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Dissenting Opinion

BayWa r.e. Renewable Energy GmbH and BayWa r.e. Asset Holding GmbH and Kingdom of Spain (ICSID CASE No. ARB/15/16)

1. This dissenting opinion is limited only to findings and conclusions in the Majority Decision on Jurisdiction, Liability and Directions on Quantum (the "Decision") starting at the Decision's para. 456 regarding the Claimants' claim based on the fair and equitable standard (the "FET") under Article 10.1 of the Energy Charter Treaty (the "ECT"). More specifically, I dissent with the Decision's reasons and determinations according to which the Claimants are only entitled to damage compensation for what the Decision characterizes as *"…the retroactive reduction in the allowed return…."*, and not to full compensation for the life of the Claimants' facilities, and the basis to establish such compensation. Therefore, I also disagree with the analysis, conclusions and way forward on quantum of damages set forth in paras. 612-617 of the Decision.

2. However, to avoid misunderstanding as to the scope of this dissent, I share: a) the Decision's conclusion at paras. 483 and 484 that a 25 year-life is appropriate for Wind Farms; b) the analysis of and conclusions on the protection and security Claimants' claim at the Decision's paras. 528-534; and c) the Decision's analysis and conclusions regarding the tax gross-up claim set forth at paras. 618-628 of the Decision. Further, although certain coincidences in the approach and reasoning in this dissent and in the Decision may be noticeable, this does not detract from substantial disagreements evidenced in the text and conclusions that follow. The undersigned believes that only reading together this dissent and the Decision's paragraphs covering the FET claim allows to adequately identify such areas of disagreement even where the Decision does not specify that it is rendered by majority.

3. A FET analysis requires a balancing exercise between Claimants' rights under the legal framework spanning 1996-2012 (the "Special Regime") and the regime put in place through legal enactments by the Spanish Government in 2013-2014 (the "New Regime").

4. It is common ground between the Parties that the Special Regime could be subject to regulatory changes. The issue is the balance to be struck between the rights granted to the Claimants and accompanying expectations of stability, gain and profit through concrete and specific provisions under the Special Regime and the New Regime regulations curtailing or eliminating such rights or baffling those expectations. Such balance requires a weighing of different factors along notions of reasonableness and proportionality. To this exercise I now turn.

5. One first relevant factor to be accounted for in this exercise is that the Claimants' rights under the Special Regime and accompanying expectations of stability, gain and profit originate (just considering the Special Regime's concrete legal provisions) in specific rules of law having mandatory force of their own. Therefore, without denying the importance of general representations or statements generating investors' legitimate expectations, the analysis should be, first and foremost, centered on the imperative legal provisions at the heart of the Special Regime.

6. Expectations arising out of such Special Regime's legal rules are *necessarily legitimate* among other things because, on the contrary, the very function of rules of law – particularly in democratic societies - to create areas of predictability and security orienting human action would be defeated. They are also *objective,* since they flow from specific rules of law and not from subjective evaluation. As set forth in the *9REN* award [1]*:*

   "There is no doubt that an enforceable 'legitimate expectation' requires a clear and specific commitment, but in the view of this Tribunal there is no reason in principle why such a commitment of the requisite clarity and specificity cannot be made in the regulation itself where (as here) such a commitment is made for the purpose of inducing investment, which succeeded in attracting the Claimant's investment and once made resulted in losses to the Claimant".

   Thus, those questioning the relevance or effects of such expectations have the burden to prove the facts and legal grounds supporting the reasons to do so.

7. Against this backdrop, the Special Regime's salient legal traits shall be now considered.

8. The Special Regime had as its point of departure Law 54/1997 which provided for less than 50 MW wind facilities like the Claimants (such Claimants' facilities hereinafter the "Wind Farms") the right to opt for pool (market) price plus premium for the sale of their electricity. Premium determination[2] "*... will take into account the voltage level of the delivery of energy to the network, the effective contribution to the improvement of the environment, the primary energy savings and energy efficiency, the production of economically justifiable useful heat and the investment costs incurred, in order to achieve reasonable profitability rates with reference to the cost of the money on capital markets"* (the "Law 54 Standard").

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[1] *9REN v. f Spain* (Award), para. 295, RL-0125. In the same vein, the *Cube v. Spain* (Decision), at para. 388: "*The Tribunal does not consider it necessary that a specific commitment be made to each individual claimant in order for a legitimate expectation to arise. At least in the case of a highly – regulated industry, and provided that the representations are sufficiently clear and unequivocal, it is enough that a regulatory regime be established with the overt aim of attracting investments by holding out to potential investors the prospect that the investments will be subject to a set of specific regulatory principles that will, as a matter of deliberate policy, be maintained in force for a finite length of time. Such regimes are plainly intended to create expectations upon which investors will rely; and to the extent that those expectations are objectively reasonable, they give rise to legitimate expectations when investments are in fact made in reliance upon them".*

[2] Law 54/1997, Article 30.4.c, C-0032.

