICSID Case No. ARB/15/34, Decision on Jurisdiction, Liability and Directions on Quantum (2020) (*Cavalum v Spin)*, para. 431 <https://jusmundi.com/en/document/decision/pdf/en-cavalum> accessed 8 May 2023; *RREEF v Spain* (n 9), para. 320; UNCTAD (n 3), 69; Valenti (n 8), 42; Dolzer and others (n 10), 208

[70] Gebhard Bücheler, *Proportionality in Investor-State Arbitration* (1st edn, OUP 2015) 201 <https://academic-oup-com.ludwig.lub.lu.se/book/2161> accessed 18 May 2023

[71] Lise Johnson and Oleksandr Volkov, 'Investor-State Contracts, Host-State 'Commitments' and the Myth of Stability in International Law' (2013) 24 Am. Rev. Int'l Arb. 361, 376 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2412592> accessed 22 April 2023

[72] *RENERGY v Spain* (n 21), para. 639;

[73] ibid, para. 639; Kałduński (n 56), 222; Dolzer and others (n 10), 209; Snodgrass (n 55), 37

background of the case and tribunal's interpretations.[74] For an undertaking to be considered specific, it shall 'give a real guarantee of stability to the investor.'[75] The most important aspect of the commitment is not its legally binding nature, but rather its capability to create a basis on which an investor can rely.[76]

A classic example of explicit representation is a contract,[77] however, an explicit promise might also be in a other form, the main requirement is for it to be explicitly stated and make a promise regarding regulatory stability.[78] The FET standard does not imply absolute regulatory stability (freezing) *per* se,[79] this aspect of the standard can be activated through the 'Stabilisation Clause'.[80] The clause refers to the provision in the contract between the investor and host state and aims to ensure that regulations relevant to the investment project will not be changed throughout the project or that such change will not apply to a particular investment at hand.[81] Stabilisation clauses are especially common in long-term investment projects in developing countries, the legislative framework of which changes and fluctuates often.[82] In the presence of stabilisation clause tribunals usually establish the

[74] *El Paso v Argentina* (n 7), para. 375 at *Masdar Solar & Wind Cooperatief U.A. v Kingdom of Spain*, ICSID Case No. ARB/14/1, Award (2018) (*Masdar v* Spain), para. 505 <https://www.italaw.com/sites/default/files/case-documents/italaw9710.pdf> accessed 23 April 2023

[75] *El Paso v Argentina* (n 7), para. 377 at ibid

[76] *El Paso v Argentina* (n 7), para. 376 at ibid

[77] Dolzer (n 3), 104

[78] *Eiser v Spain* (n 39), para. 362; *RWE Innogy GmbH and RWE Innogy Aersa S.A.U. v. Kingdom of Spain*, ICSID Case No. ARB/14/34, Decision on Jurisdiction, Liability and Certain Issues of Quantum (2019) (*RWE v Spain*), para. 451 <https://www.italaw.com/sites/default/files/case-documents/italaw11004.pdf> accessed 4 May 2023

[79] *Cube v Spain* (n 24), paras. 410-411; *InfraRed Environmental Infrastructure GP Limited and others v. Kingdom of Spain*, ICSID Case No. ARB/14/12, Award (2019) (*InfraRed v Spain*), para. 366 <https://www.italaw.com/sites/default/files/case-documents/italaw11360.pdf> accessed 23 April 2023; *SolEs v Spain* (n 31), para. 318; *Stadtwerke v Spain* (n 9), para. 195; *Hydro Energy v Spain* (n 14), para. 583; *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* [I], ICSID Case No. ARB/05/20, Award (2013), para. 666 <https://www.italaw.com/sites/default/files/case-documents/italaw3036.pdf> accessed 25 May 2023 at *Eiser v Spain* (39), para. 362; Snodgrass (n 55), 38

[80] *RENERGY v Spain* (n 21), para. 640; UNCTAD (n 3), 69; Johnson and Volkov (n 71), 370; Bücheler (n 70), 201; Alvik (n 7), 274; The tribunal in *Hydro Energy v Spain* (n 14), para. 585 noted that an investor cannot reasonably rely on the promise to the regulatory freezing, since it would be unreasonable in the circumstances 'where times and needs change, or where crisis arises.'

[81] Dolzer and others (n 10), 127; Andrea Shemberg, 'Stabilization Clauses and Human Rights', a research project conducted for IFC and the United Nations Special Representative to the Secretary General on Business and Human Rights (2008), para. 15 <https://media.business-humanrights.org/media/documents/files/reports-and-materials/Stabilization-Clauses-and-Human-Rights-11-Mar-2008.pdf> accessed 21 April 2023

[82] Dolzer and others (n 10), 126; United Nations Conference on Trade and Development, 'Investor–State Dispute Settlement: Review of Developments In 2017' (2018) International Investment Agreements Issues Note, Issue 2, 2 <https://unctad.org/system/files/official-document/diaepcbinf2018d2_en.pdf> accessed 24 May 2023, noting that majority of cases were initiated against developing countries and economies in transition; Rumana Islam, *The Fair and Equitable Treatment (FET) Standard in International Investment Arbitration: Developing Countries in Context* (Springer 2018), 100

existence of investor's legitimate expectations that the host state's regulations will not change and such change from the state shall be deemed as a violation of the FET standard.[83] Stabilisation clauses are usually seen as an obstacle for states to serve a public purpose, human rights, environmental and other concerns.[84]

2.2.1.2 Implied Representations

The basis of an investor's legitimate expectations can be the host state's implied representation, which are not directed to a particular investor, but has an abstract nature. Such grounds can be found, *inter alia*, in the host state's laws, which can be seen as general, but aims to create attractive conditions for foreign investor and is clear enough to be relied on.[85] As was mentioned earlier, the FET standard does not automatically imply regulatory freezing, however, a certain degree of stability can be regarded as an element of the standard.[86] Some tribunals interpret the FET standard as implying regulatory stability in light of the preamble of the BIT or IIA which promulgates the endeavour of the contracting parties to ensure a stable regulatory environment.[87] Such a broad implication of unqualified representation might create a situation where states will be bound by certain obligations without even intending or knowing it.[88]

Two main approaches can be identified as a result of analysis of the case law regarding the issue of whether general laws can be considered as a promise to regulatory stability: (1) accepting general legislation as a source of such expectations; and (2) stating that expectations created on such basis cannot enjoy the same level of protection as those arisen from a specific promise from the host state.[89] The fragmented and non-straightforward interpretations and approaches of

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[83] Johnson and Volkov (n 71), 370; Michele Potesta, 'Legitimate Expectations in Investment Treaty Law: Understanding the Roots and the Limits of a Controversial Concept' (2013) 28 ICSID Rev. 88, 114 <https://eds-s-ebscohost-com.ludwig.lub.lu.se/eds/pdfviewer/pdfviewer?vid=4&sid=240e1037-431d-48ca-960d-266123b09bf9%40redis> accessed 22 April 2023

[84] Dolzer and others (n 10), 131; Shemberg (n 81), paras. 34-36; see also Barrera (n 11), 203; Alvik (n 7), 274; Mouyal (n 13), 207 and 212

[85] *SolEs v Spain* (n 31), para. 313; Schill (n 1), 165

[86] *Eiser v Spain* (n 39), para. 382; *Masdar v Spain* (n 74), para. 484; *Antin Infrastructure v Spain* (n 61), para. 532; *OperaFund v Spain* (n 66), para. 508; Potesta (n 83), 111; Valenti (n 8), 44-45

[87] Potesta (n 83), 111; see eg paragraph 2 of Title I of the European Energy Charter which is part of the ECT stating that communication in the energy field, *inter alia*, includes 'formulation of stable and transparent legal frameworks creating conditions for the development of energy resources' <https://www.energycharter.org/fileadmin/DocumentsMedia/Legal/ECTC-en.pdf> accessed 4 May 2023

[88] Barrera (n 11), 204

[89] *Masdar v Spain* (n 74), paras. 490-494 and 504; *RENERGY v Spain* (n 21), para. 640

tribunals are particularly apparent when reviewing cases with identical or similar backgrounds.

