

Legitimate Expectations under the FET standard: prospective of recent RES cases

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LEGITIMATE EXPECTATIONS: APPROACHES (1/2)

- There is no universally applicable standard as to when investors' expectations deserve treaty protection under the FET requirement; any evaluation will depend on the facts.
- Two approaches to determining when investor expectations are reasonable so as to warrant treaty protection.
- The **first approach** requires the host state to have made clear assurances to the investor regarding the specific business relationship, e.g. stabilization clause in a contract between investor and State (in Ukraine – law on production sharing agreements).
- The **second approach** 'expectations could be created based on assurances provided in generally applicable laws of a country, and more generally, upon the existing framework at the time of the investment' (C.F. Dugan, D. Wallace Jr., N.D. Rubins, B. Sabahi, *Investor-State Arbitration* 502 (2008)).

The *Tecmed* arbitral tribunal explained, the host state should act 'consistently, transparently, and in a predictable and rational manner', so as not to 'affect the basic expectations that were taken into account by the foreign investor to make the investment'. The tribunal in *CMS v. Argentina* similarly observed that the stability and predictability of the legal and regulatory environment is an important component of fair and equitable treatment.

LEGITIMATE EXPECTATIONS: APPROACHES (2/2)

- The **third approach** (presented in an UNCTAD paper “FAIR AND EQUITABLE TREATMENT UNCTAD Series on Issues in International Investment Agreements II” (2012) makes the legitimate expectation claim subject to qualifying requirements.
- This approach requires proof of the following elements to find a breach of legitimate expectations:
 - legitimate expectations may arise only from a state's specific representations or commitments to the investor, on which the latter has relied;
 - the investor must be aware of the general regulatory environment in the country and expectations must be reasonable, and founded on the political, socioeconomic, cultural and historical conditions prevailing in the state;
 - investors' expectations must be balanced against the legitimate regulatory activities of the host country.

REGULATORY FRAMEWORK CHANGES

- A change in the host state's regulatory framework will not necessarily lead to a finding of a breach of the FET guarantee.
- In *Charanne v. Spain* the Tribunal concluded that Spain did not breach its FET guarantee under the ECT. As the tribunal noted, 'in the absence of a specific commitment, an investor cannot have a legitimate expectation that existing rules will not be modified.' The tribunal then observed that Spanish law pre-dating the investment allowed Spain to modify its solar energy regulations (and so such changes were objectively foreseeable), and that Spain's commitments to investors were not 'sufficiently specific' to create an expectation of a frozen legal environment. The tribunal also rejected the investors' claim (which relied on *CMS v. Argentina*) that Spain's regulatory changes operated retroactively and therefore breached their acquired rights to operate under the initial incentive regime.
- **Is there unified approach as to legitimate expectations for legislative changes based on the recent RES cases?**

CHARANNE V. SPAIN

- Having determined that RD 661/2007 and RD 1578/2008 do not constitute specific commitments to foreign investors, the *Charanne v. Spain* Tribunal opined that the investors' legitimate expectations can nonetheless be frustrated by modifications of the existing regulatory framework provided that, in enacting such modifications, the State acted unreasonably, disproportionately or contrary to the public interest (*Charanne v. Spain* Award, paras. 513-516).
- As to the proportionality, the changes would not be proportionate if they are impulsive or unnecessary and amount to sudden and unpredictable elimination of the essential characteristics of the existing regulation.

BLUSUN V. ITALY (1/2)

- The arbitrators in *Blusun v. Italy* seemed to disagree with *Charanne v. Spain* tribunal regarding the criteria which need to be observed in order to determine whether the regulatory changes violate the legitimate expectations of foreign investors.
- In particular, the arbitrators stated that:

*“Of the three criteria suggested in *Charanne*, ‘**public interest**’ is largely indeterminate and is, anyway, a judgement entrusted to the authorities of the host state. Except perhaps in very clear cases, it is not for an investment tribunal to decide, contrary to the considered view of those authorities, the content of the public interest of their state, nor to weigh against it the largely incommensurable public interest of the capital exporting state. The criterion of ‘**unreasonableness**’ can be criticized on similar grounds, as an open-ended mandate to second-guess the host state’s policies. By contrast, **disproportionality** carries in-built limitations and is more determinate. It is a criterion which administrative law courts, and human rights courts, have become accustomed to apply to governmental action.” (Award, para. 318) [emphasis added].*

BLUSUN V. ITALY (2/2)

- On the basis of this disagreement, the Tribunal in *Blusun v. Italy* defined the standard to be when assessing the legality of regulatory changes in light of the foreign investors' legitimate expectations in the absence of specific commitments as follows:

“In the absence of a specific commitment, the state has no obligation to grant subsidies such as feed-in tariffs, or to maintain them unchanged once granted. But if they are lawfully granted, and if it becomes necessary to modify them, this should be done in a manner which is not disproportionate to the aim of the legislative amendment, and should have due regard to the reasonable reliance interests of recipients who may have committed substantial resources on the basis of the earlier regime.” (Award, para. 319(5)) [emphasis added].

EISER V. SPAIN AND ISOLUX V. SPAIN

- Other Spanish cases recently resolved, namely ***Eiser v. Spain*** and ***Isolux v. Spain*** are more in line with the opinion of the Charanne tribunal.
- ***Eiser v. Spain***: “...[a]bsent explicit undertakings directly extended to investors and guaranteeing that States will not change their laws or regulations, investment treaties do not eliminate States’ right to modify their regulatory regimes to meet evolving circumstances **and public needs...**” [emphasis added] (*Eiser v. Spain* Award, para. 362).
- ***Isolux v. Spain***: the award relied on “standard of **reasonableness and proportionality**” to assess whether the legislator changes infringe the investors legitimate expectations (*Isolux v. Spain* Award, para. 430).

CONCLUSIONS

- There is no universally applicable standard as to when investors' expectations deserve treaty protection.
- This is confirmed by recent RES cases.
- Regulatory changes will not frustrate legitimate expectations provided they are reasonable, proportional and in line with the State's public interests.

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Yaroslav focuses on energy law projects (oil & gas, electricity, renewable energy and energy efficiency) and dispute resolution (international arbitration, commercial litigation).

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