9. The Wind Farms were built, commissioned and RAIPRE registered under RD 2818/1998 on 22-25 November 2002[3]. It provided certain guiding and predictable parameters defining the legal framework that in general terms remained applicable to the Wind Farms until 2013; namely, the Wind Farms could either directly sell electricity to distributors at a fixed tariff in Spanish pesetas for each kWh, or at the pool (market price) plus a fixed premium in pesetas also for each kWh. Under this Decree, the premiums were to be revised every four years considering the evolution of electricity market price, the installations' demand coverage and the effect on the management of the Electricity System as a whole. Like future decrees, it provided for a transitory regime allowing facilities pre-dating this Decree to stay under the previous regime.

10. Six years later RD 436/2004 was adopted. It maintained the option of fixed tariff (as a percentage of the TMR or *tarifa eléctrica media*) and pool price plus premium. Tariffs, premium, incentives and complements under this Decree became effective in respect of facilities commencing operations on 1 January of the second year after the revision of tariffs under this Decree, i.e., excluding the Wind Farms from the retroactive application of the Decree (Article 40.2). This is further confirmed by Article 40.3 of the Decree stating that it *"...shall not be effective retroactively on any previous tariffs and premiums"*. Premiums under this Decree were set forth at a Euro price by kWh. As allowed by this Decree, the Wind Farms chose in 2005 not to remain under the RD 2818/1998 regime until 2007 and to sell electricity under the pool price/premium option pursuant to RD 436/2004, with the annual option (never elected by the Wind Farms) to shift to the TMR percentage regime.

11. Years later RD 661/2007 was adopted. It set a Euro price tariff per kWh adjusted to the consumer price index (CPI) as one option, and as another option, a pool price plus premium also set at a Euro amount per kWh, adjusted in accordance with CPI, and subject to caps and floors. Article 44.3 of this Decree provided that it would not affect facilities commissioned prior to the second following year in which the revision shall have been performed, thus excluding its retrospective application to the Wind Farms.

12. The Wind Farms opted to stay in the pool price plus premium option under RD 436/2004 until 31 December 2012. After then it was subject to the RD 661/2007 regime with the possibility to annually choose between the fixed tariff and the pool price plus premium option under this Decree. RD 661/2007 further provided that at the expiration of a twenty-year period counted from the beginning of operations of the Wind Farms (i.e., November 2022) the option would come to an end and, without any time limitation, the electricity would be sold at the fixed tariff price only.

13. Although RDL 6/2009 did refer to the electricity system tariff deficit among its reasons, it did not affect wind facilities like the Wind Farms since it only set forth more stringent requirements for new entrants to the Special Regime. Wind facilities like the Wind Farms were not included in the New Regime enacted under RD 1565/2010 reducing the economic benefits of PV (photovoltaic) plants.

[3] November 2017 Hearing, Claimants' Opening Slides (the "Slides"), Slide 85.

14. In 2010, Royal Decree 1614 was adopted. Among other things, it provided that premiums under RD 661/2007 would be reduced by 35% but that such reduction would not apply to facilities like the Wind Farms that had chosen to stay under the RD 436/2004 regime, which would remain under the 2010 premium and tariff values (i.e., not the higher 2013 values that would have applied otherwise) once the transitory application to the Wind Farms of the RD 436/2004 came to an end. It further provided (Articles 5.2, 5.3) that facilities like the Wind Farms would not be subject to the reviews of tariffs and premiums upper and lower limits (all set at kWh prices as of 2010) established in RD 661/2007[4].

15. In view of the electric system tariff deficit, Article 1 of RDL 6/2009 of 7 May 2009 modified Law 54/1997 essentially to impose access tolls on Special Regime facilities like the Wind Farms exclusively to pay for the costs of Special Regime activities assumed to contribute to the deficit. Later, RDL 14/2010 of 23 December 2010, also aimed at coping with the tariff deficit, increased the toll burden on Special Regime facilities like the Wind Farms.

16. Royal Decree Law 1/2012, also prompted by the electricity tariff regime deficit, suppressed the pool price plus premium remuneration afforded under RDL 1/2012. However, this measure only applied to new Special Regime entrants, and the Decree emphasized that it did not retrospectively affect vested rights (including those of the Wind Farms).