The tribunal in *Operafund* case followed the first line of interpretation and considered a legislative provision stating that the regulatory change would not affect the facilities that were operating before a certain date, undoubtedly was a stabilisation clause.[90] The same reasoning was shared by the tribunal in *9REN* case noting that an undertaking is specific if it is addressed to an identifiable group of people.[91] A similar conclusion was made by the tribunal in *Cube* case considering that the provision in law rejecting retroactive effect[92] did not make a promise on the regulatory freezing, rather it contained a promise that an altered regime would not be applicable to already existing facilities.[93] The existence of stabilising commitment was similarly established by the tribunal in *Watkins* case stating that the law contained a stabilisation clause[94] and Spain guaranteed to ensure stability even though it was not obliged to do so.[95]

The second and more predominant approach[96] is that general provisions in legislation cannot create an investor's legitimate expectation to absolute regulatory stability or freezing.[97] The tribunal in the *InfraRed* case referred such expectation as 'the legitimate expectation of stability' and noted that 'a legitimate expectation of stability (i.e. immutability) can only arise in the presence of a specific commitment tendered directly to the investor or industry sector at issue.'[98] This approach is also referred to as 'Absolute Stability'.[99] The reasoning behind this is

[90] *OperaFund v Spain* (n 66), para. 485; see also *Masdar v Spain* (n 74), paras. 498-500

[91] ibid, para. 257

[92] See above RD 661/2007 art 44(3), n 38

[93] *Cube v Spain* (n 24), paras. 278, 397 and 428; However, the tribunal also mentioned that every legislation is susceptible to be changed (para. 275) and there was no promise to stability (freezing) regarding other changes in law, however, provision regarding non-retroactive application of new regime was considered 'express statement' violation of which resulted in the breach of the FET standard (see para. 428)

[94] *Watkins v Spain* (n 9), para. 526

[95] ibid, para. 528

[96] *RENERGY v Spain* (n 21), para. 641

[97] *RWE v Spain* (n 78), para. 461; *NextEra Energy Global Holdings B.V. and NextEra Energy Spain Holdings B.V. v. Kingdom of Spain*, ICSID Case No. ARB/14/11, Decision on Jurisdiction, Liability and Quantum Principles (2019) (*NextEra v Spain*), para. 584 <https://www.italaw.com/sites/default/files/case-documents/italaw10569.pdf> accessed 4 May 2023; *Hydro Energy v Spain* (n 14), para. 586

[98] *InfraRed v Spain* (n 79), para. 366

[99] *RENERGY v Spain* (n 21), para. 641

that every provision or commitment in law is subject to change.[100] Giving regulatory provision such 'stabilisation' power would limit the state's sovereign right to regulate, which is unjustified in the absence of 'a specific expression of consent by the host state.'[101] The tribunal in *RWE* case noted that a law has general nature and 'only applies whilst it remains in force.'[102] Furthermore, such a broad approach would give the FET standard overarching stabilisation clause character 'elevating each change in a domestic legal regime to a source of a potential breach of international law.'[103] The tribunal in *Antin* case stated that the stability was the '*leitmotiv'* of laws when the claimant was making investments[104] and it reflected Spain's endeavours rather than promise.[105]

For the reasons analysed above, to protect investor's legitimate expectations without limiting the state's regulatory power excessively, another concept was developed by the case law, which is 'the legitimate expectation of consistency'[106] or 'Relative Stability'.[107] The concept implies that in the absence of specific commitment, the investor's legitimate expectations are protected against the host state's disproportionate,[108] unreasonable or unjustified,[109] radical, or fundamental[110] change of regulatory framework. The issue will be reviewed in more detail in the following chapters of the present thesis.

2.2.2 Reliance of Investor on the Representations of Host State

The second element of the test is the necessity of reliance of an investor on the promise or representations made by the host state. For claiming the protection of legitimate expectations there should be undertakings from the host state relied upon by the foreign investor.[111] Reliance means that the state's representations are

[100] *RWE v Spain* (n 78), para. 538; *Masdar v Spain* (n 74), para. 504; *NextEra v Spain* (n 97), para. 584; *Cube v Spain* (n 24), para. 275

[101] *RWE v Spain* (n 78), para. 458; *InfraRed v Spain* (n 79), para. 366

[102] *RWE v Spain* (n 78), para. 461

[103] ibid

[104] *Antin Infrastructure v Spain* (n 61), para. 548

[105] ibid, para. 553

[106] *InfraRed v Spain* (n 79), para. 368

[107] *RENERGY v Spain* (n 21), para. 642

[108] *RWE v Spain* (n 78), para. 462

[109] *Masdar v Spain* (n 74), para. 484

[110] *InfraRed v Spain* (n 79), para. 368

[111] *RWE v Spain* (n 78), para. 482; *RENERGY v Spain* (n 21), para. 698; *Eiser v Spain* (n 39), para. 382; Dolzer and others (n 10), 211; Kałduński (n 56), 232; Snodgrass (n 55), 44

formulated or communicated in a way to be the decisive factor for investors in making investment. The tribunal in *RENERGY* case noted that the reliance that regulation will not change or will not be dramatically modified, is usually implied by the fact of making an investment.[112] This is the reason why this element of the test is not usually assessed[113] and is solely referred to.[114] Furthermore, the tribunal noted that the element has low standard in the Relative Stability context and only the satisfaction of two requirements is sufficient to establish the reliance: (1) investor's knowledge of relevant regulatory framework at the time of making an investment; and (2) the financial dependence of an investment on such regulatory framework.[115] In the case of Absolute Stability, a broader spectrum of expectations relied on by an investor needs to be present.[116]

Reliance is not a 'black-and-white issue',[117] an investor is liable to prove that it certainly relied on particular commitments from the host state which were decisive for him/her in making an investment. Owing to the typically long-term nature of the investment, it might be difficult to argue that the whole investment shall rely on certain representations from the very beginning since such lengthy projects are planned and amended throughout their lifetime, the main aspect is that such reliance must be significant.[118]

It is also worth noting that the state's subjective perceptions and intentions are irrelevant in determining whether certain representations can be relied on by an investor or not. In other words, even if the host state considers that it did not intend to make a representation that later would become a source of investor's expectations will not be taken into consideration as long as it objectively has such an effect on investor.[119]

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[112] *RENERGY v Spain* (n 21), para. 698

[113] Eg in *Eiser v Spain* (n 39), *Antin Infrastructure v Spain* (n 61), *Masdar v Spain* (n 74), *NextEra v Spain* (n 97); *BayWa r.e. Renewable Energy GmbH and BayWa r.e. Asset Holding GmbH v. Spain*, ICSID Case No. ARB/15/16, Decision on Jurisdiction, Liability and Directions on Quantum (2019) (*BayWa v Spain*) <https://www.italaw.com/sites/default/files/case-documents/italaw15000.pdf> accessed 10 May 2023, the tribunals mentioned the reliance element, however did not examine its content and presence in light of the factual background of the case

[114] *RENERGY v Spain* (n 21), para. 700

[115] ibid, para. 701

[116] ibid, para. 705

[117] *Cube v Spain* (n 24), para. 407

[118] *Micula v Romania* (n 85), para. 672 at *Hydro Energy v Spain* (n 14), para. 591

[119] *RENERGY v* Spain (n 21), para. 638; Kałduński (n 56), 236

2.2.3 Objectivity and Reasonability of Investor's Expectations

The third and last element of the test is the objectivity and reasonability of investor's expectations. It is a prominent practice that for an investor's expectations to be legitimate they must be reasonable and not based on the investor's subjective perceptions.[120] The test applicable is of a reasonable or prudent investor and his/her objective anticipations and only those expectations based on such objective circumstances can be regarded as legitimate and reasonable.[121] The evaluation of an investor's legitimate expectations must be based on the information an investor had while deciding to make an investment 'without appraising the investor's expectations with the benefit of hindsight.'[122] To exclude the legitimacy of investor's expectations there should be either an incorrect understanding of or incorrect reliance on the representations made by the host state or unreasonableness of such expectations.[123]

In the examination of the objectivity and reasonability of investor's expectations, not only explicit or implied representations of a host state needs to be considered. Host state's political and socioeconomical characteristics are equally important[124] which needs to be considered by a prudent investor before making investment.[125] This is because such circumstances contribute to the formation of investment environment of a state.[126] The relevance of factual background and political and economic development of a state are evident in the arbitral proceedings against for example post-soviet countries.[127]

Parkerings v Lithuania case relevant to this end, where the tribunal, for the purposes of the determination of the legitimacy of investor's expectations considered the

[120] *RENERGY v Spain* (n 21), para. 638; *Antin Infrastructure v Spain* (n 61), para. 536; *Watkins v Spain* (n 9), para. 517; McLachlan and others (n 10), para. 7.190; Snodgrass (n 55), 41; Kałduński (n 56), 229

[121] *RREEF v Spain* (n 9), para. 261; *Stadtwerke v Spain* (n 9), para. 264; *SolEs v Spain* (n 31), para. 312; *InfraRed v Spain* (n 79), para. 371; *RENERGY v Spain* (n 21), para. 638; Dolzer and others (n 10), 209

[122] *RENERGY v Spain* (n 21), para. 638

[123] *Cube v Spain* (n 24), para. 399

[124] *RREEF v Spain* (n 9), para. 378 citing *Toto Costruzioni Generali S.p.A. v. The Republic of Lebanon*, ICSID Case No. ARB/07/12, Award (2012), para. 165; Ursula Kriebaum, 'The Relevance of Economic and Political Conditions for Protection under Investment Treaties' (2011) 10 Law Pract. Int. Courts Trib. 383, 384 <https://eds-s-ebscohost-com.ludwig.lub.lu.se/eds/pdfviewer/pdf> accessed 24 May 2023

[125] *Cavalum v Spain* (n 69), para. 443; *Stadtwerke v Spain* (n 9), para. 264; Potesta (n 83), 118

[126] Levashova (n 35), 153

[127] Levashova (n 35), 153; Kriebaum (n 124), 387

relevant factual background of the country.[128] The tribunal noted that at the time when the investor decided to invest, Lithuania was in the transition phase from formerly being part of the Soviet Union into becoming a candidate for the European Union membership.[129] In these circumstances it would be unreasonable to expect regulatory stability and 'as any businessman would, the Claimant was aware of the risk that changes of laws would probably occur.'[130] For these reasons, the tribunal did not establish the existence of the investor's legitimate expectations, since such expectations were unreasonable and were not founded on legal grounds.[131] The tribunal in *SolEs v Spain* case agreed with the respondent that economic circumstances along with the regulatory framework, are crucial in forming investor's expectations.[132]

It follows from the case law that it is impossible to precisely articulate what makes expectations reasonable and legitimate. Such analysis and findings vary and it shall be decided on a case-by-case basis, considering every relevant factual circumstance of the case along with specific features of the country.[133] As long as expectations are relied on assurances of the host state and are objective at the same time, it is more likely to be protected by treaty provisions.

2.3 Due Diligence – Investor's Share of Responsibility

The last part of the determination of the concept of legitimate expectations is the review of the investor's share of responsibility to act diligently. Even though this is not an element of the legitimate expectations test, due diligence obligation plays a crucial role in the creation of investor's legitimate expectations on the one hand and

[128] *Parkerings-Compagniet AS v. Republic of Lithuania*, ICSID Case No. ARB/05/8, Award (2007) paras. 334-338 <https://www.italaw.com/sites/default/files/case-documents/ita0619.pdf> accessed 2 May 2023; Spanish Renewable Energy Saga does not contain the analysis of surrounding circumstances. This case gives us the clear understanding of the importance of country's socio-political features in the establishment of investor's legitimate expectations

[129] ibid, para. 335

[130] ibid

[131] ibid, paras. 336 and 338

[132] *SolEs v Spain* (n 31), para. 434

[133] *Antin Infrastructure v Spain* (n 61), para. 536; see also *El Paso v Argentina* (n 7), para. 364; *Micula v Romania* (n 85), para. 669; Even though these last cases do not belong to Spanish Renewable Saga case law, referring to them serves the purpose to indicate that the approach is shared by tribunals outside Spanish Saga cases

the failure to conduct proper due diligence might result in the exemption of the host state from responsibility under the FET standard.[134]

The consideration of the violation of the FET standard and the frustration of legitimate expectations by the host state, equally considers investor's diligence.[135] Carrying out proper due diligence serves the purpose to inform an investor regarding regulatory and business environment in a state where he/she intends to invest.[136] While the state's assurances are important in establishing investor's expectations, the latter is similarly liable to diligently plan investment and not to base his/her hopes solely on the state's representations. It is a widely recognized approach of tribunals that investor's expectations are reduced in circumstances where the host state's regulatory, social, or business environment is unstable.[137]

The exact content of the obligation of due diligence varies, nevertheless, it usually implies a prudent investor's obligation to know the host state's legislation[138] or important judgments of courts.[139] Properly conducted analysis of the regulatory and investment environment of a host state might conduce the establishment or rule out legitimate expectations.[140] There is no consensus on to what extent investor is required to take such precautionary measures. Some tribunals consider that an investor is not required to perform 'any particular form or scale of legal due diligence by external advisors', what matters is the existence reasonable understanding of state's representations.[141] In contrast, other tribunals underline that investor is obliged to carry out 'rigorous' due diligence for the establishment of the legitimacy of expectations,[142] especially in heavily regulated sector.[143]

The analysis of the concept of investor's legitimate expectations includes the examination of the information that was or should have been available for an

[134] Shaun Matos, 'Investor Due Diligence and Legitimate Expectations' (2022) 23 J. World Invest. Trade. 313, 315 <https://brill-com.ludwig.lub.lu.se/view/journals/jwit/23/2/article> accessed 24 May 2023

[135] *Antin Infrastructure v Spain* (n 61), para. 537; *Stadtwerke v Spain* (n 9), para. 264; UNCTAD (n 3), 15; Valenti (n 8), 41; Potesta (n 83), 119; Dolzer (n 3), 104; Snodgrass (n 55), 42

[136] Dolzer and others (n 10), 210; Johnson and Volkov (n 71), 408

[137] Dolzer and others (n 10), 210

[138] *Stadtwerke v Spain* (n 9), para. 281

[139] *RWE v Spain* (n 78), para. 534; *RENERGY v Spain* (n 21), para. 665; *SolEs v Spain* (n 31), para. 429

[140] *OperaFund v Spain* (n 66), para. 486

[141] *Cube v Spain* (n 24), para. 396

[142] *Stadtwerke v Spain* (n 9), para. 264

[143] *InfraRed v Spain* (n 79), para. 370; *Cavalum v Spain* (n 69), para. 444

investor 'with the requisite degree of diligence.'[144] The tribunal in the *Stadtwerke* case rejected the existence of an investor's legitimate expectations in the absence of a promise of stability, which was obvious for a prudent investor who conducted proper due diligence.[145] Furthermore, the tribunal in *RWE* concluded that in the situation of visible regulatory instability investor was obliged to carry out due diligence on the relevant regulatory framework and the investor's reliance on a specific understanding of particular law was unreasonable in the absence of such due diligence.[146] In the *Hydro Energy* case the tribunal underlined two possible aspects of due diligence: (1) whether an investor is aware of the host state's regulatory framework; and (2) whether an investor is assured that official statements that it relied on can be attributed to the host state.[147]

The failure to conduct due diligence can undermine the legitimacy of expectations.[148] Interestingly, the tribunal in *RENERGY* case noted that the failure to carry out due diligence does not deprive the investor of having legitimate expectations of Relative Stability.[149] This reasoning might be resulting from the character of Relative Stability, the main target of which is a state, that is liable to refrain from dramatically amending the regulatory framework.

Investors should also consider the development level and cultural characteristics of the country where he/she invests. The targets are usually developed countries, however, along with the interest to earn more return on investment, certain risks accompanied by investing in developing jurisdictions must be considered.[150] The tribunal in *RENERGY* case noted that when a particular issue includes public interest to a great extent, a diligent investor shall expect a change in the regulatory framework since public interest trumps the investor's particular interest.[151]

[144] *Antin Infrastructure v Spain* (n 61), para. 537
[145] *Stadtwerke v Spain* (n 9), para. 308
[146] *RWE v Spain* (n 78), paras. 513-514
[147] *Hydro Energy v Spain* (n 14), para. 601
[148] *RENERGY v Spain* (n 21), para. 707; *Cavalum v Spain* (n 69), para. 472
[149] *RENERGY v Spain* (n 21), para. 707
[150] UNCTAD (n 3), 71
[151] *RENERGY v Spain* (n 21), para. 681(v)

2.4 Summary

Investor's legitimate expectations is a crucial element of the FET standard and is widely used by investors in disputes against the host state. Tribunals in recent cases aspire to outline a test or guidance in light of which the existence of legitimate expectations is established. The analysis of the case law and literature has indicated that for the existence of such expectations, the presence of explicit or implicit representations from the host state must be present which were relied on by the investor. Even though specific and explicit commitments prevail over implied promises, the latter also enjoys protection subject to particular conditions and limitations. However, the exact extent of protection conferred to expectations based on an implied promise (such as regulatory provision) vastly depends on the particular tribunal.

Only those expectations are protected by treaty provisions, which are reasonable and objective. This element implies the analysis of the reasonableness of investor's expectations neglecting his/her subjective perceptions and hopes. While the main actor in forming legitimate expectations is the host state, investors also have their share of responsibility. An investor's action or omission is measured from a prudent or reasonable investor's perspective that has duly conducted due diligence. Failure to take such precautionary measures might result in the refusal of protection based on the absence of legitimacy of expectations.

3. State's Regulatory Power

3.1 Introduction

The state's right and power to regulate derive from the international law principle of state sovereignty.[152] Freedom of states to act is protected under international law, 'unless there is a rule constraining this.'[153] Treaties are classic examples of the limitation of sovereignty, under which countries assume a duty to refrain from enacting regulations or taking measures that might negatively affect foreign investments.[154] The aim of this, in the international investment law context, is to attract foreign capital. The legal basis of the right to regulate can be found in treaties or in a general framework which is international law principles.[155] The state's right to regulate is not articulated in the ECT, neither are given exceptions from the FET standard.[156] The inclusion of such exceptions in the treaties is a rare phenomenon[157] and due to that tribunals enjoy vast freedom to regulate this issue.[158]

In contrast with the FET standard, exceptions for public purposes can be seen regarding the expropriation clauses.[159] Owing to that, the state's regulatory power is usually referred to in expropriation cases, however, the development of the case law brought by the broadening the coverage of the principle to the FET standard.[160]

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[152] Levashova (n 35), 25; Catharine Titi, *The Right to Regulate in International Investment Law* (1st edn Nomos Verlagsgesellschaft 2014), 32 <https://eds-p-ebscohost-com.ludwig.lub.lu.se/eds/ebookviewer/ebook> accessed 29 April 2023; Freya Baetens, 'Protecting Foreign Investment and Public Health Through Arbitral Balancing and Treaty Design' (2021) 71 ICLQ 139, 160 <https://www.cambridge.org/core/services/aop-cambridge-core/content/view> accessed 11 May 2023; Mouyal (n 13), 31

[153] Malcolm N. Shaw, *International* Law (6th edn, CUP 2008), 212

[154] The tribunal in *Watkins v Spain* (n 9), para. 521 noted that Spain could amend its regulatory framework 'but after having entered into the ECT, there are limitation on its powers to alter the regulatory framework'; Baetens (n 152), 160

[155] Titi (n 152), 33

[156] However, such exceptions is established by the case law, particularly, the tribunal in *RWE v Spain* (n 78), para. 451 noted that 'Article 10(1) does not eliminate the Contracting Parties' right to modify their regulatory regimes to meet evolving circumstances and public needs'; Similar approach was taken by tribunal in *Antin Infrastructure v Spain* (n 61), para. 530 stating that the ECT does not cancel or 'extremely limit' state's regulatory authority; in this vein see also *Cavalum v Spain* (n 69), para. 420; *RREEF v Spain* (n 9), para. 241; *Stardtwerke v Spain* (n 9), para. 264; *Watkins v Spain* (n 9), para. 560