17. As from 2013, the New Regime drastically put an end to and in fact erased the Special Regime by introducing a "new model" for the compensation of renewable energy producers like the Wind Farms[5], essentially as follows:

    a) It eliminated the price plus premium option (the one elected by the Wind Farms)

    b) It changed the tariff adjustment factor, eliminating unprocessed foods and energy products from the adjustment basket.

    c) It afforded no possibility to sell electricity at a fixed tariff option (meaning that electricity prices are freely fixed by the market).

    d) It eliminated the regime of fixed tariffs and premiums for all renewable energy facilities, new and old, introduced for the first time a remuneration system based on standard costs per unit of installed power plus standard amounts for operating costs and set a target rate of return at 300 points above the ten-year average yield of Spanish Government ten-year bonds.

    e) It set the remuneration parameters for standard facilities including standard costs (without considering the actual costs of each specific facility) as a result of which the reasonable return is set at 7.398% pre-tax for all facilities like the Wind Farms, subject to periodical three-year and six-year reviews. The first such six-year period lapses on

[4] Slides 106 and 108.

[5] Ministerial Order IET/1045/2014 of 16 June 2014 (the "IET Order"), at 46430, C-0216.

31 December 2019 counted as from the coming into effect of RDL 9/2013 of 12 July 2013)[6]. After the facilities' regulatory period lapses (20 years after the beginning of their operation in the case of the Wind Farms), the facilities would not receive any price other than the pool (market) price.

f) Facilities deemed to have reached such reasonable return level could not benefit from a specific compensation paid by the State covering investment costs and operating costs that cannot be recouped through sales in the electricity market, such costs corresponding to a type or standard facility defined in the IET Order based on standard revenue obtainable from sales in the electricity market, standard costs necessary for the operation of the facility and the standard value of the original investment for an enterprise deemed efficient and well managed during its useful life.[7]

18. Until the enactment of the New Regime, unlike the situation of other renewables, such as the photovoltaic facilities, the measures taken by the Spanish Government were aimed at preserving the Special Regime for wind facilities like the Wind Farms.

19. This is especially true in connection with the Wind Farms, not only because of the specific rights vested in them under the Special Regime, but also because of the successive elections they made to remain under RD 436/2004 by exercising the option to choose between regulated tariff and pool price under such Decree and remain under the RD 661/2007 on renewable energy and cogeneration once the RD 436/2004 would cease to apply to them.

20. In particular, the Official Press Release of 25 May 2007 of the Ministry of Industry, Tourism and Commerce of the Kingdom of Spain in connection with RD 661/2007 assigned priority to profitability and stability of the incentives under the Special Regime and emphasized both its non-retroactive character and its non-application to facilities like the Wind Farms in operation by 1 January 2008.

21. Among other things, this press release expressed that RD 661/2007 was aimed at establishing *"....a stable system of incentives guaranteeing an attractive return for the activity of energy production under the special regime"*, as part "*...of the energy policy commitment to promote the use in our country of clean, autochthonous and efficient sources of energy..."*. It also expressed that the Decree was a manifestation of the Spanish Government's commitment to seek in the new regulation *"...stability in time (...) allowing business owners to plan in the medium and long term, as well as a sufficient and reasonable return which, like the stability, makes the investment and engagement in this activity attractive"*. It also stated that *"Any revisions of tariffs to be carried out in the future shall not affect the facilities already in operation. This guarantee provides legal certainty for the producer, providing stability for the sector and promoting its development* [8].

[6] IET Order, at 46431.
[7] *Ibidem*, at 46432.

[8] Slides 101-104.

22. Statements in this press release are consistent with the wording precluding the retrospective application of its provisions set forth in Article 44.3 of RD 661/2007, constitute specific representations that future tariff revisions would have no retroactive effect and would not affect facilities already in operation, although the stability afforded was not unlimited in time [9].

23. In other words, in part by exercising rights contemplated under the Special Regime allowing them to preserve the pool price plus premium option, in part because of the very legal provisions of the Special Regime applying to them and expressions attributable to the Respondent in connection with RD 661/2007, it is fair to say that the Wind Farms could unequivocally rely on the Special Regime's stability specifically designed to attract their long-term investment in the Spanish renewable energy sector.

24. This contrasts with the remuneration criteria introduced by the New Regime because:

    a) as summarized in the *Eiser* award[10]: *The new regime pays no regard to actual costs (including loan servicing) or actual efficiencies of specific existing [plants](…) Moreover, within limits intended to assure threshold amounts of production, remuneration no longer is based on the amount of electricity generated. Instead, existing plants' remuneration is based on their generating capacity and regulators' estimates of the hypothetical capital and operating costs, per unit of generating capacity, of a hypothetical standard installation of the type concerned. The regulatory regime also sets the regulatory life of a plant*[11]*. Once set, neither the regulatory life nor the prescribed "initial value of the investment" can be changed"*;

    b) the investors in the Wind Farms were legitimately relying on a remuneration mechanism based on the production of electricity quantities at an hourly price for kWh and not on a remuneration regime exclusively depending on a relationship between standardized operative costs and cash inflows or efficient investment criteria, which, further, are all disconnected from the *actual* operation costs and investment data of the Wind Farms. Reasonable return references in different provisions of the Special Regime were merely benchmarks without setting forth maximum return limits on investments. Thus, under the Special Regime, the more electricity produced the more remuneration (and eventually a higher return for the investors) was obtainable, i.e., there was an incentive to produce more electricity to feed the market reducing the need to inject in the grid electricity from less environmental friendly sources[12] (it should be noted that the New Regime does not put emphasis on environmental concerns);

    c) the New Regime is perverse not only because the rigid standardized criteria it imposes *ex post* renders some wind facilities (like the Wind Farms) unprofitable and others profitable without regard to the actual economic characteristics of each facility in terms, *inter alia*, of their real investment and operating costs, but also because it does not

[9] *Cube v. Spain* (Decision) cit. *supra*, at paras. 273, 311.
[10] *Eiser v. Spain* (Award), at para. 398, CL-0217.
[11] For wind facilities, reduced from 25 to 20 years.
[12] KPMG Second Regulatory Report, at para. 9, CER-0003.

allow the Claimants to predict future costs and investment standards – as well as return rates for the following years - since they depend on variables unilaterally and discretionarily determined by the Respondent, and in any case detached from the realities of the Claimants' investments and operations;

d) wind facilities like the Wind Farms are unable to adapt *ex post* to existing investment and operational characteristics to fit under the New Regime's standardized parameters resulting in the imposition of a maximum pre-tax return, which also did not account for the differentiated tax regime wind facilities may be subject to depending on their location in different administrative and tax territorial divisions of the Spanish Kingdom [13], and are left as their only option to actually attain the pre-set, pre-tax 7.398% return by reducing their costs even if their reduction might not be realistically attainable or technically convenient, or even if such reductions may lead to economic or technical demise of the facility;

e) without such predictability levels, project finance, allowing higher leverage levels that result in better value for consumers (since this form of financing is less expensive than other forms of financing, including owners' equity infusions) would not be possible[14].

f) both Decrees 6/2009 and 14/2010 mentioned at para. 15 above, as well as the freezing at 2010 values of incentives pursuant to Royal Decree 1614 described in para. 14 above, constituted a reassurance to investors in wind facilities like the Claimants' that they had already contributed their fair share to address the tariff deficit within the general context of the existing Special Regime proportionately to their benefits under the Special Regime, and therefore, that no further sacrifices would be requested from them to pay for a deficit that, after all, there is no evidence that at least the Wind Farms originated or contributed to in any substantial way.

25. The record further shows that:

a) the tariff deficit addressed by the New Regime originated in 2000,[15] well before the enactment of the decrees of 2004 and 2007 constituting the core of the rights and expectations on which the Claimants' claims are based. The Spanish Government, certainly aware of the deficit, chose however to further burden it through the introduction of the Special Regime in order to attract, promote and benefit from investments in renewable energy technologies. If the balance between such burden and the tariff system was miscalculated by the Spanish Government or the ensuing imbalance not early cauterized, it has of course the right and the obligation to rebalance the system, but not at the cost of sacrificing rights and expectations of investors like the Claimants, which are protected by the ECT.

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[13] *Ibidem* at paras. 26-27.
[14] *Ibidem* at para. 24.
[15] *Ibidem*, at para. 113.

b) It is undisputed that since 2001 the Wind Farms were financed by resorting to project finance.[16] There is no indication under the Special Regime or related evidence that project finance or other forms of financing should be excluded from the cost, remuneration and profit calculation of investors investing in wind facilities like the Wind Farms. In fact, both the 2000-2010 Renewable Promotion Plan approved by the Spanish Council of Ministers on 30 December 1999[17] and the 2005-2010 Renewable Promotion Plan approved by the Spanish Council of Ministers of 26 August 2005[18] referred to project finance as a normal means to finance projects like the Wind Farms and none of them excluded the consideration of financial costs under these facilities from the Project costs to be taken into account in the Claimants' profit or return estimates and associated expectations under the Special Regime in their decision making process regarding investing in the Spanish wind power sector.[19] As the *NextEra* arbitral tribunal found:[20]

> *"The question before the Tribunal is not how a regulated activity should determine what constitutes a reasonable return, but what loss the Claimants suffered. On undertaking an investment an investor would reasonably expect that the returns from the investment would cover all the costs of making that investment. The examples given by Claimants where regulatory regimes do include financing costs in determining a reasonable rate of return reinforce the reasonableness of this expectation. No rational investor would sink money into a project that did not offer a return that would cover its costs. And, the financing of projects of this size and duration inevitably involves a regime with third party financing".*

c) Therefore, these financing costs were legitimately considered by the investors in the Wind Farms when estimating the Project's cash flows under the Special Regime. The mere fact that the Project cash flows exceeded the operating costs[21] does not detract from the fact that the investors' legitimate expectations in the Wind Farms included obtaining cash flows through electricity sales permitting them to meet their obligations with the lenders to avoid acceleration of the loans and the insolvency of the Wind Farms

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[16] CWS-ES, paras. 21-23, at pp. 5-6.