[157] Levashova (n 35), 28

[158] Titi (n 152), 71

[159] Eg ECT, art 13(1)(a)

[160] Farnelli (n 26), 31

The state's sovereign power to legislate in public interests is an undisputed principle of investment law.[161] It is seen as an instrument to achieve the goals of the state and its restriction is possible only under specific circumstances, in the presence of the state's 'unequivocal commitment.'[162] The FET standard, including its elements in the form of legitimate expectations and regulatory stability, does not affect the exercise of regulatory power for responding to changing circumstances.[163]

State's right to regulate is usually reviewed under the 'police power' doctrine excluding the state's liability for damage due to bona fide regulation.[164] However, this doctrine is only applicable in the expropriation context[165] and the attempt to introduce it in the FET standard violation cases has been unsuccessful.[166] This is due to the nature of the FET standard which implies in itself the examination of whether the state exceeded its power to regulate and violated investor's rights thereof.[167]

Another interesting aspect of the state's right to regulate in the international investment law context is the effect of the execution of such authority. While the state's right to regulate is an acknowledged principle of international law, there is no consensus on whether the state should compensate foreign investors even if it carries out its regulatory function reasonably and properly.[168] An interesting approach is suggested by Markert stating that the proportionality principle should be reflected in compensation granted to an investor and instead of an 'all-or-nothing' approach, public interest and the damage sustained by an investor should

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[161] *Eiser v Spain* (n 39), para. 362; *9REN v Spain* (n 53), para. 253; *Cavalum v Spain* (n 69), para. 419; *Eurus v Spain* (n 61), para. 364; *Hydro Energy v Spain* (n 14), para. 582; *Masdar v Spain* (n 74), para. 485; *OperaFund v Spain* (n 66), para. 485; Balcerzak (n 65), 330; UNCTAD (n 3), 77; Alvik (n 7), 261

[162] *RREEF v Spain* (n 9), para. 244

[163] *Hydro Energy v Spain* (n 14), para. 582

[164] Farnelli (n 26), 31; Alvik (n 7), 261; Mouyal (n 13), 177

[165] *9REN v Spain* (n 53), para. 362; *Tecmed v Mexico* (n 36), para. 119; *Saluka v Czech Republic* (n 7), para. 262

[166] *Suez, Sociedad General de Aguas de Barcelona, S.A. and Interagua Servicios Integrales de Agua, S.A. v. Argentine Republic*, ICSID Case No. ARB/03/17, Decision on Liability (2010) (*Suez and Interagua v Argentina*), para. 148 <https://www.italaw.com/sites/default/files/case-documents/ita0813.pdf> accessed 4 May 2023; *United Utilities (Tallinn) B.V. and Aktsiaselts Tallinna Vesi v Republic of Estonia*, ICSID Case No. ARB/14/24, Award (2019) (*United Utilities v Estonia*), para. 767 <https://www.italaw.com/sites/default/files/case-documents/italaw10648.pdf> accessed 24 April 2023; Even though these cases are not part of the 'Spanish Renewable Energy Saga', they provides an understanding of the general framework that is applicable, *inter alia*, in Spanish cases context

[167] ibid

[168] Titi (n 152), 34

be considered.[169] This issue, of what is the extent of the state's liability and how a balance can be achieved will be reviewed in more detail in the next chapter of this thesis.

3.2 Regulatory Objectives

As mentioned earlier under Chapter 3.1 above, the state's regulatory power is considerably limited in the investment law context in light of its undertaken obligations towards investors. For this reason, such authority is allowed to be carried out in exceptional circumstances, in case of a solid legitimate aim. While IIAs are primarily focused on safeguarding foreign investments, it is crucial to remember that the state's obligations towards its citizens and its commitments under international treaties hold equal (or probably greater) importance.[170] Moreover, 'economic, social, environmental and legal circumstances and problems are by their nature evolutionary, dynamic and bound to constant change, and it is indispensable for successful public infrastructure and public services to be adaptable to change in evolving circumstances.'[171] Regulatory flexibility is crucial for a state to safeguard public interests and adapt its regulatory framework and policy according to ongoing challenges.[172]

Objectives of state measures vary and include, but are not limited to, public order, national security, environmental or cultural protection, and overcoming economic crisis. The present chapter will review these objectives forwarded by host states to justify their regulatory measures. One of such objectives is the economic crisis, which is a very narrow aspect of the public interest. The review of this public policy argument will be conducted in light of the Spanish economic crisis and the Renewable Energy Saga case law. However, for a more comprehensive understanding and illustration, this chapter will also review other possible

[169] Lars Markert, 'The Crucial Question of Future Investment Treaties: Balancing Investors' Rights and Regulatory Interests of Host States' in Marc Bungenberg and others (eds) *International Investment Law and EU Law* (Springer 2011), 145, 166 <https://link-springer-com.ludwig.lub.lu.se/chapter/10.1007/978-3-642-14855-2_10#citeas> accessed 29 April 2023

[170] Areta Jez, 'Environmental Policy-Making and Tribunal Decision-Making: Assessing the Scope of Regulatory Power in International Investment Arbitration' (2019) 40 U Pa J Int'l L 989, 993 <https://heinonline-org.ludwig.lub.lu.se/HOL/Page?handle=hein.journals> accessed 11 May 2023; Alvik (n 7), 262

[171] *Hydro Energy v Spain* (n 14), para. 587; *Cavalum v Spain* (n 69), para. 428

[172] Mouyal (n 13), 19

objectives and refer to other cases, thereby exploring potential grounds that states may invoke.

3.2.1 Economic Crisis

The global and national economic crisis is considered to be one of the grounds for significant intervention by a state in investments.[173] An economic crisis can be determined as a situation when such an intervention is desirable for public interests.[174] Economic crisis is especially severe and devastating for developing countries with limited resources which ultimately results in worsened investment environment.[175] However, measures taken by host states to deal with economic crisis can frustrate investor's legitimate expectations and result in the violation of the FET standard.[176] Tackling an economic crisis is one of the objectives referred to by host states to justify their measures negatively affecting foreign investments. Since most IIAs or treaties do not contain exceptions in treaty provisions entitling states to execute their regulatory powers without accountability, the approaches taken by tribunals differ, and the issue of liability and scope of a state's such power is not settled.[177]

It is fundamental to the nature of sovereignty that the state is liable to ensure the proper functioning of the system, including the economy, and respond to changes.[178] This obligation of the state is impossible to be fulfilled without proper and effective power to enact or modify regulations. Therefore, without amending legislation or adopting new rules it is practically impossible to tackle relevant challenges and crises in a country.

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[173] Jeffery P. Commission, 'The Global Financial Crisis and International Investment Regimes' (2010) 104 Am. Soc'y Int'l L. Proc. 443, 443 <https://www-jstor-org.ludwig.lub.lu.se/stable/pdf> accessed 3 May 2023

[174] Cedric Dupont and others, 'Political Risk and Investment Arbitration: An Empirical Study' (2016) 7 J. Int. Disput. Settl. 136, 143 <https://academic-oup-com.ludwig.lub.lu.se/jids/article/7/1/136/2357919> accessed 9 May 2023; Christian Bellak and Markus Leibrecht, 'Do Economic Crises Trigger Treaty–Based Investor–State Arbitration Disputes?' (2021) 24 J. Int. Econ. Law 127, 129 <https://academic-oup-com.ludwig.lub.lu.se/jiel/article/24/1/127/6151734> accessed 9 May 2023

[175] Islam (n 82), 140

[176] Levashova (n 35), 153; see also Dupont and others (n 174), 144

[177] Giorgio Sacerdoti, 'The application of BITs in time of economic crisis : limits to their coverage, necessity and the relevance of WTO law' in Giorgio Sacerdoti and others (eds) *General Interests of Host States in International Investment Law* (CUP 2014) 3, 8 <https://www-cambridge-org.ludwig.lub.lu.se/core/books/general-interests-of-host-states-in-international-investment-law> accessed 8 May 2023; Bayrak (n 22), 149

[178] *Cube v Spain* (n 24), para. 305

The first significant crisis which resulted in a considerable number of investor-state disputes was Argentina's crisis in the 2000s when Argentina took a number of emergency measures to handle the economic crisis.[179] The same argument (economic crisis) was forwarded by Spain to justify the modification of the regulatory framework. In the Spanish Renewable Saga cases the existence of an economic crisis in the form of a tariff deficit was undisputed and a matter of fact.[180]

The tribunal in the *RENERGY* case considered it undisputed that the global economic crisis caused a crisis in Spain increasing tariff deficit (by 365%)[181] which in the end was a change of circumstances and the main reason behind the adoption of disputed measures.[182] Other tribunals in Saga cases took the same approach regarding the existence of an economic crisis and Spain's right to address the tariff deficit and crisis problems.[183] The dynamic and changing nature of 'economic, social, environmental and legal circumstances and problems' needs to be underlined requiring modification of public infrastructure and services.[184]

3.2.2 National Security

The Argentinian economic crisis case law differs from the Spanish Renewable Energy Saga and this difference is primarily provided by the treaty they were grounded on. A number of disputes were based on the US-Argentina BIT,[185] Article XI of which laid down exceptional circumstances. Particularly, the article entitled signatories to apply measures necessary for public order, international peace or security, or the protection of 'essential security interests'. During these dispute settlement processes, Argentina argued that measures taken sought to maintain