[17] C-0030 at pp. 61, 177-184, 203-218. (SPA Original)

[18] C-0033 at 281-284. (SPA Original)

[19] The Respondent refers to a *Memoria Económica* underlying the proposal of RD 436/2004 which in its page 5 states that only financing of the Projects under this Decree with investors' own funds is covered, and that having recourse to external finance is a decision under the responsibility of the investors. However, the record does not permit to conclude whether this document went beyond being a mere proposal or not, and its recommendations may not be traced to actual provisions in the Decree. There is no reason to give to this isolated document more weight than the 2000-2010 and 2005-2010 plans mentioned above, expressly including project finance among the financial resources for the Special Regime. Furthermore: a) project finance was already resorted to finance the Wind Farms' activities in 2001 (CWS-ES, paras. 21, 26 at pp. 5-7), i.e., well before RD 436/2004, which could not have been foreseen by the investors in the Wind Farms in 2001 even assuming that such RD excluded financing costs from the investments in the Wind Farms, which it did not; b) the 2006 financing and any later financings were refinancing of the original 2001 financing; and c) the 2005-2010 Plan, which refers to RD 436/2004 and came after this Decree maintains project finance as part of the allowed financing and also provides that the wind facilities like the Wind Farms would rely that 80% of the investment would be sourced from external financing.

[20] *NextEra v. Spain* (Decision) para. 658, RL-0121.

[21] CWS-ES, p. 7.

inevitably ensuing – as unrebutted evidence shows[22] -- from the New Regime, and this despite the refinancing of the project finance debt in 2006. It is also unrebutted that the unprecedented situation created by the New Regime resulted in a failure to meet the debt coverage ratio under the project financing structure leading to the acceleration of the loans and possibly triggering the insolvency of the Wind Farms,[23] which was only averted after a renegotiation of the project finance debt bringing about, among other negative consequences, that the Claimants – under the current New Regime scenario – will not receive any dividend from the Wind Farms until 2024.

26. In sum:

a) the Claimants could not anticipate when investing in the Wind Farms that they would be imposed a model which redefined *ex post facto* whether the Wind Farms were and are efficiently operated and well-managed and the economic benefits derived from them;[24]

b) the radical change in the model brought about by the New Regime was not limited to suppressing the pool price plus premium mechanisms under the Special Regime, since it also radically eliminated the investment, remuneration and cost criteria on which investors under the Special Regime relied upon for calculating economic burdens and profits and set a limit on investors' returns;

c) the New Regime drastically changed the remuneration criteria and cost and investment structure existing under the Special Regime, both for the past and for the future, in ways and on the basis of criteria that were totally unpredictable for the Claimants;

d) although Special Regime regulations changed across time, such changes did not constitute a radical innovation in the then applicable legal framework or a Copernican modification going to the roots of the Special Regime, and could not be deemed to have been the harbinger of the radical new model introduced through the New Regime as far as the Wind Farms are concerned.

27. The following considerations are apposite for scenarios like the ones depicted above:

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[22] *Ibidem*, paras. 38-42, at p. 10.

[23] As it was clearly set forth in the letter of 8 October 2014 to the Wind Farms from UNI Credit Corporate and Investing Banking, the agent bank representing the project finance creditors C-0270:

> "*In particular, the approval of the New Regulations and the impact that, among other factors, they could have on the Project, are circumstances that, in the reasonable opinion of the Banks, have a clear and direct negative effect on the cash flows of the Project and, therefore, on its viability. In this regard, the Banks are of the reasonable understanding that the aforesaid circumstances could become a Material Adverse Effect as they could substantially impair, among others, the financial solvency of the Borrowers and the Guarantors considered collectively as well as the viability of the Project. These circumstances are an event of default as provided in clause 16.1 h) of the Loan Agreements*".

[24] IET Order, at 46434, C-0216.

a) *"…Indeed, an investor has the legitimate expectation that, when the State modifies the regulation under which the investor made the investment, it will not do so unreasonably, contrary to the public interest, or in a disproportionate manner (…)The Arbitration Tribunal considers that the proportionality requirement is fulfilled as long as the modifications are not random or unnecessary, and that they do not suddenly and unexpectedly eliminate the essential features of the regulatory framework in place"*[25].

b) "*Taking account of the context and of the ECT's object and purpose, the Tribunal concludes that Article 10(1)'s obligation to accord fair and equitable treatment necessarily embraces an obligation to provide fundamental stability in the essential characteristics of the legal regime relied upon by investors in making long-term investments. This does not mean that regulatory regimes cannot evolve. Surely they can... '[T]he legitimate expectations of any investor [...] [have] to include the real possibility of reasonable changes and amendments in the legal framework, made by the competent authorities within the limits of the powers conferred on them by the law.' However, the Article 10(1) obligation to accord fair and equitable treatment means that regulatory regimes cannot be radically altered as applied to existing investments in ways that deprive investors who invested in reliance on those regimes of their investment's value.*"[26]

28. Circumstances described in paragraphs 17-26 above, examined against the backdrop of the above considerations, lead to concluding that the New Regime measures imposed a disproportionate, unreasonable and unexpected economic burden on the Claimants which suppressed the legal and economic substance of the regulatory framework they relied upon when investing, and thus defeated their legitimate expectations.

29. There is no reason to depart from these findings and conclusions because of the alleged violation by the Wind Farms of the European State Aid Provisions (the "State Aid") invoked by the Respondent on the basis of the European Commission (the "EC") decision SA.40348 (2015/NN) of 10 November 2017 (the "EC Decision") issued in response to a notification by the Respondent of 22 December 2014, the purpose of which was to validate the New Regime under the State Aid regime.

30. The Respondent refers particularly to Sections 3.5.2. and 3.5.3 of the EC Decision in which the EC, in statements that can only be considered *obiter dicta* given the fact that the Respondent's consultation only concerned the compatibility of the New Regime with the State Aid (and not the Special Regime), asserts: (i) that State Aid to investors by a Member State without respecting the notification and stand-still obligation under Article 108.3 of the Treaty on the Functioning of the European Union ("TFEU") does not generate legitimate expectations; and (ii) the lack of jurisdiction of arbitral tribunals to decide investment disputes in intra-European cases (an allegation that has been unanimously rejected in this arbitration).

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25 *Charanne v. Spain* (Final Award), paras. 514, 517, RL-0049.
26 *Eiser v. Spain* (Award), cit. *supra* at para. 382, CL-0217.

31. The EC Decision – addressed to the Kingdom of Spain and not to the Claimants or the Wind Farms – raises for the first time the issue of investors' legitimate expectations from an European law perspective specifically in connection with the Special Regime. In itself – because of its date – the EC Decision could not have been taken into account when the Claimants invested. The same should be said, because of their dates, of the European Court of Justice 19 December 2013 decision *Association Vent de Colère!* and the order of the same Court in the *Elcogas SA* matter of 2014. As far as the timing of the EC Decision and these European Court decision and order is concerned, they cannot be invoked to challenge the Claimants' legitimate expectations when investing in the Wind Farms.

32. The issue is then whether the investors, prior to investing within the framework of the Special Regime, failed to properly discharge their due diligence obligations as a *diligent businessman* should do.[27]

33. It is undisputed that the Respondent failed to notify the Special Regime to the EC or comply with the standstill obligation set forth in Article 108.3 of the TFEU. On the other hand, the Respondent could not have been unaware, or had the duty to be aware, of any substantive violation of European law by the Special Regime. The essential failure to comply with European law or the hypothetical unlawfulness of the Special Regime is first and foremost imputable to the Respondent, which is indeed alleging, for the first time in this arbitration, its own fault in order to shirk its obligations and responsibilities under the EC Treaty FET standards, in violation of the principle *nemo turpitudem suam allegarem potest.*

34. The conduct of the Respondent is even more reprehensible if one considers that it relied for a period spanning 1997-2013 on the Special Regime to attract renewable energy investments and gave assurances as to the benefits of the Special Regime, at least in connection with RD 661/2007.

35. The legitimate expectations of the Claimants and their reliance on the representations arising out of the Special Regime *"....do not depend on there being evidence of any particular form or scale of legal due diligence by external legal advisors.."*[28] This is true also when the alleged incompatibility of the Special Regime with the State Aid system not captured in the due diligence carried out by the investor prior to investing is invoked to deny the investor's rights under the ECT in a scenario in which the investor is confronted with a drastic suppression of the very legal regime enticing its investment which could not be reasonably anticipated by the due diligence exercise. Indeed, investing is not a *caveat emptor* exercise like buying goods under a sales contract and requires a cooperative attitude by States among themselves and with the addressees of the ECT protective provisions as part and parcel of the implementation of policies aimed at attracting foreign investment. This is illustrated by the ECT text itself:

> *ARTICLE 2 PURPOSE OF THE TREATY* This Treaty establishes a legal framework in order to promote long-term cooperation in the energy field, based on

[27] This standard is mentioned at fn. 64 of the EC Decision, RL-0107.
[28] *Cube v. Spain* (Decision), cit. *supra*, at paras. 395, 396.

complementarities and mutual benefits, in accordance with the objectives and principles of the Charter.