[179] United Nations Conference on Trade and Development, 'The Protection of National Security in IIAs' (2009) UNCTAD Series on International Investment Policies for Development (UNCTAD 2009), 8 <https://unctad.org/system/files/official-document/diaeia20085_en.pdf> accessed 1 May 2023; Bayrak (n 22), 131; Over 40 cases were brought against Argentina during this crisis <https://investmentpolicy.unctad.org/investment-dispute-settlement/country/8/argentina> accessed 1 May 2023

[180] *RENERGY v Spain* (n 21), para. 245; *Antin Infrastructure v Spain* (n 61), para. 493; *Eurus v Spain* (n 61), para. 338; *BayWa v Spain* (n 113), para. 213; *Cube v Spain* (n 24), para. 350; *Cavalum v Spain* (n 69), para. 615; *Stadtwerke v Spain* (n 9), para. 261

[181] *RENERGY v Spain* (n 21), para. 895

[182] ibid, para. 896

[183] Eg *Eiser v Spain* (n 39), para. 371; *RREEF v Spain* (n 9), para. 244; *9REN v Spain* (n 53), para. 65; *RWE v Spain* (n 78), para. 555; *Cube v Spain* (n 24), para. 305; *Stardtwerke v Spain* (n 9), para. 320; *Antin Infrastructure v Spain* (n 61), para. 555

[184] *Cavalum v Spain* (n 69), para. 428; *Eiser v Spain* (n 39), para. 362

[185] 17 cases arising from Argentina's economic crisis are based on the US-Argentina BIT <https://investmentpolicy.unctad.org/investment-dispute-settlement/country/8/argentina> accessed 1 May 2023

public order and national security (essential security interests).[186] In contrast with the US-Argentina BIT, such an exception is not provided by the ECT.

The classic meaning of national security can envisage military threats to the state and its people, terrorism, or espionage, however, the development of Argentina crisis case law brought by the inclusion of threats to the environment or health or severe economic crisis.[187] The tribunal's task was to determine, whether the 'essential security interests' provision was broad enough to contain the economic emergency of a country.[188] The tribunal in *CMS v Argentina* case noted that if the mentioned provision was read in a way to include immediate political and national security concerns disregarding economic emergencies, such an approach would result in an unbalanced understanding of the article.[189] Furthermore, such a restricted understanding of the 'essential security interests' would undermine the fact that the economic crisis negatively affects people's lives and the state's ability to function, which, due to its severity, might equal military invasion.[190] Even though the differences in interpretations and findings, tribunals came to the same conclusion that Article XI of the BIT covered economic crisis.[191]

Solely the existence of an economic emergency is not enough to activate the exceptions clause, but rather the grievance of such a crisis must be present.[192] The severity of Argentina's financial problems sufficient for tribunals to exclude liability differed. Some tribunals established a high threshold requiring the crisis to result in a 'total economic and social collapse'[193] or threat to the very existence of a state[194] while others considered the significance of existing crisis enough for a state to take appropriate measures.[195]

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[186] Eg *El Paso v Agentina* (n 7), para. 567; *LG&E v Argentina* (n 6), para. 215; *CMS v Argentina* (n 63), para. 344

[187] UNCTAD 2009 (n 178), 7; Titi (n 152), 79

[188] *CMS v Argentina* (n 63), para. 359

[189] ibid, para. 360

[190] *LG&E v Argentina* (n 6), para. 238

[191] UNCTAD 2009 (n 178), 9

[192] *CMS v Argentina* (n 63), para. 261

[193] ibid, para. 355

[194] *Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic*, ICSID Case No. ARB/01/3, Award (2007), para. 306 <https://www.italaw.com/sites/default/files/case-documents/ita0293.pdf> accessed 10 May 2023; *Sempra Energy International v. The Argentine Republic*, ICSID Case No. ARB/02/16, Award (2007), para. 348 <https://www.italaw.com/sites/default/files/case-documents/ita0770.pdf> accessed 10 May 2023

[195] Eg *LG&E v Argentina* (n 6), paras. 226, 229-237

Even though the economic crisis was the basis of investment disputes in Argentina and Spain, these two situations are different in the coverage and extent. While in Spanish cases economic crisis problem was regarded as part of public interests or simply separate ground, it was covered under the 'essential security interests' concept in Argentinian case law. According to some awards in Argentinian investment disputes 'nightmare' the threshold for qualification for exemption was as high as the total collapse of the economy of a country, while such a strict approach was not adopted by tribunals in Spanish Renewable Energy Saga cases. It is interesting and unknown how tribunals would rule in case of the absence of an exceptions clause in the US-Argentina BIT and *vice versa*, what conclusion would be reached by tribunals in the Spanish Saga context if the same clause was included in the ECT. Considering a quite strict line adhered to in Argentina's awards, it is quite possible for tribunals to refuse the indemnity in the absence of an 'immunity' clause, solely based on the economic crisis argument.

3.2.3 Other Objectives

Concerns and efforts regarding environmental protection is increasing in recent years. Even though states aspire to include environmental exception clauses in IIAs,[196] they are usually hand-tied to take measures to this end due to the fear of facing investment disputes.[197] Good examples of this dilemma of the state are pending arbitration proceedings against the Netherlands enacting a law in 2017 by which coal plants shall be closed down by 2030.[198] This prohibition introduced by the Netherlands aims to decrease greenhouse gas emissions which is in line with the 'State's long-standing constitutional duty to protect the environment and public health'.[199] Similarly, the prohibition of mining in the Paramos ecosystem[200] by

[196] Jez (n 170) 991

[197] Joshua Paine and Elizabeth Sheargold, 'A Climate Change Carve-Out for Investment Treaties' (2023) J. Int. Econ. Law 1, 4 <https://watermark.silverchair.com/jgad011.pdf?token> accessed 10 May 2023

[198] *RWE AG and RWE Eemshaven Holding II BV v. Kingdom of the Netherlands* (*RWE v Netherlands*), ICSID Case No. ARB/21/4, Claimant's Memorial (2021), para. 286 <https://www.italaw.com/sites/default/files/case-documents/italaw170473.pdf> accessed 10 May 2023; *Uniper SE, Uniper Benelux Holding B.V. and Uniper Benelux N.V. v. Kingdom of the Netherlands*, ICSID Case No. ARB/21/22, Claimant's Memorial (2022), para. 264 <https://www.italaw.com/sites/default/files/case-documents/italaw170449.pdf> accessed 10 May 2023; It needs to be noted that as of 10.05.2023 both cases are pending, which means that tribunal's award is not made yet

[199] *RWE v Netherlands*, Respondent's Counter-Memorial (2022), paras. 420-423 and 952 <https://www.italaw.com/sites/default/files/case-documents/italaw170892.pdf> accessed 10 May 2023

[200] *Eco Oro Minerals Corp. v. Republic of Colombia*, ICSID Case No. ARB/16/41, Decision on Jurisdiction, Liability and Directions on Quantum (2021) (*Eco Oro v Colombia*), para. 86: 'high-mountain ecosystems that

Colombia to protect the environment was considered an undisputed purpose.[201] Even though the tribunal found that the disputed measures aimed to attain a legitimate public purpose - environmental protection and it was implemented in a good faith[202], the inconsistent manner in which Colombia acted (regarding the delimitation of Santurbán Páramo (territory))[203] frustrated investor's legitimate expectations.[204] Thus, it was not regulatory objective, but rather state's misconduct that resulted in the treaty violation.

Public health argument was forwarded by Uruguay in the *Philip Morris* case.[205] Particularly, Uruguay introduced legislation requesting tobacco product manufacturers to place health warnings on 80% of the packaging of cigarettes and tobacco products.[206] Leaving only 20% of the space for manufacturers to place their trademarks, Uruguay argued that the legislation aimed to protect public health.[207] The tribunal noted that states are bound by an obligation to take care of public health and tribunals have to respect governments' judgments in that regard.[208] Moreover, the tribunal considered it irrelevant whether the state's measure had its intended effect, what mattered was its reasonability when it was adopted.[209] Therefore, the tribunal found that as long as 'the measure taken was not disproportionate to that concern and that it was adopted in good faith' its actual effects are immaterial.[210]

Another objective of a state can be the protection of cultural heritage. One of the earliest cases in that regard is *SPP v Egypt* in which Egypt, by the decree, declared a territory[211] as a 'public property (Antiquity)'[212] which was previously conferred

play a central role in maintaining biodiversity, premised on a unique capacity to absorb and restore wate' <https://www.italaw.com/sites/default/files/case-documents/italaw16212.pdf> accessed 10 May 2023

[201] ibid, paras. 195 and 635

[202] ibid, para. 642

[203] ibid, paras. 781-782

[204] Ibid, para. 804

[205] *Philip Morris v Uruguay* (n 9)

[206] ibid, para. 121

[207] ibid, para. 181

[208] Ibid, para. 399

[209] ibid, para. 409

[210] ibid

[211] The territory consisted of the historical places, particularly, Pyramids area near Cairo and at Ras El Hekma on the Mediterranean coast

[212] *Southern Pacific Properties (Middle East) Limited v. Arab Republic of Egypt*, ICSID Case No. ARB/84/3, Award (1992), para. 63 <https://www.italaw.com/sites/default/files/case-documents/italaw6314_0.pdf> accessed 11 May 2023

to an investor for development purposes.[213] The main argument of the state was that it was obliged to cancel the project since it was contrary to its obligation under the United Nations Educational, Scientific and Cultural Organization (UNESCO) Convention to protect cultural heritage.[214] The tribunal acknowledged the state's unquestionable sovereign right to cancel the project 'for a public purpose, namely, the preservation and protection of antiquities in the area.'[215]

3.3 Summary

State's sovereign right to regulate has been deeply rooted in international investment law. While states are bound by investment treaties, they still reserve flexibility and the right to enact legislation or modify existing laws in the public interest. Only legitimate and reasonable exercise of regulatory powers can be justified in investment law. The starting point of finding the reasonability and legitimacy is to determine the objective which state measure aimed to attain.

Legitimate regulatory objectives vary and can include public order, national security, protection of environment, cultural heritage, or public health. Despite the universally established principle of the state's right to regulate, approaches of tribunals regarding its extent are not unanimous. Drawing a line between legitimate and illegitimate exercise of regulatory authority is a difficult task that tribunals undertake while aspiring to balance the state's right to regulate with investor's legitimate expectations, which is the cornerstone of the next chapter of the thesis.

[213] ibid, para. 43

[214] ibid, para. 150

[215] ibid, para. 158; However, the tribunal considered that Egypt's expropriation of the site was subject to compensation since investors had made significant investments (paras. 172 and 179)

4. Balancing Investor's Legitimate Expectations Against State's Right to Regulate

4.1 Introduction

The previous chapters of the thesis reviewed two pans of Themis' scale – the concepts of investor's legitimate expectations to regulatory stability and the state's regulatory power. The present part aims to analyse how these conflicting interests can be balanced against one another and what approaches are adopted by tribunals to ensure the protection of one interest without entailing another.

State's exercise of its sovereign regulatory power is often alleged to be frustrating investor's legitimate expectations. The relationship between these opposing interests is also referred to as the 'stability-flexibility dilemma'.[216] While the investor is afforded treaty protection from state measures, state's right to regulate is similarly acknowledged principle of investment law. The tension between these two legitimate interests derives from the investor's interest to be afforded regulatory stability and state's necessity to have regulatory flexibility.[217] State's obligations are not limited to foreign investors, its liability and accountability towards its people are greater. Since both interests are equally worthy, the conflict between them arises and by protecting one unilaterally, without balancing against another, the latter is likely to be unreasonably limited.

IIAs and ISDS systems are usually favouring investors by imposing obligations solely on states and limiting their freedom of action (including in public interests).[218] That is the reason behind the necessity to find an offsetting approach to ensure proper execution of the state's regulatory authority and limit the extent of protection claimed by an investor by the reasonability criteria and proportionality

[216] Mouyal (n 13), 19

[217] Levashova (n 35), 115; Mouyal (n 13), 19

[218] UNCTAD (n 3), 11; Mouyal (n 13), 18; Kriebaum (n 124), 404

principle. While the main purpose of the IIAs and treaties, especially the first-generation BITs,[219] is to protect investors against arbitrary, unlawful, or discriminatory measures of the state,[220] the legitimate interests of the latter are equally important. Aron Broches, father of the ICSID Convention wrote that 'the purpose of the Convention is to promote private foreign investment by improving the investment climate for investors and host States alike. The drafters have taken great care to make it a balanced instrument serving the interests of host States as well as investors.'[221] The same balancing requirement is enshrined in the ECT balancing state's sovereignty and responsibility 'for the development of economic activities and the necessity to protect foreign investment and its continuing flow.'[222]

The basis of the necessity to adopt a balancing approach can be found in several sources. Schill argues that the principle of proportionality, referring to a proper balance between private and public interests, originates from the rule of law.[223] And by the inclusion proportionality principle in the FET standard balancing the interests of the host state and foreign investors would be possible.[224] The *OperaFund* tribunal stated that proportionality is an 'inherent element' of the FET standard.[225] On the other hand, it is also argued that the principal idea of the FET standard is to 'assess and balance' the host state's right to regulate and investor's legitimate expectations.[226] In other words, the FET standard includes a balancing

[219] Titi (n 152), 73; Bayrak (n 22), 153

[220] Mouyal (n 13), 10

[221] Aron Broches, 'The Convention on the Settlement of Investment Disputes between States and Nationals of Other States' (1972) 136 Collected Courses of the Hague Academy of International Law 334, 348 <https://referenceworks-brillonline-com.ludwig.lub.lu.se/entries/the-hague-academy-collected-courses> accessed 13 May 2023

[222] *Hydro Energy v Spain* (n 14), para. 543

[223] Schill (n 1), 158

[224] Schill (n 1), 170; Benedict Kingsbury and Stephan W. Schill, 'Public Law Concepts to Balance Investors' Rights with State Regulatory Actions in the Public Interest - The Concept of Proportionality' in Stephan W. Schill (ed) *International Investment Law and Comparative Public Law* (OUP 2010) 75, 78 <https://www.iilj.org/wp-content/uploads/2016/08/Kingsbury-Schill> accessed 13 May 2023; Jürgen Kurtz, 'Adjudging the Exceptional at International Investment Law: Security, Public Order and Financial Crisis' (2010) 59 ICLQ 325, 366 <https://www.jstor.org/stable/40835393> accessed 9 May 2023, Kurtz does not refer to the inclusion of proportionality in the FET standard, he generally emphasizes that proportionality principle can be used in balancing exercise to determine whether regulatory measure is necessary to attain public objective

[225] *OperaFund v Spain* (n 66), para. 555; *Hydro Energy v Spain* (n 14), para. 573; *Cavalum v Spain* (n 69), para. 414; *Stadtwerke v Spain* (n 9), para. 325

[226] *Suez and Interagua v Argentina* (n 166), para. 148; *United Utilities v Estonia* (n 166), para. 767; see also Valenti (n 8) 35

exercise in itself.[227] The tribunal in the *RENERGY* case noted that a balancing exercise is deriving from not only the concepts of fairness and equity but also from the object and purpose of the ECT.[228] Irrespective of the source, tribunals are unanimous in finding that balance needs to be exercised between the state's regulatory power and investor's expectations.[229]

The importance to find an equilibrium between the two interests and adopt a more restrictive interpretation of the concept of legitimate expectations lies in the need to give states regulatory flexibility and the ability to fulfil international obligations (undertaken regarding e.g. human rights, environment, etc.).[230] For this reason, a growing number of tribunals emphasise the need to balance investor's expectations against the state's regulatory authority.[231] *Saluka v the Czech Republic* case is considered to be the foundation of this approach.[232] Particularly, the tribunal noted that for finding the frustration of investor's expectations, the host state's legitimate regulatory power must also be considered, therefore, it requires 'a weighing of the Claimant's legitimate and reasonable expectations on the one hand and the Respondent's legitimate regulatory interests on the other'.[233] Furthermore, the tribunal stated that even if the state's regulatory measure negatively affects investor's expectations, the violation of the FET standard will not be established if such a measure is implemented in a consistent, transparent, and non-discrimination manner.[234] The same line of argumentation is shared by the tribunals in recent awards.[235] The *InfraRed* tribunal noted that a measure taken in the public interest does not automatically amount to the breach of the FET standard, rather tribunals are obliged to carry out balancing exercise to establish whether radical regulatory change can be justified.[236]

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[227] *Cavalum v Spain* (n 69), para. 423; Titi (n 152), 277; Balcerzak (n 65), 334; Kriebaum (n 124), 404; McLachlan and others (n 10), paras. 7.24 and 7.361

[228] *RENERGY v Spain* (n 21), para. 608

[229] *Hydro Energy v Spain* (n 14), para. 583; Balcerzak (n 65), 335

[230] UNCTAD (n 3), 14; McLachlan and others (n 10), para. 7.155

[231] UNCTAD (n 3), 73; Valenti (n 8), 52

[232] UNCTAD (n 3), 73

[233] *Saluka v Czech Republic* (n 7), paras. 305-306

[234] ibid, para. 307

[235] UNCTAD (n 3), 74

[236] *InfraRed v Spain* (n 79), para. 368; see also *RREEF v Spain* (n 9), para. 466 citing *Novenergia II - Energy & Environment (SCA) (Grand Duchy of Luxembourg), SICAR v. The Kingdom of Spain*, SCC Case No. 2015/063, Final Award (2018), para. 657

For the establishment of the liability on the state's part, tribunals usually assess the following: (i) the existence of special promise to regulatory stability; (ii) the arbitrariness and discriminating legislation; or (iii) a total alteration of the regulatory framework.[237] This approach is covered by newly emerged concepts of Absolute Stability and Relative Stability, which shall be reviewed in the following chapters and how (or whether) balance is achieved in each case will be analysed.

4.2 Absolute Stability

The term 'Absolute Stability' was introduced by the *RENERGY* tribunal to refer to a promise made by the state on absolute freezing of regulatory framework.[238] Therefore, a specific undertaking must be present for an investor to claim the Absolute Stability of the legal system of the host state. The tribunal in the *InfraRed* case discussed such a situation under the concept of the 'legitimate expectation of stability' which can arise solely in case if specific promise directed to a particular investor or sector is made.[239]

Since Spanish Renewable Energy Saga cases were based on general regulatory changes and not arising from contractual relationships, it lacks the analysis of the Absolute Stability in the case of the stabilisation clause in the agreement. The contractual commitment was referred to by the *Startwerke* tribunal noting that power purchase agreements quite commonly envisage pricing conditions and rules for changing these conditions which aim to reduce regulatory risks for investors.[240] Thus, in the absence of such an agreement, no investor can have the same expectations that they would have in case of such an agreement.[241] The balancing analysis with respect to the Absolute stability will be provided in light of cases establishing the presence of special promise to regulatory stability.