36. Raising in arbitration as a lack of due diligence on the side of the investor its not having detected that the failure to notify the Special Regime was an infringement of European Law or its failing to realize the substantial incompatibility of the Special Regime with the State Aid system, with the ultimate consequence of invalidating the very Special Regime the Respondent was relying upon to attract millions of Euro investments to its renewable energy sector, is inimical to the cooperation purposes of the ECT. In fact, it is an attempt by the Respondent to capitalize on its own failure to observe obligations under European law in violation of the principle of good faith under international law, including as comprised by the ECT FET standard.

37. This conduct is even more blatantly in violation of the ECT in view of the relevant parts of its Article 10.1:

> *Each Contracting Party shall, in accordance with the provisions of this Treaty, encourage and create stable, equitable, favourable and transparent conditions for Investors of other Contracting Parties to make Investments in its Area. Such conditions shall include a commitment to accord at all times to Investments of Investors of other Contracting Parties fair and equitable treatment*.

38. Even admitting that the encouragement of stable, equitable and transparent conditions for foreign investors and investments in the energy sector is part already of FET protection, under the ECT (and not an autonomous standard), the fact that ECT, Article 10.1, lays special emphasis on these objectives cannot be mere happenstance and can only be interpreted as meaning that among the protective standards covered by FET, the EC Member States assigned particular importance to ensuring stable, favorable and transparent conditions for foreign investment. The Respondent infringed its transparency and stability commitments by: a) failing to notify the Special Regime pursuant to its obligations under European law; b) failing to alert prospective investors – like the Claimants – as to potential risks of the very Special Regime the Respondent was seeking to draw benefit from; and c) only raising this defense in arbitration.

39. Further (as the Decision points out) it is undisputed that: a) The EC was well informed about the Special Regime, never raised any issues regarding its lawfulness under European law, and even extolled its benefits although the Kingdom of Spain had not notified the Special Regime to the EC in compliance with European Law; b) there is no specific EC decision rendering the Special Regime unlawful; c) there is no EC right of or duty on the Kingdom of Spain to procure the reimbursement of the Special Regime payments made to the Claimants or anybody else.

40. This is the situation the Claimants were confronted with when investing and the situation contemplated by the Respondent when the investments were made. Whatever the realities of the European legal system might be or have been, it can only be concluded, from the perspective of the FET protection afforded to the Claimants under the ECT, that if the

investors invested and the Kingdom of Spain accepted the application of the Special Regime to such investments during a period spanning at least ten years, both were persuaded that the Special Regime was lawful under Spanish and European law, and shared legitimate expectations that such would be the case.

41. Indisputably, State Aid rules are part of Spanish law. A higher level of due diligence regarding the situation of Spanish law cannot be required from the foreign investor than the one incumbent on the Respondent in enforcing European law and its own law incorporating State Aid provisions. The same can be said of the EC during the existence of the Special Regime under which millions of Euros were infused into the Spanish renewables sector, without however the EC raising red flags about the incompatibility of the Special Regime with European law or supposedly excessive investor returns.

42. A different conclusion would mean that the Kingdom of Spain was acting in bad faith by actually blowing hot and cold at the same time, i.e., resorting to the Special Regime to attract foreign investment to the renewable energy sector and in parallel not complying with European law as regards the Special Regime or knowing that the Special Regime did not comply with European law. It would also imply that during the long years in which the Special Regime was in place, the EC failed in its duties to monitor and oversee the Special Regime in light of European law protecting fair competition in the European markets. From the perspective of the ECT and international law, such facts and circumstances lead to concluding that the expectations of the Claimants arising out of the Special Regime are not illegitimate and, therefore, that are entitled to protection under the ECT FET standard.

43. On the basis of the above reasons and findings, it is to be concluded that the Respondent has violated the FET standard under the ECT and that the Claimants are entitled to full compensation for past and future damages resulting to the Claimants from the New Regime.

A. <u>Quantum Issues</u>

44. The Parties' quantum experts have adopted very different approaches.

45. KPGM quantifies the Special Regime incentives the Claimants have been deprived of during the useful life of the Wind Farms. Depending on the date the calculation is made, and considering that the relevant measure came into effect on 1 January 2013, KPGM proceeds as follows: a) at the date of calculation, it calculates the difference between free cash flows to the Claimants under the New Regime and free cash flows to the Claimants under the Special Regime between 1 January 2013 and the date of calculation; and b) after the date of calculation, it calculates the moneys the Claimants should receive in the future in accordance with the Special Regime, discounted to present value to the date of calculation pursuant to a DCF methodology .

46. Econ One's analysis, on the contrary, is premised on a maximum reasonable return approach in line with the New Regime provisions and the Law 54/1997 standard.