It follows from the concept of Absolute Stability that tribunals' powers are very limited in exercising balancing. This is due to the fact that once a promise to Absolute Stability is established, any deviation from such promise shall result in a violation from the host state. Therefore, there is no room for examining whether the

[237] McLachlan and others (n 10), para. 7.165
[238] *RENERGY v Spain* (n 21), para. 641
[239] *InfraRed v Spain* (n 79), para. 366
[240] *Stadtwerke v Spain* (n 9), para. 307
[241] ibid

enactment of new laws or modification of the previous ones was carried out in the public interests. Absolute Stability can be seen as a blanket rule disregarding the intentions and objectives behind the change.

The tribunal in the *OperaFund* case did not in fact adopt a balancing approach,[242] instead, it noted that despite acknowledging the state's freedom to take measures, this does not release it from liability for changing 'the rules of the game' burdening investors.[243] For this very reason, such an amendment cannot be considered reasonable in the presence of an 'express statement' that the old regime would not be changed.[244]

The *9REN* tribunal noted that along with the frustration of legitimate expectations, being only 'a relevant factor' in assessment, the violation of the FET standard must be also established.[245] The tribunal found that Spain's one-sided method of risk distribution, which included that in both cases - increase and decrease of the energy prices – Spain would never sustain damages, and the burden of price reduction would be on investor, was neither fair nor sustainable.[246]

Watkins tribunal went too far and concluded that the balancing exercise can be done by tribunals only in case parties agree on that.[247] Furthermore, the tribunal neglected the state's regulatory authority and noted that Spain could not explain the basis of 'its so-called rights to regulate.'[248]

The *InfraRed* tribunal, after the establishment of the frustration of investor's legitimate expectations by changing the regime[249] noted that it would not discuss the claimants' alleged 'expectation of consistency' since the violation based on the change of the regime was already established.[250] This statement of the tribunal is crucial for the present discussion and indicates already established practice that special commitment from the state gives rise to the promise of Absolute Stability,

[242] *OperaFund v Spain* (n 66), para. 555; see also *Masdar v Spain* (n 74), para. 522
[243] *OperaFund v Spain* (n 66), para. 510
[244] ibid, para. 511
[245] *9REN v Spain* (n 53), para. 308; see also *Watkins v Spain* (n 9), paras. 601-603
[246] *9REN v Spain* (n 53), para. 311
[247] *Watkins v Spain* (n 9), para. 496
[248] ibid
[249] *InfraRed v Spain* (n 79), para. 453
[250] ibid, para. 456

which does not incorporate the assessment of the legitimacy or necessity of the state's regulatory measure. But rather, it can be said that the frustration of the promise of Absolute Stability automatically results in the violation of the FET standard. The tribunal in the *Hydro Energy* case noted that amendment of general legislation is not prevented by the FET standard 'at least in the absence of a stabilization clause.'[251]

4.3 Relative Stability

The balancing exercise is mainly conducted in cases involving a promise of Relative Stability or the legitimate expectation of consistency.[252] Similar to Absolute Stability, the term Relative Stability was introduced by the *RENERGY* tribunal to refer to a well-established practice that even in the absence of specific commitment, the FET standard protects investor's expectations from state measures exceeding a certain margin.[253] It follows that the concept of Regulatory Stability prohibits revolutionary rather than evolutionary change of regulatory framework.[254] The extent of the regulatory change amounting to excessive modification is characterized by various words, such as fundamental,[255] unreasonable,[256] radical,[257] disproportionate,[258] random,[259] and eliminating essential features.[260] Irrespective of the wording of how a measure shall be to surpass the state's protected scope of the right to regulate, the principle is the same, it shall not be revolutionary, totally changing the previous regime. Furthermore, the state's freedom to legislate under the Relative Stability can be limited by its statements and continuous emphasis on the importance of regulatory stability.[261] As to exactly what kind of change can be

[251] *Hydro Energy v Spain* (n 14), para. 676(11)

[252] *InfraRed v Spain* (n 79), para. 368

[253] *RENERGY v Spain* (n 21), para. 642

[254] Balcerzak (n 65), 328

[255] *Eiser v Spain* (n 39), para. 363; *InfraRed v Spain* (n 79), para. 368; *NextEra v Spain* (n 97), para. 599; *Cube v Spain* (n 24), para. 427

[256] *Masdar v Spain* (n 74), para. 484; *RWE v Spain* (n 78), para. 451; *Watkins v Spain* (n 9), para. 521

[257] *InfraRed v Spain* (n 79), para. 368; *Watkins v Spain* (n 9), para. 521; *RWE v Spain* (n 78), para. 617; *NextEra v Spain* (n 97), para. 599; *RENERGY v Spain* (n 21), para. 682; *Hydro Energy v Spain* (n 14), para. 675

[258] *RENERGY v Spain* (n 21), para. 550

[259] *RREEF v Spain* (n 9), para. 460

[260] *Antin Infrastructure v Spain* (n 61), para. 556

[261] *RENERGY v Spain* (n 21), para. 911; The tribunal noted that even though Spain did not made any commitment to Absolute Stability, 'it repeatedly made statements underlining the importance of regulatory stability, thus somewhat narrowing the acceptable margin of change under the notion of Relative Stability.'

qualified as fundamental, depends on particular factual background and is decided on a case-by-case basis.

Tribunals actively state that in order to determine the disproportionality of the state's measure aiming to handle economic crisis, 'some reasonable margin of appreciation' must be allowed for the state to decide what measure would be useful for ongoing challenges.[262] By referring to the margin of appreciation tribunals underline the necessity to give due regard to the state's choice of certain measure. The assessment of the violation of the FET standard does not enable tribunals to provide their views on the appropriateness of the measure,[263] it does not afford tribunals an 'open-ended mandate to second-guess government decision-making.'[264] Moreover, it is important to bear in mind that discretion (margin of appreciation) cannot be equated with arbitrariness, which falls beyond the justifiable exercise of regulatory power.[265] The line between these two is drawn by the balancing exercise through the proportionality principle.

Relative Stability implies the analysis and balancing of an investor's legitimate expectation of stability against the state's regulatory measure. The balancing exercise by tribunals is based on the proportionality or reasonability test.[266] The proportionality prerequisite is satisfied in case changes in the regulatory framework are not 'random, unnecessary or arbitrary'.[267] The introduction of qualifying requirements as to the scope of regulatory changes in Spanish Saga context is connected to the *Eiser* case stating that the FET standard protects investors against fundamental change in a regulatory framework.[268] However, the tribunal did not adopt any test, it found the violation of the FET standard by examining facts.[269]

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[262] *RWE v Spain* (n 78), paras 553 and 567; see also *Cavalum v Spain* (n 69), para. 430; *RREEF v Spain* (n 9), paras. 242 and 262; *Hydro Energy v Spain* (n 14), para. 589

[263] *RREEF v Spain* (n 9), para. 468

[264] *Saluka v Czech Republic* (n 7), para. 284 at *RWE v Spain* (n 78), para. 553; *RENERGY v Spain* (n 21), para. 901; *Hydro Energy v Spain* (n 14), para. 570; *BayWa v Spain* (n 113), para. 480; *Eurus v Spain* (n 61), para. 338

[265] *RREEF v Spain* (n 9), para. 468

[266] ibid, para. 462; Levashova (n 35), 205

[267] *RREEF v Spain* (n 9), para. 460; *SolEs v Spain* (n 31), para. 316

[268] *Eiser v Spain* (n 39), para. 363

[269] ibid, para. 418

Balancing investor's legitimate expectations against the state's right to regulate through the proportionality principle is shared by a number of tribunals.[270] The test includes the following elements for assessing the legality of state measure: (i) the existence of legitimate purpose; (ii) necessity; (iii) suitability and (iv) proportionality *sensu stricto*.[271] A different approach is taken by the *RREEF* tribunal that divided the above elements in two-tier test: reasonability and proportionality.[272] The tribunal argued that the first three elements (legitimacy, suitability, and necessity) are covered by the reasonability principle while proportionality implies finding a 'fair balance' between conflicting interests.[273] Similarly, the *Hydro Energy* tribunal noted that proportionality is part of the reasonableness standard.[274]

The suitability of a measure implies an assessment of whether there is a relationship between the measure and its purpose.[275] The requirement does not set a high threshold.[276] For example, the *RENERGY* tribunal considered that tribunal was unable to decide what the best policy decision for a state would be, it was sufficient to establish that measure taken was not *per se* unsuitable for achieving its aim.[277] As regards necessity, with due regard to the margin of appreciation of a state, requires the examination of the existence of less restrictive measures.[278] In case a tribunal finds an alternative with a less negative effect on an investor, taking the state's regulatory freedom into consideration, the measure will be less likely to be considered necessary.[279] Necessity analysis contains two aspects: whether there is less restraining measure and whether such measure is equally effective.[280] The last element, proportionality *sensu stricto* implies a balancing exercise between the

[270] *RREEF v Spain* (n 9), para. 460; *RWE v Spain* (n 78), paras. 569-570; *Eurus v Spain* (n 61), para. 336; Kingsbury and Schill (n 224), 86; Levashova (n 35), 205

[271] *RWE v Spain* (n 78), paras. 551, 554; *Hydro Energy v Spain* (n 14), para. 574; *Cavalum v Spain* (n 69), para. 415; Kingsbury and Schill (n 224), 86; Federico Ortino, 'Investment Treaties, Sustainable Development and Reasonableness Review: A Case Against Strict Proportionality Balancing' (2017) 30 LJIL 71, 73 <https://www-cambridge-org.ludwig.lub.lu.se/core/journals/leiden-journal-of-international-law/article> accessed 18 May 2023

[272] *RREEF v Spain* (n 9), para. 463

[273] ibid, paras. 464-465; see also *Stadtwerke v Spain* (n 9), para. 318; *SolEs v Spain* (n 31), para. 326

[274] *Hydro Energy v Spain* (n 14), para. 573; see also *Cavalum v Spain* (n 69), para. 414

[275] *RWE v Spain* (n 78), para. 554; Kingsbury and Schill (n 224), 86

[276] ibid, para. 554

[277] *RENERGY v Spain* (n 21), para. 899

[278] *RWE v Spain* (n 78), para. 554; Kingsbury and Schill (n 224), 87

[279] *RWE v Spain* (n 78), para. 554

[280] Kingsbury and Schill (n 224), 87

state's legitimate objective and private interest and it assesses whether a measure is excessive for an investor.[281] A measure shall be considered disproportional in case an excessive burden is placed on an investor.[282]

The *RENERGY* tribunal referred to the concept of 'margin of change'[283] and underlined several elements necessary for the establishment that regulatory measures exceeded acceptable margin:[284]: (i) the magnitude of change; (ii) economic impact; (iii) abruptness of the change; (iv) change of external circumstances; (v) public interests involved; (vi) prior legislative practice; (vii) stability assurances.[285]

The idea of balancing conflicting interests through the proportionality principle has opponents claiming that by using proportionality analysis tribunals will second-guess and undermine the state's measures against investor's interests.[286] Moreover, it is argued that the incorporation of the proportionality principle would result in a situation where investor's private interests will trump the state's public policy objectives.[287] However, it follows from the above analysis that tribunals, adopting proportionality standard in the balancing process clearly limit their power in the examination of the suitability of state measure. Without the proportionality principle, it is more likely private interests to outweigh legitimate public objectives since the primary aim of investment treaties is to protect investors from state measures. The proportionality principle and balancing exercise can restore fairness crisis in international investment law by weighing those interests on Themis' scale.

4.4 Summary

The present chapter reviewed the necessity to achieve balance between two conflicting interests, the investor's legitimate expectations on the one hand and the state's right to regulate on the other. Balancing exercise requires a comprehensive

[281] Kingsbury and Schill (n 224), 87; Levashova (n 35), 206

[282] *RWE v Spain* (n 78), para. 569 citing EDF (Services) Limited v. Romania, ICSID Case No. ARB/05/13, Award (2009), para. 293

[283] See also *Philip Morris v Uruguay* (n 9), para. 423 at *Hydro Energy v Spain* (n 14), para. 590

[284] *RENERGY v Spain* (n 21), paras. 680 and 683

[285] ibid, para. 681

[286] Prabhash Ranjan, 'Using the Public Law Concept of Proportionality to Balance Investment Protection with Regulation in International Investment Law: A Critical Appraisal' (2014) 3 Cambridge J Int'l & Comp L 853, 861 <https://heinonline-org.ludwig.lub.lu.se/HOL/Page?handle=hein.journals> accessed 18 May 2023

[287] ibid

understanding and review of the case with its surrounding circumstances in order to avoid unjustified restriction of one interest on account of another. The recent case law clearly and unequivocally emphasises the importance and need to exercise such balancing. However, the scope of a tribunal's authority to weigh interests against one another depends on the content and nature of the promise made by a state to an investor. In the case of Absolute Stability tribunals are very limited in adopting balancing approach and end in automatically finding the frustration of legitimate expectations if a state modifies the legal system. Tribunals enjoy more flexibility in Relative Stability situation when they usually weigh public and private interests and balance them in light of the proportionality principle.

5. Summary and Conclusions

Investor's legitimate expectations and the state's right to regulate are seen as two conflicting interests. The conflict arises when the state exercises its regulatory power and takes a legislative measure that frustrates investor's legitimate expectations of regulatory stability. Such expectations can arise from either explicit or implied representations made by the state. Tribunals do not usually find it difficult to establish the existence of promise in case of explicit commitment from the state. Implied representations belong to the grey area, since their legal status and capability to become a basis of legitimate expectations is usually disputed. The issue is particularly sophisticated in case an investor alleges the existence of a promise in a general regulatory framework. Approaches taken by tribunals differ in that regard and divide into two camps: one claiming that general regulatory framework can serve as special representations to regulatory freezing (Absolute Stability), while others state that provisions in legislation can only be the basis of expectation to Relative Stability. The latter implies adoption of a balancing approach to ascertain whether state measures are excessive for an investor.

Along with the representation, an investor must prove that it relied on such undertakings while making investment. The last element of the legitimate expectations test is the assessment of the reasonability of expectations. Investor's expectations can be afforded protection as long as they are objective and reasonable. The examination of reasonability is conducted from a prudent investor's perspective which includes the assessment of every relevant factual background surrounding the case with the possibility to affect the formation of investor's expectations. Prudent investor standard also implies carrying out proper due diligence and the examination of the relevant regulatory framework of a state before investing.

While the protection of investors is important and this is the main purpose of investment treaties, state's public objectives are also crucial and worthwhile. State's right to regulate is a principle of international law that is significantly limited in the

investment law context. Only those regulatory measures can be justified, that serve legitimate purpose. Such objectives vary and can include resolving economic crisis as it was in the Spanish Renewable Energy Saga cases, securing national security, the exceptional circumstance resorted to by Argentina, environmental protection, public health protection, or the conservation of cultural heritage.

Ensuring regulatory flexibility is vital for states to properly function and fulfil their sovereign rights and obligations. A certain degree of regulatory freedom needs to be afforded to states. However, such freedom shall not unfairly impair investor's protection. In the absence of a promise to Absolute Stability, state is entitled to freely adopt or modify regulation as long as it is not revolutionary, radical, or fundamental and does not essentially change existing regulatory framework. Both, investor's and state's legitimate interests to stability and flexibility, respectively, are equally important and it is very difficult to draw a line between them without unreasonably favouring one over another.

To strike a balance between public and private interests, tribunals incorporate the reasonability or proportionality principle in the assessment process. However, tribunals' authority in the interpretation and adjudication process is considerably limited in the case of the promise of Absolute Stability. In such a situation, the derogation from the promise by modifying the regulatory framework automatically results in the frustration of investor's legitimate expectations. Tribunals do not usually examine the state's measures in light of the proportionality principles.

More flexibility is afforded to tribunals in the case of Relative Stability, where even in the absence of a special promise, an investor is still protected from change that is radical, fundamental, unreasonable, or disproportionate. In Relative Stability tribunals adopt the proportionality principle for balancing exercise comprising of four elements: (1) legitimate aim; (2) suitability; (3) necessity; and (4) proportionality *sensu stricto*. Only in case a measure satisfies the proportionality principle and does not impose an excessive burden on the investor, can it be justified. Considering a measure in light of the proportionality principle prevents tribunals to decide without properly weighing public and private interests against one another. Without a balancing exercise the adoption of one-sided (which

presumably would be pro-investor) decision is more likely which ultimately shall result in unreasonable limitation of another side.

Lastly, a few words need to be said about the current development of the balancing exercise. While the proportionality principle and balancing exercise are becoming a substantial part of the assessment process in case of the Relative Stability, the issue is still problematic in the Absolute Stability context. The reason behind this is that tribunals do not assess investor's expectations against the state's legitimate regulatory objective. They establish the frustration of such expectations without appellation. Such a formalistic approach might raise questions and concerns regarding the fairness in the dispute settlement process, since only one party's interest (investor's) is taken into consideration, neglecting possible reasonable objectives on the other side. A state might face serious economic or other challenges requiring appropriate measures that might violate the promise given to an investor. The adoption of such a one-sided resolution protecting investor's interests poses a serious threat to the state's public interest and aspiration for development. This is especially relevant in the case of developing states for which new rules and measures are of utmost importance to handle ongoing challenges. By establishing a violation in case of acting in public interests, states are becoming significantly vulnerable and limited in exercising their sovereign power to regulate. Such an inequitable attitude is likely to result in the protection of one investor's interests on account of millions (citizens of the host state).

On the other hand, investor's legitimate concern about regulatory and investment environmental stability is equally important. Investors make decisions and take actions based on the business and investment environment, which includes special representations made by the state. Thus, it is crucial to ensure that such a promise is kept in the future. It follows that the conflict between these two interests is present and they need to be balanced against each other. Adopting a pro-investor or pro-state decision will not serve fairness and proportionality principles, both sides need to be weighed, and only after careful consideration of every relevant factor should the decision be made.

Even in the case of Absolute Stability, tribunals shall aspire to adopt balancing approach since circumstances surrounding the moment of making a promise by a

state is subject to change and such change of circumstances needs to be considered. Moreover, it would be reasonable to state that balancing exercise in Absolute Stability is likely to be weaker compared to Relative Stability, since in the former case there is explicit undertaking by a state restricting its margin of appreciation. Such a limitation is absent in case of the Relative Stability where a state is bound by general principles and rules of the proportionality and reasonability.

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