47. However, the Special Regime, which did not impose maximum limitations on the investors 'returns[29], set forth a premium or tariff regime necessarily compatible with the Law 54 Standard, because on the contrary an oxymoron would ensue: the Special Regime would be incompatible and compatible at the same time with such Standard. Consequently, the Claimants legitimately relied on the Special Regime as expressing in concrete legal norms the Law 54 Standard. On the other hand, there is nothing in the wording of the Special Regime indicating that the open-ended (and opaque) text of the Law 54 Standard would lead to – and much less justify- the replacement of the Special Regime with an utterly different model unilaterally destroying the substance of the Claimants' rights under the Special Regime.

48. As found by the arbitral tribunal in *Novenergia II*:[30]

> *As regards statements in relation to 'economic sustainability' and 'reasonable rate of return' the Tribunal finds the Respondent's arguments unconvincing, since these principles were still generally vague and insufficiently defined at the time of the Claimant's investment. Precise content was given to these principles through the introduction of Law 15/2012 and RDL 9/2013, which were enacted long after the Claimant had already made its investment. Accordingly, they cannot be considered apposite for the assessment of the reasonability of the Claimant's expectations at the time of the investment, as the Respondent suggests (...) The above conclusion deals with the majority of the Respondent's statement's*.

49. It is then too much to rub to the open-textured and undefined terms of the Law 54 standard and what purports to be a particularization of such standards in the New Regime, the imposition on the Wind Farms, not only retroactively, but also for the future, of an entirely new and unpredictable cost, investment and remuneration model.

50. Therefore, the FET violation does not directly depend on the deprivation of the Claimants' return, whatever that return might be: rather, it is the direct consequence of the suppression of the Special Regime the Claimants relied upon when investing. Thus, it is such suppression, rather than the suppression of real or hypothetical returns, which must be compensated. In the words of the *Eiser* tribunal (coincidental with the *NextEra* holding when rejecting the reasonable return calculations of both parties' experts):

> *Without entering into the details of Claimants' experts' calculation of this alternate claim, and of Respondent's rebuttal to it, the Tribunal finds the legal theory underlying it unpersuasive. ECT Article 10(1) does not entitle Claimants to a 'reasonable return' at any given level, but to fair and equitable treatment*.[31]

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[29] For example, in respect of RD 661/2007, declaration of Respondent's expert Dr. Daniel Flores in cross-examination, November 2017 Hearing, Day 4, at pp. 86-88.
[30] *Novenergia II v. Spain* (Final Award), paras. 673, 674, CL-0227.

[31] *Eiser v. Spain* (Award), para. 434, CL-0217.

51. And as it was held by the *Cube* tribunal[32]:

> *The Tribunal does not accept that the cost-based approach, calculating a reasonable rate of return on the amount initially invested, is appropriate in the present context. The 2013-2014 change of the regulatory regime so as to introduce the concept of a reasonable rate of return as a cap on support under the regulatory regime, in place of the fixed tariffs and premiums for which the Special Regime had provided, is one of the measures at the very heart of the complaint in this case; and the Tribunal has found that this amendment constituted such a fundamental change in the economic basis on which the investments were made – a 'mid-stream switch in the regulatory paradigm' – as to amount to a defeat of the Claimants' legitimate expectations in breach of the FET standard in Article 10 ECT.*

52. For these reasons, the KPGM methodology for calculating damages resulting from the deprivation of the Special Regime appropriately corresponds to the findings on the merits set forth above.

53. However, KPGM's calculations should be adjusted as follows:

   a) The appropriate date to be considered as the New Regime implementation date for calculation purposes should be the date of the IET Order setting forth the New Regime in full and in its final form, i.e., 16 June 2014 rather than 1 January 2013; and

   b) Using a DCF methodology to calculate future damages for the useful life of the Wind Farms is justified for the 25-year period counted from 25 November 2002 through 25 November 2027. Calculating future damages through the end of the useful life of the Wind Farms beyond this date seems too speculative given the variables taken into account to such effect.[33] Therefore, also in accordance with reasonableness and proportionality notions, the calculation of future damages and application of the DCF methodology should not go beyond 25 November 2027.

54. As calculated by KPGM as of 6 November 2017 (pre-award interest included), the compensation amount equals € 65,243,815[34].This sum should be adjusted to an updated calculation date taking into account the criteria set forth in paragraph 53 and also by excluding compensation for the imposition of the 7% tax and without computing the tax gross-up, both denied by the Arbitral Tribunal.

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[32] *Cube* (Decision), para. 473.
[33] KPMG First Damages Report, paras.153, 208, CER-0002.
[34] November 2017 Hearing, KPGM Damages Slides, slide 67 (Appendix V. Sensitivities to Damages Calculation (Euros)).

Dr. Horacio A. Grigera Naón
Arbitrator